ERGO Insurance SE

ANNUAL REPORT 2018

ANNUAL REPORT

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Core business:	**non-life insurance**
Beginning of financial year:	**1 January 2018**
End of financial year:	**31 December 2018**
Chairman of the management board:	**Bogdan Benczak**
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**

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Review of operations

A strong owner

Through their parent, ERGO Group AG, 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 ERGO Group's owner and parent: 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.

Partnerships with the world's strongest reinsurance providers

ERGO collaborates 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 2018 in figures

Gross premium income	183.8 million euros
Total assets	234.5 million euros
Investments in financial instruments	168.1 million euros
Insurance contract provisions	153.0 million euros
Equity	55.1 million euros
Comprehensive income	7.1 million euros
Return on equity	15.9%
Insurance contracts in force	1,024,807
Offices	16 in Estonia, 23 in Latvia, 63 in Lithuania
Employees	934

Economic environment

In its Winter 2019 Economic Forecast, the European Commission projects that the European economy will continue to grow in 2019, for the seventh year in a row. At the same time, the pace of growth is expected to slow compared to previous years and the outlook is subject to significant uncertainty. For the European Union, Brexit remains a major source of uncertainty.

Estonia

Economic growth in 2018 was driven by high domestic demand and wage growth.

Domestic demand and a strongly performing labour market are also expected to remain the main growth drivers in the next two years, even though weakening external conditions may subdue the growth rate. In 2019, public spending is expected to soar and the rapid inflation of recent years is set to slow due to the stabilisation in global commodity prices and the waning effect of rises in excise duty rates.

Estonia's main risk factor is the dependence of its small and open economy on the external environment.

Latvia

Economic growth has mainly been driven by rapid wage growth and an upsurge in investments made with the help of the EU structural funds, which in turn has boosted private consumption. Inflation has remained moderate despite rapid wage growth.

GDP growth is expected to continue in 2019, although at a slowing pace. The growth rate will be influenced by decreasing investment and a tight labour market. Wages will continue to rise, which together with energy and food price inflation is expected to increase inflation. Due to slowing domestic demand, export will be the main growth driver in the next few years.

Lithuania

Economic growth in 2018 was broad-based across all sectors (with the exception of agriculture).

Growth momentum is expected to continue in 2019, particularly due to strong private consumption which is supported by amendments to the income tax regulation. Continuing support from the EU structural funds is likely to have a positive effect on investment growth. Unfortunately, the Lithuanian economy will not be able to escape the impact of weaker growth in its main trading partners, which will moderate its GDP growth.

The key issue for the Baltic region continues to be population decline.

Legal environment

On 11 January 2018, the Estonian Financial Supervision Authority and the Estonian Consumer Protection Board issued a non-binding guideline setting out requirements to financial services advertising. The guideline seeks to explain the requirements to financial services advertising resulting from advertising regulations and legislation regulating the activities of entities subject to financial supervision.

On 1 May 2018, the Estonian Financial Supervision Authority issued guidelines for supervised entities' operational risk management and business continuity, information technology and information security arrangements.

The purpose of the operational risk management guideline is to help insurance undertakings identify and manage their operational risks based on the scale and complexity of their business and their past experience, and to prevent operational risks.

The purpose of the information technology and security guideline is to establish minimum information technology and security requirements for companies operating in the financial services sector and hence increase the efficiency of the financial services sector and reduce systemic and operational risks.

The purpose of the business continuity guideline is to provide supervised entities with general guidance for organising their business continuity processes and developing their business continuity plans consistent with relevant international standards and practice as well as the recommendations of international organisations.

On 25 May 2018, General Data Protection Regulation No 2016/679 approved by the European Parliament became effective, replacing the previous Data Protection Directive. The new regulation is directly applicable in all member states. The Data Protection Regulation introduced more stringent rules for protecting the personal data of individuals (data subjects). The main changes were as follows:

- new principles for asking for the data subject's consent (companies must demonstrate that the data subject has given consent unless there is another legal basis for processing personal data);
- more detailed requirements for communicating with the data subject upon collecting personal data (the company's privacy policy must be made available on its public website);
- specification of the data subject's right to request from the controller that he/she be forgotten, his/her data be suppressed, deleted, etc.;
- the data subject’s right to request that his/her data be transmitted to another service provider;
- principles for data protection by design and by default (see explanations below);
- more detailed requirements for processors;
- obligation to notify the supervisory authority and the data subject about personal data breaches;
- obligation to designate a data protection officer and detailed requirements for the position;
- requirement to carry out data protection impact assessments;
- heavy administrative fines that may be imposed on controllers and processors.

ERGO has established new principles for processing personal data, new general terms and conditions for employment relationships and new internal regulations that meet the requirements of the Data Protection Regulation. ERGO has also provided training to its employees and partners. We have paid a lot of attention to notifying customers, processing customer enquiries and handling incidents related to data processing.

On 1 October 2018, amendments to the Insurance Activities Act (new requirements to insurance distribution), adopted under the EU Insurance Distribution Directive (IDD) 2016/97, became effective.

The purpose of the directive and the Insurance Activities Act is to achieve undistorted competition in insurance distribution, better consumer protection and a more integrated insurance market in the European Union. The new insurance distribution requirements ensure the same level of protection for the customer regardless of the distribution channel through which insurance is purchased. Insurance contracts may be concluded with or via an insurance undertaking, an agent, a broker, a website, a telecommunication company, a car rental company or other persons. To ensure that the quality of information disclosed to the customer before the conclusion of an insurance contract does not depend on the channel through which the contract is concluded, the IDD applies not only to insurance undertakings and insurance intermediaries but also to persons for whom insurance intermediation is an ancillary business. Upon offering an insurance product, an EU insurance service provider must give the customer a relevant insurance product information document. Also, the new legislation strives to ensure that insurance distributors are qualified and their knowledge is commensurate with the complexity of the insurance products they sell. Relevant responsibility rests with insurance undertakings and intermediaries.

On 15 October 2018, a guideline for carrying out suitability (fit and proper) assessments established by the Estonian Financial Supervision Authority entered into force. The purpose of the guideline is to explain the procedures, principles and forms of suitability assessments carried out by the authority.

Financial performance of ERGO Insurance SE

ERGO Insurance SE's gross premium income for 2018 was 183.8 million euros. In terms of premium income, ERGO Insurance SE maintained the second position in the Estonian and the fourth position in the Baltic non-life insurance market. Claims and benefits incurred totalled 112.1 million euros, accounting for 61.0% of gross premium income. The net expense ratio was 29.5% (2017: 32.0%) and the net loss ratio was 64.3% (2017: 63.1%). Despite the increase in the loss ratio, the net combined ratio for 2018 declined to 93.8% (2017: 95.1%). ERGO Insurance SE ended 2018 with total comprehensive income of 7.1 million euros (2017: comprehensive income of 4.5 million euros). The insurance result was a profit of 10.5 million euros, net investment income amounted to 0.5 million euros and other activities generated a loss of 1.9 million euros. Income tax expense amounted to 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 234.5 million euros (2017: 207.1 million euros). Investments in financial instruments amounted to 168.1 million euros (2017: 141 million euros), debt securities accounting for 87.0% (2017: 86.3%), loans for 0.8% (2017: 1.0%) and equities and fund units for 12.2% (2017: 12.7%) of the total. Altogether, investments in financial instruments accounted for 71.1% (2017: 68.1%) of total assets. Insurance provisions totalled 153.0 million euros (2017: 134.2 million euros), accounting for 85.3% (2017: 84.4%) of total liabilities and 65.3% (2017: 64.8%) of total assets. At the reporting date, insurance provisions were backed with investments in financial instruments and reinsurance assets which exceeded insurance provisions by 24.3 million euros (2017: 15.7 million euros), providing the company with an adequate liquidity buffer.

Insurance activities

Gross premium income by insurance class

In euros	**2018** Gross written premiums	Share of class, %	**2017** Gross written premiums	Share of class, %	**Change** Gross written premiums	Share of class, pp
Motor liability insurance	76,769,383	41.8%	66,070,743	39.6%	10,698,640	2.2 pp
Accident insurance	7,072,364	3.8%	6,469,901	3.9%	602,463	0.0 pp
Travel insurance	3,891,252	2.1%	3,934,965	2.4%	-43,713	-0.2 pp
Technical risks insurance	5,631,412	3.1%	5,119,357	3.1%	512,055	0.0 pp
Individuals' property insurance	12,264,580	6.7%	11,419,977	6.8%	844,603	-0.2 pp
Legal persons' property insurance	10,089,344	5.5%	9,832,521	5.9%	256,823	-0.4 pp
Agricultural risks insurance	2,080,900	1.1%	1,786,750	1.1%	294,150	0.1 pp
Motor own damage insurance	45,940,594	25.0%	43,812,415	26.3%	2,128,179	-1.3 pp
Liability insurance	6,964,465	3.8%	6,081,685	3.6%	882,781	0.1 pp
Goods in transit insurance	1,411,263	0.8%	1,481,341	0.9%	-70,078	-0.1 pp
Carrier's liability insurance	2,712,156	1.5%	2,775,742	1.7%	-63,586	-0.2 pp
Watercraft insurance and watercraft owner's liability insurance	588,725	0.3%	505,723	0.3%	83,002	0.0 pp
Guarantee insurance	2,884,438	1.6%	2,166,732	1.3%	717,706	0.3 pp
Railway rolling stock insurance	1,141,415	0.6%	1,222,799	0.7%	-81,384	-0.1 pp
Assistance insurance	1,885,399	1.0%	1,664,124	1.0%	221,275	0.0 pp
Financial risks insurance	508,851	0.3%	405,323	0.2%	103,528	0.0 pp
Loss of employment insurance	211,881	0.1%	33,116	0.0%	178,765	0.1 pp
Legal expenses insurance	1,822,300	1.0%	2,101,407	1.3%	-279,107	-0.3 pp
Total from insurance activities	**183,870,722**	100.0%	**166,884,620**	100.0%	**16,986,102**	0.0 pp
Accident insurance	0	0.0%	0	0.0%	0	0.0 pp
Legal persons' property insurance	-43,731	0.0%	0	0.0%	-43,731	0.0 pp
Liability insurance	0	0.0%	0	0.0%	0	0.0 pp
Health insurance	0	0.0%	0	0.0%	0	0.0 pp
Total from reinsurance activities	**-43,731**	0.0%	**0**	0.0%	**-43,731**	0.0 pp
Total	**183,826,991**	100.0%	**166,884,620**	100.0%	**16,942,371**	

In 2018, ERGO Insurance SE generated premium income of 183.8 million euros, a 10.2% increase on 2017. The largest classes were motor third party liability (hereafter 'motor liability') and comprehensive motor vehicle (motor hull, hereafter 'motor own damage') insurance, which generated premium income of 76.8 million euros and 45.9 million euros, accounting for 41.8% and 25.0% of the total portfolio respectively. Individuals' property insurance contributed 12.3 million euros, i.e. 6.7%, and legal persons' property insurance 10.1 million euros, i.e. 5.5%. Premiums written in accident insurance and liability insurance totalled 7.1 million euros and 7.0 million euros respectively and their respective contributions were 3.8% and 3.8%. The total contribution of other insurance classes, which each accounted for less than 3.1%, was 24.6 million euros, i.e. 13.4%.

Compared to 2017, the share of motor liability insurance increased by 2.2 percentage points and its premium income grew by 10.7 million euros, i.e. 16.2%. In addition to motor liability insurance, rapid growth was achieved in motor own damage insurance and liability insurance where premium income grew by 4.9% and 14.5%, i.e. 2.1 million euros and 0.9 million euros year on year respectively.

Claims and benefits paid by insurance class

In euros	2018		2017		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	41,230,687	41.2%	34,396,697	38.7%	6,833,990	2.5 pp
Accident insurance	3,182,803	3.2%	2,859,166	3.2%	323,637	0.0 pp
Travel insurance	2,363,377	2.4%	1,940,387	2.2%	422,990	0.2 pp
Technical risks insurance	3,474,976	3.5%	1,966,262	2.2%	1,508,714	1.3 pp
Individuals' property insurance	5,481,143	5.5%	5,369,390	6.0%	111,753	-0.6 pp
Legal persons' property insurance	5,662,136	5.7%	5,718,646	6.4%	-56,510	-0.8 pp
Agricultural risks insurance	3,657,238	3.7%	2,993,770	3.4%	663,468	0.3 pp
Motor own damage insurance	28,557,330	28.5%	27,175,458	30.6%	1,381,872	-2.1 pp
Liability insurance	2,185,548	2.2%	1,866,423	2.1%	319,125	0.1 pp
Goods in transit insurance	299,950	0.3%	407,826	0.5%	-107,876	-0.2 pp
Carrier's liability insurance	1,400,219	1.4%	1,381,476	1.6%	18,743	-0.2 pp
Watercraft insurance and watercraft owner's liability insurance	169,389	0.2%	183,652	0.2%	-14,263	0.0 pp
Guarantee insurance	86,168	0.1%	381,295	0.4%	-295,127	-0.3 pp
Railway rolling stock insurance	230,303	0.2%	202,807	0.2%	27,496	0.0 pp
Assistance insurance	1,106,087	1.1%	1,071,963	1.2%	34,124	-0.1 pp
Financial risks insurance	354,250	0.4%	417,829	0.5%	-63,579	-0.1 pp
Loss of employment insurance	21,442	0.0%	4,854	0.0%	16,588	0.0 pp
Legal expenses insurance	672,361	0.7%	523,521	0.6%	148,840	0.1 pp
Total	**100,135,407**	100.0%	**88,861,422**	100.0%	**11,273,985**	

Claims and benefits paid in 2018 totalled 100.1 million euros (2017: 88.9 million euros). Claims incurrence trends did not change significantly. The largest share of claims was settled in motor liability insurance: 41.2 million euros, i.e. 41.2% of claims paid. The next-largest class was motor own damage insurance where claims and benefits paid totalled 28.6 million euros, i.e. 28.5%.

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 has been 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 Asset-Management 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 2018, 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: 48.3% (2017: 54.7%) had an AAA (by Standard & Poor's) or Aaa (by Moody's) credit rating, 16.6% (2017: 14.1%) were rated AA or Aa, 15.5% (2017: 16.2%) had an A rating, 16% (2017: 14.9%) had a BBB or Baa rating and 3.6% were rated BB or Ba.

At the year-end, investments consisted of investments in associates and subsidiaries of 0.6 million euros (2017: 2.5 million euros), debt securities of 146.3 million euros (2017: 121.7 million euros), loans of 1.4 million euros (2017: 1.4 million euros), and equities and fund units of 20.4 million euros (2017: 17.9 million euros). There were no investments in term deposits.

Income on assets with interest rate risk amounted to 0.48 million euros (2017: 0.57 million euros). Realisation of equities and fund units resulted in a loss of 0.15 million euros (2017: nil million euros) and realisation of debt securities produced a gain of 0.27 million euros (2017: 0.1 million euros). Dividend income amounted to 0.21 million euros (2017: 0.21 million euros). The fair value reserve decreased by 1.16 million euros (2017: 0.5 million euros). Thus, the overall yield of the investment portfolio was −0.22% (2017: 0.26%). Investment management expenses accounted for 0.22% 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.

In 2018, our Estonian team participated in the Praise the Service Provider campaign. Compared to 2017, ERGO once again improved its result, rising by 13 places to the 9th position and being the best insurer among service companies. The campaign calls on consumers to notice and praise excellent service providers, customer care and services and recognises service providers that customers praise the most. Thanks to customers' recognition, a large number of our offices can proudly display the sign Customers Praise 2018.

In May, our Latvian entity applied a new customer service standard: ERGO PRO. The goal is to provide uniformly high-quality customer service experience throughout the company.

A survey of customer satisfaction with service by e-mail, conducted by customer service improvement company Dive, rated ERGO as the best of 10 insurance companies in both Estonia and Latvia. The survey measured the speed and quality of e-mail responses. The rating also took into account whether home insurance was offered based on benefits to the customer or price, whether the customer's needs were identified and other products presented, and how the contact with the customer ended.

ERGO achieved a high, 14th place in Latvia's TOP 50 employers list prepared by CV-Online in Latvia.

In June, our Latvian entity participated in the Sustainability Index assessment for the second time and received a Silver Award. The year before, ERGO received a Bronze Award. Companies' sustainability and corporate social responsibility are assessed based on internationally recognised methodology. ERGO was also among companies recognised as family-friendly organisations by Latvia's minister of social affairs.

In July, ERGO launched a hotline for customers and employees in Lithuania that can be used to report discrimination, corruption or other concerns.

In October, ERGO was ranked one of five most popular brands in the Latvian financial services sector.

SERVICES

From 8 February 2018, ERGO offers motor liability insurance customers in Estonia not only statutory but also supplementary insurance coverage, such as ERGO roadside assistance, big game collision insurance, replacement car insurance and driver's optional limited accident insurance coverage.

At MELT Innovation Forum held on 10 April 2018 in Tallinn Creative Hub, ERGO and Telia introduced their jointly developed vehicle insurance app and talked about cooperation. The focus of the day was on inspiring stories that encourage change, product development and myths surrounding innovation.

Since April, ERGO's customers in Estonia have been able to use a convenient life and accident insurance calculator available at www.ergo.ee/minuelu in Estonian and www.ergo.ee/minuelu/rus in Russian.

In May, our Latvian entity introduced a new user-friendly sales portal for business partners: brokers, medical institutions, petrol stations, etc.

Our Latvian entity's e-office launched a new subpage for purchasing motor liability insurance that is easy to use on both PCs and mobile devices. At the e-office, customers can check and change the terms and conditions of their insurance policies and conclude contracts within minutes.

Our Lithuanian entity introduced a new option for reporting vehicle-related claims. Via ERGO Smart app, the customer receives a personal link that opens to a personalised environment which can be used, for example, to take and upload pictures of the vehicle. The new app makes claims handling more convenient and faster.

In August, ERGO's Estonian entity and BENU pharmacies began offering ERGO's health insurance customers the option to deduct their medicinal products benefits from the purchase already in the pharmacy. It is comfortable and provides a sense of security for the customer who does not need extra cash for buying medicines.

On 1 October, AS Luminor Bank and ERGO began offering customised travel insurance for the bank's credit card holders in the Baltics.

MARKETING

In January, ERGO's Latvian entity was the main sponsor of the first Latvian snow volleyball championship ERGO Winter Open. In February, the entity participated in the national road safety campaign Stop Before You Drive Off the Road aimed at raising awareness of driver fatigue.

Our Latvian entity is the co-producer and insurance expert of the weekly TV show Car News where new cars are tested and car-related topics discussed.

In March, ERGO's Estonian entity reminded its travel insurance customers that they do not need extra funds in the event of travel disruption because ERGO buys them a new ticket for the return journey.

In May, our Estonian entity introduced legal expenses insurance. It explained that legal expenses insurance makes expensive legal services affordable for ordinary people. Legal costs are predictable: by paying a fixed amount per month, customers will avoid unexpected expenses when they need legal assistance.

Our Latvian entity and EuroPark padded the bollards of several car parks in Riga to prevent cars from being scratched. In addition to the fact that parking became safer, information printed on padded bollard covers drew drivers' attention to motor own damage insurance.

In September, our Estonian entity joined the Estonian Insurance Association's anti-accident campaign. We promoted awareness of the need for accident and life insurance until November.

In July and August, our Latvian entity sponsored the concert tour of the most popular Latvian pop band Brainstorm by arranging free guarded bicycle parking at concert venues in several cities. ERGO feels it is important to help people come to concerts in a way that helps preserve nature, without having to worry about bicycle parking.

Our Latvian entity sponsored United Buddy Bears, an art exhibition started in Berlin that was brought to the Baltic states for the first time.

On 14-16 September 2018, our Estonian entity provided mentoring support and awards at a creative industries' hackathon held at Tallinn University of Technology Innovation and Business Centre Mectory.

SPONSORING AND SOCIAL RESPONSIBILITY

On 13 March, our Estonian team announced a competition for a young athlete grant of 25,000 euros. The grant was awarded for the third year to show that ERGO supports healthy lifestyles and wishes to improve the health of society as a whole. Due to economic reasons many young people stop playing sports when they become independent. We support the sports activities of dedicated 18-25-year-old athletes by offering them an opportunity to apply for ERGO's young athlete grants.

During the period, 74 athletes from 34 fields applied.

The selection committee decided to support the beneficiaries with 2,500 euros each.

The beneficiaries of 2018 were:

- Aksel Nõmmela, cycling
- Erika Kirpu, fencing
- Johann Poolak and Marko Laius, rowing
- Joosep Karlson, canoeing
- Kristjan Koll, cross country skiing
- Mai Narva, chess
- Margaret Markvardt, swimming
- Marten Liiv, speed skating
- Robin Nool, athletics – pole-vaulting
- Saskia Alusalu, speed skating.

The grant selection committee comprised sports experts Allar Levandi and Ivar Jurtšenko, representatives of the Estonian Olympic Committee Martti Raju and Aivo Normak, and ERGO's representatives Alo Alunurm and Erko Makienko.

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

In Estonia, ERGO continues to support the Bully Free School Foundation. Every school year, we help around five schools to join the Bully Free School programme that is aimed at preventing and reducing bullying at Estonian schools.

In Lithuania, ERGO was the main sponsor of one of Lithuania's largest cultural events, the Vilnius International Film Festival, for the sixth year already.

The employees of our Lithuanian entity participated in the annual campaign Let's Do It. The purpose of the initiative is to clean up the environment and engage the community. ERGO's employees have been involved in the campaign for five years already.

In May, the employees of our Latvian entity planted 2,800 pine trees at a local forest planting event. In the last eight years, ERGO's employees have planted around 27,000 pines and spruces.

Environmental protection is one of ERGO's social responsibility topics. Therefore, our Lithuanian entity sponsored an annual 300 km race of environmentally friendly electric cars from the capital Vilnius to Palanga. A two-member ERGO team also participated in the race.

In Lithuania, ERGO supports the social initiative One and a Half Meters, which aims to raise drivers' awareness of the fact that a safe distance for passing a cyclist is 1.5 meters.

In early summer, our Latvian entity launched another bicycle riding programme for children under 12 that provides opportunities for practicing cycling on special tracks and obstacle courses. This is a good way for children to test and improve their cycling skills. Those who successfully pass a cycling test receive a certificate. The programme is carried out in several Latvian cities until the end of September.

In Lithuania, ERGO organises office visits for schoolchildren. The purpose is to give children an exciting overview of insurance, talk about the profession of an insurance advisor and show the work of claims handlers.

In August, our Estonian entity participated in the Opinion Festival for the second year in a row. This time, ERGO supported the area of security and health where we led two panel discussions.

- "I'll be dead before I get to the doctor" – The discussion addressed the positive and negative aspects of the Estonian health insurance system and opportunities offered by private health insurance.
- "When volunteering becomes an obligation – who is responsible for safety?" – The discussion focused on community safety, volunteer rescuers, and what people can do to make their homes and communities safer.

In July and September, ERGO organised the We Are for a Safe Car! campaign in Latvia to raise drivers' awareness of the need to make sure that the car is in a good technical condition.

For six years, our Latvian entity has been the principal sponsor of the beach volleyball competition ERGO OPEN. Competitions are held throughout the summer. The finals and the awards ceremony were also attended by Ingrīda Kirse, a member of ERGO's management board.

In Lithuania, ERGO continued to support For Safer Lithuania (#ForSafeLithuania), a social campaign initiated by the Lithuanian President Dalia Grybauskaitė. Eleven children from low-income families were given an opportunity to attend a summer camp in the framework of the campaign.

In August, Velomaraton, the largest bicycle race in the Baltics took place in Lithuania. Our Lithuanian entity has been the principal partner of the event for seven years already. The ERGO team has grown year by year: in 2018 over 200 employees participated. As the largest team, we received a T-shirt signed by the Lithuanian president. ERGO offers free cyclist insurance to all participants.

The Estonian and the Latvian teams of ERGO participated in a sports week in September. Our Estonian team arranged joint gym visits. Both the Estonian and the Latvian teams launched an autumn challenge which motivated employees to increase their physical activity. On the international sports day, our Latvian entity organised a laughter yoga session in its head office that helped people wake up and find joy in every moment.

For 17 years ERGO's Latvian entity has been providing scholarships to young orphans who need support to acquire higher education. Scholarships have been awarded to 78 young people in the amount of 300,000 euros. In December, there was a formal meeting of new, present and future beneficiaries.

In Lithuania, ERGO has been a long-standing partner of SOS Children's Villages. In December, our team took children to the theatre where they met actors and visited backstage.

In December, the staff of our Estonian entity organised a charity coffee and cake event. The money raised was donated to a children's day centre for purchasing new windows.

Since December, our Estonian entity has been working closely with the Estonian Rescue Association and supporting the insurance of the vehicles of voluntary rescue teams.

Organisation and management

On 28 March 2018, the supervisory board decided to renew the contracts of the members of the management board of ERGO's Baltic entities Kęstutis Bagdonavičius, Tarmo Koll, Ingrīda Ķirse and Bogdan Benczak. The term of office of management board member Saulius Jokubaitis came to an end and his responsibilities were taken over by Tadas Dovbyšas, a new board member appointed by the supervisory board. Tadas Dovbyšas will also continue as Chief Operating Officer of the ERGO Insurance SE branch in Lithuania.

On 6 April 2018, the supervisory board approved a new management model with six management board members instead of the former five.

In May, the supervisory board appointed Marek Ratnik (Chief Underwriting Officer, CUO) as the sixth member of the management board of ERGO's Baltic entities. Marek Ratnik is responsible for underwriting, product development, pricing, reinsurance and claims handling in the Baltics. He is also Chief Operating Officer in Estonia.

On 1 November 2018, the former chairman of the management board Kęstutis Bagdonavičius began working for ERGO International AG in Düsseldorf, Germany. Therefore, management board member Bogdan Benczak (Chief Transformation Officer, CTO) was elected as the new chairman of the management board of ERGO's Baltic entities.

ERGO will continue to harmonise processes and develop a new business model in the Baltics. The aim is to benefit from Baltic synergies and experience, while respecting local customs and fully seizing local opportunities.

ERGO Insurance SE's business and future outlook

ERGO Insurance SE's business is determined by the strategic framework of ERGO Group: the main priority is always customer satisfaction. Globally, ERGO Group is also strongly focused on innovation and digitalisation.

ERGO strives to be the most innovative and efficient insurance undertaking in the Baltics that provides the best possible customer service and is a responsible employer in all three countries.

Key financial indicators

In thousands of euros, except for ratios *As at 31 December or for the year*	**2018**	2017
For the year		
Gross written premiums	**183,827**	166,885
Gross earned premiums	**177,018**	154,360
Gross claims and benefits incurred	**112,128**	87,948
Gross expenses	**50,859**	48,262
Gross loss ratio	**63.3%**	57.0%
Net loss ratio	**64.3%**	63.1%
Gross expense ratio	**28.7%**	31.3%
Net expense ratio	**29.5%**	32.0%
Gross combined ratio	**92.1%**	88.2%
Net combined ratio	**93.8%**	95.1%
Claims handling ratio	**10.4%**	10.3%
Claims paid ratio	**54.5%**	53.2%
As at the year-end		
Total assets	**234,529**	207,156
Ratio of investments to total assets	**71.7%**	69.3%
Ratio of equity to total assets	**23.5%**	23.2%
Ratio of insurance provisions to total assets	**65.3%**	64.8%
Profitability indicators		
Insurance result (technical result)	**10,544**	7,180
Investment result	**-689**	-17
Profit for the financial year	**8,228**	5,014
ROE	**15.9%**	10.9%
ROA	**3.7%**	2.5%
ROI	**-0.2%**	0.3%

Explanation of figures and ratios

Gross earned premiums	gross written premiums + 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 written premiums
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 2018 the company developed in line with the insurance market and achieved its main business goals and targets.

Bogdan Benczak

Chairman of the Management Board

Financial statements

Income statement

In euros	Note	2018	2017
Income			
Gross written premiums	3	183,826,991	166,884,620
Written premiums ceded to reinsurers	3	-7,884,786	-8,523,874
Change in gross provision for unearned premiums	21	-6,808,551	-12,524,369
Reinsurers' share of change in provision for unearned premiums	15	168,288	140,486
Net earned premiums		**169,301,942**	**145,976,863**
Reinsurance commission income	4	914,055	1,577,088
Investment income	5	813,895	861,602
Other income	6	1,994,951	2,177,120
Total income		**173,024,843**	**150,592,673**
Expenses			
Claims and benefits incurred	7	112,127,566	87,947,928
Reinsurers' share of claims and benefits incurred	7	-3,314,266	4,164,122
Net policyholder claims and benefits incurred		**108,813,300**	**92,112,050**
Acquisition costs	8	40,649,475	38,565,263
Administrative expenses	8	8,095,401	7,697,355
Other operating expenses	8	2,113,715	1,999,039
Investment expenses	8	341,696	356,874
Other expenses	8	2,134,044	3,306,226
Total expenses		**162,147,631**	**144,036,807**
Operating profit		**10,877,212**	**6,555,866**
Share of profit of equity-accounted investees	13	77,245	17,045
Other finance costs	13	-1,924,852	0
Profit before income tax		**9,029,605**	**6,572,911**
Income tax expense	27	**-801,393**	**-1,558,932**
Profit for the year		**8,228,212**	**5,013,979**

Statement of comprehensive income

In euros	Note	2018	2017
Profit for the year		**8,228,212**	**5,013,979**
Items of other comprehensive income that may be reclassified subsequently to profit or loss			
Change in value of available-for-sale financial assets	20	-1,161,010	-521,760
Total other comprehensive expense for the year		**-1,161,010**	**-521,760**
Total comprehensive income for the year		**7,067,202**	**4,492,219**

The notes on pages 24 to 83 are an integral part of these financial statements.

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Statement of financial position

In euros

As at 31 December	Note	2018	2017
Assets			
Deferred tax assets	27	215,412	241,849
Property and equipment	10	6,933,663	7,622,945
Intangible assets			
Deferred acquisition costs	11	7,934,493	7 283 616
Other intangible assets	12	5,724,931	6 115 212
Investments in associates and subsidiaries	13	50,000	2,534,979
Assets held for sale	13	637,372	0
Investments in financial instruments			
Equities and fund units	14	20,440,287	17,893,727
Debt and other fixed-income securities	14	146,295,885	121,736,796
Loans	14	1,380,000	1,380,000
Total investments in financial instruments		168,116,172	141,010,523
Reinsurance assets	15	9,230,307	8,948,187
Insurance and other receivables	16	25,943,332	21,498,810
Cash and cash equivalents	17	9,743,461	11,900,068
Total assets		**234,529,143**	**207,156,189**
Equity and liabilities			
As at 31 December	Note	**2018**	**2017**
Equity			
Share capital	18	6,391,391	6,391,391
Capital reserve	19	3,072,304	3,072,304
Fair value reserve	20	70,670	1,231,680
Retained earnings (prior years)		37,387,319	32,373,340
Profit for the year		8,228,212	5,013,979
Total equity		**55,149,896**	**48,082,694**
Liabilities			
Insurance contract provisions	21	153,044,740	134,244,029
Reinsurance payables	22	3,129,520	2,739,769
Insurance payables	23	10,752,095	8,609,239
Other payables and accrued expenses	24	6,452,892	7,480,458
Subordinated loan	28	6,000,000	6,000,000
Total liabilities		**179,379,247**	**159,073,495**
Total equity and liabilities		**234,529,143**	**207,156,189**

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Statement of cash flows

In euros

(Inflow + , outflow –)	Note	2018	2017
Net cash used in/from operating activities		**-1,272,991**	**7,244,845**
Insurance premiums received		173,840,606	162,262,476
Claims, benefits and handling costs paid		-96,744,943	-87,367,939
Settlements with reinsurers		-3,478,440	-4,063,693
Settlements with holders of reinsurance policies		-13,811	10,805
Paid in operating expenses		-55,957,670	-52,452,766
Other income and expenses		9,736,766	6,139,778
Acquisition of equities and fund units		-11,315,224	-5,019,199
Disposal of equities and fund units		8,317,955	0
Acquisition of debt and other fixed-income securities		-95,374,438	-46,440,271
Disposal of debt and other fixed-income securities		68,015,281	31,809,497
Interest received		2,741,814	2,469,520
Dividends received		110,358	111,795
Corporate income tax paid		-986,359	-76,000
Paid in investment expenses		-164,886	-139,158
Net cash used in investing activities		**-883,616**	**-2,964,265**
Acquisition of an associate		0	-612,459
Acquisition of subsidiaries net of cash acquired	29	0	-2,737,041
Paid on acquisition of property and equipment and intangible assets		-947,616	-1,427,294
Proceeds from sale of property and equipment and intangible assets		64,000	1,812,529
Net cash flow		**-2,156,607**	**4,280,580**
Cash and cash equivalents at beginning of year		**11,900,068**	**7,619,488**
Decrease/increase in cash and cash equivalents		-2,156,607	4,280,580
Cash and cash equivalents at end of year	17	**9,743,461**	**11,900,068**

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Statement of changes in equity

In euros	Note	Share capital	Capital reserve	Fair value reserve	Retained earnings	Total equity
Balance at 31 December 2016		**6,391,391**	**3,072,304**	**1,753,440**	**33,100,599**	**44,317,734**
Changes from business combination		0	0	0	-727,259	-727,259
Total transactions with owners		**0**	**0**	**0**	**-727,259**	**-727,259**
Profit for the year		0	0	0	5,013,979	5,013,979
Other comprehensive expense		0	0	-521,760	0	-521,760
Total comprehensive income for the year		**0**	**0**	**-521,760**	**5,013,979**	**4,492,219**
Balance at 31 December 2017		**6,391,391**	**3,072,304**	**1,231,680**	**37,387,319**	**48,082,694**
Profit for the year		0	0	0	8,228,212	8,228,212
Other comprehensive expense		0	0	-1,161,010	0	-1,161,010
Total comprehensive income for the year		**0**	**0**	**-1,161,010**	**8,228,212**	**7,067,202**
Balance at 31 December 2018		**6,391,391**	**3,072,304**	**70,670**	**45,615,531**	**55,149,896**

The notes on pages 24 to 83 are an integral part of these financial statements.

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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 comprehensive motor vehicle (motor hull, hereafter '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 2018 comprise the financial information of ERGO Insurance SE's head office in Estonia and its Latvian and Lithuanian branches.

The company has not consolidated the financial information of the subsidiary DEAX Õigusbüroo OÜ because the subsidiary's revenue and assets account for an immaterial share of the company's respective figures.

These financial statements were authorised for issue by the management board on 25 March 2019. 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 2018.

(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.

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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.

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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 written premiums 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 written premiums.

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 2018, the tax payable on dividends distributed in Estonia and Latvia was 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 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 Lithuania was 15% (the same as in the previous year).

At the Lithuanian entity, 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.

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.

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(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	3–5 years
Cars, office and communication equipment	5 years
Furniture	5–7 years
Buildings	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 written premiums 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)). Other intangible assets comprise acquired software and licences which are amortised on a straight-line basis over their estimated useful lives. The estimated useful life of other intangible assets is 3-5 years. 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;

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- 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.

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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 2018) 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, interpretations and amendments are not yet effective for the annual period ended 31 December 2018 and thus have not been applied in preparing these financial statements. The company plans to adopt these pronouncements when they become effective.

IFRS 9 *Financial Instruments* (2014)

Effective for annual periods beginning on or after 1 January 2018; to be applied retrospectively with some exemptions. The restatement of prior periods is not required, and is permitted only if information is available without the use of hindsight. Early application is permitted. Under IFRS 4 *Insurance Contracts* effective from 1 January 2018, insurance companies have an option to adopt IFRS 9 together with IFRS 17 from 1 January 2022.

The company, as an insurance provider, has elected to use the option to defer the application of IFRS 9 and, accordingly, the standard will not have a significant impact on its financial statements before it is applied for the first time. The company meets the conditions for deferral because it has not applied IFRS 9 before and the carrying amount of its insurance contract liabilities accounts for more than 90% of the carrying amount of its total liabilities.

IFRS 9 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.

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.

IFRS 9 includes a new general hedge accounting model, which aligns hedge accounting more closely with risk management. The types of hedging relationships – fair value, cash flow and foreign operation net investment – remain unchanged, but additional judgment will be required.

The standard contains new requirements to achieve, continue and discontinue hedge accounting and allows additional exposures to be designated as hedged items.

Extensive additional disclosures regarding an entity's risk management and hedging activities are required.

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 the measurement of its financial instruments are expected to change.

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The company intends to adopt IFRS 9 together with IFRS 17 in 2022.

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 expected that a significant portion of debt securities will be reclassified under IFRS 9 either into or out of at FVOCI.

IFRS 15 *Revenue from Contracts with Customers*

(Effective for annual periods beginning on or after 1 January 2018. Earlier application is permitted.)

The new standard provides a framework that replaces the 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 and 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 must 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 arising from a contract with a customer.

Management does not expect that the new standard, when initially applied, will have a 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 its operations and the types of revenues it earns.

IFRS 16 *Leases*

Effective for annual periods beginning on or after 1 January 2019. Earlier application is permitted if the entity also applies IFRS 15.

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

It is expected that the new standard, when initially applied, will have a significant impact on the 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.

The company leases office premises and office equipment under operating leases. Contracts that fall in the scope of the standard include leases of office premises and IT equipment. The impact of the initial application of the standard on the carrying amounts of the company's assets and liabilities is 7,839,302 euros.

IFRS 17 *Insurance Contracts*

Effective for annual periods beginning on or after 1 January 2022; to be applied prospectively. Early application is permitted (has not yet been endorsed by the EU).

IFRS 17 replaces IFRS 4, which was brought in as an interim standard in 2004. IFRS 4 has given companies dispensation to carry on accounting for insurance contracts using national accounting standards, resulting in a multitude of different approaches.

IFRS 17 solves the comparison problems created by IFRS 4 by requiring all insurance contracts to be accounted for in a consistent manner, benefiting both investors and insurance companies. Insurance obligations will be accounted for using current values, instead of historical cost.

The company expects that the new standard, when initially applied, will have a material impact on its financial statements because the company's core business is non-life insurance. There will be changes in valuation models, the classification of insurance contracts (profitable and onerous) and the insurance portfolio's aggregation requirements.

IFRIC 23 *Uncertainty over Income Tax Treatments*

(Effective for annual periods beginning on or after 1 January 2019. Early application is permitted)

IFRIC 23 clarifies the accounting for income tax treatments that have yet to be accepted by tax authorities, whilst also aiming to enhance transparency. Under IFRIC 23, the key test is whether it is probable that the tax authority will accept the entity's chosen tax treatment. If it is probable that the tax authority will accept the uncertain tax treatment then the tax amounts recorded in the financial statements are consistent with the tax return with no uncertainty reflected in measuring current and deferred taxes. Otherwise, the taxable income (or tax loss), tax bases and unused tax losses will be determined in a way that better predicts the resolution of the uncertainty, using either the single most likely amount or expected (sum of probability weighted amounts) value.

An entity must assume the tax authority will examine the position and will have full knowledge of all the relevant information.

The company does not expect that the interpretation, when initially applied, will have a material impact on its financial statements as the company does not have material uncertain tax positions.

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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 kind and the right size. 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 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 some property directly related to an insurance contract will occur. The risk may relate to a 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 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 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 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.

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.

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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 rates 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 is not allowed to 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 12 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 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 reported 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.

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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

Non-life insurance premiums are usually calculated for one year on the basis of established insurance rates. The adequacy of insurance rates is checked on a regular basis. Rates may be changed due to changes in claim incurrence statistics, market trends and the provision of a broader or more limited insurance cover. The company has a routine procedure for changing rates. Rates 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 includes 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 on 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.

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 a negative 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	2018			2017		
	Gross provisions	**Reinsurers' share**	**Net provisions**	**Gross provisions**	**Reinsurers' share**	**Net provisions**
Estonia	43,619,992	3,132,952	40,487,041	38,561,154	2,566,514	35,994,640
Latvia	31,863,816	2,193,177	29,670,639	29,200,284	2,367,896	26,832,388
Lithuania	77,560,932	3,904,178	73,660,751	66,482,591	4,013,777	62,468,814
Total	153,044,740	9,230,307	143,818,431	134,244,029	8,948,187	125,295,842

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 1.0 million euros per insurance contract in property insurance and 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 1.0 million euros for each individual insured item 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.

Breakdown of reinsurance retention by insurance class as at 31 December 2018

Class of insurance	Retention in euros
Property and technical risks insurance	1,000,000
Motor liability insurance	1,000,000
Liability insurance	500,000
Accident, travel, animal, goods in transit, watercraft and carrier's liability insurance	300,000
Motor own damage and guarantee insurance	250,000

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 2018 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 2018)

In euros	*Year of loss incurrence*					
Estimate of cumulative claims	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
At end of year of incurrence	77,091,746	64,433,543	72,990,244	83,980,608	91,153,852	103,666,793
One year later	75,950,590	64,306,855	65,771,093	82,607,595	89,565,397	
Two years later	75,873,325	61,875,565	65,495,499	83,469,185		
Three years later	71,225,429	60,924,844	65,535,533			
Four years later	65,472,855	60,650,972				
Five years later	61,384,548					
Cumulative payments until 31 December 2018	55,938,289	57,363,614	63,477,272	76,445,922	79,696,474	65,587,257
Provision for claims outstanding (incl. IBNR) at 31 December 2018	5,446,258	3,287,358	2,058,261	7,023,263	9,868,924	38,079,536

At 31 December 2018, the provision for claims outstanding for earlier years of loss incurrence amounted to 10,118,583 euros (2017: 8,626,756 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 2018		**As at 31 December 2017**	
	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	3.5	-2,493,299	3.5	-1,969,948
Motor own damage insurance	0.5	-212,962	0.6	-251,744
Individuals' property insurance	0.8	-90,911	0.8	-82,551
Legal persons' property insurance	1.6	-117,770	1.9	-140,115
Other classes of insurance	2.0	-678,660	1.9	-555,328

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. A 5% decrease in premium income for 2018 would have had a -1.1 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 2018 using the liability adequacy test.

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The test indicated that contractual liabilities did not exceed the insurance provisions recognised in any classes of insurance. As a result, the company did not reduce the deferred acquisition costs of any classes of insurance (see note 11) and did not recognise an additional unexpired risks provision. Detailed information on insurance provisions is provided in note 21.

In euros

	As at 31 December 2018		As at 31 December 2017	
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	0	0	146,866	0
Motor own damage insurance	0	0	0	0
Travel insurance	0	0	5,692	0
Total	**0**	**0**	**152,558**	**0**

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. 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. 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 team, 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 table below describes the company's debt securities portfolio by the issuer's credit rating. At the year-end, the weighted average rating of the company's fixed-income securities was A- (2017: 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. A receivable that is more than 60 days overdue is written down.

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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.

2018	**Standard & Poor's**	**AAA**	**AA**	**A**	**BBB**	**BB**	**Without rating**	**Total**
In euros	**Moody's**	**Aaa**	**Aa**	**A**	**Baa**	**Ba**	**Without rating**	
Debt securities at fair value		70,630,965	24,353,905	22,688,870	23,337,316	5,284,829	0	**146,295,885**
Proportion of debt securities		48.28%	16.65%	15.51%	15.95%	3.61%	0.00%	**100.00%**
Reinsurance assets		0	4,888,597	591,332	2,653		3,747,725	**9,230,307**
Proportion of reinsurance assets		0.00%	52.96%	6.41%	0.03%	0.00%	40.60%	**100.00%**

2017	**Standard & Poor's**	**AAA**	**AA**	**A**	**BBB**	**BB**	**Without rating**	**Total**
In euros	**Moody's**	**Aaa**	**Aa**	**A**	**Baa**	**Ba**	**Without rating**	
Debt securities at fair value		66,642,408	17,204,233	19,755,525	18,134,630	0	0	**121,736,796**
Proportion of debt securities		54.74%	14.13%	16.23%	14.90%	0.00%	0.00%	**100.00%**
Reinsurance assets		0	6,411,350	485,785	3,817	0	2,047,235	**8,948,187**
Proportion of reinsurance assets		0.00%	71.65%	5.43%	0.04%	0.00%	22.88%	**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 2018 *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	17,981,213	1,877,805	214,506	278,150	**20,351,674**
Receivables from intermediaries	653,763	698,109	1,620	146,718	**1,500,210**
Receivables from reinsurers	2,601	83,063	658,606	397,169	**1,141,439**
Other receivables	247,090	0	64,573	118,322	**429,985**
Loan receivables	1,380,000	0	0	0	**1,380,000**
Accrued income – interest receivable	154,274	0	0	0	**154,274**
Total	**20,418,941**	**2,658,977**	**939,305**	**940,359**	**24,957,582**

As at 31 December 2017 *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	14,360,622	1,832,760	107,600	153,639	**16,454,621**
Receivables from intermediaries	689,390	709,128	58,570	148,496	**1,605,584**
Receivables from reinsurers	11,454	45,139	497,672	222,099	**776,364**
Other receivables	592,114	371,640	41,597	40,495	**1,045,846**
Loan receivables	1,380,000	0	0	0	**1,380,000**
Accrued income – interest receivable	117,456	0	0	0	**117,456**
Total	**17,151,036**	**2,958,667**	**705,439**	**564,729**	**21,379,871**

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 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 also includes 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 2018, the weighted average yield to maturity of fixed-income available-for-sale debt securities was -0.1% (31 December 2017: −0.32%).

Assets exposed to interest rate risk, by interest rate

In euros	As at 31 December 2018		As at 31 December 2017	
	Cost	**Fair value**	**Cost**	**Fair value**
Fixed-income debt securities				
Interest rate 0.00−2.50%	98,778,440	98,653,664	89,112,447	89,407,559
Interest rate 2.51−3.50%	7,987,299	7,975,234	7,928,927	7,940,078
Interest rate 3.51−4.50%	21,899,455	21,937,994	9,736,026	9,837,469
Interest rate 4.51−5.50%	10,654,551	10,806,540	7,566,156	7,776,760
Interest rate 5.51−6.50%	589,617	588,484	1,986,745	1,992,892
Total fixed-income debt securities	**139,909,363**	**139,961,915**	**116,330,301**	**116,954,758**
Floating rate debt securities	6,261,993	6,333,970	4,547,235	4,782,038
Total	**146,171,356**	**146,295,885**	**120,877,536**	**121,736,796**

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If at 31 December 2018 the yield curve had shifted evenly 100 basis points upward/downward across all maturities, the company's equity would have decreased/increased by 2.6 million euros (2017: 1.9 million euros). The rise in risk is attributable to an increase in the modified duration 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), either changes resulting from 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 2018 the value of investments in equity and debt securities funds had increased/decreased by 10%, the company's equity would have increased/decreased by 2 million euros (2017: 1.8 million euros). The increase in risk is attributable to the acquisition of investments in debt securities funds during the financial year.

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

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Investments in financial instruments by issuer's domicile

In euros **As at 31 December**	**2018**	**2017**
Debt and other fixed-income securities		
Australia	2,838,225	1,852,803
Austria	866,631	986,200
Belgium	2,057,022	2,903,159
Canada	4,159,236	6,909,170
Czech Republic	667,453	579,732
Denmark	13,218,863	12,654,393
Estonia	480,719	498,098
Finland	1,018,089	1,038,579
France	22,047,356	19,429,492
Germany	23,206,965	25,192,425
Great Britain	13,116,540	5,798,838
Hungary	1,943,210	1,432,664
Ireland	761,760	1,392,113
Italy	6,129,951	5,862,655
Korea	2,524,838	0
Latvia	2,811,849	1,223,702
Lithuania	3,082,941	5,363,721
Luxembourg	0	602,261
Mexico	2,787,122	0
Netherlands	1,316,879	3,258,665
New Zealand	4,017,812	2,648,457
Norway	1,410,006	3,206,585
Poland	2,534,607	2,784,931
Croatia	2,825,888	0
Spain	9,499,295	9,083,590
Sweden	0	354,208
Switzerland	3,123,701	3,042,839
European Investment Bank	2,619,415	0
Macedonia	2,458,941	0
Singapore	1,109,830	0
Romania	2,493,107	2,240,194
Portugal	1,839,498	0
Indonesia	2,667,908	0
China	4,660,226	1,397,321
Total debt and other fixed-income securities	***146,295,885***	***121,736,796***
Equities and fund units		
Ireland	20,396,844	9,240,509
Lithuania	43,443	43,443
Luxembourg	0	8,609,775
Total equities and fund units	***20,440,287***	***17,893,727***
Loans		
Belarus	1,380,000	1,380,000
Total loans	***1,380,000***	***1,380,000***
Total investments in financial instruments	**168,116,172**	**141,010,523**

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(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.

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 2018 USD	As at 31 December 2017 USD
Insurance and other receivables	36,872	25,000
Reinsurance assets	0	95,356
Investments in financial instruments – available-for-sale debt securities	0	2,454,503
Other liabilities from direct insurance business	626	0
Other liabilities and accrued expenses	0	4,788
Reinsurance payables	24,627	22,193
Total	**62,125**	**2,601,840**

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 178 million euros (2017: 153 million euros) including available-for-sale debt securities of 146 million euros (2017: 122 million euros), equities and fund units of 20.4 million euros (2017: 17.9 million euros), loans of 1.4 million euros (2017: 1.4 million euros) and cash and cash equivalents of 9.7 million euros (2017: 11.9 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 1.94 years (2017: 1.9 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.

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Financial assets and liabilities exposed to liquidity risk by maturity

In euros

As at 31 December 2018	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	27,456,468	19,348,127	14,625,433	7,366,693	3,075,341	**71,872,062**
Of which net insurance pension payments	21	0	1,719,741	1,990,300	2,701,636	2,634,750	1,887,125	**10,933,552**
Financial assets (investments in financial instruments and cash and cash equivalents)	14, 17	30,183,748	22,381,518	46,301,089	78,993,279	0	0	**177,859,633**
Other financial assets	16	0	23,583,511	0	0	0	0	**23,583,511**
Other financial liabilities	23, 24, 28	0	15,663,340	0	0	6,000,000	0	**21,663,340**
Net exposure (assets less liabilities)		30,183,748	2,845,221	26,952,962	64,367,846	-13,366,693	-3,075,341	**107,907,742**

In euros

As at 31 December 2017	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	23,531,366	15,704,959	10,424,565	6,876,744	3,456,102	**59,993,736**
Of which net insurance pension payments	21	0	1,748,887	1,881,915	2,237,560	1,903,133	1,409,856	**9,181,351**
Financial assets (investments in financial instruments and cash and cash equivalents)	14, 15	29,793,795	20,878,451	60,616,766	41,123,481	498,098	0	**152,910,591**
Other financial assets	16	0	20,001,790	0	0	0	0	**20,001,790**
Other financial liabilities	23, 24, 28	0	14,499,630	0	0	6,000,000	0	**20,499,630**
Net exposure (assets less liabilities)		29,793,795	2,849,245	44,911,807	30,698,916	-12,378,646	-3,456,102	**92,419,015**

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 2018 was 15.9% (2017: 10.9%).

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. The company's own funds meet the capital requirements set out in the law.

The table below provides information about the structure of available own funds by tier.

In euros

Basic own funds	As at 31 December 2018	As at 31 December 2017	Tier
Ordinary share capital (including own shares)	6,391,391	6,391,391	Tier 1 – unrestricted
Reconciliation reserve	54,500,295	42,544,410	Tier 1 – unrestricted
Subordinated liabilities	6,000,000	6,000,000	Tier 2
Deferred tax assets	215,412	241,849	Tier 3
Total basic own funds	**67,107,098**	**55,177,650**	

2.4. Strategic risks

Strategic risks may result from wrong business decisions or poor execution of decisions already made. We also regard reluctance to adapt to changes in the environment (e.g. the legal environment) as a strategic risk.

The main strategic risks result from a competitive market environment: market competition causes price competition and has an adverse impact on general profitability. Other sources of risk are the demographic situation and changes in consumer behaviour: continuing population ageing may create a need for services different from those offered by us and the number of prospective customers is declining. Also, changes in customer behaviour increase the need for digitalisation.

Strategic risks are mitigated by integrating risk management processes into the adoption of strategic decisions, particularly into the preparations and decisions made during the planning process.

As part of strategic risk management, we identify the most significant risks, which are assessed and monitored at the level of the management board. Where necessary, the management board determines the appropriate risk mitigation measures. In the case of all significant risks the company appoints the persons responsible for the implementation of measures.

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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 practicable. 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 areas:

- 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 appropriate control of IT applications used. Company-level control activities also ensure compliance with legal and regulatory requirements.

Through the internal control system, the company has identified, analysed and assessed both company-wide risks and the risks inherent in the 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.

We mitigate the risks resulting from business processes with process, IT and company level controls. Process level controls include authorisation systems, the four-eye principle, segregation of duties, rules and regulations, etc. IT controls include backup solutions, access controls and incident management planning. The purpose of company level controls is to assess whether all requirements of an adequate and appropriate control environment are met.

The continuity of critical business processes and systems in emergency or crisis situations is ensured by well-designed incident management, an appropriate crisis management structure and adequate disaster recovery concepts. Business continuity systems are tested on a regular basis.

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

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 risks

Reputational risk is the risk that negative publicity regarding ERGO's business practices or operations, whether true or not, will cause a situation where trust in the company is lost. 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 risk can occur in a number of different ways: directly as a result of the company's actions, indirectly due to the actions of an employee or tangentially through third parties.

ERGO has identified two subcategories of reputational risk:

- data and information;
- communication risk.

Reputational risk related to the unauthorised disclosure of confidential information is increasing because the public's awareness of matters related to the disclosure of personal data is improving and the member states of the European Union have adopted new data protection regulations.

Reputational risks are identified by three methods:

- preparation of extraordinary reports;
- regular quarterly communication between the risk management team and other relevant parties, e.g. the compliance control, internal audit and corporate communication teams;
- the internal control system where the evaluation of every operational risk is accompanied by the assessment of potential damage to reputation.

Risk takers – process owners – determine the measures including the implementation plans required for minimising and managing risk. Depending on relevance and significance, they may consult with other relevant parties such as the compliance control or internal audit teams and inform them about the measures determined. The measures for mitigating the most important reputational risks are discussed and approved by local management. The management of ERGO Group AG and Munich Re or relevant committees are notified of measures adopted according to need.

The greatest reputational risks are added to the company's risk profile and the company prepares quarterly risk reports on them. The company has put in place a special reporting system to make sure that (potential) reputational risks are reported without delay.

Risk controllers – the compliance control and internal audit teams – evaluate reputational risk using their own methods and report all actual or anticipated reputational risks they have identified to the risk management team and other responsible stakeholders.

Note 3. Premium income

The following table outlines gross and net premiums for 2018 and 2017 by insurance class.

In euros	2018			2017		
	Gross written premiums	Reinsurers' share	Net earned premiums[1]	Gross written premiums	Reinsurers' share	Net earned premiums[1]
Motor liability insurance	76,769,383	1,228,757	72,063,398	66,070,743	1,105,150	56,776,207
Accident insurance	7,072,364	25,592	6,750,400	6,469,901	29,236	6,195,509
Travel insurance	3,891,252	69,351	4,105,816	3,934,965	104,289	3,706,741
Technical risks insurance	5,631,412	280,023	5,046,204	5,119,357	227,089	4,367,900
Individuals' property insurance	12,264,580	203,742	11,691,263	11,419,977	196,403	10,899,318
Legal persons' property insurance	10,089,344	2,592,046	7,178,682	9,832,521	2,939,208	6,890,982
Agricultural risks insurance	2,080,900	438,355	1,502,557	1,786,750	452,104	1,170,100
Motor own damage insurance	45,940,594	21,896	44,899,830	43,812,415	48,860	41,349,360
Liability insurance	6,964,465	1,230,927	5,151,076	6,081,685	1,292,321	4,637,603
Goods in transit insurance	1,411,263	142,452	1,337,360	1,481,341	145,804	1,235,455
Carrier's liability insurance	2,712,156	15,569	2,747,453	2,775,742	3,704	2,832,945
Watercraft insurance and watercraft owner's liability insurance	588,725	37,548	522,566	505,723	46,974	455,574
Guarantee insurance	2,884,438	1,229,815	1,231,079	2,166,732	987,474	998,588
Railway rolling stock insurance	1,141,415	203,580	933,360	1,222,799	242,659	1,074,358
Assistance insurance	1,885,399	0	1,797,229	1,664,124	0	1,613,147
Financial risks insurance	508,851	165,133	316,174	405,323	72,992	351,560
Loss of employment insurance	211,881	0	212,012	33,116	0	32,559
Legal expenses insurance	1,822,300	0	1,859,214	2,101,407	645,538	1,373,026
Total from insurance activities	**183,870,722**	**7,884,786**	**169,345,673**	**166,884,620**	**8,539,805**	**145,960,932**
Legal persons' property insurance	-43,731	0	-43,731	0	-15,931	15,931
Total from reinsurance activities	**-43,731**	**0**	**-43,731**	**0**	**-15,931**	**15,931**
Total	**183,826,991**	**7,884,786**	**169,301,942**	**166,884,620**	**8,523,874**	**145,976,863**

[1] Net earned premiums = gross written premiums – 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 disclosed in note 21. On the merger with D.A.S. Õigusabikulude Kindlustuse AS in 2017, the company acquired insurance provisions of 577,853 euros (including the provision for unearned premiums of 146,237 euros) and reinsurers' share of the provisions of 346,713 euros (including of the provision for unearned premiums of 87,742 euros). Therefore, the year 2017 change in the provision for unearned premiums in note 21 does not equal the change recognised in the income statement.

Breakdown of gross written premiums by currency

In euros	2018	2017
EUR	183,715,030	166,636,204
USD	111,961	248,416
Total	**183,826,991**	**166,884,620**

Breakdown of gross written premiums by country

In euros	2018	2017
Estonia	57,314,444	57,422,607
Latvia	34,399,227	30,017,728
Lithuania	92,157,051	79,444,285
Total from insurance activities	**183,870,722**	**166,884,620**
Russia	-43,731	0
Total from reinsurance activities	**-43,731**	**0**
Total	**183,826,991**	**166,884,620**

Note 4. Commission income

In euros	2018	2017
Reinsurance commissions	871,611	1,418,423
Participation in reinsurers' profit	125,013	194,258
Reinsurers' share of deferred acquisition costs	-82,569	-35,593
Total	**914,055**	**1,577,088**

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Note 5. Investment income

In euros	2018	2017
Interest income on		
Loans	102,917	112,563
Term deposits	426	1,482
Available-for-sale debt securities	380,378	451,351
Total interest income	**483,721**	**565,395**
Dividend income	213,288	209,085
Net realised gains on		
Equities and fund units	-154,039	0
Available-for-sale debt securities	270,924	87,121
Investments in associates	0	0
Total net realised gains	**116,885**	**87,121**
Total	**813,895**	**861,602**

Note 6. Other income

In euros	2018	2017
Gain on disposal of property and equipment	83,943	181,300
Fees, commissions and charges received	1,060,647	915,119
Insurance brokerage income	121,819	120,948
Foreign exchange gain	231,331	232,960
Rental income	139,021	248,225
Miscellaneous income	358,190	478,568
Total	**1,994,951**	**2,177,120**

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Note 7. Claims and benefits

The following table shows claims paid and incurred in 2018 and 2017 by insurance class

In euros	2018				2017			
	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	41,230,687	11,252,704	-1,083,091	51,400,300	34,396,697	6,781,516	1,158,919	42,337,127
Accident insurance	3,182,803	-55,679	0	3,127,125	2,859,166	-60,015	0	2,799,150
Travel insurance	2,363,377	48,955	21,025	2,433,356	1,940,387	51,488	-151,386	1,840,490
Technical risks insurance	3,474,976	310,964	-1,324	3,784,615	1,966,262	-4,664,182	4,349,789	1,651,868
Individuals' property insurance	5,481,143	167,198	0	5,648,342	5,369,390	-141,603	0	5,227,786
Legal persons' property insurance	5,662,136	-721,311	-130,682	4,810,230	5,718,646	-2,156,168	963,491	4,525,969
Agricultural risks insurance	3,657,238	-30,033	-2,010,008	1,617,197	2,993,770	198,046	-2,160,340	1,031,476
Motor own damage insurance	28,557,330	-775,643	1,159	27,782,846	27,175,458	50,007	7,866	27,233,331
Liability insurance	2,185,548	2,011,203	-33,002	4,163,750	1,866,423	-398,008	-20,744	1,447,671
Goods in transit insurance	299,950	-36,104	-136	263,710	407,826	-320,938	0	86,889
Carrier's liability insurance	1,400,219	-264,501	-65	1,135,652	1,381,476	-358,226	15,487	1,038,739
Watercraft insurance and watercraft owner's liability insurance	169,389	-39,492	0	129,897	183,652	24,533	0	208,186
Guarantee insurance	86,168	134,439	-78,183	142,424	381,295	-129,475	-34,166	217,654
Railway rolling stock insurance	230,303	-80,354	42	149,991	202,807	388,848	-42	591,613
Assistance insurance	1,106,087	19,965	0	1,126,051	1,071,963	-55,867	0	1,016,097
Financial risks insurance	354,250	-41,465	0	312,699	417,829	-164,950	0	252,879
Loss of employment insurance	21,442	31,391	0	52,834	4,854	7,616	0	12,470
Legal expenses insurance	672,361	59,923	0	732,284	523,521	33,884	35,249	592,654
Total	**100,135,407**	**11,992,159**	**-3,314,266**	**108,813,300**	**88,861,422**	**-913,494**	**4,164,122**	**92,112,050**

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

On the merger with D.A.S. Õigusabikulude Kindlustuse AS in 2017, the company acquired insurance provisions of 577,853 euros (including the provision for claims outstanding of 431,616 euros) and reinsurers' share of the provisions of 346,713 euros (including of the provision for claims outstanding of 258,971 euros). Therefore, the year 2017 change in the provision for claims outstanding in note 21 does not equal the change recognised in the income statement.

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Claims handling costs

In euros	2018	2017
Salaries	3,585,635	3,280,324
Social security charges	1,091,836	994,041
Depreciation and amortisation	440,304	334,056
Services purchased	3,591,749	2,859,876
Other labour costs	79,051	63,346
Business travel expenses	41,163	24,426
Costs of company cars	50,823	79,562
Training and other staff costs	55,475	58,303
Rental and utilities charges	100,043	103,842
Office expenses	132,888	187,978
Communication expenses including mobile phone charges	83,513	102,207
IT costs	461,935	426,882
Miscellaneous costs	719,904	671,798
Total	**10,434,320**	**9,186,642**

The following table provides an overview of income from subrogation and salvage recoveries in 2018 and 2017.

In euros	2018	2017
Motor liability insurance	1,915,162	1,924,291
Accident insurance	2,289	1,113
Travel insurance	13,522	6,503
Technical risks insurance	22,745	20,755
Individuals' property insurance	624,158	349,191
Legal persons' property insurance	299,829	215,647
Motor own damage insurance	4,173,965	3,604,771
Liability insurance	128,037	19,200
Goods in transit insurance	26,957	88,248
Carrier's liability insurance	8,416	22,209
Watercraft insurance and watercraft owner's liability insurance	50,200	150
Guarantee insurance	118,692	25,972
Assistance insurance	7,334	12,978
Railway rolling stock insurance	197,655	6,201
Other property insurance	-12,847	-1,700
Legal expenses insurance	20,657	1,089
Total	**7,596,773**	**6,296,616**

Catastrophes and major losses in 2018

In 2018, there were no natural disasters with a significant impact. The largest loss event reported to the company occurred in Lithuania, was related to agricultural risks and amounted to 2.3 million euros (gross amount).

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Note 8. Expenses

In euros	Note	2018	2017
Acquisition costs		**40,649,475**	**38,565,263**
Salaries		8,550,168	8,468,776
Social security charges		3,442,313	3,394,105
Depreciation and amortisation		1,495,429	1,824,450
Service fees and commissions		20,602,403	19,502,945
Change in deferred acquisition costs		-653,063	-1 768 415
Other labour costs		349,682	274,441
Business travel expenses		96,681	85,003
Costs of company cars		323,874	334,410
Training and other staff costs		171,237	148,092
Rental and utilities charges		1,869,210	1,851,347
Office expenses		669,148	571,579
Communication expenses including mobile phone charges		350,022	367,949
IT costs		1,314,168	1,400,120
Marketing expenses		1,265,234	1,281,382
Miscellaneous expenses		802,969	829,078
Administrative expenses		**8,095,401**	**7,697,355**
Salaries		3,949,247	3,934,759
Social security charges		1,101,409	1,162,887
Depreciation and amortisation		580,776	511,459
Other labour costs		160,296	107,718
Business travel expenses		170,779	131,596
Costs of company cars		53,434	54,803
Training and other staff costs		121,352	146,205
Rental and utilities charges		763,177	769,208
Office expenses		130,904	97,479
Communication expenses including mobile phone charges		54,138	58,830
IT costs		928,520	615,885
Miscellaneous expenses		81,369	106,527
Other operating expenses		**2,113,715**	**1,999,039**
Membership fee to Estonian Traffic Insurance Fund		2,113,715	1,995,649
Miscellaneous operating expenses		0	3,390
Investment expenses		**341,696**	**356,874**
Salaries		87,026	118,253
Social security charges		21,632	28,694
Services purchased		75,730	137,687
Other labour costs		1,911	2,560
Business travel expenses		16,051	18,977
Training and other staff costs		1,210	2,926
Rental and utilities charges		8,544	8,263
Office expenses		147	117
Communication expenses including mobile phone charges		2,816	2,417
IT costs		24	2,114
Other services		24,066	21,954
Miscellaneous expenses		102,539	12,913

In euros	Note	2018	2017
Other expenses		**2,134,044**	**3,306,226**
Fees to the Financial Supervision Authority and membership fees to professional associations		274,293	376,861
Insurance brokerage expenses		115,843	118,657
Audit and legal fees		131,691	134,688
Loss on sale of property and equipment		96,851	0
Write-off of intangible assets	12	580,296	1,448,774
Write-off of property and equipment	10	14,929	3,150
Interest paid		205,008	205,008
Expenses related to leasing out premises		45,608	30,564
State fees, stamp duties and late payment interest		44,657	30,917
Foreign exchange loss		284,133	746,246
Miscellaneous expenses		340,735	211,361

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 a loss of 52,802 euros (2017: a loss of 513,286 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 2018, the cost of fully depreciated items still in use amounted to 3,087,572 euros (31 December 2017: 2,899,146 euros). ERGO Insurance SE has only such items of property and equipment that are in its own use.

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In euros

Asset class	Land	Buildings	Improvements to leased premises	Equipment and other items	Total
Cost					
As at 31 December 2016	**1,242,918**	**10,013,412**	**770,791**	**5,262,571**	**17,289,692**
Value adjustment	0	0	0	75,144	75,144
Additions	0	0	122,751	186,933	309,684
Sales	-203,630	-2,407,908	0	-69,747	-2,681,285
Write-off	0	0	-39,506	-429,431	-468,937
As at 31 December 2017	**1,039,288**	**7,605,504**	**854,036**	**5,025,470**	**14,524,298**
Additions	0	0	21,671	223,410	245,081
Sales	0	-158,341	0	-102,086	-260,427
Write-off	0	0	-21,468	-783,016	-804,484
As at 31 December 2018	**1,039,288**	**7,447,163**	**854,239**	**4,363,778**	**13,704,468**
Accumulated depreciation					
As at 31 December 2016	**0**	**3,255,903**	**473,418**	**3,903,032**	**7,632,353**
Value adjustment	0	0	0	18,043	18,043
Depreciation for the year	0	174,499	64,599	501,960	741,058
Sales	0	-951,417	0	-69,747	-1,021,164
Write-off	0	0	-39,506	-429,431	-468,937
As at 31 December 2017	**0**	**2,478,985**	**498,511**	**3,923,857**	**6,901,353**
Depreciation for the year	0	159,627	70,340	441,140	671,107
Sales	0	-57,450	0	-66,529	-123,979
Write-off	0	0	-5,981	-671,695	-677,676
As at 31 December 2018	**0**	**2,581,162**	**562,870**	**3,626,773**	**6,770,805**
Carrying amount					
As at 31 December 2017	**1,039,288**	**5,126,519**	**355,525**	**1,101,613**	**7,622,945**
As at 31 December 2018	**1,039,288**	**4,866,001**	**291,369**	**737,005**	**6,933,663**

Note 11. Deferred acquisition costs

In euros	**2018**	**2017**
Balance as at 1 January	**7,283,616**	**5,505,972**
Amortised portion	-6,659,647	-5,306,908
Addition from new contracts	7,310,524	7,237,110
Reduction after the liability adequacy test	0	-152,558
Balance as at 31 December	**7,934,493**	**7,283,616**

Note 12. Other intangible assets

In euros	Software and licences
Cost	
As at 31 December 2016	**16,404,164**
Addition through purchase of software and licences	1,936,017
Addition through internally generated IT projects	387,070
Write-off of software and licences	-4,398,727
As at 31 December 2017	**14,328,524**
Addition through purchase of software and licences	2,163,716
Addition through internally generated IT projects	5,945
Write-off of software and licences	-2,266,653
As at 31 December 2018	**14,231,532**
Accumulated amortisation	
As at 31 December 2016	**9,233,328**
Amortisation for the year	1,929,937
Write-off	-2,949,953
As at 31 December 2017	**8,213,312**
Amortisation for the year	1,882,477
Write-off	-1,589,188
As at 31 December 2018	**8,506,601**
Carrying amount	
As at 31 December 2017	**6,115,212**
As at 31 December 2018	**5,724,931**

Internally generated IT project ALICE

	Carrying amount
As at 31 December 2018	2,413,471
As at 31 December 2017	3,257,056

The useful life of insurance software ALICE is 10 years.

ALICE is insurance software that is being developed by ERGO Group. The costs that are capitalised include mainly 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 based 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.

At the end of the year, the company decided to write off old IT developments with a carrying amount of 580,297 euros (2017: 1,448,774 euros) including developments of ALICE of 312,624 euros (2017: 1,247,716 euros) because it was determined that they can no longer be used.

No intangible assets were sold in the reporting period. At 31 December 2018, the cost of fully amortised assets still in use was 5,110,021 euros (31 December 2017: 4,579,313 euros).

Note 13. Investments in associates and subsidiaries

In connection with the development of a new strategy, in 2017 ERGO International AG measured the value of all of the Group's foreign subsidiaries. The performance and profitability of an entity were determined based on the following criteria: strategic importance, attractiveness of the market, profitability and market position. Since CJSC ERGO Ins. Co did not meet the identified criteria, the sole shareholder of ERGO Insurance SE decided to sell its investment in CJSC ERGO Ins. Co.

Negotiations for the sale of CJSC ERGO Ins. Co. began on 21 December 2018. ERGO received the final offer on 14 February 2019. The company is planning to finalise the sales transaction in the second quarter of 2019.

A successful completion of the sales transaction in 2019 is highly probable. Therefore, the investment in CJSC ERGO Ins. Co. has been reclassified to assets held for sale. Assets held for sale are carried at their fair value of 637,372 euros. The difference between fair value and carrying amount has been recognised as an impairment loss.

In euros	**Investment in CJSC ERGO Ins. Co., Belarus**
As at 31 December 2017	**2,484,979**
Company's share of investee's profit or loss	77,245
Impairment loss	-1,924,852
Reclassification to assets held for sale	-637,372
As at 31 December 2018	**0**

ERGO Insurance SE is the sole shareholder in DEAX Õigusbüroo OÜ whose share capital amounts to 50,000 euros. Since the business volume of DEAX Õigusbüroo OÜ is insignificant compared to the total assets and revenue of ERGO Insurance SE, in the financial statements as at 31 December 2018 the subsidiary is accounted for using the cost method.

Note 14. Investments in financial instruments

In euros **As at 31 December**	**Note**	**2018**	**2017**
Available-for-sale financial assets			
Equities and fund units	14.1	20,440,287	17,893,727
Debt and other fixed-income securities	14.2	146,295,885	121,736,796
Total available-for-sale financial assets		**166,736,172**	**139,630,523**
Loans and receivables			
Loans	14.3	1,380,000	1,380,000
Total loans and receivables		**1,380,000**	**1,380,000**
Total		**168,116,172**	**141,010,523**

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

According to the hierarchy, at 31 December 2018 the company's available-for-sale debt securities and listed equities and fund units of 166.7 million euros (2017: 140 million euros) fell into Level 1. The fair value of unlisted securities (carrying amount at 31 December 2018 43,443 euros and at 31 December 2017 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 2018		As at 31 December 2017	
	Cost	Fair value	Cost	Fair value
Units in listed debt funds	20,450,705	20,396,844	17,477,901	17,850,284
Unlisted equities	43,443	43,443	43,443	43,443
Total	**20,494,148**	**20,440,287**	**17,521,344**	**17,893,727**

Equities not listed on a public stock exchange comprise other equities at their cost of 43,443 euros (2017: 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.

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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.

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 2018		As at 31 December 2017	
	Cost	Fair value	Cost	Fair value
Fixed-income debt securities				
Government bonds	85,010,416	85,062,727	56,898,614	57,360,293
Financial institutions' bonds	54,898,945	54,899,187	59,431,687	59,594,465
Total fixed-income debt securities	**139,909,361**	**139,961,914**	**116,330,301**	**116,954,758**
Floating rate debt securities				
Government bonds	1,715,585	1,656,783	0	0
Financial institutions' bonds	4,546,408	4,677,188	4,547,235	4,782,038
Total floating rate debt securities	**6,261,993**	**6,333,971**	**4,547,235**	**4,782,038**
Total	**146,171,354**	**146,295,885**	**120,877,536**	**121,736,796**

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 2018, 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.

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14.3. Loans

Mortgage loans by maturity

In euros **As at 31 December**	**2018**	**2017**
Three to four years	1,380,000	0
Four to five years	0	1,380,000
Total	**1,380,000**	**1,380,000**

At 31 December 2018, mortgage loans recognised in the statement of financial position of ERGO Insurance SE comprised a loan provided to CJSC ERGO Ins. Co. of 1,380,000 euros (31 December 2017: 1,380,000 euros). During the period 15 December 2017 to 1 July 2018 the interest rate was 8.14% per year and during the period 1 July 2018 to 1 July 2019 the interest rate is 6.5% per year. The settlement of the loan is ensured by the agreement on the sale of the investment in CJSC ERGO Ins. Co. and the loan will be settled when the sales transaction is finalised.

Note 15. Reinsurance assets

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

In euros **As at 31 December**	**2018**	**2017**
Provision for unearned premiums	1,504,469	1,336,181
Provision for claims outstanding – claims incurred and reported	*5,971,879*	*5,987,125*
Provision for claims outstanding – IBNR	*32,874*	*43,973*
Provision for insurance pension annuities	*1,721,085*	*1,580,908*
Total provision for claims outstanding	7,725,838	7,612,006
Total	**9,230,307**	**8,948,187**

Information on reinsurance assets is also provided in note 21.

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

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Reinsurance result

In euros	Note	2018	2017
Premiums paid to reinsurers	3	-7,884,786	-8,523,873
Reinsurers' share of change in provision for unearned premiums	3	168,289	140,486
Commissions and profit participation paid by reinsurers	4	996,623	1,612,681
Reinsurers' share of claims paid	7	3,200,432	2,745,083
Reinsurers' share of change in provision for claims outstanding	7	113,834	-6,909,206
Reinsurers' share of deferred acquisition costs	4	-82,569	-35,593
Total		**-3,488,177**	**-10,970,422**

Note 16. Insurance and other receivables

In euros **As at 31 December**	2018	2017
Receivables from policyholders	20,351,674	16,454,620
Receivables from brokers and other intermediaries	1,500,210	1,605,584
Receivables from reinsurers	1,141,439	776,364
Subrogation and salvage receivables	5,929	1,920
Total insurance receivables	***22,999,252***	***18,838,488***
Other receivables	429,985	1,045,846
Accrued income – interest receivable	154,274	117,456
Total other financial assets	***23,583,511***	***20,001,790***
Prepaid taxes	767,556	121,773
Prepaid expenses	1,592,265	1,375,247
Total non-financial assets	***2,359,821***	***1,497,020***
Total	**25,943,332**	**21,498,810**

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**	2018	2017
Demand deposits	9,743,461	11,900,068
Total	**9,743,461**	**11,900,068**

Cash and cash equivalents by original currency

As at 31 December	2018	2017
EUR	9,743,461	11,900,068

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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 2018	384,629	6,391,391	6,391,391
As at 31 December 2017	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 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 2018 and 2017 no dividend was declared.

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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 17 August 2017, 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 2018, 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 2018, the capital reserve amounted to 3,072,304 euros (31 December 2017: 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	**2018**	**2017**
At 1 January	**1,231,680**	**1,753,440**
Derecognised from equity and recognised in profit or loss in connection with sale and impairment	-115,686	-56,300
Derecognised from equity and recognised in profit or loss in connection with arrival of maturity date	-1,881	-32
Net change in fair value recognised in other comprehensive income or expense during the year	-1,043,443	-465,428
At 31 December	**70,670**	**1,231,680**

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Note 21. Insurance contract provisions and reinsurance assets

In euros **As at 31 December**	**Note**	**2018**	**2017**
Gross provisions			
Provision for unearned premiums		73,446,840	66,638,287
Provision for claims outstanding – claims incurred and reported		*51,197,403*	*44,757,463*
Provision for claims outstanding – IBNR		*12,030,142*	*8,748,332*
Provision for claims outstanding – indirect claims handling costs		*3,715,719*	*3,337,687*
Provision for insurance pension annuities		*12,654,636*	*10,762,259*
Total provision for claims outstanding		79,597,900	67,605,742
Total gross provisions		**153,044,740**	**134,244,029**
Reinsurers' share of provisions			
Provision for unearned premiums		1,504,469	1,336,181
Provision for claims outstanding – claims incurred and reported		*5,971,879*	*5,987,125*
Provision for claims outstanding – IBNR		*32,874*	*43,973*
Provision for insurance pension annuities		*1,721,085*	*1,580,908*
Total provision for claims outstanding		7,725,838	7,612,006
Total reinsurers' share of provisions	15	**9,230,307**	**8 948 187**
Net provisions			
Provision for unearned premiums		71,942,371	65,302,106
Provision for claims outstanding – claims incurred and reported		*45,225,524*	*38,770,338*
Provision for claims outstanding – IBNR		*11,997,268*	*8,704,359*
Provision for claims outstanding – indirect claims handling costs		*3,715,719*	*3,337,687*
Provision for insurance pension annuities		*10,933,551*	*9,181,351*
Total provision for claims outstanding		71,872,062	59,993,736
Total net provisions		**143,814,433**	**125,295,842**

Movements in provisions for unearned premiums

In euros	**2018**			**2017**		
	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	66,638,287	1,336,181	65,302,106	53,967,682	1,107,953	52,859,729
Changes from business combination	0	0	0	146,237	87,742	58,495
Premiums written	183,826,990	7,884,785	175,942,204	166,884,620	8,523,874	158,360,746
Premiums earned	-177,018,437	-7,716,497	169,301,940	-154,360,252	-8,383,388	-145,976,864
At 31 December	**73,446,840**	**1,504,469**	**71,942,371**	**66,638,287**	**1,336,181**	**65,302,106**

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Provisions for unearned premiums by insurance class.

In euros

Insurance class	**Gross provision for unearned premiums 31 Dec 2018**	**Gross provision for unearned premiums 31 Dec 2017**	**Net provision for unearned premiums 31 Dec 2018**	**Net provision for unearned premiums 31 Dec 2017**
Motor liability insurance	29,490,466	26,013,235	29,490,466	26,013,236
Accident insurance	2,885,452	2,589,080	2,885,452	2,589,080
Travel insurance	677,542	961,852	675,082	958,997
Technical risks insurance	2,627,758	2,277,506	2,582,692	2,277,506
Individuals' property insurance	5,321,593	4,952,017	5,321,593	4,952,018
Legal persons' property insurance	4,016,278	3,729,496	3,765,245	3,447,159
Other property insurance	871,784	731,797	871,784	731,797
Motor own damage insurance	19,166,826	18,147,957	19,166,826	18,147,957
Liability insurance	3,171,719	2,645,644	2,755,507	2,173,045
Goods in transit insurance	406,176	475,346	406,162	474,711
Carrier's liability insurance	914,554	965,420	914,554	965,420
Watercraft insurance and watercraft owner's liability insurance	173,979	145,368	173,979	145,368
Guarantee insurance	1,816,547	1,180,267	1,103,502	679,957
Railway rolling stock insurance	992,235	987,760	928,936	924,462
Assistance insurance	620,553	532,383	620,553	532,383
Financial risks insurance	187,544	160,278	174,204	146,128
Loss of employment insurance	1,413	1,544	1,413	1,544
Legal expenses insurance	104,423	141,337	104,423	141,337
Total	**73,446,840**	**66,638,287**	**71,942,371**	**65,302,106**

Movements in provisions for claims outstanding.

In euros	**2018**			**2017**		
	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	67,605,742	7,612,006	59,993,736	68,087,622	14,262,242	53,825,380
Changes from business combination	0	0	0	431,616	258,971	172,645
Claims incurred in the reporting period	110,484,170	2,720,093	107,764,077	96,600,338	2,311,572	94,288,766
Change in claims incurred in prior periods	1,643,395	594,171	1,049,224	-8,652,412	-6,475,695	-2,176,717
Claims paid	-100,135,407	-3,200,432	-96,934,975	-88,861,422	-2,745,084	-86,116,338
At 31 December	**79,597,900**	**7,725,838**	**71,872,062**	**67,605,742**	**7,612,006**	**59,993,736**

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Provisions for claims outstanding by insurance class

In euros

Insurance class	Gross provision for claims outstanding 31 Dec 2018	Gross provision for claims outstanding 31 Dec 2017	Net provision for claims outstanding 31 Dec 2018	Net provision for claims outstanding 31 Dec 2017
Motor liability insurance	55,908,228	44,654,858	50,174,854	39,749,704
Accident insurance	948,546	1,004,227	948,547	1,004,227
Travel insurance	709,643	661,351	683,958	597,164
Technical risks insurance	2,056,128	1,712,803	2,023,766	1,430,280
Individuals' property insurance	1,818,225	1,651,026	1,818,225	1,651,026
Legal persons' property insurance	2,410,801	3,164,473	2,352,374	2,761,648
Other property insurance	280,259	310,292	122,164	139,530
Motor own damage insurance	4,259,234	5,034,878	4,259,236	5,034,878
Liability insurance	7,772,647	5,761,443	6,377,405	4,254,910
Goods in transit insurance	225,681	261,786	212,305	248,411
Carrier's liability insurance	1,277,078	1,541,580	1,277,033	1,541,535
Watercraft insurance and watercraft owner's liability insurance	69,010	108,502	69,010	108,502
Guarantee insurance	635,108	500,669	325,871	234,110
Railway rolling stock insurance	528,000	608,354	528,000	608,312
Assistance insurance	128,859	108,894	128,859	108,894
Financial risks insurance	5,500	46,965	5,500	46,965
Loss of employment insurance	39,532	8,142	39,533	8,142
Legal expenses insurance	525,422	465,499	525,422	465,499
Total	**79,597,900**	**67,605,742**	**71,872,062**	**59,993,736**

In motor liability insurance, the provision for claims outstanding also includes the provision for insurance pension annuities. At 31 December 2018, annuity claim files were open for 234 persons: 119 in Estonia, 63 in Latvia and 52 in Lithuania.

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

In euros	Year of incurrence						
	2018	2017	2016	2015	2014	2013 and earlier	Total
Gross provision for pension annuities	897,509	1,514,163	2,226,693	273,793	1,253,999	6,488,480	12,654,637
Net provision for pension annuities	897,509	1,514,163	2,226,693	273,793	1,253,999	4,767,395	10,933,552

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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 2018 indicated that the provisions made for all classes of insurance were adequate to cover ERGO Insurance SE's obligations in these classes. Based on the test results, deferred acquisition costs were not reduced (2017: were reduced by 152,558 euros). No additional unexpired risks provision was recognised (see notes 2.1 and 11). 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**	**2018**	**2017**
Payables to reinsurers	2,739,635	2,432,453
Reinsurers' share of deferred acquisition costs	389,885	307,316
Total	**3,129,520**	**2,739,769**

Note 23. Insurance payables

In euros **As at 31 December**	**2018**	**2017**
Payables to policyholders	6,843,889	5,245,692
Payables to brokers and other intermediaries	3,803,213	3,279,195
Other payables	104,993	84,352
Total	**10,752,095**	**8,609,239**

Note 24. Other payables and accrued expenses

In euros As at 31 December	2018	2017
Other payables	426,573	653,191
Payables to suppliers	1,101,708	746,665
Accrued vacation pay payable	781,764	773,340
Payables to employees	1,230,955	1,996,120
Other accrued items	1,370,245	1,721,075
Total other financial liabilities	***4,911,245***	***5,890,391***
Personal income tax payable	195,365	266,314
Corporate income tax payable	847,055	582,817
Value added tax payable	131,360	80,964
Social security tax payable	343,237	631,645
Income tax payable on fringe benefits	4,303	4,915
Social security tax payable on fringe benefits	3,965	5,495
Payables to 2nd pillar pension funds (mandatory funded pension)	16,362	17,916
Total non-financial liabilities	***1,541,647***	***1,590,066***
Total	**6,452,892**	**7,480,458**

Note 25. Fair value of financial instruments

In euros		As at 31 December 2018				
	Note	**Carrying amount**	**Fair value**	**Level I**	**Level III**	**Total**
Financial assets measured at fair value						
Units in listed debt funds	14.1	20,440,287	20,440,287	20,440,287	0	20,440,287
Unlisted equities[1]	14.1	43,443	N/A[1]	N/A[1]	0	0
Government bonds	14.2	85,842,390	85,842,390	85,842,390	0	85,842,390
Financial institutions' bonds	14.2	60,453,495	60,453,495	60,453,495	0	60,453,495
Financial assets measured at amortised cost						
Loans	14.3	1,380,000	1,405,190	0	1,405,190	1,405,190

In euros		As at 31 December 2017				
	Note	**Carrying amount**	**Fair value**	**Level I**	**Level III**	**Total**
Financial assets measured at fair value						
Units in listed debt funds	14.1	17,893,727	17,893,727	17,893,727	0	17,893,727
Unlisted equities[1]	14.1	43,443	N/A[1]	N/A[1]	0	0
Government bonds	14.2	57,360,293	57,360,293	57,360,293	0	57,360,293
Financial institutions' bonds	14.2	64,376,503	64,376,503	64,376,503	0	64,376,503
Financial assets measured at amortised cost						
Loans	14.3	1,380,000	1,391,504	0	1,391,504	1,391,504

[1] Fair value cannot be measured reliably.

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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 2018, operating lease expenses on premises totalled 1,783,727 euros (2017: 1,736,353 euros). Operating lease expenses on other assets totalled 232,832 euros (2017: 493,400 euros).

Most lease contracts are for a term exceeding 12 months. From 1 January 2019, accounting for leases was changed in accordance with the requirements of IFRS 16.

Note 27. Income tax

At 31 December 2018, the company's retained earnings totalled 45,615,531 euros (31 December 2017: 37,387,319 euros) and the carrying amount of intangible assets was 5,724,931 euros (31 December 2017: 6,115,212 euros). Thus, distributable profit amounted to 39,890,600 euros (31 December 2017: 31,272,107 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 7,978,120 euros (31 December 2017: 6,254,421 euros) and the maximum amount that could be distributed as the net dividend is 31,912,480 euros (31 December 2017: 25,017,686 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 in the reporting period the profit of the Lithuanian entity was taxed in its domicile 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 2019 cannot exceed the company's distributable profit as at 31 December 2018.

In euros

Income tax expense	**2018**	**2017**
Income tax expense	774,956	624,515
Change in deferred income tax	26,437	934,417
Total income tax expense	**801,393**	**1,558,932**

In euros

Recognised deferred income tax assets	**2018**	**2017**
Deductible temporary differences on other liabilities	215,412	241,849
Total	**215,412**	**241,849**

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In euros

Reconciliation of accounting profit and income tax expense	2018	2017
Profit before tax	9,029,605	6,572,911
Tax rate 0%	0	0
Effect of tax rates in foreign jurisdictions	474,737	9,278
Effect of exempt income and taxable expenses	7,785	0
Effect of non-deductible expenses	292,434	615,237
Change in recognised deferred tax assets	26,437	934,417
Income tax expense for the year	**801,393**	**1,558,932**

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 reporting period totalled 707,121 euros (2017: 605,640 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.

In euros

As at 31 December Related party	Receivables 2018[1]	Receivables 2017[1]	Payables 2018[2]	Payables 2017[2]
Parent of the group – Münchener Rück	39,356	0	400,457	410,365
Other group companies	1,661,978	1,671,905	6,461,831	6,666,514

In euros

Related party	Services purchased 2018[4]	Services purchased 2017[4]	Services sold 2018[3]	Services sold 2017[3]
Other group companies	1,928,816	989,221	752,153	814,207

[1] Including a loan of 1,380,000 euros (2017: 1,380,000 euros) provided to CJSC ERGO Ins. Co.

[2] Including a subordinated loan of 6,000,000 euros (2017: 6,000,000 euros) received from ERGO Life Insurance SE.

[3] Including interest of 154,274 euros (2017: 146,521 euros) on the loan provided to CJSC ERGO Ins. Co.

[4] Including interest of 2,247 euros (2017: 205,008 euros) on the loan received from ERGO Life Insurance SE.

Recognised in profit or loss on the basis of reinsurance contracts

In euros

Reinsurance contracts	2018	2017
Münchener Rückversicherungs-Gesellschaft AG		
Ceded reinsurance premiums	303,821	406,109
Reinsurers' share of claims paid	174,281	48,436
Reinsurance commissions and profit participation	-23,770	-17,889
Other group companies		
Ceded reinsurance premiums	92,646	951,379
Reinsurers' share of claims paid	10,498	462,759
Reinsurance commissions and profit participation	23,498	676,584

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Signatures to annual report 2018

The management board of ERGO Insurance SE has prepared the company's review of operations and financial statements for 2018.

Bogdan Benczak
Chairman of the Management Board .... 26 March 2019

Tarmo Koll
Member of the Management Board .... 26 March 2019

Tadas Dovbyšas
Member of the Management Board .... 26 March 2019

Ingrīda Ķirse
Member of the Management Board .... 26 March 2019

Marek Ratnik
Member of the Management Board .... 26 March 2019

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Independent Auditors' Report

(Translation of the Estonian original)

To the Shareholder of ERGO Insurance SE

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of ERGO Insurance SE (the Company), which comprise the statement of financial position as at 31 December 2018, the income statement, the statements of comprehensive income, cash flows and changes in equity for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the financial statements presented on pages 20 to 83, present fairly, in all material respects, the financial position of the Company as at 31 December 2018, 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.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

<table>
<tr><th colspan="2">Valuation and completeness of the provision for claims outstanding</th></tr>
<tr><td colspan="2">The gross carrying amount of the provision for claims outstanding as at 31 December 2018 was EUR 79,598 thousand and the expense recognised in profit or loss from the change in the provision for claims outstanding was EUR 11,992 thousand.

We refer to the financial statements: Notes 1 and 2 (accounting policies), Note 21 (financial disclosure).</td></tr>
<tr><th>The key audit matter</th><th>How the matter was addressed in our audit</th></tr>
<tr><td>The provision for claims outstanding as at 31 December 2018 comprises of the provision for incurred but not reported claims of EUR 12,030 thousand, the provision for reported but not settled claims of EUR 63,852 thousand and the provision for indirect claims handling costs EUR 3,716 thousand.

Provisions have been recognised to cover the future claims arising from the insurance contracts issued by the Company (provision for claims</td><td>In auditing the provisions relating to the insurance business we engaged actuaries as part of our audit team. Together with actuaries we, among other things, performed the following procedures:

• assessed whether the methods to calculate the provisions used by the management are appropriate and compliant with the financial reporting framework;</td></tr>
</table>

outstanding). The Company performs the liability adequacy test to assess the adequacy of provisions. As at 31 December 2018, no additional unexpired risk provision was recognised as a result of the test. Actuarial models which take into account inputs such as premiums earned, the loss ratio, the length of the claim reporting period and the estimated amount of the expected loss, are used for both calculating the provisions and carrying out the liability adequacy test. We have assessed this area as a key audit matter, as calculating provisions is subject to uncertainty and judgment. Estimation uncertainty arises mainly from the rate of occurrence and the speed of settlement of large claims and the development of long-term claims. We have also assessed the completeness and quality of data used by the Company in the calculation of provisions as a key audit matter.	• assessed how management derives the key assumptions and whether those methods are appropriate; • assessed the reliability and completeness of the previous year provisions by taking into account the actual claims paid and changes in claims provisions during current financial year; • compared the key inputs with historical information; • tested whether the general controls over the IT environment are effective; • carried out alternative calculations of provisions for selected insurance classes; • tested based on a sample whether claim data corresponds to the data in the claim file; • assessed the completeness of underlying data used by comparing it to the information retrieved from the Company's databases; • assessed whether the disclosures made in the financial statements (including in respect of the sensitivity of estimation results to the key assumptions applied) are sufficient and appropriate.

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.

KPMG

Report on Other Legal and Regulatory Requirements

We were appointed by the sole shareholder of ERGO Insurance SE on 06 April 2018 to audit the financial statements of ERGO Insurance SE for the year ended 31 December 2018. Our total uninterrupted period of engagement is 16 years, covering the periods ending 31 December 2003 to 31 December 2018.

We confirm that:

- our audit opinion is consistent with the additional report presented to the Audit Committee of the Company;
- we have not provided to the Company the prohibited non-audit services referred to in Article 5(1) of EU Regulation (EU) No 537/2014. We also remained independent of the audited entity in conducting the audit.

For the period to which our statutory audit relates, in addition to the audit and audit related services, we have not provided additional services to the Company.

Tallinn, 29 March 2019

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 2018 of 8,228,212 (eight million two hundred and twenty-eight thousand two hundred and twelve) euros be transferred to retained earnings;

4) no distribution be made to the sole shareholder;

5) As at 1 January 2019, retained earnings amount to 45,615,531 (forty-five million six hundred and fifteen thousand five hundred and thirty-one) euros.

On behalf of the management board of ERGO Insurance SE

Bogdan Benczak
Chairman of the Management Board

Information on the sole shareholder

This information is presented as at 20 March 2019.

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 2018 – 31 December 2018	Amount
Non-life insurance (65121)	183,826,991

Activities planned for the period 1 January 2019 – 31 December 2019

Non-life insurance (65121)