ALM Risks

When changes in different market risk variables (interest rates, inflation, foreign exchange rates) cause a change in the fair values of investment assets and derivatives that is of different size than the respective change in the economic value of insurance liabilities, the company is exposed to ALM risk. It has to be noted that the cash flows of insurance liabilities are modelled estimates and therefore uncertain in relation to both their timing and amount. This uncertainty is a central component of ALM risk.

On balance sheet level, ALM risks contribute considerably to economic values, risks and capital need. Sampo Group companies analyse ALM risks and monitor ALM exposures actively and the risks are taken into account when managing investments and developing insurance products. In addition to the risks relating to fluctuations in market values and economic values, ALM risks include liquidity risk. Additionally, single name concentration risks over assets, liabilities and other agreements are to be monitored at the balance sheet level. A balance sheet level concentration may arise for example when a company is insured by Sampo Group companies, Sampo Group has holdings in debt and equity instruments issued by the company and the company is a tenant in a property owned by Sampo Group.

Principles of Asset and Liability Management

In Sampo Group, insurance liabilities are the starting point for investment management. Insurance liabilities are modeled and analyzed to form an understanding of their expected future cash flows and their sensitivities to changes in factors such as inflation, interest rates and foreign exchange rates.

Solvency position and risk appetite are defining general capacity and willingness for risk taking. The stronger the solvency position and the higher the risk appetite, the more the investment portfolio can potentially differentiate from a portfolio replicating cash flows of insurance liabilities.

Rating targets and regulatory requirements are major external factors affecting market and liquidity risk taking in general at the balance sheet level, and specifically at the investment portfolio level.

Investments are managed according to the Investment Policies which are approved by the Boards of Directors of respective companies. Asset class allocations, risk limits by risk types, the risk governance of investment activities and the decision making authorizations are set in the companies' Investment Policies in a way that maintains the balance between earnings potential, risks and capitalization also at the balance sheet level.

If P&C and Mandatum Life are following the above mentioned principles, but they apply it by taking also into account the specific characteristics of their own businesses.

ALM in If P&C

The ALM risk in If P&C is managed in accordance with Sampo Group‘s principles. ALM is taken into account through the risk appetite framework and is governed by If P&C's Investment Policies.

In accounting the major part of the technical provisions is nominal. However, a still significant part (the provisions for claims outstanding pertaining to annuities), is discounted with interest rates in accordance with regulatory rules. Thereby If P&C is, from an accounting perspective, mainly exposed to changes in inflation and the regulatory discount rates. From an economic perspective, in which the cash flows of insurance liabilities (technical provisions) are discounted with prevailing interest rates, If P&C is exposed to changes both in inflation and nominal interest rates. For more information see the table Sensitivities of Technical Provisions, If P&C, 2014 in Non-life Underwriting Risks section.

To maintain the ALM risk within the overall risk appetite, the cash flows of insurance liabilities (technical provisions) are matched to a certain degree by investing in fixed income instruments and by using currency derivatives. The degree is dependent on the solvency position and market view.

ALM in Mandatum Life

The Board of Directors of Mandatum Life approves annually the Investment Policies for both segregated assets and other assets regarding the company's investment risks. These policies set principles and limits for investment portfolio activities.

The Investment Policy for segregated assets defines the risk bearing capacity and the corresponding control levels. Since the future bonus reserves of the segregated group pension portfolio is the first buffer against possible investment losses, also the risk bearing capacity is based on the amount of future bonus reserve. Different control levels are based on fixed stress scenarios of assets.

The Investment Policy for other investment assets defines the control levels for maximum acceptable risk and respective measures to manage the risk, which are based on the company level solvency and on both Solvency I and Solvency II type of approaches.

In the Solvency I type of approach, control levels are set above the Solvency I using a VaR-analysis of the investment assets. In the Solvency II type of approach, control levels are set also based on other confidence levels in addition to the 99.5 per cent level used in Sampo Group. The general objective of these control levels and respective guidelines is to maintain the required solvency and to ensure that investments are sufficient and eligible for covering technical provisions.

When above mentioned control levels are breached, the ALCO reports to the Board which then takes the responsibility on the decisions related to the capitalization and the market risks in the balance sheet.

The cash flows of Mandatum Life's with profit technical provisions are relatively well predictable, because in most of the company's with profit products, surrenders and premiums are restricted. The company's claims costs do not contain significant inflation risk element and thus the inflation risk in Mandatum Life is mainly related to administrative expenses.

The long-term target for investments is to provide sufficient return to cover the guaranteed interest rate plus bonuses based on principle of fairness as well as the shareholder's return requirement with acceptable level of risk. In the long run the most significant risk is that fixed income investments will not generate adequate return compared to the guaranteed rate. In addition to investment and capitalization decisions, Mandatum Life has implemented active measures in the liability side to manage the balance sheet level interest rate risk. The company has reduced the minimum guaranteed interest rate in new contracts, supplemented the technical provisions with discount rate reserves and adjusted policy terms and conditions as well as policy administration processes to enable more efficient interest rate risk management.