HDI

HDI Group Solvency and Financial Condition Report 2020

At a glance

- The HDI Group uses its approved internal model and shows a very strong capitalisation.
- The HDI Group's so-called "risk kernel" – the Talanx Group – also clearly meets its strategic risk objectives.
- Own funds and risk are determined using a range of views that vary in terms of both their model scope and the economic and regulatory aspects used to determine eligible own funds. The resulting key indicators are explained in more detail in this report.
- The HDI Group proved resilient during the coronavirus pandemic, with our risk management system and very strong capitalisation playing a key role in this.

KEY INDICATORS FOR DIFFERENT VIEWS

EUR thousand	Talanx Group (economic view)		HDI Group (regulatory view)		HDI Group (excluding transitional)	
Own funds	Basic own funds (BOF)	23,107,965	Eligible own funds	23,073,703	Eligible own funds (excluding transitional)	18,875,771
Solvency capital requirement	(Full) economic internal model	8,752,471	Full internal model	8,874,227	Full internal model	9,179,118
Ratio	Capital adequacy ratio (Talanx)	264%	Solvency II ratio (including transitional)	260%	Solvency II ratio (excluding transitional)	206%

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Summary

This report presents the HDI Group's solvency and financial condition and describes in particular the Talanx Group, which is the HDI Group's material risk kernel and which is relevant for the capital market. Further information is also available in the reports prepared by the various subsidiaries.

This report contains disclosures on solvency capital requirements and own funds as at 31 December 2020. Here we have a very strong level of capitalisation of 206% excluding transitional and 264% in economic view.

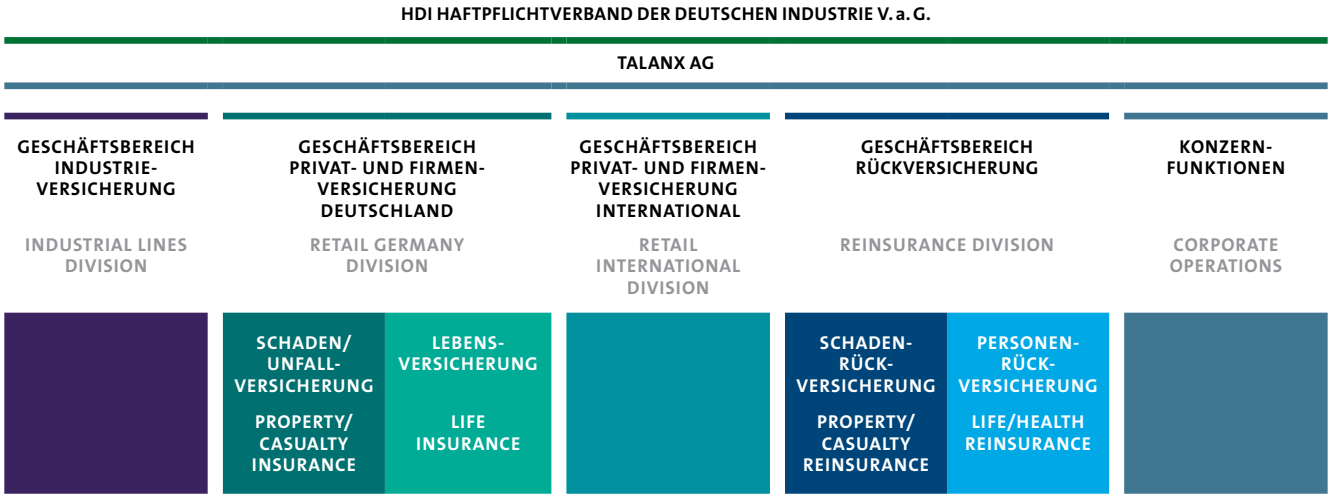
Group structure

As the ultimate parent undertaking of the HDI Group, HDI V.a.G. owns 79% of the shares of Talanx AG. In its role as an insurance company, it contributes to HDI Global SE's domestic business via a 1‰ co-insurance share. HDI V.a.G. is primarily invested in low risk, highly liquid assets. This means that the risk profile of the HDI Group is essentially defined by the risk profile of the Talanx Group. To this extent, this forms the risk kernel of the Group.

Talanx AG acts primarily as a finance and management holding company that in turn owns significant participations in insurance companies and cooperates with partners in more than 150 countries. Our business model consists of assuming underwriting and financial risk. Talanx AG also operates as an intragroup reinsurer.

The HDI Group works with its companies in several different areas of primary insurance and reinsurance, both in property/casualty insurance and in life insurance. Its broad geographical and sectoral positioning is the backbone for our high level of diversification.

GROUP STRUCTURE

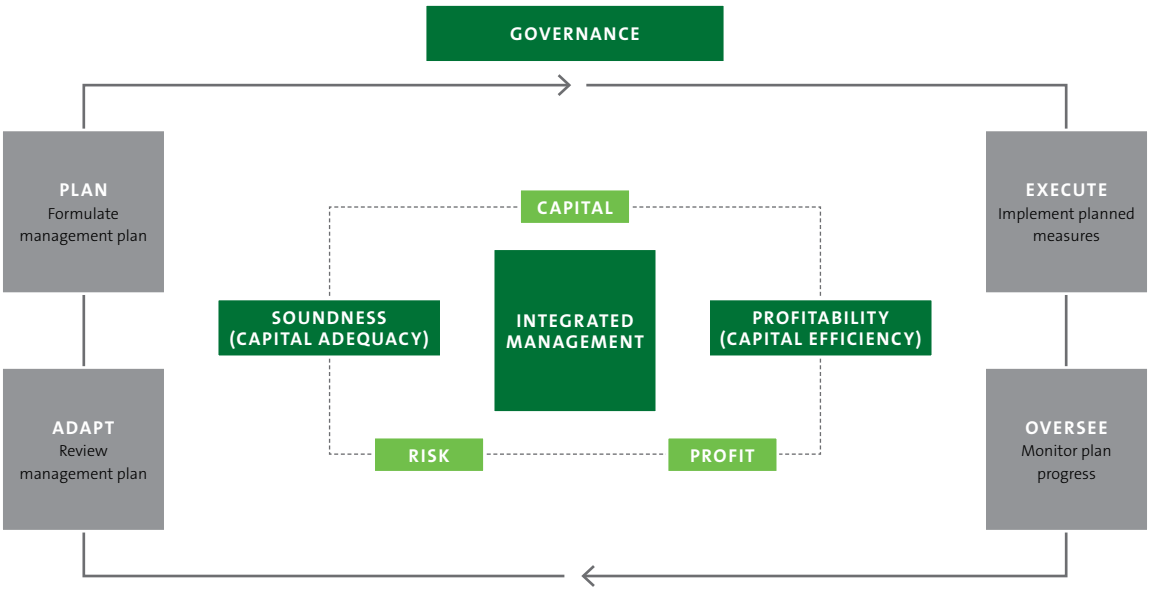


Brief overview of enterprise risk management and targets

Insurance companies can look back on many years of experience with the application of actuarial methods and procedures for pricing and/or defining their risk exposure. These processes have been enhanced in terms of both methodology and content in the period since the 1990s, thanks to the systematic treatment of issues relating to value management and risk management. Holistic models known as enterprise risk management (or ERM) models are used for this, enabling a consistent benchmark to be adopted for measuring, assessing and managing accepted risks, income generated and capital deployed. Synthesizing these components culminates at a management level in a performance concept that we use as the basis for economic decision-making.

In this performance concept, Risk Management performs tasks and functions in both economic and regulatory contexts, making it an explicit part of the value chain. The HDI Group's risk management philosophy uses a customised, Solvency II version of the ISO 31000 risk management standard, which allows us to harmoniously combine our Talanx Purpose with technical needs, supervisory requirements and economic imperatives. The risk management process revolves around the Talanx Enterprise Risk Model (TERM) – the HDI Group's internal, holistic risk model.

PERFORMANCE CONCEPT AND INTEGRATED MANAGEMENT



We regard our enterprise risk management as a process, continuously enhancing the approaches we take and adjusting them to changes in the strategic and economic framework. We also refer to the results of internal and external audits, and of the internal validation process.

In this respect the Talanx Group's enterprise risk management system was also examined in the context of the Standard & Poor's rating process and assessed as good. We are also one of the few European insurers whose internal model means that S&P requires lower rating capital requirements (thanks to the M-factor).

We use our ERM approach to derive annual targets for the Group, taking into account our risk-bearing capacity (soundness), the need to maintain our rating (trustworthiness) and the need to meet anticipated capital market expectations (profitability).

Capital concepts

The solvency balance sheet presents assets and liabilities on a market-consistent basis in accordance with Solvency II, and is the focal point for the supervisory framework. We have added a reconciliation between "own funds" as per the IFRS financial statements and as per the Solvency II balance sheet in section D so as to permit a comparison with familiar, published information.

The various concepts for "capital" differ both in terms of their economic (eligibility of hybrid capital) and their regulatory content (transitional and restrictions on availability) and in relation to the valuation principles applied.

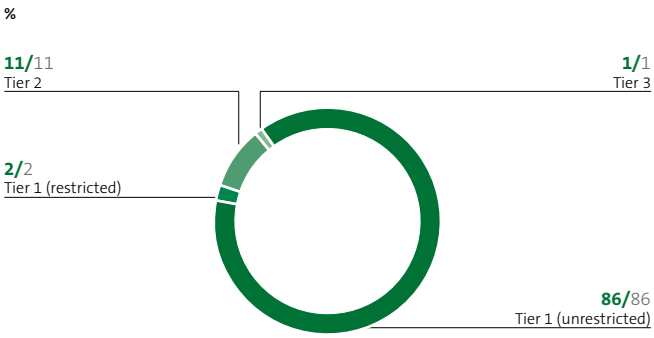
Talanx's basic own funds excluding transitional and the solvency capital requirements are used to assess our risk-bearing capacity, risk budgeting, and Group limits and thresholds.

Regulatory capital requirements are compared with eligible own funds.

In addition to the volume of own funds, investment liquidity is particularly important. The HDI Group uses appropriate limits to ensure it has a comfortable liquidity position.

For supervisory purposes, eligible own funds are broken down into different quality categories. This process is known as "tiering". The following graphic shows that 86% of the HDI Group's own funds are assigned to the highest quality tier. This means that the HDI Group has extremely generous levels of high-quality own funds.

BREAKDOWN OF OWN FUNDS



2020/2019

Risk assessment using TERM, Capital Adequacy Ratio

Given the highly differentiated economic and regulatory concepts for capital, it makes sense to use a comparable approach during risk measurement.

We use a full internal model that has been approved by the supervisory authority. This takes account of all quantifiable risks under Solvency II.

TERM permits consistent risk modelling and measurement both at subsidiaries and for the Group as a whole, using a combination of event models and corporate models. Event models form the landscape of the risk factors (e.g. specific natural catastrophes or interest rate risks) of the HDI Group. The corporate models build on the event models to model the solvency balance sheet for the undertakings that are being analysed, and by doing so allow an assessment of the consequences of potential adverse events for the solvency balance sheet.

TERM uses Monte Carlo simulations to forecast the solvency balance sheets for the individual undertakings and to consolidate them on a Group-wide basis. A one-year horizon is used for the projected distributions produced for the components and for the net solvency balance sheet amount.

This allows us to determine the Solvency Capital Requirement (SCR) for all quantifiable risks under Solvency II.

The relationship between the SCR and own funds is expressed using the concept of excess cover or the capital adequacy ratio (CAR):

KEY RISK PARAMETERS FOR THE HDI GROUP

%	Limit	2020
Solvency II ratio (HDI Group, excluding transitional)	150–200	206
CAR (Talanx, economic)	200	264
Share of market risk (Talanx)	≤ 50	41

A minimum CAR of 200% is designed to ensure the capitalisation needed to maintain an AA rating (S&P). As a result, the solvency level used by the Group far exceeds the level required by the regulator.

Investing, and hence assuming market risk, are important parts of our business. However, we clearly define ourselves as an insurance group and so aim to keep the share of our overall risk accounted for by investment risk to less than or equal to 50% on a permanent basis. At present it is approximately 41% (tail value at risk).

Diversified risk profile

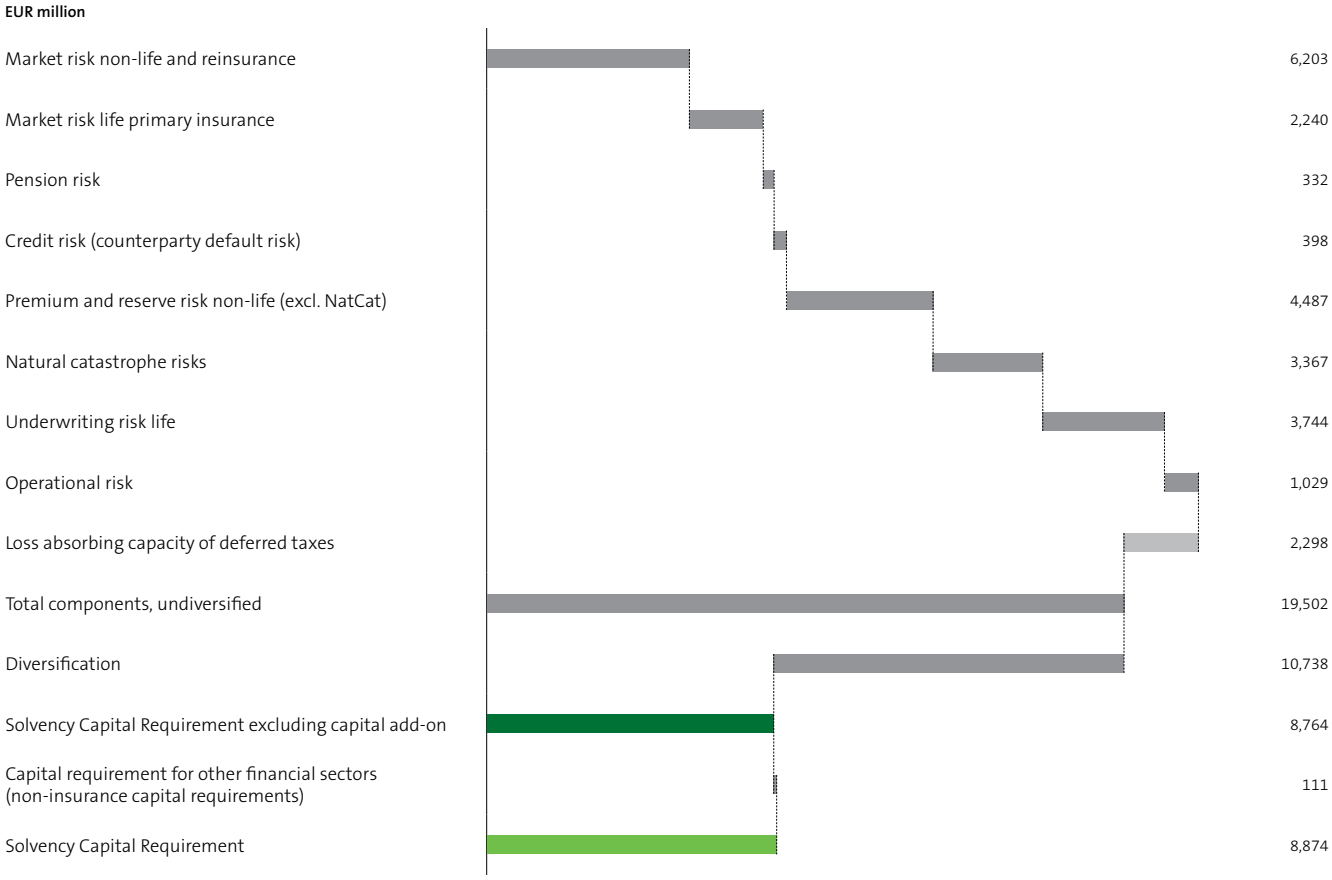
Risk profiles are used to depict aggregated risk factors that are subsumed under generic concepts such as "underwriting risk".

The following bar chart shows the HDI Group's material risk categories, based on the internal model. The Group's risk profile contains the following key risk categories:

- Market and credit risk
- Underwriting risk – non-life, and particularly natural catastrophe risk
- Underwriting risk life

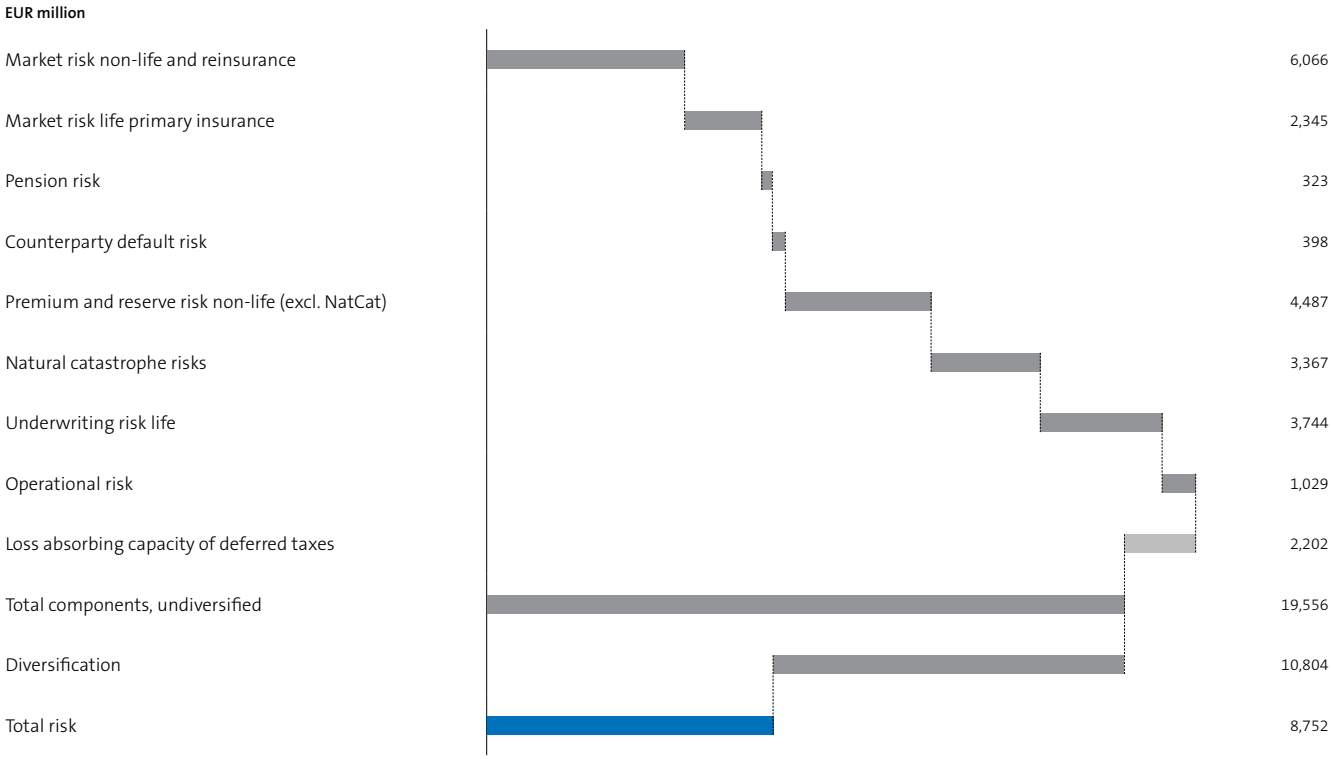
Diversification plays a crucial role in defining overall risk: our geographical spread and business diversity allow us to reduce our risk by roughly 55%. As the key risk categories shown above are only loosely correlated for intrinsic reasons, this high degree of diversification is well founded and is based on intrinsic rather than on theoretical model considerations.

HDI GROUP'S SOLVENCY CAPITAL REQUIREMENT BY RISK CATEGORY (REGULATORY VIEW)



The Talanx Group is the dominant component of the HDI Group's risk profile. Risks are analysed primarily from an economic viewpoint with TERM. The following diagram shows the SCR determined in this way, broken down by risk category.

TALANX GROUP'S SOLVENCY CAPITAL REQUIREMENT BY RISK CATEGORY (ECONOMIC VIEW)

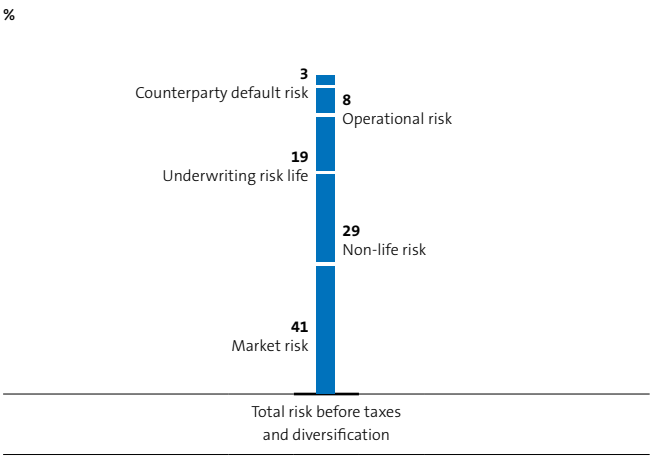


The differences in the risk profiles between the HDI Group and the Talanx Group are due to the additional risk associated with HDI V. a. G. The different assessment approaches result in differences as a result of the separate disclosure of institutions for occupational retirement provision (as required by the regulator).

Overall, the two risk profiles are highly similar.

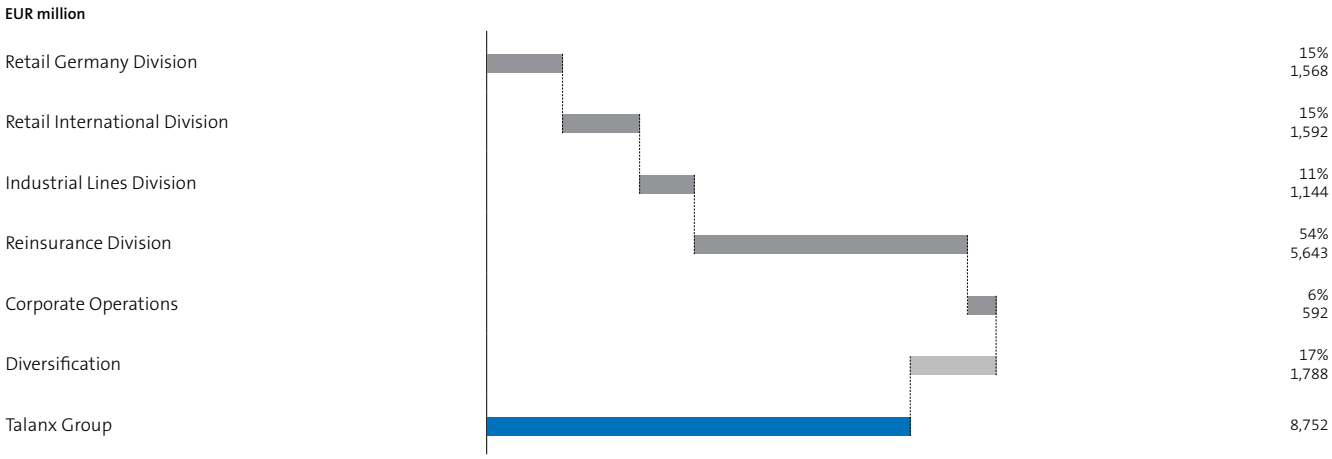
As regards risk management for the Group, it makes sense for a large number of reasons to use the TERM internal model for the Talanx risk kernel in the economic view. In particular, we have defined a specific risk strategy target in this view, which stipulates that market risk should not exceed 50% of the overall risk. As shown in the following graphic, the current level is around 41%.

RISK COMPONENTS (TALANX), ECONOMIC VIEW



At Group level, we not only focus on the risk categories but also analyse the risk profile for our subsidiaries, which are presented by division (the management unit concerned). The following graphic shows the contribution made by the individual divisions to the Group's SCR:

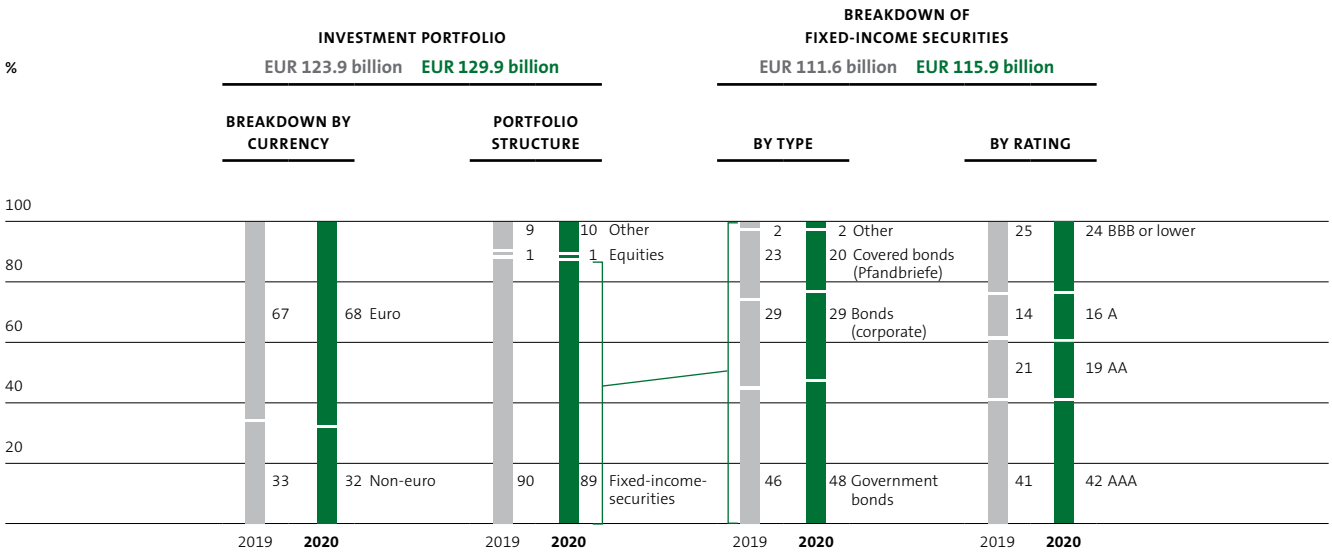
RISK PROFILE BY TALANX DIVISIONS, ECONOMIC VIEW



Details of the risk profile

It is clear that market risk constitutes the largest factor in the overall risk. Exposure to this risk is influenced by the investment portfolio structure. The following graphic shows the Talanx Group's portfolio as measured in the IFRS financial statements:

HDI GROUP PORTFOLIO BY CURRENCY, ASSET CLASS AND RATING



The portfolio is clearly dominated by fixed-income securities, over 76% of which have at least an A rating. We selectively supplement bonds with very good credit quality and long durations with high-yield bonds with short maturities. The majority of our investments are denominated in euros, whereas the US dollar dominates in the non-euro area. Our goal is to achieve an appropriate mix of the euro and foreign currencies.

Our investment strategy results in a relatively low-risk portfolio overall. The significant role played by market risk in the Group's risk profile is therefore also partly due to the portfolio's size.

In line with our business model, life and non-life underwriting risk is another key factor influencing our risk profile. The other categories account for a much lower share.

The following table shows our exposure to natural catastrophes for specific accumulation scenarios (net losses, total annual loss).

ACCUMULATION SCENARIOS (BEFORE TAXES)[1]

EUR thousand	2020
200-year loss Atlantic hurricane	2,626,343
200-year loss US/Canadian earthquake	2,261,120
200-year loss Asia-Pacific earthquake	1,595,815
200-year loss Central and South-American earthquake	1,524,548
200-year loss European storm	1,187,409
200-year loss European earthquake	1,112,244
200-year loss European flood	988,005

[1] In reality, natural catastrophes may follow a course that differs from assumptions based on models.

We regularly analyse how sensitive the capital adequacy ratio is in relation to changes in individual risk categories and/or the occurrence of certain events. The following table gives an approximate answer to this question by analysing changes in material risk factors.

SENSITIVITIES OF THE CAPITAL ADEQUACY RATIO (CAR) AND SOLVENCY II RATIO OF RISK FACTOR STRESSES

	2020	
%	CAR (Talanx, economic)	Solvency II ratio (HDI Group, excluding transitional)
Year-end 2020	**264**	**206**
Equity markets –30 %	260	202
Equity markets +30 %	268	209
Credit spread +50 bp	255	197
Interest rate –50 bp	249	194
Interest rate +50 bp	267	208
NatCat event (200-year event, European storm)	254	200

The biggest sensitivity exists for a decline in interest rates, which would chiefly have a negative impact on the risk situation in life business.

Such market developments and the associated risks are influenced to a greater extent by external events such as political uncertainties than underwriting risk is. This, together with the comparatively high sensitivity to such movements, is a further argument in favour of limiting the proportion of the overall risk accounted for by market risk.

The uncertainties associated with economic models are far greater than those involved in scientific applications using statistical and mathematical forecasting models. The HDI Group expressly takes this factor into account by, among other things, quantifying these uncertainties using a validation process and expert assessments and buffering them with capital. Not only model uncertainties but also strategic risk and emerging risk are taken into account here. In this way, we increase our resistance even to withstand unforeseeable events.

Compliance with the regulatory framework

We comply in full with the requirements of Solvency II as set out in the German Insurance Supervision Act (VAG) with regard both to due and proper management and to supervisory capital requirements. In particular, the Group's capitalisation is well in excess of the level required by the supervisory authority.

The figures in this report are given in thousands of euros (EUR thousand), in line with the regulatory requirements. To the extent that Article 293(2) to (4) of the Commission Implementing Regulation requires reference to be made to the annual financial statements, minor differences to the presentation in the Group's annual financial statements can arise, since the figures there are consistently rounded to millions of euro.

The HDI Group's use of an internal model for regulatory purposes depends on an extremely intensive audit by the supervisory authority. The HDI Group was granted unlimited approval to use its partial internal model (TERM) by way of a letter dated 19 November 2015. Approval for the full internal model by including operational risk was granted by way of a letter dated 20 September 2019. Changes to this model are subject to a comprehensive planning and approval process, with the latest changes approved by the letter dated 29 March 2021.

Even before the supervisory audit process, we had undergone corresponding reviews by rating agencies that produced positive results. This means that our models have been validated in a series of external assessments, something that further increases the trust in our internal model for third parties.

Our Solvency Capital Requirement and the volume and composition of our regulatory own funds are presented in section E of this report in particular.

In the course of the transition to the Solvency II supervisory regime, the supervisory authority approved the use of the transitional measure on technical provisions at several HDI Group companies. Talanx's basic own funds excluding transitional and the solvency capital requirements are used to assess our risk-bearing capacity, risk budgeting, and Group limits and thresholds; thus our relevant ratio is currently 206%. In addition, the dynamic volatility adjustment is permanently applied. The solvency ratio (regulatory view) for the HDI Group after application of the transitional is 260%. The HDI Group clearly exceeds the regulatory Solvency Capital Requirement even without the use of these measures, as can be seen from the table below. Further details can be found in section D.2 of this report.

IMPACT OF VOLATILITY ADJUSTMENT (VA) AND TRANSITIONAL (TR)

		31.12.2020			
EUR thousand	Key indicators including volatility adjustment (VA) and transitional (TR)	Key indicators excluding measures			
		Impact of the TR	Including VA and excluding TR	Impact of the VA	Excluding VA and TR
Technical provisions	123,449,597	6,775,211	130,224,807	746,490	130,971,298
Basic own funds (HDI Group)	22,950,881	–4,197,931	18,752,950	285,633	19,038,582
Eligible own funds for SCR	23,073,703	–4,197,931	18,875,771	285,633	19,161,404
SCR	8,874,227	304,891	9,179,118	2,827,313	12,006,432
Solvency II ratio (%)	260	–54%-pts	206	–46%-pts	160

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