Risk Management

Swiss Life pursues an integrated, value-oriented risk management approach, involving both quantitative and qualitative elements. The goal is to protect customers' funds and ensure the best possible investment of risk capital, while complying with the regulatory requirements and taking into account the challenging economic conditions.

Risk management is a key component of the Swiss Life Group's management process. The respective committees of the Corporate Executive Board and the Board of Directors monitor and make decisions in the area of risk management; these are then incorporated into the annual planning process. On the one hand, they comprise qualitative assessments relating to the strategy, to operational risks and to the internal control system (ICS). On the other hand, quantitative elements for each insurance unit, such as risk budgeting and investment strategy, are included in asset and liability management. Based on risk capacity and risk appetite, limits are set in the individual units for the financial risks incurred, according to which the investment targets are set. The qualitative risk management elements mentioned above are presented and discussed below. Detailed information on the risk budgeting process and asset and liability management is provided in Note 5 (Risk Management Policies and Procedures) of the Consolidated Financial Statements.

STRATEGIC RISK MANAGEMENT – Swiss Life uses analytical methods to ensure that strategic risks are dealt with adequately in today's very demanding economic environment. In its strategic risk management process, Swiss Life incorporates all the information on risks and the risk/return characteristics in its strategic decisions. An understanding of the interplay of individual risks is essential in order to take due account of the factors influencing risks during strategy development so that these factors can be steered appropriately.

OPERATIONAL RISK MANAGEMENT AND INTERNAL CONTROL SYSTEM – Operational risk management (ORM) at Swiss Life includes the methods and processes used for the identification, assessment and steering or avoidance of operational risks. ORM defines operational risk as the danger that losses may result from shortcomings or failures in internal processes, people or systems, or from external events. Swiss Life's internal control system (ICS) consists of the totality of procedures, methods and measures prescribed by the Board of Directors and the Corporate Executive Board to ensure the orderly conduct of business. The focus is on the reliability of financial reporting, the effectiveness of business processes and compliance with laws and regulations issued to protect the company's assets.

CAPITAL MANAGEMENT

SWISS SOLVENCY TEST – The SST is the new Swiss legislation which governs the capital requirements of insurance companies and groups and their reporting to the regulator. It was enacted in 2006 with the revised Insurance Supervision Law and corresponding Insurance Supervision Ordinance and solely constituted a reporting requirement during a five-year transition period before the capital requirements ultimately became binding from 1 January 2011. The SST is a principles-based framework where the main objective is the alignment of the required capital with the underlying risks. The SST capital requirement underpins a high level of confidence that insurers will meet their obligations towards policyholders even in adverse circumstances. The available and the required capital for the SST is determined based on an internal model which is subject to approval by the FINMA. Based on this internal model Swiss Life met the capital requirements.

ECONOMIC CAPITAL — The value of a life insurance company for its shareholders comprises the economic net worth and the present value of future profits. The optimal amount of economic capital an insurance company needs to hold to maximise the company value is a trade-off between benefits and costs. For risk and capital management decisions, the Swiss Life Group uses an integrated approach. The economic risk capital is determined bottom-up for each large business unit and takes into account market risk, credit risk and insurance risk. These risks are calculated on the basis of loss distributions using a specified risk measure. The overall capital requirement is obtained by taking into account appropriate diversification benefits among the above-mentioned risk categories.

Individual elements of the bottom-up risk capital per business unit allow for a monthly estimate of the SST solvency situation. The calibration is done based on the full SST calculations as at the beginning of each calendar year and as at mid-year.

Economic and statutory capital constraints and the profit target are the main elements determining the risk budgets. Based on these risk budgets, the Corporate Executive Board (Group Risk Committee) defines the risk limits for each country and business unit. Compliance with these limits is checked each month.

STANDARD & POOR'S RATING CAPITAL — Swiss Life has defined a target capitalisation in line with its rating ambition. In the Standard & Poor's risk-based insurance capital model the total adjusted capital (TAC) is the measure used for capital available to meet a company's capital requirements. TAC is set against the capital required given the company's targeted rating category (target capital). The factor-based model takes into account, among other factors, insurance risks, asset value volatility and credit risks. Within the capitalisation analysis, in addition to assessing capital adequacy, Standard & Poor's also assesses the quality of capital in its various dimensions such as debt, hybrid and reinsurance leverage.

In line with its active capital management, the Swiss Life Group uses hybrid instruments to optimise its capital structure.