4 Major risk factors and their management within the Group

4.1 Risk factors

The Group draws readers' attention to the risks described below. These risks could significantly affect the Group's operations, consolidated net income, financial position, share price, solvency margin and ability to achieve projected results.

The description of risks provided below is not exhaustive. Other risks and uncertainties that are currently unknown or regarded as minor could, in the future, significantly affect the Group's business, financial position, consolidated net income, cash flows or share price.

The risks described below are inherent to the nature of the Group's operations and its economic, competitive and regulatory environments. In view of the numerous contingencies and uncertainties associated with these risks, senior management is not always able to quantify their impact accurately. However, to prevent, detect and manage risks on an ongoing basis, the Group has implemented numerous risk management processes, procedures and controls. These processes, like any control and monitoring system, cannot be regarded as an absolute guarantee. Rather, they offer a reasonable assurance of security in respect of operations and of control over results.

The Risk Management structure is described in section 4.2 of this Registration Document. In cases where the risks described in section 4.1 may have measurable financial consequences or potential for significant liabilities, these factors are reflected in the Group's consolidated financial statements, in accordance with the applicable IFRS accounting standards. The risks described below are classified on the basis of their origin. This presentation aims to reflect senior management's current views on the potential consequences of each risk for the Group. While senior management devotes significant resources to risk management on an ongoing basis, as described in section 4.2 of this document, the Group's risk management activities, like any system of control, are subject to inherent limits and cannot provide absolute certainty or protect the Group against all risks described in section 4.1 or all losses potentially caused by these risks.

4.1.1 Risk factors related to insurance activity

The risk factors described in this section affect the risks described in quantitative detail in sections 4.2.2. and 4.2.4.

The prevailing and future economic environment

By nature, the Group's business is directly related to economic activity.

Today's challenging economic environment has various effects, some of which may conflict with each other:

- a decline in premium income stemming from a downturn in economic activity, leading to a reduction in policyholder turnover – used as the basis for calculating the insurance premium – or a loss of policies (termination of unprofitable policies by the Group, default by policyholders, termination by policyholders, etc.);
- a potential increase in premium income resulting from new policies (new policyholders seeking coverage of their customer receivables or existing policyholders extending their coverage), or from rate increases;
- an increase in the frequency of claims and an increase in the severity of peak claims.
- the declaration of claims on companies that are in good financial health, but are unable to transfer capital to their creditor outside their country.

Other economic factors could affect the economic environment, particularly higher oil prices, the euro-dollar exchange rate, or the occurrence of a BREXIT type event.

To address this risk, the Group acts in four ways to reduce the sensitivity of its results to the economic environment:

- more precise monitoring of limits granted, aimed at limiting the losses borne jointly by policyholders, reinsurers and the Group;
- diversification of sector and geographical risks;
- product diversification through the introduction of service products less closely correlated to activity;
- implementation of a risk transfer policy to reduce the effects of higher claims frequency and to limit the severity of peak risks.

Ongoing difficult economic conditions may have a negative impact on the Group's net income, financial strength, solvency margin, share price and, potentially, reputation.

Given the eurozone situation, the large proportion of the Group's business generated in Europe could be an aggravating factor for this risk. However, the Group has taken measures to reduce its dependency on Europe.

The occurrence of natural or human disasters, and the consequences of emerging and inherently unpredictable risks

The proliferation of weather events worldwide, not to mention other risks such as acts of terrorism, nuclear events, the emergence and spread of pandemics and the impact of future climate change could, in addition to their immediate damage and impact, have a material impact on insurers' operations as well as their current and future results.

While past experience shows that such events have little impact on the Group's results, the Group cannot rule out the possibility that such events could affect its net income in the future.

The establishment of sanctions regimes by a State or group of States against another State in which the Group delivers guarantees, the economic impact of these sanctions and any counter-sanctions

The Group has established a range of processes (governance, IT, legal (through policy terms or limits granted) and *reporting*) to demonstrate its compliance with the various sanctions regimes.

However, the Group cannot rule out:

- being subject to control or even in disagreement with the authorities controlling its activities in countries under sanctions regimes;
- being the target of legal proceedings by a policyholder or one of its customers due to measures taken in response to sanctions regimes;
- being subject to internal or external fraudulent activity aimed at circumventing sanctions regimes.

In addition to the above points, the application of sanctions has the following effects on the Group's activity:

- reducing its activity in the country concerned due to the cancellation of certain policies, even policies signed in other countries, as policyholders may no longer have coverage in the country under sanction;
- increased claims in the country under the sanctions regime;
- increased claims in the countries or business sectors that might be subject to counter-sanction by a country under a sanctions regime.

The establishment of these sanctions regimes might lead to a decrease in the Group's net income due to the increased cost of demonstrating compliance with the sanctions regimes, a reduction in its activity or increased claims due to the implementation of these sanctions regimes (or counter-sanctions), reputational risk or fines if its operational processes fail to manage these sanctions regimes.

Default or a regulatory change impacting the process of underwriting insurance risks

The management of credit-insurance and bonding risk is based on a strong risk culture associated with contract management and customer service. In addition to managing the underwriting of contracts, the Group provides a service to policyholders to reduce receivables-related risks. During the period of insurance, all requests for insurance cover on a given customer are analyzed by applying specific solvency criteria (financial analysis, prior claims, etc.) to the customer in question. Cover is then issued on the basis of the risk profile of the commercial transaction associated with the request.

Credit-insurance risk management processes are based on analyzing the solvency of the policyholder's customer using all information gathered.

This analysis involves the following elements:

- the possibility of gathering or purchasing information about the Group's policyholders' customers;
- the correct functioning of a centralized information system gathering information and requests for cover;
- the establishment and consistent application of written rules governing the analysis of information gathered and decisions on requests for cover;
- monitoring the implementation of these rules at two levels: a central team responsible for this task and internal audit.

A failure of one of the processes or tools in place, or change in the statutory or regulatory requirements under which such operations are carried out, could have an impact on net income or financial strength. They could also lead to statutory or regulatory fines. Lastly, they could have consequences in terms of reputation.

The possibility of recording losses in the event that assumptions used to determine insurance reserves materialize

Determining insurance reserves, including reserves for premiums not yet written or reserves for un-notified claims, is based on inherently uncertain elements derived from assumptions about future changes in factors that may (i) be economic, demographic, social, legislative, regulatory, financial, (ii) be linked to the conduct of the policyholder or its customer or (iii) be dependent of the anticipation of the nature of the claims (frequency claims vs peak claims).

The use of these numerous assumptions and their revision requires a high degree of assessment by the Group's management bodies.

They might influence the level of reserves determined and might have a negative impact on the net income, financial position, solvency margin and valuation of the Group.

Default by reinsurers, an incorrect application of reinsurance contracts, higher reinsurance costs or reduced capacity of reinsurers in the credit insurance market

The theoretical exposure granted by the Group is not based solely on the Group's available capital.

The theoretical exposure is based on the fact that some of the claims arising from this exposure will be transferred to external reinsurers; this transfer is purchased to cover a subscription year.

It should be borne in mind that the act of transferring some of the risks borne by the Group to reinsurance companies does not release it from its obligation to indemnify its policyholders.

In concrete terms, the Group is subject to the following risks:

- the insolvency of one of its reinsurers;
- inability to place its reinsurance contracts at acceptable prices.

failure in the process of applying reinsurance contracts that leads to a loss of the benefit of the coverage purchased

The Group has put management rules in place in order to be sure of the solvency of its reinsurers and guarantee a good level of diversification in its ceded claims. Nevertheless, it is possible that one or more reinsurers may no longer be able to meet its/their commitments, leading to a rise in the Group's own losses.

In addition, reinsurance capacity and the pricing of reinsurance contracts depend on prevailing economic conditions, and can vary substantially. As such, the Group might have difficulty in purchasing reinsurance at acceptable prices.

The materialization of one of these risks could have a long-term effect on the Group's activity, net income and solvency margin.

Default or a regulatory change impacting the process of underwriting insurance risks

Management of credit insurance and bonding risk is relatively more capital intensive than other business segments. Because of a significant difference between its risk profile and the profile used by the EIOPA for the standard formula, the Group has established an internal model and obtained authorization to use this internal model from its European regulators. This model is also being used temporarily in the Group's reinsurance subsidiary in Switzerland.

The loss of the authorization to use an internal model by EH SA or EH Ré SA or non-authorization for EH Re AG could lead the Group to revise its underwriting policy for the risk covered and, as a result, have impacts on its commercial policy, or require a search for other sources of capital (capital increase or equivalent, increase in outwards reinsurance or equivalent, etc.). Over time, the Group's net income and valuation will be affected.

4.1.2 Risk factors related to financial markets, the soundness of the credit rating, the valuation of assets and other related aspects

The risk factors described in this section particularly affect the risks described in greater quantitative detail in section 4.2.3.

Risks related to the investment portfolio

The risks described below could, if they materialize, have negative impacts on current and future turnover, net income, cash flows, financial position and, in some cases, the Euler Hermes Group share price.

I Interest rate risk

As its portfolio is invested primarily in bonds (national, supranational and, to a lesser extent, *corporate*), the Group is subject to interest rate risk.

During periods of declining interest rates, the risk is that the portfolio's average interest rate could fall (reinvestment being made at lower rates) or that the portfolio duration could increase (making the portfolio more susceptible to future changes in interest rates).

During periods of rising interest rates, the risk is that the market value of the bond portfolio could decline, possibly resulting in unrealized losses.

The Group has implemented an asset management policy aimed at minimizing these risks, including asset-liability management factoring in all local constraints.

II Equity market risk

As part of its portfolio is invested in equities (or equity equivalents), the Group is exposed to a decline – whether short- or long-term – in the equity markets. This could result in the Group having to record unrealized losses or asset impairments.

The Group has implemented an asset management policy aimed at selecting high-quality issuers and diversifying risk in this asset class.

III Real-estate risk

The Group is exposed to real-estate risk via the buildings housing its operations, as well as its investment properties.

The risk is that market values may fall and as such reduce the unrealized capital gains on these buildings or even lead to recorded unrealized losses.

IV Counterparty risk

Default by financial institutions and third parties, including potential defaults on sovereign debt payments or restructurings, could lead to the loss or impairment of invested assets, or to unrealized losses, which could all affect the value of the Group's investments and reduce profitability.

The Group has implemented management rules to diversify risk (geographical as well as sectoral) and to reduce the risk of default by investing in counterparties boasting robust financial health.

The downgrading of ratings reflecting capacity to settle claims and financial strength

Ratings related to the capacity to settle claims and financial strength have become increasingly important elements in determining insurance companies' relative competitive positions. Rating agencies review their ratings and methodologies on an ongoing basis and can revise their ratings at any time. Accordingly, the Group's current ratings are subject to change.

In a difficult economic and financial climate, some rating agencies have revised their outlook downwards for the insurance sector and downgraded an increasing number of companies. Euler Hermes Group, however, managed this period without a revision of its AA- rating from Standard & Poor's; its rating was confirmed as AA- outlook stable on October 26 2015. Furthermore, Dagong Europe confirmed Euler Hermes Group AA- rating with outlook stable rating in January, 2015.

A ratings downgrade – actual or potential – and, more importantly, a fall in the rating below A, could have adverse effects on the Group, by:

(i) undermining its competitive position;

(ii) hindering the distribution of new insurance policies;

(iii) increasing the rate of redemption or termination of existing insurance policies;

(iv) raising the cost of reinsurance;

(v) limiting its access to sources of funding or increasing the cost of such funding;

(vi) imposing the need to provide additional guarantees for certain contracts;

(vii) having an adverse impact on relations with creditors or trading counterparties;

(viii) having a significant impact on public confidence.

Each of these scenarios could have a negative impact on the business, liquidity level, consolidated net income, revenues and financial position of the Group.

Exchange rate fluctuations

The Group is exposed to exchange rate fluctuations due to:

- the presence of subsidiaries outside the eurozone. The Group's main subsidiaries outside the eurozone operate in US Dollar, British Pound and Swiss Franc;
- a subsidiary granting limits in a currency that is not the subsidiary's accounting currency.

As of December 31, 2015, 39.3% of its revenues were generated outside the eurozone.

To reduce its exposure to exchange rate fluctuations, the Group applies the principle of congruence (matching assets and liabilities denominated in a different currency from the currency used for its accounting).

Moreover, the Group has no investments in foreign currencies for speculative purposes.

At the end of 2015, the Group had no hedging instruments in place to protect against exchange rate fluctuations.

Market conditions, changes in accounting principles and other factors could affect the recognized value of goodwill

The Group's accounting principles and policies, along with the analysis of intangible assets (including goodwill) are set out in Notes 2, 3 and 4 in the notes to the consolidated financial statements presented in section 5.6 of this Registration Document.

Changes in the business and the market may affect the value of the *goodwill* recognized in the consolidated statement of financial position, the amortization of *Deferred Acquisition Costs* (DAC) and the Value of Business In force (VBI), and the valuation of deferred tax assets of the Group.

A deterioration in the operating performance of companies or market conditions could accelerate the amortization of DAC and VBI or reduce the assets, leading to a reduction in consolidated net income and weakening the Group's financial position.

4.1.3 Risks factors within the Group

The reliance of Euler Hermes Group on its subsidiaries to cover its expenses and pay dividends

As a holding company, Euler Hermes Group has no activity of its own; all insurance and service activities are performed by its subsidiaries. As such, Euler Hermes Group is dependent on the dividends paid by its subsidiaries, and on other funding sources, to meet its expenses, including the payment of dividends and interest on its debt.

Due to the various risk factors described in this section, Euler Hermes Group may receive a reduced dividend or no dividend from some of its subsidiaries, or may need to provide some of them with significant financial support in the form of loans or capital contributions. This could significantly impact its liquidity and its ability to pay dividends.

The Group is subject to a certain number of legal and regulatory constraints which restrict the use of capital, and, in particular, the payment of dividends.

In particular, each of the legal insurance entities and the Group must maintain a minimum solvency margin calculated in respect of national regulations and - in the case of some - a minimum level of equalization reserve.

As at December 31, 2014 and subject to validation by local regulators, all the Group companies satisfy their regulatory requirements.

If a Group subsidiary were to fall below the required regulatory standards, an action plan would be put in place in order to return to compliance. This action plan could rely, *inter alia*, on changes in arbitrage or investment policies, changes in reinsurance conditions or changes in the shareholding structure.

The Group's finance department, in close collaboration with the subsidiaries' finance departments, monitors the risks resulting from potential regulatory restrictions and the implementation of new solvency policies, and, in particular, Solvency II in Europe, the Swiss Solvency Test (SST) in Switzerland, and the Solvency Modernization Initiative (SMI) in the United States.

Risk assessments made by the Group and its governing bodies

Determining the amount of reserves and impairments is based on periodic assessments and estimates of the known and inherent risks of each underlying event. These assessments and estimates are revised as conditions change or as new information becomes available.

The Group's governing bodies, in the light of this information and in accordance with the accounting principles and methods set out in the consolidated financial statements (see Note 2 "IFRS recognition and measurement rules" in the notes to the consolidated financial statements), make decisions on what constitutes an adequate booked level of reserves and impairments. These decisions are taken based on their analysis, and the assessment and appraisal of the causes and consequences of any changes affecting previous risk estimates.

However, the Group cannot guarantee that its management bodies have correctly estimated the level of impairment and the reserves recognized in the financial statements, or that additional impairments or reserves may not negatively affect the Group's net income and financial position.

Reduction in the growth of the Group's businesses

Growth observed in recent years, both organic and acquisition-driven, may, despite the strategic expansion objectives of the management bodies, not continue or may not be in line with expectations, mainly due to challenging conditions in the financial markets and changes in economic conditions.

The Group has implemented initiatives to enter new markets either by expanding its existing credit-insurance business in new geographical areas in which the Group was not previously present or where its earlier presence was only marginal, or in the form of new products related to credit insurance, such as recovery for third parties.

Maintaining a high level of development could, however, be affected by changes in current regulations or tax legislation.

Any inability on the part of the Group to capitalize on innovative products and on partnerships or new methods of distribution, to deploy them within the Group and to develop them in accordance with its objectives, could adversely affect the growth of the Group's business.

The diversity of the countries in which the Group operates

The Group markets its products and services in Europe, North and South America, Asia, Oceania, Turkey, Russia, and certain African countries through various legal structures and distribution channels, including majority- or minority-owned subsidiaries, partnerships with insurance companies or banks, joint ventures, agents and independent brokers.

The diversity of the Group's international presence exposes it to very different and often widely fluctuating economic, financial, regulatory, commercial, social and political environments, which could potentially affect demand for its products and services, the value of its investment portfolio or the solvency of its local business partners.

The successful implementation of the Group's overall strategy may be hampered by the environment in some countries in which it operates, with adverse effects on the Group's net income and financial position.

Existence of unexpected liabilities relating to discontinued operations and expenses relating to other off-balance sheet commitments

The Group may occasionally retain insurance and reinsurance liabilities or other off-balance sheet commitments stemming from the sale or liquidation of various activities, or be required to provide guarantees and undertake other off-balance sheet transactions.

If the existing reserves for such obligations and liabilities are insufficient, the Group may have to record additional charges that may impact its net income significantly.

For more information, see Note 33 of the Group's consolidated financial statements relating to commitments given and received.

Operational failures or inadequacies

The Group's activity is based very heavily on its processes and information systems.

As such, the Group makes considerable efforts to maintain and modernize its information systems and the efficiency of its processes. In particular, the Group ensures that its processes and information systems are consistent with industry, regulatory and technological standards and with the preferences of its policyholders.

However, the Group is exposed to operational risks that are inherent to its business and which may be of human, organizational, material or natural origin, or result from other events within or outside the Group. These operational risks could materialize in various ways, mainly through interruptions or failures of information systems used by the Group; errors, fraud or malice on the part of its employees, policyholders or intermediaries; non-compliance with internal and external regulations; and hacking of its information systems.

While the Group strives to achieve better management of all of these operational risks in order to limit their potential impact, they could result in financial losses, a deterioration in the Group's liquidity, disruption of its activity, regulatory sanctions, or damage to its reputation.

4.1.4 Risk factors related to the regulatory or competitive environment

The risk factors described in this section particularly affect the risks described in section 4.2.5.

A highly competitive environment

The Group operates in a highly competitive market, in which other players are sometimes subject to different regulations, use multiple distribution channels and offer more competitive prices than those of the Group. In addition, several products offer an alternative to credit insurance and widen the coverage possibilities available to customers.

In view of this competitive pressure, the Group may need to adjust the prices of some of its products and services or its policy for underwriting risks, which could affect its ability to maintain or improve profitability and adversely affect its net income and financial position.

Reinforcement of, and changes in, local, European and international regulations

The credit insurance business is subject to specific regulations in different countries. Changes to the laws and regulations governing the insurance business could significantly affect the conduct of operations and the Group's range of insurance products.

In addition, the credit-insurance and bonding activity with a coverage period greater than 12 months is one of the factors for classification of the Allianz group as a group that is “too big to fail.” The main shareholder could decide to propose decisions that could lead to a reduction in this activity, which could affect the Group’s attractiveness, net income or valuation.

Changes to local, European and international tax laws and regulations

Changes to the tax legislation of countries in which the Group operates could have unfavorable consequences on the Group’s operations, cash flow position and net income.

In addition, such changes to tax laws and regulations, or operating performances below expected levels or occurring at different times, could lead to a significant change in the Group’s deferred tax assets and thus lead to a reduction in the value of certain tax assets or call their use into question.

This situation could have a material adverse impact on the Group’s net income and financial position.

The classification of the main shareholder of the Group as an insurance company whose failure would significantly affect the financial system

In 2014, the Group’s main shareholder, the Allianz group, was included in the list of Global Systemically Important Insurers (GSII).

Credit-insurance and bonding activity with a coverage period greater than 12 months has been classified as non-traditional insurance by the*International Association Insurance Supervisors* (IAIS) and is one of the factors in the classification of the Allianz group as a group “too big to fail.” The main shareholder could decide to propose decisions that could lead to a reduction in this activity, which could affect the Group’s attractiveness, net income or valuation.

Moreover, this classification of the main shareholder could in time have consequences for the Group if it had to cover the additional capital necessary for the main shareholder.

Finally, the Group itself could be classified as a national insurance group whose failure could significantly affect the financial system (NSII), and whose credit insurance and bonding business lines had been declared important for the economy.

Potential changes to international accounting standards

The Group’s consolidated financial statements are drawn up in accordance with international accounting standards as adopted by the European Union. International accounting standards comprise IFRS (International Financial Reporting Standards) and IAS (International Accounting Standards), together with their interpretative texts (see Note 2 “IFRS recognition and measurement rules” in the notes to the consolidated financial statements).

Plans to amend existing standards are being considered by the International Accounting Standards Board (IASB); some of them may have a significant impact on the financial statements of insurance companies and financial institutions. These potential changes could concern the recognition of both the Group’s assets and liabilities, and its income and expenses in the consolidated income statement.

The impact of such changes is difficult to assess at this stage, but would be likely to affect the Group’s net income and financial position.

The variety of legal systems in the countries in which the Group operates

In recent years, the Group has accelerated its international expansion in countries in which judicial and dispute resolution systems sometimes involve different timeframes from those that exist in Europe or the United States. As such, the Group may find it difficult to take legal action or enforce rulings. In such a situation, the possible legal implications could affect the Group’s operations and net income.

4.2 Quantitative and qualitative notes relating to risk factors

4.2.1 Risk management structure

The Risk Management function

The responsibilities of the Risk Management function are as follows:

- to identify, measure and take part in the management of financial, insurance and operational risks;
- to define and monitor risk appetite for these risks and to strengthen the risk-reporting process, risk limits and decision-making processes, in relation to four aspects: turnover, value, capital, and liquidity;
- to calculate the economic capital associated with the business. Economic capital is calculated by using an internal model, where the responsibility for developing the model is divided between the Group for risks associated with insurance activities, and the main shareholder for all other risks. The Group periodically analyzes the validity of these models for the risk profile specific to the Group.
- to construct a favorable environment in terms of models, indicators, standards and culture for the various business lines, in order to underwrite risks in the context of the risk appetite validated locally and by the Group;
- to maintain the authorization to use an internal model and complete all the procedural operations for approval of the changes on the internal models with the supervisors in view of Solvency II and the Swiss Solvency Test;
- more generally, to implement all the actions necessary to create an effective "second line of defense" on all risks in connection with other key functions (internal audit, compliance and actuarial).

In order to fulfill these missions, this team operates totally independently.

Although it does not have an operating function, it is closely associated with the Group's management and decision-making processes. It relies on other Group functions, at both the Group and local levels, and in particular the commercial, financial, underwriting, and claims management functions.

All activities and the results of risk analysis are regularly reported.

The Risk Management structure

Risk Management is organized around three pillars:

1. *Senior management* of Euler Hermes Group:

- defines and implements business strategy by delegation of the Supervisory Board and/or the Board of Management,
- defines and develops internal controls and the framework of the Risk Management function,
- ensures that the activity is consistent with the defined risk appetite.

Senior management relies on various committees to carry out its tasks, including:

- the Risk Committee,
- the Investment Committee,
- the Reinsurance Committee,
- the Commercial Committees,
- the Risk Underwriting Committees;

The Audit and Risk Committee, which reports to the Supervisory Board, debates the following matters at least every quarter: changes in the solvency margin, the main risks to which the Group is exposed, the effectiveness of the risk management framework and regulatory changes affecting the Group.

2)Risk Management, which is responsible for:

-defining and implementing the Risk Management system within the organization, particularly the risk governance rules,
- ensuring that all the Group's legal entities comply with these rules.

The Risk Management function is led by a Chief Risk Officer, who reports to the Group's Chief Financial Officer.

The Chief Risk Officer and his/her team act independently and have no operational responsibilities.

The Risk Management function works closely, in particular, with the Compliance and Ethics function, the Legal and Tax division and the Actuarial division in order to establish a coordinated second line of defense;

3)the Internal Audit function:

- independently and objectively verifies that all processes implemented as part of Risk Management are properly defined and implemented, and suggests improvements where appropriate.

The Risk Management function at the local level

Risk Management in the Group's various legal entities has the same tasks and is organized in the same way as at Group level.

In particular, each legal entity defines a local risk appetite, in line with the Group risk appetite, and manages its activity on the basis of local risk appetite.

The main Risk Management flows

The various types of risk, identified and classified by category and function together with the related control flows, are presented in the following diagram:

This structure aims to identify and proactively monitor all risks by maintaining responsibility for their management at the operational level. This allows routine Risk Management to be spread across the operations of the entire Group, while at the same time allowing the function to respond to specific events as efficiently as possible. The Risk Management function establishes risk scenarios in collaboration with other operating functions and informs senior management accordingly. The committees are important relay points, both as a center for responsibility and decision-making for Risk Management, but also to disseminate a culture and identify the strengths and weaknesses of risk control. All these elements combine to form an ongoing Risk Management mechanism that includes a forward-looking view of major risks, especially with regard to any changes in the environment or trends. As such, the Group is particularly well prepared to monitor adverse developments and take appropriate action.

4.2.2 Insurance risks

Product approval

A Group-level Product Committee has been set up that is responsible for approving all new products or changes to existing products.

The Product Committee comprises the Group's main functions, especially Marketing, Commercial Underwriting, Risk Underwriting, Management Control, Reinsurance and Risk Management.

The Committee's purpose is to approve products from different perspectives (commercial, internal processes, profitability, impact on solvency, etc.) and to make recommendations to the Board of Management.

Underwriting of risk

The underwriting of risk takes place in two phases:

1. Signature of the insurance contract

The credit insurance contract contains all management rules and parameters (deductible, maximum liability, etc.). These rules and parameters are differentiated depending on the risk profile of each policyholder. It also requires the policyholder to declare its unpaid invoices according to certain declaration timescales, and, during the insurance period, the Group and the policyholder are in regular contact, including managing customer limits as necessary. The principle of comprehensive coverage of the policyholder's revenues is one of the key elements for diversifying risk and limiting anti-selection phenomena.

2. Management of limits granted to policyholders

The Group has developed a risk business model to deal with insurance risk in the most efficient way.

The key elements of this risk business model are:

- definition of the model by a Group team;
- local risk underwriting;
- centralized control;
- a system for researching and collecting information on the Group's policyholders' customers;
- a Group risk grading system;
- specialized teams;
- a centralized IT system in which all policyholder requests are entered, and all granted limits and any information on the debtors are stored.
- quality of service standards in the response to customers.

The following tables show the Group's gross theoretical exposure, breaking it down into two segments:

1) the country in which the debtor is located [(1);]

2) the economic sector of the debtor.

(1) The Group hedges the risk of non-payment of invoices delivered by a policyholder to its customer. Consequently, the analyses are not based on the characteristics of the policyholder but rather its customers (or debtors).

1) THE COUNTRY IN WHICH THE DEBTOR IS LOCATED

(in € millions)					
Total Europe	*668 387*	*75,1%*	*650 779*	*75,7 %*	*2,7%*
of which:					
France	*186 111*	*20,9%*	*186 893*	*21,7 %*	*-0,4%*
United Kingdom	*73 069*	*8,2%*	*69 450*	*8,1 %*	*5,2%*
Germany	*159 505*	*17,9%*	*154 018*	*17,9 %*	*3,6%*
Italy	*72 044*	*8,1%*	*71 885*	*8,4 %*	*0,2%*
Belgium and Luxembourg	*22 520*	*2,5%*	*16 775*	*2,0 %*	*34,2%*
Netherlands	*24 113*	*2,7%*	*22 480*	*2,6 %*	*7,3%*
Spain	*18 218*	*2,0%*	*16 464*	*1,9 %*	*10,7%*
Eastern Europe	*41 711*	*4,7%*	*44 587*	*5,2 %*	*-6,5%*
Scandinavia	*30 284*	*3,4%*	*27 528*	*3,2 %*	*10,0%*
Other Europe	*40 812*	*4,6%*	*40 699*	*4,7 %*	*0,3%*
Total Americas	*120 578*	*13,5%*	*111 065*	*12,9 %*	*8,6%*
of which:					
United States	*89 424*	*10,0%*	*79 392*	*9,2 %*	*12,6%*
Canada	*11 193*	*1,3%*	*11 851*	*1,4 %*	*-5,6%*
Other Americas	*19 961*	*2,2%*	*19 822*	*2,3 %*	*0,7%*
Asia-Pacific	*71 120*	*8,0%*	*67 632*	*7,9 %*	*5,2%*
Middle East	*20 507*	*2,3%*	*21 311*	*2,5 %*	*-3,8%*
Africa	*9 558*	*1,1%*	*9 095*	*1,1 %*	*5,1%*
Total	**890 150**	**100,0%**	**859 882**	**100,0 %**	**3,5%**

2) THE ECONOMIC SECTOR OF THE DEBTOR.

(in € millions)					
Automotive	42 555	4,8%	36 609	4,3 %	16,2%
Chemicals	68 071	7,7%	64 999	7,6 %	4,7%
Commodities	58 334	6,6%	55 732	6,5 %	4,7%
Computers & Telecoms	25 555	2,9%	26 084	3,0 %	-2,0%
Construction	104 050	11,7%	103 385	12,0 %	0,6%
Electronics	48 551	5,5%	45 963	5,3 %	5,6%
Food	105 556	11,9%	96 802	11,3 %	9,0%
Household equipment	26 282	3,0%	26 707	3,1 %	-1,6%
IT Services	22 978	2,6%	21 382	2,5 %	7,5%
Machinery & Equipment	57 056	6,4%	56 301	6,5 %	1,3%
Metal	66 515	7,5%	69 438	8,1 %	-4,2%
Paper	17 288	1,9%	17 028	2,0 %	1,5%
Retail	125 954	14,2%	119 658	13,9 %	5,3%
Services	73 643	8,3%	74 306	8,6 %	-0,9%
Textile	19 889	2,2%	19 669	2,3 %	1,1%
Transport	23 314	2,6%	22 535	2,6 %	3,5%
Unknown	4 559	0,5%	3 285	0,4 %	38,8%
Total	**890 150**	**100,00%**	**859 882**	**100,0 %**	**3,5%**

Reinsurance

The purchase of reinsurance is an important part of the way in which the Group manages its insurance activity and controls risks.

The Group has entrusted its reinsurance purchase transactions in the market to its Switzerland-based reinsurance company (Euler Hermes Reinsurance AG).

Rules have been laid down to guide the purchase of reinsurance, and their application is subject to regular internal auditing.

In addition, a Reinsurance Committee, comprising the Chairman of the Group's Board of Management, the Group Chief Financial Officer, Euler Hermes Reinsurance AG's Chief Executive Officer, and the Group Risk Officer, makes recommendations to the Board of Management.

Purchases of reinsurance are preceded by:

- quantitative analysis to ensure that the proposed structures match the risk borne by the Group, in terms of both frequency and severity, especially in the event of changes in the economic conditions in which the Group operates;
- analysis of the financial strength of reinsurers on the panel.

Underwriting and claims management

One of the responsibilities of subsidiaries as part of their insurance activities is to establish reserves to cover the occurrence of an incident resulting in an insurance claim. These reserves must be sufficient to guarantee the settlement of future claims.

To ensure that this process works correctly, the Group has defined and implemented written procedures for:

- claims management, including the conditions for opening and settling a claim;
- management of claims recoveries (both before and after settlement);
- recognition of all transactions associated with determining the ultimate loss recorded by the Group.

These rules are subject to regular review by the Group Claims department and periodic review by Internal Audit.

This process applies to each notified claim.

The Group has implemented a process of defining reserves Incurred But Not Reported ("IBNR reserves") covering un-notified claims relating to the current and previous fiscal years. For the definition of this reserve, see the following section.

Assessment of reserves

Claims reserves recorded at a given time result from three reserves:

- reserves for notified claims, covering notified claims;
- IBNR reserves, covering un-notified claims relating to the current and previous years;
- expectations of future recoveries of settled claims.

The reserve for notified claims is subject to case-by-case analysis, as described in the preceding paragraph.

The determination of the IBNR reserves and expectations of future recoveries of settled claims result from periodic actuarial analysis conducted by the Actuarial divisions of each legal entity and overseen by the Group Actuarial division.

The Group Actuarial division is also tasked with ensuring that the overall level of the Group's reserves is sufficient to cover future claims, and to establish and verify the correct implementation of actuarial principles, with which the calculations of estimated reserves must be consistent.

The entire process is subject to periodic review by Internal Audit and by external auditors.

The rules for establishing reserves are consistent with local laws and regulations.

At the current time, the main actuarial methods used by the Group's subsidiaries are based on claims triangles (Chain Ladder, Bootstrapping method, etc.) or other methods (Bornhuetter Fergusson, etc.). These methodologies aim to define a reasonable range of estimates within which the Actuarial division sets its recommended reserve level.

On the basis of this range calculated by actuaries, their recommendations and other analyses (actuarial or not), senior management sets the level of reserves to be adopted for each quarterly closing at meetings of the Loss Reserve Committee. Loss Reserve Committee meetings are held in each subsidiary and then at Group level. They are held at least once per quarter, but can also be held in the event of a major event requiring a major revision to the level of reserves, such as a major claim.

It should nevertheless be noted that estimates are based mainly on assumptions that may differ from subsequent observations, particularly in the event of changes in the economic and legal environments, especially if they affect the Group's main portfolios simultaneously.

A description of the main factors causing changes in claims is provided in section 3.5.2 of this Registration Document.

NET CLAIMS/PREMIUMS RATIO

	2010	2011	2012	2013	2014	2015
Claims/premiums ratio	42.1%	45.1%	51.7%	50.5%	48.8%	53.3%

COST OF CLAIMS FOR THE GROUP

	2015			2014		
(in € thousands)	Gross	Assignments and retrocessions	Net	Gross	Assignments and retrocessions	Net
Cost of claims on current attachment year	**1.497.999**	**(419.767)**	**1.078.232**	**1.335.823**	**(330.747)**	**1.005.076**
Claims paid	257.162	(62.530)	194.632	286.466	(74.860)	211.606
of which, claims reserves	1.146.530	(353.352)	793.178	955.692	(252.284)	703.408
of which, claims handling expenses	94.307	(3.885)	90.422	93.665	(3.603)	90.062
Recoveries for the current period	**(120.035)**	**26.965**	**(93.070)**	**(115.159)**	**25.969**	**(89.190)**
Recoveries received	(10.240)	3.072	(7.168)	(8.705)	2.379	(6.326)
Change in reserves for recoveries	(109.795)	23.893	(85.902)	(106.454)	23.590	(82.864)
Cost of claims from prior periods	**(224.847)**	**65.810**	**(159.037)**	**(268.073)**	**35.103**	**(232.970)**
Claims paid	787.335	(213.547)	573.788	707.223	(237.778)	469.445
of which, claims reserves	(1.015.312)	278.046	(737.266)	(986.923)	272.433	(714.490)
of which, claims handling expenses	3.130	1.311	4.441	11.627	448	12.075
Recoveries from prior periods	**(5.577)**	**5.150**	**(427)**	**46.080**	**(6.242)**	**39.837**
Recoveries received	(126.612)	37.141	(89.471)	(159.091)	72.099	(86.992)
Change in reserves for recoveries	121.035	(31.991)	89.044	205.171	(78.341)	126.829
COST OF CLAIMS	**1.147.540**	**(321.842)**	**825.698**	**998.671**	**(275.917)**	**722.753**

TECHNICAL RESERVES FOR THE GROUP

	December 31, 2015			December 31, 2014		
(in € thousands)	Gross	Assignments and retrocessions	Net	Gross	Assignments and retrocessions	Net
Claims reserves gross of recoveries	**2.056.109**	**(643.733)**	**1.412.376**	**1.906.065**	**(565.768)**	**1.340.297**
Current period	1.182.755	(354.680)	828.075	1.010.239	(253.783)	756.456
Prior periods	873.354	(289.053)	584.301	895.826	(311.985)	583.841
Recoveries to be received	**(282.279)**	**91.552**	**(190.727)**	**(290.534)**	**98.967**	**(191.567)**
Current period	(110.008)	23.916	(86.092)	(107.544)	23.585	(83.959)
Prior periods	(172.271)	67.636	(104.635)	(182.990)	75.382	(107.608)
Claims reserves	**1.773.830**	**(552.181)**	**1.221.649**	**1.615.531**	**(466.801)**	**1.148.730**

(in € thousands)	December 31, 2015 Gross	December 31, 2015 Assignments and retrocessions	December 31, 2015 Net	December 31, 2014 Gross	December 31, 2014 Assignments and retrocessions	December 31, 2014 Net
Reserves for unearned premiums	**447.107**	**(75.379)**	**371.728**	**396.221**	**(62.695)**	**333.526**
Claims reserves	**1.773.830**	**(552.181)**	**1.221.649**	**1.615.531**	**(466.801)**	**1.148.730**
of which, reserves for known claims	1.239.977	(388.536)	851.441	1.130.972	(359.647)	771.325
of which, reserves for late claims	729.144	(244.024)	485.120	679.393	(194.256)	485.137
of which, reserves for claims handling expenses	87.229	(11.173)	76.056	95.688	(11.865)	83.823
of which, other technical reserves	(241)	-	(241)	13	-	13
of which, recoveries to be received	(282.279)	91.552	(190.727)	(290.535)	98.967	(191.568)
Reserves for no-claims bonuses and rebates	**166.620**	**(35.252)**	**131.368**	**165.494**	**(34.783)**	**130.711**
TECHNICAL RESERVES	**2.387.557**	**(662.812)**	**1.724.745**	**2.177.246**	**(564.279)**	**1.612.967**

Claims developments

For a specific attachment year, claims developments follow a process of claims declaration, payment and recovery. This process can run over many years.

The following tables show:

a) The development of the ultimate cost of claims per attachment and development year

- **ESTIMATED FINAL COST OF CLAIMS FOR THE MAJORITY OF GROUP ENTITIES (BEFORE REINSURANCE) (1)**

Year of occurrence Year of development (in € thousands)	1	2	3	4	5	6	7	8	9	10	Difference (2)	% Diff
2006	864.732	816.687	768.205	755.069	763.088	759.187	761.755	758.534	760.117	750.691	114.041	13,2%
2007	880.924	876.497	861.575	868.533	873.729	860.684	851.257	847.328	840.018		40.906	4,6%
2008	1.391.313	1.484.458	1.544.463	1.540.131	1.519.012	1.498.516	1.453.252	1.443.871			-52.558	-3,8%
2009	1.234.192	1.018.493	977.354	946.204	923.076	926.227	903.770				330.423	26,8%
2010	972.218	731.678	695.700	675.350	669.699	668.031					304.186	31,3%
2011	1.104.194	948.543	903.213	877.264	857.736						246.458	22,3%
2012	1.347.943	1.304.665	1.223.004	1.183.425							164.519	12,2%
2013	1.266.914	1.192.034	1.061.486								205.428	16,2%
2014	1.265.809	1.314.329									-48.519	-3,8%
2015	1.380.321											

(1) All figures (current & prior years), when necessary, have been converted based on the end of year 2014 euro conversion rate.
(2) Variance: Surplus or shortfall of the latest estimated claims cost over the initial estimated claims cost for a specific year.

b) The development of paid claims per attachment and development year

DEVELOPMENT TRIANGLES FOR CUMULATIVE CLAIMS PAID NET OF RECOVERIES FOR MOST GROUP ENTITIES (BEFORE REINSURANCE)(1)

Year of occurrence Year of development (in thousands of euros)	1	2	3	4	5	6	7	8	9	10
2006	289.087	680.755	722.795	723.846	742.544	742.625	744.606	749.419	756.855	747.491
2007	279.325	725.778	794.860	819.820	831.458	835.658	835.076	836.535	832.693	
2008	390.987	1.162.491	1.344.862	1.393.898	1.408.893	1.412.281	1.401.702	1.425.027		
2009	423.256	811.309	865.507	872.390	880.831	877.647	883.819			
2010	224.871	541.363	587.420	609.802	634.873	642.555				
2011	278.512	748.365	822.378	830.563	833.970					
2012	529.675	1.022.643	1.074.013	1.101.915						
2013	353.636	882.015	959.694							
2014	339.198	941.748								
2015	297.518									

(1) All figures (current & prior years), when necessary, have been converted based on the end of year 2014 euro conversion rate.

4.2.3 Market risks

Market risk is the risk of losses that may result from fluctuations in the prices of the financial instruments making up the Group's investment portfolio.

Interest rate risk

Interest rate risk measures how sensitive asset and liability values are to changes in the interest rate curve.

Interest rate risk management, while recognizing the short duration of the liabilities, also takes into account business continuity in order to increase the duration of investments and thus achieve higher returns on investments in fixed-income products.

BOND PORTFOLIO AT FAIR VALUE BY MATURITY

	2015		2014	
	(in € millions)	(%)	(in € millions)	(%)
0 to 1 year	201	6,7%	422	15,0%
1 to 3 years	798	26,7%	884	31,4%
3 to 5 years	836	27,9%	810	28,8%
5 to 7 years	706	23,6%	462	16,4%
7 to 10 years	431	14,4%	210	7,5%
Beyond 10 years	21	0,7%	27	1,0%
TOTAL BOND PORTFOLIO AT FAIR VALUE	**2.993**	**100%**	**2.816**	**100%**

Exchange rate risk

Exchange rate risk measures the sensitivity of assets and liabilities to changes in currencies other than the reporting currency in which assets and liabilities are recorded in the statement of financial position.

The Group faces exchange rate risk in various ways, mainly in the event of:

- limits granted for a policyholder in a currency that is not the reporting currency, which can lead to changes in cash or reserves (under collection or claims management procedures) that are not recorded in the reporting currency;
- reinsurance in a currency other than the reporting currency;
- investment in a currency other than the reporting currency;
- the presence of branches or subsidiaries operating in a currency other than the reporting currency of the parent company.

To limit exchange rate risk, and in accordance with rules laid down by local regulators, the congruence principle, i.e. the matching of assets and liabilities at the local level, is applied.

For this reason, and because of the high concentration of activity in the eurozone, the Group does not hold any currency hedging instruments.

On December 31, 2015, the portion of the financial portfolio carried by the Group in currencies other than the euro amounted to 22.9% of the market value of the portfolio.

- **FINANCIAL PORTFOLIO OF THE GROUP BY CURRENCY**

	2015		2014	
	(in € millions)	(%)	(in € millions)	(%)
EUR	3.295	77,1%	3.266	79,2%
GBP	255	6,0%	219	5,3%
USD	454	10,6%	409	9,9%
Other currencies	269	6,3%	231	5,6%
TOTAL FINANCIAL INVESTMENTS	**4.273**	**100%**	**4.125**	**100%**

Assets comprise the investment portfolio, technical reserves recorded as assets and the ceded portion of technical reserves.

Liabilities comprise technical reserves and borrowings.

The principle of matching assets and liabilities at the local level and the emphasis on the euro in the statement of financial position avoids the need to hedge residual exchange rate risk.

- **EXCHANGE RATE RISK**

	2015			2014		
(in € thousands)	United States	United Kingdom	Group	United States	United Kingdom	Group
Net income attributable to owners of the Group as at 12/31	18.467	11.082	302.476	21.562	8.003	302.060
Exchange rate at year end	0,9206	1,3568		0,8264	1,2886	
Net income attributable to owners of the Group in local currency	**23.423**	**5.899**		**26.091**	**6.211**	
Effect of a 100-basis point change in the exchange rate on income/loss	0,9106	1,3468		0,8164	1,2786	
Net income in € thousands after exchange rate variation	21.328	7.944	302.183	21.301	7.941	301.737
% change relative to initial income/loss	**-1,09%**	**-0,74%**	**-0,10%**	**-1,21%**	**-0,78%**	**-0,11%**

Equity market risk

Equity market risk measures how sensitive asset values are to changes in equity prices. By extension, minority stakes in unlisted companies and investments in funds dominated by equities are deemed to be equities.

The Group held more than 5% of its financial portfolio in equities at the end of 2015. This percentage is consistent with the strategic allocation of the investment portfolio, as well as its tactical allocation, as defined by the Investment Committee.

As at December 31, 2015, the maximum proportion of equities allowed in the strategic allocation of the investment portfolio was 10% (including private equity, convertibles and unlisted securities).

Investments in convertible bonds are classified as bonds in the table below.

	2015		2014	
(in € millions)	Amount	%	Amount	%
Bonds	2.993	64,8%	2.816	63,2%
Shares	270	5,9%	246	5,5%
Buildings third party use	240	5,2%	210	4,7%
Loans, deposits and other financial investments	769	16,7%	854	19,2%
Total financial investments	**4.273**	**92,5%**	**4.125**	**92,5%**
Cash	**345**	**7,5%**	**333**	**7,5%**
TOTAL FINANCIAL INVESTMENTS + CASH	**4.618**	**100,0%**	**4.458**	**100,0%**

Liquidity risk

Liquidity risk is the risk that the Group may not have sufficient financial resources to cover its cash needs.

Liquidity risk is subject to specific monitoring by the Group, in both its insurance activities and financial investments.

Each entity carries out projections of the cash flows derived from its insurance operations, its investment portfolio and any dividends received from subsidiaries, and then monitors these flows. These cash flow projections are reviewed at financial committee meetings.

With the exception of the Group's German entity, which participates in the cash pooling common to all the German entities of the Allianz group, the entities manage their cash independently.

Sources of liquidity available to the Group (excluding the divestment of its investment portfolio) mainly comprise:

- the excess liquidity of a company;
- shareholders;
- the banking market;
- bond issues.

Based on short- and medium-term cash flow projections and stress tests applied to these projections (liabilities as well as assets), the Group considers its liquidity risk to be low.

At December 31, 2014, some of the Group's financing debt *(described in Note 17 "Financing debt" to the consolidated financial statements)* carried covenants in addition to the traditional clauses relating to the existence of reserves or refusal to certify accounts, which could lead to a change in the loan interest expense.

Indeed, some borrowings are subject to step-up clauses providing for an increase in the annual interest rate in the event of a ratings downgrade by Standard & Poor's.

Real estate risk

Real estate risk measures how sensitive the value of property assets is to changes in values in the real estate market. This risk covers buildings housing the Group's operations (described in Note 8 "Operating property and other property, plant and equipment" to the consolidated financial statements), as well as real estate leased to third parties (described in Note 5 "Investment and operating property" to the consolidated financial statements).

Investments in real estate or real estate products (for own use or investment) account for just over 6.5% of the market value of the investment portfolio. This percentage is consistent with the strategic allocation of the investment portfolio, as well as its tactical allocation, as defined by the Investment Committee and in force as at December 31, 2015.

Sensitivity tests

In addition to calculating the capital required to cover the risk taken, the Group regularly conducts sensitivity tests to check the adequacy of its protection and the possibility of scenarios involving higher risks than initially anticipated.

The results are representative of the risks concerned but, like any simulation, have their limits. The simulation is based on the situation at a given date, i.e. the year-end in the present case. As such, the results do not reflect events that may arise after the end of the financial year.

- **RISK RELATING TO EQUITIES AND BONDS IN THE PORTFOLIO ON DECEMBER 31, 2014**

(in € millions)	Market value on December 31, 2015	Impact of a 100 bp increase in interest rates**	Impact of 10% fall in equity markets	Market value at 12/31/2014	Impact of a 100 bp increase in interest rates*	Impact of 10% fall in equity markets
Bonds	2.993	(100,1)	-	2.816	(84,7)	-
Equities	270	-	(27,0)	246	-	(23,5)
TOTAL	**3.263**			**3.061**		

* *Average sensitivity 3%, calculated on the main subsidiaries representing over 99% of the bond portfolio at the end of 2013.*
** *Average sensitivity 3%, calculated on the main subsidiaries representing over 99% of the bond portfolio at the end of 2014.*

- **RISK ON PORTFOLIO EQUITIES AT DECEMBER 31, 2015**

(in € millions)	Market value on December 31, 2015 – scenario impact	Revaluation reserves – shareholders' equity impact	Amortized cost – economic account impact
TOTAL	**270,5**	**22,3**	**248,2**
Impact of 10% fall in equity markets	(27,0)	(22,3)	(4,7)
Impact of 30% fall in equity markets	(74,8)	(22,3)	(52,5)

Impact on shareholders' equity does not take account of deferred taxes. Income impact is before tax.

(in € millions)	Net income 2014	10% fall in premiums	10% rise in cost of claims in 2015 net appeals	10% increase in management costs	2013 Net income	10% fall in premiums	10% increase in cost of claims in 2014 net appeals	10% increase in management costs
Change in net income	**302**	**(52)**	**(70)**	**(68)**	**302**	**(57)**	**(65)**	**(68)**

- **FINANCIAL PORTFOLIO ON DECEMBER 31, 2015**

(in € millions)	Assets (a)	Liabilities (b)	Foreign-currency commitments (c)	Net position before hedging (d) = (a) – (b) ± (c)	Hedging Instruments (e)	Net position after hedging (f) = (d) – (e)
EUR	3.295	252	0	3.043	0	3.043
GBP	255	0	0	255	0	255
USD	454	0	0	454	0	454
Other currencies	269	0	0	269	0	269
Total	**4.273**	**252**	**0**	**4.020**	**0**	**4.020**

(a) Financial assets.

(b) Borrowings.

The following table shows the impact of exchange rate changes on the annual operating income before tax and the own funds of subsidiaries which present their financial statements in non-euro currencies.

December 31, 2015 (in € thousands)	Impact on operating income		Impact on equity before tax	
	100 bp increase	100 bp decrease	100 bp increase	100 bp decrease
GBP	77,9	-77,9	-271,9	271,9
USD	334,9	-334,9	990,1	-990,1
TOTAL	**412,8**	**-412,8**	**718,1**	**-718,1**

4.2.4 Counterparty risks

Counterparty risk is the loss the Group would incur in the event of the insolvency of one of its business partners, namely the failure of a reinsurer, a bank, a bond or equity counterparty, or the non-performance by a policyholder of its commitments.

The Group has implemented various mechanisms to anticipate and limit the consequences of the failure of one of its counterparties.

Reinsurer default

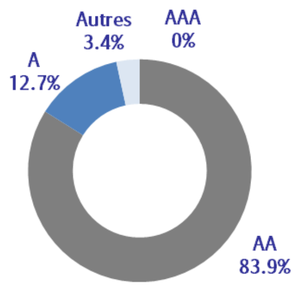
Mechanisms for detecting and limiting counterparty risk:

- selection of reinsurers on the basis of their counterparty rating (rated A or higher or subject to the special prior approval of the Group Board of Management in the event of a rating lower than A);
- limits on concentration risk relating to a single reinsurer;
- constant monitoring by the various operational entities via a maturity analysis of reinsurers' credits and debits, and the amount of technical reserves transferred to them;
- requests for letters of credit or security deposits from reinsurers;
- cut-offs of reinsurance agreements a few years after the implementation of the reinsurance contract.

In the event of reinsurer default or any event that may result in reinsurer default, the Group would conduct a risk analysis of the event. It would then take steps, on the basis of its findings, to minimize the negative impact on the Group.

In this case, the assets carried by the Group in connection with this counterparty would be written down.

- **DISTRIBUTION OF TECHNICAL RESERVES CEDED BY REINSURERS' RATINGS (THE SCOPE COVERED REPRESENTS 99.3% OF TOTAL GROUP RESERVES ON DECEMBER 31, 2014)**



Reinsurer's credit rating	Exposure (in € thousands)	%
AAA	0	0,0%
AA	555.813	83,9%
A	84.198	12,7%
Other	22.340	3,4%
TOTAL	**662.351**	**100%**

Bank default

Mechanisms for detecting and limiting counterparty risk:

- selection of banks on the basis of their rating (rated A or higher);
- limits on the cash available in in bank accounts;

- increase in the number of banks with which the companies deal.

In the event of banking counterparty default, all the Group's cash held in the accounts of the bank in question would be written down.

Bond or equity counterparty default

Mechanisms for detecting and limiting counterparty risk:

- implementation of a strict policy limiting investment in a single private issuer to 5% of total assets.

- **RATINGS OF BOND COUNTERPARTIES**

	2015		2014	
(in € millions)	Amount	%	Amount	%
AAA	856	28,6%	1.329	47,2%
From AA+ to AA-	954	31,9%	737	26,2%
From A+ to A-	443	14,8%	269	9,5%
Other	740	24,7%	481	17,1%
TOTAL FINANCIAL INVESTMENTS	**2.993**	**100%**	**2.816**	**100%**

Policyholder default

Mechanisms for detecting and limiting counterparty risk:

- procedures for the proactive management of funds held with policyholders, in particular to avoid a financial loss in the event of policyholder default.

	December 31, 2014				
(in € thousands)	< 3 months	3 months to 1 year	1 to 5 years	> 5 years old	Total
Total credit-insurance receivables	**609.623**	**15.943**	**1.268**	**-**	**626.834**

Trade receivables are subject to strict monitoring procedures. 97,3% of trade receivables have a maturity of less than three months. Reserves are recognized for the full amount of any outstanding receivable which is more than six months past due.

4.2.5 Operational, legal, regulatory and tax risks

The Group, jointly with its main shareholder, has implemented an analysis framework to identify and quantify operational risk that could stem from an overall failure of the organization and the Group's systems, due to human error or to an external event. Ensuring that appropriate processes are implemented to manage these risks is a cornerstone of the Risk Management function.

Operational risk

Operational risk is managed in accordance with the policy laid down in the Group's operational risk policy, and is based on the deployment and maintenance of an appropriate and consistent internal control organization, guaranteeing appropriate operational risk management for each Group entity.

The Group's operational risk management system is based on:

- crisis management and business continuity plans;
- internal management rules and operational procedures specifying the manner in which operations should be carried out;
- a periodic disclosure process for operating losses above €10,000 and regular analysis of scenarios that could, if they materialize, result in an operating loss.

The operational risk control system, set out for all Group entities, is based on two levels of control, with responsibilities and control plans suited to each level:

- permanent self-monitoring at the operational level and continuous management control;
- periodic checks conducted in each entity by the internal audit function.

In addition, a program covering own insurance risks has been set up in each Group entity, in a decentralized manner.

Regulatory risk

The Group is subject to various regulations governing the insurance, banking and asset management businesses.

The Group is also subject to strict regulations due to its listing on Euronext Paris.

The Group has set up the necessary structures to comply with the regulations of the countries in which it operates. They apply the laws of their country of establishment and comply with administrative requirements or those set by local supervisory authorities, as well as specific prudential rules.

In particular, each entity has appointed a correspondent tasked with implementing the European directive on data protection, and the Group has strengthened its control over the application of regulations by making a person within the Group responsible for this function, in conjunction with correspondents within each entity.

Legal and arbitration proceedings

In the ordinary course of its business, the Group is involved in legal proceedings (notably debt collection proceedings) and is subject to tax assessments and administrative audits. Reserves are systematically established accordingly.

The unfavorable outcome of any pending or future litigation could have an adverse impact on the Group's business, financial position, consolidated net income, reputation or market image. The Group carefully manages its relationships with external parties, and each entity has a local structure or the necessary legal resources to take the appropriate action in the event of disputes.

To the best of the Group's knowledge, there are no governmental, judicial or arbitration proceedings, either pending or threatened, which have had over the last 12 months, or may have in the future, a material impact on the financial position or profitability of the Company and/or Group.

Tax risks

By virtue of its legal structure, the Group operates in many countries and under a range of tax regimes.

Tax risk can arise from an operational error in the calculation and declaration of taxes or arise from a difference in interpretation of the application of tax rules.

The Group has established various processes designed to reduce this task risk. In particular,

- first- and second-level controls have been implemented in order to ensure the validity of tax calculations and timely reporting to the tax authorities;
- tax risk analyses are produced by the financial officers on a quarterly basis for the principal tax entities in order to identify the primary risks of interpretation differences.

Compliance risk

Compliance risk relates to the application of appropriate rules of behavior for a given period or situation.

To deal with this risk, a Group Head of Compliance, working in conjunction with correspondents in every region, monitors compliance with rules governing ethics, fraud, money laundering and the observance of periods during which trading in Euler Hermes Group securities is suspended.

Reputational risk

The Group has implemented measures necessary to protect its image and actively communicate with its shareholders, customers, employees and, more broadly, the financial community about its financial strength *via* :

- regular disclosure, both internally and externally;
- continuous monitoring of the Group's image and reputation;
- a set of rules to determine whether operations may result in a reputational risk.

Labor and environmental risks

On labor issues, the major challenge facing the Group is how to retain employees and how to attract the best talent in the future.

Environmental issues affect the Group to a fairly limited extent, due to the generally non-polluting nature of its business.