

Varma's interim report 1 January–30 June 2018

The comparison figures in parentheses are from 30 June 2017, unless otherwise indicated.

- Total result stood at EUR -186 (1,051) million.
- The six-month return on investments was 1.7% (4.7%), and the market value of investments stood at EUR 46.4 (45.0) billion.
- Solvency capital was strong, at EUR 11,348 (11,234) million, i.e. 1.8 (1.7) times the solvency limit.

Economic operating environment

The Finnish economy is reaching an economic peak. Growth is expected to strengthen over the remainder of the year, but will then probably level out. Uncertainty and unpredictability in trade policies increased the tension, however.

Stable global economic activity is expected to continue. Trade policy differences tightened the situation towards a trade war when economic areas threatened each other with trade barriers and tariffs. At the same time, the central banks tightened their monetary policies. Inflation pressure has strengthened from its lowest levels, which alleviates the central banks' position as they normalise their monetary policies in the cross-pressure of political risks.

The steady growth of the US economy has persisted and the Fed has continued to normalise its monetary policy. Inflation pressure has strengthened and the employment situation is strong. Economic growth in Europe remained moderate. Despite the continuing crises and growing risks, the relatively positive economic climate has held its ground in Europe and the central bank has taken a further step in normalising its monetary policy by announcing that it will end its bond purchase programme by the end of the year.

The economic outlook in the Finnish economy is still bright and economic growth is expected to accelerate during the current year. Economic growth is broad-based and strong in all of the aggregate demand areas. Companies' confidence in the economy and expectations are high. Industry investments are expected to remain at a lower level this year than last year. Employment figures have improved and the availability of competent workforce has begun to create bottlenecks in companies' production growth. Economic recovery has also supported the balancing of the public economy.

Earnings-related pension system

The clear strengthening of the economy, the protracted stock price rise and especially domestic improvement in employment figures support the sustainability of earnings-related pension system financing. The goal of the pension legislation reform that took effect from the start of 2017 is the lengthening of careers. In the long term, the securing of future pensions is also significantly impacted by demographic changes and migration.

Varma has developed workability management and vocational rehabilitation services that support the extension of careers, the accumulation of sufficient pension cover and the sustainability of pension financing.

Varma's financial trends

The total result at fair value for six months amounted to EUR -186 (1,051) million. The most important component of the total result is the investment result, which was -200 (1,028) million. The return on investments at fair value was EUR 779 (2,012) million. The interest credited on the technical provisions was EUR 979 (984) million. The estimated technical underwriting result was EUR -9 (7) million and the loading profit was EUR 24 (16) million.

Varma's solvency remained at the same strong level as in the early part of the year. The solvency capital, which serves as a risk buffer for investment operations, was EUR 11,348 million at the end of June (11,534 mill. on 1 Jan), and 132.4% in relation to the technical provisions (133.5% on 1 Jan).

Varma's solvency capital was on a sustainable level, i.e. 1.8 (1.7) times the solvency limit.

Tables illustrating Varma's financial development are presented as attachments to this interim report.

Insurance business

Varma's pension recipients numbered 340,000 at the end of June (342,000 at the start of the year). Claims paid in January–June totalled EUR 2,745 (2,617) million. By the end of June, 10,600 new pension decisions were made, which is 20% less than in the corresponding period last year. A total of 24,700 pension decisions were made in January–June.

In the first half of the year, EUR 20 million in premiums written were transferred to Varma from other pension companies. The core of customer work is workability management, for which Varma is constantly developing tools; the latest ones being the new questionnaire tools for the early identification of workability risks.

At the end of June, Varma provided insurance for 550,000 (537,000 at the start of the year) employees and self-employed persons.

Investments

The return on Varma's investments for January–June rose returned to positive figures. The return on investments stood at 1.7% (4.7%), and at the end of June the value of investments amounted to EUR 46,359 (44,989) million. The good return trend supported Varma's strong solvency, which remained at the high level of 132.4% in the first half of the year (133.5% on Jan 1). At the end of June, the average nominal investment return over five years was 6.2%, and over ten years 5.1%. The corresponding real returns were 5.6% and 3.9%.

Early on in the year, the global economic growth outlook has been adjusted slightly downwards, due to the lower-than-expected development of the European and emerging market economies. The US economy, on the other hand, displayed growth across the board, supported by its stimulating financial policy. Despite the relatively strong global confidence of companies and households, companies' investment plans may suffer from the import duties planned by the US government, which have increased uncertainty in the economic operating environment of both the US and its trade partners. Political uncertainty has resurfaced in the eurozone due to, for example, the policies of Italy's new government and Germany's government crisis.

Factors such as the surge in raw material prices and the improved employment situation have somewhat increased the inflation pressure. In many emerging economies, the increase in inflation pressure is also connected to the weakening of their currencies, to which the central banks have been forced to react with key interest hikes. The

central banks of developed economies have, in turn, reacted to the moderate acceleration of inflation with a careful normalisation of monetary policy.

The slight slowing down of global economic growth and increasing political uncertainty have caused dwindling risk appetite on the investment markets. Following the increase in market turbulence at the start of the year, investors have reduced their allocations in higher risk asset classes, such as equities and emerging market equity and fixed income investments. The increased uncertainty has also cut short the surge in long-term government bond rates earlier in the year, despite the fact that the Fed has continued its moderate normalisation of its monetary policy. In Italy, government bond rates rose very quickly in late spring due to the country's governmental crisis, but the situation calmed down as summer progressed.

Following a long period of calm, the increased volatility of the markets has served as a reminder of the benefits of investment diversification. Diversification across different asset classes and especially in unlisted investments has limited the risks resulting from volatility in the equity and fixed income markets. In Varma's investment allocation, the weight of listed equities was decreased further in the second quarter.

The H1 fixed income return fell to -1.5% (2.9%). The main reasons for the weak performance were the increased political uncertainty and increasingly moderate economic growth forecasts, which raised the credit risk premiums on emerging market bonds and corporate bonds, which had performed strongly the previous year. The interest rate levels of eurozone government bonds are still considerably low although the escalation of political uncertainty has caused southern European government bond rates to rise. Eurozone money market interest rates have remained negative and the ECB's first interest rate hikes will probably be postponed to the second half of next year.

During the first half of the year, the return on the loan portfolio was 1.6% (2.1%), on public sector bonds -4.0% (2.9%), on other corporate bonds -1.0% (4.1%) and on other money-market instruments 0.2% (-1.1%).

The return on global equity markets fluctuated strongly in H1. January's very strong performance was followed by strong equity market turbulence in February–March, after which returns reverted to a growth path. In May, the markets' risk appetite received a new blow when Italy's government crisis and trade war concerns depressed European and emerging market equities in particular. The H1 return, 3.3% (7.0%), was clearly positive, however. US and Finnish equities yielded the best returns out of listed equities.

Listed equities yielded a return of 2.6% (7.9%), private equities 7.8% (3.6%), and unlisted equities 1.2% (2.9%).

The return on real estate investments was 2.7% (2.5%) with real estate investment funds performing especially well. Direct real-estate investments yielded a return of 1.9% (1.9%) and real-estate investment funds 5.4% (4.5%). Tenant demand in commercial properties in Finland has remained at a good level also outside the Helsinki capital region. During the reporting period, Varma joined Green Building Council Finland, which promotes the sustainable development of the built environment.

The return on other investments also remained at a good level after the first quarter, 2.4% (3.8%), mostly thanks to the positive development of hedge funds. Hedge fund investments effectively diversified the risk caused by market fluctuations in equity and fixed income investments over the long term, and their return developed steadily also during February's market turbulence. The return on hedge fund investments during the reporting period was 3.4% (3.6%).

Varma has US-dollar-denominated investments in hedge funds, equities, corporate bonds and private equity funds. In accordance with Varma's investment policy, part of the currency risk is hedged. During the first half of the year, the appreciation of the US dollar supported equity returns to some extent. In terms of operations, foreign currency risks are managed as a single entity, and in financial reporting the exchange rate impact is included in the investment returns of various asset classes.

Varma's investment activities focussed on maintaining the company's strong solvency and broad diversification of investments, with a strong emphasis on risk management. In its investment risk management, the company used derivatives for hedging purposes and to control the risk level of the portfolio.

The market risk of investments is the greatest risk affecting the company's result and solvency. Equities constitute by far the greatest market risk. The VaR (Value-at-Risk) figure describing the total risk of Varma's investments stood at EUR 1,526 (1,123) million.

Operating expenses and personnel

Varma's total operating expenses in the reporting period were EUR 67 (71) million. According to a full-year estimate, Varma will use 66% (75%) of the expense loading included in the insurance contributions for operating expenses. The loading profit for the period was EUR 24 (16) million. The total loading profit will be used for client bonuses.

Varma's parent company employed an average of 533 (526 in 2017) people in the first half of the year. At the end of June, Varma's personnel were distributed as follows: pension services 28%, insurance services 16%, customer service departments 12%, investment operations 13%, and other functions 31%.

Corporate Governance

Varma's Supervisory Board held its constitutive meeting on 16 May 2018. Kari Jordan continues as Chairman of the Supervisory Board, and Saana Siekkinen and Satu Wrede were re-elected as deputy chairmen.

An up-to-date Corporate Governance Statement based on the recommendations of the Finnish Corporate Governance Code is presented on Varma's website. Varma publishes quarterly interim reports with the aim of ensuring transparent public financial reporting that conforms to best practices.

Responsibility

EcoVadis, an international corporate social responsibility assessment specialist, has awarded Varma the CSR Rating Gold recognition. In its independent assessment carried out in the summer, Varma was among the top 5% of the 45,000 companies analysed.

In investments, an annual general meeting process complying with the ownership policy introduced in 2017 was adopted. Varma participated in altogether 85 general meetings in spring 2018.

Among the key measures of Varma's CSR programme this year are updating the CSR programme, promoting responsible customer work, and improving responsible investment in different asset classes.

Risk management

Varma's risk position did not change significantly during the period under review.

Varma's greatest risks are related to investment operations and information processing. Financially the most significant risks are those concerning investments. The risks of pension insurance operations are related to pension and insurance processing and to the effectiveness of the joint systems used in the sector. The Board of Directors has confirmed the principles for the company's internal control and risk management system. More information

about insurance, investment, operative and other risks, the means for managing them, as well as related quantitative data, are provided in the notes to Varma's financial statements.

Varma's Board of Directors' investment plan lays down the general security goals for investments, diversification and liquidity goals, and the principles governing the company's currency risk hedging. The diversification of the investment portfolio is based on allocation that takes into account the return correlations of asset classes.

Outlook

Despite the relatively stable and optimistic expectations concerning economic development, the operating environment is challenging from the viewpoint of pension investors. The protracted economic growth and almost uninterrupted rise in asset values on the capital markets are building up expectations of a change in the economic situation. In the cross-pressures of tightening geopolitical tensions, economic growth has held its own so far, but risks in the economic operating environment have been building up. Continuing uncertainty can, from companies' perspective, weaken investment appetite.

The long-standing positive economic situation and rise in asset values will keep pension investors aware of risks and the benefits of skilled diversification of investments. Varma's strong solvency is a key competitive benefit in a market situation requiring the securing of pensions. In addition, strong solvency, together with efficient operations, guarantee Varma's customers excellent client bonuses.

In Europe and globally, the economic operating environment is still characterised by political uncertainty, which, together with a possible growth in protectionism, continues to pose a risk to Finland's economy.

Helsinki, 17 August 2018

Risto Murto
President & CEO

The figures presented in this interim report are unaudited figures of the parent company.

Varma Mutual Pension Insurance Company is a responsible and solvent investor. The company is responsible for the statutory earnings-related pension cover of some 890,000 people in the private sector. Premiums written totalled EUR 4.9 billion in 2017 and pension payments stood at EUR 5.5 billion. Varma's investment portfolio amounted to EUR 46.4 billion at the end of June 2018.

FURTHER INFORMATION:

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ATTACHMENT: Graphs and charts

www.varma.fi/en

www.varma.fi/annualreport

Balance sheet at fair values, Parent Company

€ million	6/2018	6/2017	12/2017
Assets			
Investments	46,359	44,989	45,409
Receivables	275	317	747
Furniture and fixtures	4	5	5
	46,638	45,310	46,161
Liabilities			
Capital and reserves	126	121	124
Valuation differences	9,186	9,302	9,147
Provision for future bonuses	2,037	1,812	2,265
Off-balance-sheet items	-1	-1	-1
Solvency capital, total	11,348	11,234	11,534
Provision for current bonuses (for client bonuses)	81	61	162
Equity-linked provision for current and future bonuses	1,010	625	769
Actual technical provision	33,959	33,102	33,501
Total	34,970	33,728	34,270
Other liabilities	240	288	195
	46,638	45,310	46,161

Income statement at fair values, Parent Company

€ million	1-6/2018	1-6/2017	1-12/2017
Premiums written	2,454	2,444	4,867
Claims paid	-2,745	-2,617	-5,248
Change in technical provisions	-619	-728	-1,324
Net investment income	798	2,030	3,373
Total operating expenses	-67	-71	-129
Other income/expenses	0	0	-8
Taxes	-7	-7	-7
Total result ¹⁾	-186	1,051	1,524

¹⁾ Result at fair value before the change in provision for current and future bonuses and equalisation provision

€ million	1-6/2018	1-6/2017	1-12/2017
Underwriting profit/loss	-9	7	34
Investment result	-200	1,028	1,453
Loading profit	24	16	45
Other income/expenses	0	0	-8
Total result	-186	1,051	1,524

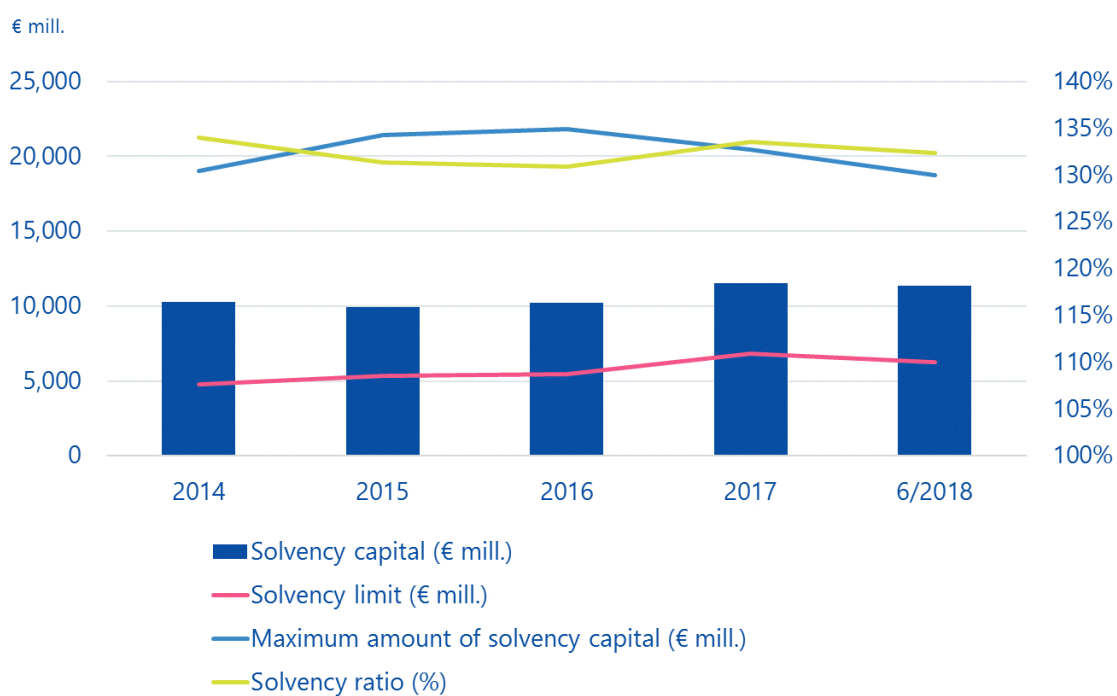
Solvency capital and limits

	30/06/2018	30/06/2017	31/12/2017
Solvency limit (€ mill.)	6,242	6,559	6,820
Maximum amount of solvency capital (€ mill.)	18,726	19,677	20,459
Solvency capital (€ mill.)	11,348	11,234	11,534
Solvency ratio (%) ¹	132.4	133.3	133.5
Solvency capital/Solvency limit ²	1.8	1.7	1.7

¹ Pension assets in relation to the technical provisions under §11 of the Ministry of Social Affairs and Health's decree governing pension institutions (614/2008).

² Solvency capital in relation to the solvency limit

Solvency development



Investments at fair value

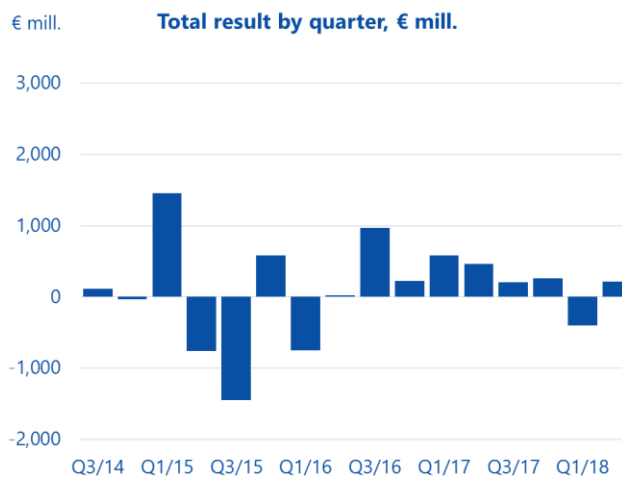
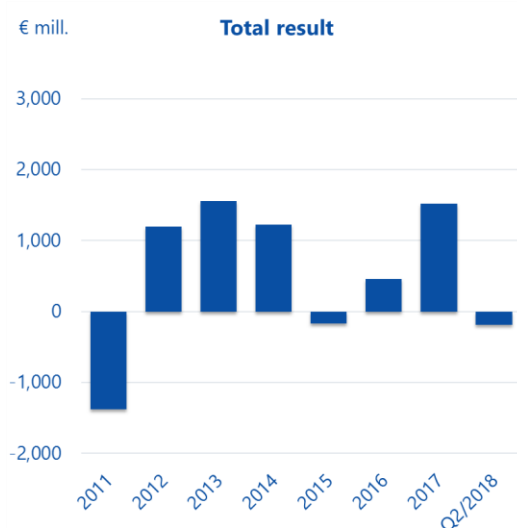
	30 Jun 2018				30 Jun 2017		31 Dec 2017		1-6/2018	1-6/2017	1-12/2017	24 m
	Market value		Risk position		Market value		Market value		Return	Return	Return	Vola- tility
	Market Value	Risk position	Market Value	Risk position	Market value	Risk position	Market value	Risk position	MWR	MWR	MWR	
	€ mill.	%	€ mill.	%	€ mill.	%	€ mill.	%	%	%	%	
Fixed-income investments ¹	14,348	31	10,563	23	9,454	21	12,579	28	-1.5	2.9	3.7	
Loan receivables	1,593	3	1,593	3	1,446	3	1,453	3	1.6	2.1	2.2	
Bonds	10,876	23	9,037	19	12,872	29	10,510	23	-2.2	3.7	5.4	2.3
Public bonds	4,228	9	2,483	5	5,419	12	4,285	9	-4.0	2.9	4.0	
Other bonds	6,648	14	6,554	14	7,454	17	6,224	14	-1.0	4.1	6.2	
Other money-market instruments and deposits	1,879	4	-67	0	-4,864	-11	617	1	0.2	-1.1	-1.9	
Equity investments	19,742	43	19,848	43	17,506	39	20,687	46	3.3	7.0	11.4	
Listed equities	15,796	34	15,902	34	13,633	30	16,753	37	2.6	7.9	11.6	6.2
Private equity	3,409	7	3,409	7	2,815	6	2,767	6	7.8	3.6	7.9	
Unlisted equities	538	1	538	1	1,058	2	1,167	3	1.2	2.9	18.5	
Real estate investments	3,811	8	3,811	8	3,654	8	3,602	8	2.7	2.5	4.9	
Direct real estates	2,804	6	2,804	6	2,839	6	2,797	6	1.9	1.9	2.9	
Real estate funds	1,007	2	1,007	2	816	2	805	2	5.4	4.5	12.0	
Other investments	8,458	18	9,917	21	7,104	16	8,907	20	2.4	3.8	9.3	
Hedge funds	8,488	18	8,488	18	6,259	14	7,886	17	3.4	3.6	8.5	1.4
Commodities	9	0	168	0	70	0	179	0				
Other investments	-40	0	1,262	3	775	2	842	2				
Total investments	46,359	100	44,140	95	37,718	84	45,775	101	1.7	4.7	7.8	2.4
Impact of derivatives			2,219	5	7,270	16	-365	-1				
Investment allocation at fair value	46,359	100	46,359	100	44,989	100	45,409	100				

The modified duration for all the bonds is 2.2.

The open currency position is 24.5% of the market value of the investments.

¹ Includes accrued interest

Total result



Summary of the key figures

	1-6/2018	1-6/2017	1-12/2017
Premiums written, € million	2,454	2,444	4,675
Net investment income at fair value, € million	779	2,012	3,343
Return on invested capital, %	1.7	4.7	7.8
	6/2018	6/2017	12/2017
Technical provisions, € million	37,087	35,601	36,696
Solvency capital, € million	11,348	11,234	11,534
in relation to solvency limit	1.8	1.7	1.7
Pension assets, € million	46,380	45,004	45,948
% of technical provisions	132.4	133.3	133.5
TyEL payroll, € million	20,239	19,225	19,367
YEL payroll, € million	798	826	802

Investments at fair value, broken down as per the regulations of the Financial Supervisory Authority

	Market value						Risk position					
	30 Jun 2018		30 Jun 2017		31 Dec 2017		30 Jun 2018		30 Jun 2017		30 Dec 2017	
	€ million	%	€ million	%	€ million	%	€ million	%	€ million	%	€ million	%
Fixed-Income Investments	14,348	30.9	17,927	39.8	13,481	29.7	10,563	22.8	9,454	21.0	12,579	27.7
Loan receivables	1,593	3.4	1,446	3.2	1,453	3.2	1,593	3.4	1,446	3.2	1,453	3.2
Bonds	10,876	23.5	12,117	26.9	10,028	22.1	9,037	19.5	12,872	28.6	10,510	23.1
Other money-market instruments and deposits	1,879	4.1	4,363	9.7	2,001	4.4	-67	-0.1	-4,864	-10.8	617	1.4
Equity investments	19,742	42.6	17,190	38.2	20,427	45.0	19,848	42.8	17,506	38.9	20,687	45.6
Listed equities	15,796	34.1	13,316	29.6	16,492	36.3	15,902	34.3	13,633	30.3	16,753	36.9
Private equity	3,409	7.4	2,815	6.3	2,767	6.1	3,409	7.4	2,815	6.3	2,767	6.1
Unlisted equities	538	1.2	1,058	2.4	1,167	2.6	538	1.2	1,058	2.4	1,167	2.6
Real estate investments	3,811	8.2	3,654	8.1	3,602	7.9	3,811	8.2	3,654	8.1	3,602	7.9
Direct real estates	2,804	6.0	2,839	6.3	2,797	6.2	2,804	6.0	2,839	6.3	2,797	6.2
Real estate funds	1,007	2.2	816	1.8	805	1.8	1,007	2.2	816	1.8	805	1.8
Other investments	8,458	18.2	6,218	13.8	7,900	17.4	9,917	21.4	7,104	15.8	8,907	19.6
Hedge funds	8,488	18.3	6,259	13.9	7,886	17.4	8,488	18.3	6,259	13.9	7,886	17.4
Commodities	9	0.0	-19	0.0	11	0.0	168	0.4	70	0.2	179	0.4
Other investments	-40	-0.1	-22	0.0	3	0.0	1,262	2.7	775	1.7	842	1.9
Total	46,359	100.0	44,989	100.0	45,409	100.0	44,140	95.2	37,718	83.8	45,775	100.8
Impact of derivatives							2,219	4.8	7,270	16.2	-365	-0.8
Total	46,359	100.0	44,989	100.0	45,409	100.0	46,359	100.0	44,989	100.0	45,409	100.0
Modified duration of the bond portfolio	2.2											

Net return on invested capital

	Net investment return at fair value	Invested capital	Return % on invested capital	Return % on invested capital	Return % on invested capital
	€ million	30 Jun 2018 € million	%	30 Jun 2017 %	31 Dec 2017 %
Fixed-Income Investments	-201	13,123	-1.5	2.9	3.7
Loan receivables	25	1,527	1.6	2.1	2.2
Bonds	-229	10,272	-2.2	3.7	5.4
Other money-market instruments and deposits	2	1,324	0.2	-1.1	-1.9
Equity investments	708	21,264	3.3	7.0	11.4
Listed equities	454	17,293	2.6	7.9	11.6
Private equity	244	3,140	7.8	3.6	7.9
Unlisted equities	10	831	1.2	2.9	18.5
Real estate investments	100	3,640	2.7	2.5	4.9
Direct real estates	54	2,780	1.9	1.9	2.9
Real estate funds	46	860	5.4	4.5	12.0
Other investments	192	7,857	2.4	3.8	9.3
Hedge funds	264	7,834	3.4	3.6	8.5
Commodities	10	11			
Other investments	-82	11			
Total	798	45,884	1.7	4.7	7.8
Unallocated income, costs and operating expenses from investment activities	-19	9			
Net investment return at fair value	779	45,893	1.7	4.7	7.8