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## Report of the Board of Directors 2014

### ***Economic operating environment***

*The economic year 2014 ended in a climate of increasing uncertainty*

Uncertainty in the economic operating environment grew in the second half of 2014, and the year ended in an atmosphere of increasing uncertainty. Political and economical tension in Middle East continued, and the conflict between Russia and the West cast a shadow on the economic outlook for Finland and Europe especially. The increased risks caused greater fluctuations in the markets. This uncertainty is counterbalanced by the fact that the financial crisis and globally the strictest fiscal discipline measures are over.

Growth remained strong in both the U.S. and the U.K. Early in 2014 the favourable development of the U.S. economy stalled, which caused concern about whether it would recover and about the risks related to the change in direction of the country's monetary policy. However, the U.S. economy resumed its upward trend, supported by the favourable development in asset values and improving labour market situation. The growth of the U.S. economy is expected to remain strong, although recovery has been moderate, especially considering how monetary policy has been used to support the economy.

Global investment demand remains feeble, and growth in global trade volumes is slow. China and other emerging economies continue to develop, although moderately compared to recent years. The investment cycle is picking up, which is expected to increase economic activity. However, the escalating geopolitical uncertainty is also increasing economic uncertainty. So far, this has not resulted in any market disturbances that would indicate a marked weakening in confidence in the global economy. The strong downward trend in oil prices since late 2014 also contributes to the economic growth of industrial countries.

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The eurozone still has not recovered. Growth did not take off, concern over deflation increased and unemployment rates remain high in several member states. Greece is struggling to meet its obligations, but many other countries in crisis have been able to make progress in balancing their economies. Considering the eurozone as a whole, growth in overall demand has been moderate, and the structural reforms and austerity measures called for by public finances are depressing the domestic markets. Adjustment measures, however, are no longer tightening, which creates conditions for stronger growth.

#### *Russian economy plummeting*

Russia's economy shrank sharply. In the last quarter of the year the price of oil was falling rapidly for reasons relating to both demand and supply. In addition to the crashing oil price, the Russian economy is being strangled by Western sanctions. The country's economy suffered from ruble rout, and the Bank of Russia had not succeeded in stabilising the situation through its actions by year-end. On one hand, the collapsing Russian economy weakens the outlook in the eurozone and especially in Finland, but on the other hand, the fall in the price of oil promotes economic growth in Finland and the rest of Europe.

#### *Monetary policy is key*

Towards the end of the year the investment markets grew increasingly restless. The rise in share prices has continued for a long time, bolstered by monetary policy. The equity markets and the real economy seem to have diverged in Finland and elsewhere in Europe. In the U.S., market valuations also climbed to historically high levels.

The European Central Bank resorted to exceptional monetary policy measures. By stretching the boundaries of its mandate, the ECB has been able to stop the financial crisis from escalating in the eurozone. Growth remains sluggish, though, and deflationary pressures also exist. The eurozone markets expected new, stronger measures by the ECB aimed at promoting economic growth. The U.S. central bank, the Fed, has been normalising its monetary policy as the economy recovers. The Fed repeatedly confirmed its commitment to maintaining economic growth. The central banks' success in adapting monetary policy to changing conditions will be critical in order to ensure economic growth and the stable development of the capital markets.

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*Finland's economy in deep trouble*

In 2014, total output in Finland is estimated to have remained at the previous year's level. Industrial output has been decreasing nearly nonstop for the past three years, and Finland has been losing market shares globally. Nearly all sectors of business and industry have been affected by the problems.

The decrease in the output of the electronics industry has a major impact on Finland's total output and its value-added rate. The renewal of business and trade structures is slow, and the price competitiveness of Finland has weakened. This has called for a moderate pay policy, which in turn has weakened the development of purchasing power and the recovery potential of the domestic markets. Declining industrial investments combined with the decreasing supply of workforce and modest development of output undermine the economy's growth potential also in the longer term. There is little leeway in Finland's public finances.

*Strong solvency is Varma's strategic choice*

Varma's task is to invest pension assets profitably and securely. The financial crisis has hit pension systems and institutional investors worldwide. Strong solvency is a strategic choice for Varma. Varma strives for the best possible return on investments based on its chosen risk profile in order to secure the payment of pensions. Strong solvency and pro-active and prudent diversification of investments play a key role in a demanding market situation. In a difficult market situation, strong solvency is a major benefit for a pension investor. Competent risk management ensures the profitable and secure investment of pension assets, as sudden movements are anticipated in the markets.

In the short-term, the goal of extending careers and companies' financial requirements do not necessarily coincide. A number of Varma's client companies are also experiencing difficult transformations. Varma's strategic goal is to offer effective pension insurance services. The ability to understand customers' needs is highlighted during major economic shifts. Varma is a strong expert in handling earnings-related pensions and a preferred specialist partner in workability management. Varma's goal is to be the most efficient pension insurance company and to offer its customers the best client bonuses in the sector.

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### ***Varma prepares for pension reform***

The 2017 pension reform will better adjust our pension system to the longer life expectancy. The Confederation of Finnish Industries EK, the Central Organisation of Finnish Trade Unions SAK and the Finnish Confederation of Salaried Employees STTK reached an agreement on the contents of the reform on 26 September 2014. According to the impact assessments, the labour organisations' amendments meet the objectives set by the Finnish Government for pension reform. Tripartite preparation of legislation is ongoing on the basis of the pension reform agreement. Pension acts will be passed by the next parliament.

The pension reform will bring about changes to pension benefits and pension financing. According to the pension reform agreement, the lower and higher age limits for old-age pension will gradually rise as of 2017. As of 2025, the age limits for old-age pension will be linked to the increase in life expectancy, and the impact of the life expectancy coefficient will be more lenient. The accrual of earnings-related pension will be changed such that pension accrues at a rate of 1.5 per cent of annual income, irrespective of age.

The pension reform will introduce, alongside disability pension, a years-of-service pension at the age of 63. This pension can be applied for after 38 years of employment, provided that the work has been physically or mentally demanding and workability has diminished. Part-time pension will be replaced by partial early old-age pension, the age limit for which is 61 years until the year 2025 and 62 years thereafter.

The pension agreement also set the level of the contribution under the Employees Pensions Act TyEL at 24.4 per cent for 2017–2019. According to the Finnish Centre for Pensions' forecasts, the contribution level is sufficient for the long term. The labour market organisations will reassess the matter no later than during the negotiations on the pension contribution for the year 2020.

Another change concerning the financing of pensions involves raising the equity-linked provision for current and future bonuses from 10 to 20 per cent. Furthermore, the equity investments of a single pension insurance provider will be limited to a maximum of 60 per cent of the entire portfolio. These changes will increase earnings-related pension insurance institutions' possibilities to invest in equities and will support the sufficiency of the agreed contribution level in the long term.

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The pension reform will have an impact on all of Varma's client companies and insured customers. Implementing the pension reform will, on one hand, increase the workload, but it will also give Varma a chance to deepen its client relationships. The goal of extending careers will not necessarily be met while the economy is suffering. However, the pension reform aims to achieve changes in the long term. Varma aims to handle its task – securing pensions and implementing the changes that the pension reform entails – as effectively as possible.

A legislative amendment that took effect at the beginning of 2014 will terminate the supplementary pension insurance (TEL-L) pursuant to the Employees Pensions Act on 31 December 2016. During 2014, policyholders and the insured were informed about the termination of the insurance and the impact this will have on the benefits of the insured. The number of these policies at Varma amount to about 330, covering around 4,400 people. Employers have until the end of 2016 to arrange a benefit corresponding to the supplementary pension cover.

In 2014, the average TyEL contribution was 23.6 (22.8) per cent of the total payroll. Employees below the age of 53 contributed 5.55 (5.15) per cent of their pay, while the rate for employees aged 53 and over was 7.05 (6.50) per cent. The YEL contribution was 23.3 (22.50) per cent of the confirmed earnings for those below the age of 53, and 24.8 (23.85) per cent for those aged 53 and over.

The return requirement on technical provisions consisted of a 3.0 (3.0) per cent fund rate, a pension liability supplementary factor and the return on equity component. The value of the supplementary factor was 1.44 per cent on average in 2014. The return on equity component in 2014 was 9.62 per cent. The technical rate of interest, which is used to determine the interest rate of the oldest premium loans, insurance contributions and a number of other items, was 4.50 until the end of June and 5.00 thereafter.

### ***Varma's financial trends***

Varma's total result at fair value stood at EUR 1,223 (1,558) million. The total quarterly result varied during the financial year, such that the second-quarter result was the strongest and the fourth-quarter result the weakest.

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Varma's solvency strengthened during 2014 by EUR 1,112 million, and at the end of the year, solvency capital amounted to EUR 10,252 (9,140) million. Varma's solvency ratio, i.e. solvency capital in relation to technical provisions, is the highest among the main earnings-related pension companies, at 34.0 (31.6) per cent. Solvency capital was at a strong level: 2.2 (2.2) times higher than the solvency limit. The solvency limit is changed in accordance with the risk level of the investments. Varma's strategic goal is to maintain the company's strong solvency through stable returns and operational efficiency.

The return on investments at fair value was EUR 2,699 (3,160) million, which represents 7.1 (9.0) per cent of the invested capital. The interest credited on the technical provisions was EUR 1,573 (1,648) million. Thus, the investment result for 2014 totalled EUR 1,125 (1,512) million. The average annual nominal return on Varma's investments over five years was 6.4 per cent, and over ten years 5.5 per cent, both of which figures are the highest in the sector. Operating expenses were 25 (24) per cent lower than the expense loading included in insurance contributions, and the loading profit stood at EUR 33 (32) million. The underwriting result was EUR 64 (15) million.

At the end of 2014, EUR 117 (105) million was transferred to the provision for current bonuses reserved for client bonuses. The transfer represents roughly 0.7 (0.6) per cent of the estimated payroll of the insured.

The TyEL payroll of those insured by Varma totalled about EUR 17.8 (17.8) billion in 2014. The payroll is estimated to have grown by 0.3 per cent. Varma's premiums written totalled EUR 4,344 (4,258) million, of which TyEL insurance accounted for EUR 4,150 (4,071) million and YEL insurance for EUR 193 (187) million.

At the end of the year, 527,140 (531,210) individuals were insured by Varma. At the end of the year, the number of valid insurance policies totalled 66,140 (66,740), covering 38,937 (39,810) self-employed persons and 488,190 (491,400) employees.

During the year, a total of 3,443 (3,796) new TyEL insurance policies and 4,875 (5,340) YEL insurance policies came into force at Varma.

Earnings and employment notifications received during the year totalled 1,631,284 (1,483,634), of which 93 (92) per cent were received electronically.

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Varma provides policyholders with services through its own service channels and through the service networks of If P&C Insurance Ltd and the Nordea Group.

In 2014, a total gross amount of EUR 5,010 (4,787) million in pensions was paid out. The number of pension recipients increased, and at year-end, Varma was paying TyEL and YEL pensions to 334,500 (333,700) people.

A total of 21,051 (23,937) new pension decisions were made during the year. The number of new pension decisions decreased 5.8 percent and the total number of all pension decisions was 5.1 per cent lower than in 2013. Old-age pension decisions numbered 11,548 (11,514), and disability pension decisions amounted to 5,107 (5,461). The number of part-time pension decisions stood at 711 (1,052). Continuation decisions on temporary pensions totalled 4,631 (4,782), and other decisions numbered 14,846 (13,131). These include decisions and preliminary decisions required as a consequence of the changes in pension rights.

Vocational rehabilitation is an alternative to disability pension, and the number of rehabilitation cases at Varma increased again. Rehabilitation has proven to be successful, as currently about 72 per cent of those who receive Varma's rehabilitation return to the job market either in full or partly. Varma has for years been a forerunner in vocational rehabilitation. Throughout 2014 Varma assisted its client companies in managing personnel risks through client-oriented co-ordination of well-being-at-work services, rehabilitation services and pension-decision services in order to support the management of pension costs and longer careers. Varma also contributed to the costs of customers' workability management projects in accordance with jointly agreed and often multi-year plans and contracts.

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	31 Dec. 2014	31 Dec. 2013	Change
<b>Number of insured</b>			
TyEL <sup>1</sup>	488 190	491 400	-3 210
YEL	38 937	39 810	-873
<b>Total</b>	<b>527 127</b>	<b>531 210</b>	<b>-4 083</b>
1 of which covered by TEL registered supplementary pension insurance	4 390	4 928	-538
<b>Number of insurance policies</b>			
TyEL	27 223	26 930	-460
<b>Number of pensioners</b>			
Part-time pension	2 567	3 320	-753
Survivors' pension	51 205	51 427	-222
Disability pension	30 671	33 324	-2 653
Unemployment pension	0	38	-38
Old-age pension	235 002	230 249	4 753
Early old-age pension	15 052	15 404	-352
<b>Total <sup>2</sup></b>	<b>334 497</b>	<b>333 762</b>	<b>735</b>
<sup>2</sup> Those receiving YEL pension	28 889	29 153	-264
Those receiving TEL/YEL supplementary pension	43 493	43 286	207

Varma's eServices for customers has become a major means of providing services. During the year under review, 75.6 per cent of all private customer contacts took place online. Through Varma's eServices, the insured can obtain the most recent estimate of their old-age and part-time pensions at various retirement ages, apply for a pension, and follow the progress of the application.

Varma sends a pension record to the insured once every three years. A total of 226,093 (235,287) such pension records were sent out in 2014. The record shows information on earnings that apply to pension as well as the pension that has accrued until the end of the preceding year. The pension record is also available via Varma's eServices.

### **Technical provisions**

Varma's technical provisions grew 2.1 (5.5) per cent to EUR 32,070 (31,399) million. They contain a provision of EUR 117 (106) million for current bonuses reserved for client bonuses, a provision of EUR 753 (1,301) million for future bonuses contained in the solvency capital, and EUR 1,007 (720) million in an equity-linked provision for current and future bonuses, which transfers part of the equity returns of the earnings-related pension system to create a buffer. The equalisation provision amounted to EUR 1,180 (1,118) million.

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At the end of the year, the assets covering the technical provisions were 126 (121) per cent of the technical provisions.

### ***Investments***

The return on Varma's investments was 7.1 (9.0) per cent. The value of Varma's investments grew to slightly over EUR 40 billion. Fixed-income investments accounted for 26 per cent, equity investments for 47 per cent, real estate investments for 6 per cent and other investments for 21 per cent of the investment result.

Share prices strengthened, and interest rates continued to fall from the already low level of the early year, which boosted interest income. Other investments also developed favourably. The average ten-year (nominal) return on investments was 5.5 per cent and the five-year return 6.4 per cent. The real returns were 3.5 and 4.3 per cent respectively.

Economic growth gained momentum in the U.S. but remained weak in the eurozone and was negative in Finland. The European Central Bank held on to its stimulus policy and lowered its interest rates, while the U.S Federal Reserve withdrew its support for the markets and ended quantitative easing. It also gave indications of a moderate interest rate increase in 2015. The U.S. dollar gained clear momentum during the year.

During 2014, Varma's result developed strongly in the first half, but there was strong fluctuation in the second half. Uncertainty was sparked by the crisis in Russia, geopolitical tension, the sharp decline in the price of oil and the markets' momentary lack of faith in the steadiness of equity prices.

Varma has US-dollar-denominated investments in hedge funds, equities, corporate bonds and private equity funds. In accordance with Varma's policy, most of the exchange rate risks have been hedged. During the year, a proportion of the currency position was unhedged, which improved the overall result as the value of the U.S. dollar increased. In terms of operations, foreign currency risks are managed as a single entity, while in the performance indicators the exchange rate impact is included in the investment returns of various asset classes.

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At the end of 2014, the value of Varma's investments totalled EUR 40,039 (37,718) million and the return at fair value was EUR 2,699 (3,160) million or 7.1 (9.0) per cent. All asset classes yielded a positive return. The value and returns of the investments are grouped according to risk in this report. The Notes show the breakdown of investments and their returns by investment category, grouped according to regulations and according to risk.

The focus of Varma's investment activities was on active risk management, and the security of investments was emphasised. The key target was to secure a strong solvency position. In its investment risk management, the company used derivatives for hedging purposes and to control the risk level of the portfolio.

#### *Fixed-income investments*

Varma's fixed income investments stood at EUR 11,983 (10,624) million at the balance sheet date and were distributed as follows:

- loan receivables EUR 1,571 (2,026) million
- public-sector bonds EUR 3,450 (3,869) million
- other corporate bonds EUR 6,282 (5,363) million
- other money-market instruments 680 (-635) million; the impact of derivatives, EUR -81 (1,878) million, is presented separately.

The return on fixed-income investments was 5.5 (1.2) per cent. The return on the loan portfolio was 2.6 (3.3), on public-sector bonds 6.7 (-1.8), on other corporate bonds 6.9 (3.0) and on other money-market instruments 0.5 (-0.4) per cent.

During the year, interest rates continued to fall from the already low level, which clearly improved the return on listed bonds. The duration of the loan portfolio was kept fairly long at around five years, which improved the result.

The return on loan receivables was in line with expectations, but valuation changes in junior loans lowered the overall return on loan receivables. The demand for TyEL loans was subdued, and their amount decreased in the course of the year. The return on money-market investments was in accordance with the prevailing short-term interest rate level.

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Interest rates in Europe have dropped to a very low, even negative, level, and it will be challenging to achieve a positive real return on fixed-income investments. Interest income may also easily turn negative, should interest rates rise.

#### *Equity investments*

At the balance sheet date, the value of Varma's equity investments was EUR 16,333 (14,756) million and were distributed as follows:

- investments in listed equities EUR 12,879 (11,579) million,
- private equities EUR 2,451 (2,175) million, and
- unlisted equities EUR 1,004 (1,002) million.

The return on equity investments was 9.1 (21.8) per cent. Listed equities yielded a return of 7.4 (23.7) per cent, private equities 13.5 (12.1) per cent, and unlisted equities 19.7 (26.7) per cent.

Equity investments yielded good returns and had the strongest performance of all asset classes. Equity investments have had a very strong six-year period, with an average return of 13.3 per cent. Share prices followed an upward trend until June, but there was strong fluctuation in the second half. The overall return on listed equities was good, with the highest return generated by U.S. equities, at 16.3 per cent. The equities of Sampo Corporation, Varma's largest domestic holding, performed very strongly, at 14.0 per cent. The crisis in Russia weighed on the share prices of certain key holdings, and the total return on Finnish equities was 6.7 per cent.

Private equity investments and unlisted equities also generated good returns. About half of Varma's private equity investments are invested in the U.S., and the rest mainly in Europe and the Nordic countries. The value of these investments developed strongly in all areas. Private equity funds exploited the strong demand and liquidated large amounts of their investments. Infrastructure funds included in the portfolio also yielded a strong return.

The return on unlisted equities was improved by the selling of Fingrid Oyj's shares, the strong development in the value of private equity co-investments, and the considerable dividend income received from the housing real-estate companies SATO Corporation and VVO Group and the increase in the value of their shares.

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Private equity and unlisted equities represent a long-term asset class, and their long-term return has been very good.

#### *Real estate investments*

Real-estate investments stood at EUR 3,841 (4,304) million at the balance sheet date, with direct real estate investments accounting for EUR 3,375 (3,739) and real estate investment funds for EUR 466 (565) million of the total. The return on real estate investments was 3.8 (3.1) per cent. Direct real-estate investments yielded a return of 3.2 (2.0) per cent and real-estate investment funds 8.0 (11.6) per cent.

The volume of real estate trade in Finland grew to EUR 3.8 billion in 2014. Foreign investors were also active in the market, and especially the share of Swedish investors grew considerably. The increase in transaction volume is partly due to the transactions relating to the establishment of the new logistics and industrial real-estate company Certeum Oy, in which Varma was also involved. Varma made EUR 74 million worth of new real estate investments, and had around 220 new rental flats under construction in the Helsinki area at the end of 2014. As regards business premises, Varma has been focussing on, in addition to maintenance construction and renovations, developing premises under its direct ownership and on improving energy efficiency. The change in fair value of Varma's directly owned real-estate holdings totalled EUR -76 million. New international investments were made during the year in Sweden and Great Britain.

#### *Other investments*

Other investments amounted to EUR 7,962 (6,157) million. These consisted of hedge funds EUR 6,717 (4,850) million, commodities EUR 370 (201) million, and other investments EUR 875 (1,106) million. The return on other investments was 8.7 (4.5) per cent.

Hedge-fund investments performed consistently with only minor fluctuations. Their share of the portfolio was increased during the year, and the strengthening of the U.S. dollar further increased their share.

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Inflation-linked investments include inflation-linked bonds issued by states with good creditworthiness. Returns were also impacted by the decline in interest rates, which improved the value of bonds with a long maturity. Changes in exchange rates also contributed to the strong returns.

The market risk of investments constitutes the greatest risk affecting the company's result and solvency. Equities constituted by far the greatest market risk. The VaR (Value-at-Risk) figure describing the total risk of Varma's investments stood at EUR 1,492 (1,118) million. The figure represents the maximum fall in the market value of the company's investment portfolio in normal conditions over a period of one month with a probability of 97.5 per cent.

The central principles in Varma's ownership policy are high-quality governance in the companies in which it has a holding, transparency of operations, active engagement, and the monitoring of incentive schemes for key personnel. In 2014, Varma actively participated in the Annual General Meetings of the domestic companies in which it owned shares and in the work of the companies' Shareholders' Nomination Boards. Varma's website contains a list of the company's memberships on the Nomination Boards of listed companies.

### ***Operating expenses***

Varma used 75 (76) per cent of the expense loading, included in the pension insurance contributions, to cover operating expenses. Controlling operating expenses is a key objective while simultaneously improving operational efficiency. Good operational efficiency benefits Varma's customers by means of client bonuses. Varma's goal is to manage the assets of both present and future pensioners as efficiently as possible.

In addition to economies of scale, increasing efficiency also requires continuous control of human resources and, in particular, IT system expenses, as these account for most of Varma's operating expenses. Overall operating expenses remained at the previous year's level, totalling EUR 142 (143) million.

Varma is actively involved in the administration of the pension sector's joint information systems and expects transparency and efficiency in terms of costs.

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**Personnel**

The average number of the parent company's personnel and the salaries paid during the financial year are shown in the table below.

	2014	2013	2012	2011	2010
Average number of personnel	552	565	572	588	601
Salaries and remunerations, EUR million	40,1	37,9	37,0	39,5	36,9

Tieto Esy, which is included in the Consolidated Financial Statements using the equity method, had an average of 82 employees in 2014.

At year-end, Varma's personnel were distributed as follows: pension insurance and customer service departments 57 per cent, investment operations 13 per cent, and other functions 30 per cent.

**Group companies and associates**

At the end of 2014, the Varma Group comprised 186 (205) subsidiaries and 24 (22) associates. The most important subsidiaries and associates are Tieto Esy Ltd (50.1 per cent), Garantia Insurance Company Ltd (30.5 per cent), SATO Corporation (22.8 per cent), Technopolis Plc (23.9 per cent), Certeum Oy (38.9 per cent) and NV Kiinteistösjöitus Oy (45.0 per cent). The Varma Group also owns 50 per cent of the guarantee capital of Kaleva Mutual Insurance Company. Most of the subsidiaries and associate companies are real estate companies. An agreement concerning the divestment of Garantia Insurance Company's shares has been drawn up, and the transaction is expected to take effect at the end of March 2015.

**Corporate Governance**

At Varma's Annual General Meeting, policyholders have about 78 per cent, the insured about 20 per cent, and the Sampo Group (the owner of the guarantee capital) about two per cent of the votes.

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Varma's Annual General Meeting was held on 20 March 2014. The Annual General Meeting approved the financial statements and discharged the Board of Directors, the Supervisory Board and the President and CEO from liability for the financial year 2013. In addition, Matti Rihko and Jorma Vehviläinen were elected as new members of the Supervisory Board.

Continuing as Supervisory Board members are: Tapio Kuula (Chairman), Martti Alakoski (Deputy Chairman), Juri Aaltonen, Berndt Brunow, Petri Castrén, Erkki Etola, Stig Gustavson, Tauno Heinola, Tapio Korpeinen, Päivi Kärkkäinen, Olli Luukkainen, Ilkka Nokelainen, Lauri Peltola, Hannu Penttilä, Juhani Pitkäkoski, Pertti Saarela, Kari Sairo, Mika Seitovirta, Saana Siekkinen, Jorma J. Takanen, Arja Talma, Leena Vainiomäki, Kari Virta, Anssi Vuorio, Satu Wrede and Göran Åberg.

Authorised Public Accountants Petri Kettunen and Paula Pasanen were elected as Varma's auditors. Authorised Public Accountant Marcus Tötterman and Authorised Public Accountants KPMG Oy Ab were elected as deputy auditors.

In 2014, Varma's Board of Directors was composed of Kari Jordan (Chairman), Jari Paasikivi (Deputy Chairman), Antti Palola (Deputy Chairman), Riku Aalto, Mikael Aro, Johanna Ikäheimo, Ari Kaperi, Lasse Laatunen, Petri Niemisvirta, Karsten Slotte, Kai Telanne and Veli-Matti Töyrylä, and deputy members Mikko Ketonen, Arto Kuusiola and Liisa Leino.

In its meeting on 2 December 2014, the Supervisory Board re-elected to the Board of Directors the following members, whose terms were expiring: Riku Aalto, Petri Niemisvirta and Kai Telanne. New members elected to the Board effective 1 January 2015 are Berndt Brunow, Jyri Luomakoski and Ilkka Oksala. Kari Jordan, Karsten Slotte and Lasse Laatunen resigned from the Board on 31 December 2014.

At its organising meeting on 21 January 2015, Varma's Board of Directors elected Berndt Brunow as Chairman, and Jari Paasikivi and Antti Palola as Deputy Chairmen of the Board.

By decision of Varma's Board of Directors in 2012, the company maintains an internal related party register, which includes the members of the Board of Directors, the President & CEO, and other members of the Executive Group. As of 1 January 2015, the register also covers members of the Supervisory Board. Significant trades and other transactions between Varma as a company and a

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registered related party must be approved by the Board of Directors before they are realised. Varma will also disclose these. No such transactions took place during the financial year.

Pursuant to the new regulations under the act on earnings-related pension companies, the memberships in the executive bodies of other entities of Varma's staff making investment decisions were disclosed at the beginning of 2015. Corresponding information concerning the members of the Board of Directors, the President and CEO and members of the Executive Group has been included in Varma's Corporate Governance Report, published since 2009. The holdings of listed shares of the President and CEO and members of the Executive Group have been disclosed on a quarterly basis on Varma's website. Pursuant to the act on earnings-related pension companies, insider register information on the Board members will also be made public by the beginning of June 2015.

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. Varma aims at transparent financial reporting that conforms to best practices.

### ***Capital and reserves***

Varma has 71 guarantee capital shares, which are held by Sampo Plc and Mandatum Life Insurance Company Limited. Under the Articles of Association, an interest approved by the Annual General Meeting is paid to the guarantee capital of EUR 11,941,342.78 each year. The maximum rate is the technical interest rate applied to the insurance provided in accordance with the legislation on employee pensions plus one percentage point. A guarantee capital share gives the holder 420 votes in the Annual General Meeting.

### ***Risk management***

The risks related to Varma's result and solvency are primarily affected by the result of investment activities. The most important operative risk concerns IT systems, which have a key role particularly in the processing of pensions and insurances within a mainframe environment and in the networked operating environment of the pension system.

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In the earnings-related pension system, the liquidity risk is manageable, as pension expenditure can be accurately forecast and investments are strongly focussed on liquid instruments. Varma's insurance business risks, which are minor, are linked to the sufficiency of the insurance contributions collected and the technical provisions accumulated from them in relation to the pensions that are the company's responsibility.

Varma's investment plan determines, among other things, the general security goals set for investments, the diversification and liquidity goals of investments, and the principles for organising foreign currency business. The Board of Directors assesses the risks in Varma's investments with respect to changes in value, expected returns, security, and the foreign currency business, and the company's risk-bearing capacity in the area of investments, including the development of the company's solvency position. The basic allocation laid down in the investment plan also lays down the basic level for the total portfolio risk. Deviations from the basic allocation are allowed within defined limits. The maximum risk level is measured so that even after a 25 per cent drop in the value of listed equity investments and certain hedge fund investments, the solvency capital still exceeds the minimum solvency capital by at least the amount of the VaR and is, in any case, always at least at the solvency limit. The diversification of the investment portfolio is based on allocation that takes into account the return correlations of asset classes. Risks are managed by, for example, diversifying investments by asset class and item, by analysing the investment portfolio and items, by avoiding risk concentrations, by securing guarantee policy, through careful valuation practice, by using derivatives, and by applying a supervision and follow-up system.

The agreement on the contents of the pension reform in 2017, reached by the major labour market organisation in the autumn of 2014, will contribute to the structural adjustment of the Finnish economy. The main risk of the pension reform, from the point of view of implementing pension provision, is if there is not enough time for making technical preparations before the year 2017, due to the slowness of the law-making procedure. Another central risk is the complexity of the future legislation and the problems it could cause in applying the legislation. These risks apply especially to the new pension types: the years-of-service pension and the partial early old-age pension.

The defined-benefit nature of earnings-related pension provides security and financial predictability. Securing the pension benefits of the young and future generations strengthens the future of the earnings-related pension system. The fact that the contribution level has been agreed until the end of this decade is an important stabilising factor for companies in the current challenging economic

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situation. Owing to the agreed benefit adjustments, balancing the financing of pensions with a reasonable cost burden seems possible. The increase in the retirement age will facilitate financing in the longer term.

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

### ***Outlook***

Uncertainty in the economic operating environment will continue. We can expect to see volatility in the capital markets also during the economic year 2015. The major monetary policy decisions by the ECB will, when correctly allocated, promote the recovery of the European economy and market development. At the same time, the long-standing rise in share prices and the low interest rate level will make the investment environment very challenging. The profitable and secure investment of pension assets requires careful diversification across different asset classes and skilful risk management. Varma's strong solvency gives the company excellent opportunities to succeed, also in an uncertain environment, in targeting a return that secures pension benefits and a reasonable contribution level.

Growth is expected to remain strong in the U.S. and reasonable in emerging countries. The declining price of oil is contributing to global economic growth.

Finland's economic situation remains difficult. In 2015, the economy is expected to pick up very slightly. For Finland, it is crucial that the export markets pick up. The falling price of oil and the weakening euro promote both Finland's exports and the growth of its main markets.

Improving the price competitiveness of Finland's exports requires reasonable pay increases, which, however, means low growth in purchasing power and feeble demand in the domestic markets. The possibilities to increase purchasing power by relaxing taxation are limited. Economic development in the near future will be characterised by the adjustment of public finances and the ongoing change in the structures of trade and industry. Finland is struggling with growing debt, sizable sustainability gap, and dwindling growth. The balancing act between these will continue for years to come.

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The private sector earnings-related pension system is on a strong financial footing, and it offers the insured stable defined-benefit pensions. Varma aims to be a forerunner in earnings-related pensions as well as a reliable partner to its clients in earnings-related pension insurance. Varma highlights pension companies' responsibility for professionally handling investment risk management and supports the sector's efficiency and transparency and the prerequisites for competition. Earnings-related pension insurance companies must handle the task set out for them as efficiently as possible for current and future pension recipients.