

Report of the Board of Directors 2015

The economic operating environment

The global economy is divided: recovery in the developed economies has started while the emerging economies are still struggling. In addition to geopolitical issues, uncertainty in China caused special concern in the markets in 2015.

Global economic growth continued in 2015, but the development was uneven. The economies of industrialised countries grew, yet at the same time emerging economies struggled with major problems. Inflation remained clearly below the central banks' target level in all the main economic areas.

The outlook for economic growth in the US remained stable, and growth became broader-based. Employment rates improved, but no major pressure on pay levels was seen yet. The Fed started to normalise its monetary policy by raising its benchmark rate.

Strong fluctuations in the capital markets continued in 2015. In summer, the troubles in the Chinese economy, where growth has been declining for some time now, raised special concern. In addition to the fundamentals of China's economy and the broader effects of the country's economic problems, the lack of trust was also linked to the reliability of its economic information.

Raw material prices fell, and the price of oil declined sharply. The Russian economy remained in deep trouble and suffered from low raw material prices. Risks relating to global economic growth are still substantial, although the emerging markets have a reasonable growth outlook.

Recovery in eurozone continued

Europe's economic cycle is lagging behind compared to the US. The eurozone's economic picture continued to become clearer in the course of 2015, and the economic crisis was brought under control. The eurozone recovery was boosted by the European Central Bank's substantial monetary policy measures. Consumer prices did not show an upward trend. The ECB's measures were at the core of European economic policies, and the monetary policy framework continues to prop up growth in the eurozone.

Most of the EU member states that took the worst battering by the economic crisis have undergone major structural reforms, the impacts of which were reflected in stronger growth. The tightening of public finances has eased, which contributed to growth in overall demand. Employment rates in Europe picked up, although unemployment and youth unemployment in particular remain major problems.

No turn for the better for Finland's economy

Finland's economic problems have accumulated, and the economic climate is weak. In 2015, total output in Finland is estimated to have remained at around zero. According to preliminary data by Statistics Finland, gross domestic product developed even less favourably at the end of the year than earlier in the year. So there were no clear signs of the economy picking up.

The volumes of Finnish exports were smaller than expected, and also in terms of value, exports shrank. The competitiveness of export prices was weak as there has been little flexibility in cost levels. Industrial output continued to fall in 2015. According to Statistics Finland, industrial output decreased by 1.6 per cent year-on-year between January and November. Business confidence indicators remained low, especially within industry. The business cycle indicator for the construction industry strengthened towards the end of the year.

Private consumption has shown fairly steady growth in light of the weak economic development. Households' income will grow very moderately over the coming years, which means that no major boost can be expected from the domestic markets. Consumer confidence in the Finnish economy weakened as of the autumn. The rise in unemployment seemed to have halted in the second half of the year, but in December unemployment increased year-on-year. There is no sign of a rapid improvement in the employment rate.

The rate at which public finances are weakening has been alarming. Tight fiscal policy required by the balancing act and austerity measures will hamper growth in the short-term. Getting public finances in balance is, however, necessary in order to secure longer-term conditions for growth.

Varma prepares for pension reform together with customers

The bills on pension reform were passed by parliament in autumn 2015. The purpose of the pension reform is to lengthen careers and to strengthen statutory earnings-related pension cover. Varma is preparing for the future changes together with its customers. Changing pension legislation increases the need for information among customers. Varma aims to handle its task – securing pensions and implementing the changes that the pension reform entails – as efficiently and effectively as possible.

The pension reform will bring about changes to both pension benefits and pension financing. The age limits for old-age pension will gradually rise by two years, and thereafter will be linked to life expectancy. There will be changes to how pension accrues, and pension contributions will no longer be deducted when determining the pensionable salary. Instead of the former accelerated accrual, employees will be encouraged to extend their work careers through an increase for deferred retirement and a reduction for early retirement. The current part-time pension system will be abolished. New pension types as of 2017 will be partial early old-age pension, and a years-of-service pension for those who have been performing strenuous and wearing work for a long time.

It is estimated that the pension reform has stabilised pension contributions at the current level. The equity-linked share of the return requirement on technical provisions will be gradually raised to 20 per cent as of the beginning of 2017. This is a buffer jointly maintained by earnings-related pension companies to bear

some of the risks resulting from the fluctuations in equity income. The decision will improve the opportunities for long-term risk-taking and thus support the financing of pensions and keeping pension contributions at a reasonable level.

The significance of employment is highlighted in the partly fund-based pension system. This makes it important to promote the achievement of the pension reform goals in the workplace. The goal of extending careers does not always necessarily coincide at workplaces and in people's lives when the economy is suffering and structural changes are shaking the business sector. We support our client companies and the insured in the midst of these changes: Varma is a strong expert in vocational rehabilitation and workability management.

Pension contributions and return requirement on technical provisions

In 2015, the average TyEL contribution was 24.0 (23.6) per cent of the salaries or wages. Employees below the age of 53 contributed 5.70 (5.55) per cent of their pay, while the rate for employees aged 53 and over was 7.20 (7.05) per cent. The YEL contribution was 23.7 (23.3) per cent of the confirmed earnings for those below the age of 53, and 25.2 (24.8) per cent for those aged 53 and over.

The return requirement on technical provisions consisted of a 3.0 per cent fund rate, a pension liability supplementary factor and the return on equity component. The value of the supplementary factor was 2.0 per cent on average in 2015. The return on equity component in 2015 was 12.3 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 5.50 until the end of June and 5.75 thereafter. As of the beginning of 2016, an insurance contribution interest rate, which is 2 per cent at the moment, will be used instead of the technical rate of interest in the calculation of the insurance contributions.

Varma's financial trends

Varma's total result at fair value stood at EUR -164 (1,223) million. The total quarterly result varied during the financial year, such that the first-quarter result was the strongest and the third-quarter result the weakest.

Varma's solvency weakened during 2015 by EUR 296 million, and at the end of the year, solvency capital amounted to EUR 9,956 (10,252) million. Varma's solvency ratio, i.e. solvency capital in relation to technical provisions, was at 31.4 (34.0) per cent. Solvency capital was at a strong level: 1.9 (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 1,679 (2,699) million, which represents 4.2 (7.1) per cent of the invested capital. The interest credited on the technical provisions was EUR 1,902 (1,573) million. Thus, the investment result for 2015 totalled EUR -223 (1,125) million. Operating expenses were 26 (25) per cent

lower than the expense loading included in insurance contributions, and the loading profit stood at EUR 36 (33) million. The underwriting result was EUR 23 (64) million.

At the end of 2015, EUR 115 (117) million was transferred to the provision for current bonuses reserved for client bonuses. The transfer represents roughly 0.6 (0.7) per cent of the estimated payroll of the insured.

The TyEL payroll of those insured by Varma totalled about EUR 18.4 (17.8) billion in 2015. The payroll is estimated to have grown by 3.0 per cent. Varma's premiums written totalled EUR 4,576 (4,344), of which TyEL insurance accounted for EUR 4,380 (4,150) million and YEL insurance for EUR 196 (193) million.

At the end of the year, 524,340 (527,140) individuals were insured by Varma. At year-end, the number of valid insurance policies totalled 64,530 (66,140), covering 37,380 (38,937) self-employed persons and 486,960 (488,190) employees.

During the year, a total of 2,732 (3,443) new TyEL insurance policies and 4,330 (4,875) YEL insurance policies came into force at Varma. Varma did well in the TyEL portfolio transfers for the second consecutive year. According to the TyEL client transfer statistics of the Finnish Pension Alliance TELLA, Varma's net result was the best in the sector, at EUR 52 million (EUR 55 million in 2014). This success will promote a positive trend in premium income.

Earnings and employment notifications received during the year totalled 1,744,332 (1,631,284), of which 95 (93) per cent were received electronically.

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 2015, a total gross amount of EUR 5,183 (5,010) million in pensions was paid out. The number of pension recipients increased, and at year-end, Varma was paying TyEL and YEL pensions to 337,100 (334,500) people.

A total of 23,111 (21,056) new pension decisions were made during the year. The number of new pension decisions increased 9.7 percent and the total number of all pension decisions was 9.0 per cent higher than in 2014. Old-age pension decisions numbered 13,175 (11,539), and disability pension decisions amounted to 5,649 (5,107). The number of part-time pension decisions stood at 694 (711). Continuation decisions on temporary pensions totalled 4,161 (4,631), and other decisions numbered 16,832 (14,771). These include decisions and preliminary decisions required as a consequence of the changes in pension rights. Pension applications made online accounted for 39 (33) per cent of all new pension applications.

During the year, the implementation of the new pension application processing system was completed, and the new system is in full use now. It will speed up the processing of pension applications and facilitate the automatisisation of the different stages of the process in the future.

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 73 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 2015 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.

	31 Dec. 2015	31 Dec. 2014	Change
Number of insured			
TyEL ¹	486 960	488 190	-1 230
YEL	37 380	38 937	-1 557
Total	524 340	527 127	-2 787
1 of which covered by TEL registered supplementary pension insurance	3 867	4 390	-523
Number of insurance policies			
TyEL	27 150	27 223	-73
Number of pensioners			
Part-time pension	1 765	2 567	-802
Survivors' pension	51 156	51 205	-49
Disability pension	28 545	30 671	-2 126
Old-age pension	241 084	235 002	6 082
Early old-age pension	14 556	15 052	-496
Total ²	337 106	334 497	2 609
² Those receiving YEL pension	28 674	28 889	-215
Those receiving TEL/YEL supplementary pension	43 643	43 493	150

Varma's eServices has become a major means of providing services. During the year under review, 74 per cent of all private customer contacts took place online. There was a clear increase in the use of eServices, which require identification. Through Varma's online services, the insured can obtain the most recent estimate of their old-age and part-time pensions at various retirement ages; 94 per cent of these estimates were carried out online. You can also apply for pension and follow the progress of the application online.

Varma sends a pension record to the insured once every three years. A total of 208,327 (226,093) pension records were sent out in 2015. 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 decreased 0.6 (increased 2.1) per cent to EUR 31,866 (32,070) million. They contain a provision of EUR 115 (117) million for current bonuses reserved for client bonuses, a provision of EUR -1,083 (753) million for future bonuses contained in the solvency capital, and EUR 1,402 (1,007) 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 1,203 (1,180) million.

At the end of the year, the assets covering the technical provisions were 131 (126) per cent of the technical provisions.

Changes in insurance portfolio

At the end of the financial year, the pension liabilities of the pension fund Yrittäjien Eläkekassa Oma, and the EUR 70 million in assets covering those liabilities were transferred to Varma. Of that amount, solvency capital totalled EUR 16 million. The pension fund was in liquidation, and pension institutions paid EUR 22 million to supplement its solvency capital, of which Varma's share was EUR 8 million.

At the end of the financial year Varma transferred a part of its insurance portfolio to a newly established pension fund. The transferred pension liabilities totalled EUR 33 million, of which solvency capital accounted for EUR 8 million.

The changes in the insurance portfolio had no significant impact on Varma's solvency, technical provisions or investable assets.

Investments

The return on Varma's investments was 4.2 (7.1) per cent. The value of Varma's investments grew to EUR 41.3 (40.0) billion.

Exceptionally large movements were experienced in the capital markets in both equities and fixed income investments in 2015. These movements were stimulated by the central banks' monetary policy measures and concerns over the state of Greece's economy and the sustainability of China's economic growth. Broad diversification of investments muted the risks caused by strong market movements, and returns were largely generated by equities.

The average ten-year nominal return on Varma's investments was 4.8 per cent and the five-year return 5.1 per cent. The real returns were 3.0 and 3.6 per cent respectively.

Varma's result developed strongly early in the year, but fluctuated from the spring onwards. Market uncertainty was exacerbated by, in addition to the economic problems in Greece and China, expectations of interest hikes by the US central bank and the steep decline in the prices of energy and other commodities.

Equities generated the strongest return, and Finnish equities in particular performed strongly. Real estate and other investments also generated reasonable returns. The return on fixed-income investments remained slightly negative.

Varma's investment activities focused 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.

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.

At the end of 2015, the value of Varma's investments totalled EUR 41,293 (40,039) million and the return at fair value was EUR 1,679 (2,699) million or 4.2 (7.1) per cent. 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.

Fixed-income investments

Varma's fixed income investments stood at EUR 12,268 (12,845) million at the balance sheet date and were distributed as follows:

- loan receivables EUR 1,361 (1,571) million
- public-sector bonds EUR 2,653 (4,312) million
- other corporate bonds EUR 6,105 (6,282) million
- other money-market instruments EUR 2,151 (680) million,
- the impact of derivatives, EUR -336 (-81) million, is presented separately.

The return on fixed-income investments was -0.4 (5.8) per cent. The return on the loan portfolio was 2.4 (2.6), on public-sector bonds -2.5 (7.4), on other corporate bonds 0.4 (6.9) and on other money-market instruments 0.5 (0.5) per cent.

Fixed income investments consisted mainly of government and corporate bonds, money-market instruments and loans which include pension loans to Varma's customers.

The fixed income market experienced a significant correction in the area of eurozone government bonds. The ECB's expanded public sector bond purchase programme that was launched in March pushed long-term interest rates in the eurozone to a record low. The interest rate levels of bonds with a shorter maturity fell clearly into negative territory. The strong correction in interest rates starting in late April caused one of the fastest downward spirals in the price of eurozone interest-bearing securities in their history. Towards the end of the year, interest rates started to decline again, but the expected interest hike by the US central bank caused fluctuation in the fixed-income market.

Corporate bond markets were weighed down by concerns over China's economic growth and the steep decline in energy prices, which influenced especially American corporate bonds with a lower credit rating. The fairly long-standing decline in emerging countries' currencies also in part depressed the returns on emerging market bonds.

The return on government bonds was -2.5 (7.4) per cent and on corporate bonds 0.4 (6.9) per cent. The duration of the loan portfolio was kept fairly short, at around 2.3 years, which dampened the impact of the interest rate movements on the result.

The return on loan receivables, 2.4 (2.6) per cent, was strong in the low interest-rate environment. The amount of TyEL loans continued to decline during 2015.

The return on money-market investments was good in relation to the prevailing short-term interest rate level, standing at 0.5 (0.5) per cent.

Interest rates in Europe have dropped to a very low level and were largely negative for government bonds. It will be challenging to achieve a positive real return on fixed-income investments in future. 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 18,465 (16,333) million and they were distributed as follows:

- investments in listed equities EUR 14,938 (12,879) million
- private equities EUR 2,617 (2,451) million, and
- unlisted equities EUR 909 (1,004) million.

The return on equities totalled 8.8 (9.1) per cent, of which listed equities yielded 8.0 (7.4) per cent, private equities 7.8 (13.5) per cent, and unlisted equities 21.2 (19.7) per cent.

Share prices rose sharply in the first quarter, especially in Europe, when the European central bank launched its massive stimulus measures. Over the course of the spring, the equity markets were negatively influenced by concern over Greece's ability to pay off its maturing loans. Equity markets hit bottom in the autumn, as fears over the sustainability of China's economic growth spread to the global equity markets. At the end of the year, the equity markets again recovered as the economic indicators in the US improved and the ECB signalled its commitment to further stimulus measures.

Despite the strong market fluctuations, the return on listed equities was good, at 8.0 per cent. Finnish equities yielded the best return, at 19.4 per cent.

Finnish equities accounted for 37.6 per cent of Varma's listed equities. To counterbalance the high share of domestic equities, Varma has broadly diversified its portfolio outside of Finland, not only in international equities, but also in private equity investments, hedge funds and bonds.

On the other hand, US equities yielded a low return and emerging market equities a clearly negative return. Concerns over China's economic growth and the strong decline in energy prices depressed share prices in many emerging countries.

Real estate investments

Real-estate investments stood at EUR 3,906 (3,841) million at the balance sheet date, with direct real estate investments accounting for EUR 3,313 (3,375) and real estate investment funds for EUR 593 (466) million of the total. The return on real estate investments was 3.3 (3.8) per cent. Direct real-estate investments yielded a return of 2.3 (3.2) per cent and real-estate investment funds 9.9 (8.0) per cent.

Varma continued to increase the international diversification of its real estate investments in 2015. New investment commitments in international real-estate funds totalled EUR 365 million. The biggest single investment was the acquisition of a share in the Skärholmen Centrum shopping centre in Stockholm, Sweden. At year-end, the value of Varma's international and Finnish real estate fund investments amounted to EUR 593 (466) million and the return was 9.9 (8.0) per cent.

The weighting of domestic, directly-owned real estate investments was slightly decreased. In 2015, Varma divested a total of EUR 28 million in direct real estate investments. The weighting of equity-type domestic real-estate investments was reduced over the year as Varma divested half of its holding in Certeum Oy and its entire holding in SATO Corporation for a grand total of EUR 336 million.

In 2015, the value of transactions in the Finnish real estate market increased by more than 30 per cent from 2014, but the challenges in the rental market were reflected in the vacancy rates, returns and values of the direct real estate portfolio. At year-end, the vacancy rate for the business premises owned directly by Varma stood at 7.2 per cent.

Investments in 2015 totalled EUR 73 million, and they were focussed on development, maintenance construction and renovations of existing properties, and housing construction. At the end of 2015, Varma had a total of 130 new rental flats under construction in the Helsinki Metropolitan area. Several other housing construction and development projects are also under planning. In Finland, investments are focussed on the Helsinki Metropolitan area and the largest growth centres.

In 2015, the impact of fair valuation of real estate under Varma's direct ownership totalled EUR -88 (-76) million. The fair value of the real estate owned directly by Varma stood at EUR 3,313 (3,375) million at year-end. The return on direct real estate investments was 2.3 (3.2) per cent. The value of and total return on the portfolio were influenced by fair valuations, the divestment of properties and investments carried out.

Other investments

Other investments amounted to EUR 6,991 (7,100) million. They consisted of hedge funds EUR 6,663 (6,717) million, commodities EUR 352 (370) million, and other investments EUR -24 (13) million. The return on other investments was 3.5 (8.4) per cent.

The return on hedge fund investments was 3.9 (7.8) per cent. Hedge fund investments yielded a consistent return and effectively diversified the risk caused by market fluctuations in equity and fixed income investments. The strengthening of the dollar contributed to the good return. Within the portfolio, market-neutral strategies yielded the strongest returns. The environment for opportunistic strategies was more challenging, influenced especially by increasing risk awareness in the US at the end of the year. The return on Varma's hedge investments has been very good over a long period, and volatility has been very low.

The return on commodities remained negative due to the long-standing decline in the commodities market. Energy and metal prices especially declined towards the end of the year to a remarkably low level.

Total portfolio risk

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 1,842 (1,492) 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.

Varma's share ownership policy

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 2015, 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 74 (75) 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 145 (142) million.

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

Personnel

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

	2015	2014	2013	2012	2011
Average number of personnel	549	552	565	572	588
Salaries and remunerations, EUR million	39.6	40.1	37.9	37.0	39.5

Tieto Esy, which is included in the Consolidated Financial Statements using the equity method, had an average of 81 employees in 2015.

At year-end, Varma's personnel were distributed as follows: pension insurance and customer service departments 56 per cent, investment operations 13 per cent, and other functions 31 per cent.

Group companies and associates

At the end of 2015, the Varma Group comprised 186 (186) subsidiaries and 20 (24) associates. The most important subsidiaries and associates are Tieto Esy Ltd (50.1 per cent), Technopolis Plc (23.9 per cent) and

NV Kiinteistösi joitus 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.

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 2 per cent of the votes.

Varma's Annual General Meeting was held on 19 March 2015. 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 2014. In addition, Jarmo Hyvärinen, Kari Jordan (Chairman), Erkki Järvinen, Hannu Kottonen (resigned 20 January 2016), Päivi Leiwo and Christoph Vitzthum were elected as new members of the Supervisory Board.

Martti Alakoski (Deputy Chairman), Satu Wrede (Deputy Chairman), Juri Aaltonen, Petri Castrén, Erkki Etola, Stig Gustavson, Tauno Heinola, Tapio Korpeinen, Päivi Kärkkäinen, Olli Luukkainen, Ilkka Nokelainen, Lauri Peltola, Juhani Pitkälä, Matti Rihko, Pertti Saarela, Mika Seitovirta (resigned 24 November 2015), Saana Siekkinen, Leena Vainiomäki, Jorma Vehviläinen, Kari Virta (resigned 6 May 2015), Anssi Vuorio and Göran Åberg continued as Supervisory Board members.

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 2015, Varma's Board of Directors was composed of Berndt Brunow (Chairman), Jari Paasikivi (Deputy Chairman), Antti Palola (Deputy Chairman), Riku Aalto, Mikael Aro, Johanna Ikäheimo, Ari Kaperi, Jyri Luomakoski, Petri Niemisvirta, Ilkka Oksala, Kai Telanne and Veli-Matti Töyrylä, and deputy members Arto Kuusiola (until 11 March 2015), Eija Hietanen (as of 12 March 2015), Mikko Ketonen and Liisa Leino.

In its meeting on 2 December 2015, the Supervisory Board re-elected to the Board of Directors the following members, whose terms were expiring: Mikael Aro, Ari Kaperi, Ilkka Oksala and Antti Palola.

At its organising meeting on 21 January 2016, 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 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 are also public.

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.

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 reached by the major labour market organisations on the contents of the pension reform in 2017 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 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 situation. Owing to the agreed benefit adjustments, balancing the financing of pensions with a reasonable cost burden appears to be 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.

Responsibility

In autumn 2015 we drew up a new corporate responsibility programme. It is based on an extensive survey that aimed to determine the areas of responsibility Varma's stakeholders consider important for an earnings-related pension company. A total of 1,168 respondents participated in the online survey. The feedback provided by the stakeholders was used to define a vision, targets and indicators for Varma's responsibility work. In future, responsibility issues will be reported using the GRI guidelines.

Outlook

We expect the uncertainty in the economic operating environment to continue. We can expect to see volatility in the capital markets also during the economic year 2016, as the first weeks of the year have shown. The central banks' measures are now at different phases of the cycle. The U.S. central bank, the Fed, continues to normalise its monetary policy as the economy recovers. The European Central Bank is committed to pursue an accommodative monetary policy, which promotes the eurozone's recovery.

Provided that economic growth in Europe continues as anticipated, investments can be expected to increase. This should finally boost the recovery of Finnish exports. As a small economy, Finland is strongly dependent on global trade volumes, and a pick-up in exports is presumed to boost economic growth. At the same time, the competitiveness of Finland's export prices is weak, as there has been little flexibility in cost levels. Society in general has a shared understanding of the nature and scale of the problems, but reaching decisions that improve cost competitiveness has proven difficult. From the perspective of securing earnings-related pensions, improving competitiveness and achieving higher employment rates is crucial.

Interest rates can be expected to remain at a low level for a long time. The environment of low real interest rates is challenging in terms of financing pensions. As sudden and strong movements can be expected in the markets, competent risk management promotes the profitable and secure investment of pension assets. In a volatile market situation, strong solvency is a major benefit for a pension investor.