

Varma's Interim Report 1 January–30 September 2017

The comparison figures in parentheses are from 30 September 2016, unless otherwise indicated.

- Total result amounted to EUR 1,262 (234) million.
- The nine-month return on investments was 6.2 (3.1) per cent, and the market value of investments stood at EUR 45.4 (42.4) billion.
- Solvency capital was EUR 11,444 (10,101) million, i.e. 1.9 (2.2)¹ times the solvency limit.
- Pension assets were 133.6 (131.0) per cent of the technical provisions.

Economic operating environment

The global economy is in good shape, and the uncertainty stemming from the financial crisis appears to have subsided. Economic growth is now on a broader base, and different economic regions are moving at a slightly different pace in the business cycle. The Finnish economy is experiencing brisk growth, and expectations concerning economic growth in the coming years are positive.

The US economy continues to show steady growth, but in Europe and emerging economies the business cycle is in a more active phase. Investments have picked up, which supports increasing production potential. Employment rates have also improved, although unemployment is still a problem in many EU member countries. The strengthening euro is somewhat hampering the recovery of exports. China has revived its economy with strong measures, and debt growth is still a major concern. Growth has been gaining momentum more broadly in the emerging economies, which further improves the outlook for global economic growth.

Inflationary pressures are still fairly muted, from a global perspective. In the US, the Fed is moving forward with the normalisation of its monetary policy and is beginning to reduce its sizable balance sheet. The eurozone monetary policy will continue to be accommodative for some time, but the European Central Bank will also tighten its monetary policy once this becomes possible in terms of the business cycle and inflation. Central banks' tighter monetary policy represents a significant economic turning point, and they aim to control the shift and make pricing in the markets easier through proactive communication. The fixed income markets continue to be a challenging operating environment for an investor.

Although the economy is overshadowed by political risks, market volatility has nevertheless remained low. It is difficult for the markets to price in the uncertainty caused by political risks. Varma's strong solvency and careful diversification of investments provides some leeway and makes it easier to prepare also for unexpected market situations. Pensions are well secured in Finland's defined-benefit earnings-related pension system.

The growth rate of Finland's total output is expected to increase to 3 per cent during the current year. The development of the labour market has so far been more modest. The employment rate has slightly improved, and while long-term unemployment has somewhat declined, it still persists. The long-standing weak economic development threw Finland's public finances out of balance. The recovery of economic growth and adjustment measures have strengthened public finances, but they are expected to remain in deficit until the end of this decade.

¹ Under the new solvency legislation, Varma's solvency limit changed on 1 January 2017. The amount of solvency capital remained at the same level, but with the higher solvency limit, the ratio of solvency capital to solvency limit decreased. The new solvency limit is not directly comparable with the previous limit.

Earnings-related pension system

The new pension laws that took effect at the beginning of the year aim to further strengthen the earnings-related pension system and its funding, as well as reduce the sustainability gap in public finances. Application of the new legislation has not posed significant problems. Varma prepared for the application of the new legislation ahead of its introduction through training and by providing additional advice related to the pension reform. Varma has especially focussed on developing its digital services for private customers, as the reformed pension legislation has increased the need for information.

Varma is a pioneer in disability risk management. We have been developing our services together with customers so as to take changes in customers' business better into account in terms of disability risks. The goal is to extend people's careers.

The Finnish government presented a bill concerning an Incomes Register to Parliament at the beginning of October. The Incomes Register is due to be introduced at the beginning of 2019, and it will have a major impact on Varma's insurance business. Varma has been preparing for the changes proactively for a long time in order to ensure smooth business transactions, reduce the administrative load and improve cost efficiency.

The composition of client bonuses was changed as of the beginning of the year, and client bonuses to be paid to Varma's customers for 2017 include the full loading profit. This is affected by the company's efficient operations. Client bonuses paid to Varma's customers will continue to be based on two factors: Varma's solvency and loading profit efficiency. Loading profit efficiency, i.e. the company's operating efficiency, is becoming an increasingly important competitive factor, and under the new client bonus model, efficient operations fully benefit our customers.

Varma's financial trends

The total result at fair value for the nine-month period amounted to EUR 1,262 (234) million. The most important component of the total result is the investment result, which was EUR 1,223 (266) million. The return on investments at fair value was EUR 2,676 (1,271) million. The interest credited on the technical provisions was EUR 1,453 (1,005) million. The estimated technical underwriting result was EUR 14 (-57) million and the loading profit was EUR 25 (26) million.

Legislation governing how earnings-related pension institutions' solvency is calculated changed as of the start of 2017. The change did not have a material impact on Varma's solvency position. Varma's solvency strengthened in comparison to the situation at the beginning of the year. At the end of September, the solvency capital, which serves as a risk buffer for investment operations, was EUR 11,444 million (10,199 mill. on 1 Jan), and pension assets in relation to the technical provisions were 133.6 per cent (130.9% on 1 Jan).

Varma's solvency capital was on a sustainable level, i.e. 1.9 (2.2) times the solvency limit². The solvency limits have been calculated in accordance with the regulations in force at the time.

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

Insurance business

Varma's pension recipients numbered 344,000 at the end of September (340,000 at the start of the year). Claims paid in January–September totalled EUR 3,955 (3,740) million. By the end of September, 19,550 new pension decisions were made, which is roughly 11.7% more than in the corresponding period last year. A total of 38,375

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pension decisions were made in January–September. Partial early old-age pension, which took effect at the start of the year, continued to be popular; by the end of September, 2,197 people had been granted the pension.

At the end of September, Varma was providing insurance to 542,000 (530,000 at the start of the year) employees and self-employed persons.

Varma succeeded well in the account transfer rounds between earnings-related pension companies that were concluded at the end of September. According to the statistics of the Finnish Pension Alliance TELA, the contributions to be transferred to Varma total EUR 48 million. The insurance contributions transferred to Varma over the last five years total approximately EUR 200 million.

The EU's new General Data Protection Regulation (GDPR) will enter into force on 25 May 2018. Varma is preparing for the regulation by developing its operations to comply with the new regulation. Work on our IT systems in the area of data protection is also under way. As a controller, Varma requires that its contractual partners who process personal data also comply with the GDPR in their role as processors.

Investments

Varma's investment returns in January–September experienced a strong and steady increase across all asset classes. The return on investments stood at 6.2 (3.1) per cent, and at the end of September, the value of investments totalled EUR 45.4 (42.4) billion. Thanks to the strong return trend, Varma's pension assets in relation to technical provisions increased to the high level of 133.6 (131.0) per cent by the end of September.

Global economic growth is gaining momentum on a broad front from Asia to Europe. The US administration has made a proposal concerning tax reforms to support economic growth, but the passing of the reform is surrounded by political uncertainty. In Europe, the German federal election went peacefully, but the Catalonia independence referendum and subsequent uncertainty about Spain's next steps have increased political uncertainty. Geopolitical risks have surfaced from time to time due to North Korea's missile tests, but have not had any material impact on the investment markets so far.

Central banks' monetary policies have remained highly expansionary, although a slow turn in monetary policy is taking place. The Fed has announced that it will start reducing its balance sheet in October. The ECB is also expected to announce the reduction of quantitative easing next year. Slightly rising inflation expectations and the anticipation of monetary policy being gradually tightened moderately raised the interest rate levels towards the end of the third quarter.

The strengthened growth of the global economy, combined with low return expectations for fixed-income investments, continued to encourage allocation across internationally diversified equity investments. Effective diversification across asset classes will offset the risks resulting from the strong movements in the equity markets. In Varma's investment allocation, the weight of hedge funds and listed equities was slightly increased in the third quarter.

Equities generated the strongest return of Varma's investments, and listed equities in particular performed strongly. All other asset classes have also yielded very strong returns since the beginning of the year. At the end of September, the average nominal investment return over five years was 6.6 per cent, and over ten years 4.3 per cent. The corresponding real returns were 6.0 and 2.8 per cent.

The return on fixed income investments during January–September was an excellent 3.6 (4.2) per cent in relation to the market interest rate level. Government bond interest rates in the eurozone continue to be remarkably low, although market expectations of a gradual winding down of monetary policy stimulus measures have somewhat raised the interest rate levels in the autumn. The credit margins on corporate bonds, however, have narrowed as economic growth has picked up and political uncertainty has subsided in the eurozone. Eurozone money market interest rates have remained negative. In January–September, the return on the loan portfolio was 1.7 (3.2) per

cent, on public-sector bonds 4.2 (4.1) per cent, on other corporate bonds 5.5 (6.8) per cent and on other money-market instruments –1.6 (–0.5) per cent.

Global equity markets have continued their upswing backed by the improvement in global growth and continued monetary policy stimulus measures. The strengthening of the euro against the US dollar as of May has cut the returns on USD-denominated equities. Varma's equity investments produced the highest returns of all asset classes during the January–September period, at 9.6 (3.2) per cent. Listed equities yielded a return of 10.8 (1.5) per cent, private equities 4.1 (8.1) per cent, and unlisted equities 8.1 (15.4) per cent.

Finland's economic growth has also strengthened during the year, thanks to the recovering export outlook. Finnish shares have performed very well, pushing the return of Varma's Finnish listed equities to a high 14.9 per cent.

The return on real estate investments rose to 3.1 (–0.4) per cent. Direct real-estate investments yielded a return of 2.3 (–1.5) percent and real-estate investment funds 5.9 (4.8) per cent. During the third quarter, Varma sold two thirds of an old office property purchased in Katajanokka, Helsinki, in 2016. The remaining part is currently being converted to accommodate 120 rentals flats. Approximately 11,000 m² of vacant office premises in Salmisaari, Helsinki, were let on a long-term lease.

The return on other investments was also good, at 5.7 (2.5) per cent, as global economic growth improved. The return on hedge fund investments has developed consistently during the year, reaching a return of 5.3 per cent. Hedge fund investments effectively diversified the risk caused by market fluctuations in equity and fixed income investments over the long term.

Varma has USD-denominated investments in almost all asset classes. In accordance with Varma's investment policy, part of the currency risk is hedged. The considerable weakening of the US dollar during the summer pushed down the result. 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 1,049 (1,399) million.

Operating expenses and personnel

Varma's total operating expenses in the first nine months of the year were EUR 107 (109) million. According to a full-year estimate, Varma will use 75 (75) per cent of the expense loading included in the insurance contributions for operating expenses. For 2017, the expense loading was cut by roughly 6 per cent from the 2016 level. The loading profit for the period was EUR 25 (26) million.

Varma's parent company employed an average of 524 people in the period under review (540 in 2016). At the end of September, the employees were distributed as follows: pension, insurance and customer service departments 57 per cent (56% at the end of 2016), investment operations 13 (13) per cent and other functions 30 (31) per cent.

Corporate Governance

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 financial reporting that conforms to best practices.

Responsibility

Varma's goal is to reduce the carbon footprint of the real estate owned by Varma by 15 per cent between 2015 and 2020. In August, Varma announced that it will build solar power plants in its properties starting in the autumn. In the first phase, a total of 5,000 solar panels will be installed on the roofs of seven properties, including shopping centres in Tornio, Hyvinkää and Kotka, and at Varma's head office in Helsinki.

In September, Varma joined the Climate Leadership Council (CLC), an organisation formed by Finnish companies and the Finnish Innovation Fund Sitra that challenges businesses and society to mitigate climate change. One of Varma's key responsibility targets is to mitigate climate change, and we aim to develop our investment portfolio to conform with the targets of the Paris climate agreement.

In September, Varma appointed a Director of Responsible Investment, who will report directly to the Chief Investment Officer. The new position will support the development of responsible investment in different asset classes.

In the last quarter of the year, key measures under Varma's CSR programme include charting the supply chain, drawing up criteria for responsible procurements and promoting equality.

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 foreign currency business. In calculating solvency, investment risks are taken into account according to the actual nature of the risk. The diversification of the investment portfolio is based on allocation that takes into account the return correlations of asset classes.

Outlook

The economic operating environment remains favourable, and we expect the global economy to grow steadily. Recovery continues also in Europe. Political risks will continue to cause economic uncertainty. The turn in monetary policy is a major economic shift that is challenging to manage, especially as market valuations have been rising for a long time.

Finland's economic recovery continues. The growth rate is expected to slow down somewhat over the next two years in comparison to the current year. Provided that the current salary negotiations result in a cost level which further supports the improvement of price competitiveness, it can be expected that Finnish companies will benefit from the global economic growth and that export volumes will increase. This will also help improve the employment rate in the long term. The shift in business structures and the demand and supply discrepancy in the labour market underline the need to continue structural reforms and efforts to ensure good conditions for economic growth also in the future.

Along with the positive economic development, Varma also expects its insured payroll to increase from the previous year. This trend is supported by Varma's success in the transfer rounds in earlier years. Varma continues to effectively implement pension provision.

Helsinki, 26 October 2017

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 878,000 people in the private sector. Premiums written totalled EUR 4.7 billion in 2016 and pension payments stood at EUR 5.3 billion. Varma's investment portfolio amounted to EUR 45.4 billion at the end of September 2017.

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ATTACHMENT: Graphs and charts

www.varma.fi/en

www.varma.fi/annualreport

Balance sheet at fair values, Parent Company

€ million	9/2017	9/2016	12/2016
Assets			
Investments	45,429	42,440	42,852
Receivables	436	399	604
Furniture and fixtures	5	5	4
	45,870	42,844	43,460
Liabilities			
Capital and reserves	123	117	118
Valuation differences	8,860	8,864	9,625
Equalisation provision	0	1,020	1,034
Provision for future bonuses	2,463	100	-578
Off-balance-sheet items	-1		
Solvency capital, total	11,444	10,101	10,199
Provision for current bonuses (for client bonuses)	30	29	122
Equity-linked provision for current and future bonuses	722	1,437	324
Actual technical provision	33,344	31,093	32,599
Total	34,067	32,530	32,923
Other liabilities	328	184	215
	45,870	42,844	43,460

Income statement at fair values, Parent company

€ million	1-9/2017	1-9/2016	1-12/2016
Premiums written	3,666	3,484	4,675
Claims paid	-3,955	-3,740	-5,005
Change in technical provisions	-1,037	-688	-1,063
Net investment income	2,701	1,296	1,982
Total operating expenses	-107	-109	-138
Other income/expenses	0	0	14
Taxes	-7	-8	-8
Total result ¹⁾	1,262	234	457

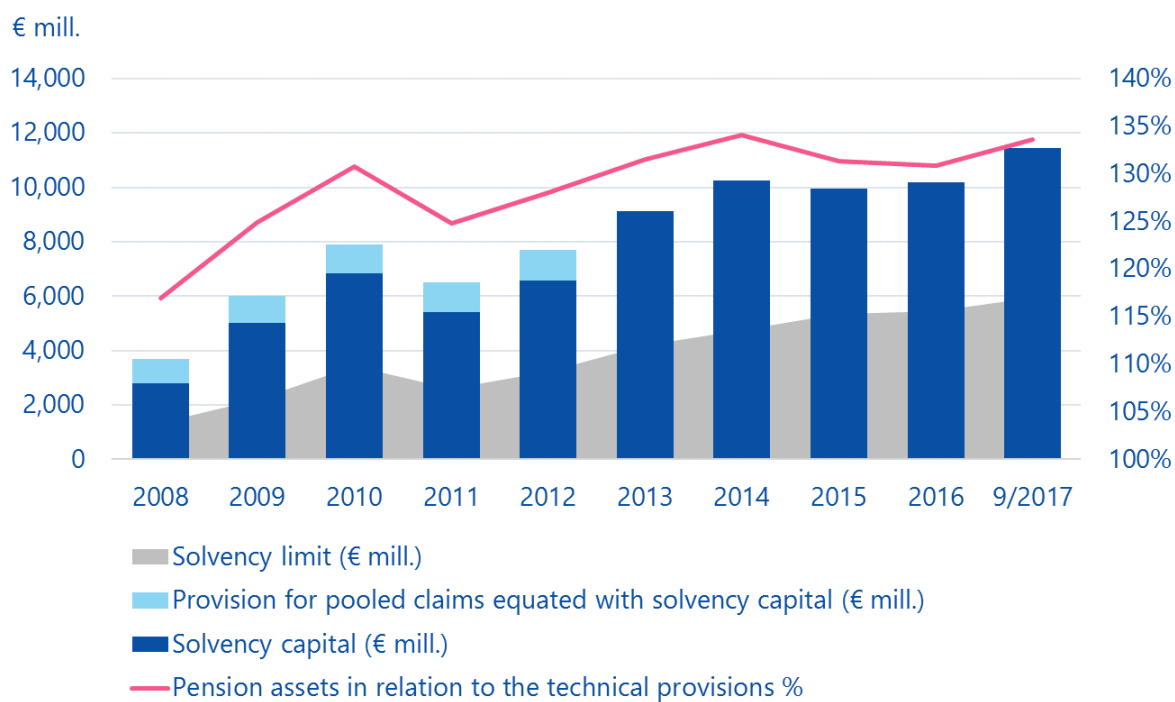
¹⁾ Result at fair value before the change in provision for current and future bonuses and equalisation provision

€ million	1-9/2017	1-9/2016	1-12/2016
Underwriting profit/loss	14	-57	-38
Investment result	1,223	266	441
Loading profit	25	26	39
Other income/expenses	0	0	14
Total result	1,262	234	457

Solvency capital and limits

	30/09/2017	30/09/2016	31/12/2016
Solvency limit (€ mill.)	5,955	4,533	5,455
Maximum amount of solvency capital (€ mill.)	17,866	18,131	21,819
Solvency capital (€ mill.)	11,444	10,101	10,199
Solvency ratio %	133.6	131.0	130.9
Solvency capital/Solvency limit	1.9	2.2	1.9

Solvency development



Investments at fair value

	30-September-2017				30-September-2016				31-December-2016				1-9/2017	1-9/2016	1-12/2016	24 m
	Market value		Risk position		Market value		Risk position		Market value		Risk position		Return	Return	Return	Volatility
	Market Value				Market Value				Market Value				MWR	MWR	MWR	
	€ mill.	%	€ mill.	%	€ mill.	%	€ mill.	%	€ mill.	%	€ mill.	%	%	%	%	
Fixed-income investments¹	15,836	35	2,056	5	15,139	36	394	1	13,695	32	18,066	42	3.6	4.2	4.2	
Loan receivables	1,478	3	1,478	3	1,416	3	1,416	3	1,432	3	1,432	3	1.7	3.2	4.2	
Bonds	9,672	21	9,219	20	11,944	28	11,304	27	11,435	27	12,780	30	5.1	5.7	5.3	3.1
Public bonds	3,900	9	3,448	8	5,037	12	3,767	9	4,092	10	5,374	13	4.2	4.1	1.8	
Other bonds	5,772	13	5,772	13	6,908	16	7,537	18	7,343	17	7,406	17	5.5	6.8	7.8	
Other money-market instruments and deposits	4,687	10	-8,641	-19	1,779	4	-12,325	-29	828	2	3,854	9	-1.6	-0.5	-0.4	
Equity investments	18,298	40	18,374	40	16,851	40	15,603	37	18,333	43	18,527	43	9.6	3.2	6.4	
Listed equities	14,304	31	14,380	32	13,348	31	12,099	29	14,599	34	14,793	35	10.8	1.5	4.5	10.2
Private equity	2,836	6	2,836	6	2,654	6	2,654	6	2,794	7	2,794	7	4.1	8.1	11.2	
Unlisted equities	1,157	3	1,157	3	850	2	850	2	940	2	940	2	8.1	15.4	23.7	
Real estate investments	3,556	8	3,556	8	3,708	9	3,708	9	3,643	9	3,643	9	3.1	-0.4	-0.9	
Direct real estates	2,741	6	2,741	6	3,033	7	3,033	7	2,897	7	2,897	7	2.3	-1.5	-2.6	
Real estate funds	815	2	815	2	675	2	675	2	746	2	746	2	5.9	4.8	6.8	
Other investments	7,739	17	8,683	19	6,741	16	7,054	17	7,182	17	7,320	17	5.7	2.5	5.3	
Hedge funds	7,771	17	7,771	17	6,773	16	6,773	16	7,184	17	7,184	17	5.3	2.7	5.6	2.8
Commodities	1	0	90	0	-19	0	293	1	-1	0	137	0				
Other investments	-33	0	822	2	-12	0	-12	0	-2	0	-2	0				
Total investments	45,429	100	32,669	72	42,440	100	26,759	63	42,852	100	47,555	111	6.2	3.1	4.7	4.1
Impact of derivatives			12,760	28			15,681	37			-4,703	-11				
Investment allocation at fair value	45,429	100	45,429	100	42,440	100	42,440	100	42,852	100	42,852	100				

The modified duration for all the bonds is 3.0.

The open currency position is 18.6% of the market value of the investments.

¹ Includes accrued interest

Total result

