

Varma's Interim Report 1 January – 30 September 2019

The comparison figures in parentheses are from 30 September 2018, unless otherwise indicated.

- Total result was EUR 1,656 (108) million.
- Nine-month return on investments was 8.8% (3.5%), and the market value of investments was EUR 47.4 (46.9) billion.
- Solvency capital was strong, at EUR 11,274 (11,642) million, i.e. 1.7 (1.9) times the solvency limit.

Economic operating environment

The general economic outlook weakened, but global growth nevertheless continued in the third quarter of the year. Geopolitical conflicts escalated in the Middle East. The US–China trade war and political uncertainty discouraged investments and weakened growth prospects. The central banks in the US and Europe responded to the growing risks in the operating environment with new stimulus measures.

The US economy has enjoyed a long period of economic growth. The uncertainty brought by the trade war and import duties, however, are beginning to cause a strain on export companies and industry. Despite the deceleration, the US economy is still on a relatively stable footing, but China's economic growth has slowed. The preliminary understanding reached in the US–China trade negotiations in October would – if it leads to an actual agreement – raise confidence in the stability of the economic operating environment.

A change of course in monetary policy in the US, while the economy continues to grow at a reasonable pace, has sparked debate on the need for stimulus measures. The US central bank, a.k.a. the Fed, has been rather cautious in its messages on the future direction of its monetary policy. The European Central Bank announced alongside its interest rate decisions that it will relaunch its bond purchase programme. The interest rate level in the eurozone is expected to support growth well into the future. Europe did not manage to reach a more normal path of monetary policy, and if a new crisis strikes, there will be less leeway than before.

In Europe, the industrial sector in particular has been put to the test, as expectations of global economic growth have diminished. The eurozone's largest economy, i.e. Germany, and its industry, have suffered badly from the trade policy conflicts. The intense Brexit negotiations have continued. The formation of a new commission for the European Union is ongoing. This has influenced expectations related to the EU's financial policy.

Finland's economic cycle has peaked, and growth is expected to fall short of last year's rate. In summer, growth in total output was still reasonable. Employment has continued to rise, but the improvement will wane. Domestic demand is expected to remain stable, if not modest, and its importance in terms of economic growth will be highlighted as exports diminish.

Earnings-related pension system

The low birth rate appears to be a long-term trend, which complicates the long-term financing of both earnings-related pensions and public services and income transfers. From the perspective of earnings-related pensions, a

low birth rate, increasing work disability, and slower economic growth, along with the possible subsequent lower return expectations on the capital markets, are a challenging combination.

In line with its Government Programme, the current government made increases to the smallest pensions paid under the national pension scheme. Preparatory work to merge Finland's pension systems has been initiated in accordance with the Government Programme. The objective is for the pensions of municipal employees to be insured in future under TyEL, the private-sector pension system, and to create a new earnings-related pension insurance company from part of the insurance portfolio of the current public sector pension provider Keva.

Varma's financial trends

The total result at fair value for the nine-month period amounted to EUR 1,656 (108) million. The most important component of the total result is the investment result, which was EUR 1,600 (83) million. The return on investments at fair value was EUR 3,853 (1,592) million. The interest credited on the technical provisions was EUR 2,253 (1,509) million. The estimated technical underwriting result was EUR 20 (-9) million and the loading profit was EUR 36 (34) million.

Varma's solvency strengthened further. At the end of September, the solvency capital, which serves as a risk buffer for investment and insurance operations, was EUR 11,274 million (9,619 mill. on 1 Jan), and 130.6% (127.5% on 1 Jan) in relation to the technical provisions.

Varma's solvency capital was on a sustainable level, i.e. 1.7 (1.6 on 1 Jan) times the solvency limit.

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

Insurance business

Varma's pension recipients numbered 343,000 at the end of September (343,000 on 1 Jan). Claims paid in January–September totalled EUR 4,271 (4,135) million. By the end of September, 16,744 new pension decisions were made, which is 1.3% less than in the corresponding period last year. A total of 38,831 pension decisions were made in January–September. The increase in disability pension applications that began in 2018 has continued. In January–September, 9,575 disability pension decisions were made, up 2% from corresponding period in 2018.

According to TyEL application data, EUR 41 million in additional premiums written were transferred to Varma from other earnings-related pension companies during the reporting period. The account transfer result was especially good in small businesses.

At the end of September, Varma was providing insurance to 557,000 (560,000 on 1 Jan) employees and self-employed persons.

Investments

Varma's investment returns in January–September 2019 were strong, as the markets recovered from the dip of late last year. The downward correction in the investment markets in August was short-lived, and the third-quarter return development remained strong. The return on investments stood at 8.8% (3.5%), and at the end of September the value of investments totalled EUR 47,361 (44,015 on 1 Jan) million. The good return trend further supported Varma's solvency ratio, which strengthened to 130.6% in the third quarter of the year (127.5% on 1 Jan).

In spite of the weakened economic development, the current year has been very strong on the investment markets. In the first nine months of the year, the equity markets recovered from the sharp correction of late last

year. Expectations of expansionary monetary policy and the gradual cooling off of the trade war contributed to an improvement in risk appetites. Fixed income market returns over the current year have also been excellent, thanks to plummeting interest rates and narrowing risk premiums. Germany's ten-year interest rate fell well into negative territory and its lowest level ever in the third quarter. These exceptionally strong interest rate movements also affect other asset classes, and hike the price of gold and defensive equities, among others. The conflict between the development of the equity markets and real economy kept institutional investors relatively cautious in their equity allocations, however. In Varma's investment allocation, the weight of listed equities was raised in the third quarter of the year.

The return on Varma's investments in January–September was strong. The best returns were generated by listed equities and, boosted by the strengthened dollar, the euro-denominated return on US equities was exceptionally high. Fixed income investments also performed favourably, despite clearly falling short of the return on equity investments. The returns on non-liquid equity investments were strong, albeit more modest than those of listed equities. The returns on hedge funds and real estate investments were stable, but more moderate than fixed income investments. The US dollar has strengthened against most currencies during the year. At the end of September, the average nominal investment return over five years was 4.8%, and over ten years 5.8%. The corresponding real returns were 4.1% and 4.5%.

The return on fixed income investments in January–September was 4.2% (-1.2%). The good return is explained by the lower risk premiums in the corporate bond and emerging markets, and the significant decline in interest rates. The latter was driven by the deceleration in global economic growth and the considerable mitigation of inflation expectations. In the eurozone, risk premiums were also weighed down by the relaunching of bond purchase programmes. Money market interest rates fell globally, as both the US and European central banks lowered their key interest rates. As liquidity became more constrained on the US financial markets, short-term interest rates rose temporarily, and the Fed took action with market interventions and purchases of short-term government bonds to support the markets' liquidity. In January–September, the return on the loan portfolio was 2.9% (2.7%), on public sector bonds 3.2% (-4.5%), on other corporate bonds 5.8% (-0.1%), and on other money-market instruments 0.8% (0.1%).

The rise of the global equity markets continued in the third quarter, in spite of the downward trend of financial and result forecasts. Behind the optimism was the markets' expectations of lighter monetary policy and the slight detente in the US–China trade negotiations. The equity markets rose on a broad front, but euro-denominated returns were exceptionally strong in US equities. The return on Finnish equities was also high, although more moderate than global equities. Listed equities yielded a return of 18.0% (5.5%). Private equity investments yielded 11.9% (12.2%), while unlisted equity investments yielded 1.7% (7.1%).

The return on real estate investments was 2.6% (4.0%). Direct real-estate investments yielded a return of 2.8% (3.2%) and real-estate investment funds 2.0% (6.6%). A transaction was announced in August in which Varma acquired the 18,500 m² OOPS office campus, which is currently under construction in the Leppävaara district of Espoo, from NCC Property Development. After the review period, in the beginning of October, Varma announced that it was selling SOK's 41,000 m² head office property in Vallila for EUR 130 million.

The return on other investments was 3.3% (3.4%). Hedge funds did not perform as well as fixed income investments, yielding a return of 3.6% (4.9%). The risk profile of Varma's funds is more moderate than typical hedge funds which have equity-based strategies.

Varma has US-dollar-denominated investments in hedge funds, equities, corporate bonds and private equity funds. In accordance with Varma's investment policy, part of the currency risk is hedged. During the year, the appreciation of the US dollar supported equity returns. 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 1,652 (1,357) million.

Operating expenses and personnel

Varma's total operating expenses in the reporting period were EUR 102 (101) million. According to a full-year estimate, Varma will use 66% (68%) of the expense loading included in the insurance contributions for operating expenses. The loading profit for the period was EUR 36 (34) million. The total loading profit will be used for client bonuses.

Varma's parent company employed an average of 540 people in the reporting period (532 in 2018). At the end of September, Varma's personnel were distributed as follows: pension services 28%, insurance services 15%, customer service departments 13%, investment operations 13%, and other functions 31%.

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 public financial reporting that conforms to best practices.

Sustainability

In an international assessment, the UN-supported Principles for Responsible Investment (PRI) included Varma in the PRI Leaders' Group for its responsible investment work. The PRI identified investors with excellent responsible investment practices when selecting external asset managers and monitoring their operations.

A sustainable exchange-traded fund (ETF) developed by Varma was listed on the London Stock Exchange. The ETF tracks the performance of European equities, taking sustainability criteria broadly into account.

Varma took part in the Global Real Estate Sustainability Benchmark (GRESB) assessment of real estate sustainability performance for the first time. With 68 points, the company scored two out of five stars. GRESB assesses the sustainability of Varma's directly owned real estate portfolio.

As part of the Responsible Summer Job campaign, summer employees assessed their workplaces, and Varma was ranked second in the large corporations category.

Risk management

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

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

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

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

Outlook

The escalation and expansion of the US–China trade war has been the biggest risk to the global economy's favourable development. The parties have continued to negotiate. If they arrive at solutions to break the cycle and undo the tariffs that have been set, uncertainty in the economic operating environment will decrease.

The central banks' change of course and a possible easing of the trade war support the development of valuations in the markets. From the perspective of pension asset investing, however, strong market corrections cannot be ruled out. Varma's strong solvency also brings leeway in a turbulent operating environment. The low interest rate level and stagnant zero interest rate environment make for a challenging operating environment for pension systems.

Finland's economic growth will slow if the global economy and the most important export markets continue to develop along their predicted paths. The importance of domestic demand and, in particular, public demand will be highlighted if export demand diminishes. Financial policy is limited by the cautious approach to taking on debt that is required to manage the sustainability gap, also in the short term. Payroll growth, on the other hand, is limited by the fact that maintaining the price competitiveness of work is essential for the success of the open sector.

Improving employment requires investments in competence development, occupational health and improving the employment opportunities of people with partial work ability. The importance of work-ability management and its effectiveness is highlighted as the population ages and economic structures shift. Longer careers and ensuring work ability benefit not only the sustainability of pension financing, but also our customers – the insured and corporate customers alike.

Helsinki, 1 November 2019

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 900,000 people in the private sector. Premiums written totalled EUR 5.1 billion in 2018 and pension payments stood at EUR 5.7 billion. Varma's investment portfolio amounted to EUR 47.4 billion at the end of September 2019.

FURTHER INFORMATION:

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ATTACHMENT: Graphs and charts

www.varma.fi/en

www.varma.fi/annualreport

Balance sheet at fair values (Parent Company)

€ million	9/2019	9/2018	12/2018
Assets			
Investments	47,361	46,936	44,015
Receivables	897	494	858
Furniture and fixtures	4	4	4
	48,262	47,434	44,878
Liabilities			
Capital and reserves	134	128	130
Valuation differences	10,131	9,710	8,004
Provision for future bonuses	1,010	1,805	1,486
Off-balance-sheet items	-1	-1	-1
Solvency capital, total	11,274	11,642	9,619
Provision for current bonuses (for client bonuses)	38	40	154
Equity-linked provision for current and future bonuses	934	1,165	-255
Actual technical provision	35,925	34,328	35,137
Total	36,859	35,494	34,882
Other liabilities	91	258	224
	48,262	47,434	44,878

Income statement at fair values (Parent Company)

€ million	1-9/2019	1-9/2018	1-12/2018
Premiums written	4,019	3,835	5,118
Claims paid	-4,271	-4,135	-5,404
Change in technical provisions	-1,862	-1,102	-446
Net investment income	3,878	1,618	-872
Total operating expenses	-102	-101	-125
Other income/expenses	0	0	-4
Taxes	-6	-7	-8
Total result ¹⁾	1,656	108	-1,741

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

€ million	1-9/2019	1-9/2018	1-12/2018
Underwriting profit/loss	20	-9	23
Investment result	1,600	83	-1,816
Loading profit	36	34	56
Other income/expenses	0	0	-4
Total result	1,656	108	-1,741

Solvency capital and limits

	30/09/2019	30/09/2018	31/12/2018
Solvency limit (€ mill.)	6,588	6,238	5,973
Maximum amount of solvency capital (€ mill.)	19,763	18,715	17,918
Solvency capital (€ mill.)	11,274	11,642	9,619
Solvency ratio (%) ¹	130.6	132.8	127.5
Solvency capital/Solvency limit ²	1.7	1.9	1.6

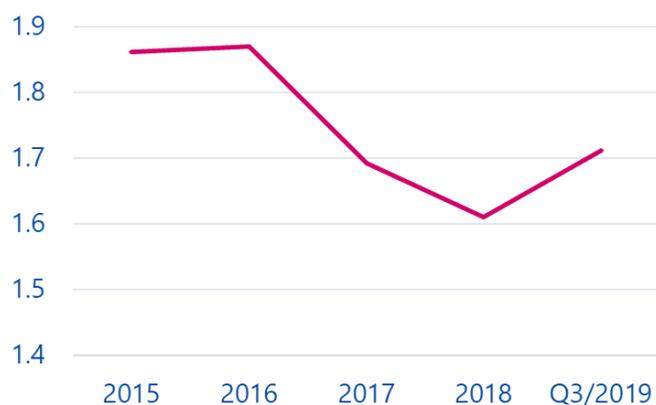
¹ Pension assets in relation to the technical provisions under §11 of the Ministry of Social Affairs and Health's decree governing pension institutions (614/2008).

² Solvency capital in relation to the solvency limit

Solvency development



Solvency capital in relation to the solvency limit



Investments at fair value

	30 Sep 2019				30 Sep 2018				31 Dec 2018				1-9/2019	1-9/2018	1-12/2018	24 m
	Market value		Risk position		Market value		Risk position		Market value		Risk position		Return	Return	Return	Vola-
	€ mill.	%	MWR	MWR	MWR	tility										
Fixed-income investments ¹	12,708	27	12,202	26	14,262	30	10,881	23	13,522	31	10,568	24	4.2	-1.2	-1.8	
Loan receivables	2,051	4	2,051	4	1,737	4	1,737	4	1,817	4	1,817	4	2.9	2.7	3.7	
Bonds	9,701	20	10,687	23	10,882	23	9,757	21	10,625	24	9,031	21	4.8	-1.9	-2.9	2.0
Public bonds	3,541	7	4,526	10	4,236	9	3,471	7	4,104	9	2,142	5	3.2	-4.5	-4.2	
Other bonds	6,160	13	6,160	13	6,646	14	6,285	13	6,520	15	6,889	16	5.8	-0.1	-2.0	
Other money-market instruments and deposits	956	2	-535	-1	1,643	4	-613	-1	1,080	2	-280	-1	0.8	0.1	-0.1	
Equity investments	21,596	46	21,271	45	19,917	42	19,695	42	17,916	41	18,222	41	16.3	6.6	-3.6	
Listed equities	16,409	35	16,085	34	15,715	33	15,493	33	13,407	30	13,713	31	18.0	5.5	-8.3	12.4
Private equity	4,935	10	4,935	10	3,676	8	3,676	8	4,255	10	4,255	10	11.9	12.2	17.5	
Unlisted equities	251	1	251	1	527	1	527	1	254	1	254	1	1.7	7.1	3.8	
Real estate investments	4,100	9	4,100	9	3,854	8	3,854	8	3,879	9	3,879	9	2.6	4.0	5.5	
Direct real estates	3,011	6	3,011	6	2,851	6	2,851	6	2,895	7	2,895	7	2.8	3.2	3.9	
Real estate funds	1,089	2	1,089	2	1,002	2	1,002	2	984	2	984	2	2.0	6.6	10.6	
Other investments	8,958	19	9,911	21	8,903	19	10,236	22	8,699	20	10,037	23	3.3	3.4	-1.4	
Hedge funds	8,970	19	8,970	19	8,916	19	8,916	19	8,703	20	8,703	20	3.6	4.9	1.6	2.3
Commodities	-14	0	-1	0	15	0	46	0	-8	0	25	0				
Other investments	2	0	942	2	-28	0	1,274	3	3	0	1,308	3				
Total investments	47,361	100	47,483	100	46,936	100	44,665	95	44,015	100	42,705	97	8.8	3.5	-2.0	4.5
Impact of derivatives			-123	0			2,271	5			1,310	3				
Investment allocation at fair value	47,361	100	47,361	100	46,936	100	46,936	100	44,015	100	44,015	100				

The modified duration for all the bonds is 4.2.

The open currency position is 29.4% of the market value of the investments.

¹ Includes accrued interest

Total result

