

## Report of the Board of Directors 2017

### The economic operating environment

The Finnish economy grew faster than expected in the financial year 2017. The broad-based recovery of the economy was finally also reflected in the labour markets, supporting the financing of earnings-related pensions. The favourable development in the capital markets boosted Varma to a strong result. The reformed earnings-related pension legislation, which took effect at the start of 2017, targets a stronger pension system by extending careers.

Robust global economic growth and a pick-up in global trade bolstered the rise in the Finnish and European economy and the recovery of export volumes. The US economy has been growing for a long time now, and employment rates have continued to improve. During the year, the US central bank took several steps to normalise its monetary policy and announced that it will continue its measures in 2018.

Capital market asset values kept rising, and geopolitical risks, which were intensely highlighted from time to time, hardly showed as increased market uncertainty. The rise in share prices is backed by companies' good results and the continued very favourable outlook. The tightening monetary policy in the US has also not resulted in strong market reactions, which is a sign of a normalised situation. Nevertheless, inflationary pressures remain low.

The European economy has been strengthening better than expected. Investments have somewhat picked up, employment rates have improved and the balancing of public finance deficits, which soared during the economic crises, has progressed. A strong global economy, structural measures and the sustained accommodative monetary policy have put Europe back on its feet and the economy on a steady growth track. Improved confidence and the bright outlook in both the business and household sectors signal a further strengthening of the foundation for growth.

#### *In Finland, the economic turn finally shows in employment rates*

The Finnish economy grew faster than expected in 2017. The strong global economic and trade cycle boosted the relatively brisk recovery. The solid growth was especially the result of a rapid pick-up in export demand. Export volumes rose in both services and goods.

Broad-based recovery in overall demand was a major contributor to the growth. The labour market gained momentum as the broad economic growth began to clearly show as higher demand for labour. The unemployment rate is down, and there's a healthy supply of job vacancies. The employment rate is expected to close in on 71% during 2018. The productivity of work is now on the rise. The sustained economic growth creates good conditions for the favourable development of the labour markets to continue, but the labour market still faces structural issues, especially in terms of supply meeting demand.

Despite stronger economic growth, public spending in Finland still exceeds revenues. The recovery of economic growth and adjustment measures have strengthened public finances, and this trend is expected to continue in the coming years as the economic growth boosts tax revenues. According to the Ministry of Finance, the debt ratio is expected to take a downturn and fall below 60% by 2019. The debt ratio is, however, expected to take an upward turn again in the 2020s due to a strong rise in age-related public spending.

### **Earnings-related pension system**

The earnings-related pension legislation was reformed at the beginning of 2017. The objective of the reform is an economically and socially sustainable earnings-related pension system. It introduced major changes in the contents of the earnings-related pension cover of the insured while keeping the basic principles of the private sector earnings-related pension system unchanged.

The age limits for old-age pension were increased, with the lower limit rising gradually to 65 years. Later on, the age limits will be tied to changes in life expectancy. Part-time pensions were no longer granted as of the beginning of the financial year as that pension benefit was replaced by partial early old-age pension. The years-of-service pension is a new pension benefit intended for people whose capacity for work is lowered and who have had a long career in a strenuous job. As regards old-age pension, the regulations concerning financial incentives for continuing to work longer were changed.

Varma prepared for the pension legislation reform together with its clients well in advance, and the application of the new legislation has been smooth.

The aging population puts pressure on the earnings-related pension system and public finances as a whole. Longer careers support the pension system. At the same time, Finland's business and trade structures are in a state of transformation, and technology is reshaping the way we work. Varma has been vigorously developing its workability management services together with its clients in order to promote longer careers. The goal is to improve the effectiveness of the services especially by taking into account strategic and operative changes in clients' business and the challenges they pose to personnel.

New laws concerning the calculation of the solvency limit took effect on 1 January 2017. The calculation is now more based on risk factors, and the separate regulations on technical provisions were abolished. In terms key performance indicators, the new solvency limit is not directly comparable with the previous limit.

Finland ranked fifth in an international pension scheme comparison in 2017, slipping down a notch from fourth place in the previous year. The Melbourne Mercer Global Pension Index compares retirement income systems around the world based on the adequacy of the pension cover, sustainability of funding and integrity of governance. Finland's pension system was again ranked number one in terms of integrity in the comparison.

### **Pension contributions and return requirement on technical provisions**

In 2017, the average TyEL contribution was 24.4% of the salaries or wages. Employees below the age of 53 and over the age of 62 contributed 6.15% of their pay, while the rate for employees aged 53–62 was 7.65%. Entrepreneurs' YEL contribution was 24.1% of the confirmed earnings for those below the age of 53 and over the age of 62, and 25.6% for those aged 53–62. In 2016, the employee contribution was divided into two groups based on age. The age limit was at 53. Correspondingly, the YEL contribution was also divided into two age-based groups in 2016.

The return requirement on technical provisions consisted of a 3.00% fund rate, a pension liability supplementary factor and the return on equity component. The value of the supplementary factor was 1.36% on average in 2017. The return on equity component in 2017 was 9.59%. The technical rate of interest, which is used to determine the interest rate of the oldest pension loans to Varma's customers and a number of other items, was 4.75% between 1 January and 30 June 2017 and 5.25% between 1 July and 31 December 2017. The insurance contribution interest rate, used to calculate pension contributions, stood at 2.00% throughout the year.

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

Varma's total result at fair value stood at EUR 1,524 (457) 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 strengthened during 2017 by EUR 1,335 million, and at the end of the year, solvency capital amounted to EUR 11,534 (10,199) million. Varma's pension assets in relation to technical provisions (solvency ratio) was 133.5% (130.9%). Solvency capital was at a strong level: at 1.7 (1.5 from 1 January 2017) 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 3,343 (1,953) million, which represents 7.8% (4.7%) of the invested capital. The interest credited on the technical provisions was EUR 1,890 (1,511) million. Thus, the investment result for 2017 totalled EUR 1,453 (441) million. Operating expenses were 33% (28%) lower than the expense loading included in insurance contributions, and the loading profit stood at EUR 45 (39) million. The underwriting result was EUR 34 (–38) million.

At the end of 2017, EUR 161 (121) million was transferred to the provision for current bonuses reserved for client bonuses. The transfer represents roughly 0.8% (0.6%) of the estimated payroll of the insured.

The composition of client bonuses was changed as of the beginning of the financial year, and client bonuses to be paid to Varma's customers for 2017 include the full loading profit. In addition to this, one percent of the solvency capital is distributed as a part of the client bonuses. Thus, Varma's strong solvency and operational efficiency benefit its clients in full.

The TyEL payroll of those insured by Varma totalled roughly EUR 19.4 (18.8) billion in 2017. The payroll is estimated to have grown by 2.75%. Varma's premiums written totalled EUR 4,867 (4,675) million, of which TyEL insurance accounted for EUR 4,683 (4,488) million and YEL insurance for EUR 184 (187) million.

At the end of the year, 537,241 (529,892) individuals were insured by Varma. At year-end, the number of valid insurance policies totalled 61,493 (62,116), covering 35,918 (35,998) self-employed persons and 501,323 (493,894) employees.

During the year, a total of 2,780 (2,616) new TyEL insurance policies and 5,862 (3,157) YEL insurance policies came into force at Varma. Once again, Varma did extremely well in the TyEL portfolio transfers. According to the TyEL client transfer statistics of the Finnish Pension Alliance TELA, Varma's net result was the best in the sector, at EUR 48 (43) million. This success in client acquisitions will promote a positive trend in premium income.

Earnings and employment notifications received during the year totalled 2,113,398 (1,905,672), of which 96% (96)% 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 2017, a total gross amount of EUR 5,544 (5,345) million in pensions was paid out. The number of pension recipients increased, and at year-end, Varma was paying pensions to 342,600 (340,100) people.

A total of 24,507 (22,550) new pension decisions were made during the year. The number of new pension decisions increased 8.7% and the total number of all pension decisions was 7.0% higher than in 2016. Old-age pension decisions numbered 12,801 (12,585), disability pension decisions 5,116 (5,583) and partial early old-age pension decisions 2,705. In 2016, part-time pension decisions numbered 1,076 – this pension benefit was terminated in conjunction with the pension reform at the beginning of 2017. Continuation decisions on temporary pensions totalled 4,390 (4,433), and other decisions numbered 11,870 (11,112). Other decisions include decisions and preliminary decisions required as a consequence of the changes in pension rights. The share of rejected new disability pension applications was 33.4% (31.7%). The number of pension applications made online continued to rise and accounted for 54% (47%) of all new pension applications.

Varma's total processing time for pension applications in 2017 was 37 days, which was 6 days shorter than the average processing time in the earnings-related pension sector.

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 about 75% of those who received Varma's rehabilitation returned to the job market either in full or partly. Varma has for years been a forerunner in vocational rehabilitation, and the company actively steers those with a workability risk to rehabilitation. A larger share of Varma's customers use rehabilitation to return to working life than retire on disability pension. Throughout 2017 Varma assisted its client companies in managing personnel risks through client-oriented co-ordination of workability management, 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. Varma has been publishing its new well-being at work contracts since April 2017.

	31 Dec 2017	31 Dec 2016	Change
Number of insured			
TyEL <sup>1</sup>	501,323	493,894	7,429
YEL	35,918	35,998	-80
Total	537,241	529,892	7,349
<sup>1</sup> of which covered by registered TEL supplementary pension insurance	0	3,427	-3,427
Number of insurance policies			
TyEL	25,575	26,118	-543
Number of pensioners			
Part-time pension	937	1,615	-678
Partial early old-age pension	2,430		2,430
Survivors' pension	50,713	50,702	11
Disability pension	24,039	26,530	-2,491
Old-age pension	251,023	247,230	3,793
Early old-age pension	13,439	14,018	-579
Total <sup>2</sup>	342,581	340,095	2,486
<sup>2</sup> Those receiving YEL pension	29,655	29,469	186
Those receiving TEL/YEL supplementary pension	43,715	43,913	-198

In terms of customer service, Varma's eServices are a major service channel. During the year under review, 72% of all private-customer contacts took place online. Through Varma's online services, the insured can obtain the most recent estimate of their pension at various retirement ages; 95% of these estimates were carried out online. You can also apply for pension and follow the progress of the application online. 58% of old-age pension applications were submitted online. A total of 14,000 applications were submitted electronically during the year.

Varma sends a pension record to the insured once every three years. A total of 230,000 (223,000) such pension records were sent out in 2017. 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 9.5% (5.1%) to EUR 36,696 (33,501) million. They contain a provision of EUR 161 (121) million for current bonuses reserved for client bonuses, a provision of EUR 2,265 (-578) million for future

bonuses contained in the solvency capital, and EUR 769 (324) million in an equity-linked provision for current and future bonuses.

At the beginning of 2017, the equalisation provision, totalling EUR 1,019 million, was incorporated in the provision for future bonuses, which will also serve as a buffer for the insurance business.

### **Changes in insurance portfolio**

At the end of the financial year, Varma transferred a part of its insurance portfolio to an existing pension fund. The transferred pension liabilities totalled EUR 133 million, of which solvency capital accounted for EUR 26 million.

### **Investments**

#### *Strong investment returns in an environment of faster economic growth*

In 2017, the return on Varma's investments was good, at 7.8%. The equity markets have experienced an upward trend worldwide as a result of global growth picking up. At the same time, central banks' monetary policies have remained highly accommodative due to subdued inflation. In 2017, market development was more tranquil than in the previous years. Broad diversification of investments also muted the risks caused by market movements, and returns were generated consistently by the different asset classes.

The value of Varma's investments grew to EUR 45.4 billion, and solvency capital increased to EUR 11.5 billion. The strong investment returns boosted Varma's solvency to a high level of 133.5% (130.9%).

Global economic recovery was broad-based in 2017. In the US, equity market performance was boosted by expectations of a promised tax reform, which was finally approved by the Senate and House of Representatives at the end of December. Despite the stronger economic growth, inflationary pressures have been conspicuous in their absence. Employment rates have been on the rise on both sides of the Atlantic, but the pressures to raise salaries and wages have remained very moderate. Geopolitical risks have surfaced from time to time, but have not had a material impact on the investment markets so far.

The recovery of economic growth in Europe has taken a back seat to several political events. In 2017, the investment markets were concerned about the impacts of elections in the Netherlands, France and Germany, and of the Brexit on the entire continent's economy and mutual trade. Further concerns were caused by the Catalonia independence referendum and Spain's measures to prevent it. In spite of all the political uncertainty, economic growth has gained broad momentum in the entire eurozone. Economic growth in Finland also picked up speed as a result of export recovery in early 2017 and brisk domestic demand. As political uncertainty surrounding the French presidential election subsided, the euro strengthened sharply against the US dollar, weighing on euro-denominated returns on listed equity towards the end of the year.

Central banks' monetary policies have remained highly expansionary, although a slow turn in monetary policy is taking place. The US central bank raised its benchmark rate three times in 2017 and started to reduce its balance sheet in October. Short-term interest rates have increased steadily, but the increase in long-term interest rates

has been suppressed by the weaker-than-expected inflation development. The European Central Bank has also announced that it will start to scale down its quantitative easing, but no interest rate hikes are expected to take place in 2018. Government bond interest rates in the eurozone continue to be remarkably low, and money market interest rates have remained clearly in the negative zone.

#### *Solid investment result through effective diversification*

The return on Varma's investments was 7.8% (4.7%).

The strongest returns were generated by equity investments, which benefitted from the general rise in the equity markets thanks to recovering economic growth. The return on equity investments was 11.4% (6.4%). Listed equities yielded a return of 11.6% (4.5%), private equities 7.9% (11.2%) and unlisted equities 18.5% (23.7%).

The return on fixed income investments has been excellent, at 3.7% (4.2%), in light of the low level of market interest rates. The narrowing credit margins on corporate bonds as the economy recovers have improved the return on fixed-income investments. The return on the loan portfolio was 2.2% (4.2%), on public-sector bonds 4.0% (1.8%), on other corporate bonds 6.2% (7.8%) and on other money-market instruments -1.9% (-0.4%).

The return on real estate investments was 4.9% (-0.9%). Direct real-estate investments yielded a return of 2.9% (-2.6%) and real-estate investment funds 12.0% (6.8%). During the year, the real estate portfolio was further developed through divestments and new investments in Finland and abroad. Rental and real estate development activities were also successful. During the year, the expansion of the Flamingo hotel was started, and the construction of Kalasatama Campus progressed as planned.

The return on other investments grew to 9.3% (5.3%). They mainly consist of hedge funds, factor investments and a small commodities position. The return on hedge funds increased to 8.5% (5.6%) as the market's risk premiums narrowed during the year. The return on Varma's hedge investments has been very good over a long period, and volatility has been very low.

Varma has US-dollar-denominated investments particularly in equities and hedge funds, and in corporate bonds. In accordance with its investment policy, Varma generally hedges its open exchange rate risks in all other asset classes except equity investments. The considerable weakening of the US dollar during the summer pushed down the result. The exchange result is included in the investment returns of the asset classes.

The average nominal investment return over five years was 6.5%, and over ten years 4.5%. The corresponding real returns were 5.8% and 3.0%.

Varma's investment activities focussed on maintaining the company's strong solvency and broad diversification of investments, with a strong emphasis on risk management.

At the end of 2017, the fair value of Varma's investments totalled EUR 45,409 (42,852) million and the return at fair value was EUR 3,343 (1,953) million or 7.8% (4.7%). The value and returns of the investments are grouped according to risk in this report. The Notes show the breakdown of investments and investment returns by asset class, grouped according to regulations and according to risk.

#### *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 1,218 (1,633) 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%.

#### *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. The share ownership policy was updated in early 2017, and the policy is available on Varma's website. In 2017, Varma actively participated in the Annual General Meetings of the domestic companies in which it owned shares and in the work of 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's operational efficiency is very good. Varma used 67% (72%) of the expense loading, included in the pension insurance contributions, to cover operating expenses. As of the beginning of 2017, the loading component was reduced by 7% in comparison to 2015. 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.

Increasing operational 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 decreased 6%, totalling EUR 129 (138) million.

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

	2017	2016	2015	2014	2013
Average number of personnel	524	540	549	552	565
Salaries and remunerations, EUR million	39.3	36.0	39.6	40.1	37.9

Tieto Esy, which is included in the Consolidated Financial Statements using the equity method, had an average of 50 employees in 2017.

At year-end, Varma's personnel were distributed as follows: pension services 29%, insurance services 16%, customer service departments 12%, investment operations 13%, and other functions 30%.

## Group companies and associates

At the end of 2017, the Varma Group comprised 139 (152) subsidiaries and 17 (22) associates. The most important subsidiaries and associates are Tieto Esy Ltd (50.1%) and NV Kiinteistösjointus Oy (45.0%). The Varma Group also owns 50% 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%, the insured about 20%, and the Sampo Group (the owner of the guarantee capital) about 2% of the votes.

Varma's Annual General Meeting was held on 15 March 2017. 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 2016. The new members elected to the Supervisory Board are Olavi Huhtala, Juha Häkkinen, Jari Latvanen, Risto Penttinen and Saana Siekkinen.

Kari Jordan (Chairman), Satu Wrede (Deputy Chairman), Juri Aaltonen, Petri Castrén, Erkki Etola, Stig Gustavson, Erkki Järvinen, Jukka Jäämaa, Niina Koivuniemi, Ville Kopra, Tapio Korpeinen, Timo Koskinen, Päivi Kärkkäinen, Päivi Leiwo, Olli Luukkainen, Ilkka Nokelainen, Lauri Peltola, Jari Suominen, Leena Vainiomäki, Jorma Vehviläinen, Christoph Vitzthum, Anssi Vuorio and Göran Åberg continued as Supervisory Board members. Erkki Järvinen resigned from the Supervisory Board on 23 October 2017.

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

In 2017, Varma's Board of Directors was composed of Jari Paasikivi (Chairman), Antti Palola (Deputy Chairman), Kai Telanne (Deputy Chairman), Riku Aalto, Mikael Aro (until 2 March 2017), Johanna Ikkäheimo, Rolf Jansson (as of 8 March 2017), Ari Kaperi, Casimir Lindholm, Jyri Luomakoski, Petri Niemisvirta, Ilkka Oksala and Pekka Piispanen, and deputy members Eila Annala, Eija Hietanen, and Liisa Leino.

At its meeting on 15 December 2017, Varma's Board of Directors elected Jari Paasikivi as Chairman, and Antti Palola and Kai Telanne as Deputy Chairmen of the Board, effective 1 January 2018.

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.

### **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.

### **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% 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.

Varma increased its currency exposure towards the end of the financial year, and this level has been maintained in 2018. The opening of the currency risk involves normal investment risks.

The pension reform that took effect at the beginning of 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, relates to the application of the new legislation, especially in terms of the new pension benefits, years-of-service pension and 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. Agreeing on the contribution level 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**

Since autumn 2015, Varma has been building a Corporate Social Responsibility (CSR) programme, including targets and measures. The programme defines the most essential impacts of Varma's CSR. Varma has assessed its CSR risks relating to operations and business relations and has put in place sufficient and appropriate processes, which ensure duty of care as regards these risks.

Varma's CSR targets and measures are explained in a separate report conforming to the GRI guidelines. The report is integrated in Varma's online annual report.

## **Report on non-financial information**

### *Business model description*

Varma has a responsible core task – to secure pensions. The greatest impacts in terms of matters relating to environmental and social responsibility and employees, respecting human rights, and fighting corruption and bribery are linked to Varma's investment operations. Taking care of personnel and responsibility for the environment bear the greatest importance in Varma's own operations.

The key policies guiding Varma's responsible business operations are the Corporate Social Responsibility Programme, Code of Conduct, Principles for Responsible Investment, Climate Policy for Investments, and Supplier Code of Conduct.

#### *Social responsibility and employee-related factors*

For Varma, social responsibility means high-quality implementation of pension provision and promoting our customers' workability.

In recent years, Varma has been improving its pension application processing to provide faster pension decisions to its customers. The average processing time shortened from 44 days in 2016 to 37 days in 2017. This is 6 days quicker than the average for the sector. The first pension payment was made to the pensioner within four days of the pension decision.

Varma's goal is to lengthen the careers of its client companies' employees and reduce disability pensions by developing workability management and offering effective rehabilitation. In 2017, the average disability pension contribution category of Varma's client companies was 3.7 (3.4). Varma's clients are happy with our workability management services, and the willingness to recommend is at a high level: the NPS score, which measures the likelihood of a customer recommending the company, was 52.7 (54.2). Of Varma's vocational rehabilitation customers, 75%, i.e. 1,335 people, returned to working life in 2017.

During the financial year, Varma rejected 33.4% (31.7%) of new disability pension applications. The rejection rate for all earnings-related pension companies was 33.7% (31.4%). The Pension Appeal Board changed Varma's disability pension decisions in 13.1% (13.3) of the cases it handled. The corresponding rate for the entire private earnings-related pension sector was 14.1% (13.1)

Varma takes care of the well-being at work, competence, and equal and non-discriminative treatment of its personnel. The achievement of goals in the different areas is monitored through an annual employee survey. The PeoplePower Index, which measures Varma employees' satisfaction and engagement, stood at 71.4 in 2017, which is a satisfactory – borderline good – level. The employee survey indicators were changed in 2017, so there are no comparable figures from the previous year.

The realisation and experience of equality and non-discrimination is measured through a separate survey, which is conducted once every two years to identify any areas needing improvement. In 2016–2017, Varma focused on developing the work culture, improving equality, and reforming the job requirements system.

#### *Environmental responsibility and mitigation of climate change*

Varma monitors the environmental impacts of its operations (Varma's office building and environmental impact of work performed in it), its supply chain and its investments.

The environmental impacts of Varma's own operations are controlled using WWF's Green Office system, which was certified in 2016. In order to reduce the carbon footprint of its own operations, Varma had a solar power system installed on the roof of its office building in Salmisaari, Helsinki, in September. The carbon footprint of the company's own operations was 17% lower compared to the 2015 base level. The introduction of green electricity was a major contributor to this.

The environmental aspects of the supply chain are taken into account in the Supplier Code of Conduct, in which our suppliers are encouraged to use a certified environmental system or a documented operating method for managing their environmental matters.

In 2016, Varma determined the carbon footprint of its investments and drew up an environmental policy, which sets targets for CO<sub>2</sub> reduction in direct investments by asset class and states that the portfolio will be developed such that it is in line with the 2-degree target agreed on at the Paris climate conference. The share ownership policy was updated in 2017. The policy states that Varma requires from the companies in which it has a holding transparent assessment and reporting practices on the impacts of climate change on their business operations, now and in future.

Varma has excluded direct equity investments in coal mines, as well as energy companies that rely on coal for more than 1/3 of their electricity production.

In 2017, the carbon footprint of Varma's listed equity investments in relation to net sales declined 27% from the baseline of 2015 and was 39% lower than Varma's benchmark index. The carbon footprint of Varma's listed corporate bond investments in relation to net sales was 22% lower than in 2015 and 57% lower than Varma's benchmark index. The CO<sub>2</sub> footprint of real estate investment was 18% lower per gross square metre than in 2015.

#### *Respecting human rights and fighting corruption and bribery*

In its Code of Conduct, Varma is committed to operating on market terms, combating the grey economy and bribery, and responsible investment principles. Varma is also committed to operating in accordance with the UN's principles concerning business and human rights and expects the same from its supply chain. Varma own operations do not entail major human rights risks.

Varma's Code of Conduct provides anti-bribery and anti-corruption guidelines concerning, for example, offering and accepting gifts and hospitality and avoiding conflicts of interest. An online course helps raise awareness of the Code of Conduct, and in 2016, the course was completed by 88% of Varma's employees. The course will be updated in 2018, and every Varma employee is expected to complete it every two years.

The Code of Conduct is complemented by other internal guidelines and instructions relating to, for example, data security and data protection, and the identification of money laundering.

### *Responsible supply chain management*

In 2017, Varma surveyed its supply chain to identify responsibility issues. At the same time, Varma determined the responsibility requirements to be applied to suppliers and drew up the Supplier Code of Conduct.

The premise of the Supplier Code of Conduct is that Varma expects its direct service providers, i.e. first-tier suppliers, to commit to the responsibility requirements. A direct service provider is responsible for its own supply chain. The Supplier Code of Conduct covers, among other things, good business practices, human rights, occupational safety and health, and respect for the environment. It also includes a notification requirement and a permission for audits. The Supplier Code of Conduct will be attached to agreements.

The first tier of Varma's supply chain mainly covers Finland alone: of all purchases made in 2017, Finnish service and goods providers accounted for 99.1%. Main purchases relate to construction activities, the real estate business, and IT services.

### *Investment objects review*

Varma expects listed companies that it invests in to comply with local legislation and international standards and agreements, typically the principles of the UN Global Compact initiative on social responsibility. Varma reviews the compliance with the standards with the help of an external service provider, which examines Varma's direct listed equity investments, listed corporate bond investments and equity funds twice a year.

The review of compliance with standards, performed in October 2017, covered all of Varma's direct equity investments in listed companies, direct listed corporate bonds and active equity funds. The review covered 31% of Varma's investment portfolio. At the end of the year, listed equity investments and listed corporate bond investments included one company with a confirmed environmental violation. Varma is involved in a class action lawsuit against the company in question.

For ethical reasons Varma excludes companies that concentrate on the manufacture of tobacco and nuclear weapons from its direct listed investments.

Varma signed the UN-supported Principles for Responsible Investment (PRI) in 2011. We report on responsible investment annually in accordance with the PRI framework.

## **Outlook**

Varma expects economic development to remain favourable, but the growth rate is forecast to level out in the coming years. The structural challenge for the Finnish economy is the sharp growth in public spending caused by the ageing of the population. Increasing employment rates and productivity is essential for the funding of pensions and welfare promises.

The recovering economy and employment also support the funding of earnings-related pensions. A major pension-political question emerging in the coming years relates to the repercussions that structural changes, such as those taking place in the production of social and health care services, will have on the interfaces between private and public sectors.

The most significant risks in the economic operating environment still relate to how well changes in the direction of monetary policies are managed and to geopolitical risks.

A key focus area for the work carried out in the earnings-related pensions sector in 2018 is preparing for the implementation of the national Incomes Register. As of the beginning of 2019, employers will report their employees' incomes to a single centralised system. 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 change in the way of working brought by the national Incomes Register provides Varma with major development opportunities in terms of implementing the earnings-related pension system and delivering even better services to its customers.