

A young girl with braided hair is performing a handstand on a large, flat rock on a sandy beach. She is wearing a colorful, long-sleeved shirt and grey leggings. Her legs are straight and pointing upwards. In the background, there is a calm lake, a line of trees, and a blue tower structure in the distance under an overcast sky.

Responsible investment practices for various asset classes

Varma 2020



Contents

Listed investments

Climate targets in listed equity investments and corporate bonds

Direct equity investments and equity funds

Listed corporate bonds

Taking climate change into account in direct equity investments and corporate bonds

Negative screening and enhanced ESG monitoring in equity investments and corporate bonds

Compliance with international norms and agreements and the supervision thereof

Government bonds

Unlisted investments

Private equity

Hedge funds

Responsibility of hedge fund investees

Real estate

Direct real estate investments

New real estate investments

Rent and maintenance

Construction

Real estate funds

Co-operation and networks

Listed investments

Equity investments, corporate bonds and government bonds



Climate targets in listed equity investments and corporate bonds

We renewed our climate targets in 2019

- The goal is to reduce the carbon intensity of listed equity and corporate bond investments, i.e. greenhouse gas emissions in relation to revenue, from the 2016 level as follows:
 - 30% by 2023
 - 40% by 2025
 - 50% by 2027
- We are committed to exiting from investments in thermal coal by 2025.
- We are committed to excluding oil exploration by 2030.
- For investees that require enhanced monitoring we will create an engagement process to accelerate the decommissioning of coal-based operations. The coal plants of the monitored companies must be decommissioned by 2030. Otherwise, we will exit the investment.

- We aim for a carbon-neutral investment portfolio by 2035.
- We are building a climate allocation, according to which by 2025, 20% of our investments will be in various asset classes
 - whose business benefits from actions to mitigate climate change
 - whose operations are low emission
 - who have a clear strategic and science-based target of reducing greenhouse gas emissions
 - whose operations offer carbon sinks.



Direct equity investments and equity funds

- Varma analyses an investee's risk/return ratio also from an ESG perspective. Portfolio managers use a tool for analysing ESG factors that are relevant to different industries. These factors are addressed at the meetings with companies.
- Portfolio managers also make use of various company- and industry-specific ESG reports and ESG ratings on companies by various service providers.
- When investing in equity funds, a sustainability survey is conducted in connection with a due diligence analysis, and thereafter, the fund's sustainability is monitored regularly.
 - Asset managers' ESG principles and practices are surveyed. The minimum requirement is that the asset manager has signed the PRI or that it has a responsible investment policy in place. We monitor asset managers' and investment funds' ESG reporting and carbon footprint, as well as any changes therein and how it differs from the benchmark index.
 - We review compliance with international standards with the help of an external service provider, which maintains a database of companies' confirmed and suspected violations. The service provider engages in discussions with the companies and updates the database accordingly. We are able to directly engage with the companies, together with other investors and through the service provider. If a company has violated norms, no further investments will be made in the company. We may exclude the company from our portfolio if our efforts to engage with the company are unsuccessful in the long run.

Engagement in direct equity investments

Varma's engagement in direct equity investments takes place in three ways.

1. In direct meetings with companies and by voting at shareholder meetings.

In its meetings with companies, Varma discusses topics such as sustainable business and taking climate change into account in business operations and encourages companies to report on their climate risks in accordance with the TCFD framework. Varma maintains a register on its portfolio managers' meetings with companies. Voting in shareholder meetings is guided by Varma's share ownership policy.

2. Jointly with other investors, for example, in cases where Varma's holding in a company is small or is not a direct holding.

3. Through a third party, such as a fund management company or a service provider, for example, if there is a suspected violation of norms.



Listed corporate bonds

- The portfolio managers of corporate bonds analyse the ESG themes of companies and different industries using various tools and ESG ratings. Risk assessments play a very important role in fixed income investments and in corporate financing. Our objective is to identify ESG risks and reduce exposure to them by investing in companies that are capable of adapting to future changes.
- As a fixed income investor, Varma is a borrower of capital and thus its opportunities for engagement are weaker than in equity investments. Even as a fixed income investor, however, Varma can encourage companies to disclose more information, for example, related to taking ESG risks and opportunities into account in the company's operations. The best opportunities for engagement in meetings with companies arise especially when the company announces a new bond issue.
- Varma's goal is to find investees that benefit from climate change trends. In its listed corporate bond portfolio, Varma monitors the share of industries that carry a greater risk in terms of climate change (see slide 7).

Green bonds

Varma invests in green bonds. The debt capital raised through the issuance of a green bond is earmarked for environmentally friendly investments. Varma believes that responsible companies have greater potential to achieve future success than average. Green bonds are a part of the big picture of responsible investment, and we want to contribute to the development of a green financial market.

Taking climate change into account in direct equity investments and corporate bonds

Our goal is to find investees that benefit from climate change mitigation.

In our listed equity portfolio, we monitor the share of industries that carry a greater risk in terms of climate change. Enhanced ESG monitoring concerns the following industries:

- Oil & gas
- Utilities
- Electricity production
- Automotive industry
- Mining industry
- Concrete industry
- Transport
- Chemical industry

Varma also monitors the carbon footprint of its direct equity investments, listed corporate bonds and real estate every six months and reports on it annually.

Negative screening and enhanced ESG monitoring in equity investments and corporate bonds

Varma has defined industries that it does not invest in or which require enhanced ESG monitoring.

Excluded for ethical reasons



- Tobacco
- Nuclear weapons
- Controversial weapons (anti-personnel mines, cluster bombs, and chemical and biological weapons)

For climate reasons



- Excluded from direct equity investments: companies that rely on coal- or lignite-based operations for more than 30% of their net sales

Enhanced ESG monitoring

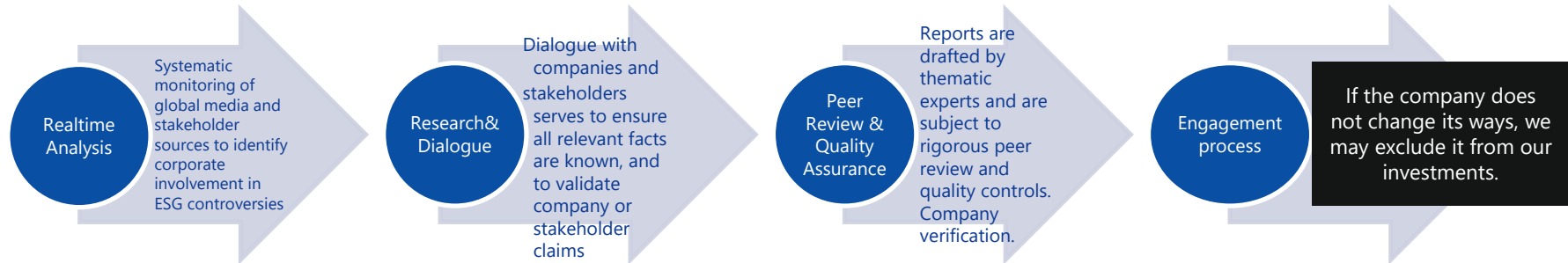


- Monitored are industries that are significantly exposed to climate risks, such as the oil & gas industry, electricity & heat production, and the automotive, mining, concrete, chemicals and transport industries
- Companies that rely on coal- or lignite-based operations for 15–30% of their net sales
 - Alcohol
 - Legal cannabis products
 - Adult entertainment
 - Gambling
 - Conventional weapons

When investments are made in companies operating in these industries, the portfolio manager responsible for that area of investment prepares a report on the ESG risks for the responsible-investment analyst, who maintains a register on the investments in question.

Compliance with international norms and agreements & compliance monitoring

- We require that our investees comply with international agreements and norms, for instance:
 - UN Global Compact initiative on corporate responsibility
 - OECD guidelines for multinational enterprises
 - ILO labour conventions
- When a company breaches the above-mentioned norms, our primary objective is to engage with the company in order to bring about a change in their operating methods. If we have a large holding in the company, we conduct the dialogue with the company ourselves. If we have a smaller ownership, we engage in dialogue through an external service provider.
- A service provider that covers over 20,000 companies oversees compliance with norms
 - The screening covers Varma's listed equity investments and corporate bonds
 - Portfolio managers have access to the services provider's database
 - The information also flows directly to Varma's internal systems

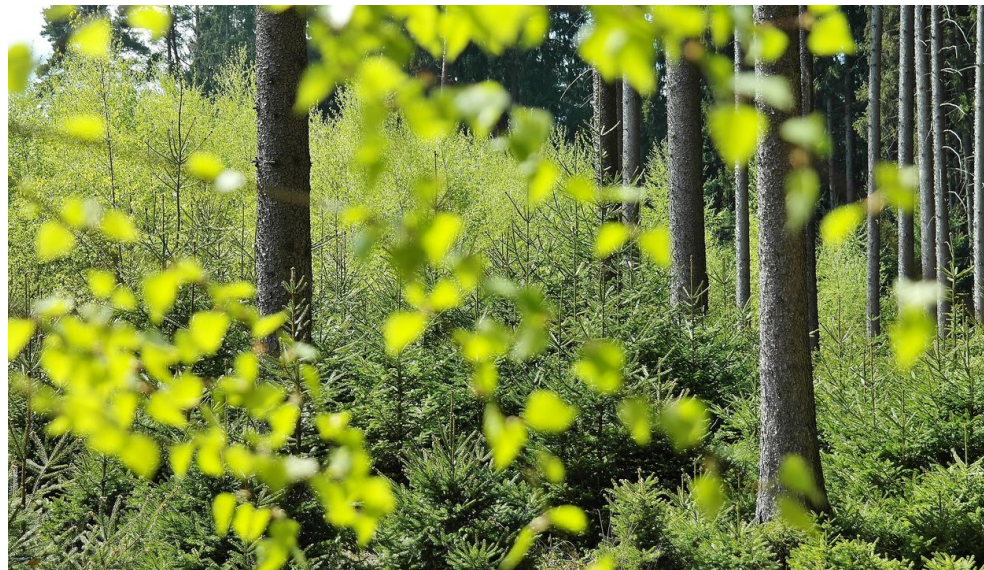


Exchange-traded funds

- Two sustainable exchange-traded funds (ETF) developed by Varma were listed on the stock exchanges in London and the United States.
- The ETFs were created jointly with the asset management company Legal & General Investment Management (LGIM) and the index investment company Foxberry.
- The ETFs track the performance of European equities, taking sustainability criteria broadly into account.

Index funds

- Our goal is to increase the share of low-carbon funds to 35% of our index funds by 2025.



Government bonds



- In government bond investments, ESG factors are naturally integrated in the investment process. When investing in government bonds, the government's ability and willingness to pay back the loan is assessed by analysing, among other things, the macroeconomy, financial and monetary policy and political risks. Macro variables, such as inflation and the economic growth rate also affect ESG risks and opportunities.
- Of the ESG themes, **governance** is a key factor when assessing, for instance, the strength of a country's institutions, the independence of its central bank, its political system, corruption and the implementation of its rule of law.
- Also important are **social aspects**, such as unemployment, demographics and inequality, which may lead to the realisation of political risks.
- **Environmental matters** have a long-term global impact. Climate change affects different countries, for instance, through the changing environment, demand for fossil fuels and international climate agreements.
- Key tools for assessing governments are monitoring, analysing and forecasting the country's macro data, financial markets and financial and monetary policy, as well as following elections and the political situation.
- Varma does not invest in countries that are ranked in the bottom 25% of the UN's Sustainable Development Goals index. In an exceptional case, an investment can be made if the country's ranking is expected to clearly improve.
- Engagement in government bond investments takes place together with other investors.

Unlisted investments

Private equity, hedge funds and real estate investments

Private equity investments



Responsibility in private equity investments

- As a fund investor, Varma's guiding principle is the equality of the investors; this means that all fund-related information must be equally accessible to all investors of the fund. We also demand annual responsibility reporting from fund management companies.
- Responsibility must be a part of private equity fund investment operations and investment risk management. For that reason, responsibility assessments are a part of the fund selection process. An assessment of the fund's responsibility is part of the due diligence process, and portfolio managers always include a responsibility assessment in their investment proposal, assessing the ESG policy that the fund management company is bound to, as well as how the policy is implemented in the fund's own investment process.
- Varma requires the fund to regularly report on its compliance with the principles of responsible investment at the fund level and, where applicable, also at the portfolio level. If the fund management company does not have an ESG policy in place, it must be able to credibly demonstrate that the fund takes responsibility principles into account in its investment process.
 - We encourage funds and the underlying companies to report on the financial risks and opportunities of climate change in accordance with the TCFD reporting framework.
- When we make co-investments with a fund, we assess the fund's responsible investment practices and include a responsibility assessment in the investment proposal. We evaluate the ESG policy of the fund management company offering the co-investment and we include an assessment of the investee's ESG performance and possible ESG risks.
- In accordance with our climate targets, in private equity funds, we aim to increase the share of renewables to 50% of electricity generation investments by 2030.
- When we invest directly in unlisted Finnish companies, we apply some of the same responsible investment practices as those applied to listed equity investments.

Engagement in private equity investments

Varma's opportunities for influencing a fund's policies are greatest when the fund is being established. At that time, the detailed investment strategy and practices are outlined in the operating agreement for the life of the fund. Varma's objective is, for example, that the private equity funds it uses do not invest in industries that are excluded from Varma's investments.

Varma actively participates in funds' advisory committees, where sustainability issues can also be discussed with both the partners responsible for the fund's activities and the fund's other investors. In the advisory committees, Varma demands that ESG matters are addressed as a permanent matter on the meeting agenda.

In private equity fund investments, the aim is to steer the portfolio towards the goals of the Paris Climate Agreement. Our aim is for the weight of fossil industries in our private equity fund investments to be smaller than the weight of fossil industries in the listed private equity market. Varma selects for its portfolio investments that

- are not significantly exposed to climate change risks
- are transitioning towards greener operations or
- benefit from mitigating or adjusting to climate change



Hedge funds



- The focus is primarily on the fund management company's responsible investment principles and practices. The fund's investment strategy sets the basic criteria for potential investees. More detailed fund-specific requirements depend on the fund's investment strategy, style, sectors and instruments.
- In a fund management company, key factors to assess include the principles and policies for responsible investment. This means mostly assessing governance, i.e. reviewing the incentive systems, conflicts of interest, internal processes and control measures.
- Varma is an investor member of the Standards Board for Alternative Investments (SBAI). Its standards concern the disclosure obligation, valuation, risk management and governance. An investor member's role is to encourage funds to adopt the standards and to follow the criteria themselves. Varma expects the funds that join the SBAI standard to abide by the rules according to the 'comply or explain' principle.
- Varma also supports the PRI's standards for hedge funds. These relate to governance, avoiding conflicts of interest, ESG factor analyses, active and responsible ownership, risk management and clear and transparent policies and practices.

Responsibility of hedge fund investees

- Varma encourages fund management companies to define their own principles for responsible investment and to apply those principles in their investment policies and when selecting individual investees. We continuously monitor the development of the principles.
- We regularly engage in dialogue with fund management companies on the various aspects of responsible investment. If necessary, we also discuss individual investments, although Varma's engagement opportunities in fund investments are limited.
- Varma actively discusses its own responsible investment principles and practices with fund management companies and explains the benefits of responsible operations. In the longer term, we expect a more in-depth understanding of the topic from fund management companies so that we can place even greater emphasis on the inclusion of ESG criteria in the funds' investment process when selecting industries and funds.
- We encourage our hedge funds to report on ESG matters annually, preferably integrated with their normal reporting.
- In order to avoid double taxation on investment returns, hedge funds often have an offshore domicile, meaning their activities take place elsewhere than in their country of registration. However, fund management companies should not choose their domicile on the basis of tax benefits that are contrary to the intention of applicable tax legislation or that lead to a situation where income is not subject to any taxation.
- Varma advocates full transparency of taxation and the exchange of information between national tax authorities. We expect fund management companies, their partners and those employed by the management company to pay their taxes to the jurisdiction where they work and where the economic activity or work is deemed to take place.



Taking climate change into account in hedge funds

Varma's goal is to actively raise awareness and to engage by sharing Varma's climate targets both when making new investments and at manager meetings. Climate policy implementation is monitored based on an annual survey and observations.

In the long term, Varma has the opportunity to allocate assets to sectors and managers whose operations are in line with Varma's goals. Also in hedge funds, Varma has the goal of developing reporting on funds' investments in industries that are significantly exposed to climate risks (oil & gas, electricity production, automotive industry, mining industry, concrete industry and transport).

Direct real estate investments



New real estate investments

- Properties to be purchased must be situated near public transport connections with services nearby.
- We demand at least a BREEAM Good level of certification, or a similar level, of our new construction. BREEAM environmental certification will be sought for all of Varma's significant properties by 2025.
- Location and certification are intended as a means of securing stable returns on the properties to be purchased, interest among tenants and long-term liquidity.
- In real estate investments, Varma's climate goal is to reduce the carbon dioxide emissions of our direct real estate investments by switching to fossil-free heating and electricity by 2030 and 2025 respectively.
- Before arriving at an investment decision, we conduct comprehensive research on the property. For surveying technical and environmental characteristics, we generally use outside experts. They analyse the condition of the property, the construction materials used, the technical systems and the condition of the soil on the plot of land.
- We require the properties we purchase to have
 - clean or cleanable soil
 - buildings that are in good condition with healthy and safe rooms (unless the purpose is to develop the property, whereupon these criteria will be left to Varma to meet).





- Our objective is to arrange functional and safe spaces for tenants. Acute repairs are carried out without delay.
- BREAM certification and, in future, WELL or similar well-being-related certification for business premises are used to promote tenants' well-being.
- The well-being of residential tenants is promoted by focussing attention on, for instance, yard areas and common areas.
- An independent third party annually conducts a customer satisfaction survey to determine tenants' opinions on responsibility matters and their satisfaction with both the spaces they rent and the care and maintenance of the spaces.
- We provide our tenants with guidance in responsibility matters in order to inspire them to act sustainably.
- Varma is prepared to enter into a Green lease with tenants if they wish. (Green lease).
- Varma intends to cut emissions from its residential properties in half by 2024. This will be achieved by introducing heat pumps as the heat source in some properties. Some apartment buildings will give up district heating completely.



- Our maintenance partners must have the required competence and resources to support our targets for responsible maintenance. We also require our partners to take responsibility issues into account in their operations and to fulfil their social obligations.
- We strive to reduce the energy consumption and carbon dioxide emission of Varma-owned properties, and in this way reduce the environmental load of the properties and create savings in maintenance costs. We use consumption data to calculate the carbon footprint of properties every year.
- In buildings, possibilities for more energy-efficient use of technical equipment are assessed.
- Opportunities for making use of renewable energy are regularly looked into, and we install solar power systems when such is possible. We are continuously increasing the use of purchased green electricity.
- Parking opportunities for electric cars are being increased, and the intention is to introduce electric car parking spaces in at least six new locations a year. BREEM In-Use environmental certification is sought for nearly all of Varma's business premises.

Construction



When commissioning the construction of new buildings and in renovation projects, we strive to use energy-efficient building solutions and environmentally sound building materials, within a framework of reasonable costs.

The goal is to build Varma's office and commercial buildings with characteristics that make certification according to at least the BREEAM Good level possible once they are completed.

Our construction partners must have experience in energy-efficient building methods. We also require our partners to take responsibility issues into account in their operations and to fulfil their social obligations.





Real estate funds

- When making indirect real estate investments, we follow a comprehensive due diligence (DD) process concerning the fund or any similar investment instrument, covering, among other things, the investment's strategy and structure, and the background, fees and operating policies of the fund management company.
 - As part of the DD process, we require the fund's management company to complete INREV's Due Diligence Questionnaire for real estate funds in order to determine ESG issues in the fund's activities. The fund management company's ESG policy and possible ESG reports, as well as references showing how the ESG policy is applied in real estate investments are reviewed.
- Making an investment in a fund requires that the fund management company take ESG factors into account in its operations. The fund's management company must report on ESG matters at least once a year by including a section on ESG matters in its fund reporting.
- The fund's activities are actively monitored, and when meeting with the fund's management, ESG matters are discussed as part of the review of the fund's investment activities. Varma additionally participates in, e.g., meetings of the fund's advisory committee.

Co-operation and networks

We participate in responsible real estate investment co-operation and committees in Finland and abroad. We actively participate in, for instance, Rakli's and INREV's activities, and we are a member of the Green Building Council. Nearly all of our properties are part of the national energy efficiency agreement scheme, which sets energy-saving targets for set periods and annually monitors the realisation of the targets. Our objective is also to support responsible investment research.

VARMA