

Varma's Interim Report 1 January–31 March 2019

The comparison figures in parentheses are from 31 March 2018, unless otherwise indicated.

- Total result amounted to EUR 998 (–405) million.
- The three-month return on investments was 5.1 (–0.4)%, and the market value of investments stood at EUR 45.8 (45.7) billion.
- Solvency capital was strong, at EUR 10,616 (11,128) million, i.e. 1.7 (1.7) times the solvency limit.

Economic operating environment

In the first quarter of the year, the economic environment was divided. On one hand, it is estimated that the global economy has topped out and growth is expected to slow down in many economic regions. There are major global economic risk scenarios. On the other hand, share prices made a strong recovery from the low point at the end of 2018.

The sustained strong growth in the US slowed down last year as the impacts of tax cuts on overall demand are dwindling, and the increased uncertainty, trade policy tensions and slower global growth weakened the outlook and cast a shadow on confidence. Preliminary data shows that, in the first quarter of the year, the economy gained momentum and grew at a much faster rate than expected.

The Brexit process has turned out to be complex, and it poses major economic risks to the eurozone and the UK. The European Parliamentary election will be held in May, and it is expected to influence the governance and steering of the economic region. In economic and political terms, Italy's situation has become a lasting problem, in addition to Brexit.

Finland's business cycle outlook remains reasonable, but the country's structural problems are yet to be solved. Finland's recovery started late in comparison to competitor countries. The improvement in the competitiveness of labour costs has boosted export demand and driven economic growth. Meanwhile, business and trade structures have changed. The investment appetite remains fairly moderate, which combined with competence-related challenges dampens the expectations concerning the economy's future production capacity.

Slower growth in the main economic regions and muted growth in global trade overshadow Finland's outlook. Finland is highly dependent on export demand, and a clear weakening of the business cycle in the export markets would inevitably have an impact on its economic activity and welfare. For Finland, especially problematic are the troubles in Germany and elsewhere in Europe.

Employment in Finland has been improving at a strong rate in recent years. The employment rate has shown a marked improvement, and unemployment is down. Last year, the employment rate rose to nearly 72%. The strong growth in employment has helped sustain consumers' confidence in the economy, despite the fact that the economy has topped out.

As the population ages, the growing need for services and rising pension costs call for an even higher employment rate and stronger public finances. The economic recovery and the implemented adjustment measures have improved the sustainability of public finances; in the longer term, however, the demographic development, age-related welfare commitments and costs, and challenges linked to the economy's productive potential will necessitate decisive measures from the decision-makers.

Earnings-related pension system

The Finnish Centre for Pensions has published new estimates concerning the long-term cash flows of the pension system. The estimates are used to regularly assess the earnings-related pension system in the light of different scenarios. When the 2017 pension legislation reform was being prepared, it was estimated that the pension contribution level agreed at the time would be sufficient in the long term. According to the latest long-term estimates, however, there are pressures to raise the contributions. At the end of 2018, Statistics Finland published a new population projection, which is included in the Finnish Centre for Pensions' new long-term estimates. According to the projection, the dwindling birth rate over a period of several years has turned into a long-term trend.

Longer careers are essential for securing the financial sustainability of the earnings-related pension system and sufficient pensions. The number of new disability pensions increased in 2018. Varma is a pioneer in workability management and vocational rehabilitation services and works closely with its customers with regard to both workability management services and vocational rehabilitation. During spring 2019, Varma will launch research activities focussing on workability management and disability risk management. The aim is to identify and describe disability risk factors and to determine the effectiveness of the methods and operating models used in managing disability risks. A key aspect is to apply the results in practice together with Varma's customers in order to ensure the effectiveness of the workability management services.

A working group looking into the separate earnings-related pension systems completed its work. The group assessed the possibilities of integrating the municipal pension system with the private-sector earnings-related pension system. A working group assessing the development of the self-employed persons' pension system also drew up its final report.

Varma's financial trends

Varma's total result at fair value for the three-month period amounted to EUR 998 (-405) million. The most important component of the total result is the investment result, which was EUR 977 (-423) million. The return on investments at fair value was EUR 2,230 (-165) million. The interest credited on the technical provisions was EUR -1,253 (-259) million. The estimated technical underwriting result was EUR 9 (7) million and the loading profit was EUR 11 (11) million.

Varma's solvency remained strong, and strengthened since the beginning of the financial period. The solvency capital, which serves as a risk buffer for investment operations insurance risks, was EUR 10,616 million at the end of March (9,619 mill. on 1 Jan), and pension assets in relation to the technical provisions were 129.4% (127.5% on 1 Jan).

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

Insurance business

The national Incomes Register was launched on 1 January 2019. In this context, the actuarial principles concerning insurance contributions, and insurance terms were also reformed. There has been some uncertainty regarding the functioning of the Incomes Register during the early year. Varma's customer service has been supporting customers in matters related to the Incomes Register to secure their earnings reporting. Varma adopted new systems for the basic functions related to insurance contribution calculation, invoicing and collection. The introduction of the Incomes Register as a whole has been smooth for Varma.

At the end of March, Varma's pension recipients numbered 344,000 (343,000 on 1 Jan), and claims paid during the reporting period totalled EUR 1,420 (1,331) million. During the period, the number of old-age pension applications increased 18% compared to the same period in 2018. This was mainly the result of the gradual increase in the retirement age as agreed in the pension reform: in the first quarter of 2018, none of those born in 1955 reached the lowest retirement age. Correspondingly, no one will reach the retirement age in April–June this year.

New pension decisions made by the end of March totalled 6,273, which is roughly 18% more than in the corresponding period last year. A total of 14,103 pension decisions were given in January–March. Partial early old-age pension, which was introduced at the start of 2017, remained popular – Varma made a total of 720 new decisions concerning this pension type during the first quarter.

At the end of March, Varma was providing insurance for 566,000 (560,000 on 1 Jan) employees and self-employed persons. Varma was successful in the transfer rounds of early 2019; based on the information submitted in the applications, the transfers will amount to EUR 24 million in annual premiums written.

Investments

In the first quarter of 2019, Varma's investments showed strong returns as the markets rebounded from the turbulence of late 2018. Boosted by the strong performance of the equity and fixed income markets, the early-year returns almost entirely offset the dip of the last quarter of last year. The return on investments stood at 5.1% (–0.4%), and at the end of March, the value of investments amounted to EUR 45,796 (45,660) million. The good return trend supported Varma's solvency ratio, which strengthened to 129.4% in the first quarter of the year (127.5% on Jan 1).

Uncertainty concerning the outlook for global growth persisted, but the continued negotiations between the US and China offered hope that the escalation of the trade war may come to an end. Increasingly expansionary policies than before by the central banks, especially by the Fed, also had a major influence on the market sentiment. Economic activity continued to slow down, however, and growth was muted especially in the eurozone and in China. China's economic indicators did recover towards the end of the quarter, and the growth rate was reasonable. In Europe, political uncertainty remained elevated due, for example, to the messy Brexit process, but its impacts on the market ultimately remained moderate. The more accommodative policies by the central banks of many emerging countries combined with diminishing global turbulence and trade war fears supported companies' confidence.

Inflationary pressures declined clearly at the beginning of the year, and global inflation expectations lowered. Both in the US and in the eurozone, wage inflation picked up somewhat, but its impact on consumer price inflation has remained marginal so far. The central banks therefore seem to have plenty of time to wait for inflation to accelerate to its target level or temporarily even to surpass it. Exchange rates began to stabilise in many emerging countries late last year, which dampened import price inflation, and consumer price inflation fell to a record-low level.

In the investment market, the first quarter of the year was a mirror image of the development at the end of last year. Following the major correction, market development was exceptionally strong in almost all asset classes. Top returns were generated by oil, and by Chinese and technology equities, but many of the larger markets' equity indices also yielded double-digit return rates in local currencies.

Despite the strong performance, a number of major investors were cautious about allocating significant funds to higher-risk investment objects, such as equities, following the correction last year. The looser policies adopted by the central banks and the major decline in interest rates, however, provided strong incentive to steer investments to higher-risk objects. In the first quarter, the returns on unlisted investments clearly fell short of the strongly rising equity and fixed income markets, indicating in part a delay in the valuation of these investments. In Varma's investment allocation, the weight of listed equities was raised in the first quarter of the year.

The return on Varma's investments was strong in the early year. The best returns were generated by listed equities and, boosted by the strengthened dollar, the return on US equities was exceptionally strong. The returns on fixed income investments were positive but clearly modest compared to equities. The returns on non-liquid investments, such as private equity, hedge funds and real estate investments, were moderate in the first quarter. Their more modest return development compared to listed equities and corporate bonds was due to the slower rate at which their valuation is updated and their risk profile, which is more moderate than that of listed equities. The U.S. dollar gained clear momentum against most currencies during the early year. At the end of March, the average nominal investment return over five years was 4.9%, and over ten years 6.5%. The corresponding real returns were 4.4% and 5.2%.

The return on fixed income investments was 1.9% (–0.3%) in the first quarter. The strong performance is explained by both the eased market turbulence, which lowered the risk premiums of corporate bonds and emerging market bonds, and the significant decline in interest rates. The markets no longer had faith in the European Central Bank's ability to raise its benchmark interest rates in the near future, which caused the eurozone money-market rates to remain in the negative. In the first quarter, the return on the loan portfolio was 1.1% (1.0%), on public sector bonds 1.1% (0.0%), on other corporate bonds 2.8% (–0.9%), and on other money-market instruments 1.2% (0.2%).

The global equity markets recovered quickly. The rise was backed by the central banks' rapid changes in their policies, the partial fading of recession risks, and detente in the trade negotiations between the US and China. The equity markets rose on a broad front. Varma's Finnish equities generated better returns than European equities, despite the opposite trend in benchmark indices. The return on listed equities was 13.1% (–2.2%). In the first quarter, private equity investments generated a return of 1.0% (2.6%), while infrastructure and unlisted equity investments yielded –1.8% (0.7%).

The return on real estate investments was 0.7% (1.2%), with business premises generating the best returns. Direct real-estate investments yielded a return of 0.9% (1.0%) and real-estate investment funds 0.1% (2.2%). The returns on a few international real-estate funds were weighed down by, among other things, the direct and indirect impacts of the Brexit process, and the levelling of return requirements compared to the previous year. Of the business premises owned by Varma, 38 had BREEAM environmental certification, i.e. a third of the business premises portfolio has been certified.

The return on other investments and hedge fund was good, at 1.9% (1.8%) and 2.0% (1.9%) respectively. 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 first quarter, the appreciation of the US dollar supported equity returns to some extent. 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 1,814 (1,995) million.

Operating expenses and personnel

Varma's total operating expenses in the reporting period were EUR 35 (33) million. According to a full-year estimate, Varma's efficiency ratio will remain roughly at the 2018 level. The loading profit for the period was EUR 11 (11) million.

Varma's parent company employed an average of 535 (532 in 2018) people in the first quarter. At the end of March, 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

Varma's Annual General Meeting was held on 14 March 2019. The General Meeting appointed eight new members to the Supervisory Board, raising the number of members from 28 to 32. Kari Ahola, Lasse Heinonen, Mika Joukio, Risto Kalliorinne, Mari Keturi, Johanna Moisio, Panu Routila and Sauli Vantti were elected as new members to the Supervisory Board. 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 2018.

Continuing as Supervisory Board members are Saana Siekkinen (Deputy Chairman), Satu Wrede (Deputy Chairman), Juri Aaltonen, Eero Broman, Petri Castrén, Jukka Erlund, Erkki Etola, Olavi Huhtala, Juha Häkkinen, Jukka Jäämaa, Kari Kauniskangas, Ville Kopra, Tapio Korpeinen, Timo Koskinen, Pekka Kuusniemi, Päivi Leiwo, Olli Luukkainen, Jari Suominen, Leena Vainiomäki, Petri Vanhala, Jorma Vehviläinen, Christoph Vitzthum and Anssi Vuorio.

The Chairman of Varma's Supervisory Board, Kari Jordan, resigned from the Supervisory Board on 28 March 2019, following his election as a member of Nordea's Board of Directors. According to the Act on Earnings-Related Pension Insurance Companies, the chairman of a supervisory board cannot be a member of a bank's board of directors.

Authorised Public Accountants Antti Suominen and Jenni Smedberg continue as Varma's auditors. Authorised Public Accountant Robert Söderlund and Ernst & Young Oy, with Authorised Public Accountant Tuija Korpelainen as chief auditor, continue as the deputy auditors.

As of the beginning of 2019, Varma's Board of Directors is composed of Jari Paasikivi (Chairman), Antti Palola (Deputy Chairman), Kai Telanne (Deputy Chairman), Riku Aalto, Eila Annala, Johanna Ikäheimo, Rolf Jansson, Ari Kaperi, Jyri Luomakoski, Petri Niemisvirta, Ilkka Oksala and Pekka Piispanen, and deputy members Eija Hietanen, Liisa Leino, and Risto Penttinen.

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

Varma's Board of Directors approved the updated sustainability programme during the review period. Varma's sustainability efforts focus on climate change mitigation, promoting workability and good working life, ethical business, open communication and responsibility for Varma employees.

As part of its Annual and Sustainability Report 2018, Varma reported on climate-related risks and opportunities according to the recommendations of the international Task Force on Climate-related Financial Disclosures (TCFD).

The report includes, for example, an analysis of how well Varma's equity investments are aligned with different temperature scenarios. The analysis shows that Varma's equity portfolio is in line with keeping global warming at below 1.75 degrees Celsius above the pre-industrial era. Maintaining this situation, however, requires the continuous reduction of emissions in the future.

During the review period, Varma joined two initiatives highlighting social responsibility in investments. The Workforce Disclosure Initiative aims to provide substantial and comparable information on how employees are managed in companies and in supply chains, while the international Tobacco-Free Finance Pledge highlights the entire finance sector's responsibility to limit investments in the tobacco industry worldwide. Varma has excluded tobacco companies from its investments since as far back as 15 years ago.

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 macroeconomic outlook has deteriorated, global economic risks remain significant and the challenging investment environment persists. Varma's strong solvency secures some leeway in the company's allocation decisions. Considering the economic cycle, the Finnish earnings-related pension system is on a solid foundation and can withstand normal market fluctuations.

Political uncertainty may cause problems in decision-making. Slower growth in the main economic regions and muted trade growth overshadow Finland's outlook. The situation in Europe appears highly challenging in terms of both the economy and politics.

Improving employment and the strong development of the equity markets have supported the financing of the earnings-related pensions in recent years. As the population ages, the growing need for services and rising pension costs call for an even higher employment rate. Raising the employment rate and strengthening public finances are demanding goals in an environment of economic contraction. At the same time, the availability of labour is declining as a result of the aging population. Finland's economy also faces structural challenges relating to growth potential, such as the relatively low investment appetite and needs relating to competence. These issues must be resolved if we want to improve future growth potential.

In Helsinki, [30] April 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 some 910,000 people in the private sector. Premiums written totalled EUR 5.1 billion in 2018 and pension payments stood at EUR 5.7 billion. The company's investment portfolio amounted to EUR 45.8 billion at the end of March 2019.

FURTHER INFORMATION:

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ATTACHMENT: Graphs and charts

www.varma.fi

www.varma.fi/annualreport

Balance sheet at fair values, Parent Company

€ million	3/2019	3/2018	12/2018
Assets			
Investments	45,796	45,660	44,015
Receivables	1,224	251	858
Furniture and fixtures	4	4	4
	47,025	45,916	44,878
Liabilities			
Capital and reserves	131	125	130
Valuation differences	9,081	8,646	8,004
Provision for future bonuses	1,404	2,359	1,486
Off-balance-sheet items	-1	-1	-1
Solvency capital, total	10,616	11,128	9,619
Provision for current bonuses (for client bonuses)	115	121	154
Equity-linked provision for current and future bonuses	622	657	-255
Actual technical provision	35,405	33,775	35,137
Total	36,027	34,432	34,882
Other liabilities	267	234	224
	47,025	45,916	44,878

Income statement at fair values, Parent Company

€ million	1-3/2019	1-3/2018	1-12/2018
Premiums written	1,322	1,240	5,118
Claims paid	-1,420	-1,331	-5,404
Change in technical provisions	-1,107	-122	-446
Net investment income	2,238	-154	-872
Total operating expenses	-35	-33	-125
Other income/expenses	0	0	-4
Taxes	-1	-5	-8
Total result ¹⁾	998	-405	-1,741

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

€ million	1-3/2019	1-3/2018	1-12/2018
Underwriting profit/loss	9	7	23
Investment result	977	-423	-1,816
Loading profit	11	11	56
Other income/expenses	0	0	-4
Total result	998	-405	-1,741

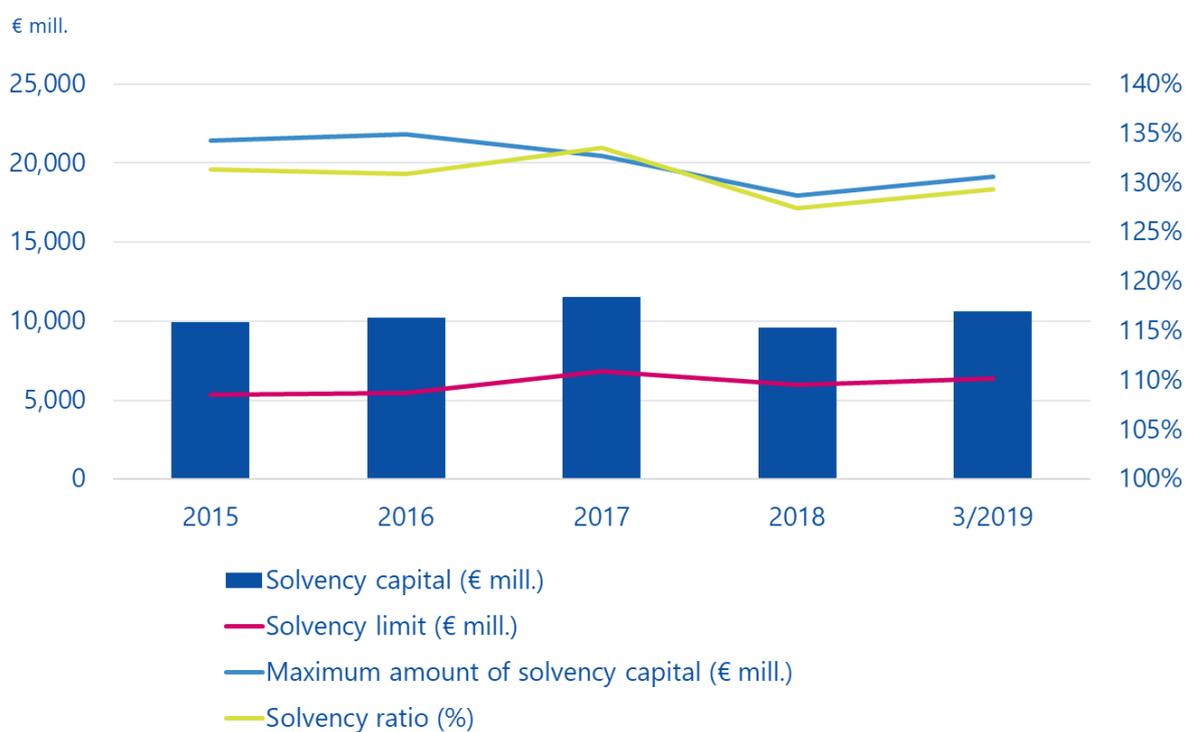
Solvency capital and limits

	31/03/2019	31/03/2018	31/12/2018	31/12/2017
Solvency limit (€ mill.)	6,372	6,648	5,973	6,820
Maximum amount of solvency capital (€ mill.)	19,115	19,944	17,918	20,459
Solvency capital (€ mill.)	10,616	11,128	9,619	11,534
Solvency ratio (%) ¹	129.4	132.2	127.5	133.5
Solvency capital/Solvency limit ²	1.7	1.7	1.6	1.7

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

	31 Mar 2019				31 Mar 2018				31 Dec 2018				1-3/2019	1-3/2018	1-12/2018	24 m
	Market value		Risk position		Market Value		Risk position		Market Value		Risk position		Return	Return	Return	
	€ mill.	%	MWR	MWR	MWR	Vola- tility										
Fixed-income investments ¹	13,330	29	10,756	23	13,358	29	8,560	19	13,522	31	10,568	24	1.9	-0.3	-1.8	
Loan receivables	1,890	4	1,890	4	1,525	3	1,525	3	1,817	4	1,817	4	1.1	1.0	3.7	
Bonds	10,321	23	9,134	20	9,981	22	8,727	19	10,625	24	9,031	21	2.1	-0.5	-2.9	2.1
Public bonds	3,910	9	2,723	6	4,082	9	2,287	5	4,104	9	2,142	5	1.1	0.0	-4.2	
Other bonds	6,411	14	6,411	14	5,900	13	6,440	14	6,520	15	6,889	16	2.8	-0.9	-2.0	
Other money-market instruments and deposits	1,118	2	-268	-1	1,851	4	-1,692	-4	1,080	2	-280	-1	1.2	0.2	-0.1	
Equity investments	19,801	43	19,868	43	20,816	46	21,291	47	17,916	41	18,222	41	10.0	-1.4	-3.6	
Listed equities	15,225	33	15,292	33	16,715	37	17,190	38	13,407	30	13,713	31	13.1	-2.2	-8.3	11.1
Private equity	4,329	9	4,329	9	3,224	7	3,224	7	4,255	10	4,255	10	1.0	2.6	17.5	
Unlisted equities	247	1	247	1	877	2	877	2	254	1	254	1	-1.8	0.7	3.8	
Real estate investments	3,946	9	3,946	9	3,635	8	3,635	8	3,879	9	3,879	9	0.7	1.2	5.5	
Direct real estates	2,939	6	2,939	6	2,768	6	2,768	6	2,895	7	2,895	7	0.9	1.0	3.9	
Real estate funds	1,007	2	1,007	2	868	2	868	2	984	2	984	2	0.1	2.2	10.6	
Other investments	8,720	19	10,043	22	7,852	17	9,180	20	8,699	20	10,037	23	1.9	1.8	-1.4	
Hedge funds	8,725	19	8,725	19	7,834	17	7,834	17	8,703	20	8,703	20	2.0	1.9	1.6	2.2
Commodities	-3	0	-17	0	9	0	131	0	-8	0	25	0				
Other investments	-2	0	1,335	3	9	0	1,216	3	3	0	1,308	3				
Total investments	45,796	100	44,613	97	45,660	100	42,666	93	44,015	100	42,705	97	5.1	-0.4	-2.0	4.1
Impact of derivatives			1,183	3			2,994	7			1,310	3				
Investment allocation at fair value	45,796	100	45,796	100	45,660	100	45,660	100	44,015	100	44,015	100				

The modified duration for all the bonds is 3.3.

The open currency position is 27.5% of the market value of the investments.

¹ Includes accrued interest

Total result

