Varma's half-year report 1 January–30 June 2019

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

- Total result amounted to EUR 1,374 (-186) million.
- The six-month return on investments was 6.9% (1.7%), and the market value of investments stood at EUR 46.5 (46.4) billion.
- Solvency capital was strong, at EUR 10,992 (9,619 on 1 Jan. 2019) million, and 1.9 times (1.6 on 1 Jan. 2019) the solvency limit.

Economic operating environment

The escalation of trade policy tensions cast a shadow on the global economy. After the G20 meeting at the end of June, the markets reached a fleeting period of calm, when the US and China agreed to continue negotiations and the US refrained from its most recent threat of raising tariffs. At the turn of July and August, however, the situation escalated again. Finding a lasting solution will be challenging, as the strategic interests of these great powers are difficult to reconcile. On the other hand, the countries have a strong economic interdependence, and the trade war has started to seriously threaten their growth outlook. A weakened investment appetite in important export markets is especially problematic for Finland.

The economic cycle is maturing, conflicts are drawing out and increased uncertainty is weakening confidence and growth prospects. Confidence in central banks' willingness to take action has reassured the markets. The escalating trade war moves at the start of August unsettled the markets.

Economic growth in the US has continued for a record-long ten years. Some of the economic trend and confidence indicators are showing signs of softening, which is to be expected during the maturity phase of the economic cycle. The Fed has conveyed its responsiveness and preparedness to take action if the risks in the economic operating environment escalate. In response to the risks the global uncertainty poses to the US economy, the Fed cut its key interest rate at the end of July, marking the first time it has done so in more than ten years.

Growth in the eurozone is expected to continue, albeit at a slower pace. Inflation expectations continue to be rather low. Employment has improved, thanks to the long period of growth. Financial policy has been moderately expansionary, and the availability of financing is good. These factors will support continued growth, but the risks have intensified. The escalating trade war and the likelihood of a no-deal Brexit are weakening companies' outlook and chipping away at growth expectations in Europe. The ECB still considers monetary policy that supports growth to be necessary.

Finland's economic cycle has peaked out. The improvement in employment will inevitably slow down, for reasons due to both the economic cycle and structural mismatch problems. Consumers' economic expectations have been weakening since the end of last year, and according to surveys conducted during the summer, consumers have had a very pessimistic opinion of Finland's economic development. Finland's economy is overshadowed by the weakened growth, especially in Europe, and by the trade policy uncertainty.

Earnings-related pension system

In June, the labour market organisations concluded an agreement that proposes changes to survivors' pensions. The organisations also propose that the age limit for additional days of unemployment security be raised. The changes aim to improve employment, modernise survivors' pension and save in pension costs.

The Government Programme of Finland's new Government contains entries concerning earnings-related pensions. The most significant of these for the sector is one whereby the Government commits to preparing the merger of the municipal and private sector pension systems based on the proposals put forward by the working group on separate pension systems.

Varma's financial trends

The total result at fair value for six months amounted to EUR 1,374 (-186) million. The most important component of the total result is the investment result, which was EUR 1,338 (-200) million. The return on investments at fair value amounted to EUR 3,027 (779) million, and the interest credited on the technical provisions was EUR 1,689 (979) million. The estimated technical underwriting result was EUR 14 (-9) million and the loading profit was EUR 23 (24) million.

Varma's solvency strengthened further compared to its strong level at the beginning of the year. The solvency capital, which serves as a risk buffer for investment operations, was EUR 10,992 million at the end of June (EUR 9,619 mill. on 1 Jan.), and 130.2% in relation to the technical provisions (127.5% on 1 Jan.).

Varma's solvency capital was on a sustainable level, i.e. 1.9 (1.8) times the solvency limit.

Tables illustrating Varma's financial development are presented as attachments to this half-year report.

Insurance business

Varma's pension recipients numbered 343,000 at the end of June (343,000 on 1 Jan.). Claims paid in January–June totalled EUR 2,843 (2,745) million. By the end of June, 11,061 new pension decisions were made, which is roughly 3.9% more than in the corresponding period last year. A total of 25,870 pension decisions were made in January–June.

In the first half of the year, an additional net amount of EUR 21 million in TyEL premiums written was transferred to Varma from other pension companies. The core of customer work is work ability management, for which Varma is constantly developing tools; the latest ones being the new questionnaire tools for the early identification of work ability risks.

At the end of June, Varma provided insurance for 558,000 (560,000 at the start of the year) employees and self-employed persons.

Investments

Varma's investment returns in the first half of 2019 were strong. The markets continued to recover from the turbulence at the end of 2018. The correction in the markets in May was relatively short-lived, and the total returns were positive in nearly all asset classes. The return on investments stood at 6.9% (1.7%), and at the end of June, the value of investments amounted to EUR 46,540 (46,359) million. The good return trend further supported Varma's solvency ratio, which strengthened to 130.2% in the first half of the year (127.5% on Jan. 1).

The investment markets' strong development was, however, in conflict with the growing uncertainty surrounding the global economic growth outlook. Economic growth slowed down at the start of the year especially in industry, where investments decreased substantially due to increased fears of a trade war. The US's economic growth weakened considerably in the second quarter, in the wake of the rest of the world's weakened situation. The continuation of negotiations between the US and China gave rise to fragile hope that the escalation of the trade war would be halted, but it is difficult to see an easy solution to a number of contentious points. In terms of market sentiment, a more significant change than trade negotiations was the clearly more expansionary monetary policy stances of the central banks. Especially the Fed's hints at the now-implemented key interest rate cut in order to support inflation and economic growth clearly pushed interest rates down substantially and fuelled risk appetite in the equity and corporate bond markets. The notion that a lower interest rate level will not only reflect a weakening economic cycle outlook, but also expectations that the natural, long-term interest rate level will be lower than previously expected was also reinforced in the market.

Inflationary pressures remained very subdued in the first half of the year, even though the price of oil rose during summer as geopolitical tensions increased in the Middle East. Inflationary expectations continued to decline globally, and they posed challenges for the credibility of monetary policy. In the US, wage inflation slowed down slightly in recent months. In the euro zone, wage inflation was relatively brisk, but – just like in the US – its impact on consumer inflation was only marginal, at least for the time being. Moderate inflation gave central banks the opportunity for expansionary monetary policy, and it appears the current exceptionally low interest rate environment will continue for several more years. Also in most emerging economies, inflation reached a historical low, as the cooling down of global economic cycles, moderate development of raw material prices and stable development of foreign exchange rates curbed import price inflation.

Despite the strong development of the investment markets, investors were very sceptical of whether the return performance would remain strong. Several surveys indicated that investors were maintaining very moderate allocations in higher-risk investments and were sceptical of whether the economic upswing would continue. The central banks' expansionary policy stances and expectations of a very long-lasting, extremely low interest rate environment nevertheless created strong incentive to hold investments in asset classes that can be expected to yield at least reasonable returns in the coming years. The returns on unlisted investments were more modest in the first half of the year than the equity and fixed income markets, but this was partly due to the valuation delays of these investments. In Varma's investment allocation, the weight of listed equites was decreased in the second quarter of the year.

The return on Varma's investments was strong in the first half of the year. Listed equities yielded the best returns, and with the strengthening dollar, US equities were the top performer. The returns on fixed income investments were also very positive, but clearly lower than the returns on equities. The returns on non-liquid investments, such as private equity, hedge funds and real estate investments, were reasonable in the first half of the year, albeit more modest than the returns on listed equities and other bonds. The US dollar gained clear momentum against most currencies during the early year. The average nominal investment return over five years reached 4.7% at the half-year point, and over ten years 6.3%. The corresponding real returns were 4.0% and 4.9%.

The return on fixed income investments in the first half of the year was 3.5% (-1.5%). Behind the strong development is the confidence in the central banks' ability to uphold, through expansionary monetary policy, the economic upswing and support the markets if the turbulence experienced at the end of last year strikes the markets again. Confidence in the central banks did, in fact, keep the risk premiums of business and emerging markets very moderate. The decline in eurozone inflationary expectations continued, and the interest on Germany's 10-year government bond fell to all-time-low figures. Market expectations predict that the central banks will resort to substantial cuts in key interest rates already in the near future, which pushed eurozone money market interest rates further into negative territory. In the first half of the year, the return on the loan portfolio was 2.1% (1.6%) and on public sector bonds 2.8% (-4.0%), Other corporate bonds yielded 4.9% (-1.0%), and other money-market instruments 0.7% (0.2%).

In the second quarter of the year, the global equity markets continued to recover from the turbulence of late 2018. The most important factor behind the strong development was probably the central banks' clearly more expansionary policy stances, which overpowered the global economy's weakened growth outlook. The trade conflicts between the US and China at times negatively affected risk appetite, but it is in the interest of both countries to prevent the tensions from spiralling out of control. The rise of the equity markets was more moderate in the second quarter than in the first, and the differences between different countries and sectors grew. So-called defensive equities, with more stable profitability development, were strong in the first half of the year, but the cyclical and technological equities that suffered from the escalation of the trade war struggled at times following the strong performance early in the year. Varma's Finnish equities outperformed European equities and defensive financial equities, in particular, developed strongly in the first six months of the year. Listed equities yielded a return of 15.3% (2.6%). The return on private equity investments was 4.5% (7.8%) and on unlisted equity investments -0.2% (1.2%) in the first six months of the year.

The return on real estate investments was 1.9% (2.7%). Direct real-estate investments yielded a return of 2.0% (1.9%) and real-estate investment funds 1.6% (5.4%). The return on real estate investment funds was weighed down by, among other things, the negative value change in investments in the UK. Commercial premises leasing operations have been active. At the end of June, Varma and Elo concluded an agreement whereby the Flamingo entertainment shopping centre, which is situated in Vantaa and is owned by Varma, and Jumbo shopping centre, which is owned by Elo, will be merged to form the largest shopping centre in the Nordic countries.

The return on other investments was 2.9% (2.4%) in January–June 2019. Hedge funds, yielding 3.1% (3.4%), had more moderate returns than fixed income investments during the period under review. The risk profile of Varma's funds is lower 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. 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 1,591 (1,526) million.

Operating expenses and personnel

Varma's total operating expenses in the reporting period were EUR 68 (67) 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 23 (24) million. The total loading profit will be used for client bonuses.

Varma's parent company employed an average of 536 (532 in 2018) people in the first half of the year. At the end of June, Varma's personnel were distributed as follows: pension services 28%, insurance services 15%, customer service departments 13%, investment operations 14%, and other functions 30%.

Corporate Governance

Varma's Supervisory Board held its constitutive meeting on 16 May 2019. The Supervisory Board elected Christoph Vitzthum as its Chairman. Satu Wrede and Saana Siekkinen continue as deputy chairpersons.

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.

Sustainability

Varma encourages the companies in its portfolios to report on their climate impacts in accordance with the international Task Force on Climate-related Disclosures (TCFD). In order to chart companies' climate risks, Varma conducted a survey among European companies in summer asking how they take climate change into account in their business operations.

Varma joined the Workforce Disclosure Initiative, an international initiative to promote decent work. It aims to improve employees' working conditions in companies' operations and supply chains. In addition, Varma signed an international appeal to G20 leaders ahead of the meeting in Osaka in June. In the statement, a group of investors urge the governments to speed up actions to meet the targets set at the Paris climate conference.

In spring of 2019, Varma participated in the general meetings of 86 public companies. Information about Varma's positions and votes at the general meetings is published on Varma's website.

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

We expect the uncertainty and unpredictability of the economic operating environment to continue. There are no easy solutions to the trade war in sight, as the US and China have conflicting strategic interests.

Signs of the central banks' willingness to take new measures support the economy and asset values in the markets. At the same time, a dependency on monetary policy has emerged. Of course, the central banks still have a range of tools at their disposal, but with less leeway in the event of a major market disturbance than before the financial crisis.

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.

Helsinki, 16 August 2019

Risto Murto
President & CEO

The figures presented in this half-year report are unaudited figures of the parent company.

Varma Mutual Pension Insurance Company is a responsible and solvent investor. The company is responsible for the statutory earnings-related pension cover of 900,000 people in the private sector. Premiums written totalled EUR 5.1 billion in 2018 and pension payments stood at EUR 5.7 billion. Varma's investment portfolio amounted to EUR 46.5 billion at the end of June 2019.

FURTHER INFORMATION:
Pekka Pajamo, SVP, Finance and Internal Services, tel. +358 10 244 3158 or +358 40 532 2009
Katri Viippola, SVP, Communications, HR and CSR, tel. +358 10 244 7191 or +358 400 129 500

ATTACHMENT: Graphs and charts
www.varma.fi/en
www.varma.fi/annualreport

VARMA

Balance sheet at fair values (Parent Company)

€ million	6/2019	6/2018	12/2018
Assets			
Investments	46,540	46,359	44,015
Receivables	1,245	275	858
Furniture and fixtures	4	4	4
	47,789	**46,638**	**44,878**
Liabilities			
Capital and reserves	133	126	130
Valuation differences	9,667	9,186	8,004
Provision for future bonuses	1,194	2,037	1,486
Off-balance-sheet items	-1	-1	-1
Solvency capital, total	10,992	11,348	9,619
Provision for current bonuses (for client bonuses)	77	81	154
Equity-linked provision for current and future bonuses	723	1,010	-255
Actual technical provision	35,623	33,959	35,137
Total	36,346	34,970	34,882
Other liabilities	374	240	224
	47,789	**46,638**	**44,878**

Income statement at fair values (Parent Company)

€ million	1-6/2019	1-6/2018	1-12/2018
Premiums written	2,633	2,454	5,118
Claims paid	-2,843	-2,745	-5,404
Change in technical provisions	-1,388	-619	-446
Net investment income	3,042	798	-872
Total operating expenses	-68	-67	-125
Other income/expenses	0	0	-4
Taxes	-3	-7	-8
Total result [1]	**1,374**	**-186**	**-1,741**

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

€ million	1-6/2019	1-6/2018	1-12/2018
Underwriting profit/loss	14	-9	23
Investment result	1,338	-200	-1,816
Loading profit	23	24	56
Other income/expenses	0	0	-4
Total result	**1,374**	**-186**	**-1,741**

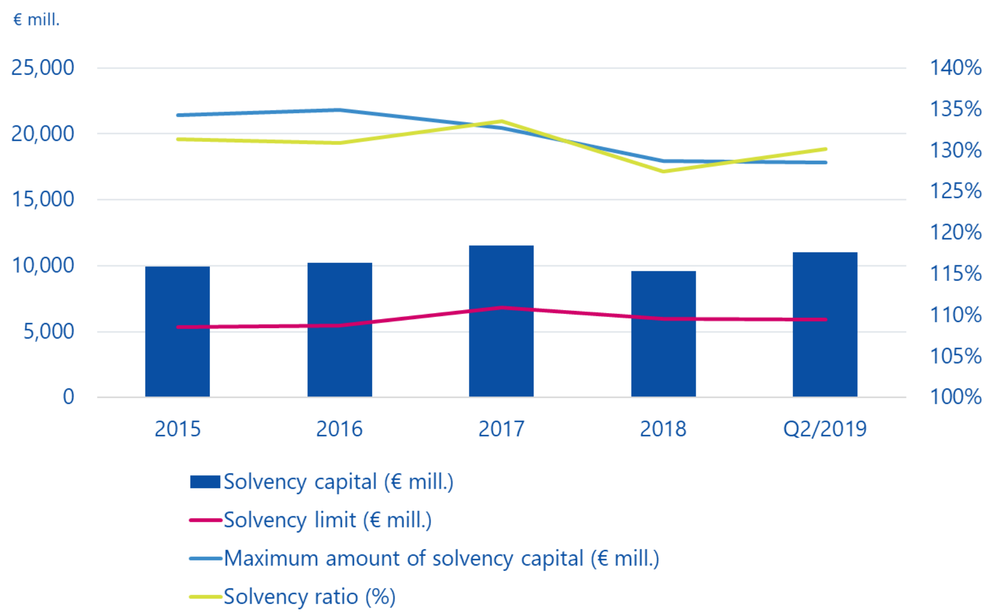
Solvency capital and limits

	30/06/2019	30/06/2018	31/12/2018
Solvency limit (€ mill.)	5,937	6,242	5,973
Maximum amount of solvency capital (€ mill.)	17,812	18,726	17,918
Solvency capital (€ mill.)	10,992	11,348	9,619
Solvency ratio (%) [1]	130.2	132.4	127.5
Solvency capital/Solvency limit [2]	1.9	1.8	1.6

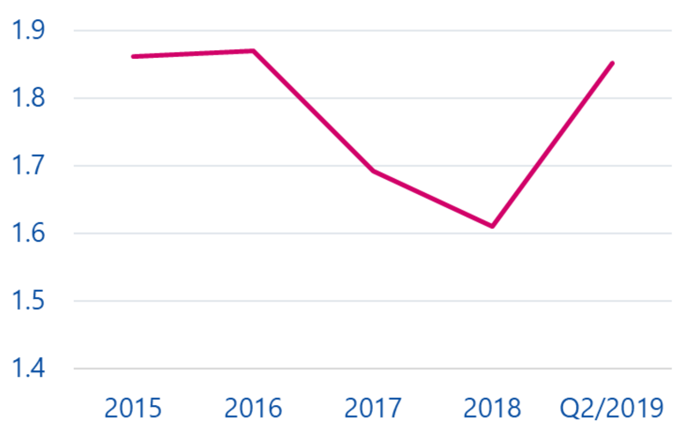
[1] Pension assets in relation to the technical provisions under §11 of the Ministry of Social Affairs and Health's decree governing pension institutions (614/2008).

[2] Solvency capital in relation to the solvency limit

Solvency development



Solvency capital in relation to the solvency limit



Investments at fair value

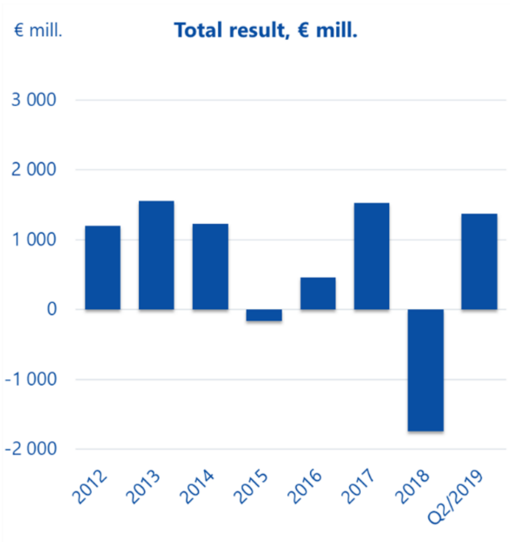
	30 Jun 2019 Market value				31 Dec 2018 Market value				1-6/2019	1-6/2018	1-12/2018	24 m
	Market Value		Risk position		Market Value		Risk position		Return MWR	Return MWR	Return MWR	Vola-
	€ mill.	%	€ mill.	%	€ mill.	%	€ mill.	%	%	%	%	tility
Fixed-income investments [1]	**13,307**	**29**	**12,327**	**26**	**13,522**	**31**	**10,568**	**24**	**3.5**	**-1.5**	**-1.8**	
Loan receivables	1,968	4	1,968	4	1,817	4	1,817	4	2.1	1.6	3.7	
Bonds	10,458	22	11,002	24	10,625	24	9,031	21	4.1	-2.2	-2.9	2.1
Public bonds	4,015	9	4,559	10	4,104	9	2,142	5	2.8	-4.0	-4.2	
Other bonds	6,443	14	6,443	14	6,520	15	6,889	16	4.9	-1.0	-2.0	
Other money-market instruments and deposits	880	2	-643	-1	1,080	2	-280	-1	0.7	0.2	-0.1	
Equity investments	**20,253**	**44**	**19,670**	**42**	**17,916**	**41**	**18,222**	**41**	**12.5**	**3.3**	**-3.6**	
Listed equities	15,467	33	14,884	32	13,407	30	13,713	31	15.3	2.6	-8.3	12.2
Private equity	4,540	10	4,540	10	4,255	10	4,255	10	4.5	7.8	17.5	
Unlisted equities	246	1	246	1	254	1	254	1	-0.2	1.2	3.8	
Real estate investments	**4,086**	**9**	**4,086**	**9**	**3,879**	**9**	**3,879**	**9**	**1.9**	**2.7**	**5.5**	
Direct real estates	2,988	6	2,988	6	2,895	7	2,895	7	2.0	1.9	3.9	
Real estate funds	1,098	2	1,098	2	984	2	984	2	1.6	5.4	10.6	
Other investments	**8,894**	**19**	**10,222**	**22**	**8,699**	**20**	**10,037**	**23**	**2.9**	**2.4**	**-1.4**	
Hedge funds	8,896	19	8,896	19	8,703	20	8,703	20	3.1	3.4	1.6	2.3
Commodities	-9	0	-1	0	-8	0	25	0				
Other investments	6	0	1,327	3	3	0	1,308	3				
Total investments	**46,540**	**100**	**46,304**	**99**	**44,015**	**100**	**42,705**	**97**	**6.9**	**1.7**	**-2.0**	**4.5**
Impact of derivatives			235	1			1,310	3				
Investment allocation at fair value	**46,540**	**100**	**46,540**	**100**	**44,015**	**100**	**44,015**	**100**				

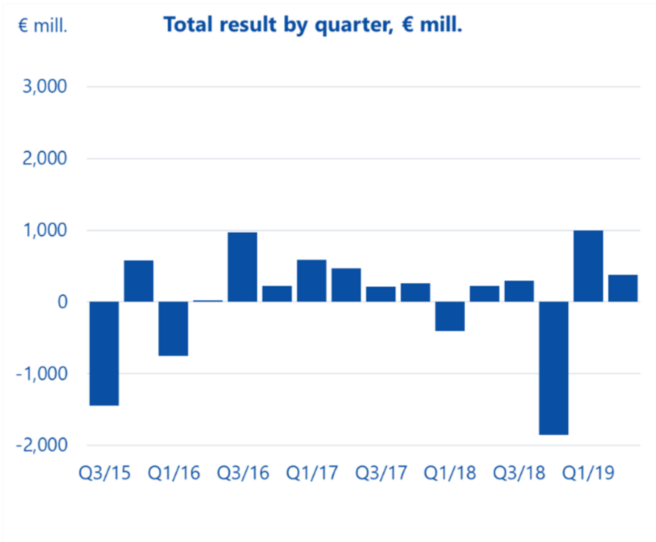
The modified duration for all the bonds is 4.2.

The open currency position is 25.4% of the market value of the investments.

[1] Includes accrued interest

Total result





Summary of the key figures

	1-6/2019	1-6/2018	1-12/2018
Premiums written, € million	2,633	2,454	5,118
Net investment income at fair value, € million	3,027	779	-902
Return on invested capital, %	6.9	1.7	-2.0
	6/2019	**6/2018**	**12/2018**
Technical provisions, € million	37,617	37,087	36,521
Solvency capital, € million	10,992	11,348	9,619
in relation to solvency limit	1.9	1.8	1.6
Pension assets, € million	47,395	46,380	44,636
% of technical provisions	130.2	132.4	127.5
TyEL payroll, € million	21,108	20,239	20,385
YEL payroll, € million	810	798	797

Investments at fair value, broken down as per the regulations of the Financial Supervisory Authority

	Market value						Risk position					
	30 Jun 2019		30 Jun 2018		31 Dec 2018		30 Jun 2019		30 Jun 2018		31 Dec 2018	
	€ million	%	€ million	%	€ million	%	€ million	%	€ million	%	€ million	%
Fixed-Income Investments	**13,307**	**28.6**	**14,348**	**30.9**	**13,522**	**30.7**	**12,327**	**26.5**	**10,563**	**22.8**	**10,568**	**24.0**
Loan receivables	1,968	4.2	1,593	3.4	1,817	4.1	1,968	4.2	1,593	3.4	1,817	4.1
Bonds	10,458	22.5	10,876	23.5	10,625	24.1	11,002	23.6	9,037	19.5	9,031	20.5
Other money-market instruments and deposits	880	1.9	1,879	4.1	1,080	2.5	-643	-1.4	-67	-0.1	-280	-0.6
Equity investments	**20,253**	**43.5**	**19,742**	**42.6**	**17,916**	**40.7**	**19,670**	**42.3**	**19,848**	**42.8**	**18,222**	**41.4**
Listed equities	15,467	33.2	15,796	34.1	13,407	30.5	14,884	32.0	15,902	34.3	13,713	31.2
Private equity	4,540	9.8	3,409	7.4	4,255	9.7	4,540	9.8	3,409	7.4	4,255	9.7
Unlisted equities	246	0.5	538	1.2	254	0.6	246	0.5	538	1.2	254	0.6
Real estate investments	**4,086**	**8.8**	**3,811**	**8.2**	**3,879**	**8.8**	**4,086**	**8.8**	**3,811**	**8.2**	**3,879**	**8.8**
Direct real estates	2,988	6.4	2,804	6.0	2,895	6.6	2,988	6.4	2,804	6.0	2,895	6.6
Real estate funds	1,098	2.4	1,007	2.2	984	2.2	1,098	2.4	1,007	2.2	984	2.2
Other investments	**8,894**	**19.1**	**8,458**	**18.2**	**8,699**	**19.8**	**10,222**	**22.0**	**9,917**	**21.4**	**10,037**	**22.8**
Hedge funds	8,896	19.1	8,488	18.3	8,703	19.8	8,896	19.1	8,488	18.3	8,703	19.8
Commodities	-9	0.0	9	0.0	-8	0.0	-1	0.0	168	0.4	25	0.1
Other investments	6	0.0	-40	-0.1	3	0.0	1,327	2.9	1,262	2.7	1,308	3.0
Total	**46,540**	**100.0**	**46,359**	**100.0**	**44,015**	**100.0**	**46,304**	**99.5**	**44,140**	**95.2**	**42,705**	**97.0**
Impact of derivatives							235	0.5	2,219	4.8	1,310	3.0
Total	**46,540**	**100.0**	**46,359**	**100.0**	**44,015**	**100.0**	**46,540**	**100.0**	**46,359**	**100.0**	**44,015**	**100.0**

Modified duration of the bond portfolio	**4.2**

Net return on invested capital

	Net investment return at fair value € million	Invested capital 30 Jun 2019 € million	Return % on invested capital %	Return % on invested capital 30 Jun 2018 %	Return % on invested capital 31 Dec 2018 %
Fixed-Income Investments	**463**	**13,144**	**3.5**	**-1.5**	**-1.8**
Loan receivables	39	1,864	2.1	1.6	3.7
Bonds	417	10,206	4.1	-2.2	-2.9
Other money-market instruments and deposits	7	1,073	0.7	0.2	-0.1
Equity investments	**2,253**	**18,030**	**12.5**	**3.3**	**-3.6**
Listed equities	2,059	13,463	15.3	2.6	-8.3
Private equity	194	4,315	4.5	7.8	17.5
Unlisted equities	-1	251	-0.2	1.2	3.8
Real estate investments	**74**	**3,945**	**1.9**	**2.7**	**5.5**
Direct real estates	58	2,931	2.0	1.9	3.9
Real estate funds	16	1,014	1.6	5.4	10.6
Other investments	**253**	**8,680**	**2.9**	**2.4**	**-1.4**
Hedge funds	267	8,680	3.1	3.4	1.6
Commodities	-6	-2			
Other investments	-8	1			
Total	**3,043**	**43,798**	**6.9**	**1.7**	**-1.9**
Unallocated income, costs and operating expenses from investment activities	-16	7			
Net investment return at fair value	**3,027**	**43,805**	**6.9**	**1.7**	**-2.0**