

## ILMARINEN'S INTERIM REPORT 1 JANUARY TO 30 JUNE 2016

- The return on investments in January–June was -0.6 per cent (6.2 per cent in corresponding period of 2015), and the market value of investments was EUR 35.7 (36.4) billion.
- Return on investments in Q2 was 0.8 (-0.8) per cent.
- Solvency capital was EUR 7,386 (9,087) million; 26.1 (33.2) per cent of technical provisions and 2.2 (2.4) times the solvency limit.
- The number of insured, the insured payroll and development of premiums written was modest due to the general economic situation.

### 1. OPERATING ENVIRONMENT

The first part of 2016 was challenging in terms of the investment environment. After the stock price plummet at the beginning of the year, the second quarter took off on a positive note with easing concerns about China's growth and devaluation of the currency, and the oil price. The price of oil rose from 40 dollars to 50 dollars during the quarter.

The UK's referendum on exiting the EU, held towards the end of June, gradually became the main concern of investors, with polls showing that the risk of Brexit was growing. Europe's equity markets began moving in sync with the Brexit polls and the victory of the Leave vote caused the positive investment result of Q2 to eventually fall slightly below zero. The pound weakened against the dollar by 11.2 per cent in two days.

Despite the UK's Brexit referendum, the world's stock markets rose by 1.4 per cent in local currencies during Q2. The interest rate on Germany's ten-year government bond fell from Q1's 0.16 per cent to a negative -0.13 per cent, driven by expectations of stimulating monetary policies and demand for secure investments.

Finland's economic development continued to be relatively weak during the early part of the year. Statistics Finland estimates that total production grew at a rate of approximately 1 per cent but that the export of goods shrank compared to the previous year. Due to slow growth, also the development of employment was weak and the growth of the payroll and pension premiums written remained slow.

The labour market organisations reached an agreement in June concerning the Government's competitiveness pact, according to which a portion of employers' social security contributions will gradually be transferred, between 2017 and 2020, to employees to pay. As a result of this, employers' and employees' earnings-related pension contributions will change. The government has promised to compensate for any loss of net earnings by lightening earnings taxation. The new labour market solution also states that no general pay increases will be made to wages and salaries in 2017 and that annual working hours will increase by 24 hours.

### 2. RESULT AND SOLVENCY

The first half of 2016 on the investment markets was characterised by uncertainty. Between January and June, Ilmarinen's investments yielded -0.6 (6.2) per cent, which caused solvency to weaken somewhat. Nonetheless, solvency remained strong. Solvency capital at the end of June stood at EUR 7,386 (9,087) million, which is 26.1 (33.2) per cent of the technical provisions used in

calculating solvency and 2.2 (2.4) times the solvency limit. Ilmarinen's technical provisions amounted to EUR 30,204 (30,614) million. The solvency technical provisions, in the amount of EUR 28,352 (27,364) million, do not include the provision for future bonuses of EUR 916 (2,195), the equalisation provision of EUR 917 (1,036) or the EUR 19 (19) million in earnings-related pension contributions that remain open receivables in the YEL basic insurance.

Ilmarinen's total financial result at current value from the first half-year was EUR -729 (1,245) million. Net investment return at current value came to EUR -213 (2,143) million. The investment result for the first half of the year was EUR -718 (1,208) million. The result of the underwriting business was EUR -26 (20) million and the loading profit EUR 16 (17) million.

### **3. INSURANCE OPERATIONS**

Ilmarinen's insurance portfolio declined slightly compared to the end of 2015. As a result of policy transfers between pension companies, Ilmarinen's TyEL insurance portfolio grew by 52 policies but the impact of the transferred policies on premiums written was EUR 7 million negative. The YEL insurance portfolio fell by 80 insurance portfolios but premiums written grew by EUR 0.2 million. At the end of June, Ilmarinen managed 61,558 (61,851 at end of 2015) self-employed persons' pension insurance policies and 38,013 (38,354 at end of 2015) earnings-related pension policies taken out by employers.

At the end of June 473,200 (478,700) insured employees were covered by Ilmarinen's TyEL insurance, which is some 1.1 per cent less than a year ago. The key factor impacting the number of insured was the general economic and employment development that continued to be weak. The TyEL payroll insured at Ilmarinen is estimated to come to EUR 16.6 (16.7) billion in 2016. Premiums written are expected to remain almost unchanged in 2016 compared to 2015.

At the end of June, the number of pension recipients was 324,857 (320,494), which is 1.4 per cent more than a year earlier. TyEL pensions were received by 283,902 (280,040) pension recipients while 40,955 (40,454) received YEL pensions. The pensions paid to them came to EUR 2,263 (2,198) million in January–June.

During the first half of the year, 11,877 (11,070) new pension decisions were made, which is 7.3 per cent more than in the corresponding period of the previous year. A total of 20,888 (20,823) pension decisions were made. New rehabilitation decisions came to 1,380 (1,555).

### **4. INVESTMENTS**

At the end of the first half of 2016, Ilmarinen's total investment assets at current value stood at EUR 35,744 million (EUR 36,412 million on 30 June 2015). The return on investments at current value was -0.6 (6.2) per cent. The return on the first quarter was -1.4 per cent and 0.8 per cent on the second quarter.

Ilmarinen's long-term investment returns remained on a good level. Calculated from 1997, the average annual return at current value for Ilmarinen's investments has been 5.7 per cent. This corresponds to an annual real yield of 4.0 per cent. The Finnish Centre for Pensions uses a 3.5 per cent expected real return rate to estimate the future development of earnings-related pension insurance contributions.

Fixed-income investments accounted for a total of 44.7 (48.8) per cent of the investment portfolio and their return at current value was 0.3 (0.8) per cent. Their total market value, taking into account derivatives, was EUR 15,995 (17,751) million. Bonds accounted for a total of 40.6 (40.7) per cent of Ilmarinen's investment assets and their return was 0.0 (0.7) per cent. Other money market instruments and deposits totalled EUR 280 (1,452) million and accounted for 0.8 (4.0) per cent of the investment assets. Loan receivables made up 3.3 (4.0) per cent of the investment assets, with a return of 1.9 (2.1) per cent. The modified duration of bonds was 0.9 (1.5) years.

Listed and non-listed equities and shares as well as private equity investments made up 38.6 (36.8) per cent of all investments. Their value at the end of the first half of 2016 was EUR 13,807 (13,415) million. The amount of risk related to listed equities and shares was reduced by EUR 1,585 million through derivatives. Their proportion of the risk breakdown was 25.6 (30.1) per cent. Domestic equities made up 26.2 (28.9) per cent of investments in listed equities and shares. The return on equities, calculated at current value, was -3.6 (14.0) per cent. The return on listed equity investments was -5.8 (15.4) per cent.

At the end of June, real estate investments amounted to EUR 4,043 (3,500) million, accounting for 11.3 (9.6) per cent, of which indirect investments made up 1.4 (1.4) percentage units. The total return of the real estate investments was 1.7 (3.0) per cent. The return on direct real estate investments was 1.8 (2.6) per cent.

Of the market value of investment assets, 5.3 (4.8) per cent consisted of commodity investments, investments in absolute return funds and other investments at the end of H1. Absolute return funds were worth EUR 811 (632) million, and generated a return of -1.3 (9.7) per cent on capital employed.

## **5. OPERATING EXPENSES AND PERSONNEL**

Ilmarinen's total operating expenses for the first half of the year came to EUR 78 (77) million. The operating expenses covered by the expense loading component included in the earnings-related pension contribution stood at EUR 56 (56) million. Loading profit, in other words the difference between the expense loading and the costs covered by it, amounted to EUR 16 (17) million. Half of the loading profit is refunded to the customers as client bonuses. The operating expense ratio which measures the operational efficiency of Ilmarinen's activities is expected to be at around 78 per cent (76 per cent) this year.

The average number of employees working at Ilmarinen between January and June was 532 (528), measured in person years. The number of permanent employees fell clearly during the year while the number of fixed-term employees grew.

## **6. OUTLOOK**

Uncertainty will continue to characterise the outlook for investment operations. The uncertainty is linked to international politics, the global economy and Europe's development. Key sources of uneasiness in Europe are the UK's Brexit referendum and the trouble faced by several major European banks. Economic growth in the euro zone will continue to be sluggish and inflation will clearly fall below the target set by the ECB. These will result in an exceptionally low interest rate

level. The low interest rate level will help those with debt to manage but will simultaneously narrow banks' interest rate margins and weaken the solvency of insurance companies and fully-funded pension systems. This environment emphasises the importance of strong solvency for earnings-related pension companies.

The outlook for Finland's economy has slightly improved during the first half of the year. The signing of the competition pact has brought predictability to the economy and improved the confidence of households, in particular. These positive changes are already emerging as growth in domestic demand. Particularly construction has taken off strongly and unemployment growth appears to have stalled.

Weak exports continue to be the greatest challenge faced by Finland's economy. The competition pact and the promise it contains about the new Finnish model for wage formation creates expectations of improving competition over the next few years. At the same time, however, the major uncertainty factors in the global economy are putting the brakes on growth in global investments, which is one contributor to the limited growth expectations of Finnish companies.

*The figures presented in this interim report are unaudited.*