

## Elo's Half-Year Financial Report (1 January–30 June 2018):

The comparison figures in brackets are figures for 30 June 2017.

- **The return on Elo's investments was 0.8%. The market value of Elo's investments was EUR 23.4 billion.**
- **Solvency; the solvency ratio was 123.8% and solvency capital was 1.7 times the solvency limit.**
- **The overall result was EUR -290 million.**
- **The expense loading ratio was 75.2%.**

	1.1.–30.6.2018	1.1.–30.6.2017	1.1.–31.12.2017
Premiums written, EUR million	1,827.8	1,694.8	3,510.8
Net investment income at current value, EUR million	186.3	967.3	1,607.6
Net return from investment on capital employed, %	0.8 %	4.4 %	7.4 %

	30.6.2018	30.6.2017	31.12.2017
Technical provisions, EUR million	20,612.4	19,440.8	20,134.5
Solvency capital, EUR million <sup>1)</sup>	4,524.5	4,709.3	4,815.5
ratio to solvency limit	1.7	1.7	1.6
Pension assets, EUR million <sup>2)</sup>	23,570.1	22,771.9	23,443.9
% of technical provisions <sup>2)</sup>	123.8 %	126.1 %	125.9 %
TyEL payroll, EUR million <sup>3)</sup>	13,325.3	12,194.1	12,717.0
YEL earned income sum, EUR million <sup>3)</sup>	1,824.2	1,871.9	1,824.2

<sup>1)</sup> Calculated in accordance with the regulations in force at each time (the same principle also applies to other solvency indicators)

<sup>2)</sup> Technical provisions pursuant to section 11, paragraph 10 of the Ministry of Social Affairs and Health's Decree (614/2008) + solvency capital.

<sup>3)</sup> Estimate of policyholders' salary and reported earnings for the full year

### Economic environment and development of the investment market

Global economic growth remained relatively strong during the first half of the year, but continued growth now largely depends on the United States. Due to factors including OPEC production restrictions, the price of crude oil has increased by more than 20 per cent from the start of the year, leading to a global rise in consumer price inflation, at least temporarily.

The consensus estimate of global economic growth for the year is 3.8 per cent. The US growth outlook has risen from last year's growth of 2.3 per cent to 3 per cent. While global economic growth has been gratifyingly uniform for the past few years, growth in Europe and emerging economies has now begun to slow down, at least temporarily. The consensus estimate for economic growth in the euro zone this year is 2.2 per cent, compared to 2.4 per cent last year. The growth outlook for emerging economies has declined by a few tenths of a per cent compared to the previous year.

Economic growth in the United States is still supported by expansive tax reforms, despite the fact that the country is already at practically full employment. Wage and inflation pressures in the United States have remained surprisingly moderate for the time being. The US Federal Reserve has continued to cautiously tighten its monetary policy and further tightening is expected. The effects of the Fed's monetary policy and the rise in the value of the US dollar during the first half of the year have slowed down the growth of many emerging economies.

In Europe, the diminishing growth has come as a surprise to the markets and is currently perceived to be temporary. The European Central Bank's monetary policy is still highly stimulative but, at the same time, the price of crude oil and weaker international economic growth appear to have weighed down growth in the euro zone. Finnish economic growth remained strong during the first half of the year, although the best period is likely to be over in Finland as well. Construction activity, for example, has clearly begun to slow down.

The global investment markets were characterised by volatility during the first half of the year, with negative returns in many asset classes. Investment market returns have been affected by, among other things, political uncertainties, such as fears of global trade wars, and expectations of tightening market liquidity due to the actions of central banks. Euro-denominated investors face a challenge in the form of the historically high interest

rate gap between the US and Europe, which increases the cost of the currency hedging of dollar-denominated investments, among other things.

The returns of unlisted investments have been higher across the board than the returns of the securities markets. In private equity investments, M&A activity has remained high globally and the volume is higher than last year due to significant large-scale mergers. In the Finnish real estate investment market, the number of transactions remains high after the record-breaking levels seen in 2017. A new feature of the market in 2018 has been the strong emergence of international investors in the housing investment market. Net return requirements are still at a record low level, and the transaction volume looks to remain high during the second half of the year.

### **Employment pension system**

The Ministry of Social Affairs and Health confirmed the new pension employment company-specific customer bonus principles last year. The reform will be actually visible to customers after a transition period in 2019. The customer bonus is the part of the result of the employment pension company credited to the customer. The employment pension company's solvency and operational efficiency influence the amount of the customer bonus. A pension employment company has the possibility to transfer its entire loading profit to bonuses.

Elo's bonus principles are based on fairness. Elo distributes the loading profit resulting from operational efficiency to the customers whose employment pension premiums have contributed to it and takes the customer's full history into account in distributing the profit resulting from solvency. Elo's customers will continue to receive competitive bonuses in the future.

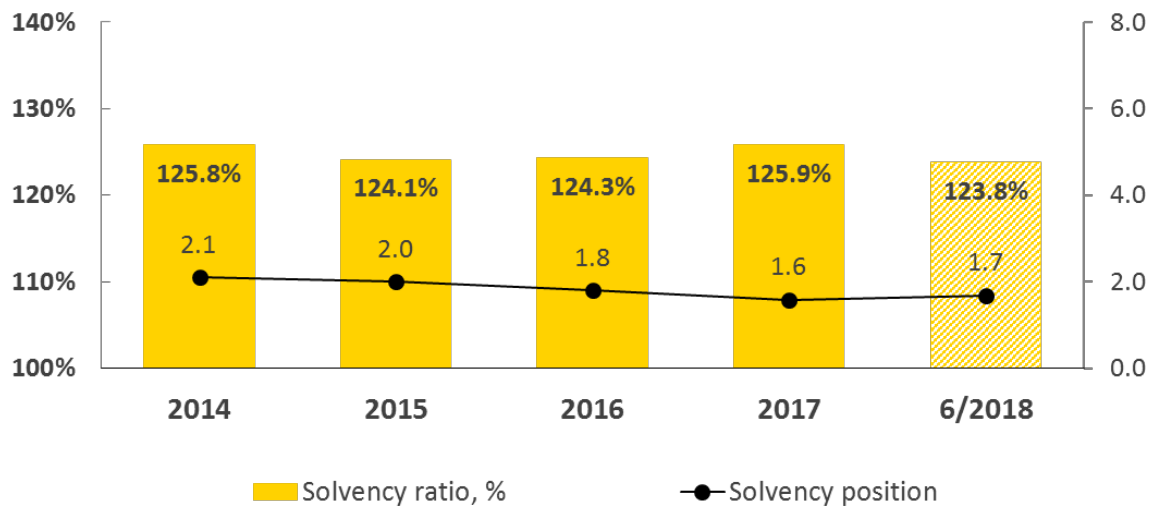
In 2018, an unofficial working group of the Ministry of Social Affairs and Health has investigated the issues and development needs related to YEL insurance and assessed potential solutions. The main principles of the definition of income, which is the basis of YEL insurance, are still the same as they were when the relevant act was prescribed in 1970. However, entrepreneurship has diversified in recent years, and the customers of invoicing service companies have given rise to particular debate. The starting point for reforms should be to increase entrepreneurs' trust in the pension system. Surveys indicate that trust in the system is currently too low. Furthermore, surveys conducted by the Finnish Centre for Pensions suggest that entrepreneurs often confirm their earned income as lower than their actual earned income. In many cases, this can lead to lower-than-expected pension cover or social security.

In 2018, it has also been investigated whether it would be appropriate and possible to discontinue the structure of having separate pension systems for the local government sector and the private sector and to have all work performed under these systems insured under the Employees' Pensions Act.

Overall, the Finnish employment pension system is in good shape and there have been discussions regarding factors that affect the pension system, such as population growth, the economy and the transformation of work.

### **Result and solvency**

Solvency capital amounted to EUR 4,525 million (EUR 4,709 million). The ratio of pension assets to technical provisions, i.e. the solvency ratio, was 123.8 per cent (126.1 per cent). The solvency capital was 1.7 (1.7) times the solvency limit.



The net return on investment operations at fair values was EUR 186 million (EUR 967 million). The return credited in technical provisions for the same period was EUR 490 million (EUR 528 million), of which technical provisions linked to equity income accounted for EUR 82 million (EUR 160 million). The result of investment operations at current value was thus EUR -304 million (EUR 440 million).

The loading profit came to EUR 16 million (EUR 10 million) and the insurance business surplus was EUR -2 million (EUR -13 million). Elo's combined total result at current value was EUR -290 million (EUR 437 million). Total operating expenses amounted to EUR 67 million (EUR 66 million) for the period under review.

Solvency capital	30.6.2018	30.6.2017	31.12.2017
Solvency limit, EUR million	2,689.8	2,719.5	3,040.2
Maximum amount of solvency capital, EUR million	8,069.5	8,158.1	9,120.6
Solvency capital, EUR million	4,524.5	4,709.3	4,815.5
Solvency ratio, % <sup>1)</sup>	123.8	126.1	125.9
Solvency capital/Solvency limit <sup>2)</sup>	1.7	1.7	1.6

<sup>1)</sup> Pension assets in relation to technical provisions as referred to in Section 11, item 10, of the Ministry of Social Affairs and Health's decree 614/2008. All years are presented according to the new presentation method.

<sup>2)</sup> Solvency capital in relation to solvency limit

### Insurance services and customer accounts

At the end of June, Elo administered 45,700 TyEL (44,700) and 84,000 YEL (84,000) insurance policies. The total number of self-employed persons and employees insured by Elo at the end of the reporting period was 503,700 (484,200), or about half a million.

Elo's market position has continued to see strong growth. Measured in terms of TyEL and YEL premiums written, Elo achieved an overall market share of 25 per cent at the end of 2017. The strengthening of Elo's market position is attributable to the successful transfer business of TyEL and YEL insurance as well as new customer prospecting in cooperation with partners. Elo continued to strengthen its market position during the first half of 2018 during the pension insurance companies' transfer periods, which saw Elo's TyEL premiums written increase by EUR 18.1 million (EUR 12.2 million). A total of 234 (514) new YEL insurance policies were gained. During the transfer period of April–June 2018, more than 41 per cent of TyEL insurance policies were transferred to Elo, measured in terms of premiums written.

The national income register will be adopted on 1 January 2019. The income register is an electronic database of income information and, following its adoption, payroll data will be reported in real time to the income register.

The project will advance and extend into reporting benefit and pension data in 2020. This represents a significant reform from the customers' perspective, in particular, as the reporting of payroll data to the employment pension insurer will change. Elo continued to prepare for the adoption of the income register as planned during the reporting period.

Elo's network of occupational health specialists was expanded to include Turku. Elo now has a comprehensive network across Finland in Turku, Tampere, Vaasa, Oulu, Kuopio, Jyväskylä and Espoo.

Elo has made significant investments in improving customer service. These efforts led to the telephone service of Elo's insurance services being selected as the best in Finland in late May in the Customer's Voice Index, in the category *Best customer service for small and medium-sized enterprises*. Winning the competition is an indication of excellent and consistent service as well as goal-oriented service development.

According to customer feedback, Elo's customers have also been satisfied with Elo's online service on working capacity management and they have felt that it has provided concrete benefits related to the management of working capacity risks. The online service was redesigned in late 2017.

Elo started a cooperation with the Finnish Olympic Committee to become one of the main partners of the competition titled Finland's Most Active Workplace. As part of the cooperation, Elo invites its customers to participate in the competition, which gives them the opportunity to assess the overall picture of employee exercise in their work community and identify areas that can be developed in order to improve working capacity and workplace well-being. The award will be given out at the Finnish Sports Gala in January 2019.

### **Pension services**

Elo gave a total of 12,756 decisions on the basis of applications during the first half of 2018. The popularity of partial early old-age pension has levelled off since last year, with 1,029 (1,536) decisions given this year.

A total of 540 entrepreneurs retired on old-age pension during the first half of the year. The number of entrepreneurs retiring on partial early old-age pension was 242. Entrepreneurs accounted for 26 per cent of those who opted for partial early old-age pension.

Elo has given only a few career pension decisions thus far in 2018. As expected, the number of applications has been relatively low.

Elo's customers have been active in starting to use new service channels. The online pension service received some 74,000 logins during the first half of the year. The use of electronic services has increased by about 6.4 per cent year-on-year. The application categories for which the online services are used the most are partial early old-age pension and old-age pension.

Elo expanded its electronic services during the first half of the year to include electronic pension decisions. Elo can now deliver a fully electronic pension application process from start to finish, including preliminary advice, the pension application itself, electronic pension decisions and services for pensioners. Electronic services will be expanded further during the second half of the year.

The number of new disability pension decisions increased very little from the previous year (by approximately 1 per cent). The active model, which has been the subject of some debate, has been reflected in individual contacts and applications. Elo received a total of 993 (887) applications for vocational rehabilitation during the first half of the year, which represents an increase of approximately 10 per cent compared to the previous year. The rate of increase in the number of rehabilitation applicants for the full year 2017 was 11.4 per cent.

A total of 233,525 pensioners were paid their pensions by Elo at the end of June. A total of EUR 1,621 million was paid in pensions during the first two quarters, of which old-age pensions accounted for EUR 1,371 million (including partial early old-age pensions).

## Focal points of investment asset classes

The equity, fixed income and currency markets were characterised by nervousness and the returns on securities were low overall during the first half of the year. There were significant geographical differences in returns between equity markets. The highest return was seen in the Finnish equity market at nearly 10 per cent, while the returns from other European equity markets were slightly negative during the first half of the year. The return from the US equity market was +2 per cent, while the emerging markets suffered the largest losses.

The returns of fixed income investments were at zero or negative in many fixed income categories, such as corporate bonds and investments in emerging markets. With regard to currencies, the US dollar appreciated slightly against the euro. Returns on hedge fund investments were positive at 2.2 per cent.

Unlisted private equity investments and real estate investments produced steady returns and supported the overall rate of return as the nervous economic climate weighed down on returns in the equity markets. The demand for real estate investments remained strong as the sustained low interest rates supported their record-high valuations.

The return on real estate investments remained stable. The occupancy rates of business premises and housing have remained at a good level, with the majority of the vacancies in the market continuing to be related to office and storage premises. With regard to Elo's domestic real estate portfolio, the focus is on further developing the existing portfolio through rental operations and property development as well as the divestment of certain properties.

Elo acquired shares in Exilion Real Estate 1 Ky in a transaction carried out during the first half of the year. The company owns three properties consisting of business premises in Helsinki's central business district and Ruoholahti, with a total leasable area of approximately 50,000 square metres.

Two new blocks of flats (comprising approximately 200 flats) were completed at the start of the year in Espoo's Niittykumpu district and in the centre of Kerava. A preliminary agreement was signed on the development of a residential property in Vantaa's Pähkinärinne district. Older housing stock was sold in different parts of Finland during the reporting period for approximately EUR 40 million.

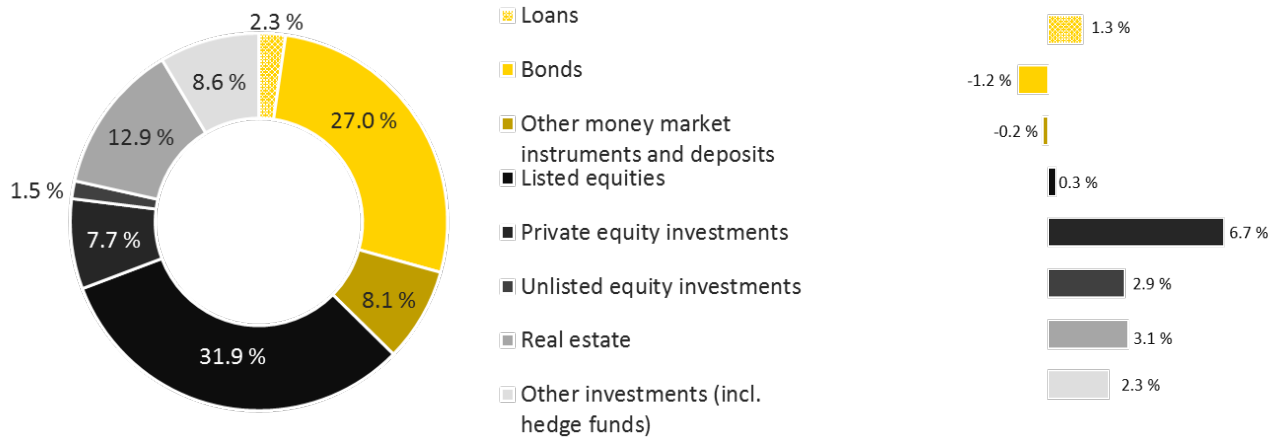
The return on private equity investments was 6.7 per cent. The factors behind the strong rate of return included the large number of exits and the robust profit performance of the companies invested in. M&A activity has remained high globally and the volume is higher than last year due to significant large-scale mergers. The amounts of capital raised in corporate transactions have also increased as funds have become larger, particularly with listed companies representing a growing share of the entities acquired in private equity transactions.

The accelerated growth of the Finnish economy was reflected in Elo's corporate financing in the form of growing demand for loans. M&A and corporate restructuring activity is high and Elo was involved in many financing arrangements related to such transactions. At the same time, the general availability of loans to companies is at a good level, which has enabled a substantial increase in investments. For example, according to the Confederation of Finnish Construction Industries RT, the new construction volume index grew by slightly under eight per cent last year, and this year's increase in volume is expected to be approximately four per cent.

At the end of June, the value of Elo's investments was EUR 23,404 million (EUR 22,607 million). Return on investments was 0.8 per cent (4.4 per cent) during the first half of the year. In the second quarter, return on investments was 1.2 per cent (1.5 per cent). From the beginning of the year, the asset class with the highest return was private equity investments, with a return of 6.7 per cent.

The average 5-year nominal return of Elo's investments was 6.1 per cent and the average 10-year nominal return was 5.4 per cent. The average 5-year real return was 5.4 per cent and the average 10-year real return was 4.2 per cent. The figures used in the calculations for 2007–2013 are the return on investments for LocalTapiola Mutual Pension Insurance Company.

## Risk allocation and return on investments



## Asset allocation and returns

	Basic allocation by market value		Actual risk position		Return incl. currency hedges	Volatility
	EUR million	%	EUR million	%	%	%
<b>Fixed-income investments</b>	<b>9,209.7</b>	<b>39.4</b>	<b>4,223.7</b>	<b>18.0</b>	<b>-0.9</b>	
Loans	532.9	2.3	532.9	2.3	1.3	
Bonds	7,023.4	30.0	6,326.7	27.0	-1.2	2.7
Public bonds	3,346.3	14.3	3,337.6	14.3	-1.5	
Other bonds	3,677.2	15.7	2,989.1	12.8	-0.8	
Other money market instruments and deposits inc. any receivables and liabilities related to investments	1,653.4	7.1	-2,635.8	-11.3	-0.2	
<b>Equities</b>	<b>9,166.8</b>	<b>39.2</b>	<b>9,626.6</b>	<b>41.1</b>	<b>1.5</b>	
Listed equities	7,003.7	29.9	7,463.5	31.9	0.3	7.5
Private equity investments	1,807.5	7.7	1,807.5	7.7	6.7	
Unlisted equity investments	355.6	1.5	355.6	1.5	2.9	
<b>Real estate</b>	<b>3,028.1</b>	<b>12.9</b>	<b>3,028.1</b>	<b>12.9</b>	<b>3.1</b>	
Direct real estate investments	2,337.6	10.0	2,337.6	10.0	3.3	
Real estate funds and joint investment companies	690.5	3.0	690.5	3.0	2.3	
<b>Other investments</b>	<b>1,998.9</b>	<b>8.5</b>	<b>2,004.5</b>	<b>8.6</b>	<b>2.3</b>	
Hedge fund investments	2,046.5	8.7	2,046.5	8.7	2.2	3.3
Commodity investments	0.1	0.0	8.7	0.0	-	
Other investments	-47.6	-0.2	-50.8	-0.2	-	
<b>Total investments</b>	<b>23,403.5</b>	<b>100.0</b>	<b>18,882.9</b>	<b>80.7</b>	<b>0.8</b>	<b>2.7</b>
Effect of derivatives			4,520.7	19.3		
<b>Total</b>	<b>23,403.5</b>	<b>100.0</b>	<b>23,403.5</b>	<b>100.0</b>		

In the Return incl. currency hedges column, the return from foreign currency derivatives is estimated in proportion to the foreign currency-denominated assets on the reporting date.

The overall return includes returns, expenses and operating expenses not allocated to investment classes. The modified duration of bonds is 3.2 years.

The open currency exposure is 21% of market value.

## Environmental responsibility in investing

Influence is highlighted as one of the key objectives of Elo's climate strategy. Elo is a member of the Institutional Investors Group on Climate Change (IIGCC), which is Europe's largest cooperation network of its kind.

Elo joined 60 other institutional investors in signing an open letter that was published in May to encourage oil and gas companies to develop solutions that are in line with the two-degree warming goal stipulated by the Paris Agreement. In June, Elo expanded its engagement efforts from corporations to governments by signing a joint statement together with hundreds of investors. The statement is aimed at urging the leaders of the G7 nations to commit to the goals of the Paris Agreement more strongly.

Elo participated in an international panel discussion at the Finnish Climate Summit on 13 June 2018 to discuss climate change from the perspective of investors and the financial markets. The Asset Owner Disclosure Project (AODP), which assesses climate-related risks and opportunities, published its report "Winning Climate Strategies"

in conjunction with the summit. Elo is included in the report as one of the 22 institutional investors globally that are taking climate issues into account the most comprehensively.

Elo also participated in the drafting of the Finnish financial sector's common climate reporting recommendations, which were published in June.

### **Compliance activities**

The planning of Elo's compliance activities is based on responding to observed risks, but also on continuous risk monitoring and reacting to risks throughout the year. The activities continue to be developed in accordance with the best practices related to modern compliance. In 2018, special focus is being put on the assessment of risks related to bribery, corruption and human rights, as well as related training.

Elo's new anti-bribery and anti-corruption guidelines were approved in January 2018. Bribery and corruption risks were assessed in all business areas during the spring. Training on the new guidelines began in the spring and will continue in the autumn. There were no suspected cases of bribery identified at Elo during the first half of the year.

During the spring, the human rights risks related to business operations were assessed in all of Elo's business units. There were no reports of risks related to human rights violations.

### **Corporate governance**

Elo's Annual General Meeting, held on 23 April 2018, elected new members to the Supervisory Board and appointed the company's auditor. The Annual General Meeting adopted the financial statements and consolidated financial statements, resolved on the use of profits in accordance with the proposal of the Board of Directors and discharged the members of the Supervisory Board and Board of Directors and the CEO from liability. The Annual General Meeting also decided on amendments to be made to Elo's Articles of Association.

CEO Antti Rantalainen (Rantalainen Group Oy) and Vice Chair Lasse Laurikainen (Union of Professional Engineers in Finland) were elected as new members of the Supervisory Board for the term of 2018–2021. Additionally, Chairman of the Board Nanna Hietala (MSK Group) and Managing Director Tommi Sova (Intrum Justitia Oy) were elected to serve as members of the Supervisory Board until the Annual General Meeting in 2020, and EVP Esa Neuvonen (YIT Group) until the Annual General Meeting in 2021.

The following members whose term expired were re-elected: Ilkka Brotherus, Antti Hakala, Maija Hjelt, Sauli Huikuri, Kalle Kujanpää, Veli-Matti Kuntonen, Timo Mäki-Ullakko, Jukka Tikka, Pentti Virtanen, Jaana Ylitalo and Satu Yrjänen.

The Annual General Meeting resolved to keep the annual compensation paid to the Chair and Deputy Chair of the Supervisory Board and the meeting fees paid to the members unchanged. Detailed information about the remuneration is disclosed in the remuneration report published on Elo's website. Ernst & Young Oy, Authorised Public Accountants, was appointed as the company's auditor.

### **Economic outlook**

Uncertainty related to international economic development and the political climate is currently reflected in the investments markets. The divergence of economic development has already begun and the United States looks to be the only strong engine of economic growth among the OECD countries in the near future, with the outlook being weaker to varying degrees in other national economies. Further divergence is expected in the monetary policy of central banks, contributing to appreciatory pressure on the US dollar and a tightening of dollar-denominated liquidity, which weighs down on the investment outlook of the most indebted emerging economies.

Aside from the usual cyclical concerns, trade policy conflicts are a newly emerged factor and they appear likely to continue—and perhaps even escalate—in the near future. While trade-related tensions are not thought to have

had a significant impact on economic growth so far, they are likely to create increased uncertainty regarding short-term economic and market development.

Economic growth in Finland in several sectors was strong during the first half of the year, but it may be that the best period is now behind us. International demand has remained favourable and private consumption is still high. Private consumption has also been supported by the positive development of employment. At the same time, however, household debt has continued to increase. The strong growth during the first half of the year has also been underpinned by investments, the growth of which is expected to peak this year. The growth of construction, for example, has already shown clear signs of slowing down. Upward pressure on prices remains minor and inflation is not expected to significantly exceed one percentage point for the year.