LOCALTAPIOLA
Mutual Life Insurance Company

LocalTapiola Mutual Life Insurance Company

Investment operations and market risk management

2014

LocalTapiola Life

LocalTapiola Life's investment assets amount to EUR 2.8 billion. Most of the investments made by LocalTapiola Life are managed by professionals at LocalTapiola Asset Management and LocalTapiola Real Estate Asset Management.

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Close to you throughout your life

LocalTapiola employs enthusiastic drivers, mothers and fathers, athletes, pet owners, boaters, house builders, world travellers, investors and entrepreneurs. Therefore, we offer the same solutions we want and use ourselves. We handle your most important matters with competence and genuine care.

LocalTapiola in brief

LocalTapiola Group is a mutual group of companies owned by its customers. It serves private customers, farmers, entrepreneurs, corporate customers and organisations. We offer non-life and life insurance services as well as investment and saving services. We also provide pension insurance and banking services.

Investment operations

Economic climate in 2014

The atmosphere at the beginning of 2014 was optimistic. The double-dip recession in Europe was over and growth expectations became stronger. In the USA it appeared that the employment rate would continue to improve rapidly and the central bank began reducing its monetary stimulus measures as planned. However, optimists experienced their first setbacks during the first quarter. The unusually harsh winter in the USA led to a surprisingly large reduction in the country's total output and the geopolitical crisis in Ukraine gave rise to additional uncertainty. During the summer, Western countries imposed financial sanctions on Russia, which responded with its own counter-sanctions. Towards the end of the year, this began to have a clear effect on Europe's economic outlook.

Finland's GDP stopped contracting in 2014 but an upward trend has still not begun. At the end of last year, total output was still more than 5 per cent below its peak at the end of 2007. Trends in domestic demand were weak due to reduced consumer purchasing power and a lower willingness to invest. Additionally, Finland suffered more from the restriction on trade with Russia than other eurozone countries on average. The trend of increasing unemployment, which began in the summer of 2012, continued, growing in strength towards the end of the year.

Similarly, 2014 was quieter than expected in developing economies. The structural deceleration of China's economic growth was no longer surprising but the rate of deceleration was a surprise. Declining commodity prices were reflected in reduced growth forecasts for several countries in South American and Africa. In the second half of the year, Russia's economy suffered severely from the effects of Western economic sanctions, the plummeting oil price and the sharp weakening of the rouble. However, India was one of 2014's few positive surprises: a successful combination of financial and monetary policy enabled India to strengthen the growth factors of its economy and reduce inflation.

Investment markets were characterised by three significant trends in 2014: 1) an unexpected decrease in interest rates, 2) the significant strengthening of the dollar, 3) the dramatic decrease in the oil price. The decline in long-term interest rates in the eurozone was due to economic concerns and the sudden decrease in inflation rates to a level approaching deflation. The dollar benefited from the USA's leading growth position and forecasts that the USA's central bank would normalise its monetary policy more quickly than other major central banks. However, the decrease in the oil price gave rise to an imbalance between supply and demand: the production capacity of oil and oil substitutes has increased in recent years by more than the actual growth rate.

Government bonds were the best-performing asset class in 2014. Government bonds in the eurozone yielded an average of 13 per cent. Share prices in developed economies yielded approximately 5 per cent in dollar terms but yields increased in euro terms by 19.5 per cent due to the sharp weakening of the euro. Shares of companies in emerging economies returned a total of 11.5% in euro terms. On the currency markets, the euro weakened against the US dollar (–12%) and the pound sterling (–6.5%). The general weakening of the yen continued as a consequence of Japan's extraordinary financial policy experiment. However, the yen weakened only slightly against the euro (–0.1%).

Outlook for 2015

Growth prospects for the eurozone have been chronically weakened by ageing populations, excessive public-sector debt and problems in the banking system. At the same time the risk of deflation has increased, driven by decreasing oil and commodity prices and the permanent deceleration of economic growth in China. The European Central Bank has been relied upon too heavily to provide growth support measures, which are restricted by the limits to the Central Bank's mandate due to differing opinions among member states. In economic policy, countries have been unable to enact the type of structural reforms that are required to improve long-term growth potential and thereby incentivise companies to hire staff and make investments. Finland is one of the least successful countries in the eurozone by this measure.

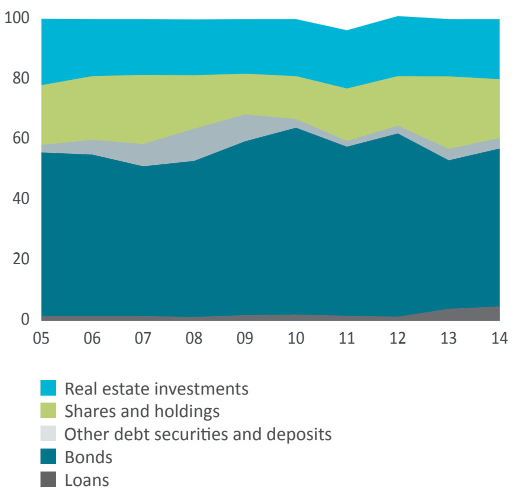
In Europe, nominal GDP growth forecasts for the forthcoming years remain low. As a consequence of this, there is only a limited possibility that interest rates will increase. However, anaemic growth will make it more difficult for governments to rebalance their debt ratios, resulting in a high risk of the euro crisis re-escalating. The US economy appears to have set itself up for annual growth of 2.5–3.0 per cent. As the unemployment rate is already very close to its natural balance, the Federal Reserve is likely to begin raising interest rates mid-way through 2015. There is still a risk that the global economic slow-down will also infect the US economy, which would require the Federal Reserve to deviate from its advance guidelines.

The strengthening of the dollar and the decrease in oil and commodity prices have raised concerns over the sustainability of growth in developing economies. The appreciation of the dollar poses a risk to several developing states, as well as to companies operating in these states, if they have debt denominated in hard currencies. Fluctuations in the oil price have a more profound effect on oil-producing countries. The majority of developing economies are net importers of oil. As such, they are more likely to benefit from the lower price. Countries that rely on high oil prices to balance their budgets, such as Russia, Nigeria, Venezuela and some countries in North Africa, face the greatest difficulties.

Table 1. Allocation and income

	Distribution, EUR million	Distribution, %	Return, %
Loans receivable	135.2	4.8	4.4
Bonds	1,474.9	52.3	4.3
Other debt securities and deposits	99.2	3.5	1.0
Fixed-income investments	**1,709.4**	**60.5**	**4.1**
Listed equity	309.9	11.0	8.3
Private equity funds	176.4	6.2	18.0
Unlisted equity	59.0	2.1	21.6
Equity investments	**545.3**	**19.3**	**12.1**
Direct real estate investments	396.9	14.0	4.3
Real estate mutual funds and collective investments	168.8	6.0	–0.4
Real estate investments	**565.7**	**20.0**	**3.1**
Infrastructure investments	5.6	0.2	2.5
Other investments	**5.6**	**0.2**	**2.5**
Total investments	**2,826.0**	**100.0**	**5.3**

1. Allocation development, %



Overall, economic cycles have become shorter and key economic factors have become more variable. A new recession will begin if the unemployment rate rises, unless there is a substantial reinstatement of opportunities for economic stimulus policies. Furthermore, economic policy measures are more difficult to schedule due to delays in economic policies.

The most significant risks for the global economy are associated with geopolitical tensions, unresolved debt problems in the eurozone, deflation in developed countries and an unexpectedly rapid deceleration of the Chinese economy.

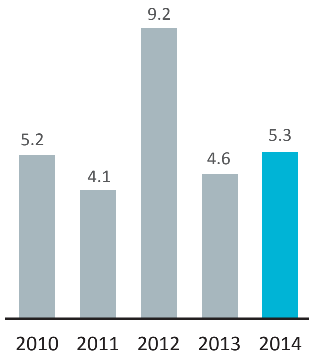
LocalTapiola Life aims for its investment operations to achieve a moderate return of approximately 3.3 per cent on its strategic allocations in 2015. In 2015, planning of the investment operations will switch to the Solvency II era, which may change the weightings of the company's strategic allocations.

Allocation

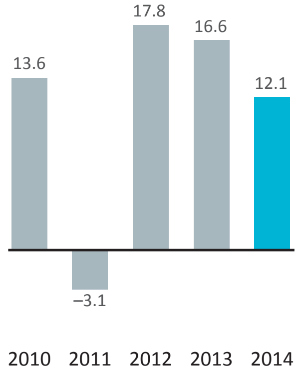
In 2014, LocalTapiola Life's net investment income at fair value amounted to EUR 141.9 million (EUR 121.8 million in 2013), or 5.3 per cent (4.6%). Investment capital at current value stood at EUR 2,826.0 million (EUR 2,730.1 million). The average five-year annual return on investment was 5.5 per cent and the average ten-year annual return was 5.3 per cent. In 2014, bonds were allocated a slightly larger weighting, while other fixed-income investments had a smaller weighting. With regard to equity investments, the weighting shifted slightly away from listed stocks in favour of capital investments.

In its investment operations, LocalTapiola uses asset managers who have signed the United Nations' Principles for Responsible Investment.

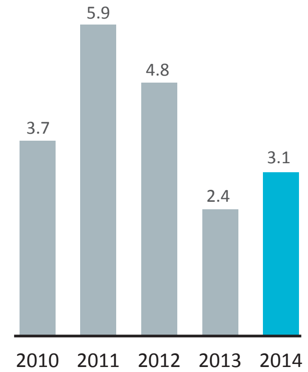
2. Development of return on investment, %



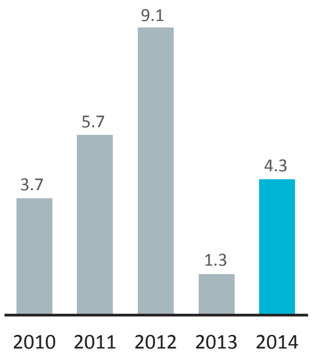
3. Development of return on equity investments, %



4. Development of return on real estate investments, %



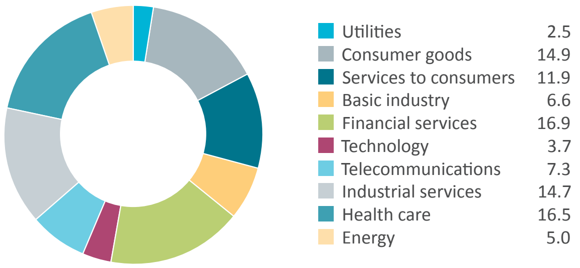
5. Development of return on bonds, %



Equity investments

Despite the multitude of problems in the global economy, share prices continued to rise. In Europe, they rose by over 7 per cent, while in the United States, they rose by 14 per cent. The strengthening of the dollar lifted returns on US investments to 30 per cent in euro terms. In a climate of low interest rates, investors favoured large companies with stable cash flows. In Europe and the USA, companies in the public utility, healthcare and defensive consumer industries showed good development. In Europe, economic growth was once again modest and forecasts were lowered throughout the year. In the US, the increase in prices was supported by increasing company profits, as has been the case for several years now. Despite the weak development of turnover, the profitability and margins of companies remained good. The estimate of a 10 per cent increase in company profits for 2015 remains rather optimistic, particularly with regard to Europe. Despite the higher valuation of shares and the uncertain economic situation, shares are supported by their valuation in relation to interest rates. The largest risks continue to be related to improvements in the global economy and initiating investments.

6. Direct equity investments by industry, %



7. Direct equity investments by region, %

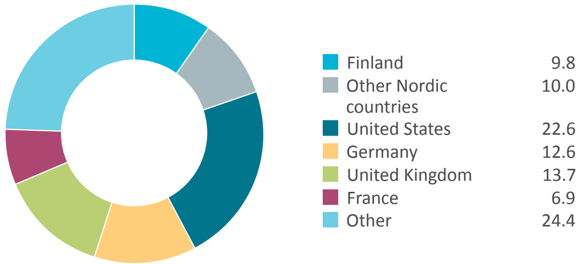
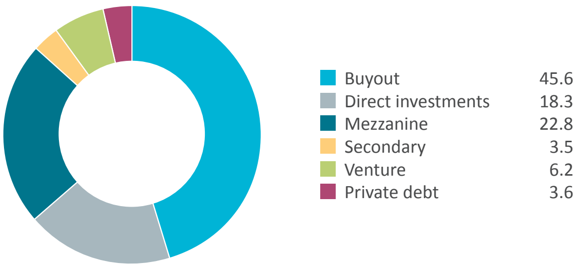


TABLE 2. 10 largest equity investments

	Market value, EUR m	% of equity investments
REED ELSEVIER NV	9.2	3.9
US Bancorp	7.8	3.3
Zurich Financial Services AG	7.8	3.3
WPP Group plc	7.4	3.1
Thermo Fisher Scientific Inc	7.2	3.0
Fresenius Medical Care Ag	7.0	2.9
VF Corp	6.7	2.8
INMARSAT PLC	6.6	2.7
Eaton Corp	6.4	2.7
PepsiCo Inc/NC	6.4	2.7

8. Private equity investments by type, %



At the end of 2014, LocalTapiola Life's equity investments totalled EUR 545.3 million (EUR 654.9 million), accounting for 19.3 per cent (24.0%) of its investments. Listed shares amounted to EUR 309.9 million, of which EUR 71.1 million was in funds. Finnish shares accounted for 9.8 per cent of listed direct equity investments. Equity investments returned 12.1 per cent (16.6%). Compared with the previous year, financial service companies were allocated a larger weighting, while consumer goods producers and industrial services were allocated a smaller weighting. The return was good in light of the fact that 2014 was a varied and challenging year for listed stocks.

Fixed-income investments

On fixed-income investment markets, 2014 was characterised by low growth and inflation, as well as substantial measures taken by the European Central Bank (ECB) to support fixed-income investment markets. The previous year had ended in a climate of rising market interest rates, a trend that was generally expected to continue into 2014. However, US economic growth was somewhat disappointing, while the crisis in Ukraine generated demand for long-term fixed-income investments in safe haven countries. European economic growth was also lower than expected, causing fears of deflation to spread to European markets. Long-term interest rates in Europe decreased due to this and the yield spread of US debt over European debt grew to record size.

The ECB decided to reduce its reference rates twice during the summer, resulting in the repo rate descending to 0.05 per cent and the ECB's bank deposit rate becoming negative, at -0.20 per cent. The ECB also proposed new support measures in the summer: the LTRO financing programme for banks and purchasing programmes for covered bonds and asset-backed securities. The purpose of these was to redirect money flows from banks to consumers to enable economic growth to take hold in Europe. In addition to this, the ECB has also strongly hinted at its intention to buy government bonds issued by eurozone states in the near future. As a consequence of this, long-term interest rates decreased sharply during the year. Germany’s 10-year interest rate ended the year at 0.54 per cent.

Countries on Europe's periphery also benefited from lower interest rates as a result of the ECB's actions, although their economic development was relatively poor, especially in Italy. After the spring, interest rates began to fluctuate more but the ECB's actions led to a new decrease in risk premiums in the autumn.

At the same time, the US central bank – the Federal Reserve – continued to reduce the amount of fixed-income instruments it purchased to support the economy and such purchases ceased altogether by October. At the end of the year, the Federal Reserve also began hinting at increases in the reference rate during the following year, boosted by the recovery of the US economy. However, interest rates also decreased in the US throughout the autumn due to the interest rates in Europe and low inflation.

The market value of LocalTapiola Life's fixed-income portfolio, including fixed-income funds and money market investments, stood at EUR 1,709.4 million (EUR 1,554.3 million), or 60.5 per cent (56.9%) of investments. Government bonds accounted for 28.6 per cent of fixed-income investments. Corporate bonds, covered corporate bonds and other public-sector loans accounted for 68.7 per cent of fixed-income investments, while money market investments accounted for 2.7 per cent. The modified duration of the portfolio, which measures its interest rate risk, was 3.1 years (3.1 yrs). Fixed-income investments yielded 4.1 per cent (1.4%). The return was reasonable but the decrease in interest rates at the end of the year will pose challenges for returns on fixed-income investments in 2015.

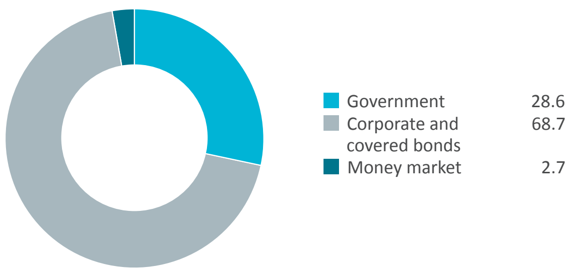
Real estate investments

In 2014, activity picked up on European real estate investment markets and transaction volumes grew substantially in comparison with the previous year. One of the most significant trends on the markets was the expansion of investments to higher-risk targets as a consequence of higher return requirements. Strong economic trends in the United Kingdom, Germany and Sweden boosted user markets and the real estate investment markets remained strong until the end of the year.

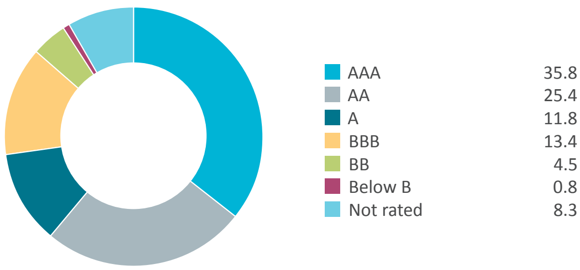
Transaction volumes on Finland's real estate investment market increased to levels last seen in 2008. Last year, several large transactions and portfolio deals were concluded, reflecting a recovery in the markets. However, investor interest in higher-risk properties has not increased noticeably and the outlook for these sites remains relatively weak. The financial markets developed positively and financing is available for good projects at reasonable terms. For the best sites, the return requirements remained stable. The return requirements for sites in the centre of Helsinki decreased. Return requirements for higher-risk sites are still increasing slightly. The weakness of the real economy led to user companies remaining cautious and occupancies decreasing throughout 2014. There is demand for office space in efficient, flexible and highly accessible properties. Rent levels for good commercial sites in central Helsinki continued to rise. However, in other major office submarkets, rents remained stable. There was no change in the rent levels for the best commercial and storage properties but the rent levels for higher-risk sites decreased.

At the end of 2014, the market value of LocalTapiola Life's real estate portfolio totalled EUR 565.7 million (EUR 517.6 million). Of LocalTapiola Life's entire investment portfolio, 20.0 per cent was allocated to real estate investments (19.0%). Real estate investments yielded 3.1 per cent (2.4%) in 2014. The total return on real estate investments was weighed down by write-downs on direct and indirect real estate investments. Two large ownership rearrangements were completed in the property portfolio: the first had the effect of clarifying the mutual ownership of properties by LocalTapiola Life and Elo Mutual Pension Insurance. These transactions were concluded at the end of 2014. The second large rearrangement was the purchase of a residential portfolio from Taaleritehdas.

9. Fixed-income investments by type, %



10. Fixed-income investments by credit rating, %



Private equity investments

Investments in private equity funds

At the end of 2014, there were a total of 50 funds in LocalTapiola Life's private equity fund portfolio, with a total fair value of approximately EUR 176.4 million (EUR 138.6 million in 2013). In 2014, investments were actively made in private equity funds belonging to target fund management companies and to fund management companies that were already in the portfolio in accordance with the strategy.

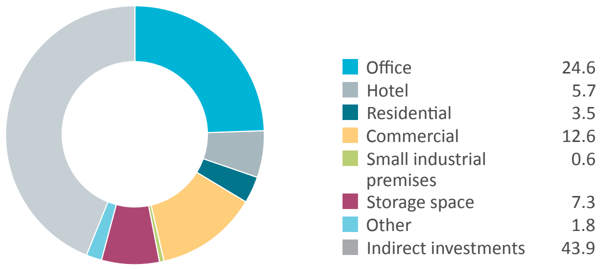
The sum invested in funds that were already in LocalTapiola Life's portfolio remained at 2013 levels and there was a strong increase in the number of exits in comparison with the previous year. The portfolio companies continued to develop favourably, which was also reflected in the companies' valuations. Private equity funds yielded a very good return of 18.0 per cent (8.3%) in 2014.

In Europe and North America, the amount of money available for investments in private equity funds increased during 2014. The ability of investment funds to raise new capital remained relatively good and the number of exits clearly exceeded the amount of new investment made by the funds. As such, activity on the private equity markets is expected to grow in 2015. The best investment targets are considered to be buyout funds investing in small and medium-sized enterprises, although the new Solvency II regulations will also increase the attractiveness of fixed-income funds.

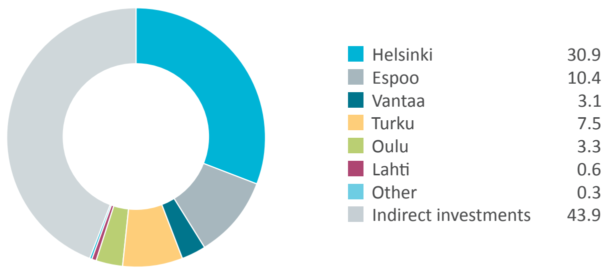
Direct investments in non-listed companies

At the end of 2014, there were a total of 16 portfolio companies in the direct investment portfolio, with a total current value of about EUR 41.3 million (EUR 29.5 million). The target companies were all Finnish, with only one exception. During the year, one new initial investment was made: a minority stake in Diacor Oy. The purchase is a good fit with LocalTapiola Group's health and welfare strategy. Final exits were completed from four portfolio companies and a partial exit was made from one portfolio company.

11. Real estate investments by type, %



12. Real estate investments by region, %



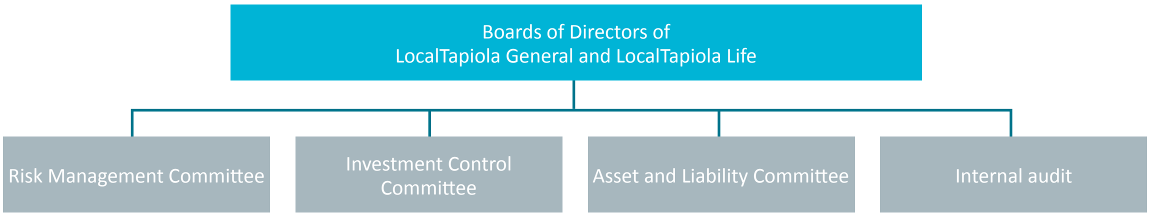
The return on unlisted investments (excluding holdings and fixed-asset shares within LocalTapiola Group) was very good, reaching 54.4 per cent (17.2%) in 2014. At the end of 2014, the combined fair value of LocalTapiola Life's holdings and fixed-asset shares within LocalTapiola Group was EUR 19.4 million (EUR 24.4 million).

Illiquid loans

Illiquid loans consisted mainly of direct loans to real estate companies. On 31 December 2014, the market value of loans receivable was EUR 135.2 million, or 4.8 per cent of the portfolio. Loans receivable yielded 4.4 per cent in 2014. In 2014, credit was mainly granted for real estate.

Market risk management

13. Market risk management organisation



Operating principles

The aim of LocalTapiola Life's investment operations is to secure its solvency and maximise returns with a managed risk position. Asset allocation is guided by the limits set by solvency, the structure of technical provisions and eligibility for the solvency margin, as well as the return requirements. In the long term, investment returns must exceed the total return targets required by the customer bonus policy. Investment operations aim to reach a high and stable return in the long term in all conditions while avoiding the risk of losing capital. Investments are diversified sufficiently across and within the various classes of instruments. Individual risks and responsibilities are controlled by establishing investment limits and criteria. Investment operations must ensure adequate liquidity under all circumstances. In addition, the investment portfolio must be sufficiently simple.

Organisation of market risk management

LocalTapiola Life has a balance sheet risk management committee that was established by the Board of Directors and that reports directly to the Board of Directors. It is responsible for monitoring and developing the company’s balance sheet risk management, particularly with regard to market risks, to ensure that it is organised appropriately and that the company's capital is efficiently used. At regular intervals, the Committee prepares proposals on strategic market risk-taking, along with associated investment targets and restrictions (limits), and submits them to the Board of Directors for approval. The limits cover investment price and interest rate risks as well as the characteristics and requirements of the technical provisions. The Asset and Liability Committee monitors the defined risk limits as well as the results of risk-taking. The Committee is also responsible for making decisions related to the Group's capital management and capitalisation and for reporting to the Board of Directors on the requirements set on the company by the nature of the capital.

The Board of Directors appoints an Investment Control Committee, which is responsible for the practical organisation of investment operations and the operational supervision of market risks. The Committee strives to ensure that the investment return target is achieved in accordance with the strategy approved by the Board of Directors. Furthermore, it monitors, develops, controls and decides upon liquidity and concentration risk management.

The risk management committee is accountable to the Board of Directors for the organisation of risk management and the monitoring of solvency.

The internal audit function supports and verifies the monitoring of investment guidelines.

Risk management processes

The risk management process is based on instructions (investment plan, derivatives policy and the ALCO investment plan frameworks), monitoring the implementation of the instructions in operations, regular risk reporting and self-assessment. In addition, the company's investment operations are guided by documentation approved by the Board of Directors concerning solvency management, capital management and liquidity management principles and market risk strategy.

The company’s Board of Directors annually confirms an investment plan that determines the targeted allocation of investments and expected returns, instrument-specific ranges, diversification and liquidity targets, and powers of decision.

The purpose of diversification is to secure a sufficient level of return regardless of market conditions, both within and between instrument categories. This principle applies to different industries, countries and investment targets. Individual risks and responsibilities are controlled by establishing limits and investment criteria. Adequate liquidity is ensured by the structure of the investment portfolio.

LocalTapiola Group strives for efficient and functional liquidity management to ensure the operational continuity of Group companies and adequate protection of the Group against liquidity risk and to determine a sufficient liquidity reserve, taking the companies' risk-carrying capacity and resilience into account.

As regards derivatives, a more detailed policy approved by the Board of Directors is used. The policy sets out the principles governing the use of derivatives. Derivatives can be used to reduce risks relating to equity, foreign exchange and fixed-income investments, among others.

Adequate analysis, diversification, derivatives and counterparty risk limits are used with the aim of ensuring that the company can operate in all market conditions. Real estate investment risks are analysed separately.

Investment risks and returns are monitored using standard market risk and reporting methods. The reports are used to regularly monitor the development of fixed-income, real estate and equity investments, as well as any risks related to them. The reports also ensure compliance with the operational principles defined in the investment plan. The company uses a risk management system based on investment-specific risk monitoring.

Market risk and solvency management

The effect of market risks on the company's solvency is monitored and managed in accordance with the current solvency practice (Solvency I). Furthermore, solvency is monitored in compliance with the solvency regulations applied to conglomerates. Preparations for the future Solvency II framework are underway.

The most significant change in solvency calculation is that, under Solvency II, in addition to assets, technical provisions will also be valued at market terms to current value. Hence, the value of technical provisions will be particularly dependent on interest rates, and the significance of interest rate risk management will increase. Another significant change is the minimum solvency capital requirement based on the company's risk level. The company has been monitoring its solvency in accordance with Solvency II in the reporting currently required by the authorities (life insurance companies' proactive solvency test and quantitative impact studies) since the beginning of 2008. Extensive projects are underway within the company to develop internal Solvency II models to meet the needs of both risk management and business operations.

The purpose of market risk management is to secure the company's solvency for the next twelve months with sufficient probability. The risk of investment value changes is continuously monitored with a probabilistic model based on historic investment values and the correlation of value changes between different investment classes. The risk is monitored by using both long-term average values for volatility and estimated key risk figures from a shorter period of time.

When necessary, investment operations are controlled more strictly, in accordance with the traffic light principle, and are based on continuous market risk monitoring. A green light indicates a situation where asset managers are able to operate within the normal limits of the investment plan. A yellow light indicates a situation in which increases in investment market risks or a neutral investment allocation within the investment plan are no longer acceptable in view of the risk content of the balance sheet. A red light refers to a situation when the balance sheet risks are too high and risk reduction measures are required. In the yellow and red light risk positions, stricter limits for investment risks, as well as possible risk reduction measures, are defined. The total risk is determined in such a manner that the solvency margin can remain secure, even if a risk is realised. If, however, the need for capital is apparent, the capital management principle approved by the company shall be followed.

14. LocalTapiola Life's market risks

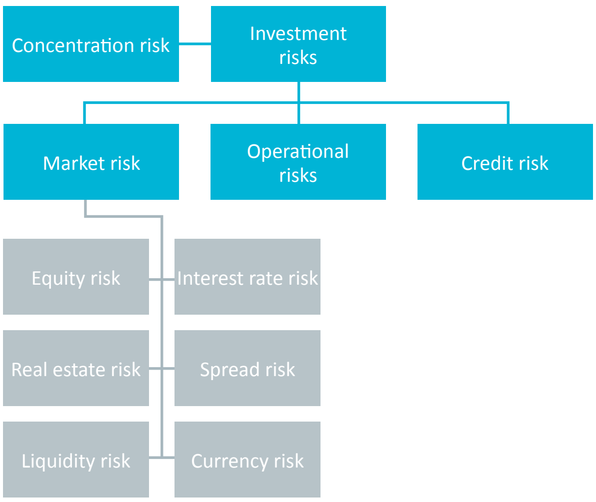
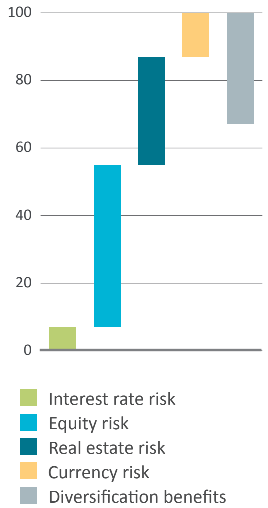


Table 3. Sensitivity of LocalTapiola Life's investments and solvency to market scenarios as of 31 December 2014

		Impact of change		
	Dec 31 2014	Share quotations –20%	Value of real estate –10%	Interest level +1 percentage point
Solvency capital, EUR m	654.0	–110.2	–56.6	–57.9
Solvency ratio, %	26.3	–4.4	–2.3	–2.3
Return on investment, %	5.3	–4.1	–2.1	–2.2

15. Investment risks, %



An estimate of LocalTapiola Life's market risk distribution on 31 December 2014.

LocalTapiola Life's market risks

LocalTapiola Life's most significant market risks are the equity risks, interest rate risks and credit risks associated with fixed income investments, as well as real estate investment risks in accordance with figure 14. Market risks may be realised in the form of lower-than-expected income cash flow or decreased asset values. Within the Solvency II framework, market risks are related to technical provisions in market terms and in terms of the capital adequacy requirement in addition to investment assets. An estimate of the distribution of LocalTapiola Life's market risk is shown in Figure 15. The benefit of diversification is realised as asset values move in different directions, creating a situation in which the total risk of the investment assets is lower than the sum of individual risks. The sensitivity of investments and solvency to market changes is described in table 3.

Market risk is managed by adequate diversification of investments by asset class, geographical location and industry sector. A key tool for controlling investment operations is basic asset class allocation. Allocation development is presented in figures 1 and 16. In addition, Solvency II risk can be reduced by changing investment assets' sensitivity to interest rates to match technical provisions, as well as by using derivatives hedging.

Equity risks

The objective of equity investments is to achieve a higher return than the benchmark index in the long term, at a lower risk level. Additionally, investments aim to secure the value of capital. For this reason, a value investment philosophy has been selected as the guiding investment principle. It requires, among other things, thorough knowledge of investment targets. Equity investments are primarily made in profitable and solvent growth companies. The equity portfolio must also be sufficiently diversified to avoid individual risk concentrations. Diversification concerns individual companies, geographical areas and industries. Further information on equity investments and allocations can be found under "Equity investments" in the section "Investment operations".

Equity investments are controlled with allocation and diversification limits. These include the following:

- The total amount of listed equity may add up to a maximum of 18 per cent of the company's investments.
- The equity portfolio must contain the shares of 30 companies at a minimum and 100 companies at a maximum.
- The 50 largest equity investments account for at least 90 per cent of the value of equity investments.
- The proportion of any one industry sector must be under 20 per cent.

Investments in listed equity are handled by LocalTapiola Asset Management Ltd.

Investments in unlisted limited companies (private equity investments) are made when particularly high return potential is seen in them. The operative targets of these investments are confirmed annually by the investment committee, and the investment operations are controlled with investment plan limits. The total amount of private equity investments may add up to a maximum of 9 per cent of the company's investment assets.

Fixed-income risks

The primary objective of LocalTapiola Life's fixed-income investments is to ensure a level of return corresponding to customers' minimum requirements by safeguarding the value of invested funds at a securely low level of risk. A secondary objective is to seek a return exceeding the benchmark index with moderate risk allocation within the fixed-income portfolio. Fixed income risks consist of interest rate fluctuations and the investment target's credit risks. In addition to the interest rate of government bonds and the intra-bank interest rate, interest rate risk is also affected by fluctuations in individual corporate bond interest premiums (spread).

Corporate bonds are used to achieve a higher return on the fixed-income portfolio. Primarily, investments are weighted toward bonds with short maturities, which are generally held to maturity. Credit risk is minimised by diversifying investments across many issuers and by setting a maximum for the proportion of a single issuer in the portfolio.

Fixed-income investments are controlled using allocation and diversification limits as described below. Investment limits are based on companies' official credit ratings. As regards countries, the credit ratings used are primarily those estimated by LocalTapiola.

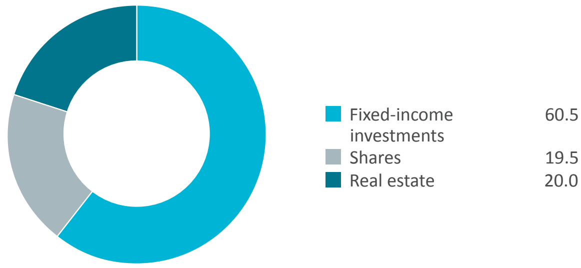
- The proportion of corporate bonds and commercial paper may not exceed 38 per cent.
- At least 65 per cent must be invested in bonds with the highest credit ratings (AAA–BBB).
- Country risk must be diversified across the entire eurozone, and excessive concentration in any single country is to be avoided.

Fixed-income investments are handled by LocalTapiola Asset Management Ltd. Further information on fixed-income investments and allocations can be found under "Fixed-income investments" in the section "Investment operations".

Real estate risks

In the Finnish market, real estate investments are mainly direct investments in real estate. The objectives of indirect real estate investments, such as real estate funds, can include diversification of the real estate investment portfolio, thus reducing the portfolio's risk, as well as making investments in international real estate markets or in special targets in Finland.

16. Investment allocation on 31 December 2014, %

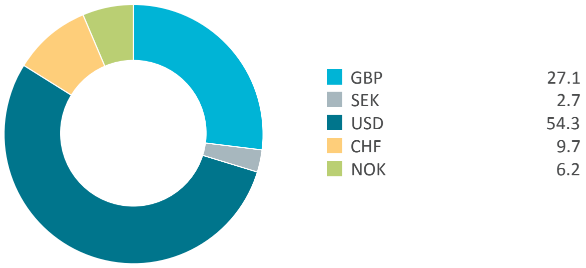


Real estate investments are handled by LocalTapiola Real Estate Asset Management Ltd. The return on direct real estate investments consists of the cumulative net operating income (rents) and capital appreciation. Real estate risks may be realised as both loss in value or decreased income cash flow.

Real estate is a long-term investment covering very long liabilities, as lease agreements are often linked to inflation. The risk-to-return ratio of the real estate portfolio is kept low by ensuring well-founded purchases and a consistent sale programme. The real level of the cash flow and related location-specific risks are managed by an active and result-oriented lease and agreement policy. An economical life cycle for the assets is ensured by professional real estate management. New investments are made in positively developing submarkets, mainly the largest cities. The multi-purpose usability and sales potential of the targets is taken into account when making investments. Besides a healthy economic structure of the municipality in which the property is located, additional criteria include the inhabitant base and user demand. At least 80 per cent of the real estate investments must be in Finland.

The total amount of real estate investments may add up to a maximum of 25 per cent of the company’s investment assets. Further information on real estate investments and allocations can be found under "Real estate investments" in the section "Investment operations".

17. Currency allocation on 31 December 2014, %



Currency risks

Direct currency risk is related to investments quoted in foreign currencies while the business operations are euro-denominated. In addition, exchange rate fluctuations may affect the business operations of individual companies and industries and thus have an indirect impact on changes in equity investment values.

A maximum value has been set for unhedged currency risk (currency position). The minimum hedging ratio of a currency position is also determined by more detailed, company-specific investment limits and legislation. At the end of 2014, the company's unhedged currency position totalled EUR 242,7 million. The open currency position allocation is presented in figure 17.

Liquidity risks

Liquidity risk is realised if companies cannot liquidate their assets to cover their due payment obligations and may be caused, for instance, by surrendering life insurance liabilities, as well as by unexpected changes in premium income behaviour or new sales.

Liquidity risk can be divided into two areas. Market liquidity risk is realised if the investment markets are not able to sell investment instruments sufficiently rapidly and with little loss. Financial liquidity risk is realised when the sources of funding are not enough to cover expected and unexpected needs over a specific time horizon.

The purpose of short-term money market investments, deposits and investments in bonds issued by states with good credit ratings is to secure the required liquidity for the company under all circumstances. The liquidity requirement has been taken into consideration in the structure of the investment portfolio, as well as the minimum amounts that have been defined for these investments. Investments required by liquidity limits are made in instruments that can be converted into cash quickly, usually without incurring capital loss.

The main instruments for money market investments and cash management are bank deposits and certificates of deposit issued by banks operating in Finland. An investment analysis is conducted annually concerning money market counterparties, and the bank counterparty risk is diversified.

LocalTapiola is close to you throughout your life

LocalTapiola is close to you everywhere in Finland. Our 20 regional companies offer comprehensive insurance, banking, savings and investment services. We are your partner in matters related to security, well-being and the economy.

Welcome to LocalTapiola!

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