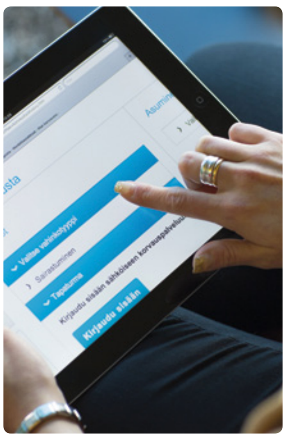
LocalTapiola General Mutual Insurance Company

Investment operations and market risk management 2013

Close to you throughout your life



LOCALTAPIOLA
Mutual Insurance Company

LocalTapiola General

LocalTapiola General's investment assets amount to EUR 3.5 billion. Most of the investments made by LocalTapiola General are managed by professionals at LocalTapiola Asset Management and LocalTapiola Real Estate Asset Management.

Close to you throughout your life

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

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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.

LocalTapiola's online reporting

LocalTapiola's online annual report 2013 and the companies' annual reports and investment reviews will be available in the week beginning 7 April 2014 in PDF format at the following address:

www.vuosiraportti2013.lahitapiola.fi

Investment operations

Economic environment in 2013

In 2013, the operating environment of the investment markets was characterised by two major turning points. The first was related to the strengthening of global growth prospects. The exceptionally long recession in the eurozone ended in the second quarter of the year and the acute economic crisis began to subside, even in the most problematic countries. Thanks to Europe's recovery, a global recovery was no longer entirely dependent on US economic growth. On the other hand, the economic outlook in emerging economies remained highly uncertain and began to stabilise only at the very end of the year. In addition, the impact of the global economic recovery on the development of Finland's overall production was less marked than expected, and there was no substantial improvement in the economic outlook during 2013.

The other major turning point was expected to occur in monetary policy. In the spring, the US Federal Reserve began to say that they may have to cut down on recovery measures for the monetary economy. The Fed's new policy also had a major impact on investment markets as the liquidity offered by central banks had significantly supported increases in asset values. During the summer, interest rates increased and risk premiums widened. The emerging economies' fixed-income investment markets, which had benefited from abundant liquidity over the previous years, were hardest hit by the repricing of risks. The equity markets recovered quite rapidly from the decrease of share prices in February as macroeconomic indicators encouraged risk-taking in the investment markets.

The increase in risky assets accelerated after the autumn, when the Fed surprised the markets by announcing that, for the time being, they will not cut back on quantitative easing measures. Long-term interest rates in the US and Germany decreased clearly from the summer's peak levels. Not even the US federal budget dispute and government shutdown at the beginning of October were able to cause major disruptions in the markets.

Shares were clearly the best-performing asset class in 2013. The shares of developed countries returned an average of 20 per cent in euro terms. Emerging markets suffered from the structural slowdown of growth and fears of a tighter monetary economy. The shares of emerging economies returned an average of –6.7% in euro terms. In fixed-income investments, the global government bond index yielded a euro-denominated return of 2.2 per cent. On the foreign exchange market, the euro strengthened against all major currencies. The US dollar weakened by 5 per cent against the euro, by 2 per cent against the UK pound and by 27 per cent against the Japanese yen.

Outlook for 2014

Global economic growth accelerated in the second half of 2013 and, based on anticipatory indicators in developed economies, economic conditions are also expected to strengthen at the beginning of 2014. All in all, 2014 will be better than the previous year in terms of economic growth.

In the eurozone, the basic economic trend is more favourable than last year. However, there is no strong upswing in sight – just slightly positive growth at best. High unemployment and a moderate increase in salaries will slow down the recovery of consumer demand. On the other hand, weak growth prospects do not encourage investments and the public authorities will have no choice but to tighten their belts. Competitive devaluations and protectionism, in turn, will put a brake on global trade recovery. The sources of sustainable growth will continue to be scarce.

Long-term market interest rates are expected to rise during the year. However, due to the uncertain economic situation in Europe, the rise will be moderate. In the US, long-term interest rates will increase more than in Europe as a result of better economic development. The biggest risk to this view is stronger-than-expected economic growth in the US, which would raise interest rates more than expected. The development of the European peripheral states' risk premiums is bound to economic growth. Therefore, stagnating growth may result in a further increase in risk premiums.

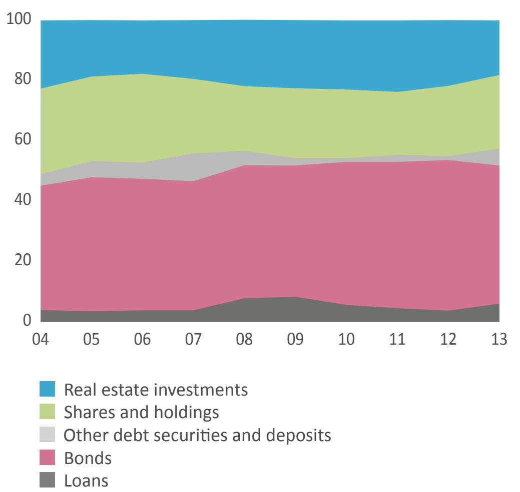
The risk premiums of corporate bonds are expected to remain stable or even slightly narrow at the beginning of the year, although corporate bonds are historically quite expensive compared to government bonds. In the first half of 2014, the prices of covered bonds will mainly remain at the current level with respect to government bonds. New regulations in the financial markets will also support the demand for covered bonds.

During 2014, GDP development in the most important emerging economies will set out on a new path of long-term growth. This means growth of about 6–7 per cent for China and India and a growth rate of about 3–4 per cent for Brazil and Russia. Within emerging markets, the focus of growth is shifting from the so-called BRIC countries to new, less developed areas. In the BRIC countries, growth is slowed down by many structural problems, such as sloped demand structure, ineffective public sector and labour know-how bottlenecks. However, many African countries are entering a phase of stronger growth.

TABLE 1. Allocation and returns

	Distribution, EUR m	Distribution, %	Return, %
Loans receivable	206.8	5.9	3.8
Bonds	1,590.3	45.0	1.1
Other debt securities and deposits	195.7	5.5	0.3
Fixed-income investments	**1,992.8**	**56.4**	**1.2**
Listed equity	492.5	13.9	19.0
Private equity funds	153.3	4.3	9.7
Unlisted equity	264.0	7.5	–8.9
Equity investments	**909.8**	**25.7**	**11.2**
Direct real estate investments	485.2	13.7	5.0
Real estate mutual funds and collective investments	143.1	4.1	5.1
Real estate investments	**628.4**	**17.8**	**5.0**
Absolute return investments	0.0	0.0	–2.6
Infrastructure investments	3.4	0.1	0.0
Other investments	**3.4**	**0.1**	–1.6
Total investments	**3,534.4**	**100.0**	**4.1**

1. Allocation development, %



From the point of view of the investment markets, the outlook for the operating environment continues to be rather favourable: there are positive changes, but economic growth in the main market areas will remain such low that central banks will not be able to start tightening their monetary policies to a large extent for quite some time. Investment risks, however, will be increased by structural economic changes and the associated political risks, as well as by the weaker predictability of the global economic cycle.

Allocation

In 2013, LocalTapiola General's investment assets at fair value amounted to EUR 3,534.4 million (EUR 3,025.9 million in 2012). Listed shares and loans were allocated a slightly larger weighting, while bonds had a smaller weighting. In 2013, net investment income at fair value amounted to EUR 158.4 million (EUR 234.8 million), or 4.1 per cent (8.1%). The average five-year annual return on investment was 5.4 per cent and the average ten-year annual return was 5.4 per cent.

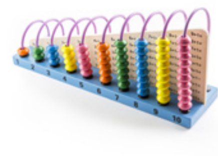
In its investment operations, LocalTapiola uses asset managers who have signed the United Nations' Principles for Responsible Investment.

Equity investments

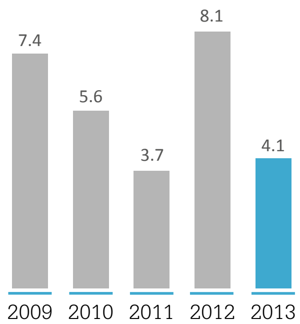
Despite the problems of the global economy, share prices continued to rise, especially in the emerging markets. They rose by over 20 per cent in Europe and by over 30 per cent in the US. The best performers were telecommunications, technology, industrial services and consumer services in Europe and health care and industrial services in the US.

In Europe, economic growth was once again modest and forecasts were lowered throughout the year. In the US, the increase in prices was also supported by growth in company profits. However, the liquidity offered by central banks and low interest rates were important reasons for the increase in prices. Despite the weak development of net sales, the profitability and marginals of companies remained good.

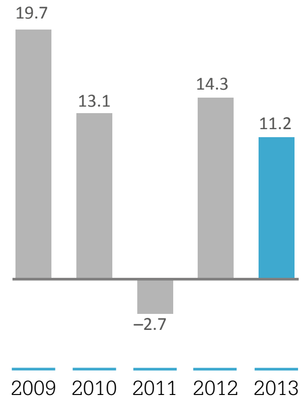
The estimate of a 10 per cent growth in company profits for 2014 is very optimistic. Despite the higher valuation of shares and the uncertain economic situation, shares are supported by their valuation in relation to interest rates. The biggest risks continue to be associated with the improvement of the economic situation in Europe, the launching of investments and whether economic growth will be able to increase sales and company profits.



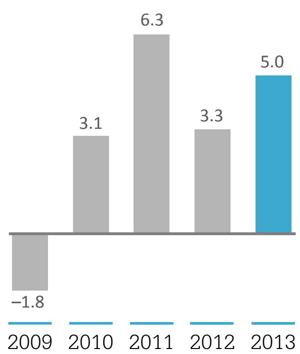
2. Development of return on investment, %



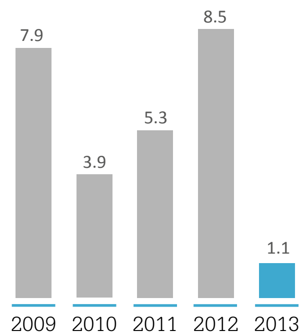
3. Development of return on equity investments, %



4. Development of return on real estate investments, %



5. Development of return on bonds, %

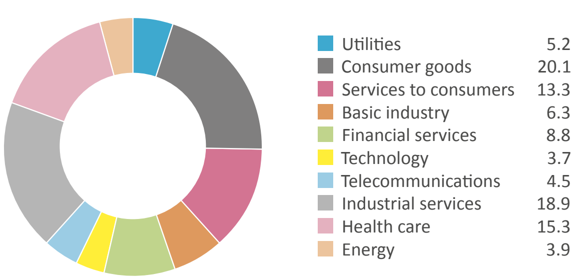


At the end of 2013, LocalTapiola General's equity investments totalled EUR 909.8 million (EUR 703.4 million), accounting for 25.7 per cent (23.2%) of all investments. Listed shares amounted to EUR 492.5 million, of which EUR 95.7 million was in funds. Finnish shares accounted for 12.4 per cent of listed direct equity investments. Equity investments returned 11.2 per cent (23.5%). Compared to the previous year's weightings between different industries, the share of financial, consumer product and energy companies was slightly increased.

Investments in private equity funds

At the end of 2013, there were a total of 55 funds in LocalTapiola General's private equity fund portfolio, with a total fair value of about EUR 153.3 million (EUR 145.5 million). In 2013, many private equity fund investments were made in new funds of both target fund management companies and fund management companies already in the portfolio.

6. Direct equity investments by industry, %



7. Direct equity investments by region, %

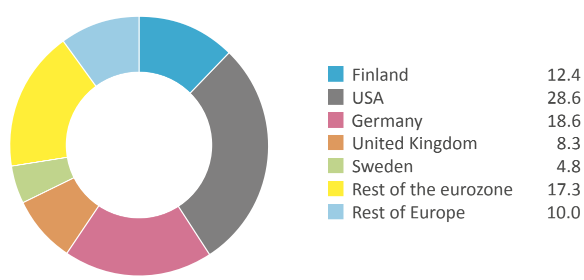
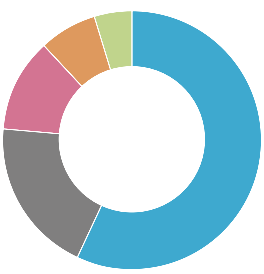


TABLE 2. 10 largest equity investments

	Market value, EUR m	% of equity investments
Bayer Ag	10.7	2.7
VF Corp	10.3	2.6
WPP Group plc	10.3	2.6
Adidas Ag	10.2	2.6
REED ELSEVIER NV	9.9	2.5
United Technologies Corporation	9.3	2.3
US Bancorp	8.8	2.2
Waste Management Inc	8.8	2.2
STADA ARZNEIMITTEL AG	8.8	2.2
SES	8.7	2.2

8. Private equity investments by type, %



Buyout	57.2
Direct investments	19.2
Mezzanine	11.9
Venture	7.1
Secondaries	4.6

The funds' investment activity remained at the same level as in 2012 and portfolio companies continued to develop favourably, which was also reflected in the companies' valuations. Private equity funds yielded a good return of 9.7 per cent (10.2%) in 2013.

The amount of money available for investments in private equity funds began to increase during 2013 in both Europe and North America. Fund-raising picked up, even though the amount of investments made continued to remain rather low. From the above, it follows that the activity of the Private Equity market is expected to increase considerably.

In the private equity investment sector, Europe's attractiveness as an investment area has increased recently and the difference with the US is now small. According to investors, the buyout funds that invest in small and medium-sized companies are clearly the best investment.

Direct investments in non-listed Finnish companies

At the end of 2013, there were a total of 23 portfolio companies in the direct investment portfolio, with a total current value of about EUR 37.1 million (EUR 27.7 million). All but two of the portfolio companies were Finnish. During the year, 2 initial investments were made. A final exit was completed from one portfolio company and a partial exit was made from one portfolio company.

Return on unlisted investments (excluding holdings and fixed-asset shares within LocalTapiola Group) was a good 13.5 per cent (33.3%) in 2013.

At the end of 2013, the combined fair value of LocalTapiola General's holdings and fixed-asset shares within LocalTapiola Group was EUR 165.0 million (EUR 143.3 million).

Fixed-income investments

In the fixed-income investment markets, 2013 was the first year in a long time that the markets were not dominated by the crisis in the peripheral European states and that the direction of the markets was determined by a budding economic recovery in emerging markets. Economic growth was quite slow at the beginning of the year, which drove the core countries' long-term interest rates to record lows. At the same time, monetary policy support measures for the Japanese economy increased the demand for interest-bearing securities in emerging markets. At the beginning of May, Germany's 10-year interest rates fell to 1.17 per cent, which was the lowest level of the year.

The outlook for the US economy improved in May, which led to a sharp rise in long-term interest rates – especially in the US. Interest rates also increased due to the expectations of a reduction by the US Federal Reserve in their obligation purchase programmes supporting the fixed-income investment markets.

The European Central Bank cut its key interest rates in May, when economic development in Europe was less favourable. As a consequence, interest rates in Europe and the US developed in different directions, even though the sharp rise in interest rates in the US also impacted Europe's long-term interest rates.

This trend continued for the rest of the year – long-term interest rates rose quickly in the US and considerably more slowly in Europe. The European Central Bank cut its key interest rates again at the end of the year due to poor economic development, which slowed down the increase in long-term interest rates in Europe. Germany's ten-year market interest rate was 1.76 per cent at the end of 2013, whereas at the beginning of the year it had been 1.32 per cent.

In this environment of low interest rates, there was high demand in the markets for fixed-income investments offering risk premiums and bonds issued by peripheral European states became much more expensive compared to the core states' bonds. For example, the spread between Italian/Spanish bonds and German bonds increased by over one hundred points.

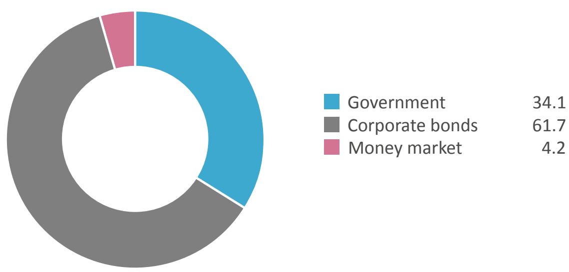
Furthermore, corporate bonds became more expensive compared to government bonds – especially those with low credit ratings. The interest rates of low-risk bonds, such as covered bonds, decreased. However, the decrease was rather small due to the already low risk premiums.

Money market interest rates were very low in 2013. The two interest rate cuts by the European Central Bank and Europe's weak economic development kept short-term interest rates low. In its statements, the European Central Bank assured the markets that it will keep short-term interest rates at the current level or even lower. Therefore, no major changes are expected in the near future.

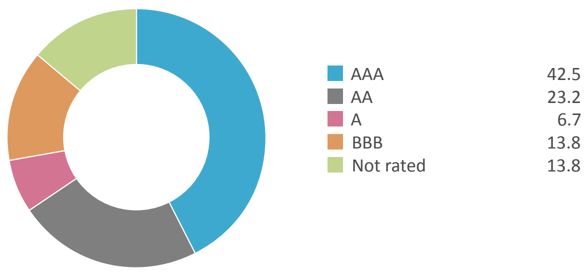
LocalTapiola General's duration was adjusted several times during the year. With respect to its index, it was mainly neutral or long at the beginning of the year and shorter as of May. The duration was closer to neutral towards the end of the year, albeit still slightly shorter than the index.

The market value of LocalTapiola General's fixed income portfolio, including fixed income funds and money market investments, stood at EUR 1,661.1 million (EUR 1,444.6 million), or 54.9 per cent (50.8%) of investments. Government bonds accounted for 34.1 per cent of fixed income investments. Corporate bonds, covered corporate bonds and other public-sector loans accounted for 61.7 per cent of fixed income investments, while money market investments accounted for 4.2 per cent. The modified duration of the portfolio, which measures its interest rate risk, was 3.1 years (4.6 yrs). Fixed-income investments yielded 1.2 per cent (8.7%).

9. Fixed-income investments by type, %



10. Fixed-income investments by credit rating, %



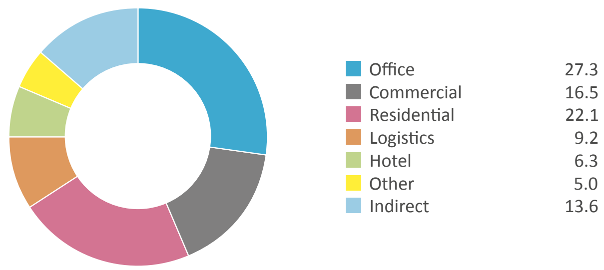
Real estate investments

The persistence of the euro crisis in 2013 continued to be reflected in the eurozone countries' real estate markets. The real estate markets of Southern Europe continued to show no signs of improvement, even though the interest of opportunistic investors in, for example, the Spanish real estate market increased. In Germany, activity in the real estate market remained stable as a result of the strong economy.

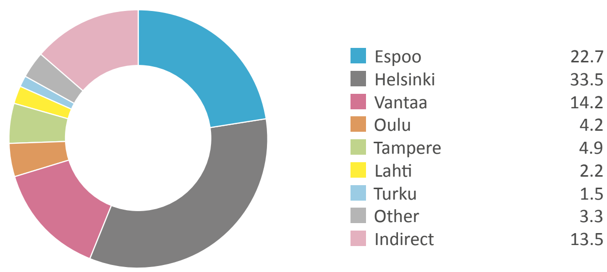
Transaction volumes in the Finnish real estate market were low for the fifth consecutive year. Many investors are particularly selective when choosing investments. However, investor demand is sufficient for good real estate properties and the best sites are sold through competitive bidding. The financial markets are still challenging, but financing is available for the right projects on reasonable terms. The decrease in return requirements for the best sites came to a halt in 2013. Return requirements for riskier sites are increasing and demand for investments in these sites continues to be low. Changes in the real economy are reflected in the commercial real estate market and real estate owners compete intensely, especially over good tenants for commercial real estate in the Greater Helsinki Area. The utilisation rates of real estate located in weaker areas are decreasing. Rent levels for good commercial sites in central Helsinki continued to rise slightly. However, in other office submarkets, rents either remained stable or decreased slightly. No significant changes occurred in the rents and utilisation rates of business and storage premises.

At the end of 2013, the market value of LocalTapiola General's real estate portfolio totalled EUR 628.4 million (EUR 660.7 million). The allocation to real estate investments fell to 18.1 per cent (21.8%) and real estate investments returned 5.0 per cent (3.3%) in 2013. The total return on real estate investments was weighed down by the buildings occupied by LocalTapiola General itself. The most significant additions to the real estate portfolio consisted of additional real estate fund investments. In addition, several smaller development investments were made in existing sites. The value of the assets in real estate funds amounted to EUR 143.1 million (EUR 127.4 million). In 2013, the Aura-Tapiola head office real estate and residential properties from several companies in the Greater Helsinki Area, among others, were sold from the direct real estate portfolio. The average vacancy rate rose to 9.2 per cent (4.4%)

11. Real estate investments by type, %



12. Real estate investments by region, %

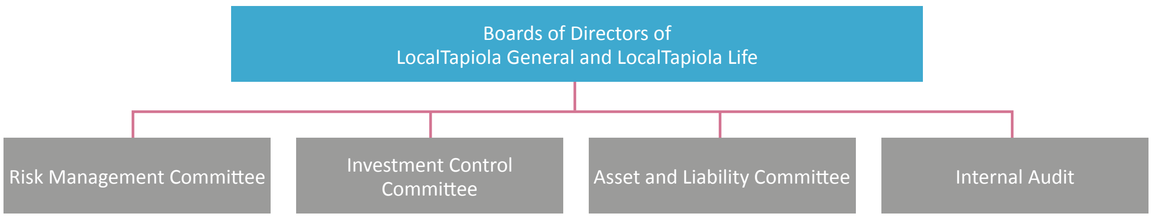


Illiquid loans

Illiquid loans consisted of direct loans to real estate and other companies. In 2013, the market value of loans receivable in LocalTapiola General Mutual Insurance Company's investment portfolio was EUR 206.8 million, or 5.2 per cent of the portfolio. Loans receivable generated a return of 3.8 per cent (3.3%). The mortgage loan market had attractive yield spreads in 2013. The spreads of the best sites decreased slightly at the end of the year. The marginals of corporate loans remained quite satisfactory in 2013 as banks began to lend money on tighter terms and there was demand for refinancing in the markets.

Market risk management

13. Market risk management organisation



Operating principles

The aim of LocalTapiola General'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 General set up an Asset and Liability Committee in 2007. The Committee, which is appointed by and reports directly to the Board of Directors, is an organ whose tasks include balance sheet risk management and monitoring, development and decision-making. Furthermore, it is responsible for ensuring that the management of the company's balance sheet risks – especially its market risks – is appropriately organised and that the company's capital is efficiently used. The Committee draws up, at regular intervals, a proposal on strategic market risk-taking and the associated investment targets and restrictions (limits) and submits it 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 makes sure that the investment return target as per the strategy approved by the Board of Directors is achieved. Furthermore, it monitors, develops, controls and decides upon liquidity and concentration risk management. The Risk Management Committee is responsible to the Board of Directors for organising risk management and monitoring 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 takes market risks based on its approved 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 limits, 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 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, for example.

Adequate analyses, diversification, derivatives and counterparty risk limits are used with the aim of securing freedom of action 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. In the short term, the current solvency practice is the more significant and limiting system.

The most significant change in solvency calculation will be that, under Solvency II, in addition to assets, technical provision will also be valued in market terms at 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 baseline 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 stochastic 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. At the end of the year, the volatility of fixed-income and equity investments and the expected short-term risks were at the previous year's level.

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 operations are required. In the yellow and red light risk positions, stricter limits for investment risks, as well as possible risk reduction operations, 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 principles approved by the company shall be followed.

14. LocalTapiola General's market risks

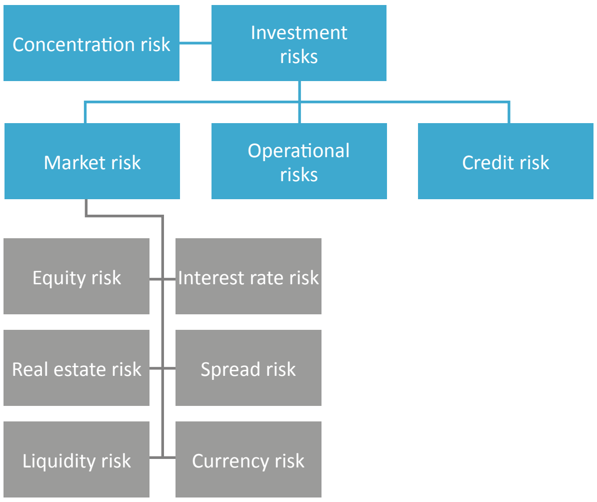
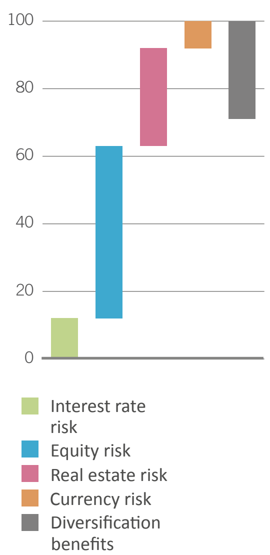


TABLE 3. Sensitivity of LocalTapiola General's investments and solvency to market scenarios as of 31 December 2013

		Impact of change		
	31.12. 2013	Share quotations −20%	Value of real estate −10%	Interest rate +1 % points
Solvency capital, EUR m	1,646.2	−182.6	−62.8	−60.5
Solvency ratio, %	87.2	−9.7	−3.3	−3.2
Return on investment, %	4.1	−4.6	−1.6	−1.5

15. Investment risks, %



An estimate of LocalTapiola General's market risk distribution under Solvency II at the end of 2013.

LocalTapiola General's market risks

LocalTapiola General'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 LocalTapiola General's market risk distribution is presented in figure 15. Risk values are based on the risk models and parameters prescribed by the current official regulations (EIOPA). 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 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. In the main, equity investments are 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.
- No single company's shares can account for more than 5 per cent of the equity portfolio's value.
- The equity portfolio must contain 30 companies' shares at a minimum, and 100 companies' shares 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 operations are controlled with investment plan limits. The total amount of private equity investments in the form of shares may total a maximum of 6 per cent of the company's investment assets.

Fixed-income risks

The primary objective of LocalTapiola General's fixed-income investments is to secure the value of invested funds and thus ensure that customers can be rewarded with a return that is at least equivalent to their minimum requirement. 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. Investments are made in stable companies with good credit ratings. 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 with the following allocation and diversification limits among others: Investment limits are based on companies' official credit ratings. As regards countries, the credit ratings used are primarily those estimated by LocalTapiola.

- Government bonds must make up at least 10 per cent of the fixed income investment portfolio.
- The proportion of corporate bonds and commercial paper may not exceed 50 per cent.
- Other bonds issued by public corporations and covered bonds may not account for more than 50 per cent of the portfolio.
- At least 50 per cent must be invested in bonds with the highest credit ratings (AAA–AA).
- 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 domestic 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.

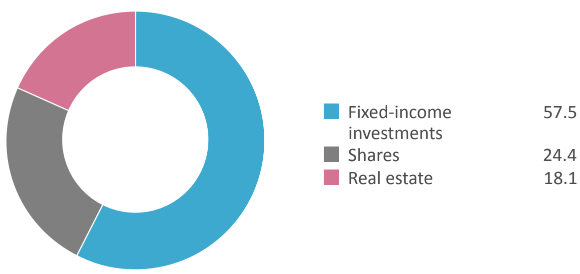
Real estate investments are handled by LocalTapiola Real Estate Asset Management Ltd.

The return on direct real estate investments consists of change in net operating income (rents) and capital appreciations. Real estate risks may be realised as both loss in value or decreased income cash flow.

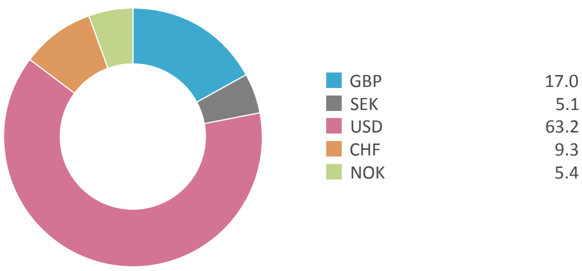
Real estate is a long-term investment covering very long liabilities, as lease agreements are often linked to inflation. The risk-to-return ratio of the real estate portfolio is kept low by ensuring well-founded purchases and a consistent sale programme. The real level of the cash flow and related location-specific 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 the healthy economic structure of the municipalities, additional criteria include the inhabitant base and user demand. At least 70 per cent of the real estate investments must be in Finland.

Real estate investments may account for 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".

16. Investment allocation 31 Dec 2013, %



17. Currency allocation 31 Dec 2013, %



Currency risks

A 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 2013, the company's unhedged currency position totalled EUR 249.4 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 large claims paid, 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 is to secure the required liquidity for the company under all circumstances. To secure sufficient liquidity in the longer term, 2–20 per cent of assets must be in money market 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 regional companies offer comprehensive insurance, savings and investment services. We also provide banking services. We are your partner in matters related to security, well-being and the economy.

Welcome to the new LocalTapiola!

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