Tapiola Life's investment activities and risk management 2010

TAPIOLA

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Investment operations

1. Allocation

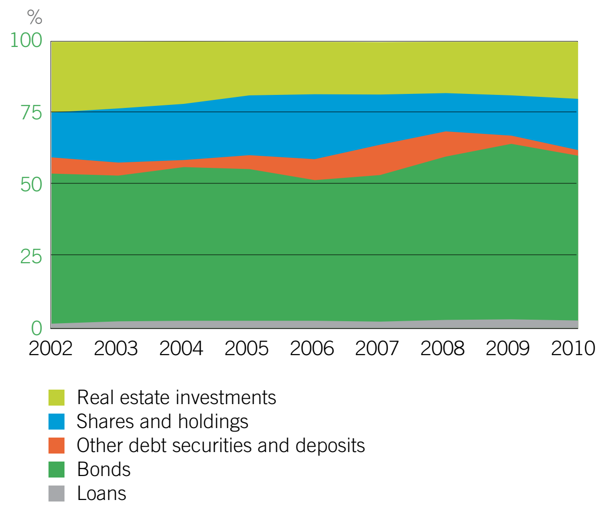
The return on Tapiola Life's investment portfolio at current value was 4.9% (7.0%) in 2010. Investment assets at current value totalled EUR 2,586.6 million (EUR 2,564.8 million), and net investment income at current value came to EUR 123.2 million (EUR 174.1 million).

The average five-year annual return on investment was 4.1 per cent and the average ten-year annual return was 5.3 per cent. Compared to 2009, return on investment decreased in all areas, with the exception of real estate investments. In 2010, allocations remained at the levels seen in 2009 in terms of the distribution of investments between different asset classes. In fixed-income investments, corporate loan allocation was increased. The interest rate risk of the investment portfolio was moderately increased. In its investment operations, Tapiola Life uses asset managers that have signed the United Nations' (UN) Principles for Responsible Investment.

1. Allocation and income

31.12.2010	Distribution, EUR m	Distribution, %	Return, %
Loans receivable	44.7	1.7	1.9
Bonds	1,504.3	58.2	3.7
Other debt securities and deposits	51.5	2.0	2.7
Fixed-income investments	**1,600.5**	**61.9**	**3.6**
Listed shares	329.0	12.7	17.3
Private equity funds	77.3	3.0	8.8
Unlisted shares	52.1	2.0	2.8
Equity investments	**458.4**	**17.7**	**14.2**
Direct real estate investments	404.3	15.6	5.7
Real estate mutual funds and collective investments	115.0	4.4	-2.7
Real estate investments	**519.3**	**20.1**	**3.7**
Absolute return investments	8.4	0.3	-15.9
Other investments	**8.4**	**0.3**	**-15.9**
Total investments	**2,586.6**	**100.0**	**4.9**

1. Allocation development



2. Equity investments

The equity market developed favourably in 2010. However, share price fluctuations were occasionally high. Share prices rose by 11.6 per cent in Europe, and in Finland they rose by as much as 29.8 per cent, measured by the OMX Helsinki Cap index. Due to problems relating to government debts, share prices decreased markedly before the summer, when concerns about the situation in Greece were at their peak. Companies' results and prospects exceeded expectations throughout the year. This supported equity investments, and the valuation of shares was attractive throughout the year. After the summer, the total values of shares developed favourably despite the occasional downswing. This could especially be seen at the end of the year, when Ireland's debt problems surfaced. At that time, there were no signs of a major crash in the equity market, and the attitude towards the situation was much more relaxed than during the crisis that hit Greece.

As in 2009, the most successful industries in Europe were cyclical industries, such as basic industry, industrial services and consumer companies. Correspondingly, the utility and finance sectors ended up having negative returns. The share prices of banks, in particular, developed unfavourably throughout the autumn due to the problems in the financial markets. In terms of P/E ratio and cash flows, shares continue to be considered attractive. The valuation of shares is even more attractive in relation to interest rates, and cash flows and strong balance sheets support good dividend income. In 2010, the companies were still able to keep their expenses well under control. In the future, this will be significantly more difficult as a clear increase in prices is to be expected – especially for raw materials and components. The sustainability and extent of economic growth will be a decisive factor for the equity markets in 2011. The indebtedness of public sector economies may continue to be cause for concern, which will definitely be reflected not only in shares but also in the fixed-income investment and foreign exchange markets.

2. Largest equity investments

	Market value, EUR m	% of equity investments
Fortum Corporation	8.82	3.3
Kone Corporation	8.07	3.0
Lassila & Tikanoja plc	7.66	2.9
Metso Corporation	7.15	2.7
DnB NOR Bank ASA, Oslo	7.09	2.6
Telefonica Sa	6.96	2.6
Nestle Sa	6.96	2.6
Hennes & Mauritz Ab	6.50	2.4
KLOECKNER & CO	6.38	2.4
United Technologies Corp	6.29	2.3

Tapiola Life's equity investments yielded 14.2% in 2010

Tapiola Life's direct listed equity investments yielded 17.3 per cent in 2010, which exceeded the yield of European equity markets. The yield was achieved at a lower risk than the general equity market risk. At the end of 2010, Tapiola Life's equity investments totalled EUR 458.4 million, accounting for 17.8 per cent of the investment distribution. The equity portfolio contained 10.3 per cent of direct investments in listed companies, 2.4 per cent of fund investments and 3.0 per cent of unlisted shares. Return on equity investments was 14.2 per cent, and return on equity funds came to 21.3 per cent. The proportion of Finnish shares decreased during the year to 23.5 per cent. In equity investments, the allocation on the Nordic countries was increased. The allocation on industrial, consumer product, utility, energy and telecommunications companies increased, and the share of other industries declined. In particular, the share of basic industry was reduced and that of industrial services was increased.

The 50 largest equity investments accounted for 95.5 per cent of direct equity investments. Equity investments outside the euro area, with the exception of the dollar and the pound sterling, have been, for the most part, currency-hedged.

2.1. Tapiola Life's investments in Private Equity funds

At the end of 2010 there were a total of 37 funds in Tapiola Life's venture capital fund portfolio with a total current value of about EUR 77.3 million. No new fund commitments were made in 2010; instead, the focus was on monitoring and analysing the current portfolio.

During the year, the investment activity in the funds rose significantly compared to previous year and the portfolio companies developed favourable, which also reflected in the companies' valuations. In 2010, the return on Private equity funds became positive again, reaching 8.8 per cent.

2.2. Direct investments in non-listed Finnish companies

At the end of 2010, there were a total of 21 portfolio companies in the direct investment portfolio, with a current value totalling approximately EUR 30.7 million. The portfolio companies were Finnish, with only three exceptions. No new initial investments were made over the year. However, two additional investments were made in existing portfolio companies. Final exits were completed on three portfolio companies.

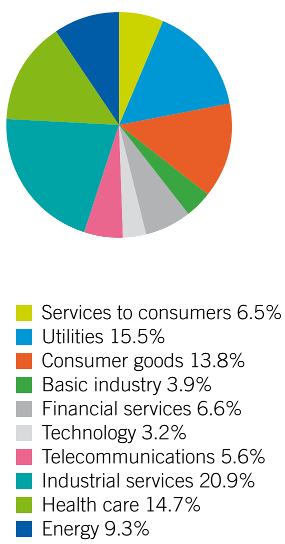
Non-listed investment - including holdings in Tapiola Group companies - yielded a return of 3.2 per cent during 2010.

3. Fixed-income investments

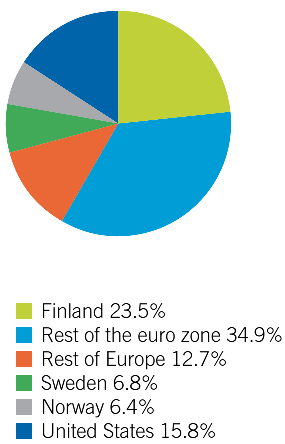
The financial crisis in countries on the periphery of Europe was a main influencing factor in the fixed-income investment markets in 2010. The financial crisis in Greece worsened throughout the spring and reached its peak in May 2010, when the EU countries decided, together with the IMF, on significant support measures. As a consequence of the crisis, the risk premiums in other states on the periphery of Europe (Greece, Ireland, Portugal, Spain, Italy) grew vigorously, which, in turn, resulted in more demand for the bonds of the best states as well as in a sharp decrease in interest rates – especially in Germany. At the end of the summer, weak economic indicators in the Western countries gave rise to the fear of economic growth coming to a halt, which decreased the interest rates of United States and German bonds to a record low. At the end of August, Germany's 10-year interest rate decreased to a level of about 2.1 per cent. However, long-term interest rates began to rise sharply in September thanks to the economic recovery. At the turn of the year, interest rates increased to 3 per cent, which is close to the rate at the start of the year.

The crisis in the peripheral European countries took another turn for the worst in November, when the price of Irish government

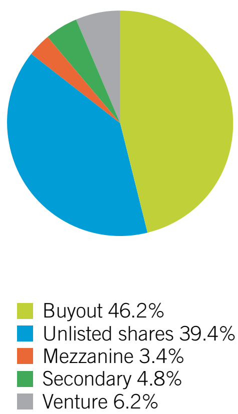
2. Direct investments by industry



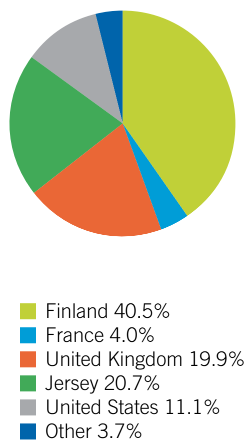
3. Direct investments by region



4. Private equity investments by type



5. Private equity investments by region



bonds decreased dramatically. This was caused by greater-than-expected difficulties in the banking sector and housing market. The European Union had to commit again to crisis interventions, which only partially alleviated the problems in these states. In addition, the interest rates on Portuguese and Spanish bonds rose dramatically towards the end of the year.

Collateralised bonds were a stable sector in fixed-income investment markets in spite of the fact that the collateralised loans of Europe's peripheral states suffered to some extent from the government bond crisis. Volatility was moderate, and risk premiums were low.

The corporate loan markets, too, were quite stable, and risk premiums remained relatively stable. During the government bond crisis, fixed-income investors felt that corporate loans, excluding banks, were safe. Bonds issued by banks were under pressure in 2010 as many international banks had significant investments in the government bonds of European states in crisis. At the same time, modifications to European regulations in the banking sector increased uncertainty associated with the financing capabilities of banks. At the end of the year, the risk premiums paid by banks were at a historically high level.

European Central Bank (ECB) policy supported the bond markets in 2010. The ECB kept its key interest rates unchanged and helped the states in crisis through support purchases. Furthermore, the US Federal Reserve strongly supported its own government bond market, which also supported Europe indirectly.

During the year, the rate of return for corporate loans was 6.0 per cent and, for bonds, 3.7 per cent.

Companies' interest rate risk, i.e., duration, varied throughout the year according to market conditions, but was, in the main, somewhat shorter than its benchmark index. Collateralised loans were overweighted throughout the year, allocation on public sector loans was increased to overweight, and allocation on government bonds was decreased to underweight.

The entire fixed-income portfolio, including money market investments, yielded 3.6 per cent. At the end of 2010, the market value of Tapiola Life's fixed-income portfolio totalled EUR 1,600.5 million. Government bonds accounted for 33 per cent of fixed-income investments, real estate and public sector collateralised loans, as well as corporate loans, accounted for 64 per cent, and money market investments accounted for approximately 3 per cent. The modified duration of the portfolio was about 5.1 years. Throughout the year, interest derivatives were actively used to manage the portfolio's interest risk profile. The average capital-weighted credit rating of the entire fixed-income investment portfolio was good: AA-. The average capital-weighted credit rating of corporate loans was A, or AA- with real estate and public sector collateralised loans also included.

3.1. Customer loans

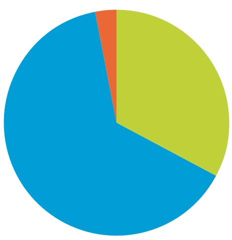
The proportion of loan receivables in Tapiola Life's total investments decreased. Loan receivables yielded a return of 1.6 per cent in 2010.

4. Real estate investments

The international real estate markets began to recover in 2010, and business volumes have grown in many European countries. Return expectations had long been increasing but, by the middle of the year, this trend came to a halt in most submarkets. Expectations even decreased slightly in some markets, such as Great Britain. The general economic situation continues to threaten the markets.

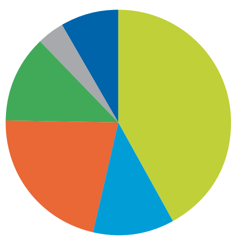
In 2010, the atmosphere in the Finnish real estate market improved compared to the uncertainty of the previous year.

6. Fixed-income investments by type



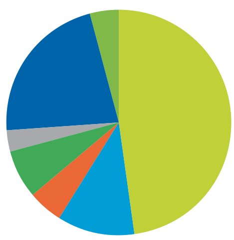
- Government 33%
- Corporate and covered bonds 64%
- Money market 3%

7. Fixed-income investments by credit rating



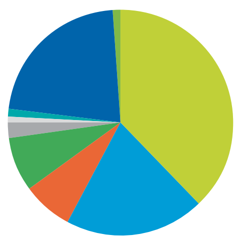
- AAA 42.2%
- AA 11.5%
- A 21.7%
- BBB 12.4%
- Under BBB 4.0%
- No rated 8.2%

8. Real estate investments by type



- Office 48%
- Hotel 11%
- Commercial 5%
- Residental 7 %
- Logistics 3%
- Funds 22%
- Other 4%

9. Real estate investments by region



- Helsinki 38%
- Espoo 20%
- Turku 7%
- Vantaa 8%
- Oulu 2%
- Lahti 1%
- Kouvola 1%
- Funds 22%
- Other 1%

This, however, did not result in significantly higher business volume. Foreign investors' share of business volume is on the rise. Yield requirements have decreased slightly in the best areas, and there is enough investment demand for good sites. The pricing of higher-risk real estate is unpredictable due to the shortage of reference sales, and the demand for these sites continues to be low. The challenges in the real economy continued to have an impact on the Finnish premises rental market in 2010, causing pressure to reduce rents, especially in the most challenging office areas of the Helsinki Metropolitan Area. However, the decrease in rents has already stopped in the prime areas, and there are even pressures to increase the rents of business premises, particularly in the city centre area.

At the end of 2010, the market value of Tapiola Life's real estate portfolio totalled EUR 519.3 million (EUR 485.4 million). The allocation on real estate investments rose to 20.1 per cent (18.9%). Real estate investments yielded 3.7 per cent (-0.6%) in 2010. The total return on real estate investments was weighed down by the low return on indirect real estate investments, as well as by buildings under construction.

The most significant additions to the real estate portfolio were real estate fund investments and additional investments in projects under construction. The most important construction projects were Kiinteistö Oy Espoon Revontulenkuja 1, Asunto Oy Helsingin Vanhalinna, Kiinteistö Oy Elimäenkatu 12–16 in Helsinki, Kiinteistö Oy Harkkokuja 2 in Vantaa and Kiinteistö Oy Metsänpojankuja 4 in Espoo.

The most significant sale was of a proportion of the shares of Kiinteistö Oy Kielas, a company located in Espoo. The average vacancy rate rose to 10.3 per cent (5.9%).

Market Risk management

5. Operating principles

The aim of Tapiola Life Group'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 limits and investment criteria. Investment operations must ensure adequate liquidity under all circumstances. In addition, the investment portfolio must be sufficiently simple.

6. Organisation of market risk management

Tapiola Life Group established an Asset and Liability Committee (ALCO) in 2007. The Committee is an expert organ tasked with managing and monitoring balance sheet risks. It reports directly to the Board of Directors. It is responsible for ensuring that the company's balance sheet risk management is organised in an appropriate manner. At regular intervals, ALCO prepares a proposal for the Board of Directors on strategic market risk-taking and the associated limits. The limits cover investment price and interest rate risks, as well as the characteristics and requirements of the technical provisions. ALCO monitors the defined risk limits as well as the results of risk-taking.

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 Investment Control Committee includes the investment manager, the CEOs of the insurance companies, the actuarial managers and members appointed from among Tapiola Group by the Board of Directors.

The ERM Committee is responsible to the Board of Directors for the organisation of risk management and the monitoring of solvency.

Compliance with investment guidelines is monitored by internal audit.

7. 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.

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 in all market conditions, both within and between instrument categories. The diversification principles apply to various business sectors, countries and investment targets. Individual risks and responsibilities are controlled by establishing limits and investment criteria. Sufficient liquidity is ensured by the structure of the investment portfolio.

As regards derivatives, a more detailed policy approved by the Board of Directors is used. The policy describes 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.

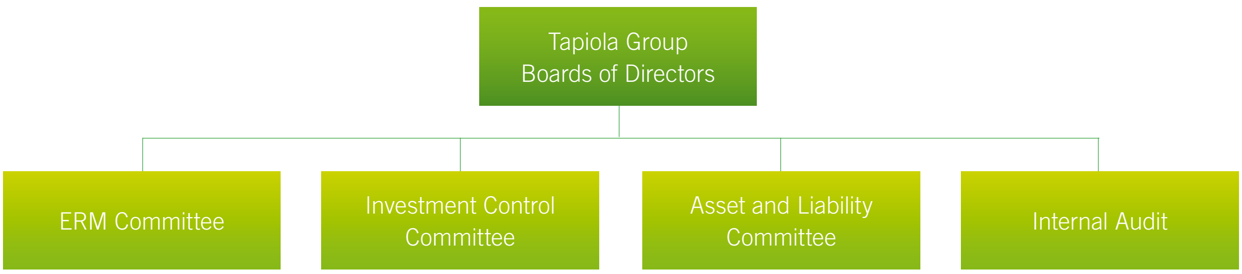
Adequate analyses, diversification, derivatives and counterparty risk limits are used with the aim of securing freedom of action in all market conditions. Real estate investment risks are analysed separately.

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.

7.1. Market risk and solvency management

The effect of market risks on the company's solvency is monitored and managed in accordance with two separate systems. One is the current solvency practice (Solvency I) and the other is the Solvency II framework, which is expected to come into force at the beginning of 2013. Furthermore, solvency is monitored in compliance with the solvency regulations applied to conglomerates. In the short term, the current solvency practice is the more significant and limiting system.

10. Market risk management organisation



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 rate levels, and the significance of interest rate risk management will increase. 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 basis for market risk management is that the company's solvency is secured for the next twelve months with sufficient probability. The risk of investment value changes is continuously monitored with a probabilistic model that is based on historic investment value fluctuation 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. The volatility of fixed-income and equity investments and the expected short term risks have decreased from the rather high level of last spring – which was due to the Greek debt crisis – back to the level seen in late 2009.

When necessary, investment operations are controlled more strictly, in accordance with the so-called traffic light principle, and are based on continuous market risk monitoring. A green light refers to a situation where asset managers are able to operate in accordance with the normal investment plan limits. A yellow light relates to a situation when any 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 defined in such a manner that the solvency margin remains secure, also in the event of any of the risks occurring.

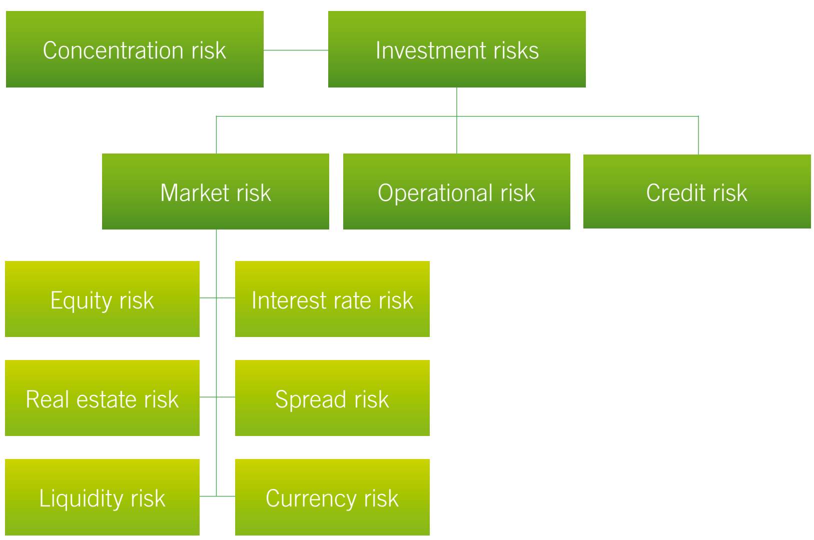
8. Tapiola Life Group's market risks

Tapiola Life Group's most significant market risks are equity risks, interest risks and credit risks associated with fixed-income investments, as well as real estate investment risks in accordance with figure 11. Market risks may be realised as lower-than-expected income cash flow or as 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. Tapiola Life Group's market risk distribution in accordance with Solvency II is presented in figure 12. Risk values are based on the risk models and parameters as prescribed by the current official regulations. 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.

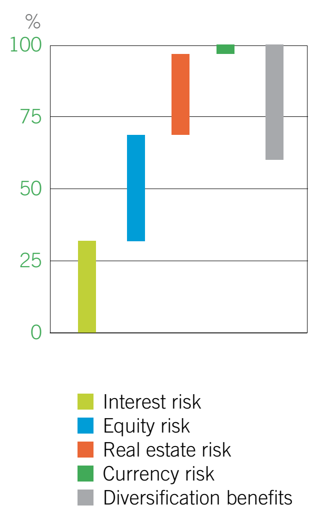
The sensitivity of Tapiola Life Group's investments and solvency to market scenarios as of 31 December 2010

		IMPACT OF CHANGE		
	31.12. 2010	Share quotations -20%	Value of real estate -10%	Interest level +1 percentage point
Solvency capital, EUR m	**428.8**	-116.2	-67.1	-109.0
Solvency ratio, %	**18.1**	-5.0	-2.9	-4.7
Return on investment, %	**4.9**	-4.6	-2.7	-4.3

11. Tapiola General's market risks



12. Investment risks



An estimate of Tapiola Life Group's market risk distribution on 31 December 2010

Market risk is managed by adequate diversification of investments by asset class, geographical location and industry sector. A key tool for controlling investment activities is basic asset class allocation. Allocation development is presented in figures 1 and 13. 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.

8.1. 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 are aimed 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 is given in section 2.

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

- The total amount of listed shares may add up to a maximum of 15 per cent of the company's investments.
- One company's shares in the equity portfolio may not account for more than 5 per cent of the 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 shares are handled by Tapiola 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 may add up to a maximum of 5 per cent of the company's investment assets.

8.2. Fixed-income risks

The primary objective of Tapiola Life Group's fixed-income investments is to secure the values of investments 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 investment risks consist of interest rate fluctuations and the investment target's credit risks. In addition to the general interest rate level of government bonds and the intra-bank interest rate, the interest rate risk is also affected by fluctuations in the individual corporate bond interest premiums (spread).

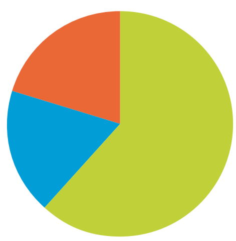
Corporate bonds are used to achieve a higher return on the fixed-income portfolio. Investments are made in stable companies with good credit ratings. Primarily, investments are weighted toward bonds with short maturities, which are generally held to maturity. Credit risk is minimised by diversifying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

Investment limits are based on companies' official credit ratings. Fixed-income investments are controlled with the following allocation and diversification limits among others:

- Government bonds must make up at least 25 per cent of the fixed-income investment portfolio.
- The proportion of corporate bonds may not exceed 30 per cent.
- Other bonds issued by public corporations and collateralised bonds may not account for more than 50 per cent.
- At least 60 per cent must be invested in bonds with the highest credit ratings (AAA-AA).
- Country risk must be diversified across the entire euro zone, and excessive concentration in any single country is to be avoided.

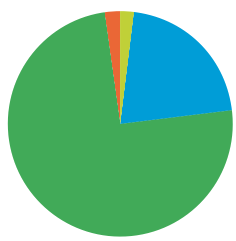
Fixed-income investments are handled by Tapiola Asset Management Ltd. Further information on fixed-income investments and allocations is given in section 3.

13. Investment allocation on 31 December 2010



Fixed-income investments
Equities 18.0%
Real estate 20.1%

14. Currency allocation on 31 December 2010



DKK 2.1%
GBP 21.1%
USD 74.7%
Other 2.0%
Open currency position EUR 96 million

8.3. 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 and thus reducing the portfolio's risk, as well as making investments in international real estate markets or in domestic special targets.

Real estate investments are handled by Tapiola Real Estate Ltd.

The return on direct real estate investments consists of change in net operating income 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 return-risk structure of the real estate portfolio is ensured with 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.

The total amount of real estate investments may add up to a maximum of 23 per cent of the company's investment assets. Further information on real estate investments and allocations is given in section 4.

8.4. 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 impact the business operations of individual companies and industries and thus have an indirect impact on changes in equity asset values.

As a rule, the currency position is hedged using derivatives when investments are made in foreign currency. The minimum hedging ratio of a currency position is determined by company-specific investment limits and legislation. At the end of 2010, the company's unhedged currency position totalled EUR 96 million. The open currency position allocation is presented in figure 14.

9. Liquidity risks

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

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.