

VARMA MUTUAL PENSION INSURANCE COMPANY (VARMA)

Asset owner: Pension plan (public, corporate, other) * Headquarters: Finland * AUM: US\$ 45.8 billion (2017)¹

AT A GLANCE

Varma is the largest pension insurance provider (and investor) in Finland. Weary of the risks climate change and “stranded assets”, Varma has made a pledge to reduce its own carbon footprint and intensity of its investments, and to integrate environmental, social and governance (ESG) considerations within its investment selection to ensure it is creating long-term value for Finland and other countries invested in.

TOOLS OF INTENTIONALITY

- | | |
|--|---|
| <input type="checkbox"/> Additionality | <input type="checkbox"/> Polity |
| <input type="checkbox"/> Diversity of Approach | <input type="checkbox"/> Self-Organization |
| <input type="checkbox"/> Evaluations | <input type="checkbox"/> Solutions |
| <input type="checkbox"/> Interconnectedness | <input checked="" type="checkbox"/> Standards Setting |
| <input type="checkbox"/> Locality | <input type="checkbox"/> Utility |

ON-RAMPS

- | | |
|---|--|
| <input checked="" type="checkbox"/> ESG integration | <input checked="" type="checkbox"/> Long-term value creation |
| <input type="checkbox"/> Impact investment | <input type="checkbox"/> Universal ownership |
| <input type="checkbox"/> Investment stewardship | |

ASSET CLASSES INTEGRATED INTO

- | | |
|---|---|
| <input checked="" type="checkbox"/> Fixed income | <input checked="" type="checkbox"/> Public equities |
| <input type="checkbox"/> Infrastructure and real assets | <input type="checkbox"/> Real estate |
| <input type="checkbox"/> Private equity | <input type="checkbox"/> Venture capital |
| <input type="checkbox"/> Other | |

YEARS INTEGRATING

Varma has been integrating environmental considerations into its investment approach for **3 years**, since 2014 when it launched its Principles for Responsible Investment policy. In 2015, Varma published launched its new Corporate Social Responsibility program which further integrates these considerations and began tracking its carbon footprint

SYSTEMS & THEMES FOCUSED ON

- Environmental

- Biodiversity
- Climate change
- Natural resources
- Oceans
- Renewable energy
- Sustainable land use
- Waste management and pollution
- Water
- Other

- Societal

- Consumer health and safety
- Corporate governance
- Corruption
- Employment, labor rights and working conditions
- Food production and security
- Human rights
- Income inequality and financial inclusion
- Infrastructure
- Social equality and diversity
- Other

- Financial

- Shareholder rights
- Stability
- Transparency
- Other

TOOLS OF INTENTIONALITY: THE VARMA "TIIPING" POINT

Varma intentionally uses the tool of **Standards Setting** in its abstention from investments in securities that are damaging to the environment or society. These include investments in companies manufacturing tobacco and nuclear weapons products, and electricity companies using coal to generate more than 30% of their electricity.

ABOUT VARMA

Founded in 1998, Varma is the largest pension insurance provider in Finland. It pays pensions to roughly 340,100 people and provides pension coverage for nearly 870,000 people. It is also the largest investor in Finland.

Varma notes that responsibility is important to it in this role given that the “investment decisions [it] makes shape, through the availability of financing, the operational conditions of companies and other investment objects” (Varma 2016(a): 20). As such, Varma invests to **create long-term value** particularly in Finland, where it allocates 25% of its total investments.

In 2015, Varma launched its new Corporate Social Responsibility (CSR) program, which incorporates both its corporate operations and investment and ownership activities. Its internal Principles for Responsible Investment policy and its asset-class specific responsible investment efforts largely govern the investment-related program. Among other things, the policy affirms Varma’s commitment to the U.N. Principles for Responsible Investment; **environmental, social, and governance (ESG) integration**; and alignment with other recognized principles and norms such as the U.N. Global Compact initiative for corporate responsibility, Organization for Economic Co-operation and Development (OECD) guidelines for multinational enterprises, and International Labor Organization conventions.

In 2016, Varma integrated an emphasis on **climate change** into its CSR program and committed to reducing its carbon footprint across its investment portfolio and continuing to work towards meeting the 2^o Celsius target established during the 2015 U.N. Climate Change Conference. It has set the following goals for its carbon reduction:

- Varma aims to reduce its carbon footprint by 25% relative to revenue in **listed equity** by 2020 through selecting companies that are prepared for climate change and will be receptive to reducing their carbon footprint and disclosure over time. Varma aims to have 95% of its listed equity investments disclosing greenhouse gas emissions by 2020.²
- Varma aims to reduce its carbon footprint in **corporate bonds** by 15% relative to revenue by 2020 through selecting companies that “tak[e] into account the carbon intensiveness of their operations” (Varma (2016c): 4) and that use best practices in their own operations.³ It will engage these companies to underscore the importance of addressing and mitigating climate risk.
- Varma aims to reduce its carbon footprint by 15% for “comparable **real estate** that it is responsible for maintaining by 2020 and 20% by 2025 from the 2015 levels in relation to gross square meters” (Varma (2016c): 3)
- Varma aims to have more than 50% of **private equity and hedge fund** managers using a climate change policy and integrating climate change risks into investment decision-making by 2020.

Varma recognizes the risks posed by climate change, particularly as it relates to stranded assets. Thus, Varma’s portfolio managers evaluate ESG risks when assessing future cash flows. It also aims to further embed responsible investment into its investment selection process by broadening its ESG integration across its portfolios and increasing “stakeholder-specific communication” (Varma (2017a): 7). Varma currently includes social and governance data in investment analysis such as security weighting and portfolio construction, and ESG considerations into non-financial analysis.

APPROACHES IN PRACTICE

➤ INVESTMENT ACTIVITIES

Investment beliefs statements

N/A

Security selection & portfolio construction

Varma screens prospective investments to ensure that the companies it invested in are not involved in the manufacturing of tobacco and nuclear weapons, and are not electricity companies that “generate more than 30% of their electricity with coal” (Varma (2016a): 34). Companies invested in must also comply with the United Nations (U.N.) Global Compact, the U.N. Declaration of Human Rights and Convention against Corruption, the International Labor Organization labor conventions, and the Rio Declaration on Environment and Development.

Direct equity and fixed income investments. Varma integrates ESG considerations into its direct equity and fixed-income investment screening. Within its direct equity investments, Varma evaluates financially material ESG sector- and company-specific criteria which it acquires from specialized data providers. Varma acquires ESG data for its direct fixed-income investments through interacting with companies at roadshows, as well as from data providers. For both asset classes, Varma also considers the “availability and quality of the ESG analysis as one criterion in equity broker assessments” (Varma (2014c): 2). To meet Varma’s carbon footprint reduction goals, it looks to invest in “companies with the best practices... taking into account the carbon-intensiveness of the companies’ operations ((Varma (2016c): 4).

Real estate. Viable real estate investments are those that meet soil quality and energy efficiency (in new buildings renovations) conditions.

Varma does not apply its responsible investment criteria to its indexed funds nor its passive corporate bond funds.

Varma offers a “climate change-themed portfolio” which consists of “companies whose operations benefit from climate change mitigation” (Varma (2016a): 37). These holdings include technology companies, companies who produce renewable energy, and those that are positioned to participate in a lower carbon economy.

Corporate engagements

Varma engages directly with those companies in which it has a large holding. In instances when a company in which Varma has a small stake has a “severe and long-term [breach] of international norms,” Varma hires an external service provider to engage with them (Varma (2017b): 61).

Varma engages differently by asset class:

- **Listed equities.** Varma hires service providers to report which of its companies is suspected of, or is in fact operating in violation of Varma’s responsibility policies. Varma engages with violators to “influence [them] such that they rectify the detected violations and change their ways of operating” (Varma (2016a): 21) and divests if engagement is not successful or violations otherwise persist. Varma also engages with its listed equity holdings regarding climate change preparedness.
- **Direct equity investments.** Varma identifies which of its direct equity companies to engage with using on information provided by portfolio managers based on reviews of their holdings and engages with those companies found to be “infring[ing on] international norms” (Varma (2014a): 3). Varma exercises voting rights among all the Finnish listed companies that it invests in.

- **Direct fixed-income investments.** Varma uses roadshows as its primary means of influencing company ESG performance and intentionally holds investments in “both corporate bonds and equities of one and the same company” so it can work with the portfolio manager of the investment (Varma (2014c): 2). Like direct equity investments, Varma also asks that its corporate bond managers review their holdings and develop engagement proposals for companies that have been found to be “infring[ing on] international norms” (Varma (2014c): 2).
- **Private equity.** As a limited partner, Varma encourages disclosure of responsible investment principles and policies and uses the early stages of the fund’s establishment to influence its responsibility-related policies. It also encourages funds to abstain from investment in sectors that Varma does not invest in.
- **Hedge funds.** Varma engages with its hedge fund managers to promote its own Principles of Responsible Investments and advocate for adopting responsible investment by “clarify[ing] the benefits of responsible investments” (Varma (2014b): 3). It encourages hedge fund managers to publish their own responsible investment principles and policies and to integrate these concepts into their investment selection.

Highlights:

In the 2016 voting season, Varma “influenced 23 companies, mainly in matters relating to governance” (Varma (2016a): 21).

Targeted investment programs

N/A

Manager selection, directives & monitoring

Varma assesses its external equity manager’s “governance practices” and “favors fund management companies which [adopt the] principles for responsible investment and [integrate] ESG criteria in their investment process” (Varma (2014a): 1). It fields a responsible investment questionnaire—which includes climate change specific questions—with prospective external managers; once hired, Varma meets with external managers regularly to monitor and discuss their approach to responsible investment.

➤ OTHER ACTIVITIES

N/A

➤ STAFFING

The Chief Investment Officer—alongside the head of each asset class—is responsible for applying the practices of responsible investment within Varma’s operations.

➤ IMPACT MONITORING & REPORTING

In 2016, Varma published its first ever integrated Annual Report and Corporate Social Responsibility Report. This report discusses Varma’s approach to responsibility regarding pension assets, customers, employees and the environment. Its pension assets and customer chapters report the financial information typical of an annual report, and the employees and environment chapters feature information commonly seen in a CSR such as carbon footprint reduction, employee satisfaction, employee diversity, as well as information on portfolio-level integration of climate change risks.

Varma's calculation of its carbon footprint focuses on listed equity investments and corporate bond holdings and it reports such information using the following metrics: tonne of carbon dioxide equivalent, share of disclosing companies in relation to capital, carbon footprint in relation to revenue and invested capital, and carbon intensity. Similarly, Varma also reports energy data for its real estate holdings and reports the residential, business premises, and total heat, water and electricity usage across all Varma owned properties.

POLICY DEVELOPMENT AND MONITORING

The Board of Directors approve Varma's Principles for Responsible Investment which is continuously updated as "responsible investment activities evolve and new issues to consider emerge" (Varma (2014): 3). These principles apply to all of Varma's assets and offer asset-specific guidance on how to integrate responsible investment without compromising returns.

Varma also uses its Climate Change Policy to guide its carbon reduction efforts, develop ways to assess climate change risks and opportunities, encourage climate change preparedness and carbon reductions by investees and as an annual carbon-intensity reporting framework. A working group of Investment Operations, communications and CSR employees helped to draft the climate policy.

SUCCESSSES AND CHALLENGES

N/A

SOURCES

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NOTES

- ¹ Varma (2014): 11.
- ² These reduction targets are set to apply between 2015-2020.
- ³ These reduction targets are set to apply between 2015-2020.

Profile developed in: September 2017

Profile developed by: The Investment Integration Project (TIIP). TIIP helps institutional investors understand the big picture, or “systems-level,” context of their portfolio-level decisions. “Systems-level” events, such as economic crises, ecosystems under stress, and societies in turmoil can disrupt the best-laid plans of investors and cost them dearly. Even seemingly “local” issues are now having much greater impact than they once did as the world becomes increasingly interconnected.

TERM DEFINITIONS

What are "Tools of Intentionality"?

Tools of intentionality are specific pathways through which investors can bridge the gap between daily portfolio management decision-making and systems-level investing. Investors use these tools intentionally because the portfolio-level discipline of efficiency alone does not naturally lead them to systems-level considerations. Investors can use these tools to manage risks and rewards at systems levels and facilitate impact in a variety of ways.

What are "On-Ramps"?

On-ramps are investment approaches that represent logical extensions of the concept that investment has impact on the world at large—and on its component environmental, societal and financial systems—and that that impact can be managed to maximize these systems' wealth-creating potential in society.

What are "Asset Classes Integrated Into"?

Into which asset classes does the investor incorporate a systems-related approach?

What are "Years Integrating"?

The number of years since investor initiated systems-related approaches.

What is the "Tipping Point"?

Description of investor's primary approaches to adopting/executing system-related considerations.

What is "About"?

General description of the investor and their approach to systems-related investing.

What are "Approaches in Practice"?

How does the investor's systems-related approach manifest itself? We examine five key investment activities as well as other intentional systems-related undertakings. We also look at staffing and impact monitoring and reporting.

What are "Investment Beliefs Statements"?

Inclusion of observations about environmental, societal or governance considerations in the investor's formal investment belief statements or in more general statements of beliefs about the relevance of these considerations at portfolio or systems levels.

What are "Security Selection & Portfolio Construction"?

The incorporation of environmental, social and governance factors into individual security valuation and portfolio construction.

What are "Targeted Investment Programs"?

Creation of specialized sector or theme-based funds with an explicit environmental or social focus and the stated purpose of serving sustainable or responsible investors.

What are "Corporate Engagements"?

Communication on environmental, social and governance issues with corporations indirectly through proxy voting, or directly through individual or collaborative dialogue, the filing of shareholder resolutions, or other means in order to promote improvements in practice.

What are "Manager Selection, Directives and Monitoring"?

Incorporation of systems-related or on-ramp themes into the selection and monitoring of external managers.

What are "Other Activities"?

Additional investment policies and practices beyond those captured in key investment activities. Those intentional policies and practices that seek to achieve systems-goals are highlighted. They vary considerably across investors.

What is "Staffing"?

When information is available, this section describes investor contracting with external entities to execute systems-related approaches; internal personnel whose responsibilities exclusively or primarily include developing, executing or overseeing investor systems-related approaches; committees/groups with systems-related responsibilities; training provided to staff.

What is "Policy Development and Monitoring"?

When information is available, describes the processes undertaken by the investor to develop systems-related approaches.

What is "Impact Monitoring and Reporting"?

Discusses whether and how the investor measures and reports on the non-financial outputs, outcomes or impacts (effectiveness) of its systems-related approaches, or has plans to do so. Also whether and how the investor reports on the content of its systems-related activities.

What are "Successes and Challenges"?

Discusses the main successes and challenges reported by the investor about its systems-related approaches. This includes successes and challenges reported on a TIIP survey or in an interview, or statements describing successes and challenges in publicly available materials.