KLP SFCR 2020

Solvency and Financial Condition Report 2020
(Rapport om Solvens og Finansiell stilling)

Sensitivitet: Begrenset

KLP
Solvency and Financial Condition Report 2020
Kommunal Landspensjonskasse gjensidig forsikringsselskap
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Summary

The Solvency II regulations were introduced from 01.01.2016. The rules are the same in all countries in the EU and in the EEA area. Among other things, the rules are intended to provide increased protection for policy-holders. Solvency II lays down requirements for information disclosure, including through this report. The report should provide information on the company's business and results, the system of risk management, and how internal control within the company operates. The report is also intended to provide information on the risks to the company, the methods used for valuation of both assets and liabilities, and an overview of the company's solvency capital composition. The solvency capital is meant to cover the risk that the company has assumed by means of statutory solvency capital requirements.

The main product offered by Kommunal Landspensjonskasse gjensidig forsikringsselskap (KLP) is public sector occupational pensions. The Company is owned by its customers, which are Norwegian municipalities, county administrations, health enterprises and companies associated with the public sector.

The Company's asset management is divided into a customer portfolio (NOK 607 billion at 31.12.2020) comprising all pension funds, and a corporate portfolio (NOK 45 billion at 31.12.2020), which includes the Company's equity and other assets.

The financial income associated with the customer portfolio amounted to NOK 24 billion in 2020 (44 billion in 2019). This represented a value-adjusted return of 4.2 per cent for the year. Financial income in the corporate portfolio amounted to NOK 1.5 billion in 2020 (1.5 billion in 2019) corresponding to a return of 3.1 per cent.

For 2020, the risk result (arising from the fact that mortality and invalidity in the period differ from what is assumed in the premium tariff), was NOK 1.2 billion within public sector occupational pensions. The corresponding figure for 2019 was NOK 1.0 billion.

The system of governance, as it is organised and implemented, is considered appropriate to KLP's business. The Company's articles of association and applicable legislation provide the framework for proper corporate governance and a clear division of roles between the governing bodies and executive management. The Company's highest authority is the General Meeting. The Company also has a corporate assembly which elects the Company's Board of Directors.

The risk management system within KLP is tailored to Solvency II and organised on the principle of the three lines of defence. The Board of Directors of KLP has established a remuneration committee, an audit committee and a risk committee.

The Board has adopted a policy for risk management and internal control and a series of other guidelines to provide for good risk management and compliance with laws and regulations. Requirements have also been laid down for the overall competence of the Board, in addition to the 'fit and proper' requirements which also apply to managers and key functions within the Company.

The development of the Company's risk and solvency situation is monitored through detailed reporting to the Board and senior management. This includes reporting from all three lines of defence.

The Group's principal risks are underwriting risk, market risk and credit risk.

Underwriting risk is dominated by longevity risk, i.e. the risk that people entitled to pension payments from KLP will live longer than expected and so require larger payments than expected. The risk that more people could suffer early disability is another material underwriting risk. The risk of customers moving away from KLP is not a risk to the Company's financial strength. Solvency capital and capital requirements related to this are nevertheless included in the calculations of KLP's capital adequacy under Solvency II.

Around 60% of customers' deposits are invested in interest-bearing securities. The rest are invested in equities and property. Market risk is dominated by equity and property risk, along with interest rate and credit risk. The Company has substantial buffers to enable this allocation. The risk profile changes dynamically in that a policy rule adjusts the proportion of risky investments to the buffer level that the Company has.

Under Solvency II, all assets and liabilities are valued at market value. There are two key differences in the valuation of assets and liabilities in Solvency II and in the financial accounts. One is the valuation of insurance obligations. The Solvency II accounts take account of real interest rates, whereas the financial statements use guaranteed interest in the valuation. The other main difference is that bonds and loans reported at amortised cost in the financial statements are shown at fair value in the Solvency II accounts. Other differences are due to differing treatment of intangible assets and deferred tax.

The Solvency II regulations lay down requirements for the amount of solvency capital through the solvency capital requirement. KLP applies a transitional rule to the Solvency II regulations for technical provisions. Using this transitional rule, KLP had capital adequacy of 359 per cent at 31.12.2020. Even without applying this transitional rule, KLP has capital adequacy of 283 per cent, which is also well over its own target of at least 150 per cent.

This report has been produced by KLP as a life company. A similar report has been produced for the KLP Group.

A. Business and performance

A.1 Business

a) The name of the Company is Kommunal Landspensjonskasse gjensidig forsikringsselskap. The Company's address is: Dronning Eufemias gate 10, postboks 400 Sentrum, N-0103 Oslo

b) The Financial Supervisory Authority of Norway exercises financial supervision of the Company. The address of the Financial Supervisory Authority of Norway is: Revierstredet 3, postboks 1187 Sentrum, N-0151 Oslo

c) The Company's external auditor is PwC, Dronning Eufemias gate 71.
The contact person is Erik Andersen, erik.andersen@pwc.com

d) Customers with public-sector occupational pensions from KLP own the Company. These comprise Norwegian municipal and county authorities, the regional healthcare enterprises (RHF) with their subsidiary healthcare companies (HF), and other public-sector businesses.

e) Kommunal Landspensjonskasse (KLP) is the parent company for the KLP Group. KLP's wholly-owned subsidiaries are organised as limited companies. The following wholly-owned subsidiaries are part of the Group:
- KLP Banken AS and its subsidiaries:
  - KLP Boligkreditt AS
  - KLP Kommunekreditt AS
- KLP Eiendom AS
- KLP Forsikringsservice AS
- KLP Kapitalforvaltning AS
- KLP Skadeforsikring AS

Figure 1: Corporate structure

f) KLP's principal product is public-sector occupational pension provision. The Group is also a major provider of non-life insurance, banking services and investment products. The property company KLP Eiendom is the third-largest property management company in the Nordic region. With the exception of the property business, which has a lot of properties abroad, KLP's operations are exclusively in Norway.

g) Apart from the sale of KLP Bedriftspensjon AS and the merger between KLP Bankholding AS and KLP Banken AS, there is nothing to report regarding activities or

events occurring in the reporting period which had a significant impact on the Company.

A.2 Underwriting performance

For 2020, following an application to the Financial Supervisory Authority of Norway, the risk result, together with the extraordinary risk surplus, has been used to strengthen the premium reserve for the changed mortality tariff for men and to adjust the calculation rate downwards. After strengthening the premium reserve, the recognised risk result in KLP is minus NOK 395 million. This result is financed by the risk equalisation fund.

The risk result is an expression of how mortality and disability have developed in the insured population in relation to the assumptions used in the annual setting of premiums. The risk result for 2020 was NOK 1,201 million within public-sector occupational pension provision. The corresponding figure for 2019 was NOK 1,031 million. No extra disability provisions have been raised as a result of the coronavirus pandemic. The risk result does not generally fluctuate much from year to year. However, some fluctuations have to be factored in. This is especially true of the risk result for disability. The mortality tables are still felt to allow good margins, and the trend in 2020 shows that margins overall are still somewhat greater than expected.

The extraordinary risk surplus amounts to NOK 2,671 million and relates to changes in longevity adjustment – changes in NAV's ratios and divisors based on Statistics Norway's mortality forecasts – and changes in disability tariffs from 1 January 2020.

The total surplus of NOK 3,872 million (a risk result of NOK 1,201 million and an extraordinary risk surplus of NOK 2,671 million) is used to cover the need to strengthen the premium reserve in response to changed mortality assumptions for men (NOK 2,579 million) and to the reduction in the calculation rate (NOK 1,688 million). In the Joint Scheme for Closed Agreements, the amount needed to strengthen the premium reserve is NOK 395 million more than the risk result and the extraordinary risk surplus.

As the whole of the surplus, with the exception of the Joint Scheme for Closed Agreements, has been used to strengthen the premium reserve, the total recognised risk result is equal to minus NOK 395 million.

A.3 Investment performance

The Company's capital management is split into a customer portfolio which covers all the pension assets, and a corporate portfolio which covers the investment of the Company's remaining assets.

A.3.1 Investment performance for the customer portfolio

The customer portfolio is divided into two portfolios, the common portfolio and the investment options portfolio. All returns from the management of these portfolios are credited to customers; nothing falls to KLP.

Table 3: Income from investments in the common portfolio. Figures in NOK millions.

Common portfolio	2020	2019	Change
Income from investments in subsidiaries, associates and joint ventures	6,009	2,876	3,133
Income from interest and dividends etc. on financial assets	11,224	10,444	780
Unrealised gains and losses on investments	1,240	28,591	-27,351
Realised gains and losses on investments	5,698	2,140	3,558
Income from investments	**24,170**	**44,051**	**-19,881**

Table 4: Income from investments in the investment options portfolio. Figures in NOK millions.

Investment options portfolio	2020	2019	Change
Income from investments in subsidiaries, associates and joint ventures	25	16	9
Income from interest and dividends etc. on financial assets	42	44	-2
Unrealised gains and losses on investments	-152	199	-351
Realised gains and losses on investments	158	22	136
Income from investments	**74**	**281**	**-207**

In the common portfolio, the Company has undertaken to deliver a minimum annual return. In the investment options portfolio, KLP has to honour the investment guarantee after five years, while customers have to cover any shortfall in annual returns during this five-year period. KLP collects a premium in return for committing to this guaranteed return (interest guarantee premium). The interest guarantee premium is intended to reflect the market value of the return guarantee, and the premium is fixed in advance for one year at a time. The value of the interest guarantee premium is given in table 8 in section A.5, Other information.

Any shortfall in returns has to be covered from the Company's equity or supplementary reserves. Supplementary reserves are retained surplus returns from previous years, allocated to individual customer contracts. The additional provisions can be used to cover the Company's return guarantee where the actual return is lower than the guaranteed return. Returns below zero have to be covered from the Company's equity in any case.

The financial income associated with the customer portfolios amounted to NOK 24 billion in 2020; in 2019 it totalled NOK 44 billion (see tables 3 and 4 above). This corresponded to a value-adjusted return of 4.2 per cent in 2020, against 8.5 per cent in 2019 in the common portfolio, and 4.2 per cent in 2020 and 9.9 per cent in 2019 in the investment options portfolio.

In 2020, the Company generated surplus returns of NOK 12.4 billion, of which NOK 8,2 billion was allocated to supplementary reserves and NOK 4.1 billion to the premium fund. The securities adjustment fund decreased by NOK 0.6 billion in 2020. In 2019, the Company generated surplus returns of NOK 10.3 billion, of which NOK 8,0 billion was allocated to supplementary reserves and NOK 2.3 billion to the premium fund. The premium fund was also allocated NOK 0.5 billion from the risk result in 2019.

The costs of managing customer assets were NOK 213 million in 2020. In 2019, the cost was NOK 198 million. The costs are covered by a special cost element in the pension premium and are included in the administration result that falls to the Company. The administration result is stated in section A.5 under table 8, Profit and loss elements in the corporate portfolio.

The table below shows the breakdown of the common portfolio into main asset classes and the returns per asset class. The total will differ slightly from the accounting figure because of

differing accounting classifications. In the table, derivative items are also reported net, whereas they are posted gross to the accounts. The largest contributor to financial income in 2020 was property.

Table 5: The common portfolio. Figures in NOK millions.

Assets in the common portfolio	Balance-sheet 31.12.2020	Return 31.12.2020	Balance-sheet 31.12.2019	Return 31.12.2019
Property	79,212	6.8%	70,659	6.7%
Lending	77,097	2.1%	71,042	2.4%
Equities and alternative investments	136,384	6.3%	144,551	21.5%
Long-term/HTM bonds	172,004	3.5%	165,181	3.6%
Short-term bonds	101,128	6.5%	87,803	7.9%
Liquidity/money markets	30,275	1.5%	29,031	1.9%
Total	**596,099**	**4.2%**	**568,267**	**8.6%**

For information, KLP did not post any investment costs or income against equity. Nor does KLP have any investments in securitisation.

A.3.2 Investment performance for the corporate portfolio

Financial income from investments in the corporate portfolio totalled NOK 1.5 billion in 2020, very similar to 2019 (NOK 1.5 billion). This gave a return on equity of 3.1 per cent in 2020, compared with 4.3 per cent in 2019. The costs of managing the corporate portfolio were NOK 165 million. Returns on the corporate portfolio and costs of managing this are included in total comprehensive income for the Company.

Table 6: Income from investments in the corporate portfolio Figures in NOK millions.

Investment performance for the corporate portfolio	2020	2019	Change
Income from investments in subsidiaries, associates and joint ventures	783	519	264
Income from interest and dividends etc. on financial assets	745	725	20
Net operating income from property	85	67	18
Unrealised gains and losses on investments	325	-197	522
Realised gains and losses on investments	-482	411	-893
Income from investments	**1,457**	**1,525**	**-68**

The table below shows the breakdown of the portfolio into main asset classes and the returns on investments per asset class. The total will differ slightly from the accounting figure because of differing accounting classifications.

Table 7: The corporate portfolio. Figures in NOK millions.

Assets in the corporate portfolio	Balance-sheet 31.12.2020	Return 31.12.2020	Balance-sheet 31.12.2019	Return 31.12.2019
Shares in subsidiaries	4,917		5,043	
Property	4,529	16.9%	4,033	11.2%
Long-term shareholdings and associated companies			8	11.8%
Hedging of subordinated loans	3,065	-3.4%	5,884	0.6%
Long-term/HTM bonds	16,050	7.6%	12,698	3.4%
Short-term bonds	3,033	6.3%	3,396	5.7%
Liquidity/money markets	7,770	1.7%	8,995	2.2%
Total	**39,364**	**3.1%**	**40,057**	**4.3%**

A.4 Profit/loss from other activities

All significant income and expenses are included in the above.

A.5 Other information

The sections above describe the underwriting performance (risk result) and the investment result. Positive underwriting and investment results in the customer portfolio accrue to customers. The corresponding negative result is charged to the Company's equity. The interest guarantee premium and the administration result are included in the Company's annual results along with the return in the corporate portfolio. KLP is a mutually owned company. These amounts are one reason why the growth in equity follows the growth in the pension obligations. The table below shows the amount of the interest guarantee premium and the administration result for 2020 and 2019. The necessary growth in equity over and above this level is provided by calling in an annual capital contribution from the owners.

Table 8: Profit and loss elements in the corporate portfolio. Figures in NOK millions.

Profit and loss elements	31.12.2020	31.12.2019
Interest guarantee premium	494	476
Administration result	171	247
Total	**665**	**723**

The Company's total income before tax was NOK 1.3 billion in 2020, compared with NOK 2.6 billion in 2019.

New public sector occupational pensions from 1 January 2020
Changes in the occupational pension scheme for public-sector employees have been made through amendments to the Act on the Government Pension Fund, the Coordination Act and some other laws. Within the collective agreements for local government workers, the legislative changes have been incorporated into the new central general special agreement (SGS 2020) on pension schemes. The new public-sector occupational pensions took effect on 1 January 2020. A new sectoral agreement on calculated national insurance in public-sector occupational pensions was adopted by Finance Norway on the same date.

The rules on new public-sector occupational pensions will initially affect old-age pension entitlements for public-sector employees from 1 January 2020. For employees born in 1963 or later, old-age pension rights accrued under the rules in place before 1 January 2020 (the gross scheme) will cease. These people have been granted a pension entitlement from the gross scheme from 1 January 2020, and they will continue to earn old-age pension rights in the public-sector occupational pension scheme according to a new model.

The changes, which take effect on 1 January 2020, have meant that the deduction for benefits from national insurance will differ from what has previously been used as the calculation basis for the pension scheme. For some parts of KLP's insured population, this has resulted in a net increase of NOK 1,059 million in the premium reserve. This increase is taken into account in the premium reserve reported in the annual accounts for 2020. Premium income which will fund the increase in the premium reserve has also been factored in. For the majority of KLP's insured population, however, this entails a release of premium reserves allocated to the premium fund. This amounts to NOK 23,203 million, and has been taken to profit/loss as a transfer between changes in the premium reserve and changes in the premium fund in the annual accounts for 2020.

B. System of governance

The description in this section covers KLP both as a company and as a group. The section is identical to the corresponding section in the KLP Group SFCR.

The system of governance, as it is organised and implemented, is considered appropriate to KLP's business, in relation to the nature, scope and complexity of the risks.

B.1 General information on the system of governance

B.1.1 Structure of KLP's administration, management and controlling bodies

The Company's articles of association and applicable legislation provide the framework for proper corporate governance and a clear division of roles between the governing bodies and executive management.

The General Meeting
KLP has a broad ownership structure. Members of the General Meeting are appointed through election meetings in the relevant constituencies, to which all owners are invited. Voting rights are calculated on the basis of the individual member's share of the previous year's ordinary premium. At the General Meeting each individual delegate has one vote.

The General Meeting is the Company's highest authority and comprises elected representatives of the Company's owners.

The General Meeting elected 179 delegates from 15 constituencies for 2020-2022. The county administrations and the municipalities in each county make up 10 of the constituencies. The four regional health enterprises and their subsidiaries each form one constituency. The companies together form one constituency. In each constituency an election meeting is held to elect delegates to the General Meeting. The General Meeting approves the annual report and accounts for the Company and the Group, including the allocation of profits or provision for losses. The tasks of the General Meeting also include electing 24 of the 45 members of the Corporate Assembly and approving the remuneration of the Corporate Assembly.

The Corporate Assembly
The Corporate Assembly comprises 45 members, 24 of them elected by the General Meeting. A further six representatives are nominated by the staff organisations in the local government sector. 15 representatives are elected from and by the staff in the Group. The Corporate Assembly has essentially the same responsibilities as a corporate assembly under the provisions of the Norwegian Public Limited Liability Companies Act. The corporate assembly elects the Board and its Chair. The Corporate Assembly members elected by the General Meeting elect five members with deputies to the Board of Directors, while the full Corporate Assembly elects the Chair and Deputy Chair of the Board of Directors. The Corporate Assembly elects an election committee with four members and a deputy member.

The Board of Directors of KLP (Group Board)
The Board of Directors is a collective body responsible for the interests of the Company and its owners. The Board is required to monitor the Group's compliance with business regulations and licence requirements. The Board provides for appropriate organisation of the business, determines policies, plans and budgets, keeps abreast of the Company's financial position and obligations and ensures that the business, accounts and asset management are subject to satisfactory control. The Board is required to supervise the executive management and the Company's business generally. The Board of Directors comprises eight members who are elected for a term of two years in such a way that half are up for election each year.

Five Board members with up to the same number of deputies are elected by the members of the Corporate Assembly who are elected by the General Meeting. Two members with deputies are elected by and from KLP's employees. One member and a deputy are nominated by the employee organisation or negotiating alliance with most members in the pension schemes. In addition two observers are nominated from those organisations that are second and third in regard to the number of members. The Group Chief Executive Officer is not a member of the Board of Directors.

Group CEO
The CEO is responsible for the day-to-day management of KLP's business and has to follow the guidelines and orders issued by the Board. The CEO reports to the Company's Board of Directors. The CEO's responsibilities and duties are set out in the instructions adopted by the Board.

Group senior management
The KLP Group senior management comprises ten experienced individuals with a broad background from Norwegian business and public sector activities. Group senior management is the top level of management in KLP and is responsible for the functional management of the company.

Group senior management is organised according to business areas, representing the Life Insurance, Banking, Non-Life Insurance, Capital Management and Property departments. Group senior management also includes the divisional heads with responsibility for Economy and Finance, IT, Communications and Markets, and HR and Internal Services.

The Board's sub-committees
The Board of Directors has three sub-committees: a remuneration committee, an audit committee and a risk committee. The committees do not make decisions on behalf of the Board, but present their assessments and recommendations to the Board.

Remuneration committee
The remuneration committee is a preparatory and advisory working committee for the Board's deliberations on remuneration questions. In 2011 the Financial Supervisory Authority of Norway gave permission for a joint remuneration committee in the KLP Group. On this basis the committee also serves those boards of directors in the KLP Group that are required by law to have remuneration committees. The committee's responsibilities include ensuring the requirements laid down in law and in the regulations on remuneration schemes in financial institutions, investment firms and asset management companies are complied with in those companies in the KLP Group that are subject to these regulations.

Audit committee
The audit committee is a preparatory and advisory working committee for the Board. The Committee was set up in accordance with the requirements for an audit committee pursuant to the Norwegian Act on Insurance Activity. The committee helps to quality-assure the Board's work to do with financial reporting, audit and governance.

Risk committee
The Committee acts as a risk committee for the Board of KLP. The principal tasks of the risk committee are to assist the Board in monitoring and managing the Company's overall risk and assessing whether the Company's management and control systems are appropriate to the level of risk and the scope of the overall business of the Group. The committee also ensures that the Company has good systems for internal control and risk management, and that the second-line functions work properly. The committee also ensures that there is a satisfactory organisation with a clear organisation structure, and an appropriate division of

responsibilities and tasks between executing and monitoring functions. The risk committee assists the Board in preparing Board actions in other matters to do with risk management.

Risk management committee
The Group CEO has established a committee to act as his advisory body in matters concerning the Company's overall risk and solvency. The committee addresses the general risk appetite, the overall risk strategy and risk exposure from all the major risk factors, including market risk, underwriting risk and operational risk.

Key functions
The risk management, compliance and actuarial functions and Internal Audit are the key functions in KLP. The Board ensures that these have the necessary authority, resources and independence through guidelines adopted by the Board for each of the functions. These guidelines allow the managers of each function to report directly to the Board on matters affecting their areas of responsibility. The key functions produce quarterly and annual reports which are discussed by the Board.

B.1.2 Significant changes in the system of governance made during the reporting period

No significant changes were made to the system of governance in the reporting period.

B.1.3 Remuneration policy

Principles
The Board previously adopted remuneration principles for KLP and additional guidelines for KLP Kapitalforvaltning AS. The remuneration rules were last discussed and revised at the Board meeting of KLP on 03.12.2020.

In accordance with the Norwegian Financial Institutions Act and the Act on Securities Funds with associated regulations, the Board of KLP has determined and ensured that the Company always has and applies guidelines and frameworks for a remuneration scheme covering the whole of the Company including its subsidiaries.

The KLP Group aims to have competitive pay and employment conditions compared to similar companies, but without leading the way. The remuneration scheme is designed to be cost-effective for the Group.

The Group's remuneration schemes should be open and performance-based, so as to be perceived as fair and predictable wherever possible. There should be a correlation between agreed performance requirements and the remuneration given.

Remuneration based on results
No individual or collective remuneration (bonus) is given to employees on the basis of KLP's results.

Pension scheme
All employees of KLP are members of KLP's pension scheme.
Until 01.05.2013, KLP also had a scheme for 'Pensions for salaries over 12 G[1]'. This scheme has been modified:

- Persons employed by KLP after 30.04.2013 are not covered by the scheme.

[1] National Insurance basic amount

- Persons employed before 30.04.2013 who have salaries below 12 G today will not be covered by the scheme even if they later receive salaries over 12 G.
- For persons who have a salary above 12 G at 30.04.2013, the following applies: “Persons with salaries over 12 G have additional cover to ensure that fixed pay in excess of 12 G is counted as fully pensionable. This scheme applies only to qualification time accrued directly in KLP. If the pension is calculated on part-time working as an employee of KLP, the pension base over 12 G will be reduced accordingly.”

B.1.4 Transactions with related parties

KLP has transactions with other companies in the KLP Group, as well as members of the administration, management or control bodies. These are transactions that are part of the products and services offered by KLP or its subsidiaries to their customers. The transactions are entered into on market terms and include occupational pensions, non-life insurance, bank deposits, lending, asset management and fund saving.

B.2 ‘Fit and proper’ requirements

B.2.1 The Company’s ‘fit and proper’ requirements

The Company ensures that managers of the business and others in the business who hold central and key functions are suitable and ‘fit and proper’ to handle their tasks and areas of responsibility as stated in each individual’s job description.

The Board of KLP has adopted a guideline on ‘fit and proper’ criteria which is revised annually. The guideline contains qualification requirements which are designed to provide for appropriate diversity of qualifications, knowledge and relevant experience, to ensure that the Company is managed and supervised in a professional manner.

As part of the qualification requirement, the Board of KLP should have sufficient insight and understanding to be able to question the assessments of the administration, take a critical view of the answers and initiate the necessary action. The whole Board of KLP should at least have qualifications in these areas:

- The insurance and finance market
- Business model and strategy
- The business system, including an understanding of the risks the Company is exposed to and its ability to handle them
- Financial and actuarial analysis.
- Regulatory frameworks and requirements.
- Understanding of social issues.
- Customer and product knowledge.

B.2.2 The Company’s process for ‘fit and proper’ assessment

The ‘fit and proper’ assessment is made by the individual’s manager. Persons to be assessed have to submit a completed and signed form for use in the assessment approved by the Financial Supervisory Authority of Norway. These persons are assessed when employed/elected, or in specific situations. An annual confirmation has to be given to the effect that no new circumstances have arisen since the last assessment/confirmation. This is especially important in relation to conduct.

All persons in Group management, key functions and the Board must meet certain standards of suitability (conduct). For persons listed above, KLP assesses the following aspects:

- Criminal record

- Sanctions against companies
- Administrative sanctions and charges
- Financial situation
- Tax matters
- Other matters

Persons to be assessed must present a copy of a police certificate no more than three months old. Information may also be obtained from the publicly accessible Register of Bankruptcies and the Register of Company Accounts.

If any of the criteria listed above is not met, an individual assessment will be made. A principle of proportionality will be applied, whereby consideration will be given to the nature and severity of the offence, whether there has been a final judgment, the number of offences, the person's subsequent behaviour and the time aspect.

B.3 Risk Management system

B.3.1 Risk Management system. Strategies, processes, and reporting procedures

The risk management system at KLP is implemented through policies, processes/strategies and reporting procedures. Mandates, instructions and job descriptions for the various roles are also included in the system.

Guidelines
The Company has drawn up a comprehensive set of guidelines, rules and instructions to provide for effective risk management through appropriate and thorough processes and procedures. The guidelines are reviewed annually and approved by the Board. The Group CEO also lays down the necessary rules to implement the guidelines.

The various guidelines have different areas of application. Some guidelines apply to the whole Group but are still adopted by the boards of the subsidiaries. Other guidelines apply wherever appropriate and provide a basis for the subsidiaries' own guidelines. Every subsidiary will also have its own guidelines to govern matters specified fir the Company's business in the acts and regulations to which it is subject.

Processes/strategies
The overall risk in the Company is normally divided into three main parts: market risk, underwriting risk and operational risk, including strategic and reputational risk.

The main processes for monitoring, managing and measuring market risk are the overall risk management strategy, the asset management strategy and the capital plan. The asset management strategy and strategy for overall risk management are adopted in the autumn for the next calendar year. It includes targets for the overall risk, a framework for allocation and the design of the Group's dynamic strategy for exposure to risky assets (policy rule). The capital plan is drawn up in parallel with the Own Risk and Solvency Assessment, and sets the long-term course for the Company's capitalisation.

A strategy for underwriting risk is adopted each year. However, this risk is by nature long-term and the strategy is broadly fixed over time. Operational, strategic and reputational risk are assessed as part of the annual process for risk management and internal control; see section B.4.

Reporting
Risk reporting in KLP takes place at many levels. At each Board meeting, the CEO includes current topics in his briefing. A separate briefing on risk management and asset management

is also a fixed item on the agenda. The Board also receives a detailed monthly report on developments in the Group.

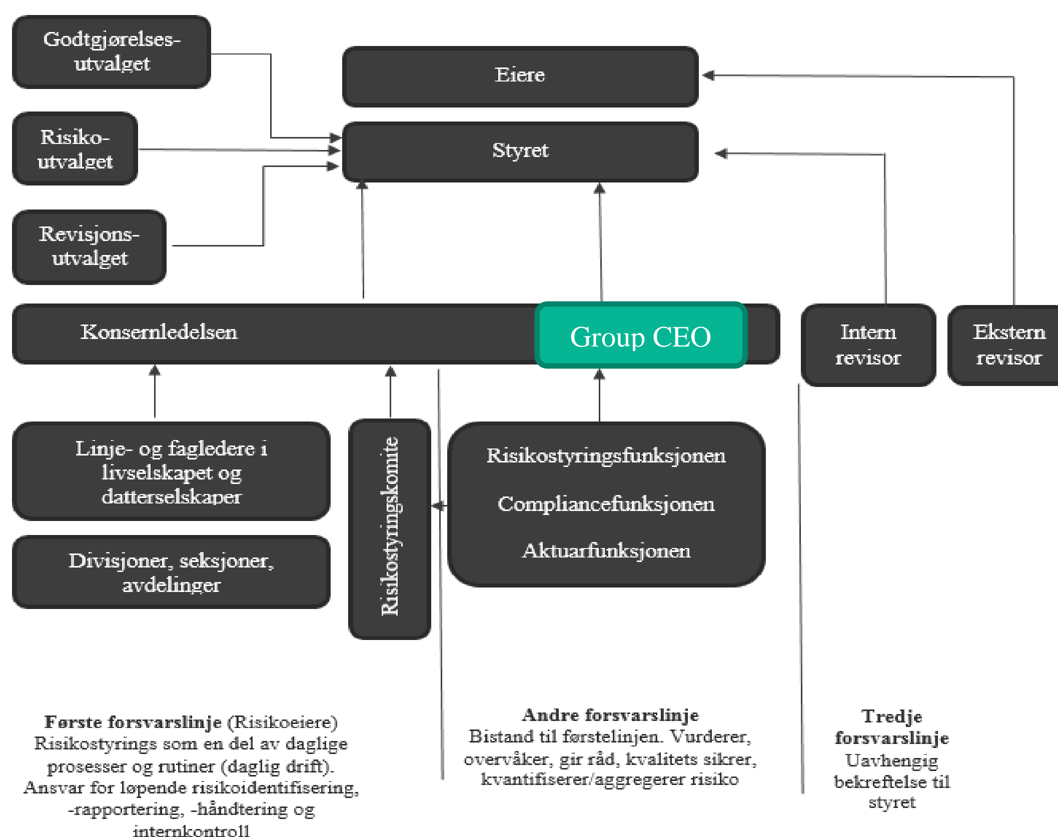
The second-line functions produce quarterly reports from their areas, which are addressed by the Board. The actuarial and compliance functions also produce their own annual reports. The risk management function coordinates the self-assessment of the Company's risk and solvency and compiles the ORSA[2] report.

The risk management committee monitors changes in the policy rule at each meeting.

B.3.2 Organisation of the risk management system

The risk management system at KLP is organised on the principle of the three lines of defence. This is in line with the latest principles of risk management and adapted to the requirements in the Solvency II rules. The organisation is illustrated in the figure below:

Figure 2: The risk management system at KLP



<u>First line – Risk management and operation</u>
The Group CEO and all managers and employees in the operational units and subsidiaries make up the first line of defence. They bear the primary responsibility for good risk management through their responsibility for doing their jobs in line with authorisations, instructions and guidelines. Managers are also required to establish proper procedures and control measures within their areas.

<u>Second line – Monitoring and quality assurance</u>

[2] Own Risk and Solvency Assessment

The control functions that make up the second line are the risk management function, the compliance function and the actuarial function. For a more detailed description of the compliance function and the actuarial function, see sections B.4 and B.6.

The risk management function is headed by the Chief Risk Officer (CRO), who reports to the Group CEO. The head of the actuarial function reports to the CRO, as this function is organised as an integral part of the risk management function. The main responsibility of the risk management function is to monitor the Group's overall risk, including the risk management system. The unit, which is headed by the CRO, also calculates the Company's capital adequacy. Capital adequacy is a key part of the quarterly reporting from the risk management function, which is discussed by the Board of Directors. The Own Risk and Solvency Assessment is an important task for the risk management function; see section B.3.3.

To safeguard the independence of the actuarial function from the CRO, the Group CEO approves the remuneration of the head of the function. Independence is also ensured by the fact that the second-line functions have the right to report directly to the Board of Directors on matters concerning their areas of responsibility.

Third line – Independent verification
Independent verification is provided by the Group's own Internal Audit unit and its external auditors. The Internal Audit function is described in detail in section B.5.

Risk management committee
The Group CEO has established a committee to act as his advisory body in matters concerning the Company's overall risk and solvency. The committee includes the CFO and the directors responsible for the Company's risk management, as well as the heads of the actuarial and compliance functions. The committee addresses the general risk appetite, the overall risk strategy and risk exposure from all the major risk factors, including market risk, underwriting risk and operational risk. Each year, the committee discusses the principal assumptions used to calculate the Company's capital adequacy. The committee is administered by the CRO and assists the CRO in carrying out the 'Own Risk and Solvency Assessment'.

B.3.3 Own Risk and Solvency Assessment

B.3.3.1 Process

The process for the 'Own Risk and Solvency Assessment' (ORSA) is laid down by the Board in a separate guideline. The guideline sets out the main principles for the process, with requirements for implementation, division of responsibilities, performance requirements and documentation. The process is carried out each year and is normally discussed at the Board meeting in June.

The ORSA process is largely based on the Company's other processes for managing risk and solvency. Apart from market and underwriting risk, risks in the process of governance are identified in the autumn. This process also quantifies the most important remaining risks. Quantification is used to calculate the capital requirements for operational risk.

B.3.3.2 Implementation and approval

The risk management function is responsible for coordinating the implementation of the ORSA process and compiling the report. The process follows an established set of tasks, starting with introductory discussions in the risk management committee. These identify factors to be focussed on in the year's process, often based on evaluations and feedback on the process from the previous year.

The ORSA plan and suggested changes in related guidelines are discussed by the Board in March. Work on sensitivity tests, scenario analyses and specially selected key areas will continue until the report is completed. An integrated process is followed for KLP as a company and as a group, and the report covers each of these.

The Board is involved in the process and approves the ORSA by looking at guidelines for the ORSA, adopting the plan for the ORSA and finally approving the report. This cements the Board's ownership of the process. The Board's risk committee also conducts an extended review of the ORSA plan and the ORSA itself and makes its recommendations to the Board.

An extraordinary ORSA has to be produced if there are changes that could affect the risk and/or capital substantially. Changes may be driven by internal decisions or external factors.

B.3.3.3 Determination of own solvency needs

The Board determines its solvency requirements based on the assessments made in the ORSA process. KLP's solvency capital requirements are defined by the regulatory solvency capital requirement as this is larger than that obtained by using the Company's own assumptions and methods.

The solvency target is that capital adequacy for KLP should be more than 150 per cent without including transitional rules for technical provisions. Predictability is important to KLP's customers/owners, so there should be a low probability of having to call up extraordinary equity to strengthen the solvency position. The target is therefore set considerably higher than the regulatory requirement of 100 per cent.

B.4 Internal control system

B.4.1 KLP's internal control system

Internal control is concerned with systematic follow-up of the business. The purpose of good internal control is to maintain effective processes and procedures to meet business objectives. An important aspect of the internal control system in KLP is to deal with any risks that could prevent the Company from achieving its goals in a cost-effective manner and in line with the current framework for the business.

Both risk management and internal control ensure that KLP can achieve its objectives by identifying and analysing relevant risks that could prevent it from attaining its goals, and by implementing effective measures to handle, control and report on the risks. The Board of KLP has adopted a policy for risk management and internal control in KLP The policy defines fundamental principles, processes, roles and responsibilities connected with governance. Relevant risks and internal control measures should be assessed in decisions on significant changes to the business.

The risk management system helps ensure that KLP can achieve its objectives in all significant areas of business through:

- Identifying, measuring, monitoring, documenting and reporting on all material risks that could prevent target attainment.
- Establishing appropriate risk strategies to manage risk-taking
- Establishing measures to handle and control material risks
- Establishing contingency plans to handle the impact of any remaining risks
- Establishing appropriate reporting procedures for unwanted events

The Company’s managers at all levels should always have a proper overview of the specified goals, risks, key controls and possible unwanted events in their area, so they can adequately handle risks associated with the business on an ongoing basis.

The second-line functions also assist all managers in providing for good governance, and make independent assessments of the managers’ handling and control of risk. KLP has also established an Internal Audit unit to provide the Board with an independent assessment of whether the internal control system is working. The Board of KLP assesses the internal control within the company at least once a year.

B.4.2 Compliance function

The compliance function helps the Board and senior management to ensure that KLP has implemented effective procedures for compliance with the applicable rules, including the framework for effective management and control.

The compliance function identifies, monitors and reports risks of non-compliance within KLP. In particular, the compliance function monitors the material risks linked to non-compliance in the Group, and is an active ‘sparring partner’ to the Board, management and staff within KLP in relation to the operational handling of non-compliance risk.

The compliance function works preventively by providing advice, guidance and ongoing quality control when operational changes are made to regulations, and carries out control activities to ensure that internal control in the Company is effective. Advice, dialogue, presence and training take a high priority. The aim of these activities is to develop an organisation structure in which compliance with the framework is an intrinsic value.

The head of the compliance function reports to the Group CEO and briefs the management on his/her own initiative on matters that are or could be of significance to the business. Serious breaches of laws and regulations, or a significantly increased risk of non-compliance, must be reported without undue delay to the Group CEO.

To preserve the independence of the compliance function, the function has no operational or decision-making roles in activities that the function is required to monitor. This does not prevent the compliance function from assisting management in developing appropriate processes, procedures and methods to provide for effective follow-up of managers’ control responsibilities. The Board has adopted a special policy for the compliance function.

The Board has also established a special policy for compliance risk. The policy defines roles and responsibilities to ensure compliance within KLP, and sets out the Board’s risk appetite and requirements for how to handle risks of non-compliance.

B.5 Internal Audit function

B.5.1 Exercise

Based on risk assessments etc., an audit plan is drawn up for areas to be audited. The areas to be audited are operational and support processes, risk management systems, IT systems and IT security, products and regulatory requirements. The audit plan is approved by the Board.

The findings from the audit are reviewed with the operational and line managers for the area that has been audited, who take a view on the recommendations and set deadlines for implementing them. The audit reports are reviewed in the audit and risk committee before the conclusions and recommendations are presented to the Board. Progress in implementing the recommendations is presented to the Board in the annual report from Internal Audit. The

annual report from Internal Audit provides an assessment of business and risk management and of the internal control in key areas.

In order to perform its function effectively, Internal Audit looks at internal operational reports, Board actions and reports, and communicates with senior management, the risk, compliance and actuarial functions and external auditors.

On its own initiative or at the request of the administration, Internal Audit conducts ad-hoc reviews or tasks within control-related problem areas.

B.5.2 Independence and objectivity

Internal Audit reports to the Board and has to be professionally independent in its work in relation to the areas and persons being audited. The Board engages and dismisses the head of Internal Audit and defines that person's conditions.

Internal Audit has no operational or financial responsibility or decision-making authority within the different areas of activity. Internal Audit cannot therefore perform ongoing operational tasks, take decisions or carry out other activities that might compromise its independence or objectivity.

The head of Internal Audit has to demonstrate to the Board on an annual basis that the function is independent. In the guideline from the Board, the internal auditors are required to comply with the applicable laws, regulations and orders from the Financial Supervisory Authority of Norway and ethical rules and standards issued by the Institute of Internal Auditors.

Every five years, there is an external evaluation of KLP's Internal Audit function; the last of these was in 2018. The audit committee in KLP reviews this evaluation and communicates its findings to the Board.

B.6 Actuarial function

The actuarial function at KLP has responsibilities and duties as described in the Solvency II rules. The actuarial function is organised as an integral part of the risk management function. In order to safeguard its independence, the head of the actuarial function is allowed to report to the Group CEO and the Board on all matters within its area of responsibility. The actuarial function also reports directly to the Group CEO every quarter. The report deals with the activities and assessments made by the actuarial function in the quarter and helps to demonstrate its independence.

The role and responsibilities of the actuarial function are described in the policy for the actuarial function, adopted by the Board of KLP. The actuarial function should ensure that technical provisions are calculated by a combination of:

- Ensuring that methods, models and assumptions used in the calculation of technical provisions are appropriate
- Assessing whether the data used in the calculation of technical provisions is sufficient to ensure the necessary quality
- Comparing best estimates with the Company's experience
- Informing the Board and senior management as to whether the calculation of insurance technical provisions is reliable and sufficient
- Testing any simplified calculations of best estimates based on approximate values and individual assessments of notified claims cases
- Expressing a view on the Company's policy for underwriting risk

- Expressing a view as to whether the Company's reinsurance programme is sufficient
- Contributing to the effective implementation of the risk management system, particularly with regard to the risk modelling which forms the basis for calculating the Solvency Capital Requirement and self-assessment of the Company's capital needs

The actuarial function may use professional resources in other entities for specified tasks. In this case the manager of the actuarial function must ensure that there are no conflicts of interest for the function or the people doing work for the function. The head of the actuarial function in KLP and the Group is a member of the risk management committee at KLP and also has access to Board actions and the right to attend Board meetings where actuarial matters are discussed.

At least once per year, the actuarial function draws up a written report which is submitted to the Board of KLP. This report documents all the tasks carried out by the actuarial function, and the results of these, and clearly identifies any deficiencies and makes recommendations for rectifying these.

B.7 Outsourcing

Outsourcing is used where KLP chooses to use contractors to perform work assignments which could also have been carried out by the Company itself. The Board of KLP has adopted an outsourcing policy. The Code of Conduct applies to both outsourcing contracts within the KLP Group and when the business is contracted out to external companies.

The guideline is meant to ensure that outsourcing from KLP is handled in a proper manner and in accordance with the applicable rules. It gives guidance as to what should be regarded as outsourcing for KLP (the life insurance company), and the Company's responsibilities with regard to such outsourcing. The guideline also lays down requirements for assessing reliability, notification, outsourcing contracts and checks on the contractor's business.

Even if work activities are outsourced, KLP will still be responsible for the business that has been contracted out. KLP must therefore be able to fulfil its obligations, and check the contractor's risk management and internal control systems, including compliance with laws and regulations for the outsourced business.

B.8 Other information

The foregoing is considered to cover all the key details of the risk management system.

C. Risk profile

C.1 Underwriting risk

The two biggest underwriting risks for KLP are longevity risk and disability, both characterised by slight variations in measurable risk from year to year. Longevity risk means that the customer lives longer than presumed, and disability risk means that more people than expected are becoming disabled, or that fewer than expected are returning to work.

Longevity and disability risk are monitored every quarter via reports of underlying risk items from KLP's membership system, while a full analysis including a calculation of risk results forms part of an annual process. The risk result is followed up carefully and provides the basis for assessing whether prices and provisions are sufficient. The analysis entails statistical processing of relevant data on the membership base with a view to measuring the trend in mortality and disability, in order to arrive at a best estimate of how this trend may be expected to evolve in the coming years. The expected development is quantified by deriving a new basis for calculation. This will be the basis for best estimate assumptions in Solvency II calculations and perhaps also for new premium and reserve calculations (before actuarial safety margin).

- Longevity risk
  Because old-age pensions after the age of 67 in public-sector occupational pension schemes are age-adjusted in the same way as the national insurance-based old-age pension, the potential economic consequences of the trend towards greater longevity in the future will be limited. If longevity increases more than the projections used by Statistics Norway (SSB), this will cause a downward adjustment of accrued old-age pensions compared to what has been insured and financed for all year-groups that have not yet turned 61.
  In the Joint Scheme for Municipalities and Enterprises, the Joint Scheme for County Administrations, the Joint Scheme for State Health Enterprises, the Joint Scheme for Closed Agreements and the Pension Scheme for Publicly Elected Representatives, the premium reserve at 31 December 2020 has been determined from a strengthened calculation basis based on the K2013 tables with a higher mortality rate for men. The change in the assumption of a decline in mortality for men is based on Statistics Norway's updated forecasts in 2020.

  The K2013 tariff is defined by the formulae and parameters explicitly provided by the Financial Supervisory Authority of Norway in 2013. This data has a basic margin in the initial mortality rate of 12 per cent. For the Pension Scheme for Nurses and for the Pension Scheme for Hospital Doctors, a bigger margin is used in the initial mortality rate. Experience shows a significantly greater longevity among the persons insured in these schemes and the assumptions provide for tariffs with roughly the same safety margin in all risk groups. For the Pension Scheme for the Nurses, a higher mortality rate for men is also used.

  The overall calculation base used by KLP (K2021_KLP) is described in a separate product report to the Financial Supervisory Authority of Norway. The marital status elements of the premium tariff are as specified in K2013.

  The current mortality base has been found to have good margins and a robust level of premiums and provisions. There are substantial resources in the risk equalisation fund. This reduces the risk that deficits might have to be covered by equity outside the risk equalisation fund.

An abrupt fall in mortality, as assumed by stress tests for solvency purposes, is much less of a real risk than longer lives in the future, but companies still need to maintain solvency to withstand this because such stress tests are essential to the capital requirements placed on companies under Solvency II.

- Disability risk
  KLP's disability tariff was changed from 1 January 2020 based on observations of its own population for the period 2015-2018. From 31 December 2020, the disability tariff is changed in all risk groups based on observed trends up to and including 2019. The new disability tariffs use specific parameters for disability and re-entry into work in each risk group. In the past, all risk groups had a common disability tariff except for the Pension Scheme for Nurses and the Pension Scheme for Hospital Doctors. The changes involve some easing or marginal changes in all risk groups.

- Departure risk
  Customers with public-sector occupational pensions from KLP can opt to move to another provider at each year-end. Customers then take with them all the assets assigned to them, but they also take all the technical provisions associated with the customer relationship. Customers also take away their share of the equity contributed. On the other hand, retained earnings stay with KLP. The result of a customer moving is thus an improvement in the Company's solvency.

  Customers moving are only regarded as a strategic risk to the Company if large numbers are involved. Disposals are not considered to be a risk to the Company's solvency.

  In calculating capital requirements under the Solvency II rules, departures are categorised as an underwriting risk. The capital requirement associated with departure risk is significant as the standard method requires KLP's schemes to assume that 70 per cent of customers will move. The capital requirement arises from the fact that future margins factored into the Company's capital disappear. This means that the capital requirement for underwriting risk is much higher than that calculated for longevity risk and disability alone.

Underwriting risk is mainly managed by maintaining a robust level of premiums and provisions. This gives an expected low probability of a negative insurance result. Great use is made of the risk equalisation fund, which can cover any negative risk result, to minimise the risk of losses related to underwriting risk affecting other equity. The Company is allowed to allocate a maximum of half of any positive risk result to the risk equalisation fund, while the rest has to go to the customers' premium fund.

KLP has no reinsurance contracts related to underwriting risk. The extent of reinsurance is regularly assessed in light of the Company's risk-bearing capacity and the nature of the products.

As KLP exists mainly to provide occupational pension solutions to municipal and county authorities and health enterprises, it is not considered appropriate to exclude any of these customer categories from offers from KLP on grounds of risk. KLP can anyway decline to offer public-sector occupational pension schemes to businesses that represent an unreasonably large risk. This applies mainly where historical data indicate a particularly high disability risk, but very few of our potential customers have such a prevalence of disability and it is very rare for anyone to be refused. Customer selection is therefore very little used to manage underwriting risk.

In practice, as it is specified what the insurance cover in public-sector occupational pension schemes must include, the underwriting risk is contained within these limits. There is also a

general requirement to equalise premiums so customers cannot be charged individually, except for the interest guarantee premium and capital management costs.

Underwriting risk and the development of the market for relevant pension products are reported each year in a separate report from the Actuarial/Product department. The Board of Directors sets an annual strategy for underwriting risk and reinsurance.

C.2 Market risk

Market risk is the risk that the value of investments will change. Typical factors are changes in share prices, property prices, interest rates and exchange rates.. Market risk in KLP arises in the management of the pension assets and equity in the Company. In its long-term asset management strategy, KLP seeks to put together a portfolio which, in relation to KLP's obligations, can give the highest possible competitive return subject to limits on risk-taking. The limitations on risk mean that the risk is adjusted to ensure that the Company is solvent at all times and that it maintains sufficient risk capacity over time. This means that the Company should have a capacity for risk that allows us to maintain a certain level of risky assets in the short and long term, even after a year of heavy losses in asset management. The risk capacity is also assessed in a long-term perspective, taking account of the impact of interest rates on risk capacity over time.

The risk capacity is regularly monitored and reported on at each Board meeting. The risk is measured both at the end of the year and on a rolling one-year horizon. Measurements are taken at intervals through the year.

To support these goals, the following principles form the basis of the capital management approach:

- Long-term investment perspective
- Diversified portfolios
- Focus on efficient markets and cost-effective management
- Risk management adapted to the company's long-term financial risk within regulatory limits
- Active corporate social responsibility

KLP's market risk is made up of equity risk, property risk, interest rate risk, credit risk, concentration risk and currency risk. The gross capital requirement for market risk under Solvency II as at 31.12.2020 was estimated at NOK 94.5 billion, allowing for the diversification effect between the various asset classes. KLP's property portfolio is organised into limited companies, and the property portfolio is stressed according to changes in the regulations as part of the property module when calculating the capital requirement. The net capital requirements (after using buffer capital etc.) related to market risk was NOK 4.6 billion at 31.12.2020.

It should be possible to record, measure and report all investments in relation to external and internal guidelines for risk monitoring and reporting in place at any given time. This means that the Company should not trade in instruments without having developed the expertise and systems to provide for proper follow-up.

KLP follows up the market risk by way of stress tests and sensitivity analyses etc. Market risk is also a key part of the self-assessment of risk and solvency in the annual ORSA process. KLP calculates its solvency capital coverage at least quarterly.

KLP have its financial assets invested in customer portfolios and a corporate portfolio. The customer portfolios are made up of customers with public-sector occupational pensions, and

the portfolios are divided according to risk-bearing capability. The market risk affects income and profits differently for the different portfolios.

The risks in the customer portfolios are compared taking account of objectives such as remaining solvent and maintaining risk capacity over time. Annual investment limits are set for the different asset classes. The portfolio breakdown for each asset class is generally well diversified so non-systematic risk is very limited. The risk in the portfolio is also handled dynamically though operational rules. This means that the risk in the customer portfolios is constantly adjusted to the risk-bearing capacity. The adjustments will normally be made in the equity market, as long as equities account for the bulk of the total risk in the common portfolio.

The market risk in the corporate portfolio affects equity directly. For the corporate portfolio, KLP aims to take low market risk. The majority of the funds are invested in interest-bearing securities with an average duration of 4.2 years as of 2020. The corporate portfolio has a low correlation with the customer portfolios.

Equities
The listed equity component of the common portfolio includes Norwegian exposure and global exposure in developed and emerging markets. Investments in unlisted shares consist of investments in special funds, private equity and other equity investments. Management is mainly through mandates issued to KLP Kapitalforvaltning AS.

The corporate portfolio has investment limits relative to the total assets under management in the portfolio. The equity portfolio is made up of shares in subsidiaries and, to a lesser extent, associates, based on Board resolutions.

Property
KLP's portfolio of property is mainly managed by the subsidiary KLP Eiendom AS, along with some investments in global real estate funds. Investments by KLP Eiendom AS are mainly in Norway, but portfolios have also been established in Sweden and Denmark, for example. We aim at long leases with solid counterparties. KLP's fundamental management philosophy is to hold high-quality properties in central shopping streets.

The property exposure in the corporate portfolio is made up of KLP's offices in Oslo and Bergen and low-risk leasehold sites.

Interest
The technical provisions are long-term, but it is not appropriate to have investments with the same duration. This is because investments with durations equal to the obligations are difficult to obtain, and because the duration in KLP is perceived to be short in regulatory terms as KLP can collect an annual interest guarantee premium.

Interest rate risk is not a significant contributor to KLP's capital requirements, but persistent low interest rates are naturally a challenge to the Company's ability to generate good returns for its customers.

The risk of the Company being unable to achieve a return greater than the guaranteed return is reduced in any given year by posting a substantial part of the interest-bearing investments to the accounts at amortised cost. The expected return for the hold-to-maturity portfolio in 2021 is around 3.5 per cent, and the average duration is around 5 years.

Other

The basic principles for asset management are set out above. This, combined with management mandates and limits that restrict exposure to individual issuers, means that KLP has only minimal exposure to concentration risk.

KLP hedges its global fixed income and property portfolios against currency fluctuations. The hedging rate for global equities in developed markets is around 60 per cent, while shares in emerging markets are not hedged. No significant changes are expected in 2021. The Company will therefore continue to have little exchange rate risk across all portfolios.

There were no significant changes in market risk in 2020.

C.3 Credit risk

Credit risk is a risk of losses where counterparties cannot met their debt obligations. The risk includes losses on loans and losses related to bank deposits, or non-fulfilment of contracts by counterparties in reinsurance contracts or financial derivatives. Losses in the securities portfolio that can be linked to these types of losses are categorised as market risk.

Credit risk is part of market risk, so it is included as ‘other market risk’ in the various risk assessments and analyses carried out. Credit risk is classified at least once a year by country, rating and sector. Assessments of bad debt provision/valuation and default are made in line with the relevant accounting principles.

Credit limits are set on all credit exposure before an investment is undertaken. These limits are set by a separate credit committee. The credit limits are reviewed annually and monitored quarterly. The limits for Norwegian credit are primarily based on internal credit assessments. Lending to foreign borrowers is largely based on external ratings from recognised rating agencies.

In addition to the credit limits, special requirements for diversification are laid down up in the mandates to KLP Kapitalforvaltning AS. These ensure that portfolios without diverse indices have limited non-systemic risk.

C.4 Liquidity risk

Liquidity risk in KLP is the risk of KLP being unable to meet its day-to-day commitments as they mature without substantial added costs. The risk is primarily associated with the costs of releasing assets.

KLP has a liquidity portfolio which should be able to meet ongoing obligations relating to payment of pensions and to coverage of operating costs. Liquidity needs that may arise as a result of people moving also form part of the overall assessment of the size of the liquidity portfolio. In normal circumstances the portfolio should have sufficient funds to prevent the Company needing to release funds from other portfolios for expected payments. As a large part of KLP’s funds are invested in highly liquid assets and KLP’s liquidity requirements are normally covered by quarterly premium payments from customers, the liquidity risk is considered to be limited.

For KLP, the insurance commitment is long-term, and the cash flows are largely known long before they fall due. The liquidity risk is handled through the liquidity strategy, covering measurement, management and contingency planning relating to liquidity risk.

From each quarterly premium payment, KLP aims to set aside liquid assets that are greater than or equal to three months’ liquidity requirement. In situations where there are insufficient liquid assets to cover the liquidity need, funds have to be released from other portfolios or

obtained in some other way. The contingency plan will come into effect when an exceptional liquidity need has arisen and the liquidity has fallen below certain defined levels. Based on this, the liquidity risk is considered to be low.

Liquidity planning is based on financial accounting values. The financial accounts do not include a margin from future premiums. The size of margin from future premiums is therefore not very relevant to liquidity risk and liquidity management.

C.5 Operational risk

Operational risk is defined as the risk of financial loss or loss of reputation as a result of failure of internal processes, human error or system failure, or any other loss due to external events. Operational risk management involves detecting risk factors that can cause losses, and estimating the likelihood and impact of possible adverse events.

KLP carries out an annual governance process (risk management and internal control) in which the heads of all departments identify operational risks within their areas of responsibility. The likelihood and impact of each risk are assessed, and it is decided whether the risks are acceptable or whether risk reducing measures must/should be taken. Where the risk assessment concludes that the risk is higher than is acceptable, measures will be established to reduce the likelihood or the impact of this risk. Measures identified earlier are followed up and are included in the assessments. The identified risks are grouped together for each division. Finally, a list is produced for the Company, which is included in the Group's list. The risk management function facilitates the process and reports performance to senior management and the Board. Strategic risk and risk to reputation are valued separately.

The internal control process is supplemented with a valuation of the principal operational risks. The Company's own assessment includes a calculation of the capital requirements for operational risk based on the valuation. The Risk Management function helps to quantify the economic losses. The capital requirement for the operational risk is calculated by the standard formula based on a volume target for premiums and reserves.

The major identified operational risks in KLP are linked to the increasing scope of new general regulation, stable IT operation, data quality and increasing exposure to new IT security threats.

C.6 Other material risks

All material risks are considered to be covered in the preceding sections.

C.7 Other information

The foregoing is considered to cover all the key details of the Company's risk profile.

D. Valuation for solvency purposes

D.1 Assets

Total assets valued in the solvency balance-sheet amounted to NOK 668 billion at 31.12.2020[3]. This is an increase of NOK 39 billion since 31.12.2019. Total financial assets (accounting values) amounted to NOK 652 billion at 31.12.2020. This is an increase of NOK 31 billion since 31.12.2019.

Assets under Solvency II are recognised at fair value. The valuation principles are largely congruent with the principles for valuation at fair value under International Financial Reporting Standards (IFRS). The financial statements for KLP are drawn up in accordance with the Regulations on annual accounts for insurance companies. These rules broadly match IFRS, but bonds at amortised cost and bonds classified as loans and receivables are recognised at amortised cost. There are also differences in the valuation of intangible assets and deferred taxes.

Table 9: Assets. Figures in NOK billions.

Asset classes	Solvency II 2020	Accounts 2020	Solvency II 2019	Accounts 2019
Intangible assets	0.0	0.6	0.0	0.4
Deferred tax assets/assets after tax*	0.5	0.0	0.5	0.0
Investment properties	1.0	1.0	1.0	1.0
Investments in associates, including participations	71.4	71.4	63.5	63.5
Equities etc.	36.1	36.1	42.2	42.2
Bonds	266.5	251.6	250.4	243.0
Asset management companies etc.	164.8	164.8	162.9	162.9
Derivatives	6.8	6.8	5.0	5.0
Deposits other than cash equivalents	0.6	0.6	1.5	1.5
Lending	92.0	90.7	85.7	85.2
Other assets**	28.7	28.7	16.8	16.8
Total	**668.4**	**652.2**	**629.6**	**621.5**

* With gross tax assets under Solvency II. Net tax assets are NOK 0 at 31.12.2020

**Other assets are made up of: ‘Cash and cash equivalents’, ‘Non-insurance-related receivables’, ‘Other assets’, ‘Receivables related to direct insurance, including insurance brokers’, and ‘Property, plant and equipment for own use’.

***There may be minor discrepancies between the lines in S.02.01, but the table above is intended to reflect reality.

D.1.1 Intangible assets

Valuation, Solvency II
Intangible assets are valued at zero. Under Solvency II, intangible assets are valued at zero unless the asset can be sold separately and the company can demonstrate that it has a market value.

Valuation, accounts
Intangible assets are valued for accounting purposes at cost and depreciated over their expected service life. If there are indications that the book value of an intangible asset is higher than the recoverable amount, an impairment test is carried out. If the recoverable

[3] With gross tax assets under Solvency II. Net tax assets were NOK 0 at 31.12.2020.

amount is less than the book value, the asset is depreciated to the recoverable amount. Intangible assets are posted to the balance-sheet in the amount of NOK 0.6 billion.

D.1.2 Assets subject to tax

Valuation, Solvency II
Deferred tax is split into a deferred tax asset of NOK 0.5 billion and a deferred tax liability of NOK 1.3 billion under Solvency II in 2020.

This valuation is based on the accounting calculation but also factors in the effect of assets and liabilities with a different valuation than in the accounts, where this difference could have a tax effect. This includes assets measured at amortised cost in the corporate portfolio as well as the valuation of financial liabilities (hybrid Tier 1 perpetual capital and subordinated debt). Financial liabilities are valued slightly higher in the Solvency II balance-sheet, which produces a deferred tax asset. Assets in interest-bearing portfolios valued at amortised cost in the accounts are valued higher in the Solvency II balance-sheet, and so give rise to a deferred tax liability.

Valuation, accounts
Capitalised deferred tax assets or liabilities represent the nominal value minus any impairment of the holding which is not assumed to be usable and so has no value. The nominal value is calculated on the basis of differences between the accounting and taxation timing of changes in the value of assets and liabilities. To the extent that these differences will reverse at a later date, there will be deferred tax (accounting income taken before taxable income) or a deferred tax asset (taxable income taken before accounting income). Temporary differences are offset against each other where they are expected to reverse within the same time frame and the differences can be equalised through Group-level allocations. Net temporary differences which mean that the Company has brought forward taxable income or deferred taxable deductions are posted as deferred tax assets.

At 31.12.2020 KLP had net deferred taxes; see section D.3.4.

D.1.3 Property (other than for own use)

Solvency II valuation equal to reported value
Property investments are measured at fair value. Fair value is calculated using an internal valuation model because there is not considered to be an active market with observable prices in the property markets that KLP invests in. In order to quality-assure the interval valuation model, a selection of the Group's property stock is regularly valued by external, independent and qualified valuers. In the event of significant deviation from our own assessment of fair value, the differences are analysed and the valuation model's parameters are adjusted if this proves necessary.

D.1.4 Investments in associates, including participations

Valuation, Solvency II
Investments in associates, including participations, are measured at fair value. Fair value is estimated to equal net assets and liabilities in the subsidiary measured at fair value.

The Company's property investments are organised as companies whose purpose is to own investment property. These investments are listed under investments in associates, including participatory interests, and make up NOK 65 billion of the 71 billion in this balance-sheet item. The property investments are valued using an internal valuation model because there is not considered to be an active market with observable prices in the property markets that KLP invests in. In order to quality-assure the interval valuation model, a selection of the Group's property stock is regularly valued by external, independent and qualified valuers. In

the event of significant deviation from our own assessment of fair value, the differences are analysed and the valuation model's parameters are adjusted if this proves necessary.

Valuation, accounts
Investments in associates, including participations, are measured by the equity method. Where the subsidiary's accounts are prepared according to different principles than KLP's own accounting principles, the subsidiary's accounts are converted to KLP's principles before KLP's share of the profit/loss is entered in the accounts. To value investment property in the property subsidiaries, the same principle is used as described for the Solvency II balance-sheet.

D.1.5 Equities etc.

Solvency II valuation equal to reported value
Equities etc. are measured at fair value. Fair value should be a representative price based on what a corresponding asset would have been traded for on normal market terms and conditions.

A share is considered as listed in an active market if quoted prices are easily and regularly available from a stock market, dealer, broker, industry group, price-setting service or regulatory authority, and these prices represent actual and regularly occurring transactions at arm's length. Liquid shares are generally valued on the basis of prices provided by an index provider. At the same time, prices are compared between different sources to pick up possible errors.

If the market for the share is not active, or the share is not listed on a stock market or similar, the Group uses valuation techniques to set fair value. These are based for example on information on recently completed transactions carried out on commercial terms, and reference to trading in similar instruments. As far as possible the estimates are based on externally observable market data and rarely on company-specific information.

D.1.6 Bonds

Valuation, Solvency II
Investments in bonds are measured at fair value. Fair value should be a representative price based on what a corresponding asset would have been traded for on normal market terms and conditions. A financial instrument is considered as listed in an active market if quoted prices are easily and regularly available from a stock market, dealer, broker, industry group, price-setting service or regulatory authority, and these prices represent actual and regularly occurring transactions at arm's length.

If the market for the security is not active, or the security is not listed on a stock market or similar, the Group uses valuation techniques to set fair value. These are based, for example, on information on recently completed transactions carried out on commercial terms, reference to trading in similar instruments and pricing using externally collected yield curves and yield spread curves. As far as possible the estimates are based on externally observable market data and rarely on company-specific information.

Valuation, accounts
Investments in bonds are reported in the accounts partly at fair value and partly at amortised cost. For the portion measured at fair value, there is no difference from the valuation principles described for Solvency II.

Bonds where the intention is to receive a fixed rate of interest for the whole term to maturity are valued for accounting purposes at amortised cost. This amounts to NOK 191 billion out of

a total of NOK 248 billion. The difference in valuation between amortised cost and fair value amounts to NOK 14.9 billion.

Bonds are measured at amortised cost using the effective interest method. The internal rate of return is set through discounting contractual cash flows over the expected duration. The cash flows include setting-up charges and direct transaction costs as well as any residual value at the end of the expected duration. Amortised cost is the present value of these cash flows discounted by the internal rate of return.

D.1.7 Asset management companies etc.

Solvency II valuation equal to reported value
Securities funds etc. are measured at fair value; see description under D.1.5.

Securities funds etc. also include investments in private equity funds. The fair value of these funds is based on reported market values, as quoted in the International Private Equity and Venture Capital Valuation Guidelines (IPEV Guidelines). These guidelines are issued by the European Venture Capital Association (EVCA) and based on the principle of approximate market valuation of the companies in the funds.

D.1.8 Derivatives

Solvency II valuation equal to reported value
Derivatives are measured at fair value.

D.1.9 Deposits other than cash equivalents

Valuation, Solvency II
Deposits other than cash equivalents are measured at fair value.

Valuation, accounts
Deposits other than cash equivalents are measured at nominal intrinsic value.

D.1.10 Lending

Valuation, Solvency II
Lending is measured at fair value; see discussion of Solvency II valuation of bonds in section D.1.6.

Valuation, accounts
Loans are reported in the accounts at amortised cost. This produces a valuation NOK 1.3 billion lower than the fair value reported in the Solvency II balance-sheet.

Lending is measured at amortised cost using the effective interest method. The internal rate of return is set through discounting contractual cash flows over the expected duration. The cash flows include setting-up charges and direct transaction costs as well as any residual value at the end of the expected duration. Amortised cost is the present value of these cash flows discounted by the internal rate of return.

Loans are written down where there is objective proof of impairment. Loss assessment and loss write-down is carried out quarterly on individual loans.

Lending is also assessed by group. If there is objective proof of impairment in a group of loans, a write-down is carried out.

D.1.11 Other assets

Solvency II valuation equal to reported value
Other assets are measured at fair value.

D.2 Technical provisions

Insurance liabilities are valued differently under Solvency II and in the financial statements. Under Solvency II, the insurance liabilities are referred to as technical provisions, while the financial statements refer to them as insurance provisions.

D.2.1 Value of technical provisions, basis, methods and assumptions

Under Solvency II, all assets and liabilities are valued at market value (also called fair value). The technical provisions in Solvency II are made up of a best estimate plus a risk margin. The best estimate consists of guaranteed benefits (the market value of the guaranteed commitments) and discretionary benefits (expected value of future profit-sharing). The value of the best estimate is calculated as the sum of future cash flows from all receipts and payments expected within the contract limit and the probability-weighted average of future cash flows. The cash flows are estimated for the next 40 years with an estimated residual value in year 40.

All expected receipts and payments associated with the business are taken into account, but in such a way that future premiums linked to future earnings are not included in the cash flows. The provisions include expected future surpluses to be allocated to customers, the value of the return guarantee, the earning element of the administration premium and the value of equity contributions. For discounting the cash flows, a risk-free market rate is used in the form of a yield curve with volatility adjustment given by EIOPA.

For longevity/mortality, the K2013 price tariff is used, except for hospital doctors and nurses who have reduced mortality rates. Based on the latest forecasts from Statistics Norway on longevity trends, along with analyses of KLP's own membership, KLP strengthened the mortality base for men from 31.12.2020, except for members of the pension scheme for hospital doctors. The new tariff, K2021_KLP, is a modified version of the current tariff K2013, in which the function expressing the decline in mortality has changed. Like the other formulae in K2013, the change applies to both longevity risk and mortality risk. The calculation basis for the best estimate uses the same assumptions as the price tariff, but without a safety margin. For women, no changes have been made.

For disability and re-entry into work, KLP's own calculation basis is used for each risk group. The price tariff includes a safety margin on top of the calculation basis for the best estimate. The calculation basis for the best estimate is based on historical data, and the latest updated basis will be adopted as of 31.12.2020, with variations for each risk group. The current pandemic situation could affect the drawing of disability pensions in the next few years. In view of this, the margins have been reduced, albeit rather conservatively. Beyond this, no significant changes have been made to the assumptions used to calculate the technical provisions during 2020. The assumptions are assessed each year and updated as needed.

Because of uncertainty in the best estimate, a risk margin is added. This is intended to cover the costs of providing risk capital (eligible Tier 1 and 2 capital). The risk margin is calculated as the present value of the capital cost, by keeping the risk capital equal to the solvency capital requirement which arises from taking over the portfolio. The risk margin is based on insurance risk, counterparty risk and operational risk and accords with method 2 in the Solvency II rules.

KLP uses transitional rules to calculate technical provisions in accordance with Article 56 of the Solvency II Regulation. Technical provisions (Solvency II Directive, Article 308d). The effect is calculated as the difference between the technical provisions (sum of best estimate and risk margin) and the sum of the premium reserve, supplementary provisions, securities adjustment fund and premium fund and claims provisions. The effect is reduced on a linear basis at the beginning of each year from 100 per cent on 1 January 2016 to 0 per cent on 1 January 2032. There is also a floor defined for valuation which limits the effect of the transitional rule.

Figures for the technical provisions at 31.12.2020 and 31.12.19 are given in the table below.

Table 10: Technical provisions without transitional rules Figures in NOK billions.

Solvency II	2020	2019
Guaranteed benefits	436.7	391.7
Discretionary benefits (future bonus)	159.3	168.6
Best estimate	**595.9**	**560.3**
Risk margin	14.2	13.3
Technical provisions	**610.1**	**573.6**

Table 11: Technical provisions with transitional rules Figures in NOK billions.

Solvency II	2020	2019
Guaranteed benefits	428.4	387.6
Discretionary benefits (future bonus)	156.2	166.8
Best estimate	**584.7**	**554.4**
Risk margin	13.9	13.2
Technical provisions	**598.6**	**567.6**

Technical provisions with transitional rules for KLP amount to NOK 598.6 billion, NOK 584.7 billion for the best estimate and NOK 13.9 billion for the risk margin. There was an increase in technical provisions of NOK 31.0 billion through 2019.

Table 12: Solvency II balance without transitional rules for technical provisions. Figures in NOK billions.

Solvency II balance-sheet	2020	2019
Guaranteed benefits	436.7	391.7
Discretionary benefits (future bonus)	159.3	168.6
Risk margin	14.2	13.3
Technical provisions	**610.1**	**573.6**
Deferred tax liabilities	1.4	1.3
Subordinated debt/hybrid Tier 1 perpetual capital	5.1	8.1
Other liabilities	18.1	15.3
Total liabilities	**634.6**	**598.4**
Total assets	**668.4**	**629.6**
Excess of assets over liabilities	33.7	31.2

Table 13: Solvency II balance with transitional rules for technical provisions. Figures in NOK billions.

Solvency II balance-sheet	2020	2019
Guaranteed benefits	428.4	387.6
Discretionary benefits (future bonus)	156.2	166.8
Risk margin	13.9	13.2
Technical provisions	**598.6**	**567.6**
Deferred tax liabilities	1.4	1.3
Subordinated debt/hybrid Tier 1 perpetual capital	5.1	8.1
Other liabilities	18.1	15.3
Total liabilities	**623.3**	**592.4**
Total assets	**668.4**	**629.6**
Excess of assets over liabilities	45.0	37.2

In order to calculate the time value of future cash flows, economic scenarios are generated in an economic scenario generator (ESG). KLP uses a scenario generator from Moody's Analytics. The scenario generator is calibrated to the risk-free interest rates published by EIOPA. This yield curve is used both to discount the cash flows and as an initial yield curve for simulating future returns. The scenarios are generated to be risk neutral, so all asset classes are assigned a yield that assumes risk-free interest rates. This is in line with the Solvency II rules.

D.2.2 Uncertainty related to the value of technical provisions

Where complex cash flow models are used, as in KLP's ALM model, to value liabilities and calculate available capital and capital requirements, the results will always be fraught with some uncertainty. The results are sensitive to the assumptions, choice of methods and processing of input prior to each calculation. The level of uncertainty in the calculations of the insurance obligation is driven by uncertainty in the underlying assumptions. Such assumptions are reviewed at least once a year in the Company's risk management committee to ensure that they still accurately reflect the Company and its strategies. Plans for future management measures are adopted by the Board of Directors at the same time as the key assumptions used to calculate capital adequacy are examined.

The interest rates given by EIOPA are based on some assumptions that are uncertain, including the extrapolation methodology, time taken to obtain long-term interest, long-term interest rates and volatility adjustment levels. As part of the ORSA process, sensitivity analyses are carried out for the value of solvency capital and the capital requirements for changed assumptions, which may be related to interest rates. One intention is to increase understanding of the sensitivity of the calculations.

D.2.3 Value of technical provisions, basis, methods and assumptions

In the financial accounts, the provisions are made up of the premium reserve, additional provisions, the securities adjustment fund, other provisions to insurance funds and other technical provisions. The calculation of a premium reserve in the financial accounts is based on the present value of deposits and payments using the same assumptions as in the premium calculation basis. The present value is calculated with a discount rate equal to the guaranteed interest at the time of accrual throughout the term of the individual insurance contract.

The valuation of the technical provisions in the financial accounts is deterministic. The biometric assumptions in the premium calculation basis in use at any given time are also used. Biometric assumptions cover mortality, invalidity and re-entry into work. The assumptions include safety margins in relation to what is considered as a best estimate. For

longevity/mortality, the K2013 and K2021_KLP price tariffs are used as described in section D.2.1. For invalidity and re-entry into work, KLP's own price tariffs are used.

D.2.4 Matching adjustment

KLP does not apply the matching adjustment described in Article 3(3) of the Solvency II Regulation. Yield curve (Article 77b of the Solvency II Directive).

D.2.5 Volatility adjustment

KLP applies the volatility adjustment described in Article 3(2) of the Solvency II Regulation. Yield curve (Article 77d of the Solvency II Directive). The volatility adjustment provides a mark-up in the risk-free market interest rate. This means that the obligations will be lower than they would have been without this adjustment. The effect depends on the amount of the markup. The adjustment as at 31.12.2020 represents an interest markup of 0.3 percentage points for the first ten years. The effect of this markup is 5 percentage points for capital adequacy without the use of transitional rules for technical provisions. This is shown in table 14 below. Technical provisions are almost unchanged, while the solvency capital requirement and the eligible Tier 1 and 2 capital have increased slightly. These changes decrease capital adequacy from 286 per cent to 281 per cent without using volatility adjustment and without the use of transitional rules for the technical provisions.

Figure 3: EIOPA's interest rates with and without volatility adjustment at 31.12.2020

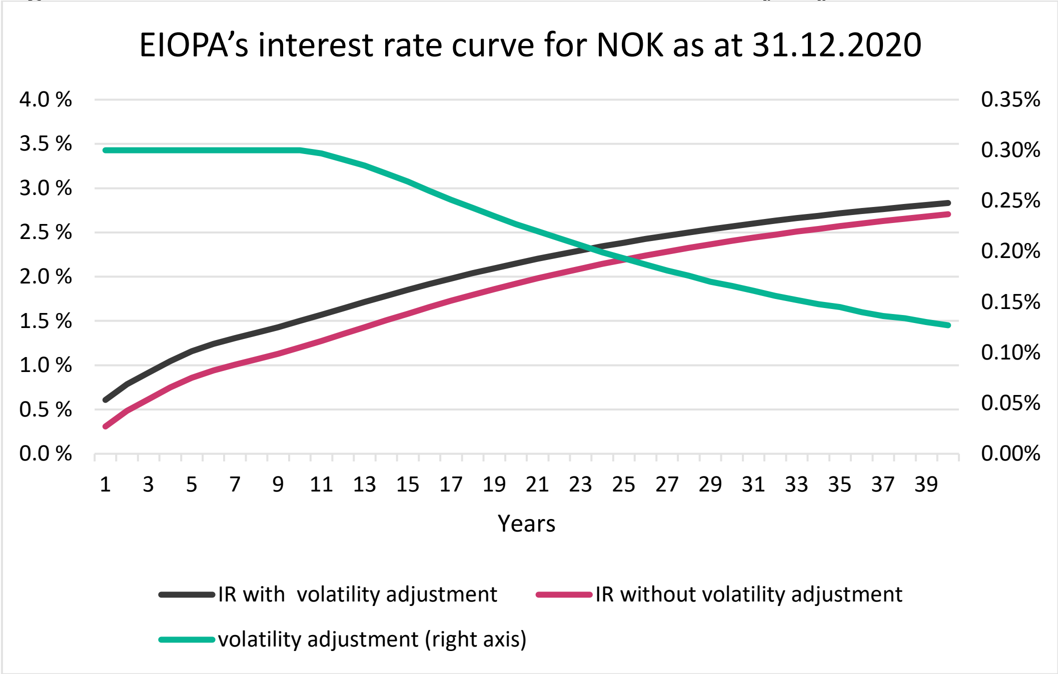


Figure 4: EIOPA's interest rates with and without volatility adjustment at 31.12.2019

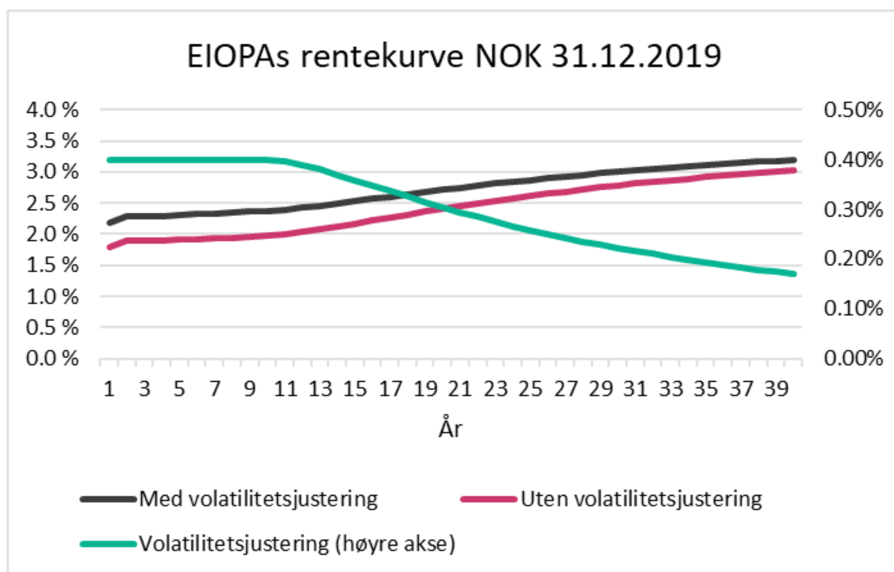


Table 14: Effect of applying the volatility adjustment, 31.12.2020. Figures in NOK billions.

2020	With volatility adjustment, without the use of transitional rules	Without volatility adjustment, without the use of transitional rules	Difference	With volatility adjustment, with the use of transitional rules	Without volatility adjustment, with the use of transition rules	Difference
Technical provisions	610.1	610.0	0.1	598.6	598.5	0.1
Solvency Capital Requirement	15.1	15.5	-0.3	15.1	15.5	-0.3
Minimum Capital Requirement	6.8	7.0	-0.2	6.8	7.0	-0.2
Eligible Tier 1 and 2 capital to cover the SCR	42.8	43.6	-0.8	54.4	54.4	0.0
Eligible Tier 1 and 2 capital to cover the MCR	36.6	37.3	-0.7	48.2	48.0	0.1
Capital adequacy	**283%**	**282%**	**1%**	**359%**	**351%**	**7%**
Minimum capital requirement	537%	535%	2%	706%	690%	16%

Table 15: Effect of applying the volatility adjustment, 31.12.2019. Figures in NOK billions.

2019	With volatility adjustment, without the use of transitional rules	Without volatility adjustment, without the use of transitional rules	Difference	With volatility adjustment, with the use of transitional rules	Without volatility adjustment, with the use of transition rules	Difference
Technical provisions	573.6	573.8	-0.2	567.6	567.8	-0.2
Solvency Capital Requirement	14.6	15.1	-0.5	14.6	15.1	-0.5
Minimum Capital Requirement	6.1	6.8	-0.7	6.1	6.8	-0.7
Eligible Tier 1 and 2 capital to cover the SCR	40.2	40.3	-0.1	46.2	46.3	-0.1
Eligible Tier 1 and 2 capital to cover the MCR	34.1	34.0	0.1	40.1	40.0	0.1
Capital adequacy	**275%**	**266%**	**9%**	**316%**	**306%**	**11%**
Minimum capital requirement	561%	499%	62%	660%	587%	73%

Difference in per cent (percentage points).

The transitional rule is described in section D. 2.7 Transitional rule for technical provisions.

D.2.6 Transitional provisions on risk-free interest rates

KLP does not apply the transitional provisions on risk-free interest rates described in Article 308c of the Solvency II Directive.

D.2.7 Transitional measure for technical provisions

KLP applies the temporary deduction provided for by the transitional measure for technical provisions described in Article 56 of the Solvency II Regulation. Technical provisions (Article 308d of the Solvency II Directive), in reports to the Financial Supervisory Authority of Norway. Note 32 Capital requirements in the accounts shows the calculations without the use of this temporary deduction. Both calculations are shown in table 16 below.

The technical provisions with transitional rules are valued at NOK 598.6 billion in the Solvency II balance-sheet for KLP at 31.12.2020. This is NOK 3.8 billion more than the liabilities of NOK 594.7 billion shown in the financial statements. Without transitional rules, the technical provisions in the solvency balance are valued at NOK 610.1 billion, NOK 15.4 billion higher than the liabilities in the financial statements.

The transitional provisions say that in 2020 we can deduct 12/16 of this difference in the Solvency II valuation. That means that the valuation of the best estimate under Solvency II including the transitional scheme is NOK 598.6 billion. The difference between the technical provisions with and without transitional arrangements is NOK 11.5 billion.

The deduction will be reduced on a linear basis until 2032. The difference for 2020 will be multiplied by 12/16, which means that there are 12 years left of the transition period. The transition period is 16 years from 2016 to 2032.

Table 16: Effect of using the transitional rule for technical provisions at 31.12.2020. Figures in NOK billions.

2020	Using the transitional rule	Without using the transitional rule	Difference
Technical provisions	598.6	610.1	-11.5
Solvency Capital Requirement	15.1	15.1	0.0
Minimum Capital Requirement	6.8	6.8	0.0
Eligible Tier 1 and 2 capital to cover the SCR	54.4	42.8	11.5
Eligible Tier 1 and 2 capital to cover the MCR	48.2	36.6	11.5
Capital adequacy	359%	283%	76%
Minimum capital requirement	706%	537%	169%

Table 17: Effect of using the transitional rule for technical provisions at 31.12.2019. Figures in NOK billions.

2019	Using the transitional rule	Without using the transitional rule	Difference
Technical provisions	567.6	573.6	-6.0
Solvency Capital Requirement	14.6	14.6	0.0
Minimum Capital Requirement	6.1	6.1	0.0
Eligible Tier 1 and 2 capital to cover the SCR	46.2	40.2	6.0
Eligible Tier 1 and 2 capital to cover the MCR	40.1	34.1	6.0
Capital adequacy	316%	275%	41%
Minimum capital requirement	660%	561%	99%

Difference in per cent (percentage points).

With the use of the transitional provision, the technical provisions are lower than without it, with the associated rise in eligible Tier 1 and 2 capital. Even without the use of the transitional measure, KLP meets the capital requirements by a good margin.

D.2.8 Miscellaneous

D.2.8.1 Reinsurance

KLP currently only has collective products without any option to choose the amount of cover for the individual parties insured. Based on this limitation, and given the size of the company and hence its large risk-bearing capacity, the need for reinsurance in KLP is considered small. KLP does not currently use reinsurance.

D.2.8.2 Significant changes in assumptions

Changes have been made to the calculation basis for mortality for men in the best estimate and in the price tariff from 31.12.2020 onwards. The initial mortality rate is unchanged, but longevity trends have changed. The changes are based on forecasts from Statistics Norway and analyses of KLP's own membership. The change has been implemented for all men, except for male hospital doctors who already have an enhanced calculation basis.

Changes have also been made to the calculation basis for disability based on updated historical data through 2019. These will be applied to all risk groups from 31.12.2020.

A new calculation method for national insurance has been used under a new collective agreement from 01.01.2020.

D.3 Other liabilities

The table below shows the breakdown of other liabilities.

Table 18: Other liabilities Figures in NOK billions.

Other liabilities	Solvency II 2020	Accounts 2020	Solvency II 2019	Accounts 2019
Hybrid Tier 1 perpetual capital	1.8	1.7	1.7	1.7
Subordinated debt	3.3	3.1	6.4	6.0
Pensions for own employees	0.6	0.6	0.5	0.5
Deferred tax liability*	1.4	1.6	1.3	1.5
Other liabilities	16.9	10.9	14.8	9.3
Total	**24.0**	**17.9**	**24.8**	**19.0**

* With gross tax liabilities under Solvency II

D.3.1 Hybrid Tier 1 perpetual capital

Valuation, Solvency II

Under Solvency II, financial liabilities are measured at fair value when the loan is taken. Later valuations will not take account of changes in the Company's own creditworthiness after this point. In the Solvency II balance-sheet, the hybrid Tier 1 perpetual capital is valued using an interest curve which does not include any credit mark-up to the Company, which produces a conservative valuation of the loan.

Valuation, accounts

The hybrid Tier 1 perpetual capital is valued for accounting purposes at amortised cost, adjusted for changes in value resulting from currency and interest rate movements according the rules on fair value hedging.

D.3.2 Subordinated debt

Valuation, Solvency II

Under Solvency II, financial liabilities are measured at fair value when the loan is taken. Later valuations will not take account of changes in the Company's own creditworthiness after this point. Subordinated debt is valued in the Solvency II balance-sheet using an interest curve where the Company's credit mark-up is kept unchanged from when the loan was taken out.

Valuation, accounts

Subordinated debt is measured at amortised cost. Subordinated debt in foreign currency has been translated to NOK using the exchange rate at the end of the reporting period. This means that the reported book value is NOK 426 million less than the Solvency II valuation.

KLP had one subordinated loan as of 31.12.2020.

D.3.3 Pensions for own employees

Solvency II valuation equal to reported value
KLP's employees have a defined-benefit pension entitlement. Most are covered through KLP's public sector occupational pensions by virtue of membership of the joint pension scheme for municipalities and enterprises ('Fellesordningen'). Other entitlements are also defined-benefit, but covered via operations.

The liability is posted to the Solvency II balance-sheet at the present value of the obligation on the reporting date, minus the fair value of the pension assets. The gross obligation is calculated using the straight-line method. The present value of the gross liability is discounted at 1.7 per cent, which is meant to reflect interest rates on Norwegian high-quality bonds.

Table 19: Net pension obligations - own employees, 2020. Figures in NOK billions.

Over/under-financing of the pension scheme 2020	Joint scheme	Via operation	Total
Present value of the obligations	1.595	0.191	1.786
Fair value of the pension assets	1.191	0.000	1.191
Net pension obligation, own employees	**0.403**	**0.191**	**0.594**

Table 20: Net pension obligations - own employees, 2019. Figures in NOK billions.

Over/under-financing of the pension scheme 2019	Joint scheme	Via operation	Total
Present value of the obligations	1.365	0.168	1.533
Fair value of the pension assets	1.025	0.000	1.025
Net pension obligation, own employees	**0.340**	**0.168**	**0.508**

Table 21: Allocation of pension funds for own employees

Composition of the pension assets	2020	2019
Shares in property subsidiaries	13.3%	12.4%
Shares and units	24.2%	25.9%
Lending	12.9%	12.5%
Fixed-income securities	49.7%	49.2%
Total	**100.0%**	**100.0%**

D.3.4 Deferred tax

Valuation, Solvency II
See notes in section D.1.2.

Valuation, accounts
At 31.12.2020, KLP recognised net deferred tax of NOK 1.6 billion; see notes in section D.1.2.

D.3.5 Other liabilities

Solvency II valuation equal to reported value

These liabilities are measured at fair value both in the accounts and in the Solvency II balance-sheet.

Note that, from 2019 onwards, this item in the Solvency II balance-sheet includes the value of the risk equalisation fund.

D.4 Alternative methods for valuation

KLP's valuation principles for assets that cannot be valued based on quoted prices are described in Note 6 'Fair value hierarchy' in the annual report for 2020.

D.5 Other information

The foregoing is considered to cover all the key information on valuation.

E. Capital management

KLP is a mutually-owned life insurance company whose main purpose is to manage the capital invested by its members in the Company either as owners (equity) or as retail customers (pension funds) as well as possible within the Company's risk capacity.

E.1 Tier 1 and 2 capital

The Tier 1 and 2 capital under Solvency II consists of own funds and supplementary capital. Own funds are the difference between the value of the assets and the liabilities in the Solvency II balance sheet and the hybrid Tier 1 perpetual capital. Subordinated debt is also included in own funds.

The future right to call for equity, the call option which KLP holds, is considered to be supplementary capital. Any net deferred tax assets may also be included in supplementary capital.

The following table shows the breakdown of the Tier 1 and 2 capital into own funds and supplementary capital, without the use of the transitional rule for the technical provisions.

Table 22: Breakdown of Tier 1 and 2 capital into own funds and supplementary capital. Figures in NOK millions Without transitional rules for technical provisions.

Tier 1 and 2 capital	2020	2019
Excess of assets over liabilities in the Solvency II balance-sheet	33,946	31,152
Hybrid Tier 1 perpetual capital	1,764	1,738
Total own funds, Tier 1	35,710	32,890
Subordinated debt	3,340	6,408
Risk equalisation fund	-	-
Total own funds, Tier 2	3,340	6,408
Call option	11,438	11,535
Deferred tax assets	-	-
Total supplementary capital	11,438	11,535
Total	**50,488**	**50,833**

Table 23: Breakdown of Tier 1 and 2 capital into own funds and supplementary capital. Figures in NOK millions With transitional rules for technical provisions.

Tier 1 and 2 capital	2020	2019
Excess of assets over liabilities in the Solvency II balance-sheet	45,023	37,154
Hybrid Tier 1 perpetual capital	1,764	1,738
Total own funds, Tier 1	46,787	38,892
Subordinated debt	3,340	6,408
Risk equalisation fund	-	-
Total own funds, Tier 2	3,340	6,408
Call option	11,438	11,535
Deferred tax assets	-	-
Total supplementary capital	11,438	11,535
Total	**61,565**	**56,835**

The purpose of the Company's Tier 1 and 2 capital is to satisfy regulatory requirements under Solvency II by a good margin. The Company reports its capital adequacy ratio for the Solvency Capital Requirement and the Minimum Capital Requirement every quarter.

The Board has adopted a policy for capital management. The purpose of this guideline is to ensure that KLP is sufficiently capitalized and meet the regulatory minimum requirements for

capital set by the Financial Supervisory Authority. The Company has also set its own targets for solvency capital coverage which are well above the requirements of the FSA.

The policy defines bands for solvency capital coverage. An annual capital plan is drawn up, in which the banding and targets for solvency capital coverage are defined for the plan period, which is normally three years. It also defines the measures that can or should be taken at different levels of solvency capital coverage. In the current period, KLP aims to have solvency capital coverage of at least 150 per cent.

The Company applies the transitional measure for technical provisions, but sets targets for solvency capital coverage without using this. For the same reason, capital adequacy is reported without using the transitional rule in notes to the Company's accounts. As of 31.12.2020, capital adequacy without using the transitional rule is 286 per cent. This was 275 per cent at 31.12.2019. Capital adequacy with the use of the transitional rule is 359 per cent at 31.12.2020; it was 316 per cent at 31.12.2019. This is well above our own target, which in turn is well above the regulatory requirements.

KLP's articles of association allow it to call in capital from its owners. The Company also collects an annual capital contribution from its owners. For 2020 the equity contribution was 0.30 per cent of the premium reserve.

The Tier 1 and 2 capital is classified in three capital groups based on the characteristics of each capital entry. Quality and availability are crucial for the classification. The main breakdown is based on whether

- The capital can be used for or paid in on demand to cover any loss at any time
- The capital can be used to cover losses and will not be refunded until all other claims have been covered, including claims arising out of insurance and reinsurance contracts.

<u>Tier 1</u>
The Company's Tier 1 and 2 capital is the difference between assets and liabilities in the Solvency II balance-sheet minus the risk equalisation fund and deferred tax assets. The hybrid Tier 1 perpetual capital is also included in Tier 1 (restricted). Restricted capital cannot exceed 20 per cent of the total of the items in Tier 1. The hybrid Tier 1 perpetual capital is well below this limit. All Tier 1 capital is classed as own funds.

<u>Tier 2</u>
Tier 2 includes subordinated loans as own funds. It also includes unpaid equity contributions and unpaid deposits reported as supplementary capital under the right to retrospective assessment. This supplementary capital is calculated as 2.5 per cent of KLP's total premium reserve at any given time, with approval for this method granted until 31.12.2023. Approval from the Financial Supervisory Authority of Norway was granted on 14.06.2019.

<u>Tier 3</u>
Tier 3 includes any net deferred tax asset, with some restrictions. At year-end 2020 and year-end 2019, this was zero.

E.1.1 Classification of Tier 1 and 2 capital

The sum of eligible capital in Tiers 2 and 3 may not exceed 50 per cent of the solvency capital requirement. For KLP, this had a limiting effect at year-end 2020 and at year-end 2019. In the event of an increase in the solvency capital requirement, the unused Tier 2 capital (NOK 10.6 billion at the end of 2019) will significantly reduce the negative effect the increase has on capital adequacy.

The hybrid Tier 1 perpetual capital (JPY 15 billion) with a Solvency II value of NOK 1.8 billion at 31.12.2020, has a fixed USD interest rate of 5.07 per cent per year. The loan is perpetual, but KLP has the right to repay it by 28.04.2034. If KLP does not exercise its right to repay in 2034, the loan will move onto floating interest. The credit margin will then increase by 1 percentage point to 6-month JPY LIBOR interest + a margin of 3.30 per cent per year. The loan was issued on 22.04.2014.

The subordinated loan (EUR 294 million) with a Solvency II value of NOK 3.6 billion at 31.12.2020, has a fixed interest rate of 4.25 per cent per year. The loan was issued on 10.06.2015 and is time-limited to mature in 2045. In 2020, the Company effected a buy-back of the loan to the tune of EUR 306 million of the nominal value. The loan can be repaid by KLP after 10 years, and on each interest payment date from then until the maturity date. The debt is listed on the London Stock Exchange.

The Solvency II rules lay down requirements for the composition of Tier 1 and 2 capital to cover the solvency capital requirement and the minimum capital requirement. This is known as eligible Tier 1 and 2 capital.

The tables below show the total Tier 1 and 2 capital per capital group split into own funds and supplementary capital. The proportion of these amounts that can be used as eligible capital for the solvency capital requirement and the minimum capital requirement is also shown in the table. The calculations of technical provisions are without transitional rules.

Table 24: Classification of Tier 1 and 2 capital. Figures in NOK millions.

2020	Tier 1 and 2 capital	Eligible Tier 1 and 2 capital	
		SCR	MCR
Tier 1, unrestricted	33,484	33,484	33,484
Deductions for shares in subsidiaries		-	-
Tier 1, unrestricted after deduction	33,484	33,484	33,484
Hybrid Tier 1 perpetual capital	1,764	1,764	1,764
Total own funds in Tier 1	**35,248**	**35,248**	**35,248**
Subordinated debt	3,340		
Total own funds in Tier 2	3,340		
Total own funds	38,588		
Call option	11,438		
Total supplementary capital in Tier 2	**11,438**		
Total tier 2	**14,778**	**7,574**	**1,363**
Deferred tax assets			
Total	**50,026**	**42,822**	**36,612**

Table 25: Classification of Tier 1 and 2 capital. Figures in NOK millions.

2019	Tier 1 and 2 capital	Eligible Tier 1 and 2 capital	
		SCR	MCR
Tier 1, unrestricted	31,152	31,152	31,152
Deductions for shares in subsidiaries		-	-
Tier 1, unrestricted after deduction	31,152	31,152	31,152
Hybrid Tier 1 perpetual capital	1,738	1,738	1,738
Total own funds in Tier 1	**32,890**	**32,890**	**32,890**
Subordinated debt	6,408		
Total own funds in Tier 2	6,408		
Total own funds	39,298		
Call option	11,535		
Total supplementary capital in Tier 2	**11,535**		
Total tier 2	**17,943**	**7,297**	**1,216**
Deferred tax assets			
Total	**50,833**	**40,187**	**34,106**

The solvency capital requirement (SCR) is intended to cover the risk of loss of the Company's Tier 1 and 2 capital, and is calculated so the probability that total losses (underwriting loss and financial loss) over a twelve-month period will not exceed the estimated capital requirement is 99.5 per cent.

The minimum capital requirement (MCR) is intended to cover the risk of loss of the Company's own funds and is calculated so the probability that total losses over a period of twelve months will not exceed the estimated capital requirement is 85 per cent. The minimum capital requirement must not be lower than 25 per cent or greater than 45 per cent of the Company's solvency capital requirement.

The solvency capital requirements and solvency capital coverage (capital adequacy) with and without the transitional rule for technical provisions are shown in the table below.

Table 26: Solvency capital requirements and solvency capital coverage without the use of transition rules for technical provisions. Figures in NOK millions.

SCR and capital adequacy	2020		2019	
	SCR	MCR	SCR	MCR
Solvency Capital Requirement	15,148	6,817	14,595	6,079
Eligible own funds	42,822	36,612	40,187	34,106
Excess capital	27,674	29,795	25,593	28,027
Capital adequacy	**283%**	**537%**	**275%**	**561%**

Table 27: Solvency capital requirements and solvency capital coverage with the use of transition rules for technical provisions. Figures in NOK millions.

SCR and capital adequacy	2020		2019	
	SCR	MCR	SCR	MCR
Solvency Capital Requirement	15,148	6,817	14,595	6,079
Eligible own funds	54,362	48,150	46,190	40,108
Excess capital	39,214	41,333	31,595	34,029
Capital adequacy	**359%**	**706%**	**316%**	**660%**

The difference between equity in the accounts and the excess of assets over liabilities in the Solvency II balance-sheet at year-end 2020 and 2019 was as shown in the table below.

Table 28: Solvency capital without the use of the call option but with the use of transitional rules for technical provisions compared with Tier 1 and 2 capital in the financial accounts. Figures in NOK millions.

2020	Solvency II	Accounts
Paid-up equity	18,194	18,194
Reconciliation reserve	15,290	
Other retained earnings		15,784
Effect of using the transitional rules for technical provisions	11,539	
Risk equalisation fund		5,404
Total own funds in Tier 1 - unrestricted/equity	**45,023**	**39,382**
Hybrid Tier 1 perpetual capital	1,764	1,764
Subordinated debt	3,340	3,135
Total including restricted capital/own funds in Tier 2/subordinated debt	**50,127**	**44,281**

Table 29: Solvency capital without the use of the call option but with the use of transitional rules for technical provisions compared with Tier 1 and 2 capital in the financial accounts. Figures in NOK millions

2019	Solvency II	Accounts
Paid-up equity	16,540	16,540
Reconciliation reserve	14,612	
Other retained earnings		15,238
Effect of using the transitional rules for technical provisions	6,002	
Risk equalisation fund		5,540
Total own funds in Tier 1 - unrestricted/equity	**37,154**	**37,318**
Hybrid Tier 1 perpetual capital	1,738	1,738
Subordinated debt	6,408	6,012
Total including restricted capital/own funds in Tier 2/subordinated debt	**45,300**	**45,068**

The difference between assets and liabilities under Solvency II includes transitional rules for technical provisions described in sections D.2.6 and D.2.7.

The main difference between Solvency II and the financial accounts is that the retained earnings which are recognised as equity in the financial statement are replaced by the reconciliation reserve in the Solvency II balance-sheet. Also, the reconciliation reserve includes retained earnings, but based on the valuation of assets and liabilities of the solvency balance sheet. The reconciliation reserve will also include the present value of future profits.

The value of technical provisions under Solvency II without the transitional rules is set at NOK 610.1 billion. The accounting value of the technical provisions is set at NOK 594.7 billion. This means that the Solvency II valuation is NOK 15.4 billion more than the accounting valuation. The transitional provisions say that in 2020 we can deduct 12/16 of this difference in the Solvency II valuation. That means that the valuation of the technical provisions under Solvency II including the transitional scheme is NOK 598.6 billion. The difference between the accounts and Solvency II is NOK 3.8 billion instead of NOK 15.4 billion. The effect on the Solvency capital is NOK 11.5 billion, as shown in Table 28 above.

At 31.12.2020, the difference between equity and subordinated debt etc. in the accounts and own funds under Solvency II was NOK 0.5 billion (NOK 0.3 billion at 31.12.2019).

E.2 Solvency Capital Requirement and Minimum Capital Requirement

The solvency capital requirement is intended to cover the risk of loss of the Company's Tier 1 and 2 capital. The minimum capital requirement is intended cover the risk of loss of the Company's own funds.

E.2.1 Solvency Capital Requirement

At year-end 2020, the capital requirements were as follows (2019 in brackets):

Minimum Capital Requirement: NOK 6.8 (6.1) billion
Solvency Capital Requirement: NOK 15.1 (14.6) billion

The capital requirements above include transitional rules for technical provisions.

KLP uses the standard formula without any company-specific parameters. The Solvency Capital Requirement at year-end 2020 and 2019 was broken down as follows:

Table 30: Composition of the solvency capital requirement without transitional rules for technical provisions. Figures in NOK billions.

Composition of SCR	2020	2019
Market risk	4.6	4.2
Counterparty risk	0.1	0.1
Underwriting risk	11.4	11.1
Diversification	-2.8	-2.6
Operational risk	2.7	2.5
Loss-absorption capacity for deferred tax	-0.8	-0.8
Solvency Capital Requirement	15.1	14.6

Table 31: Composition of the solvency capital requirement with transitional rules for technical provisions. Figures in NOK billions.

Composition of SCR	2020	2019
Market risk	4.6	4.2
Counterparty risk	0.1	0.1
Underwriting risk	11.4	11.1
Diversification	-2.8	-2.6
Operational risk	2.7	2.5
Loss-absorption capacity for deferred tax	-0.8	-0.8
Solvency Capital Requirement	15.1	14.6

The breakdown of the capital requirement across the different risks differs from what KLP itself considers correct. As mentioned in section C.1, the departure risk makes the capital requirement for underwriting risk too high relative to the other elements.

E.2.2 Simplified processes

KLP uses the simplifications to the counterparty risk module described in Articles 111 and 112 of the Norwegian Regulation laying down supplementary rules to the Solvency II Regulation.

The simplification in Article 111 means that diversification effects within a module are not taken into account in calculating the risk-reducing effects of derivatives. The simplification in

Article 112 means that the risk-adjusted value of a security is set to 75 per cent across the board. Both simplifications are used to make the calculation work easier and produce insignificant increases in the capital requirement for counterparty risk.

E.2.3 Company-specific parameters

KLP does not use any company-specific parameters.

E.2.4 Input data for calculation of the Minimum Capital Requirement

At the end of 2020, the linear formula component for the Minimum Capital Requirement was calculated from the data shown in the table below.

Table 32: Input data without transitional rules for technical provisions. Figures in NOK billions.

Input data for linear formula component	31.12.2020	31.12.2019
Guaranteed benefits	436.7	391.7
Discretionary benefits	159.3	168.6
Capital at risk	421.2	506.1
Linear formula component	**8.2**	**6.1**

The minimum capital requirement is then calculated as follows:

Table 33: Minimum capital requirement without transitional rules for technical provisions. Figures in NOK billions.

Calculation of MCR	31.12.2020	31.12.2019
Linear formula component	8.2	6.1
Solvency Capital Requirement	15.1	14.6
Ceiling for Minimum Capital Requirement	6.8	6.6
Floor for Minimum Capital Requirement	3.8	3.7
Minimum Capital Requirement	**6.8**	**6.1**

The ceiling for the minimum capital requirement is 45 per cent of the solvency capital requirement. The floor for the minimum capital requirement is 25 per cent of the solvency capital requirement.

Corresponding calculations with transitional rules on technical provisions are given in the tables below.

Table 34: Input data with transitional rules for technical provisions. Figures in NOK billions.

Input data for linear formula component	31.12.2020	31.12.2019
Guaranteed benefits	436.7	391.7
Discretionary benefits	156.2	168.6
Capital at risk	421	506.1
Linear formula component	**8.2**	**6.1**

Table 35: Minimum capital requirement with transitional rules for technical provisions. Figures in NOK billions.

Calculation of MCR	31.12.2020	31.12.2019
Linear formula component	8.2	6.1
Solvency Capital Requirement	15.1	14.6
Ceiling for Minimum Capital Requirement	6.8	6.5
Floor for Minimum Capital Requirement	3.8	3.6
Minimum Capital Requirement	**6.8**	**6.1**

We see here that the ceiling placed restrictions on the Minimum Capital Requirement in 2020.

E.3 Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement

KLP does not use the duration-based sub-module for equity risk.

E.4 Differences between the standard formula and any internal models used

KLP does not use internal models.

E.5 Non-compliance with the minimum capital requirement and the solvency capital requirement

KLP satisfies both the minimum capital requirement and the solvency capital requirement.

E.6 Other information

All of the key information on valuation is considered to be covered above.

Approval

The report was approved by the Board of Directors of KLP on 18 March 2021.

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Sverre Thornes, CEO

Templates

The following QRTs (quantitative reporting templates) are included below.

QRT kode	QRT navn
S.01.02.01	Generell informasjon om foretaket
S.02.01.01	Balansen
S.05.01.01	Premier, erstatninger og kostnader pr. forsikringsbransje
S.12.01.01	Forsikringstekniske avsetninger – livsforsikring og helseforsikring håndtert som livsforsikring
S.22.01.01	Effekten av overgangsregler og andre tiltak knyttet til langsiktige garantier
S.23.01.01	Ansvarlig kapital
S.25.01.01	Solvenskapitalkrav - for grupper som benytter standardmetoden
S.28.01.01	Minstekapitalkrav – kun livsforsikringsvirksomhet eller skadeforsikringsvirksomhet

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