The amount of investment assets EUR 177.9 billion at the end of March 2016

The amount of pension funds fell slightly in the first quarter. At the end of March, the total net amount of earnings-related pension funds came to EUR 177.9 billion. The amount of funds decreased by EUR 3.0 billion compared to the end of last year. Our analyst Peter Halonen has drawn up the following more detailed analysis on the amount and allocation of investment assets at the end of March 2016.

Halonen's analysis describes the amount and allocation of investment assets and income situation at the end of March. In addition, Halonen comments on the outlook for the investment market by the beginning of the year.

- Basic facts about investment statistics drawn and the new report model
- Investment portfolio growth came to a halt – net investment assets EUR 177.8 billion
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1. Basic facts about investment statistics drawn and the new report model

Our member organizations are responsible for investing the statutory earnings-related pension assets. The statistics cover the pension insurance companies, the TyEL funds of industry-wide pension funds and company pension funds, and the public-sector earnings-related pension providers: Keva, the State Pension Fund (VER), the pension liability fund for the employees of the Social Insurance Institution (Kela), the Central Church Fund (KKR) and the Pension Institution of the Bank of Finland (SPERA). Also included is the group of specialized pension providers, which encompasses the Farmers' Social Insurance Institution (Mela) and the Seafarer's Pension Fund (MEK).

The statistics only cover the statutory earnings-related pension assets put into funds. They do not include the value of the funds for collective supplementary pension provision, managed by company pension funds and industry-wide pension funds, which totalled about EUR 4.6 billion at the end of 2015.

The data on the first quarter of 2016 have been collected using the new report model for earnings-related pension assets devised by Statistics Finland[1]. In consequence, we now use the data collected by Statistics Finland. Previously the data were collected using a report model maintained by the Financial Supervisory Authority. The report model had been devised more than ten years ago,

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[1]Instructions by Statistics Finland for collecting data on earnings-related pension assets (in Finnish) http://www.stat.fi/keruu/telq/ohjeet.html

primarily to meet the European Central Bank’s needs at the time. Following this change, certain sections in the reporting have become more precise when compared against the old data collection model.

For instance, cash collateral given and received in connection with derivatives, and purchase price claims and liabilities associated with investments, are considered at their net value in the new reports. In consequence, the reported amount of net investment assets decreased by about EUR 0.7 billion. The statistical summaries include the adjusted figures in investment loans.

The way in which the net value of derivative contracts is reported and handled has also been specified. With respect to the reporting of cash collateral for derivatives, it should be noted that Eurostat, the statistical office of the European Union, has not yet issued detailed guidelines on how the cash collateral for derivatives should be reported in financial accounting.

2. Investment portfolio growth came to a halt – net investment assets EUR 177.9 billion

At the end of the first quarter of 2016, the total net amount of assets put into funds by earnings-related pension insurers, i.e. the net investment portfolio, came to EUR 177.9 billion. Compared against the situation at the end of 2015, the value of the investment portfolio decreased by EUR 3.0 billion. However, in the longer term, for instance between 2005 and 2015, the investment portfolio increased on average by EUR 8.5 billion per year.

There are three reasons for the decrease in the investment portfolio during the first quarter.

- The first reason is that pension asset investments had a weak return trend. Returns were weak especially for quoted shares.
- The second noteworthy reason is that, at the same time, the pensions paid out from the assets exceeded the pension contributions collected into the system. In fact, assets are put into funds and invested so that some of the financing needed for pensions can be obtained from these sources.
- The third reason for the fall in the investment portfolio was the above-mentioned statistical reform accompanied by more accurate statistical reporting.

Both investment returns and the difference between pension contributions and pension expenses have an impact on investment portfolio trends. Most of the pension contributions are used to finance current pensions. The remaining pension contributions are placed into funds and invested so that pension contributions can permanently be kept lower than in the alternative where no investments of this type are made.

In 2015, the increase of assets in the entire earnings-related pension system was solely attributable to returns, since the amount of investment assets used for financing pensions in the private sector exceeded the savings made in the public sector. Within the public sector, however, contributions to the municipal-sector pension system are still greater than pension expenses.

3. Fixed-income investments rose, equities and real estate fell

At the end of March 2016, the investment portfolio for the entire sector was broken down as follows:

- Investments in equities and equity-like instruments [2] 46.8 per cent (EUR 83.4 billion),
- fixed-income investments[3] 45.0 per cent (EUR 80.0 billion) and
- real estate investments 8.3 per cent (EUR 14.6 billion).

Investments in equities and equity-like instruments decreased by EUR 5.1 billion and their share declined by 2.1 percentage points when compared against the situation at the end of 2015. The euro amount of real estate investments also declined by EUR 2.5 billion, mainly owing to the changed reporting practice. This meant that their share shrank by 1.3 percentage points. In contrast, the amount of fixed-income investments increased by EUR 4.7 billion, and their share of all assets rose by 3.4 percentage points.

The statistical reform contributed to the mutual relations between different investment categories. The biggest factor affecting the mutual relations was in the relationship between real estate investments and one sub-category of fixed-income investments, namely investment loans. In the new data collection model for earnings-related pension assets devised by Statistics Finland, data are collected on both external and internal lending done by a group of companies. Internal lending comprises all lending to the pension insurer’s own companies, including its own real estate companies. Thus, the statistical report does not specify directly how much of the lending goes to the pension insurer’s own real estate companies.

Alongside the new reporting, all lending, whether internal or external, is included in investment loans. In consequence, the amount of real estate investments has decreased but, on the other hand, the amount of investment loans has increased by the same sum when compared, for instance, against the previous period, i.e. the last quarter of 2015. This category shift has an impact of slightly over EUR 2 billion on both investment categories.

However, the new classification and reporting have no effect on the total amount of investment assets. Nevertheless, it must still be taken into account how value changes and the relationship between purchases and sales affect the differences between investment categories.

3.1 Money market investments on the rise, category changes in investment loans

In the main, the rise of EUR 4.7 billion in fixed-income investments stemmed from the increase of EUR 2.4 billion in money market investments, but also from the increase of EUR 1.5 billion in investment loans. Additionally, the rise in bonds and convertible bonds drove fixed-income investments higher by EUR 0.9 billion. TyEL premium lending was the only category of fixed-income

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[2]When the analysis refers to investments in equities and equity-like instruments, this means the following categories of investment figures: quoted shares (incl. funds); hedge funds; and other investments in equities, which include, for instance, equity investments and investments in unquoted shares.

[3]When the analysis refers to fixed-income investments, this means the following categories of investment figures: money market investments; investment loans; TyEL premium lending; and bonds.

investments that declined – although only moderately by EUR 0.1 billion. Owing to the changes, fixed-income investments were broken down as follows:

- Bonds and convertible bonds 33.8 per cent of total investment assets (EUR 60.1 billion).
- Money market investments 7.9 per cent (EUR 14.1 billion)
- Investment loans 2.6 per cent (EUR 4.6 billion)
- TyEL premium lending 0.7 per cent (EUR 1.2 billion)

The increase in money market investments meant that their share rose from 6.5 per cent to 7.9 per cent during the quarter. The share has risen steadily during the past two years, and is currently near the figure for 2011, or 8.1 per cent. There may be various reasons behind this rise, but one reason could be pension insurers' preparation for a potential rise in uncertainty on the investment market, or the assets may be kept on the money market for a while before they are invested in longer-term instruments.

Owing to the increase in the amount of investment loans, their relative share rose during the quarter, from 1.7 per cent (EUR 3.1 billion) to 2.6 per cent (EUR 4.6 billion). Underlying this substantial increase in investment loans are the category changes caused by the statistical reform.

In consequence, new components are included in investment loans. Some of these components had a positive effect on the entire investment loan category, while others had a negative effect. When compared against the old data collection practice, the first two items on the list below are completely new components for reporting. They also have an impact on the entire investment portfolio:

1. The net amount of cash collateral for derivatives, i.e. the cash collateral given minus the cash collateral received. Their net effect on investment loans and on the whole investment portfolio is negative by about EUR 1.1 billion.

2. In contrast, the purchase price claims and liabilities arisen for the duration of clearing in connection with securities trading increased investment loans and the investment portfolio by a total of EUR 0.4 billion.

   In total, these two new components had a negative effect of EUR 0.7 billion on the whole net investment portfolio.

3. Especially the change in classification practice, propelled by the statistical reform, increased investment loans. This change was already described in more detail at the start of this section 3. However, the changes in the relatives shares of investment loans and real estate investments did not have any effect on the total amount of investment assets.

About EUR 0.7 billion of the increase in bonds was explained by the fact that, in net terms, purchases exceeded sales and maturities. The remainder, roughly EUR 0.1 billion, arose from positive value changes. With falling interest rates, the prices of interest-bearing instruments rise and the market values of portfolios containing fixed-income investments increase.

New investment loans and TyEL premium lending granted by pension insurance companies totalled about EUR 0.3 billion during the first quarter of 2016. This figure is fairly typical when compared against the first quarters of previous years. There are also exceptions; for instance, during the financial crisis in 2009 when the value of new loans granted was as high as EUR 1.3 billion. The figures give an indication of the availability of financing for Finnish companies from sources other than earnings-related pension providers. The higher the sums for these two types of loans are, the more challenging it is for companies to obtain financing, for instance, from banks.

3.2 Sales pressure on quoted shares

The decline of EUR 4.0 billion in the amount of quoted shares (incl. funds) was mainly due to a negative value change (EUR -3.1 billion). A smaller percentage of the decline stemmed from the fact that more equities and equity-like instruments were sold than purchased (EUR -0.9 billion). In particular, net sales focused on equity funds, and mostly on those that invest in the euro area. The second biggest sellers were equity funds that invest outside the euro area. The net sales of hedge fund units amounted to EUR 0.2 billion, while other equity investments, i.e. private equity funds and unquoted shares, were purchased and sold in almost equal amounts.

Purchase and sales data for the first quarter show how pension insurers have clearly increased their sales in investments considered risky. In this way, pension insurers have reduced the risk levels of investments in a partly uncertain market situation. On the other hand, during the first quarter, the risk atmosphere of markets was weak, which for its part may explain the willingness to sell. At the end of the first quarter, investments in equities and equity-like instruments accounted for the following percentages of all investment assets

- Quoted shares (incl. funds) 31.9 per cent (EUR 56.8 billion)
- Other equity investments 7.6 per cent (EUR 13.5 billion)
- Hedge funds 7.3 per cent (EUR 13.1 billion)

In summary, it can be concluded that the first quarter was weak for the value changes of equities and equity-like instruments. For instance, the weighted average return on quoted shares for five largest private-sector pension insurers was -5.0 per cent during the first quarter.

The euro-denominated index values for returns on quoted shares in various industrialised countries (including the world index) reflect the feeble global trend on the stock markets during the first quarter. The nominal index values for returns were between -6.9 and -3.3 per cent in the red during January–March: the OMXH Portfolio Index -3.3%; the MSCI World Index -4.9%; and the MSCI Europe Index -6.9%. More detailed information on returns is available in section 5, and on the contributing factors in section 6.

3.3 Changes in the allocation differences of investments among pension institution groups

The situation for the entire sector consists of the trends for various insurer groups. In the private sector, quoted shares accounted for 29.0 per cent (EUR 32.9 billion) of all assets in the private sector. In the public sector, the corresponding figure was exactly 37 per cent (EUR 23.9 billion). In the public sector, the change during one quarter was relatively small, -1.2 percentage points, whereas in the private sector the change was slightly more, -2.0 percentage points.

In the private sector, unquoted shares and private equity investments accounted for 8.3 per cent (EUR 9.4 billion) of the sector’s total assets. In the public sector, this figure was 6.3 per cent (EUR 4.1 billion). No major changes took place in these categories during the quarter. The relative shares of hedge fund investments decreased in both sectors during the quarter. In the private sector, this share was 8.6 per cent (EUR 9.8 billion) at the end of March, or 0.5 percentage points less than at the start of the year. In the public sector, hedge investments accounted for 5.1 percentage points (EUR 3.3 billion) at the end of March. This is 0.2 percentage points less than at the start of the year.

Most of the increase in fixed-income investments (EUR 4.7 billion) came from the private sector, where the increase was about EUR 4.0 billion as against EUR 0.7 billion in the public sector. The main reasons for the private sector's rise in fixed-income investments were money market investments (EUR +2.0 billion) and investment loans (EUR +1.6 billion). The changes in volumes depend on both net flows and value changes, but also on category changes that accompanied the statistical reform and affected, in particular, investment loans.

4. The trend of the past few years continues: investments outside the euro area on the rise

During the first quarter of 2016, investments in countries outside the euro area accounted for as much as 51.1 per cent of total investments. More than four years ago, in December 2011, the figure was clearly smaller, or 37.6 per cent. In 2015, this share exceeded 50 per cent for the first time, as it reached about 50.1 per cent in December.

Underlying this trend is the more efficient diversification of risks. Moreover, since pension assets have become larger, the search for suitable investments requires that some investments are made outside Finland.

On the other hand, the relative share of investments in Finland continued the upward trend of recent years – although fairly moderately. During the quarter, the share rose from 27.0 per cent to 27.7 per cent In contrast, the relative share of investments in the rest of the euro area continued to decline rapidly. During the first quarter of the current year, the share shrank from 23.0 per cent to 21.3 per cent. Ten years ago the corresponding share was still slightly over 40 per cent.

In monetary terms, investments outside the euro area increased from EUR 90.5 billion to 90.9 billion. For their part, investments in Finland went up from EUR 48.8 billion to 49.2 billion during the quarter. Altogether EUR 37.8 billion was invested in the rest of the euro area at the end of March; in December the figure had been EUR 41.6 billion.

Among domestic investments, the volumes of money market investments, bonds and convertible bonds increased. Money market investments increased from EUR 8.8 billion to 11.4 billion. The value of bonds and convertible bonds rose moderately, from EUR 5.1 billion to 5.3 billion. In contrast, quoted shares (incl. funds) declined by EUR 1.1 billion within one quarter, to EUR 12.5 billion. Because of the statistical reform, real estate investments lost their top place among domestic investments. In March, real estate investments in Finland totalled EUR 11.4 billion, whereas in December the figure had been EUR 13.8 billion. At present the biggest category is quoted shares (incl. funds).

The net value of shares and equity-like instruments sold during one quarter totalled about EUR 0.8 billion. The highest sales figures were recorded for the rest of the euro area (EUR -0.8 billion) and the second highest for Finland (EUR -0.3 billion). The area outside the euro area was the only one that had a positive net flow, i.e. more shares were purchased than sold (EUR +0.3 billion). In the whole category of equities and equity-like instruments (83.4 billion at the end of March), domestic quoted shares accounted for 18.2 per cent (EUR 15.2 billion) and the rest of euro area about 13.9

per cent (EUR 11.6 billion). The remaining 67.9 per cent were equity investments outside the euro area (EUR 56.6 billion).

5. The year began with weak returns on investments

Each quarter, our seven largest members – the five largest pension insurance companies and the two largest pension insurers in the public sector – report on the breakdown of their investments and on their returns voluntarily and in keeping with the same principles. When combined, their assets account for about 92 per cent of all earnings-related pension assets. The reporting takes place in so-called return-risk tables (www.tela.fi/en/quarterly_information_by_pension_provider). Using consistent principles independent of the return-risk tables, all our members report their returns semiannually, at the end of June and December.

The returns of the seven largest earnings-related pension insurers during the first quarter of 2016 ranged from -1.4 to +0.1 per cent. The nominal mean return on investments for the whole sector was -1.0 per cent. The real return was about -1.1 per cent on capital employed. The mean return on the investments of pension insurance companies was -1.1 per cent in nominal terms and -1.2 per cent in real terms. Similarly, the mean return figures for public-sector investors were -0.8 per cent in nominal terms and -0.9 per cent in real terms.

The highest return percentages for the period between January and March were obtained from unquoted shares, about 4 per cent, and other investments, about 8 per cent. In contrast, quoted shares yielded the weakest returns, about -5 per cent.

If the returns on investments are examined over a long period, from the start of 1997 to the end of March 2016, the annual mean returns in the private sector are 5.7 per cent in nominal terms and 4.0 per cent in real terms. In the public sector, the nominal and real returns are 6.1 per cent and 4.4 per cent, respectively. For the whole sector, the annual mean returns are 5.8 per cent in nominal terms and 4.1 per cent in real terms.

When making comparisons, it is good to remember that requirements for solvency have only been laid down for private-sector pension providers. In the public sector, decision-making bodies guide investment activities by setting allocation limits for each investment category.

6. A cautious start to the year

In early 2016, several factors diminished returns, especially on quoted shares: the market's concern over the slowdown of the Chinese economy; declining raw material prices; and rising risk premiums in high-risk corporate loans. The weak economic situation of some European banks and Britain's possible exit from the European Union have also caused concern among investors.

Moreover, concerns about global deflation and its negative effects on indebted states and corporations deepened the market's risk mood early this year. However, fears of deflation subsided as the first quarter progressed and the European Central Bank (ECB) and the People's Bank of China (PBoC) applied additional monetary policy measures to stimulate the economy. In addition, the messages sent by the U.S. Federal Reserve (Fed) have calmed down market speculations on rising interest rates.

On the other hand, thanks to slightly reduced concerns about China's economic growth and the continued liberal monetary policy of the central banks, stock markets partly recovered at the end of the first quarter. As the markets calmed down, the risk premiums of corporate loans diminished and the prices of raw materials rose. However, the improved atmosphere on the market at the end of the quarter was not sufficient to offset the investment losses arisen at the beginning of the period, for instance in shares.

7. Pension companies' solvency at a good level

Earnings-related pension providers in the private sector must meet the statutory solvency requirements. The solvency of pension providers was strong at the end of March. This reflects good preparation for potential uncertainties on the financial market. The solvency ratio describes a company's risk-bearing capacity. The solvency ratio is obtained by dividing the solvency capital with technical reserves.

The solvency ratios of the five largest pension insurance companies ranged between 13.4 and 28.6 per cent at the end of March. At the end of 2015, the corresponding range was wider, between 14.3 and 31.4 per cent.

The decrease in solvency ratios during the quarter was in part caused by weak investment returns. On the other hand, it should be kept in mind that the express purpose of the solvency capital is to serve as a buffer for the varying returns on investments.

By contrast, the solvency positions of the five largest pension insurance companies at the end of March 2016 were the same as at the end of 2015, or between 1.4 and 2.2. The solvency position is the solvency capital in relation to the solvency limit. Factors affecting the solvency limit include the risks involved in investments and their mutual correlation. In practice, the solvency position describes a company's risk-bearing capacity in relation to the risks taken. More information about the calculation of solvency is available on our page Calculation of solvency, www.tela.fi/en/calculation_of_solvency.

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Owing to revisions made to the figures in summer, the net amount of investment assets at the end of March 2016 rose by EUR 0.1 billion. The revision also had minor effects on some other figures describing the situation at the end of March. The figures for the Q1/2016 analysis were updated on 27 September 2016.