Investment assets totalled EUR 180.2 billion at the end of June 2016

The amount of earnings-related pension assets rose slightly during the second quarter of 2016. At the end of June, the total net amount of assets put into funds by earnings-related pension insurers came to EUR 180.2 (*) billion. The amount increased by EUR 2.3 billion when compared against the situation at the end of March (**). Our analyst Peter Halonen has drawn up the following more detailed analysis on the amount and allocation of investment assets at the end of June 2016.

(*) Owing to revisions made to the figures in autumn, the net amount of investment assets at the end of June 2016 fell by EUR 0.1 billion, to EUR 180.2 billion. The revision also had minor effects on some other figures describing the situation at the end of June. The figures of the Q2/2016 analysis were updated on 13 January 2017.

(**) 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 13 September 2016.

Halonen's analysis comprises the following sections:

- Basic facts about our investment statistics
- The decline in the investment portfolio came to a halt – net investment assets EUR 180.2 billion
- Fixed-income investments and real estate rose, equities fell
  - Bonds and convertible bonds on the rise – mainly because of their positive price trend
  - Hedge funds rose, the share of other equity investments fell
- The trend of the past few years continues: investments outside the euro area on the rise
- For nominal returns, the first half of the year was slightly positive; in the long term, returns have remained good
- Brexit hit the returns on equities at the end of June
- Pension companies' solvency still at a good level

1. Basic facts about our investment statistics

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 and second 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, 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 during the first quarter and rose by about EUR 0.2 billion during the second quarter. 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. The decline in the investment portfolio came to a halt – net investment assets EUR 180.2 billion

At the end of the second 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 180.2 billion. Compared against the first quarter of 2016, the value of the investment portfolio increased by EUR 2.3 billion. In the longer term, between 2005 and 2015, the investment portfolio increased on average by EUR 8.5 billion per year.

The positive return trend in the investment of pension assets during the second quarter had a favourable impact on the investment portfolio. However, since the return trend for the first quarter was clearly in the red, the indicators for the whole first half of the year were only a shade above zero.

In the second quarter, returns were relatively good – considering the exceptionally low interest rates – especially in fixed-income investments. When interest rates fall, the prices of fixed-income investments rise.

It should also be noted at the same time that the pensions paid out from the assets exceeded the pension contributions collected into the system. This had a negative impact on pension assets. In fact, assets are put into funds and invested so that some of the financing needed for pensions can be obtained from these sources.

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

When seen from the perspective of a long-term investor, such as a pension insurer, not too much weight should be given to the examination of returns over one particular quarter or even over a period of six months.

Instead of short-term analyses, it is more useful to study how pension insurers have succeeded in their investment efforts over a long term. This is, above all, because the current situation on the financial market always has a very strong impact on returns in the short term. How the selected investment plan bears fruit can only be seen in the long term. So far, long-term returns have been good. More about this in section 5.

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 and real estate rose, equities fell

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

- investments in equities and equity-like instruments[2] 46.3 per cent (roughly EUR 83.6 billion);
- fixed-income investments[3] 45.4 per cent (roughly EUR 81.9 billion);
- real estate investments 8.3 per cent (roughly EUR 14.9 billion).

Euro-denominated and relative changes by investment category, for the entire investment portfolio, when compared against the previous quarter:

- investments in equities and equity-like instruments increased by EUR 0.2 billion, but their relative share fell by 0.5 percentage points;
- the corresponding figures for fixed-income investments: EUR +1.9 billion and +0.4 percentage points;
- real estate investments: EUR 0.3 billion and +0.1 percentage points.

[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.

The rise in the relative share of fixed-income investments is explained by two factors: the first is the good return trend of fixed-income investments, and the second is the change in investment loans that is associated with changes in the amount of cash collateral for derivatives.

The euro amount of investments in equities and equity-like instruments also rose, but their relative share diminished owing to the rise in the entire investment portfolio. Similar to fixed-income investments, stock markets also fared better in the second quarter than in the first quarter; this explains their rise expressed in euros.

For real estate investments – as for fixed-income investments – both the euro amount and the relative share increased.

The statistical reform contributed to the mutual relations between different investment categories. This was particularly evident in the first quarter when compared against the data at the end of 2015. 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. Finally, 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 Bonds and convertible bonds on the rise – mainly because of their positive price trend

The rise of EUR 1.9 billion in fixed-income investments after the first quarter stemmed mainly from an increase in the amount of bonds, convertible bonds and investment loans. In contrast, money market investments declined. TyEL premium lending remained steady. Owing to the changes, fixed-income investments can be broken down as follows:

- Bonds and convertible bonds 34.7 per cent of total investment assets (EUR 62.5 billion);
- Money market investments 7.0 per cent (EUR 12.7 billion);
- Investment loans 3.1 per cent (EUR 5.5 billion);
- TyEL premium lending 0.6 per cent (EUR 1.2 billion).

Changes in fixed-income investments, in euros and relative to the entire investment portfolio, when compared against the previous quarter:

- Bonds and convertible bonds, an increase of EUR 2.4 billion and a rise of 0.9 percentage points in relative terms;
- Corresponding figures for money market investments: EUR -1.4 billion and -0.9 percentage points;
- Investment loans: EUR +0.9 billion and +0.5 percentage points;
- TyEL premium lending EUR 0.0 billion and -0.1 percentage points.

The principal reason for the rise in bonds and convertible bonds is their positive price trend (EUR +1.6 billion). Another reason for the rise of this item is the fact that their purchases exceeded their sales by about EUR 0.8 billion net.

Underlying the positive price trend – at least for government bonds and for corporate bonds with a high credit rating – is the fall in the overall interest level during the second quarter, and especially in late June after the Brexit news, when investors were seeking a safe haven for their investment capital. As was mentioned before, when interest rates fall, the prices of debt securities rise.

The growth in money market investments came to a halt in the second quarter. Prior to this period, their share had risen steadily for two consecutive years. As late as in the first quarter of the current year, this investment category’s relative share was still close to 8.1 per cent – the figure recorded in 2011, the year of the euro crisis.

There may be various reasons underlying the earlier increase, 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. In the light of the most recent figures, it seems that pension insurers have found better investment instruments than money market investments as concerns the risk-return tradeoff.

During the second quarter, the volume of money market investments declined because their sales exceeded their purchases. Value changes also played a role here.

The main factor affecting the rise in the amount of investment loans was the net increase in cash collateral for derivatives, which was about EUR +1.0 billion when compared against the first quarter. As a whole, however, cash collateral continued to be – albeit slightly – negative by about EUR -0.1 billion. In contrast, the purchase price claims and liabilities associated with clearing in securities trading fell by about EUR 0.2 billion net, to roughly EUR 0.2 billion.

Investment loans have increased significantly this year when compared against the situation at the end of 2015. Underlying this increase are the category changes stemming from 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.

2. Purchase price claims and liabilities arisen for the duration of clearing in connection with securities trading.

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.

Within one period, no major changes occurred in external and internal lending included in investment loans. New investment loans and TyEL premium lending granted by pension insurance companies totalled about EUR 0.5 billion during the second quarter of 2016. The figure is slightly higher than in the second quarters of past 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. On the other hand, the increase in lending for investment loans, in particular, may reflect the confidence that pension insurers' customers, i.e. enterprises, have in the economy, indicating that they have the courage to take out a loan, for instance for new investments.

3.2 Hedge funds rose, the share of other equity investments fell

The factors underlying the slight increase (EUR +0.2 billion) in investments in equities and equity-like instruments when compared against the first quarter were hedge funds and, to a small degree, quoted shares (incl. funds). The amount of other equity investments fell. Owing to the changes, investments in equities and equity-like instruments can be broken down as follows:

- Quoted shares (incl. funds) 31.6 per cent (EUR 57.0 billion);
- Other equity investments 6.9 per cent (EUR 12.5 billion);
- Hedge funds 7.8 per cent (EUR 14.1 billion).

Changes in investments in equities and equity-like instruments, in euros and relative to the entire investment portfolio, when compared against the previous quarter:

- Quoted shares (incl. funds): increase of EUR 0.2 billion; however, their relative share declined by 0.3 percentage points because the increase in the entire investment portfolio was greater;
- The corresponding figures for hedge funds: EUR +1.0 billion and +0.5 percentage points;
- Other equity investments: EUR -1.0 billion and -0.7 percentage points.

The factors affecting the moderate positive trend in quoted shares (incl. funds), when compared against the first quarter, were the positive net flow (EUR +0.1 billion) and positive value changes (EUR +0.1 billion). The net sum used for purchasing hedge fund units was about EUR 0.5 billion. Almost as much, EUR 0.4 billion, was used for other equity investments.

The information on purchases and sales shows how, during one quarter, pension insurers have neither increased nor reduced the amount of quoted shares considered risky. The uncertainty that prevailed in spring and early summer, for instance with regard to Brexit, certainly contributed to the small net flow. Evidently, pension insurers have not considered it sensible to increase their portfolio of quoted shares – at least not to any greater extent.

However, it should be noted how, during the first quarter, pension insurers clearly stepped up their sales in investment categories regarded as risky. Thus, pension insurers had already reduced the risk levels of investments in a somewhat uncertain market situation.

In summary, it can be concluded that the second quarter of the year was stronger for the value changes of equities and equity-like instruments than the first quarter had been. On the whole, the returns for the first six months of the year continued to be negative. The euro-denominated index values for returns on quoted shares in various industrialised countries (including the world index) reflect the feeble global trend on stock markets during the first half of the year. All nominal index values for returns were between -6.7 and -1.2 per cent in the red during January–June:

- MSCI Europe Index -6.7%.
- MSCI World Index -1.2%
- OMXH Portfolio Index -1.0%

More detailed information on returns is available in section 5, and on the contributing factors in section 6.

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

During the second quarter of 2016, investments in countries outside the euro area accounted for as much as 52.5 per cent of total investments. Some five years ago, for instance in December 2011, the figure was clearly smaller, or 37.6 per cent.

This percentage exceeded 50 for the first time in December 2015, when it reached about 50.1 per cent. Underlying this trend is the more efficient risk diversification of assets in terms of the risk-return tradeoff. Moreover, since the volume of pension assets has grown, the search for suitable investments requires that some investments are made outside Finland.

As the relative share of investments outside the euro area rose, the relative shares of investments in Finland and in the rest of the euro area declined. Both net flows and rates of return affect the increase in investment portfolios in various areas.

The list below shows the sums and relative shares of investments in the various areas, as well as the changes on the first quarter:

- Investments outside the euro area: 52.5 per cent (EUR 94.6 billion). Change on the first quarter: +1.4 percentage points and EUR +3.7 billion.
- Finland: 27.0 per cent (EUR 48.6 billion). Change: -0.7 percentage points and EUR -0.6 billion.

- Other countries in the euro area: 20.5 per cent (EUR 37.0 billion). Change: approximately -0.7 percentage points and EUR -0.7 billion.

5. As to nominal returns, the first half of the year was slightly positive; returns have remained good over the long term

For the whole sector, the nominal return during the first six months came to 0.3 per cent, whereas the real return was about -0.1 per cent.

The return figures for various pension institution groups showed slight dispersion: the nominal return was 0.0 per cent for pension insurance companies, 0.6 per cent for company pension funds and industry-wide pension funds and 0.9 per cent for public-sector pension providers. The corresponding real returns were -0.4 per cent for pension insurance companies, +0.5 per cent for the public sector and 0.2 per cent for company pension funds and industry-wide pension funds.

The nominal annual returns of the seven largest earnings-related pension insurers during the first half of 2016 ranged from -0.6 to +1.3 per cent. The corresponding real returns ranged between -1.0 and +0.9 per cent.

The best nominal six-month returns for the whole sector came from fixed-income and real estate investments: 2.4 per cent for both. In contrast, returns from shares and holdings were negative by 1.8 per cent. Over the longer term, shares and holdings have yielded the best returns, before real estate and fixed-income investments.

If the returns on investments are examined over a longer term than that used in the graphs, from the start of 1997 to the end of June 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, however, the annual mean returns are 5.8 per cent in nominal terms and 4.1 per cent in real terms.

The Finnish Centre for Pensions uses 3.5 per cent as the assumed real return in its long-term projection. 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, however, decision-making bodies steer investment activities by setting allocation limits for each investment category.

On the whole, fixed-income investments did well as investors were seeking safe havens for their investment capital, owing to Brexit and other reasons causing fluctuation on the market. However, the biggest factor reducing interest rates during the past few years has been the liberal monetary policy pursued by the central banks. This continues to bring interest rates ever lower for both government bonds and certain corporate bonds.

The prices of fixed-income instruments rise when their interest rates fall. On the other hand, future returns obtainable from fixed-income instruments are in part even negative for debt securities with a sub-zero interest rate, if the securities are kept until their maturity. In the future, the low returns on some fixed-income instruments, such as government bonds with a good credit rating, pose a challenge for long-term investors, such as pension insurers. The first six months of the year were challenging for stock markets, owing to various risk factors described in more detail in the next section.

6. Brexit hit the returns on equities at the end of June

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. For their part, the weak financial position of some European banks, Britain's decision to resign from the European Union, and the consequent economic and political uncertainty towards the EU raised concern among investors. The sluggish progress of financial performance in the first quarter also weighed down the market atmosphere.

Moreover, concerns about global deflation and its negative effects on indebted states and corporations darkened the market's risk mood early this year. However, fears of deflation subsided and financial markets calmed down as the first quarter progressed into the second quarter 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 reduced market speculations on rising interest rates. The fairly good figures received from the U.S. economy, for instance in terms of the gross national product and employment, and stabilization of China's growth prospects have encouraged investors to increase their risk-taking.

However, the improved atmosphere on the market at the end of the first quarter and, in part, at the outset of the second quarter was not sufficient to offset the investment losses arisen at the beginning of the period, for instance in shares. Moreover, Brexit also had a negative impact especially on shares in late June, and the market did not have time to recover from the collapse before the end of the month.

Still, it was unexpected how quickly the financial markets quieted down after the referendum. Stock markets, in particular, continued to recover globally almost all through the summer. In some places in August, the markets even exceeded the level that had prevailed before the referendum – thanks to central banks, companies' good financial performance in the second quarter, and partly also to the fairly stable financial figures obtained from various continents.

It is still too early to assess the final economic and political impacts of Brexit. It is certain, however, that Brexit has brought additional challenges to pension insurers in their effort to operate profitably and securely in the investment environment prevailing after the exit decision.

7. Pension companies' solvency still at a good level

Earnings-related pension providers in the private sector must meet statutory solvency requirements. The solvency of pension providers was strong at the end of June. 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 by technical reserves.

The solvency ratios of the five largest pension insurance companies ranged between 13.5 and 28.3 per cent at the end of June. At the end of the first quarter of 2016, the corresponding range was nearly the same, between 13.4 and 28.6 per cent.

Solvency ratios remained almost unchanged during the first half of the year. Admittedly, they have fallen slightly since the end of 2015, which stems in part from the weak returns on equities. It should be kept in mind, however, that the express purpose of solvency capital is to serve as a buffer for the varying returns on investments.

The solvency position of the five largest pension insurance companies at the end of June was between 1.5 and 2.3. In March, the corresponding figures had been slightly lower, i.e. 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.