Investment assets totalled EUR 184.1 billion at the end of September 2016

*At the end of September, the total net amount of assets put into funds by earnings-related pension insurers came to EUR 184.1 (*) billion. The amount increased by EUR 3.9 billion when compared against the situation at the end of June (**). Our analyst **Peter Halonen** has drawn up the following analysis on the amount and allocation of investment assets at the end of September 2016.*

(*) Owing to revisions made to the figures in winter, the net amount of investment assets at the end of September 2016 fell by EUR 0.4 billion, to EUR 184.1 billion. The revision also had minor effects on some other figures describing the situation at the end of September. The figures of the Q3/2016 analysis were updated on 23 March 2017.

(**) Owing to revisions made to the figures in autumn 2016, 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.

Halonen’s analysis comprises the following sections:

- Overview of the situation at the end of September
- Basic facts about our investment statistics
- A marked increase in the investment portfolio – net investment assets EUR 184.5 billion
- The share of equities rose clearly; the shares of fixed-income investments and real estate declined
  - A slight downturn for bonds and convertible bonds
  - The portfolio of quoted shares (incl. funds) rose together with other investments in equities
- The trend of the past few years continues: investments outside the euro area on the rise
- Returns on investments improved as the year advanced
- A cautious start for the year – however, risk taking was rewarded as the year progressed
- Pension companies’ solvency strengthened

Overview of the situation at the end of September

Despite the challenging market conditions, the first three quarters of 2016, on the whole, proved fairly good in terms of returns. Especially the third quarter was strong after the worst fears caused by Brexit had been dispelled on the financial market during the summer. This was seen the most clearly on the stock market, where the positive trend propelled the value of pension assets to the highest level ever measured: EUR 184.1 billion. However, at the same time, pension assets were weighed down by the fact that the pensions paid out from the assets exceeded the pension contributions collected into the system.

In the coming years, the increased assets will be used ever more widely to meet the continually rising pension costs. On the other hand, good returns help reduce the pressure to raise pension contributions. In other words, despite the record-high pension assets, there will be more and more uses for all assets.

The trend of returns on pension asset investments should be examined over the long term; not too much weight should be given to changes during one quarter – or even during one year. The returns realized over the long term for the pension sector are as follows:

- 2006–2015: nominal 4.8 and real return 3.0 per cent
- 2001–2015: corresponding figures 5.0 and 3.4 per cent
- 1997–2015: 5.9 and 4.2 per cent

A point worth noting in the analysis of returns is that past returns cannot be used to predict future returns. Secondly, as indicated by the figures, the returns differ from each other depending on which period is selected for the examination.

Investment of pension assets involves many challenges. One of them is the current low interest level, especially on the bond markets of developed countries. For instance, the Finnish Centre for Pensions has responded to the challenges arising from the low interest level by lowering the projected long-term real return used in the sustainability calculations of the pension system from 3.5 per cent to 3.0 per cent for the next ten years. After this, the projected real return will go back to 3.5 per cent. As indicated by its name, the figure is a projection and does not therefore have any direct impact on the investments made by pension insurers.

Pension insurers' solvency remained strong as the year 2016 progressed. Owing to these buffers planned and accumulated for rainy days, pension insurers are able to withstand occasional worse times on the financial market – thanks to good historical returns.

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 Church Pension Fund 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 each 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. During the third quarter, the net purchase price claims totalled roughly EUR 0.0 billion. The figures for the first and second quarters were EUR 0.4 billion and EUR 0.2 billion, respectively. The impact that collateral for derivative contracts has on the investment portfolio is described in more detail in section 3.

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.

2. A marked increase in the investment portfolio – net investment assets EUR 184.1 billion

At the end of the third 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 184.1 billion. Compared against the second quarter of 2016, the value of the investment portfolio increased by EUR 3.9 billion.

When examined using the more important indicator, i.e. the longer term, between 2005 and 2015 the investment portfolio increased on average by EUR 8.5 billion per year. For the sake of prudence, however, it should be noted that the amount of assets has fluctuated over a rather wide range from year to year. For instance, during the financial crisis in 2008, assets fell by as much as EUR 17.3 billion, whereas in 2009 assets increased by EUR 19.8 billion on the previous year.

The reason for the rise in the investment portfolio was the positive trend of returns gained on pension asset investments. In the third quarter, the returns were good especially in equity investments. 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.

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. The share of equities rose clearly; the shares of fixed-income investments and real estate declined

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

- investments in equities and equity-like instruments 47.7 [1] per cent (roughly EUR 87.8 billion);
- fixed-income investments 44.2 [2] per cent (roughly EUR 81.4 billion);
- real estate investments 8.1 per cent (roughly EUR 14.9 billion).

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[1] 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.

[2] 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.

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: an increase of about EUR 4.2 billion, and an increase of 1.4 percentage points in their relative share;
- the corresponding figures for fixed-income investments: about EUR -0.5 billion and a decrease of 1.2 percentage points in the relative share;
- real estate investments: a change of almost exactly EUR 0.0 billion, but a decline of 0.2 percentage points in the relative share owing to the increase in the whole investment portfolio.

Due to rounding, the change of the investment portfolio in euros does not equal the total amount of the euro-denominated changes calculated by investment type.

The increase in investments in equities and equity-like instruments is explained, in particular, by the positive value trend when the stock markets recovered fairly quickly from the Brexit shock. The decrease in fixed-income investment is explained by factors such as their sales and the shrinking euro value of investment loans, especially because of cash collateral for derivatives. Changes in real estate investments were very moderate. In the third quarter, however, they were purchased slightly more than they were sold (EUR +0.1 billion).

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 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 A slight downturn for bonds and convertible bonds

Fixed-income investments (EUR 81.4 billion) decreased moderately by EUR 0.5 billion when compared against the second quarter. Owing to the changes, fixed-income investments can be broken down as follows:

- Bonds and convertible bonds 34.1 per cent of total investment assets (EUR 62.8 billion);
- Money market investments 7.1 per cent (EUR 13.1 billion);
- Investment loans 2.4 per cent (EUR 4.4 billion);
- TyEL premium lending 0.6 per cent (EUR 1.1 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 0.34 billion; at the same time, their relative share declined by 0.6 percentage points owing to a greater increase in the value of the whole investment portfolio;
- Corresponding figures for money market investments: EUR +0.4 billion and +0.1 percentage points;
- Investment loans: EUR -1.1 billion and -0.7 percentage points;
- TyEL premium lending EUR -0.1 billion and 0.0 percentage points.

The main reason for the slight rise in bonds and convertible bonds is their positive price trend (EUR +0.8 billion). On the other hand, a negative net flow reduced the value of this investment category (EUR -0.5 billion). In other words, as a net value, their sales exceeded their purchases. Underlying the positive price trend is the slight decrease in the interest level during the third quarter. When interest rates fall, the prices of debt securities rise.

Money market investments continued their rising trend. Their share has risen fairly steadily for two consecutive years. However, when compared against the first quarter, their relative share of the whole investment portfolio has shrunk (-0.8 per cent). As late as in the first quarter, this investment category's relative share (7.9 per cent) 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 that, in part, involve higher risks.

The main reason for the decline in investment loans was a decrease of about EUR -0.9 billion in the net value of cash collateral for derivative contracts. Purchase price claims and liabilities also fell slightly – by about EUR 0.04 billion net.

However, on the whole, 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.

New investment loans and TyEL premium lending granted by pension insurance companies totalled about EUR 0.3 billion during the third quarter of 2016. The figure is of the same order of magnitude as the quarterly figures recorded in previous years. There are also exceptions; for instance, during the financial crisis in 2009 when the value of new loans granted in the first quarter 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 and TyEL premium lending 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 The portfolio of quoted shares (incl. funds) rose together with other investments in equities

Quoted shares, in particular, were behind the marked increase (EUR +4.2 billion) in investments in equities and equity-like instruments when compared against the second quarter. Other equity investments also rose. The amount of hedge funds remained unchanged. Owing to the changes, investments in equities and equity-like instruments can be broken down as follows:

- Quoted shares (incl. funds) 33.1 per cent (EUR 61.0 billion);
- Other equity investments 6.9 per cent (EUR 12.7 billion);
- Hedge funds 7.7 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): an increase of EUR 4.0 billion and a rise of 1.5 percentage points in the relative share;
- the corresponding figures for hedge funds: EUR 0.0 billion, while the relative share decreased by 0.1 percentage points owing to the increase in the whole investment portfolio;
- other equity investments: EUR +0.2 billion and the relative share remained unchanged.

The main factors behind the rapid increase in the amount of quoted shares (incl. funds) are the positive value changes: EUR +4.1 billion. A small negative net flow (EUR -0.1 billion) affected the value of this investment category. The net sales of hedge fund units came to EUR 0.2 billion, whereas other equity investments were subject to a small positive net flow (EUR +0.1 billion).

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 and other political risks, certainly contributed to the moderate net flow. 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 third quarter of the year was stronger for investments in equities and equity-like instruments than the second quarter had been. In consequence, returns on equity investments, calculated for the whole year, had a clearly positive upturn by the end of September. The euro-denominated index values for returns on quoted shares in various industrialised countries (including the world index) reflect the highly diverse global trends on stock markets during the first three quarters of the year. The index values for returns showed a rather wide range of variation as the nominal returns ranged from -2.8 to +8.8 per cent between January and September:

- 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 third quarter of 2016, investments in countries outside the euro area accounted for as much as 53.2 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.

Owing to the trend, investments abroad account for an increasingly large share of the returns obtained into the Finnish pension system. When the Finnish economy does not reach very high growth figures, for instance because of sluggish exports, the fruits of economic growth in other countries can be used, through investments made abroad, to gain additional financing for Finnish pension provision.

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 second quarter:

- Investments outside the euro area: 53.2 per cent (EUR 97.9 billion). Change on the second quarter: approximately EUR +3.3 billion and +0.7 percentage points.
- Finland: approximately 26.5 per cent (EUR 48.7 billion). Change: EUR +0.1 billion and -0.5 percentage points.
- Other countries in the euro area: 20.4 per cent (EUR 37.5 billion). Change: approximately EUR +0.4 billion and approximately -0.2 percentage points.

5. Returns on investments improved as the year advanced

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 94 per cent of all earnings-related pension assets. The reporting takes place in so-called return-risk tables.

Using consistent principles independent of the return-risk tables, all our members report their returns semi-annually, at the end of June and December.

The returns of the seven largest earnings-related pension insurers after the third quarter of 2016 ranged from +2.3 to +4.4 per cent. The nominal mean return on investments for the whole sector was +3.5 per cent. The real return was about +3.0 per cent on capital employed. The mean return on the investments of private-sector investors was +3.0 per cent in nominal terms and +2.5 per cent in real terms. Similarly, the mean return figures for public sector investors were +4.3 per cent in nominal terms and +3.8 per cent in real terms.

Between January and September, the highest rates of return were obtained from unquoted shares and equity investments. During the third quarter, investments in quoted shares also brought in solid returns. In consequence, the rate of return on quoted shares turned from negative to positive over the first three quarters of the year. Fixed-income investments have also yielded fairly good returns – thanks to factors such as the generally falling interest rates.

If the returns on investments are examined over a long period, from the start of 1997 to the end of September 2016, the annual mean returns in the private sector are 5.7 per cent in nominal terms and 4.1 per cent in real terms. In the public sector, the nominal and real returns are 6.2 per cent and 4.5 per cent, respectively. For the whole sector, the annual mean returns are 5.9 per cent in nominal terms and 4.2 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.

Other long-term and medium-term rates of return for the whole sector are as follows:

- 2011–2015: 5.4 per cent in nominal terms and 3.9 per cent in real terms
- The corresponding figures for 2006–2015: 4.8 and 3.0 per cent
- 1997–2015: 5.9 and 4.2 per cent

By examining the various time ranges, it can be noticed how returns vary depending on which years are included in the examination period.

6. A cautious start for the year – however, risk taking was rewarded as the year progressed

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.

Rates recovered slightly during the second quarter, thanks to fairly good economic figures obtained, for example, from the United States and China. The fact that the central banks continued their stimulating monetary policy also contributed to the recovery. However, the second quarter ended with Brexit and, as a result, rates fell.

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. On the whole, the economic impact of Brexit was smaller than expected.

An indication of all of this was that, as far as returns on shares were concerned, the third quarter went well. Risk sentiments were also positive on the emerging markets, owing to their improved growth prospects and the monetary policy pursued by the Federal Reserve, which was more expansionary than expected. However, it did not take long before market actors began to think about the U.S. presidential election and other political elections in Europe.

It is still too early to assess the final economic and political impacts of Brexit. It is certain, however, that Brexit and other political risk concentrations have meant additional challenges to pension insurers in their effort to operate profitably and securely in this type of investment environment.

7. Pension companies' solvency strengthened

Earnings-related pension providers in the private sector must meet statutory solvency requirements. The solvency of pension providers was strong at the end of September. 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 14.5 and 31.0 per cent at the end of September. At the end of the second quarter of 2016, the corresponding range was lower, or between 13.5 and 28.3 per cent. Thus, solvency ratios rose quite well during one quarter. This is because of the good returns on shares in the third quarter. 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 September was between 1.5 and 2.6. In June, the corresponding figures had been between 1.5 and 2.3. 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.