

Earnings-related pension assets EUR 205 billion at the end of June 2019

The earnings-related pension system is in part financed by investment assets. During the second quarter of 2019, these assets increased by approximately EUR 3 billion, totalling EUR 205 billion at the end of June. The increase in assets was mainly attributed to the favourable trend of equity investments during the first half of the year and the good returns on fixed-income investments. In the second quarter, the market was overshadowed by uncertainty caused by the trade war, but despite this, equities retained their value and, thanks to falling interest rates, the prices of fixed-income investments also developed positively.

Analyst **Kimmo Koivurinne's** analysis of the trend in earnings-related pension assets comprises the following sections:

- Return on investment after the first half of the year 7.0 per cent in nominal terms
- Capital markets continued the initial trend of the year
- Basic facts about our investment statistics

1. Return on investment after the first half of the year 7.0 per cent in nominal terms

- Investment assets of the earnings-related pension system, in total: EUR 205 billion (*)
 - Investment assets in the private sector: EUR 128 billion
 - Investment assets in the public sector: EUR 77 billion
- Growth in the second quarter: about EUR 3 billion
- Investments in equities and equity-like instruments accounted for EUR 116 billion, or 56 per cent of all investment assets
- Fixed-income investments: EUR 72 billion, share 35 per cent
- Real estate investments: EUR 17 billion, share 9 per cent
- Returns on investments for the first six months of the year: 7.0 per cent in nominal terms and 6.3 per cent in real terms.

() Unlike previously, the amount of assets has been reported as a whole number as we have detected inaccuracy in our statistical process for investment assets. We are investigating the cause and, if necessary, will adjust the figures later. Thus, the total amount of assets and their relative shares in the distribution may still be modified. In this case, we will also update the series of graphs on the development of investment assets on our website.*

When seen against the whole pension sector, **changes in the relative shares** of the various asset categories were mainly cosmetic during the first quarter. The share of fixed-income investments (36%) diminished by less than one percentage point. The share of equities and equity-like investments [1] (56%) rose by less than one percentage point, while the share of real estate investments (9%) remained almost unchanged. In the longer term, the relative share of fixed-income investments has decreased.

[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.

Nor did the **regional distribution of investments** change to any appreciable extent during the second quarter. The relative share of investments in the euro area increased by half a percentage point and the share of non-euro area investments by about half a percentage point. Correspondingly, the share of investments in Finland declined by slightly less than one percentage point. At the end of the second quarter, less than a quarter of investment assets (23%) was invested in Finland, less than one fifth (19%) elsewhere in the euro area, and more than half (58%) in countries outside the euro area. Changes in the relative shares of investments are affected by net flows – that is, the difference between purchases, sales and maturities.

In the second quarter of 2019, the returns of the six largest operators for each investment category were as follows:

- Average returns on equity investments: 11.9 per cent in nominal terms and 11.2 per cent in real terms;
- Average returns on fixed-income investments: 3.8 per cent in nominal terms and 3.2 per cent in real terms;
- Average returns on real estate investments: 2.2 per cent in nominal terms and 1.6 per cent in real terms.

The trend of returns on pension investments must be examined over the longer term; changes occurring during one quarter – or even during a year – are not of major importance to the financial sustainability of the pension system. In addition, future returns cannot be predicted on the basis of the returns realized. Over the long term, in the end, the pension assets put into funds for the future pension liabilities of the various age groups increase in step with economic growth and inflation. It should be noted that the selection of the examination period is also important.

The returns realized over the longer term look steady:

- 2014-Q2/2019 (5.5 years): 5.5 per cent in nominal terms and 4.8 per cent in real terms
- 2009-Q2/2019 (10.5 years): 6.7 per cent in nominal terms and 5.5 per cent in real terms
- 1997-Q2/2019 (22.5 years): 5.8 per cent in nominal terms and 4.2 per cent in real terms

The annual real return used by the Finnish Centre for Pensions for its long-term projections is 2.5 per cent until 2028. Thereafter, the projected annual real return is 3.5 per cent. The latter projection has been used to examine the pension system all the way until 2085. Then the whole picture depends the most on trends in employment, the birth rate and net immigration.

Pensions are financed not only by pension contributions but also by investment assets placed into funds and the subsequent returns. In addition, since 2017, investment assets have been affected by the fact that the pensions paid out of the funds and their returns have exceeded the sum of pension contributions placed into the funds. For instance in 2018, the entire pension sector collected EUR 2.7 billion of pension contributions into funds, while the sum taken out for pensions paid totalled EUR 4.4 billion. This means that the net sum used for pensions from funds and their returns totalled EUR 1.7 billion.

Thanks to the good start to the year, the solvency of pension insurers is strong. The solvency ratios of the pension insurance companies ranged between 123.2 and 130.2 per cent at the end of June. Solvency positions ranged between 1.5 and 2.3. Solvency ratios and positions remained largely unchanged during the second quarter. Thanks to the buffers meant for rainy days, pension insurers are also able to withstand worse periods on the financial market.

2. Capital markets continued the initial trend of the year

In the second quarter of the year, a major concern on the market was the trade war between China and the United States. Despite the trade war, equities on developed markets yielded good returns even if sellers dominated the equity market briefly in May when disputes came to a head. However, the positive attitude of the central banks supported the market, and the key stock indices closed the quarter on a positive note. In June, the Federal Reserve of the United States refrained from raising interest rates and, contrary to previous statements, indicated that the interest rate could also be lowered, if necessary. Due to the favourable interest rate outlook of the central banks, fixed-income investments yielded good returns, with interest rates falling to record lows during the second quarter.

- The S&P 500 index, describing the stock market performance of the five hundred largest U.S. companies, continued to rise and reached a new all-time high in late June.
- The German DAX index rose by nearly eight per cent. The FTSE index of the 100 largest companies on the London Stock Exchange was overshadowed by Brexit uncertainty and rose only by 2 per cent, while the pound simultaneously weakened.
- The OMXH25 index, which describes the development of the largest companies on the Helsinki Stock Exchange, fell by a couple of per cent. The threat of a trade war weakened the prospects of export-dependent firms in particular.
- During the same period, the OMXS30 index of the Stockholm Stock Exchange gave a better yield: an increase of more than four per cent in the second quarter. On the other hand, the Swedish krona also weakened against the euro.
- Record-low interest rates boosted returns on fixed-income investments.

Despite a good start for the year, economic growth in the near future seems to be slowing down, and the euro area, for example, is expected to grow this year by only about 1.2 per cent. Economic growth in the euro area (and naturally in the whole world) also plays an important role for our own economic growth and for the sustainability of the Finnish pension system. The adequate financing of pensions for the present and future generations has been under lively debate in Finland lately.

Investment returns fluctuate over time. In particular, the prolonged low interest rates have posed their own challenges for the activities of pension insurers, and for all other investors as well. The problem is that as interest levels fall, it will be increasingly challenging to receive even the same kinds of returns on fixed-income investments as obtained now. Pension insurers have sought more profitable investments, for instance, in unquoted shares, real estate, private equity funds and alternative investments. In the light of the returns, this strategy has worked well.

3. 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, as well as the public-sector earnings-related pension providers: Keva, the State Pension Fund (VER), the pension liability fund for employees of the Social Insurance Institution Kela, the Church Pension Fund (KER) and the Bank of Finland's Pension Fund (SPERA). Also included is the group of specialized pension providers, which comprises the Farmers' Social Insurance Institution (Mela) and the Seafarers' Pension Fund (MEK).

The statistics only cover the statutory earnings-related pension assets put into funds. They do not include the value of the collective supplementary pension funds managed by industry-wide pension funds and company pension funds, which was approximately EUR 4.2 billion at the end of 2018.