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Earnings-related pension assets EUR 209 billion at the end of September 2019

The earnings-related pension system is in part financed by investment assets. During the third quarter of 2019, these assets increased by nearly EUR 5 billion, totalling EUR 209 billion at the end of September. The increase in assets can be attributed to the favourable trend of equity investments and the exceptionally good returns on fixed-income investments, which continued during the third quarter. The rising trend on the market in the first half of the year boosted the financial performance of the third quarter: equities maintained their value and, thanks to the continuing fall in interest rates, 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 three quarters 9.0 per cent in nominal terms
- A positive mood continued on the market
- Basic facts about our investment statistics

1. Return on investment after the first three quarters 9.0 per cent in nominal terms

- Investment assets of the earnings-related pension system, in total: EUR 209 billion (*)
    - Investment assets in the private sector: EUR 131 billion
    - Investment assets in the public sector: EUR 79 billion
- Growth in the third quarter: just under EUR 5 billion
- Investments in equities and equity-like instruments accounted for EUR 119 billion, or 57 per cent of all investment assets
- Fixed-income investments: EUR 73 billion, share 35 per cent
- Real estate investments: EUR 18 billion, share 8 per cent
- Returns on investments for the first three quarters of the year: 9.0 per cent in nominal terms and 8.2 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.

In terms of the distribution of investments, the relative shares of pension assets did not change much in the third quarter. The share of fixed-income investments (35%) remained unchanged. The relative share of equities and equity-like investments [1] (57%) rose by less than one percentage point, while the share of real estate investments (8%) declined correspondingly. In the longer term, the relative share of fixed-income investments has decreased, and the share of equities and equity-like investments has risen.

[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 third quarter. The share of euro area investments declined by less than one percentage point and the share of domestic investments increased by about half a percentage point. The share of investments outside the euro area remained unchanged. At the end of the third quarter, less than a quarter of investment assets (24%) was invested in Finland, less than one fifth (18%) 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 first three quarters of 2019, the returns of the six largest operators **for each investment category** were as follows:

- Average returns on equity investments: 15.0 per cent in nominal terms and 14.1 per cent in real terms
- Average returns on fixed-income investments: 5.2 per cent in nominal terms and 4.4 per cent in real terms
- Average returns on real estate investments: 3.6 per cent in nominal terms and 2.8 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.

Selection of the examination period also affects how the returns realized appear in the medium and long term:

- 2014–Q3/2019 (5.75 years): 5.6 per cent in nominal terms and 4.9 per cent in real terms
- 2009–Q3/2019 (10.75 years): 6.8 per cent in nominal terms and 5.5 per cent in real terms
- 1997–Q3/2019 (22.75 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 big 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.

The solvency of pension insurers is in good shape. At the end of September, the solvency ratios of pension insurance companies ranged between 123.7 and 130.6 per cent. Solvency positions, i.e. the ratio of solvency capital to the solvency limit, ranged between 1.5 and 2.3. Solvency ratios and positions remained largely unchanged during the third quarter. Thanks to the buffers meant for rainy days, pension insurers are also able to withstand worse periods on the financial market.

2. A positive mood continued on the market

In the third quarter of the year, economic indicators showed further deceleration. Central banks now act as protectors of markets, and so the generous policy continued on both sides of the Atlantic. Thanks to the open-handed monetary policy, the equities of developed countries held their own despite the cooling economic outlook, while the appeal of equities on emerging markets was dampened by the prolonged trade war between China and the United States. In this sense, the tunes of the past quarter, especially on the stock market, were discordant.

- Equities in the euro area developed positively. The same occurred on the London Stock Exchange, despite the new Prime Minister.
- American equities also continued their cautious upswing. The Federal Reserve cut the key rate twice.
- In Asia, Japanese equities developed positively, whereas returns from the rest of Asia fell below the global stock market index.
- The continuing record-low interest rates boosted returns on fixed-income investments but reduced future yield expectations.

In spite of the good returns so far this year, prolongation of the rock-bottom interest level is one of the biggest challenges to pension insurers’ investment activities. As interest rates continue to fall, it is increasingly difficult to reap returns on fixed-income investments. Within the limits allowed by solvency regulations, pension insurers have sought more profitable investments, for instance, in unquoted shares, real estate, private equity funds and alternative investments. Thus, better returns are sought by expanding the traditional investment universe, whereby capital is allocated, for example, to illiquid investments independent of economic growth. Pension investors’ long time horizon enables illiquid investment instruments, while alternative income sources help diversify risks outside the equity and bond markets.

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.