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Earnings-related pension assets EUR 193 billion at the end of March 2020

Investment assets contributing to the financing of the earnings-related pension system shrank during the first quarter of 2020. The assets decreased by about EUR 22 billion, totalling EUR 193 billion at the end of March. The unusually sluggish trend of equity investments, in particular, had an impact on the decrease of assets during the first quarter, but the return on fixed-income investments was also negative. Halfway through the first quarter, fears brought on by the coronavirus spread across capital markets, followed by an abrupt change in the pricing of stock and credit risks and leading to one of the sharpest price falls in this millennium.

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

- Return on investment −9.7 per cent in nominal terms during the first quarter
- COVID-19 took capital markets by surprise
- Basic facts about our investment statistics

Return on investment −9.7 per cent in nominal terms during the first quarter

- Investment assets of the earnings-related pension system, in total: EUR 193 (*) billion
  - Investment assets in the private sector: EUR 122 billion
  - Investment assets in the public sector: about EUR 72 billion
- Fall during the first quarter: about EUR 22 billion
- Investments in equities and equity-like instruments accounted for EUR 90 billion, or 47 per cent of all investment assets
- Fixed-income investments: EUR 67 billion, share 34 per cent
- Real estate investments: EUR 19 billion, share 10 per cent
- Alternative investments: EUR 18 billion, share 9 per cent
- Return on investments for the first quarter: −9.7 per cent nominally and −9.6 per cent in real terms.

(*) According to the interim reports published by the pension providers, on 31 March 2020 total investment assets amounted to approximately EUR 194.5 billion. The amount of investment assets presented here differs from the figure in the interim reports by slightly over one billion. The reason lies in different statistical processes. We will specify the amount of assets later.

Changes in the **relative shares** of the various asset categories were slight during the first quarter. The share of fixed-income investments (34%) remained unchanged. The share of equities and equity-like instruments [1] (47%) fell by about two percentage points. The shares of real estate investments (10%) and alternative [2] investments (9%) each increased by about one percentage point. The decline in the relative share of equities is largely due to a decrease in the valuation levels of equities. In the longer term, i.e. within the 2010s, the relative share of fixed-income investments shrank by about ten percentage points. Fixed-income investments have been replaced by better performing equities, private equity and hedge funds. The underlying factor is the prolonged low interest rate level, which has led pension providers, within the framework of the solvency regulations, to transfer investments from fixed-income investments to asset categories with a higher yield. In the light of the returns, this strategy seems to have worked well.

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

[2] In the main, alternative investments refer to hedge funds.

The regional distributions of investments changed slightly during the past three months. The relative share of investments in the euro area remained steady, but the share of investments outside the euro area decreased by two percentage points. Correspondingly, the share of investments in Finland rose by two percentage points. At the end of the first quarter, a quarter of investment assets (25%) was invested in Finland, slightly less than one fifth (18%) elsewhere in the euro area, and over half (57%) 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 quarter of 2020, the returns of the six largest operators were as follows in **each investment category:**

- Average returns on equity investments: −15.6 per cent in nominal terms and −15.5 per cent in real terms;
- Average returns on fixed-income investments: −5.2 per cent in nominal terms and −5.1 per cent in real terms
- Average returns on real estate investments: 0.9 per cent in nominal terms and 1.1 per cent in real terms
- Average returns on alternative investments: −6.3 per cent in nominal terms and −6.2 per cent in real terms

The returns realized look steady in the longer term:

- 2015–Q1/2020 (about 5 years): 3.3 per cent in nominal terms and 2.7 per cent in real terms

- 2010–Q1/2020 (about 10 years): 4.9 per cent in nominal terms and 3.5 per cent in real terms
- 1997–Q1/2020 (about 23 years): 5.4 per cent in nominal terms and 3.8 per cent in real terms

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

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. However, as the low-income period draws out, it poses financial challenges for the pension system that need to be assessed separately. Low yields and, in particular, the decline in premium income due to layoffs and rising unemployment may cause difficulties in the long-term financing of pensions.

Pensions are financed not only by pension contributions but also by investment assets placed into funds and the subsequent returns. In addition, since 2014, the private sector's investment assets in funds have been affected by the fact that the pensions paid out of the funds and pension fund returns have exceeded the sum of pension contributions placed into the funds. According to preliminary calculations, in 2019, the entire pension sector collected EUR 2.7 billion of pension contributions into funds, while the sum taken out for pensions paid totalled EUR 4.5 billion. This means that the net sum used for pensions from funds and pension fund returns totalled EUR 1.8 billion.

Thanks to the good investment returns of previous years, the solvency of pension insurers is still sufficient, i.e. solvency capitals have remained above the limit required by law, including the situation at the end of March. However, solvency ratios and solvency positions decreased during the past quarter. At the end of March, the solvency ratios of four pension insurance companies ranged between 116.6 and 121.6 per cent. Solvency positions ranged between 1.2 and 1.9. Thanks to the buffers intended to offset violent market fluctuations, pension insurers are able to withstand even worse periods on the financial market.

COVID-19 took capital markets by surprise

The year started out in an unsuspecting positive mood. The best investment year of the previous decade was behind, and the current year was also expected to be at least reasonably good. Despite the news from China, it came as a surprise to the Western world and the investment market that the coronavirus began to spread and the official number of people infected increased daily by a four-digit figure. After mid-February, primitive emotions — *fear* and *panic* — took hold of the market at a very rapid pace. Simultaneously, at the beginning of March, the number of coronavirus infections began to rise in Italy as well. Now, at the latest, any capable investor began to seek ways to get rid of equity risks and credit risks.

In addition to the fear of an apocalyptic scourge created by COVID-19, the market also received concrete negative information through oil prices when OPEC and its Associate Member Russia could not agree on measures to limit oil production. The background factor was Russia’s stubborn line of failing to comply with the production limitation agreement, which spurred Saudi Arabia to start an oil price war. Thus, in no time, the market price of crude oil fell by almost a third.

The collapse of oil prices, combined with the sudden re-pricing of equity and credit risks, was a toxic combination for the market. Owing to the rapid decline in stock prices, the Financial Supervisory Authority notified the Ministry of Social Affairs and Health of exceptional circumstances on the financial market, which could significantly weaken pension providers’ solvency. However, the rock bottom of the first quarter had already been seen on the market in mid-March, and was followed by a modest recovery after the world’s central banks had announced of massive support measures. Thanks to the strong starting position at the outset of the year and the efficient diversification of investments, the solvency of pension insurers has remained at a moderate level.

Towards the end of the first quarter, the economy was struck by a negative demand shock caused by COVID-19. This hit the sector covering tourism, restaurants and entertainment especially hard. In March, pension insurers responded quickly to the domestic crisis. Among other things, they used their real estate portfolios to support companies that had been granted rent relief. In addition, pension insurers prepared a joint application to the Ministry of Social Affairs and Health for a temporary change that would allow the granting of interest-bearing payment time for the pension contributions of employees and self-employed persons. In addition, the social partners agreed to reduce the TyEL pension contributions paid by private sector employers by 2.6 percentage points from May to the end of the year. The reduction is implemented by utilizing the buffer for pooled claims included in the earnings-related pension system. The buffer will be refilled by raising the employer’s contribution in the coming years.

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 following public-sector 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 4.3 billion at the end of 2019.