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Earnings-related pension assets EUR 204 billion at the end of June 2020

Investment assets contributing to the financing of the earnings-related pension system recovered slightly during the second quarter. They increased by approximately EUR 10 billion and reached a total of EUR 204 billion at the end of June. In particular, the strong revival of equity investments contributed to the rise in assets. In the first half of the year, the return on equity investments remained negative, as did also the yield on fixed-income investments. During the second quarter, the immediate panic caused by the coronavirus abated in capital markets, easing the sharp decline recorded for the previous quarter.

The current analysis of the trend in earnings-related pension assets was compiled by **Kimmo Koivurinne**, Analyst, and **Minna Lehmuskero**, Director, Analyses. It comprises the following sections:

- Return on investment -4.2 per cent in nominal terms during the first half of the year
- Good recovery for the equity market after the collapse at the beginning of the year
- Basic facts about our investment statistics

Return on investment -4.2 per cent in nominal terms during the first half of the year

- Investment assets of the earnings-related pension system, in total: EUR 204 (*) billion
    - Investment assets in the private sector: EUR 127 billion
    - Investment assets in the public sector: about EUR 76 billion
- Increase during the second quarter: about EUR 10 billion
- Investments in equities and equity-like instruments accounted for EUR 99 billion, or 49 per cent of all investment assets
- Fixed-income investments: EUR 68 billion, share 33 per cent
- Real estate investments: EUR 19 billion, share 9 per cent
- Alternative investments, i.e. mainly hedge funds: EUR 18 billion, share 9 per cent
- Returns on investments for the first six months of the year: -4.2 per cent nominally and -3.9 per cent in real terms.

(*) According to the interim reports published by the pension providers, total investment assets on 30 June 2020 amounted to approximately EUR 204.9 billion. The amount of investment assets presented here differs from the figure in the interim reports by about 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 second quarter. The share of fixed-income investments (33%) fell by about one percentage point. The share of equities and equity-like instruments [1] (49%) increased by about two percentage points. The share of real estate investments (9%) decreased by about one percentage point and the share of alternative [2] investments (9%) remained the same as before. The rise in the relative share of equities is largely due to a change in the valuation levels of equities. In the longer term, i.e. in the 2010s, the relative share of fixed-income investments has diminished by about ten percentage points. They have been replaced by better performing equities, private equity and hedge funds. Underlying this is the prolonged low interest rate level, which has led pension providers, within the limits of the solvency regulations, to shift 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 quarter. The relative share of investments in the euro area shrank by nearly one percentage point, while the share of investments outside the euro area, and the share of domestic investments, rose by a few tenths of a percentage point. At the end of the second quarter, a quarter of investment assets (25%) was invested in Finland, slightly less than one fifth (17%) elsewhere in the euro area, and over 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 half of 2020, **the returns for each investment category**, calculated for the whole sector, were as follows:

- Average returns on equity investments: -6.4 per cent in nominal terms and -6.1 per cent in real terms;
- Average returns on fixed-income investments: -1.6 per cent in nominal terms and -1.2 per cent in real terms;
- Average returns on real estate investments: 1.0 per cent in nominal terms and 1.4 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. On the other hand, future returns cannot be predicted on the basis of the returns realized. Over the long term, in the end, pension assets placed into funds 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 look steady in the longer term:

- 2015–Q2/2020 (5.5 years): 4.3 per cent in nominal terms and 3.7 per cent in real terms;
- 2010–Q2/2020 (10.5 years): 5.4 per cent in nominal terms and 4.1 per cent in real terms;
- 1997–Q2/2020 (23.5 years): 5.6 per cent in nominal terms and 4.1 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 until 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 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 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 excellent returns on investments in 2019, the solvency of pension insurers has remained at the secure level. Solvency ratios and solvency positions were partly restored during the past quarter. At the end of June, the solvency ratios of four pension insurance companies ranged between 119.4 and 124 per cent. Solvency positions ranged between 1.4 and 1.8. Thanks to the buffers meant for rainy days, pension insurers are also able to withstand worse periods on the financial market.

Good recovery for the equity market after the collapse at the beginning of the year

The negative demand shock caused by the coronavirus continued in the second quarter. Despite the shutdown of the economy, global equity markets began a rapid recovery as soon as the quarter had changed. The factors having an effect in the background were the gradual dismantling of the shutdown and, in particular, the generous policy of the U.S. Federal Reserve. In addition to other stimulus packages, confidence in the market was also boosted by the massive economic stimulus plan of EUR 750 billion proposed by the European Commission.

The rapid recovery of the equity markets in the midst of the crisis alleviated the thus far catastrophic investment year. Of the principal stock markets, the New York Stock Exchange seems to have survived the crisis the best so far: for the S&P 500 index, the returns in the first six months of the year were only 4 per cent in the red. In Europe, COVID-19's impact on the economy has been uglier, and the STOXX Europe 600 index, which tracks the performance of the 600 largest listed companies in Europe, ended the first six months with a negative return of just over 13 per cent. During the same period, the Helsinki Stock Exchange showed a decline of less than seven per cent.

It is clear that both international and multi-asset diversification of investments help secure pension assets and offset losses even in a declining market. Now, earnings-related pension insurers and society as a whole are watching with concern to see whether there will be a second wave of shutdowns in the economy or whether, for example, we will start to see company bankruptcies more extensively. Weak economic figures and sharp declines in GDP will inevitably be reflected in the overall demand for goods and services. It is impossible to predict how well or poorly the world economy will survive this historic pandemic.

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.