Investment asset amounts, allocation and returns at the end of 2015

1. Basic facts about investment statistics drawn up by Tela

The member organizations of the Finnish Pension Alliance Tela 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 Central Church Fund (KKR) 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.

2. The investment portfolio continued to grow as in previous years

At the end of 2015, the total amount of assets put into funds by earnings-related pension insurers, i.e. the investment portfolio, came to EUR 180.9 billion. Compared against the situation at the end of 2014, the value of the investment portfolio increased by EUR 8.4 billion. The increase is close to the average annual growth rate during the past ten years. Between 2005 and 2014, the investment portfolio increased on average by EUR 8.5 billion per year.

Underlying the increase in the investment portfolio during the year were, in particular, the good returns gained from the investment of pension assets. Equities and equity-like instruments in particular yielded good returns. Real estate investments also performed well. However, it should be noted that in 2015, the increase in the investment portfolio was partly offset by the fact that the pensions paid out from the assets exceeded the pension contributions collected into the system. 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 be kept permanently 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.

Both in 2014 and 2015, the returns on pension investments exceeded the investment-derived financing needed for pensions. Some of the returns have been left in funds, where they are invested and used to cover the increased pension liability.

3. The shares of equities and equity-like instruments and fixed-income investments rose slightly while the share of real estate investments declined

At the end of 2015, the investment portfolio for the whole sector was distributed between the main categories as follows: investments in equities and equity-like instruments,[1] 48.9 per cent (EUR 88.5 billion); fixed-income investments,[2] 41.6 per cent (EUR 75.3 billion); and real estate investments, 9.5 per cent (EUR 17.1 billion).

During the year, the distribution of investments changed as follows: the share of fixed-income investment rose (+0.4 percentage points, EUR +4.3 billion). The share of equities and equity-like instruments also increased slightly, or about +0.1 percentage points (EUR +4.1 billion). The share of real estate investments decreased although the sum in euros remained the same (-0.5 percentage points, EUR +0.0 billion), owing to the increase in the total investment portfolio.

3.1 Money market investments on the rise in 2015, the popularity of TyEL relending still declining

At the end of December, the investment portfolio of bonds and convertible bonds came to EUR 59.2 billion while money market investments totalled 11.7, investment loans 3.1 and TyEL relending 1.3 billion euros. Money market investments in particular (EUR +4.1 billion) but also investment loans (EUR +0.2 billion) contributed to the increase of EUR 4.3 billion in the portfolio of fixed-income investments during the year. In addition, growth was accelerated by bonds and convertible bonds, whose portfolio increased very moderately (EUR +0.3 billion) despite their large volume, EUR 59.2 billion. On the other hand, the portfolio of bonds and convertible bonds increased markedly in previous years, from early 2011 onwards. The main reason underlying this increase is their favourable price trend accompanied by the low interest rates, but also an increase in the purchase of these instruments. Only TyEL relending reduced the growth of fixed-income investments (EUR -0.3 billion). TyEL relending has diminished systematically since the start of 2011.

The small rise in the amount of bonds and convertible bonds in 2015 was due to a positive net flow (EUR +0.7 billion). However, a moderate decrease in the prices of bonds (EUR -0.4 billion) reduced the increase. When interest rates – or investors' return requirements – rise, the prices of interest-bearing papers fall. In consequence, the market values of interest investors' portfolios decline. A positive net flow is obtained when the purchases of an investment instrument exceed its sales and maturities. Correspondingly, the net flow is negative when sales and maturities exceed purchases. The change in money market investments was caused by both value changes and a positive net flow.

Last year, new investment loans and TyEL relending granted by pension insurance companies reached only about one billion euros. This sum is slightly smaller than the corresponding figure in 2014, when the value of new investment loans and TyEL relending totalled EUR 1.3 billion. These 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

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

[2]When the analysis refers to fixed-income investments, this means the following categories of investment figures: money market investments; investment loans; TyEL relending; and bonds.

more challenging it is for companies to obtain financing from other sources. During the financial crisis and soon thereafter, new investment loans and TyEL relending totalled clearly more: in total EUR 4.1 billion in 2008, EUR 3.4 billion in 2009 and EUR 1.8 billion in 2010. At the end of December 2015, the portfolio of investment loans and TyEL relending totalled EUR 4.4 billion. The portfolio has diminished despite the new loans granted because the maturities of the old loans have surpassed them. With respect to investment loans and TyEL relending, it should additionally be noted that some of the new agreements have been made with the pension insurer's own real estate companies. For instance in 2015, the loans granted to own companies totalled about EUR 0.2 billion (EUR 0.8 billion in 2014).

3.2 Change in the value of equities and equity-like instruments clearly in the black

At the end of 2015, listed shares totalled EUR 60.8 billion, hedge funds EUR 14.0 billion and other equity investments EUR 13.7 billion. During the year, the portfolio of each of these three investment categories increased by about one billion euros.

The euro amount of equities and equity-like instruments has risen at a fair pace for the past ten years. The rising trend has been good despite the fact that the period includes both the financial crisis and the euro crisis, which have knocked the valuation levels of equities. However, recovery from the crises has been fast and, in consequence, values have returned to levels that are closer to their initial levels prevailing before the crises.

The year 2015 was no exception in the positive trend for equities and equity-like instruments. This investment category showed an annual net growth of EUR 4.1 billion. The increase was entirely attributable to the positive trend in value changes, which came to a total of EUR 8.0 billion. In part, however, the increase in the volume of equities and equity-like instruments was offset by the negative net flow of investments, which was about EUR 3.9 billion in the red. In other words, the total sum received by pension insurers from the sale of equities and equity-like instruments in 2015 exceeded the sum spent for purchases.

When the category of equities and equity-like instruments is examined for the whole year, the subcategory equity funds topped the sales (EUR -2.6 billion). The second greatest sum came from the sales of listed shares and holdings (EUR -1.9 billion). In contrast, the net values of hybrid funds (EUR +0.5 billion) and unlisted shares and holdings (EUR +0.1 billion) increased slightly. On the whole, it can be said that pension insurers repatriated some of the profits made possible by good returns, especially from equity funds and from listed shares and holdings. At the same time, pension insurers have been able to reduce the risks involved in their investments. The statistics show how sales surged in the first and second quarters of 2015.

Regional analysis over the whole year reveals that the negative net flow of equities and equity-like instruments pertained, above all, to listed shares and holdings issued outside the euro area (EUR -3.5 billion). Also for listed shares and holdings issued in Finland, the net flow was below zero (EUR -0.9 billion). In contrast, the rest of the euro area was the only region where the net flow was positive (EUR +0.5 billion).

In the first half of 2015, optimism took hold of equity markets around the world when the European Central Bank (ECB) launched a massive programme for purchasing debt instruments. On the other hand, the first half of the year was also marked by concerns about China and Greece, which for their part stoked up the sales of equities. The net flow turned positive during the second half of the year, when pension insurers shifted from the selling mode to the buying mode in equities and equity-like instruments. One factor explaining the eagerness to buy may be the rapidly falling share prices at the start of the second half of the year; in other words, pension insurers found suitable stock to buy on the falling markets. On the other hand, the exceptionally low interest rates on bond markets also have an impact on the current trend; in consequence, it is now challenging to hunt for returns on bonds. It is therefore fairly natural that the search for returns shifts to other investment instruments, such as – in part – equities and other equity-like instruments.

In summary, it can be concluded that the past year was a good one for the value changes of equities and equity-like instruments. For instance, the weighted average return on listed shares for TELA's five largest private-sector pension insurers reached 9.3 per cent in 2015 The euro-denominated index values for returns on listed shares in various industrialised countries (including the world index) reflect the strong global trend on the stock markets in 2015. The return indices increased nominally by 8.8–15.9 per cent during the year: the OMXH Portfolio Index by 15.9%; the MSCI World Index by 11.0%; and the MSCI Europe Index by 8.8%.

3.3 Minor changes in the allocation differences of investments between pension institution groups in 2015 – major changes in the long term

The situation for the entire sector consists of the trends for various insurer groups. During the year, private-sector pension insurers' assets increased by EUR 5.4 billion, while public-sector pension insurers' assets increased by EUR 3.0 billion. In total, the private-sector and public-sector assets came to EUR 115.7 billion and EUR 65.2 billion, respectively, at the end of 2015. These changes in the portfolio figures during the year did not alter the relative shares between the public sector and the private sector.

Equities and equity-like instruments increased by 0.9 percentage points in the private sector and declined by 1.5 percentage points in the public sector when compared against the situation at the end of 2014. In the private sector, equities account now for 48.6 per cent of the sector's total investment portfolio. In the public sector, the figure is 49.5 per cent. In the longer term, however, the combined share of equities and equity-like instruments has not changed much in the public sector during the past ten years. In contrast, the structure of the private-sector pension insurers' investment portfolio has undergone a change: the share of equities and equity-like instruments has had a clear rising trend over the long term. For instance in 2005, this investment category accounted only for 32.5 per cent of total investments (cf. 48.6 per cent in 2015). The fact that there are more items with higher risks in the investment portfolio is an indication of the readiness to take risks and to hunt for returns. On the other hand, diversification has also increased; clear internal shifts have taken place in the category of equities and equity-like instruments in the private sector.

In the private sector, the subcategory 'listed shares' accounted for 31.0 per cent of all assets in the private sector In the public sector, the corresponding figure was 38.2 per cent. During the year, the percentage of listed shares decreased by -2.6 percentage points in the public sector, whereas the private sector recorded a rise of 0.7 percentage points. If the developments are examined against the changes that have taken place during the past ten years, statistics indicate how the percentage of listed shares has had a slightly falling trend in the public sector, while the percentage in the private sector has been rising. On the other hand, in both sectors, the percentages in the other subcategories of equities and equity-like instruments have risen during the past ten years, sometimes even rapidly. These subcategories are hedge funds and other equity investments, such as unlisted shares and venture capital investments.

In the private sector, unlisted shares and venture capital investments accounted for about 8.5 per cent of the sector's total assets at the end of 2015. In the public sector, this figure was almost 6.0 per cent. The figures are not significantly different from the situation at the end of 2014. However, examination over a longer term reveals that the corresponding percentages were considerably smaller, for instance, in 2005: about 2.4 per cent in the private sector and close to 1.6 per cent in the public sector.

At the end of December, hedge fund investments accounted for 9.1 per cent of the total in the private sector and 5.3 per cent in the public sector. Also in the case of hedge funds, the changes are not great when seen against the situation at the end of 2014. Correspondingly, in 2005 the percentages were only 2.4 and 0.6, respectively.

The share of fixed-income investments declined by 0.3 percentage points in the private sector and rose by 1.5 percentage points in the public sector, when compared against the situation at the end of 2014. At the end of 2015, the shares were 44.8 per cent in the public sector and 39.8 per cent in the private sector. Among the categories of fixed-income investments, money market investments, in particular, rose markedly in the public sector during the year: as much as 4.4 percentage points to a total of 9.1 per cent of the entire investment portfolio. In contrast, in the private sector, the rise of this category was considerably more modest: 0.7 percentage points to a total of 5.0 per cent. The same trend is observed in the longer term: in the public sector the percentage has been on the rise, whereas in the private sector the annual changes have been smaller.

In relation to the overall structure of the portfolio, changes in the largest subcategory of fixed-income investments, bonds and convertible bonds, were moderate in both sectors during the year: The share of this subcategory declined by 2.7 percentage points in the public sector, while the decline in the private sector was 0.7 percentage points. Over a longer examination period, a clear trend can be discerned, especially in the private sector, as the share of bonds and convertible bonds fell nearly every year, particularly after the end of 2004, until 2010. In 2004, the share was over 50 per cent. Since 2010, the share has stabilized at slightly over 30 per cent. In the public sector, longer-term changes have been smaller and the percentages have varied between 35 and 40 per cent during the past ten years.

The changes have stemmed from net flows and value changes. The changes observed in other investment categories were smaller than in the categories presented above, both in the private and the public sector.

4. Investments outside the euro area reached a share of 50 per cent in 2015

In 2015, the sums invested in Finland increased by EUR 3.4 billion (+0.7 percentage points) when compared against the situation at the end of 2014. The sums invested outside the euro area also increased (EUR +6.0 billion, +1.0 percentage point). In contrast, investments in euro area countries, excluding Finland, declined (EUR -1.0 billion, -1.7 percentage points). At the end of 2015, the investment portfolio was broken down as follows: countries outside the euro area, approximately 50 per cent (EUR 90.5 billion); Finland, 27 per cent (EUR 48.8 billion); and other euro countries, 23 per cent (EUR 41.6 billion).

It is worth noting that the shares of investments in countries outside the euro area have shown a rising trend for roughly ten years, whereas the relative shares of Finland and, in particular, other euro countries have correspondingly shrunk in the investment portfolio. However, 2015 was an

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exceptional year as Finland’s share of all investment assets increased when compared to the share in 2014. It is also worth noting that although the euro amounts of investments in both Finland and other euro area countries have increased over the years, their relative shares have decreased because the total value of the investment portfolio has risen. The long-term changes in the above percentages can partly be explained by the fact that pension insurers have diversified the country distribution of their investments, and thereby their risks, more efficiently than before. Moreover, since pension assets have grown larger, the search for suitable investments also requires looking outside the borders of Finland. When talking about investments, it should always be remembered that, in investing pension assets, the cornerstones are profitability and security. Profitability and security can best be achieved by diversifying effectively and by seeking the best possible investment alternatives – also abroad.

Among domestic investments, the biggest changes during the year took place in money market investments and bonds and convertible bonds. The share of money market investments rose (+9.0 percentage points, EUR +4.7 billion) to a total of EUR 8.8 billion, while the share of bonds fell (-4.6 percentage points, EUR 1.7 billion) to a total of EUR 5.1 billion. Other investment categories remained almost unchanged. Real estate investments remained the largest domestic investment category (EUR 13.8 billion) before listed shares (EUR 13.6 billion), money market investments (EUR 8.8 billion) and bonds (EUR 5.1 billion). Other investment categories accounted for about 1 to 3 billion euros. Money market investments, other equity investments and listed shares have increased their percentages of the investments made in Finland during the past ten years. Instead, some more traditional investment alternatives, such as bonds and convertible bonds, real estate and TyEL relending have lost ground. The volume of investment loans has decreased steadily since 2009.

No significant changes took place in the distribution of investments in the euro area (excluding Finland) in 2015. The largest investment category continued to be bonds and convertible bonds (EUR 23.9 billion), while listed shares ranked second (EUR 11.6 billion). The other categories had a value of about EUR 2 billion. The general trend of investments in the euro area during the past decade has been the increase of listed shares in relation to bonds.

Among investments in countries outside the euro area, the greatest growth during the year was recorded in the amount of bonds and convertible bonds (EUR +4.3 billion) to a total of EUR 30.2 billion. The changes in other investment categories were clearly smaller, about one billion euros on both sides of zero. The largest category outside the euro area was listed shares, EUR 35.6 billion. Hedge funds totalled EUR 14.0 billion, other equity investments EUR 8.3 billion, real estate investments EUR 1.3 billion, and money market funds EUR 1.1 billion.

The changes in percentages depend on two factors: the net flow, or the difference between purchases and sales, and the changes in valuation.

5. Earnings-related pension insurers did well in their investment activities in 2015

The nominal average total return in the earnings-related pension sector came to 5.0 per cent. Owing to a negative inflation trend, the relative return was slightly higher, or 5.2 per cent. The dispersion of returns between various pension institution groups was small: the nominal return for pension insurance companies was 5.0 per cent, for public-sector pension providers 4.9 per cent, and also 4.9 per cent for company pension funds and industry-wide pension funds. The corresponding real returns were 5.2 per cent in the private sector and 5.1 per cent in the public sector and for pension funds.

The nominal annual returns for the seven largest earnings-related pension providers in 2015 ranged between 3.7 and 6.0 per cent.

The best nominal returns were obtained from investments with the highest risks, i.e. equities and equity-like instruments, which gave a return as high as 8.7 per cent. Real estate investments also yielded a good return: 6.3 per cent. By contrast, the return of fixed-income investments was modest: 0.5 per cent. On the whole, the returns of 2015 can be considered solid, especially when one takes into account the sluggish trend of fixed-income investments because of the low interest level. When analysing the overall return, it is also good to note that fixed-income investments weigh heavily in the investment portfolio of the entire pension system; this in turn restrained the growth of overall returns.

More important than studying the return figures for a single year is to examine how well pension insurers have succeeded in their investment activities in the long term. The average annual nominal return for the entire sector and on all investment assets during the past 18 years (1998–2015) is 5.6 per cent. The real return is about 3.9 per cent. In the long term, or between 1998 and 2015, shares and holdings yielded nominally on average 7.3 (in real terms 5.6) per cent, real estate investments 5.8 (4.1) per cent, and fixed-income investments a decent 4.3 (2.6) per cent. For the same period, the nominal return of pension insurance companies was 5.4 per cent. In the public sector, the figure was slightly better, or 5.8 per cent, while the real returns were 3.7 and 4.1 per cent, respectively. Company pension funds and industry-wide pension funds had a nominal return of 6.1 per cent and a real return of 4.4 per cent.

When making comparisons, it is good to remember that requirements for solvency have only been laid down for private-sector pension providers, which in part explains the difference in returns between these two sectors. In the public sector, decision-making bodies guide investment activities by setting allocation limits for each investment category. The Finnish Centre for Pensions uses 3.5 per cent as the assumption for long-term real return when projecting the sustainability of the pension system. The essential information here is that pension insurers exceeded the real return assumption used by the Finnish Centre for Pensions not only in 2015, but especially in the long term.

6. The year 2015 was eventful on the financial market

In the end, the year 2015 proved to be a good one with respect to returns, despite the occasional major market turbulence. Especially in terms of returns on equities and bonds issued by governments with a good credit rating, the year had a very positive start. This was mainly due to the announcement of the European Central Bank (ECB) that it would launch an expanded asset purchase programme (EAPP). The aim of the programme is to accelerate economic growth and inflation in the euro area.

However, the mood shifted after mid-June, when the downturn on the Chinese stock market and the slow progress of loan negotiations with Greece caused uncertainty on the markets. Uncertainty increased even more in the third quarter, when concern over slower economic growth in China and the impacts that shrinking growth would have on the world economy as a whole spread across markets. In addition, the intentions of the Federal Reserve (Fed) to tighten monetary policy, and the associated market expectations, caused restlessness on the financial markets as well as capital drains from the developing economies, owing to increased pressures for strengthening the dollar.

However, the last quarter of the year passed mainly on a positive note when stock markets took remedial action after the downturn in August–September and the central banks – such as the ECB, the Fed and the Chinese central banks – continued to follow a dove-like line in their monetary policies. Nor did the financial reports published by companies give rise to any dramatic turns, whether positive or negative, during the course of the year. Towards the end of the year, the atmosphere on the market was weighed down by the energy sector, which has suffered from the falling prices of metals and raw materials – especially oil. Lower oil prices have also dampened expectations for economic growth in developing oil producing countries; this in turn lowers expectations for the growth of the world economy. Lower growth expectations are always reflected on the financial market as well, usually in a negative way.

However, among individual regions, for instance the euro area has good possibilities for positive development of the real economy, thanks to cheaper oil, the weakened euro and the ECB's lenient monetary policy. On the other hand, the risks affecting the real economy and markets, such as concerns over China's economic growth and the financial problems of other developing economies, should not be belittled. Another factor contributing to uncertainty on the market is speculation about Britain's possible exit from the European Union. In the same way as in 2015, market turbulence will continue on the financial market in 2016.

7. Pension companies' solvency remained at a good level

Earnings-related pension providers in the private sector must meet the statutory solvency requirements. The solvency of pension providers was strong at the end of December. 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 with technical reserves. The solvency ratios of the five largest pension insurance companies ranged between 14.3 and 31.4 per cent at the end of December. At the end of 2014, the corresponding range was between 16.9 and 34.0 per cent.

By contrast, the solvency position of the five largest pension insurance companies was between 1.4 and 2.2 at the end of 2015. The year before, the corresponding figures ranged between 1.6 and 2.2. 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 behind this link.