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Earnings-related pension assets hit EUR 221 billion at the end of 2020

Investment assets, an element of the financing of earnings-related pensions, pulled through the calamity of the COVID-19 year 2020 largely unscathed. Despite the pandemic, investment assets increased by around EUR six billion last year, totalling EUR 221 billion at the end of December. The increase in assets was due to the brisk recovery of equity investments towards the end of the year. Rapid economy-boosting measures were effective in preventing the spread of the impacts of the pandemic in the financial sector. Positive results in vaccine development created a positive mood in the stock market and the key indices reached an all-time high at the end of the year.

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

- Return on investments nominally 4.8 per cent in 2020
- Roller coaster and merry-go-round of the market
- Basic facts about our investment statistics

Return on investments nominally 4.8 per cent in 2020

- Investment assets of the earnings-related pension system, in total: EUR 221 (*) billion
    - Investment assets in the private sector: EUR 138 billion
    - Investment assets in the public sector: EUR 83 billion
- Growth in the final quarter of the year: about EUR 12 billion
- Investments in equities and equity-like instruments: EUR 115 billion, share 52 per cent of all investment assets
- Fixed-income investments: EUR 70 billion, share 32 per cent
- Real estate investments: EUR 19 billion, share 9 per cent
- Alternative investments: EUR 17 billion, share 8 per cent
- Returns on investments for the whole year 2020: 4.8 per cent nominally and 4.6 per cent in real terms.

(*) According to the financial statements of earnings-related pension providers, investment assets totalled approximately EUR 222 billion on 31 December 2020. The amount of investment assets presented here differs from the figure in the financial statements by almost one billion. The reason for the differences lies in the statistical processes applied to derivatives. We will specify the amount of assets later.

In investment distribution, the relative shares of the various asset categories changed slightly during 2020. The share of fixed-income investments (32%) diminished by about two percentage points. The

share of equities and equity-like instruments [1] (52%) increased by two percentage points. The share of real estate investments (9%) remained virtually unchanged, while the share of alternative investments [2] (8%) diminished by less than one percentage point. In the longer term, i.e. during 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 earnings-related pension providers to seek replacement investments for fixed-income investments within the scope of the solvency rules. 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 distribution of investments changed only little during the past year. Correspondingly, the share of investments in Finland rose by two percentage points. The shares of investments elsewhere in the euro area and outside the euro area both fell by about one percentage point. At the end of the year, approximately one quarter of investment assets (25%) was invested in Finland, less than one fifth (17%) 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.

While the total sum of investment assets has been rising, the longer-term strategy has been to diversify investments increasingly into the global investment market. During the 2010s, the share of domestic investments in pension portfolios has shrunk from over one third at the start of the 2010s to about a quarter. At the same time, the share of investments elsewhere in the euro area has also diminished from one third to less than one fifth. On the other hand, the share of investments outside the euro area has risen from 34% at the beginning of the decade to almost 60%.

The returns on pension investments must be examined over the longer term; changes occurring during an individual 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 increase in step with economic growth and inflation. It should be noted that the selection of the examination period is also important. This is illustrated by comparing, for example, the average returns over 20 and 24 years (right side of the figure). Over a period of exactly two decades, the annual real return is on average 3.7 per cent, whereas for the whole period 1997—2020 covered by our statistics, the real returns have averaged 4.3 per cent per year.

Finnish earnings-related pensions are financed using a partly funded system. For this reason, investment assets placed in funds (more than 200 billion) do not need to match the total amount of pension liabilities accrued so far (i.e. all future pensions) (almost 700 billion). Instead, most of the

pensions paid annually continue to be covered directly from the earnings-related pension contributions collected during the year. In the future, the role of funds in financing pensions will increase further as the age structure of the population changes.

Pensions are financed not only by pension contributions but also by investment assets placed into funds and the subsequent returns. In addition, since 2014, 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 2020, the entire pension sector collected about three billion euros of pension contributions into funds, while the sum taken out for pensions paid totalled about six billion. This means that the net sum used for pensions from funds and pension fund returns totalled EUR three billion.

Thanks to the returns on investments made during the preceding decade, the **solvency of our pension insurers** is still at a secure level. In the private sector, i.e. pension insurance companies, company pension funds, industry-wide pension funds, and the Seafarers' Pension Fund, the average solvency ratio, i.e. the ratio of pension assets to technical provisions, was 128 per cent at the end of November. With respect to the market instability caused by COVID-19, the Financial Supervision Authority collected summary information from earnings-related pension insurers until the end of November.

At the end of December, the solvency figures of pension insurance companies were between 123.7 and 130.2 per cent. Solvency positions ranged between 1.6—1.9. Although solvency ratios and positions fluctuated during the year, they were roughly at the same level as they had been at the end of the previous year. Thanks to the buffers meant for rainy days, pension insurers are also able to withstand worse periods on the financial market, as happened in the wake of the COVID-19 pandemic last spring.

Roller coaster and merry-go-round of the market

The past year began in a positive market mood as the new decade started. At that time, few could have guessed that the year would become one of the oddest investment years of recent decades. At the onset of the COVID-19 pandemic, outright panic hit the market at the end of February and the world's most important stock index, the S&P 500, plunged by more than thirty per cent in a matter of weeks, with other indices abroad following suit.

A similar roller coaster type dive within the same period of time had last been seen in connection with the 2008 financial crisis. At that time, too, markets were poised very strongly against risks, which sharply reduced the valuations of investments and at the same time increased the mutual correlation between different asset categories.

Although the lockdown of the real economy hit the demand for travel and services especially hard, causing collapse in the blink of an eye, the rapidly agreed stimulus packages smothered the fire like a fire blanket. Capital markets remained operational as the U.S. Federal Reserve cut its interest rate

in a quick time window from 1.75 per cent to close to zero. The main task of the stimulation was to secure corporate financing in the short term in order to avoid a complete market chaos of the financial crisis type. The effective lockdown measures in connection with the pandemic, together with the stimulus measures, created confidence among investors, and the stock market began to recover vigorously already in the second quarter.

The global lockdown launched in spring responded to the rapidly rising numbers of coronavirus infections. At the same time, the slowly spreading virus lulled the market into a kind of respite in summer, before the second wave of the coronavirus. In autumn, a somewhat incredulous atmosphere prevailed in the stock market in particular, as share prices continued to recover despite the fact that the world was largely locked down, awaiting further developments of the pandemic.

Many who followed the investment market last year wondered why the prices of capital goods kept rising even though the economic outlook seemed really uncertain. One reason for this was that fewer service-focused companies are listed on the world's stock exchanges, and the lockdown measures hit the unlisted services sector the hardest. However, the Chicago Board Options Exchange Volatility Index (VIX), which describes market expectations and the general mood like a barometer, no longer showed the same low pressure during autumn and the rest of the year as in February–March (figure below).

Promising news from the vaccine front during the last quarter propelled the market to a steady rise. There was simultaneous excitement around the world over both the success of the U.S. presidential election and the election results. However, as the nerve-wracking countdown progressed, it soon became clear that the impact on financial markets would remain tepid. The effective stimulation, combined with low interest rates, created a veritable merry-go-round on the market, and the S&P 500 index climbed to an all-time high, first in November and a second time in early December.

- The S&P 500 index offered a strong annual return in dollars — 16.3 per cent — but at the same time the dollar weakened against the euro by about 9 per cent during the year
- The OMXH25 index, which depicts the development of the largest companies on the Helsinki Stock Exchange, rose in the wake of the world's stock exchanges by 8.6 per cent during the year
- During the same period, the OMXS30 index of the Stockholm Stock Exchange gave a weaker yield: 5.8 per cent.

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 3.9 billion at the end of 2020.