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Earnings-related pension assets EUR 233 billion at the end of March 2021

Investment assets contributing to the financing of the earnings-related pension system increased during the first quarter of 2021. The assets rose by about EUR 11 billion from the turn of the year, totalling EUR 233 billion at the end of March. The favourable trend of investments in equities affected the growth of assets during the first quarter of the year, but at the same time the real yields from fixed-income and real estate investments were negative. In the first quarter of the year, the launch and progress of coronavirus vaccinations reinforced general confidence on capital markets. This had a favourable effect on the development of equity investments, in particular.

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

- Returns on investments for the first quarter of the year: 5.1 per cent in nominal terms and 4.1 per cent in real terms
- Launching of vaccinations supported the investment market
- Basic facts about our investment statistics

Returns on investments for the first quarter of the year: 5.1 per cent in nominal terms

- Investment assets of the earnings-related pension system, in total EUR 233 billion
  - Investment assets in the private sector EUR 145 billion
  - Investment assets in the public sector about EUR 87 billion
- Increase during the first quarter about EUR 11 billion
- Investments in equities and equity-like instruments: EUR 123 billion, share 53 per cent of all investment assets
- Fixed-income investments: EUR 71 billion, share 31 per cent
- Real estate investments: EUR 20 billion, share 8 per cent
- Alternative investments: EUR 19 billion, share 8 per cent
- Returns on investments for the first quarter of the year: 5.1 per cent in nominal terms and 4.1 per cent in real terms

Changes in the **relative shares** of the various asset categories were mainly cosmetic during the first quarter. The share of fixed-income investments (31%) fell by one percentage point. Correspondingly, the share of equities and equity-like instruments [1] (53%) rose by about one percentage point. The shares of real estate investments (8%) and alternative [2] investments (8%) remained basically unchanged. The changes in the relative shares of the various asset categories are due to a longer trend, where the relative share of fixed-income investments has almost halved during the last fifteen years. To the extent allowed by the solvency regulations, earnings-related pension insurers have replaced fixed-income investments with other investments having higher return expectations, such as equities, private equity and alternative investments.

[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.

There were no significant changes in the **regional distribution of investments** during the first quarter of the year. The relative shares of both domestic and euro-area investments decreased by half a percentage point each, while the share of non-euro-area investments increased by one percentage point. At the end of March, less than a quarter of investment assets (24%) was invested in Finland, less than one fifth (16%) elsewhere in the euro area, and more than half (59%) in countries outside the euro area. Apart from changes in the value of investments, changes in the relative shares of investments are affected by net flows — that is, the difference between purchases, sales and maturities.

In the longer term, more and more investments have been diversified on the global investment market. During the past decade, the share of domestic investments in pension portfolios has shrunk from over one third to under a quarter. At the same time, the share of investments elsewhere in the euro area has also diminished from one third to clearly less than one fifth. On the other hand, the share of investments outside the euro area has risen from 34 per cent at the start of the last decade to almost 60 per cent.

In the first quarter of 2021, the returns of the six largest operators for each investment category were as follows:

- Average returns on equity investments: 9.4 per cent in nominal terms and 8.4 per cent in real terms
- Average returns on fixed-income investments: 0.4 per cent in nominal terms and −0.6 per cent in real terms;
- Average returns on real estate investments: 0.8 per cent in nominal terms and –0.2 per cent in real terms.
- Average returns on alternative investments: 3.1 per cent in nominal terms and 2.1 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:

- 2016–Q1/2021 (about 5 years): 6.3 per cent in nominal terms and 5.3 per cent in real terms
- 2011–Q1/2021 (about 10 years): 5.9 per cent in nominal terms and 4.6 per cent in real terms
- 2001–Q1/2021 (about 20 years): 5.3 per cent in nominal terms and 3.9 per cent in real terms
- 1997–Q1/2021 (about 24 years): 6.0 per cent in nominal terms and 4.5 per cent in real terms

Finnish earnings-related pensions are financed using a partly funded system. For this reason, investment assets placed in funds (233 billion) do not need to match the total amount of pension liabilities accrued so far (i.e. all future pensions) (about 700 billion). Instead, most of the pensions paid annually continue to be covered directly by 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, 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. For instance, in 2020 (preliminary data), the entire pension sector collected EUR 2.7 billion of pension contributions into funds, while the sum taken out for pensions paid totalled EUR 5.8 billion. This means that the net sum used for pensions from funds and pension fund returns totalled over EUR 3 billion.

Thanks to the returns on investments, the solvency of our pension insurers is at a secure level. Solvency ratios and solvency positions rose slightly during the past quarter. At the end of March, the solvency ratios of pension insurance companies ranged between 125.0 and 133.5 per cent. Solvency positions ranged between 1.6 and 1.9. Thanks to the buffers meant for rainy days, pension insurers are also able to withstand worse periods on the financial market.

Launching of vaccinations supported the investment market

A year ago in February, the coronavirus pandemic plunged the market into a momentary free fall. At that time the world's main stock market indices plummeted more than thirty per cent in a month and the market fear factor — the volatility index VIX — jumped to readings that were last seen in the 2008 financial crisis. Over the past year, reflation measures taken by governments and central banks kept financial markets afloat while lockdown restrictions in the real economy slowed the spread of the coronavirus. Although certain sectors of the economy, such as tourism and services, suffered drastically during the pandemic, no massive waves of bankruptcy were seen. At the end of last year, stock exchanges seemed to have recovered from COVID fully in terms of stock prices, although the vaccine test results, for example, were still only promising.

Against this background, the current year began in a rather extraordinary way in the financial sense. Stock markets continued their rising trend, as vaccinations were finally started in Western countries. In January, an astronomical stimulus package of nearly two trillion US dollars (USD 2,000,000,000,000) was approved in the United States and appeared on the market. The hefty revival measures, coupled with well progressing vaccinations, raised stock valuation levels. What's more, especially the sectors that had performed less well in the previous year, such as the energy and banking sectors, recovered throughout the world.

Although the atmosphere on the stock market early in the year bordered on real market boom, the same could not be said of interest rates. Instead, the interest rates of ten-year loans in the main issuer countries, such as the United States and Germany, began to rise. US lending rates, in particular, rose sharply in February as the market reacted to the massive relief bill passed to stimulate the economy. In the United States, the first quarter of the current year was the second worst quarter in forty years.

The rise in interest rates is also important for pension investors managing large fixed-income investments, because the valuation of the bonds in the portfolios decreases along with rising rates. For this reason, the bonds floated by public entities showed mainly negative yields at the end of March. Yields on corporate loans with higher credit ratings were also close to zero, and only high-yield corporate loans saved the fixed-income investor during the first quarter of the year.

After a fairly satisfactory first quarter, it is interesting to see what kind of investment year awaits us.

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.