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Earnings-related pension assets EUR 241 billion at the end of June 2021

The second quarter of 2021 continued along the same lines as the first quarter: the investment assets that contribute to the financing of the earnings-related pension system increased by approximately EUR 8 billion during the quarter and totalled EUR 241 billion at the end of June. The highly favourable trend of listed shares – and especially other equity investments – had an impact on the growth of assets during the first half of the year. In the second quarter, the progress made in coronavirus vaccinations and corporate performance strengthened overall confidence in investment markets, pushing the major global stock indices to new all-time highs.

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

- Nominal return on the investment of pension assets from the turn of the year 9.2 per cent
- Recovery led by stock markets
- Basic facts about our investment statistics

Nominal return on the investment of pension assets from the turn of the year 9.2 per cent

- Investment assets of the earnings-related pension system, in total EUR 241 billion
    - Investment assets in the private sector EUR 150 billion
    - Investment assets in the public sector EUR 91 billion
- Growth in the second quarter about EUR 8 billion
- Investments in equities and equity-like instruments EUR 129 billion, or 54 per cent, of all investment assets
- Fixed-income investments EUR 73 billion, share 30 per cent
- Real estate investments EUR 20 billion, share 8 per cent
- Alternative investments EUR 19 billion, share 8 per cent
- Return on investments from the turn of the year 9.2 per cent in nominal terms and 7.7 per cent in real terms.

The changes in the **relative shares** of the various asset categories were mainly cosmetic also during the second quarter. The share of fixed-income investments (30%) fell by slightly less than one percentage point. Correspondingly, the share of equities and equity-like instruments [1] (54%) rose by about one percentage point. The shares of real estate investments (8%) and alternative [2] investments (8%) remained virtually unchanged. The changes in the relative shares of the various asset categories stem from a longer trend, where the relative share of fixed-income investments has been cut in half during the last fifteen years. To the extent allowed by the solvency regulations, earnings-related pension providers have replaced fixed-income investments with other investments having higher return expectations, such as equities, private equity and alternative investments. At the same time, the solvency framework has been updated to better reflect the modern investment activities of pension insurance companies and the risks of the global investment market.

[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 second quarter of the year. At the end of June, about one quarter of investment assets (24%) was invested in Finland, less than one fifth (16%) elsewhere in the euro area, and more than half (60%) 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.

As the total volume of pension investments has increased, they have increasingly often been diversified on the global investment market. During the past decade, the share of domestic investments in pension portfolios shrank from over one third to under one quarter. At the same time, the share of investments elsewhere in the euro area also decreased 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 turn of the previous decade to 60 per cent.

In the first half of 2021, **the returns for each investment category**, calculated for the whole sector, were as follows:

- Average returns on equity investments: 16.7 per cent in nominal terms and 15.1 per cent in real terms
- Average returns on fixed-income investments: 1.3 per cent in nominal terms and −0.1 per cent in real terms
- Average returns on real estate investments: 2.1 per cent in nominal terms and 0.7 per cent in real terms
- Average returns on alternative investments: 5.6 per cent in nominal terms and 4.1 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 longer-term returns of the pension system appear stable:

- 2016–Q2/2021 (about 5.5 years): 6.7 per cent in nominal terms and 5.7 per cent in real terms
- 2011–Q2/2021 (about 10.5 years): 6.1 per cent in nominal terms and 4.9 per cent in real terms
- 2001–Q2/2021 (about 20.5 years): 5.4 per cent in nominal terms and 4.0 per cent in real terms
- 1997–Q2/2021 (about 24.5 years): 6.1 per cent in nominal terms and 4.6 per cent in real terms

Finnish earnings-related pensions are financed using a partly funded system. For this reason, investment assets placed in funds need not match the total amount of pension liabilities accrued so far (i.e. all future pensions) (about 700–800 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, the entire pension sector collected EUR 2.7 billion of pension contributions into funds, while the sum taken out for pensions paid totalled EUR 6.0 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 providers** is at a secure level. Solvency ratios and solvency positions rose slightly during the past quarter. At the end of June, the solvency ratios of pension insurance companies ranged between 126.7 and 135.6 per cent. Solvency positions ranged between 1.6 and 1.9. Thanks to the buffers intended for rainy days, pension providers are also able to withstand worse periods on the financial market.

Recovery led by stock markets

On the financial markets, the second quarter of the year saw a continuation of the upward swing of the first quarter while the economy recovered globally. In the United States, the accelerated economic recovery at the end of the first quarter began to slow down in April–June. However, this, did not prevent the key stock indices (Dow Jones, S&P 500) from reaching all-time highs in May and June. The increase in economic activity, together with helicopter money at the outset of the year, sped up inflation to close to 5 per cent in the second quarter.

Despite rising inflation, the central bank Fed kept its interest rate low and revealed no plans to reduce intervention purchases. However, recovery in the second quarter was so brisk that economic experts considered it more or less necessary that tighter monetary policy and reduced securities purchases would be introduced.

In Europe, too, progress made in vaccination and rising vaccine coverage led to strong recovery in the euro area economy after a slowdown that had continued earlier in the year. The Purchasing Managers' Index in the euro area rose to its highest level since June 2006. Inflation in the euro area rose to 1.9 per cent in June, which is slightly less than the 2 per cent level recorded in the previous month.

The EU recovery package adopted last year in Brussels also advanced in May. The package includes the multiannual financial framework for 2021–2027 and the EUR 750 billion recovery instrument. The Commission approved the first national recovery plans presented by the Member States (Spain and Portugal). This has clearly been welcomed by the financial markets.

The MSCI AC World Index, which tracks global stock markets, rose by a total of +16.1 per cent when measured in euros during the first half of the year. The World Responsible Investment Index offered a still slightly better yield of +16.8 per cent. Although the equity distributions of pension investments do not directly correspond to the diversification of the global index, the nominal return of +16.7 per cent on equity investments in the first half of the year was fairly close to the returns of global indices.

In the second quarter, the best returns on equity investments were provided by growth companies and private equity investments. Private equity investments are investments in unlisted companies, which are estimated by the lead investor to have development potential.

In terms of fixed-income investments, this year has been challenging for pension investors managing large fixed-income portfolios. The valuation of bonds in the portfolios declines as interest rates rise. With market interest rates rising slightly in the second quarter, general government bonds also showed mainly negative yields at the end of June. In fixed-income investments, returns were obtained on corporate loans, where nominal returns for the first half of the year were close to a few 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 placed 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.