"Investment of statutory employment pension assets in a diversified way in private pension institutions"

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Summary

In Finland the administration of the statutory employment pension scheme is decentralised in private, separate pension institutions. The article analyses how pension institutions' independent decision-making concerning the investment of employment pension funds supports the overall objectives set for the employment pension scheme. Pension institutions can independently decide on their investments taking account of the limitations laid down in legislation, and they are responsible for the success of their investments up to a possible bankruptcy. However, if a pension institution becomes bankrupt and its funds are not sufficient to cover its pension liabilities, the pension institutions are ultimately jointly and severally liable.

To begin with, the article describes shortly the Finnish employment pension scheme and its financing. Provisions on the benefits, objectives and principles of the statutory employment pension scheme are laid down in the employment pension legislation concerning all pension institutions. The article also deals with the administration and decision-making procedures of pension institutions in the different pension plan options.

The analysis is based on the investment plans and the data on annual accounts of pension institutions. In its investment plan a pension institution sets the goals for its investments, and the realisation of the plan can be assessed on the basis of the data on the annual accounts. At the end of the article there is a short description of the mutual competition of pension institutions in the diversified employment pension scheme.

"L'investissement des moyens legayx de la retrite du travail decentralise dans les etablissements d'assurance de retraite prives."

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Résumé

En Finlande, l'exécution du système légal de retraite du travail est décentralisée en établissements d'assurance de retraite privés et individuels. L'article analyse comment la prise de direction concernent l'investissement des moyens de la retraite du travail indépentent des établissements d'assurance de retraite soutient les objectifs du système de retraite du travail. Les établissements d'assurance de retraite peuvent independamment décider de leurs investissements d'après les restrictions législatives et sont responsables de la réussite des investissements jusqu'à la faillite. En dernier ressort, les établissements d'assurance de retraite ont pourtant une responsabilité commune, si l'institution de retraite débouche dans la faillite et les moyens de l'institution de retraite ne suffisent pas pour les engagements obligatoires de retraite.

Au début de l'article le système de retraite finlandais et son financement sont décrit en bref. Les bénéfices, les objectifs et les principes du système légal de retraite du travail sont promulgués sous la législation de retraite du travail concernent tous les établissements d'assurance de retraite. Dans l'article on décrit aussi l'administration des établissements d'assurance de retraite et la prise de direction dans les différents systèmes de retraite alternatifs.

L'analyse se base sur les plans d'investissement et l'information sur l'ârret des comptes. Dans son plan d'investissement, l'établissement d'assurance de retraite se fixe les objectifs de ses investissements, et sur la base de l'information sur l'ârret des comptes on peut apprécier la réalisation du plan. Au fin de l'article on décrit brièvement la concurrence réciproque entre les établissements d'assurance de retraite dans le système de retraite décentralisé.

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1. Description of the system

1.1 Different pension schemes

In Finland the pension cover of employees and self-employed persons is divided in two components: national pension and employment pension. The purpose of national pension is to provide a reasonable minimum income for persons with no employment pension income or whose employment pension is small. A sufficient employment pension wholly excludes the payment of a national pension.

The provision of statutory employment pension cover is divided in the pension arrangements of the private and the public sector. The public sector's pension arrangements include the pension schemes of the state, the local authorities, and the church. The contents of the pension cover of the private and public sectors differ considerably in details but the main principles are similar. There are however marked differences in the technique and regulation of the financing of pensions.

The employment pension cover is based on the mandatory, statutory employment pension. It is possible to complement the statutory employment pension by voluntary supplementary pension arrangements.

1.2 Content of the article

This article analyses the investment of pension assets and focuses exclusively on the investment of the pension assets of the private sector. Thus the national pensions, public sector pensions and voluntary supplementary pension arrangements referred to in point 1.1. above are excluded from the review. The self-employed persons' pensions of the private sector are likewise excluded from the review.

In consequence, this article only deals with the private sector wage and salary earners' employment pensions, the pension assets for which have accrued as appears from point 1.3.

1.3 Employment pension cover and its financing

The Finnish statutory employment pension cover is very comprehensive. All wage and salary earners and self-employed persons are covered by this statutory pension scheme. There is no upper limit, i.e. pension ceiling, for the amount of an employment pension. For instance the pension benefits and the responsibility for providing pension cover is regulated at the level of law. The pensions are taxable income.

The purpose of the employment pension is to safeguard employees and self-employed persons the level of consumption they have had during the time in employment. A full employment pension is

60 per cent of the pay, and it is earned in about 40 years. The pension entitlement is retained up to its full amount after an employment relationship or entrepreneurship has ended (entitlement to a paid-up policy). The general pensionable age in respect of old age pensions is 65 years.

A partly funding technique is applied in the financing of the employment pensions of the private sector wage and salary earners. In this technique part of the premiums are used immediately (pay-as-you-go) for financing the current pensions and administrative costs and part of them are transferred to a fund to wait for the payment of the pension later on. The law defines the principles according to which pensions are funded. The returns on the pension funds are used to balance the growth of premiums. From the point of view of the national economy funding is saving. It boosts the investment business and strengthens the production basis of the national economy. Thus it also improves the prerequisites for managing the future pension expenditure.

The interest used in calculating the technical provisions of employment pension institutions has been 3 per cent since 1997, whereas the requirement for the annual minimum yield (calculated interest rate, CIR) on the assets constituting the cover of pension liability set for all pension institutions is higher. The Ministry of Social Affairs and Health confirms this requirement. The CIR can be adjusted if necessary. The part of the returns on investments exceeding the CIR is used for increasing the solvency margins and/or reduction of premiums.

The yield equivalent to the difference of the CIR of 5.75 per cent (in 2001) and the interest used in the calculation of technical provisions, 3 per cent, is used for strengthening the funding of pensions.

1.4 Independent pension institutions

The statutory employment pensions of the private sector are administered by private pension institutions: pension insurance companies, pension funds, pension foundations and four separate special pension institutions. At the beginning of 2001 the pension cover under the Employees' Pensions Act TEL (TEL covers roughly one half of the Finnish workforce) was in charge of 6 pension insurance companies, 8 pension funds and 37 pension foundations. The Central Pension Security Institute is the central body administering the scheme.

The administration of the statutory employment pension cover is regulated in detail in the law. Within the framework of the law pension institutions have, however, independent decision-making powers. Thus, pension institutions decide independently, among others, on the investment of the pension assets that have accrued from premiums. But since the statutory pension cover is a part of social security, there is a system for guaranteeing the pension benefits on the basis of joint and several liability in case of a pension institution's insolvency.

Any decisions regarding a pension institution's investment business, such as drawing up of an investment plan, are taken by its board of directors. An investment plan is drawn up taking into account the institution's operating environment, the costs of its operations and the expected development of pension liability. The provisions on covering the pension liability and on the solvency of the pension institution have to be complied with, in addition.

The boards of directors of pension institutions include representatives of both the employer and the employee party. In pension foundations, the employer party may have a majority of the seats in the board of directors.

1.5 Payment techniques

The amount of the premiums collected by employment pension insurance companies is fixed in advance.

The premiums of pension foundations and pension funds must be so high that they suffice together with the annual net returns on investments to cover the payments and administration costs incurred through pensions. The premium is thus determined afterwards in the context of the annual accounts.

In pension foundations and pension funds the practice is that employers are up to their own bankruptcy jointly and severally liable for all costs of the pension institution, contrary to that in the employment pension insurance companies.

2. Starting points, objectives and expected impacts of the reforms of investment business within the employment pension scheme

In Finland the grounds for the financing of employment pensions were chosen in 1962, when the TEL entered into force. The technique chosen was applied without major problems up to the beginning of the 1990s. The changes that took place in the investment environment for employment pension assets from the outset of the 1990s necessitated a comprehensive revision of the provisions concerning the investments of and solvency requirements for employment pension institutions. The investment environment for pension institutions changed e.g. so that the demand for premium bond loans granted by pension institutions among the policyholders/employers fell considerably. The reforms were effected in stages from 1996 on.

The central goal of the investment of employment pension assets is to safeguard the financing of pensions from the point of view of, on the one hand, the solidity of investments and, on the other hand, an optimal return on the investments. The primary motive that lied in the background of the reforms was to ensure the implementation of this goal in the changed circumstances.

The reforms were based on the objective set for the investment of pension assets to reach a higher rate of returns in the long term. The final goal is to reduce the pressure to raise the employment pension contribution and thus to support the sustainability of the pension scheme. Employment pension institutions should thus be capable of investing to a larger extent in lines of investment whose expected yield in the long term is higher but which are also associated with a higher risk. In order to be able to bear the higher investment risk the solvency buffers of employment pension institutions, i.e. solvency margins, were increased and prudential supervision was improved.

The requirement for pension institutions' solvency margin was determined to depend on the riskiness of the investment distribution. Such lines of investment whose yield and values fluctuate heavily presuppose a bigger risk buffer than do less risky lines of investment. For instance, a pension institution that invests a major part of its assets in shares and real estates shall have a bigger solvency margin than e.g. a pension institution that mainly invests in government bonds. The board of directors of a pension institution and the supervisory authority can monitor the development of the solvency of the institution by means of key figures, and in case of weakened solvency they can steer the operations of the pension institution appropriately at a sufficiently early stage.

As it was not possible to increase pension institutions' solvency margins up to the target level by means of the annual outcomes, the increase in pension institutions' solvency buffers was realised at the pension scheme level from 1997 to 1999 so that a part of the surplus of the institutions' investment business was transferred to their solvency margin. Since the year 2000 the pension institutions have themselves been responsible for maintaining and increasing their solvency, and it takes place either by transferring the surplus of investment business in its entirety or in part to the solvency margin. Pension foundations and pension funds can increase their solvency margin by premiums, too. A pension institution may use its solvency margin for balancing the fluctuation in the annual returns and values of their investment instruments. Since a pension institution's need for solvency margin depends on the riskiness of its investment distribution, when deciding on their own investment policy the board of directors of the pension institution also decide on the need for solvency margin bound to the investment distribution and on the methods of maintaining it.

Implementing the objectives of the reforms of investment business in practice is the responsibility of pension institutions operating independently. At the pension scheme level the investment business of pension institutions is, however, subject to the same minimum requirement for returns (CIR income). The goal is to keep the rate of the CIR as high as allowed by the pensions institutions' expected returns on investments. The rate of the interest is deduced from the expected long-term yield from the different lines of investment, taking into account the pension institutions' investment distribution and solvency at a given moment. In practice, the annual yields on investment business in pension institutions constitute, vis-à-vis this interest, either surplus or deficit. The pension institution may buffer this fluctuation through its solvency margin, on certain conditions.

The starting points and objectives of the reforms described above are common to all pension institutions and can be summarised as follows:

- taking into account changes in the investment environment in directing the investments of pension institutions;
- ensuring the solidity of investments by means of a sufficient solvency margin;
- reaching a higher rate of returns in the long term;
- keeping the CIR as high as possible.

The differences in payment techniques between pension foundations and pension funds vis-à-vis pension insurance companies are dealt with at point 1.5. In regard to these institutions the starting points for the reforms of investment business and their expected impacts therefore differ to some extent from those concerning pension insurance companies. To begin with, there is the difference that there is a direct connection between the return on pension foundations' and pension funds' investments and premiums. The annual surpluses according to the accounting records of investment business can be used, instead of for complementing the solvency margin, for reducing the premiums for the year, if the solvency margin is sufficient. On the other hand, some pension foundations' investment distribution is one-sided so that the assets constituting the cover of pension liability have been lent in their entirety to sponsoring undertakings. A sponsoring undertaking pays the pension foundation as interest for the loan at least the CIR referred to above.

The aim of the reforms of investment business in respect of pension foundations and pension funds is to spread the investments so as to improve in the long term the yield from the spread portfolio compared with the earlier yield, to make it steadier and thus more easily foreseeable. Once implemented, the higher yields will ease the pressure to raise premiums in the long term. Furthermore, as far as pension foundations are concerned, the implementation of the objectives of the reforms will result in an essential change in the structure of the investments of a pension foundation that lends to employers. In addition to the summary above, the additional objectives concerning pension foundations and pension funds can be summarised as follows:

- the aim of the spreading of investments is to obtain a better yield;
- easing the pressure to raise premiums in the long term;
- changing the investment structure of pension foundations investing, as a rule, in loans to employers.

3. Objectives set out in investment plans for investment business

The aim of this chapter is to analyse the investment plans of pension institutions for the year 2001. The plans of some institutions concern the year 2000, but it can be supposed that the changes in their objectives in successive years are not significant. The analysis includes 51 pension institutions: 6 pension insurance companies, 3 special pension institutions, 8 pension funds and 34 pension foundations. The following principles are observed:

- the analysis is based exclusively on the lines of action defined in the investment plans;
- the analysis picks from the investment plans only such lines of action that are considered to be linked to the objectives set for the pension scheme level in law drafting.

3.1 Taking account of the investment environment in directing the investments of pension institutions

Less than a third of the pension institutions (14/51) incorporate in their investment plans an analysis of the operating and investment environment. Apart from all pension insurance companies, also some other pension institutions have analysed the expected developments in their operating environment. There are however big differences in the extent and depth of the analysis between the pension institutions. It appears from the investment plans of some pension institutions, mainly those of pension foundations, that the expertise of the sponsoring undertaking has been made use of, in addition to that of the pension institution's own investment organisation.

As a result of the analysis for instance future developments of the investment market have been anticipated, and investments have partly been directed on the basis of it. It should be noted that in a large pension institution the targeting of investments can only be altered in the long term. On the other hand, the analysis incorporates relatively thorough risk analyses, and decisions on the level of solvency of the pension institutions have been taken on the basis of them. More generally, the analysis has provided a basis for assessing the expected returns on investment instruments in the short and long term and the related risk. Suitable reference indexes have likewise been selected on the basis of the analysis.

The majority of pension institutions (32/51) set out in their investment plans some quantities or key figures deduced from the investment market. In most cases these figures are annual expected yields from specific investment instruments. The next most common ones are the choice of the reference indexes related to assessment of the profitability of investments and assessment of the expected variation (risk) related to the expected yield.

3.2 Safeguarding the solidity of investments by means of a sufficient solvency margin

Some pension institutions (10/51) have not taken a stand either on the present or the aspired level of solvency in their investment plans.

In some pension institutions assessing the demand for the solvency margin is based on the above analysis of the investment environment taking into account the instruments included in the own investment portfolio. Most pension institutions have set a target level for their solvency. This target level has been set by means of the so called solvency position key figure describing the state of solvency. In the solvency mechanism a pension institution's solvency position key figure indicates whether the pension institution's solvency margin can be considered, in relation to the amount of technical provisions, adequate (in the target zone), reduced (in the zone of limited freedom) or inadequate (in the crisis zone).

Of all pension institutions 20/41 set their solvency target fairly high: at least on the mean level of the target zone. For sixteen (16/41) institutions the aspired level is to remain in the target zone, and only 5/41 pension institutions have set their target level at the lower limit of the target zone or close to it.

Pension foundations and pension funds have, compared with pension insurance companies, a larger selection of means to maintain their solvency. Of these pension institutions 16/42 report in their investment plans by which methods they intend to achieve or keep the planned level of solvency.

Three pension institutions (3/51) have set out as the only principle regarding the solidity of investments the requirement laid down in the law concerning the solid investment of assets, without mentioning any practical measures.

3.3 Achieving a higher rate of return in the long term

A major part of pension institutions (18/51) have incorporated in their investment plans a principle according to which, apart from the net result, any changes in the real value of investments are annually taken into account in estimating the profitability of investments. Of these pension institutions 13/18 set in practice as their profit target to achieve or exceed the CIR income. On the other hand, 9/18 of these pension institutions have deduced the investment instrument specific annual expected yield from the investment market. None of these pension institutions have estimated in their investment plans the expected yields in the long term according to investment instrument.

It appears from almost half (22/51) of the investment plans of the pension institutions that the institution aims to increase the returns on investments compared with the present level. As means to that end pension institutions plan to adjust their investment distribution to be more risky, to complement their solvency margin in order to be able to aspire higher yields, to diversify their investment portfolio further, to seek for new investment instruments and to develop their professional skills. In addition, some pension institutions carry out thorough analyses and active monitoring with a view to increasing the efficiency of their investment business.

Altogether 20/51 pension institutions report in their investment plans that they aim to change their investment distribution so as to be more risky. Of these institutions 7/20 set as the target to keep their premium competitive, or to keep it low, or steady and foreseeable.

3.4 Keeping the CIR as high as possible

CIR represents the profit target for pension assets in the long term. CIR is the minimum requirement for yield that is common to all pension institutions, and the related target set in the pension scheme is to keep the CIR rate as high as possible. As the pension institutions' investment distribution and solvency are taken into account in determining the CIR, the rate of CIR is a consequence of the investment business carried on by the pension institutions. An individual pension institution thus does not set actual targets for the rate of CIR but the profit targets of the investment policy pursued by the pension institutions are reflected in the rate of the CIR. Determining the CIR is however significant in the sense that it steers to some extent the pension institutions' operations.

On the other hand, the rate of the CIR affects the premiums of various types of pension institutions differently. In pension insurance companies there is no direct connection between the premiums and the rate of the CIR, but the rate of the CIR influences the premium of pension foundations and pension funds. The connection arises so that in these pension institutions the returns on investments that exceed the CIR can be used for covering the pension institution's costs, and they thus reduce the demand for premiums. A CIR that has been set high thus reduces the amount of excess yields and presupposes a higher premium. Thus an individual pension foundation or pension fund has no direct cause to endeavour to set the CIR as high as possible.

It can be considered that there is an indirect connection between the CIR rate and premium of a pension insurance company. The chances of a pension insurance company to increase reductions in premiums for their customers improve if it increases its solvency margin. An insurance company accrues its solvency margin by the yield exceeding the CIR. On the other hand, increasing the solvency margin also improves the prerequisites for raising the rate of the CIR.

Half of the pension institutions (25/51) set their profit target so that it is actually linked to the CIR. Of these institutions 18/25 set their targets either so that the CIR income is determined as the minimum profit target or so that the target for returns on investments is to exceed the CIR income. The rest, i.e. 7/25 pension institutions set their targets by determining the margin by which the profit target should exceed the CIR income.

The expected yield in the long-term in the present investment distribution has been deduced by 14/51 pension institutions by analysing the investment market. In addition, 3/14 of these pension institutions set as their profit target simply to maximise the profit or to achieve as high a profit as possible.

A third group of pension institutions (12/51) is those that do not set any target for the return on investments in their investment plans.

3.5 A better yield by diversifying the investments

The aim of the reforms concerning the investment business of pension foundations and pension funds was to improve the yield on the investment portfolio in the long term, and to achieve a steadier and more foreseeable yield by diversifying the investments. In practice the investment portfolio has already been diversified in several pension foundations and pension funds to the extent that it can be considered that the above-mentioned target has been achieved. There are however considerable differences between pension foundations and pension funds.

The investment distribution of pension foundations and pension funds can be considered one-sided in 12/42 pension institutions. The line has been drawn so that at least 70 per cent of a pension institution's funds are invested in one line of investment only. These lines of investment are either associated with of a low risk, such as government bonds and premium loans to employers, or risky, such as shares. Of these pension institutions 8/12 have not made a plan for diversifying their investments, have decided to keep the previous distribution or are planning to diversify their distribution to a minor extent only. The rest, i.e. 4/12 pension institutions have made a plan for diversifying their investments.

Of the pension foundations and pension funds 12/42 have reported as their general principle for diversifying their investments that the investments must be kept sufficiently diversified in order to minimise any profit risks, since the CIR follows with a time lag the changes in the general interest rate. The investment distribution of these pension institutions (8/12) can be considered diversified even at present. The investment distribution of the rest, 4/12, is one-sided, since the share of one line of investment exceeds 70 per cent of all investment assets. Three pension institutions have however made a plan for reaching the target of diversifying the portfolio, and one pension institution plans to keep the present investment distribution even in the future.

Those pension foundations and pension funds whose present investment distribution can already be considered diversified number 26/42. The investment distribution of 8/12 of these pension institutions can be regarded as risky, in addition. This means that the investment distribution is concentrated on shares and/or real estates.

4/42 pension foundations and pension funds have reported neither the present nor aspired investment distribution in their investment plans.

3.6 Use of higher profits for facilitating increases in premiums in the long term

Most pension foundations (19/34) and one pension fund (1/8) state in their principles concerning the targeting of investments that the profitability of the pension institution's investments is assessed from the point of view of the whole of the investment assets and in the long term. Of these 20/42 pension institutions one states in its investment plan that it aims at easing the pressure to raise the premium in the long term, and 17/20 do not set any targets for the premium level in their investment plans.

Among the remaining 22/42 pension foundations and pension funds, 3/42 set as their target to minimise the premiums in the long term. A steady and foreseeable level of premiums in the short term is sought by 8/42 pension foundations and pension funds. In addition, 4/42 pension foundations and pension funds mention that their aim is a competitive premium in comparison with the premium collected by pension insurance companies. Furthermore, 2/42 pension institutions seek to minimise the annual premium level.

Finally, 7/42 pension foundations and pension funds do not set out any targets concerning the level of premiums in their investment plans.

3.7 Adjusting the investment structure of pension foundations investing to a considerable extent in loans to employers

As regards the pension foundations 13/34 have invested their assets in loans granted to employers. Of them in 10/13 pension foundations the share of relending exceeds 15 per cent of the pension foundation's assets.

In their investment plans the pension institutions have taken a stand on the future development of relending as follows: One pension foundation aims to invest all its assets in loans to employers. 3/34 pension foundations do not intend to limit their premium loans to employers. The employer does not intend to increase its re-borrowing considerably or at all in 5/34 pension foundations. Altogether 4/34 pension foundations aim to reduce the share of premium loans. Relending of assets to employers is prohibited in 3/34 pension foundations.

According to 4/34 of the plans concerning reduction of relending, the share of relending is intended to be reduced to a minor extent and according to a slow schedule so that relending will still constitute either a one-sided or considerable share in these pension foundations' investment distribution

4. Conclusions

4.1 Organising investment business in separate, independent pension institutions

The purpose of this review is to assess exclusively the implementation of the targets set at the level of the employment pension scheme in organising the investment of employment pension assets carried on in separate, independent pension institutions, without taking otherwise a stand on the large whole of the diversified pension scheme.

These conclusions focus on comparing the ways of organising the investment business and the decisions guiding the investment business of the pension institutions administering TEL pension cover, i.e. pension insurance companies, pension foundations and pension funds (altogether 48 institutions). Three special pension institutions have been excluded from the review, since the regulation and premium technique regarding these pension institutions deviate from those of the institutions dealing with TEL pension cover.

4.2 Taking account of the investment environment in targeting the investment business of pension institutions

The investment plans of 13/48 pension institutions that administer TEL pension cover included an analysis of the investment environment. The solvency limit indicating the riskiness of the investment distribution of these pension institutions varied between 6.6 and 14.8, while it varied between 1.5 and 30 among all pension institutions. Judging from the investment plans also the targeting of these pension institutions' investments in risky lines of investments was based on specific analyses. On the other hand, the level of solvency of these pension institutions was, with a couple of exceptions, higher than the average for all pension institutions. In this group the solvency limit of the pension insurance companies (6/13) varied between 6.6 and 10.3. The level of solvency of the pension foundations and pension funds whose solvency margin was more risky than this was – with one exception – higher than that of the employment pension insurance companies.

The pension institutions whose investment plans did not in any way deal with the investment environment and the expected yield from the lines of investment, reference index or risk, numbered 19/48. One group of them constitute the pension foundations (6/19) which have lent the bulk of their assets to employers. This can be considered understandable because the employers' need for re-borrowing constitutes the basis for the targeting of the investments. It does not appear from the investment plans of the other 13/19 pension institutions what kind of expected yields or risks the board of directors of the pension institution are prepared for in their investment plan. The solvency limit of these pension institutions varied between 2 and 22, and as the profit target had been generally defined either to exceed the CIR income, or the CIR income had been set as the minimum profit target.

Taking into account at least some pension institutions' very risky distribution, it can be assumed that employers have however made the needed analyses, although they are not incorporated in the investment plans. Judging from the investment plans, the question to what extent the board of directors of a pension institution as a whole has actually taken part in the decision-making regarding the investment distribution or are aware of the risk related to the achievement of the profit target or the level of solvency is however left open.

4.3 Ensuring the solidity of investments by means of a sufficient solvency margin

The pension institutions that have not taken a stand in their investment plans on the present or aspired level of solvency, numbered 10/48. In some pension institutions (3/10) the reason for this is probably the high level of solvency. On the other hand, some pension institutions (3/10) failed to comment on the level of solvency despite the fact that their investment distribution is risky and the level of solvency is lower than average.

Employment pension insurance companies have a limited range of means to improve their solvency position in the short term. Of these means, reducing the riskiness of the investment distribution and supplementing the solvency margin may take several years if it is question of a large insurance company.

Altogether 16/42 pension foundations and pension funds have mentioned in their investment plans the measures which their intend to apply to ensure their solvency. These measures include supplementing the solvency margin by returns on investments or premiums, or supplementing the solvency margin by sponsoring undertaking related securities or other items considered to belong to the solvency margin.

In 1999 the average solvency position of all pension institutions was 3.8, while it was 3.2. in 2000. The main reason for the fall was the reduced valuation differences of the shares included in the solvency margin. If the unfavourable development of the investment market were to continue for several successive years and the solvency of a pension institution would deteriorate for that reason, the pension institution shall in the first place itself assume responsibility for the choices concerning its investment business. In improving its solvency it should in that case apply the measures that it has decided to use in its investment plan. Otherwise the pension institution could leave the remedying of its weakened solvency to the employment pension scheme by demanding, for instance, that the CIR should be lowered.

4.4 Achieving a higher profit level in the long term

Altogether 22/48 pension institutions set as their target in the investment plans to achieve a higher level of yields on investments. On the other hand 26/48 did not set out a concrete target for the yield or methods for aspiring a higher yield. In some pension institutions seeking a higher yield presupposes supplementing the solvency margin.

The average solvency limit was 10.3 for pension foundations and 10.5 for pension funds. On the basis of this figure about 60 per cent of the pension foundations and about 40 per cent of the pension funds remain below the average value. Thus a major part of the pension foundations and pension funds can aspire high yields by their present investment distribution. It can be stated by way of comparison that the corresponding solvency limit for employment pension insurance companies varied between 6.6 and 10.3.

In the following, ten pension foundations and pension funds whose solvency is lowest are dealt with. It is noted that from these pension institutions 7/10 supplemented their solvency margin, 2/10 did not make a transfer to their solvency margin and 1/10 reduced their solvency margins.

The target of aspiring higher yields by supplementing the solvency margins appears to be implemented to some extent in regard to the pension institutions with the lowest solvency position. This target however appears to be achieved better in the pension foundations and pension funds with a higher solvency position. About half of these pension institutions supplemented their solvency margin by the excess income from investments. The solvency position of altogether 8 pension foundations and pension funds was so high that the solvency margin could not be supplemented. For two pension institutions out of these the high solvency position was a result of the low-risk investment distribution.

4.5 Keeping the CIR as high as possible

As stated in point 3.4, individual pension foundations or pension funds have no immediate reason for aspiring to set the CIR as high as possible. An employment pension insurance company increases its solvency margin by the yield exceeding the CIR, and an insurance company's amount of bonuses to clients is based on the level of the solvency margin. On the other hand, also the present mechanism of determining the CIR is based on the level of the pension institutions' solvency margin. Thus increasing the solvency margin of an employment pension insurance company will improve both the insurance company's competitiveness, as the bonuses to clients increase, and the possibilities to raise the rate of the CIR.

According to the investment plans, half of the pension institutions do not set their profit target in the long and short term on the basis of their investment distribution but on the basis of the CIR. This inevitably gives the impression that from the point of view of these pension institutions the CIR would be a requirement set from outside, the amount of which the pension institution does not influence in any way. If the CIR is determined in the future by the same method as today, according to which all pension institutions' investment distributions and solvency margins are taken into account, the co-ordination of independent pension institutions towards a well functioning whole should be developed.

Increasing pension institutions' solvency margins would be the measure to keep the rate of the CIR high in the long term. In order to reach this goal it should be deliberated within the pension scheme by which measures it would be possible to develop the provisions concerning pension foundations' and pension funds' premiums and use of solvency margin so that the interests of the pension institution and the pension scheme could be combined. In practice this would mean that the possibility of lowering premiums would be more straightforwardly tied to the level of the solvency margin.

4.6 Aspiring a better yield through diversification of investments and adjustment of the structure of the investment distribution

The investment distribution of pension foundations and pension funds is one-sided in 12/42 cases. Of these pension institutions 9/12 have invested in low-risk investment instruments so that the solvency limit is, except in one case, less than 6. Half of these pension institutions have, in addition, a fairly low solvency position. According to the investment plans the purpose is to diversify the investment distributions gradually in the years to come.

On the other hand, 3/12 pension institutions have invested one-sidedly in shares. Despite the high values of solvency margins also the solvency positions of these pension institutions were high.

When estimating the time of transition needed to implement the diversification target, account must be taken of pension institution's premium level. If that level is high, it cannot be expected that the solvency margin could be increased considerably by premiums.

The target described in point 3 of adjusting the structure of the investment distribution was set for the pension foundations whose investments were largely directed at pension assets lent to employers. The pension foundations in which the share of relending exceeds 15 per cent numbered 10/34. Of these in 4/12 pension foundations the share of relending exceeds 70 per cent. The rest, 6/12 pension foundations have invested, apart from in relending, in other lines of investment so that the solvency limit varies between 4.4 and 12.5. A common feature to these pension institutions is the fairly low level of solvency. Only 1/10 pension institutions state that they intend to give up relending within nine years. Judging from the investment plans the share of relending appears to remain considerable in pension foundations in the future, too.

4.7 Use of higher yields to facilitate increases of premiums in the long term

Use of higher yields in order to facilitate increases of premiums in the long term requires, first, that solvency margins are increased sufficiently. In their investment plans 10/42 pension foundations and pension funds set as the target to keep their premiums foreseeable, stable or competitive. Thus the pension foundations and pension funds have to a minor extent taken a stand on the level of their premiums.

It is especially important to supplement the solvency margin in those pension institutions whose solvency position is either low or in which aspiring a higher yield requires shifting to a more risky investment distribution. If a pension uses, in situations referred to above, the excess income from its investments for reducing its premium, the pension institution sets reduction of the premium in the short term as its primary goal.

In the first place this review concerns pension institutions which have at present a low-risk investment distribution and whose solvency margin should therefore be supplemented. The pension foundations and pension funds whose solvency limit is less than 6 number 9/42. One of these pension institutions can clearly be considered to have sought a premium reduction in the short term, since the level of its premium was 4 percentage points lower that the average premium of the group.

On the other hand, the pension foundations and pension funds with a low solvency position totalled 10/42. From the 7/10 pension institutions that produced a surplus, 6 made a transfer in order to increase the solvency margin. Pension institutions with a somewhat higher solvency position as a rule supplemented their solvency margin.

Despite the fact that a great many pension institutions supplement their solvency margin, they also use the surplus from investments for reducing the premiums although the level of premiums becomes several percentage points lower than the average premium level. There is a danger that the differences is organising the investment business of pension institutions will in the course of time result in a situation where pension institutions draw apart in regard to their financial position. From the point of view of the entirety of the diversified system it would be important to decide what an attitude to take towards this phenomenon.

It can be summarised from what is said above that in 14/48 pension institutions' targeting of investments the problem is either concentration of investments on such investment instruments whose expected yield remains low, and/or the pension institution's low level of solvency. From the point of view of the entirety formed by the pension institutions, co-ordination of the investment business carried on by these pension institutions, i.e. the profitability of the investment of employment pension assets, means either that individual pension institutions adapt their business so as to serve the common good of the system or that the joint system adapts itself in favour of an individual pension institution. At the level of the employment pension scheme, the analysis made shows that implementation of the targets appears to presuppose, at the minimum, guiding the independent pension institutions to some extent in the desired direction.