INTERVIEW

The Finnish approach

Adam Cadle speaks to Finnish pension fund Keva's investment team and director of finance Allan Paldanius about its structure and investment strategy

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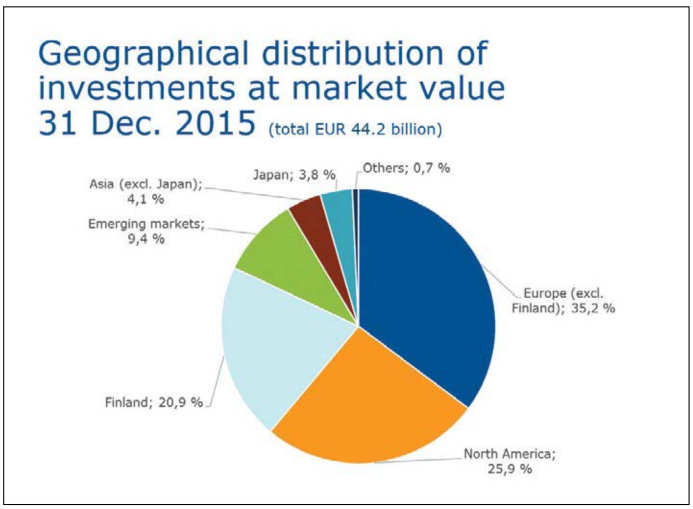
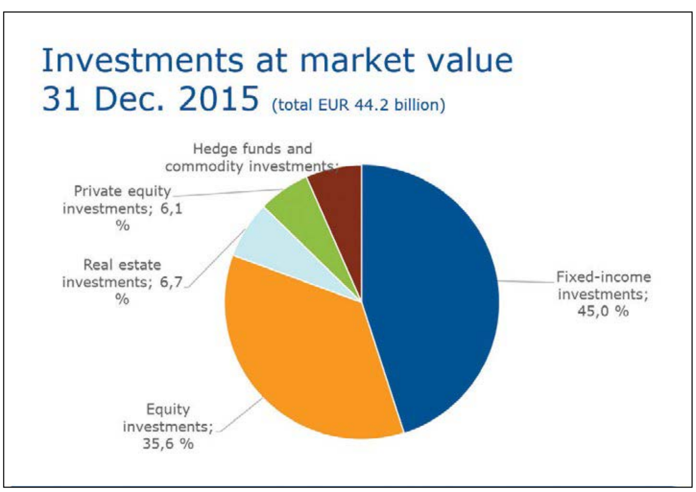
Can you explain who Keva is responsible for and its total assets under management?
Keva is responsible for the earnings-related pension cover of municipal-sector employees in Finland. We manage about €47 billion today.

How has Keva's investment strategy changed in the past couple of years to combat market volatility?
Being a long-term investor, we don't mind short-term volatility as such. However, we have reduced our exposure to market risk over the past few years, based on a view that prospective compensation for risk has been somewhat unattractive. As we look forward today, this view is essentially unchanged.

Can you explain Keva's ESG/SRI policy? Is this becoming increasingly important?
We are a signatory of UN's

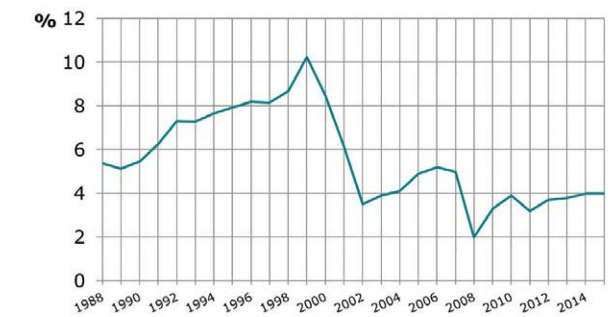




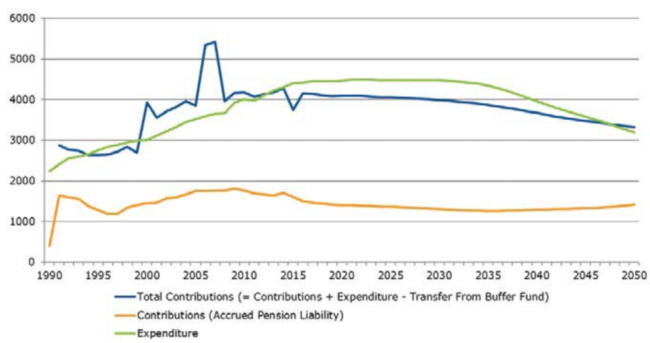
Responsible investment

- Keva's Board of Directors has approved the principles of responsible investment that are followed in our investment activities.
- Furthermore, we are
  - a signatory to the UN's Principles of Responsible Investment
  - a founding member of Finland's Sustainable Investment Forum (Finsif)
  - involved in international carbon dioxide and water initiatives
- Keva uses the monitoring services of the Swedish company GES to support the assessment of its investment portfolio.
- The responsibility of our investment activities is executed through positive criteria and exerting influence
  - we do not automatically ban certain industries, and
  - we actively strive to influence the companies' operations.
- Operations are co-ordinated within the investment organisation by the Responsible Investment Steering Group.

Cumulative real returns 1988–2015



How the Buffer Fund Alleviates Pension Expenditure



Local Government Pension Scheme: From PAYG to Buffer Fund

- Contribution income in 2015 was €5.0 billion
- Pensions expenditure in 2015 was €4.5 billion
- Since 1988, contribution income not directly used for pension payments is funded to cover future pension liability
- Even now, contributions and accruing pension liabilities are not linked at the annual level. However, contributions are adjusted so that the fund investment return and future contribution income are in balance with future pension expenditure.
- Through funding, Keva is preparing to level out and control the growth in the contribution rate when the post-war baby-boom generation has retired
- The funding ratio at the end of 2015 was ~ 42 %
- Information about Keva's portfolio allocation and investment strategies is available at www.keva.fi.

Principles for Responsible Investment and, based on these principles, look to integrate ESG into our investment strategy. We have always had the view that environmental, social and governance factors are material considerations for a long-term investor such as ourselves. However, we are currently reviewing our RI policy with the intention of further consolidating this angle into our way of long-term investing.

Can you explain how Keva's liability fund works?

Part of the pension contributions is invested in a pension liability fund.

Pensions are funded through contributions from municipal-sector employers and employees, which are mostly used directly to pay out current pensions. The assets that are not used directly to pay out pensions are transferred to a pension liability fund. By doing this, Keva seeks returns on investments that will enable it to finance part of future pension payments without having to excessively raise pension contributions even after baby-boomers have retired.

Keva's contribution income in 2014 amounted to approximately €5 billion and Keva paid out approximately €4.4 billion in municipal sector pensions, which means that about €0.7 billion could be invested in the fund. At the end of December 2015, Keva's pension liability fund, i.e. the amount of funds invested, had a market value of around €44.2 billion.

For the time being, all returns from investment operations were funded; in the future, returns will also be used for pension payments.

Keva started funding in 1988. Keva's pension liability fund is not tied to individual pension liabilities; it is a buffer fund.

What challenges do you see facing the Finnish sector in the next couple of years?

The main challenges facing the Finnish sector at the moment are ageing, slow economic growth and a low fertility rate. ■