CASE STUDY

Strategy to success

State Pension Fund of Finland (VER) CEO, Timo Löyttyniemi, **offers an insight into the challenges and successes of overseeing the government buffer fund**

Please give a short introduction to the State Pension Fund of Finland (VER).

The State Pension Fund of Finland (VER) was established in 1990 to balance state pension expenditure. It invests pension assets and helps the state to prepare for financing future pensions.

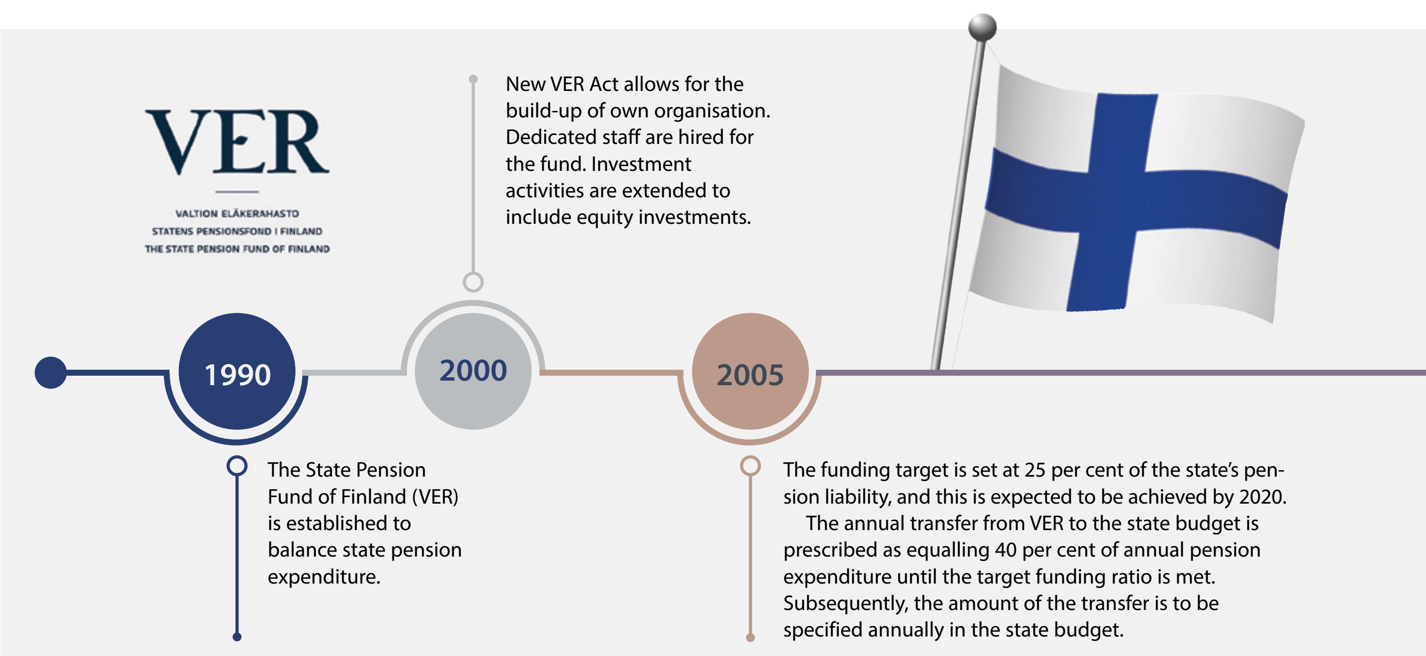
It is a long-term investor, characterised by a high standard of professionalism and an ethical code of conduct, and operates as part of the pre-funded Finnish pension system.

Please tell us about your investment strategy going forward.

The operating order of the Ministry of Finance sets a minimum requirement for VER's investment activities to exceed the effective interest rate on government debt in the long term (effective interest rate means the actual average cost of government debt).

In the long term, VER seeks maximum additional return over and above the government's financing costs at a reasonable level of risk with due regard to the specified allocation limits and foreseen net contribution income. In its own calculations, VER uses a yield assumption that exceeds the average cost of government debt by an estimated 2-3 percentage points in the long term. This is also supported by long-term historical returns achieved by VER and the return assumptions for the Finnish pension system estimated by the Finnish Centre for Pensions.

In the process to set the asset allocation leading to the



achievement of the return target, VER employs a hierarchy of two benchmark indexes. The first is a global neutral benchmark index which consists of equities and bonds. As a sort of buffer fund, VER is able to engage in long-term investment activities where the expected return is adequate but where the return on investments may fluctuate considerably. VER is exempted from the solvency computation requirements typically applied to pension funds, but its negative net contribution income may lead to situations that make it difficult to freely allocate liquid assets and shorten the investment horizon. Despite this, a global neutral benchmark index is used as a starting point for steering investment activities.

VER's board of directors determines annually in the investment plan a more detailed strategic basic allocation specifying the weights of individual asset classes to serve as a benchmark index for the investment plan. These two benchmarks are used for governing investment activities and measuring strategic and operative performance.

VER believes that the strategic asset allocation for asset classes set out in VER's investment plan is capable of achieving the above longer-term objectives.

The fund's significantly negative net contribution income imposes severe constraints on its investment activities. However, as a buffer fund, VER is able to accommodate fluctuations in the funding ratio as well as occasional years of negative returns. The buffer fund means that the state's pension expenses are covered mainly from the state budget.

What are your biggest challenges today?

■ In the coming 10 years, VER is facing increasing pension payments by the government and therefore the cash-flow will be negative in the coming years – only in 15-20 years will the equation become more balanced again. The key challenge there is to steer the investment strategy and investments through this time period in a balanced way. VER is working on this matter and the exact path will depend on multiple factors.

In terms of investments and the investment landscape, the biggest challenges are in economic growth and geopolitics. It seems that growth expectations for the coming years are moderate and the geopolitical picture is gloomy.

What have been the fund's biggest successes to date?

■ The added value of VER to the Finnish state exceeds €10 billion. Added value has been created from VER's annual income over the average financing cost of the government debt. Also, VER reaching a funding rate of 25 per cent at the end of 2021, and delivering the goals within the boundaries given, while developing a sustainable investment policy are key successes.