

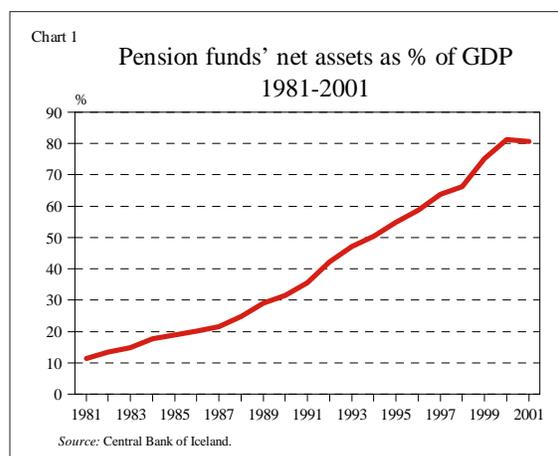
*Kristiana Baldursdóttir*<sup>1</sup>

## Pension fund developments 1999-2002

*Growth of pension funds' net assets has slowed down sharply since the end of 1999. A considerable decrease has taken place in their foreign securities assets. Overall net real return on investment was negative by 1.9% in 2001 and 0.7% in 2000. The increase in loans to members has been slowing down recently. The following article discusses the financial position of pension funds over the period 1999-2002.<sup>2</sup>*

Since the beginning of 1997 the Central Bank of Iceland Statistics Department has collected monthly financial statements from a sample of the largest pension funds and on this basis has estimated total figures for the entire pension fund sector. The sample in 2002 extends to 25 pension funds which between them held more than 90% of net pension fund assets at the end of 2001. This article is based on these monthly data for 2002, but on the funds' annual reports in other respects.

Active pension funds in Iceland totalled 54 at the end of 2001, having decreased by 2 in the course of the year. This continued a trend which has been going on ever since 1991, when they numbered 88. Their number has decreased by a further 2 so far this year, after Lífeyrissjóðurinn Hlíf merged with Sameinaði lífeyrissjóðurinn and Lífeyrissjóðurinn Eining merged with Frjálsi lífeyrissjóðurinn, both in the first half of the year. Of the 52 funds currently active, 11 no longer receive premiums, 14 enjoy employers' guarantees and 28 are fully operational general pension funds.



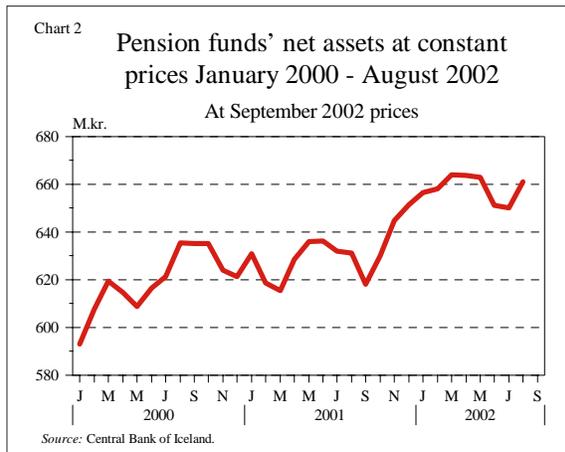
### *Net assets*

Net assets of pension funds have grown rapidly since 1981. Measured in terms of the average position for the year as a proportion of GDP, their net assets were equivalent to 11.4% in 1981 but had reached 81.2% in 2000. Last year this ratio fell by half a percentage point, to 80.7% of GDP (see Chart 1).

Over the first eight months of 2002, net assets grew by only 16.1 b.kr. compared with 45.3 b.kr. over the same period the previous year, and at the end of August they stood at 661 b.kr. Bond assets and lending increased by 27.5 b.kr. over this period, but equity assets and equity fund portfolios decreased by 11.6 b.kr.

1. The author is a Division Chief at the Central Bank of Iceland Statistics Department.

2. The author's article in *Monetary Bulletin* 2000/3, *Pension Funds' Assets and Return on Investment*, discusses pension fund developments over the period 1980-2000. It also contains more detailed definitions of the concepts dealt with here.



The main reason for slower net asset growth is a contraction in the pension funds' foreign securities portfolios which can be attributed to changes in the exchange rate of the króna and the price slump in foreign equity markets which will be discussed later. However, it should be remembered that pension fund assets are long-term investments and experience shows that market swings level out in the longer run.

When net assets are adjusted for constant prices, considerable fluctuations can be seen from the beginning of 2000 to end-2001. For most of the period they lay in the range 620-640 b.kr., but have been around 660 b.kr. in recent months (see Chart 2).

#### Domestic and foreign securities

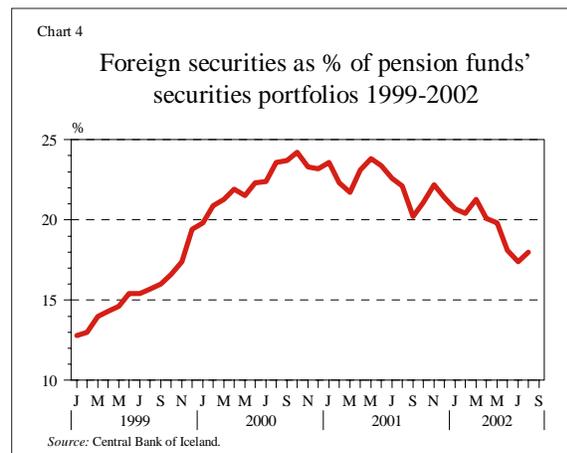
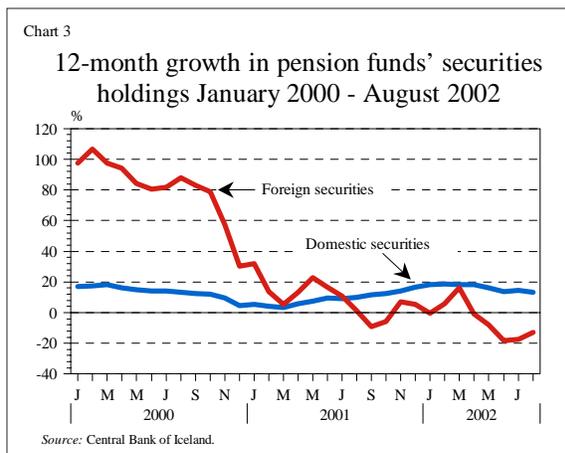
Of the pension funds' domestic securities holdings, only just under 13% were in equities and equity

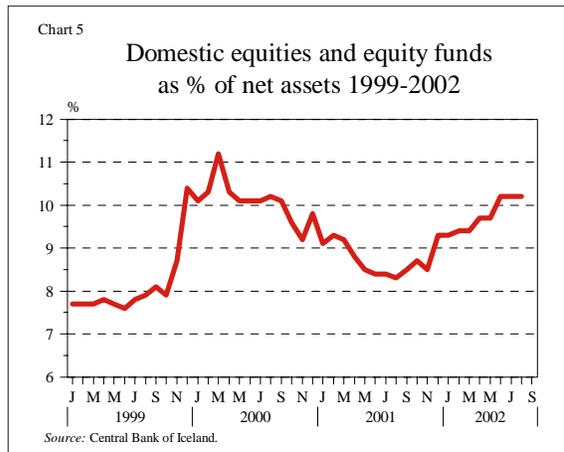
funds at the end of this August, while these accounted for 83% of their foreign securities portfolios.

Chart 3 shows the increase in pension fund securities holdings for each 12-month period. The increase in domestic securities has been fairly smooth over the period shown on the chart; for example, it was 19% over the 12 months to the end of August 2002.

Pension funds' foreign securities developed along different lines. They grew by more than 100% per month over the 12 months until February 2000, but have been shrinking recently. For example, at the end of August 2002 foreign securities assets were 12.7% lower than at the same time a year before.

The share of foreign securities in the pension funds' portfolios increased steadily from the end of 1998 to October 2000 when it peaked at just over 24%. Since then it has been declining, although with some fluctuations, and was 18% at the end of August. Foreign securities holdings stood at 116 b.kr. then, having contracted by 18.7 b.kr. since the beginning of the year. Pension funds have continued to invest abroad this year and according to information from those that submit monthly reports to the Central Bank, their net purchases of foreign securities amounted to nearly 13 b.kr. over the first eight months of the year. On the other hand, the negative revaluation of foreign securities held by pension funds was roughly 32 b.kr., since foreign equity indices have plummeted over this period.

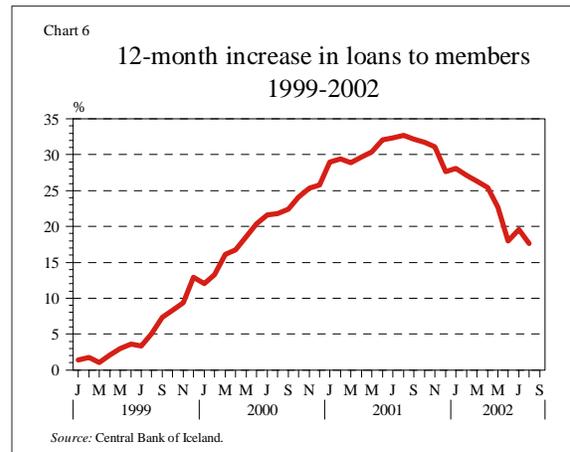




#### *Domestic equities and equity funds*

As a proportion of net pension fund assets, domestic equities and equity funds remained virtually unchanged in 1999, at between 7% and 8%, but increased at the end of that year and peaked in March 2000 at more than 11%. After that they headed downwards until summer 2001, but have been steadily increasing since and stood at 10.2% in June-August this year.

Domestic equities and equity funds increased by 7.6 b.kr. in the first eight months of the current year. Of this figure, net purchases were roughly 3.2 b.kr. and positive revaluation 4.4 b.kr. – the Icelandic



ICEX-15 index rose by 13% during the first eight months of the year, at the same time as most foreign equity funds showed a considerable drop.

#### *Loans to members*

As Chart 6 shows, there was a large and growing increase in loans to members over the period January 1999 to August 2001, when the twelve-month increase for that month measured 32.7%. At this time there was strong pressure in the housing market, which is reflected in the growth in loans to members, since homebuyers presumably took advantage of their options for borrowing from pension funds,

### Pension funds' evaluation principles in their monthly reports

The Central Bank's Statistics Department collects monthly financial statements from a sample of the 25 largest pension funds. In 2001 a survey was made of whether these funds used the same principles for revaluation in their monthly reports as stipulated in rules on the compilation of annual accounts, whereby these would be completely consistent. They were also asked how often they revalued their securities.

The survey found that the funds' evaluation principles in their monthly reports were generally in accordance with rules on their annual accounts. Shares and mutual fund units are entered at market prices except in the case of unlisted securities, which are entered at projected purchase price. Bonds are entered on the asset side based on the negotiated interest terms when they were bought,

although this is not universal. In a handful of cases market securities were entered at market price, depending upon their liquidity. Then, revaluations tended to be made on a daily basis.

The main rule regarding revaluations is that they are made on a monthly basis, although there are exceptions. Besides the daily revaluations mentioned above, there were also instances where assets were only revalued twice a year. One large pension fund revalues its domestic and foreign equity funds and its foreign equities quarterly, but all other securities monthly.

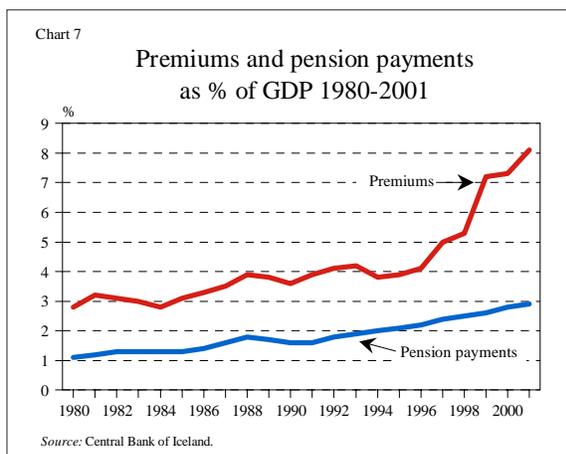
These findings suggest that the monthly figures give an excellent picture of the funds' positions at any time, and estimates for December have proved extremely close to the annual account figures.

when rising prices of real estate increased its mortgageable value. Although the growth rate has been decelerating recently, pension funds have channelled substantial amounts in this direction. Over the 12 months until the end of August this year, for example, the growth rate was 17.6%.

### Disposable capital

The pension funds' disposable capital, which is the inflow of capital to them less the outflow on account of pension payments and operating costs, amounted to 181.5 b.kr. in 2001 compared with 144.2 b.kr. in 2000. As a proportion of GDP, disposable capital was 24.2% in 2001, the fourth consecutive year that it has turned out to be more than one-fifth of GDP.

Pension funds largely allocate their disposable capital towards purchases of securities and towards lending. Some 58% of disposable capital in 2001 was employed on purchases of variable-income securities, i.e. equities and mutual funds (bond and equity funds). This is a considerably lower ratio than the previous year, when more than 70% of disposable capital was allocated to such purchases.



Almost 10% of disposable capital for the year was lent to pension fund members, a marginally lower figure than the year before. Housing bonds were bought for 12% of disposable capital.

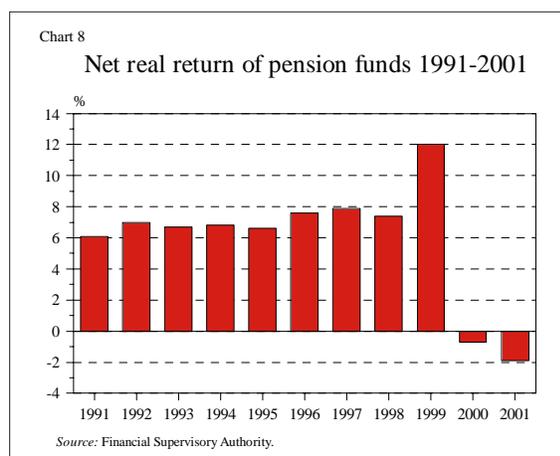
Pension funds are very active in the securities market and in 2001 they sold securities to the amount 91 b.kr., so that more than half of their disposable capital derived from securities sales. Comparable figures for 2000 were just under 71 b.kr. and 49% of

disposable capital, and in 1999 almost 66 b.kr. and 44%. It should be pointed out that the funds' disposable capital was 4.5 b.kr. less in 2000 than the previous year.

Premiums paid to pension funds amounted to 61 b.kr. in 2001 compared with 49 b.kr. in 2000. Over the period 1980-1996, they were less than 5% of GDP, but since 1996 they have grown rapidly and amounted to 8.1% of GDP in 2001.

Pension payments by the funds were 22 b.kr. in 2001 compared with just under 19 b.kr. the year before.

Pension payments were equivalent to 1-2% of GDP over the period 1980-1994, but have grown steadily to 2.9% in 2001, as shown in Chart 7. It should be mentioned that in 2000, for the first time ever, pension fund payments were higher than national insurance pensions. In 2001 this gap widened further, when pension fund payments were 2.9% of GDP but national insurance pensions 2.6%.<sup>3</sup>



### Net real return<sup>4</sup>

Net real return on investments by all pension funds was -1.9% in 2001, the lowest figure ever. From 1996-1998 it was 7-8% annually, and in 1999 it rose to 12%, matching the major upswing in equity markets. That year, pension funds invested heavily in foreign securities, almost doubling their foreign securities portfolios, and earned a good return on those

3. Source: State Social Security Institute.

4. Source: The Financial Supervisory Authority.

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Net real return on investment of the 15 largest pension funds

%	1999	2000	2001
Lífeyrissjóður starfsmanna ríkisins (Pension Fund for State Employees).....	8.4	1.5	0.0
Lífeyrissjóður verslunarmanna (Pension Fund of Commerce).....	11.8	1.1	-0.8
Lífeyrissjóðurinn Framsýn (Framsýn Pension Fund).....	14.7	-0.6	-2.5
Sameinaði lífeyrissjóðurinn (The United Pension Fund).....	17.8	-0.9	-2.8
Lífeyrissjóður sjómanna (Seamens Pension Fund).....	12.3	-0.5	-1.8
Lífeyrissjóður Norðurlands (Northern Province Pension Fund).....	16.1	-2.5	-2.0
Söfnunarsjóður lífeyrisréttinda (General Pension Fund).....	10.3	1.5	1.2
Lífeyrissjóður bankamanna (Bank employees' Pension Fund).....	7.5	-2.7	-0.3
Lífeyrissjóðurinn Lífiðn (Lífiðn Pension Fund).....	14.0	0.2	-4.9
Samvinnulífeyrissjóðurinn (The Co-operative Pension Fund).....	12.5	1.9	0.6
Lífeyrissjóður Austurlands (Eastern Province Pension Fund).....	8.4	-4.3	-9.7
Lífeyrissjóður Vestfirðinga (Pension Fund of Westfjords).....	14.2	-4.9	-4.2
Lífeyrissjóður lækna (Doctors Pension Fund).....	16.2	-4.3	-2.5
Lífeyrissjóður verkfræðinga (Engineers Pension Fund).....	21.6	-7.9	-5.1
Lífeyrissjóður bænda (Farmers Pension Fund).....	9.9	-1.8	-3.1

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investments. In 2000 pension fund returns took a downturn, with a negative real return of -0.7%.

Only 19 of the 54 active pension funds at the end of 2001 showed a positive real return for that year. Very few of Iceland's largest pension funds were in that group. However, the largest of all, Lífeyrissjóður starfsmanna ríkisins (Pension Fund for State Employees), was among them with 0.01% net real

return. The best return by any pension fund during the year was 5.9%. Almost half the funds produced a real return in the range 0% to -5%. Several showed an even poorer performance.

The table shows net real return on investment for the 15 largest pension funds over the past 3 years. It clearly reveals the negative return trend over this period.