Conclusions and recommendations of the National Audit Office

Capital management in state funds

The audit of capital management in state funds is part of the audit theme in which the focus is on the proper management of state-owned assets. The funds are a major asset item for the State of Finland. There are a total of 11 off-budget funds and they account for about one quarter of the assets held by the state (about EUR 30 billion). The new Constitution of Finland entered into force in 2000 and when it was drafted, a cautious approach to establishing off-budget funds was proposed. This was because such funds limit the budgetary powers of Parliament. Funds should only be established if it is impossible to use the flexibility instruments set out in the state budget.

The audit covered the two biggest state funds: State Pension Fund (VER) and the National Housing Fund (VAR), as well as the Development Fund for Agriculture and Forestry (Makera), which is smaller than the two first-mentioned funds. The funds were examined from the perspective of proper management of the assets tied to the funds and whether managing the assets in a fund is the right approach. The role of the funds as a policy instrument was not audited.

VER is by far the largest of the state funds and with assets of about EUR 20 billion, it accounts for one fifth of all assets held by the State of Finland. The task of the fund is to take care of the assets placed under its management. The purpose of the assets managed by VER is to prepare for the payment of pensions and to balance the pension-related costs over generations. With assets of more than EUR 6 billion, VAR is also of substantial size. Makera is much smaller than the two other funds reviewed in the audit, as it only has a capital of about EUR 300 million. VAR is a housing policy instrument, while Makera serves as a tool for agricultural and rural policy. As VAR, VER and Makera are structured as funds, they have been able to operate as lenders on a long-term basis. VAR and Makera do not invest their assets as they are placed in the State Treasury.

Despite its name, VER is not a pension fund tied to paying individual pensions. It serves as a Government tool for preparing for pension expenditure and for balancing pension costs over longer periods. VER has also been used as a fiscal policy instrument. In a favourable fiscal situation, the Government may decide not to transfer assets from the fund to the state budget. At the same time, it may be decided to transfer additional sums from VER to the state budget if central government financing needs cannot be covered in other ways. This means that, in practice, VER has served both as a pension fund and as a buffer fund.

Under the State Pension Fund Act, VER is expected to cover 25 per cent of all central government pension liabilities. The fund will accumulate assets until the target has been achieved. No deadline has been set for achieving the target but in its own strategy, VER aims to reach it by the year 2033. Achieving the target also depends on the economic situation and at the end of 2017, about 21 per cent of all central government pension liabilities were already covered by VER. It is stated in the State Pension Fund Act that decisions on how the assets placed in VER are used, will be made when the target level has been achieved. In this respect, the legislation does not support proper management of the assets. Setting the target at a specific level impacts the fund's investment strategy. Already when the fund is close to achieving the target, the emphasis will shift to ensuring the security of the assets, which may lead to unnecessary risk avoidance and thus also to lower returns.

VER has achieved its return targets when measured with a number of different indicators and also when compared with other actors with similar operating prerequisites.

In operational terms, VAR and Makera do not, in their current form, meet the requirements set for new funds. The two funds were established before the constitutional reform and they have been able to continue their operations as what are called old funds. Makera's capital is currently based on budgetary transfers and not on its own assets. Over the past ten years, budgetary transfers corresponding to the fund's existing capital have been made to Makera and in the future, too, the fund will only be able operate if it receives budgetary transfers on a regular basis. In practice, Makera is no longer a genuine fund and the reason for keeping it as a fund is to ensure that agricultural subsidies can be managed more flexibly than within an on-budget framework. VAR still has a substantial Arava loan portfolio and the fund will be able to operate with the financial income generated by it for many years.

The practicability of Makera as an agricultural and rural policy instrument should be assessed before the next EU funding period, which will start in 2021. Even though VAR may, in its current form, continue its operations for many years, its future as a fund should also be assessed by the time the Arava loan portfolio has reached low levels. The fund has accumulated large amounts of liquid assets on a central government liaison account from where they are transferred to the state. There have been suggestions for how to use these assets. Before any significant expansion of the fund's operations, it should be thoroughly assessed whether it is practicable for VAR to continue as a fund.

Recommendations of the National Audit Office

1. The Government and the Ministry of Finance should start drafting a legislative reform concerning the State Pension Fund. The role of the fund should be more clearly defined.
2. The Government and the Ministry of Finance should prepare for the situation where the State Pension Fund has reached its targeted size. If VER is to continue as a pension fund, it should be decided how its revenue and expenditure can be balanced when the fund covers 25 per cent of central government pension liabilities. This should be made before this target is achieved so that a long-term investment policy can be ensured.
3. The Government and the Ministry of Agriculture and Forestry should assess the future and the operations of the Development Fund for Agriculture and Forestry because it is no longer able to operate without on-budget funding.
4. If the operations of the National Housing Fund are to be expanded so that, in addition to direct housing subsidies, it would also include more general support for housing, the Government should reassess whether, as a body with more extensive operations, VAR can still continue as a fund.