Pension Fund Capitalism in Europe: Institutional Organisation and Governance of Finnish Pension Insurance Companies

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Abstract

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Pension capital is the single largest block of capital in the global domain of finance and a transformative social force. However, the studies on pension fund capitalism have been geographically limited. Although vast pools of pension capital have been generated outside the Anglo-American institutional environments, we still have little knowledge on the social construction of pension fund capitalism outside that context. The purpose of the study is to develop theoretical-methodological tools for studying the institutional differences in pension fund investments with habitual institutionalist theory at the level of organisation fields, and to apply these tools in an empirical case study that has theoretical relevance concerning the recent financialisation of European pension provision. The case study is focussed on the field of Finnish pension insurance companies that execute the nationally mandatory partly funded TyEL pension scheme. The case study includes a single case analysis at the organisation field level with embedded case analyses on the investment processes in two companies. The study is based on multiple sources of textual and interview data gathered and analysed with content analysis. It is argued that the institutional life of Finnish pension insurance company investments illustrates divergence from the Anglo-American pension fund capitalism and has reinforced elastic institutional solutions especially in domains of governance and regulation even under Europe-wide financialisation pressures. The Finnish case shows that there are alternative institutional solutions for various domains of pension fund capitalism, but the strong Europe-wide trends have all characterised recent institutional change in the TyEL field as well. It is concluded that although the European shift towards pension fund capitalism with the generation of increasingly independent portfolio investors with increasingly principle-based regulation and risk-based supervision has not necessarily implied strong institutional convergence, the European pension investors are likely to share a number of common questions in the future.

Keywords: Europe, governance, institutional theory, investments, organisation fields, pension funds, pension insurance companies

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1. Introduction

Financial invention and innovation have been among the key forces changing the nature of capitalist economic order during the last half century (see e.g. Shiller, 2003; Ferguson, 2008). The ‘domain of finance’ (Langley, 2008a; see also Pryke and Du Gay, 2007), the supposedly rational and technologically advanced actor-networks and cultures based on a few urban, global financial centres now spread around the world in influence and effect. This domain emerged more as a ‘structure of the world’ than of national economies (Knorr Cetina, 2006). The world of finance is built upon common platforms for trading and managing financial flows, and common expectations about the nature and quality of disclosure and risk-management, which finds differentiation and distinctions between jurisdictions and national economies inefficient (Clark, 2006b). During the last few decades, finance has become increasingly a global transformative force “promising to set the economic landscape of the 21st century” (Clark, 2006b; see also Clark and Wójcik, 2007; Clark, Dixon and Monk, 2009). The domain of finance has been considered so influential and transformative that the entire world explanation of contemporary political economists has come to stand on three pillars by adding financialisation, the redesign of interfaces between the domain of finance and other domains of life to fit the former (Langley, 2004), to complement the previous pillars of globalisation and neoliberalism (Epstein, 2005).
The practices and cultures of contemporary financial capitalism have been recently studied in various disciplines within the social sciences. Political and economic geography have been among the few academic fields that have combined empirical studies on the flows and cultures of global finance with rigorous theoretical analysis on the role of financial actors and institutions in producing social and economic transformations in different environments. An entire new framework of geography of finance has been emerging during the last few years around these building blocks (see Clark and Wójcik, 2007). The geographers have argued that despite the fact that the importance of global finance is recognised very broadly, contemporary social scientists have tended to neglect two themes: the social origins of global finance and the social consequences the structures and practices of global finance in fact produce (Clark, 2006b). Answering these questions is important not only in terms of giving inputs to academic debates on economic and social change, it is also directly about making the phenomena of global finance more tangible and comprehensible outside academic debates.

When we look at the origins of global finance from the perspective of demand for its financial products and services, one key choice made in the developed world rises above others in explaining the birth of global finance. It is the decision to tie workers’ savings and old-age income to financial investments in the Anglo-American world. Indeed, few of the financial innovations the world has seen during the last few decades could have been possible without the birth of pension funds (see Clark, 2000, for historical review). The capital provided by these large-scale institutional investors fuelled the shift of financial power from the risk-averse bank trust departments to investment management firms in the Anglo-American world, especially in the United
States. As one commentator (Clowes, 2000) has put it, pension funds ‘revolutionised’ investment in 1970s via their ‘money flood’. The US pension funds started to spread assets widely across the markets, aiming at achieving a higher rate of risk-adjusted return on growing assets in particular and a rate of return in excess of that measured by widely accepted benchmarks in general, and continued to diversify investments internationally during the following decades. The capacity of institutional investors to monitor individual stock performance and to use power brought by ownership was, however, limited (Clark and Hebb, 2004). Instead of using the power brought by large capital bases to active and broadening ownership – which Drucker (1976) famously called ‘pension fund socialism’ – they promoted delegation of these tasks to investment managers, who on their behalf relied on the market for pricing the value of traded securities and left concerns over governance to professional corporate managers (Clark, 1981).

This order where massive institutional investors come to adopt the techniques of modern professional investment management can be best titled pension fund capitalism1 (Clark, 2000; see also Toporowski, 2000 for a different approach to the concept). Pension capital is the largest single block of capital in the world, potentially overshadowed only by the sovereign wealth funds (SWFs) in the foreseeable future (Monk, 2009a). In the end of 2007, the overall pension assets directly in the form of funds had reached USD 17.9 trillion in OECD countries, and when assets all forms of

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1 Unless otherwise stated, the notion ‘pension fund capitalism’ refers in following chapters to various kinds of funds and other investment-conducting entities that turn old age and other pensions-related savings, individual or collective, to portfolio capital to be invested in financial markets and all kinds of assets – not exclusively as pension funds in legal statute. The term ‘pension funds’ thus includes within this notion trust-based Anglo-American-Dutch pension funds, many different kinds of public funds (e.g. FRR in France) and foundations (e.g. Swedish AP funds), various insurance companies (e.g. Finnish pension insurance companies), and many other organisational forms and actors that fulfil these criteria.
funded private pension arrangements and public reserve funds are added, the amount of assets that fuels pension fund capitalism was far over USD 30 trillion (see OECD, 2009). This origin of global finance continues to dominate its demand side and to strongly characterise the contemporary financial order more generally, which makes pension fund capitalism (hence: PFC) central also for understanding the social consequences of modern finance.

Pension capital has ‘pension power’ (see e.g. Hayden, 1989) that provides it an extraordinary ability to affect and change social realities through large-scale financial actions. This power relies on legitimacy arising from their role as the ‘institutional nexus’ (Engelen, 2003) between the everyday life of haute finance and the life and welfare of ordinary people (see e.g. Langley, 2008a). This means that the legitimacy of global finance is very much reliant on pensions. When this legitimate capital base is brought to the ground through investment processes, it appears as a direct challenge to inherited institutions and customary practices (Blackburn, 2003). The influence of today’s massive pension funds has been felt in every capital market in the world and changed the structure and performance of nation-states and the whole global economy (Clark, 2000). Some have gone as far as to argue that pension funds are among the most important global source of power in the beginning of the 21st century (Gourevitch and Shinn, 2005).

While the magnitude of the social impacts of PFC is broadly recognised in social sciences, the nature of these social consequences is a much-debated issue, however. From the perspective of economics, pension capital has been considered a mixed blessing. The financial economists embracing the conventional theory of loanable
funds, funded pension institutions provide a simple equation: the more there are pension savings, the more there are investments and economic growth. Indeed, pension capital has provided fuel for shorter-term financial innovations as well as for longer-term real investments (see e.g. Davis and Steil, 2001; Davis, 2002b). It may also have a more substantive economic meaning, as it has been used even as the founding pillar in building national economies (Kangas, 2006). But pension capital can be considered an economic problem as well. For theorists in the so-called critical finance school of financial economics, continuously inflowing pension capital allocated to the most liquid markets and assets tends to inflate capital markets, which has many disturbing and negative effects to the real economy (for an extensive review, see Toporowski, 2005). In this thinking, pension funds are thought as the long-term institutional arrangement guaranteeing capital market inflation, which may ultimately result to volatile and sub-optimal economic performance in medium and longer term (Toporowski, 2000; Engelen, 2003).

In a similar vein, the benefits of funded pensions to pension provision are indisputable for some pension policy scholars whilst others remain more sceptical. For some, global capital markets provide less risky source for old-age income than pay-as-you-go (PAYG) schemes reliant on performance of individual firms or national economies (see Clark, 2003a for discussion). Insofar as the performance of global financial markets exceeds the performance of national economies, funded pensions provide a potentially less costly and more sustainable arrangement for pension provision to tax or PAYG arrangements. For others, the dependence on financial markets in pension provision provides a very different kind of lesson. Just the dozens of deep financial and economic crises of last few centuries (see e.g. Kindleberger, 2005, 2006) have
caused much scepticism towards the sustainability and equality (e.g. in retirement timing in defined contribution schemes) of funded pension provision. Those who take the idea that pension funds may disturb the real economy seriously also tend to add that funding inevitably leads to failing pension promises (Blackburn, 2003, 2006a, 2006b).

Besides agreeing that it matters how the PFC should be interpreted, these divergent views share one important feature: the nature of PFC is contingent and dependent on how investments are organised to follow numerous social purposes and to generate different kinds of social impacts. In other words, pension capital is ‘substantive’ capital (see Roumpakis, 2009). PFC should thus not be just assumed to be an origin or a component of global finance among others, but a contingent choice where pension provision has been decided to be integrated to the specific cultures and networks of global finance in specific but alterable ways. This implies it is possible to understand financialisation of pensions as a contingent process where only one domain of life, old-age retirement savings, is connected to the domain of finance in potentially institutionally divergent ways.

This is not to say pension funds would have no special role in the politics of financialisation more generally. Some go as far as to consider the generation of PFC with a specific aspired institutional form (e.g. DC schemes with internationally diversified investment portfolios) as one essential core of the overall project (see Langley, 2004, for discussion). The legitimacy of pension capital certainly makes some politics of financialisation effective. However, if we take the idea of contingency seriously, pension funds may also lead to politicisation of various
institutional changes and lead to different pension regimes and varieties of PFC and, ultimately, to a different kind of global finance altogether. Asking how PFC is socially constructed\(^2\) – how exactly pension capital is generated, how its usage in investments is organised and decided upon, to what targets and vehicles it is used and why, what social impacts it is leashed to produce and in fact produces in different environments, and how the people bound to these activities come to see them as natural parts of our contemporary societies – is thus an essential thing to do if we wish to understand how pension funds and global finance more generally affect our societies and everyday lives in different corners of the world.

Yet it is striking how limited our knowledge on the social construction of PFC is. These limitations are in great part geographical. PFC has mostly been considered an Anglo-American phenomenon, and the research in the field was considered meaningful almost exclusively in that context as recently as in late 1990s (see Clark, 2000). While there is academic literature on most aspects of Anglo-American pension fund investments, we have very narrow knowledge on the social construction of PFC outside this context apart from few European funded arrangements (see Clark, 2003a). However, already a great number of European pension systems have been by and large financialised during the last few decades, as funding has become commonplace even in those countries that have previously relied purely on public PAYG and tax-based systems. For instance in the period as recent as between late 1980s and early

\(^2\) Social construction refers here to the contingent construction of social realities, which can be studied with particular branches of social theory (e.g. institutional theory, which is used in this study). The construction includes different social structures, facts and practices but also the ways they come to be perceived as taken for granted realities for those who share them. This conception relies on the social constructionist theoretical tradition that integrates both these aspects, not to the social constructivist theoretical agenda that is focussed almost exclusively on the latter aspect in broader society. In Hacking’s (1999) terms, the focus here is on the social construction of pension fund capitalism, that is, the idea of pension fund capitalism that is actually taken for granted in practices that belong to this idea – not the social construction of the idea of pension fund capitalism.
2000s, seven (Belgium, France, Greece, Ireland, Netherlands, Portugal and Spain) of the just the old EU countries, some of which traditionally antagonistic towards funded schemes (see Davis, 2002a), introduced a funded component to their public pension systems (European Commission, 2008; see also Vidlund, 2006). Moreover, relatively large pension funds and more indirectly pensions-related funds had been already generated in different points of the 20th century in various smaller European economies such as Netherlands, Switzerland, and Finland, to mention a few examples. Pension funds have also emerged in other corners of the world, especially in various Latin American and Asian developing economies, and the transitional economies of Eastern Europe, during the last few decades.

What exactly does the generation of funded arrangements in Europe imply? Are these new funded arrangements different from Anglo-American funds? Is the emergence of funded pensions leading to some distinct ‘variety’ of PFC? And, most importantly, if such differences and varieties can be found, then how and why are they different or distinct? Despite many attempts to account essential differences in different aspects in fund arrangements in Europe for instance in terms of pension policies (Clark, 2003a), fund governance (Roumpakis, 2009), fund decision-making (Boeri et al., 2006), risk management (Stewart, 2005) and regulation (OECD, 2005b), these works have not aimed at providing any theoretically comprehensive and integrative accounts on social construction of pension investments in different environments.

The lack of rigorous tools has also caused some theoretical blind spots. Social sciences have cast only scant attention for instance on pension fund governance as much in Anglo-American as elsewhere (Monk, 2009b). Debates on governance issues
have been, with few exceptions (e.g. Roumpakis, 2009; Dixon, 2009), quite limited to discussions on formal governance arrangements primarily in trust-type pension funds (see e.g. Clark and Urwin, 2008a, 2008b; Boeri et al., 2006; Evans, Orszag and Piggott, 2008), and often to very instrumental approaches, most importantly to the effects of governance structures to financial performance (e.g. Ammann and Zingg, 2010). Moreover, pension capital is always embedded in broader financial systems (Clark, 2003a), and besides organisational forms, the usage of pension capital can be affected by numerous contingencies in history and politics, as it has been recently noted by various pension scholars (e.g. Roumpakis, 2009; Swenson, 2002; Belfrage and Ryner, 2009).

A great part of pension capital now resides outside the Anglo-American institutional frameworks and in other organisational forms than the trust-based funds (Stewart and Yermo, 2008). Despite the recognised and admitted importance of pension capital in today’s world, social sciences have major theoretical gaps in as basic issue as in understanding how decision-making over pension capital is actually arranged and done in different organisational settings and political contexts. These gaps are somewhat alarming as studies on pension capital have primarily functionalist (see Clark and Wójcik, 2007; Clark, 2008). Functionalist approaches derive all social institutions from the functions of some broader or narrower system level roles or duties. But what if the institutional frameworks and practices of pension funds differ – what if things cannot be done the same way? Optimisation of investment behaviour on basis of functional analysis without looking at institutions may have ignorable practical relevance, but at worst it can be even damaging. This is why it is essential to
understand the institutional frameworks in and through which pension investments are in fact made.

The goal of this study is to take the first steps towards developing a more comprehensive account on the social construction of pension fund capitalism, which enables analysis on the social institutions of pension investments in various organisational forms and environments. The special focus here is on the question of how exactly local institutions of pension provision are integrated to the actor-networks of and cultures in the domain of finance. The developed model is applied in an empirical case study that has relevance in the context of recent financialisation processes of European pension regimes, and the results are compared to some of the key institutions characterising the social construction of Anglo-American PFC. These tools help to address various research questions in further studies, including the question of how different versions or ‘varieties’ of PFC might differ in their social nature and impacts they produce in their environments. Answering these questions can further help to understand and explain the processes in which global finance takes its mainstream shape and form, to explain how the largest actors in that domain come to shape the world around us to different directions, and, indeed, how these might be changed. By addressing these questions, this study directly addresses one set of the essential financial and economic power relations, mutual dependencies, and the social construction of risks and risk management in contemporary financial capitalism.

Increasing understanding in such terms is a somewhat typical motivation for studying social constructions in general (see Hacking, 1999). The approach here does not go beyond this point for example to any specific normative theories. Nor is the goal to
discuss the channels through which PFC becomes taken as a broadly shared natural part of contemporary societies in a social constructivist sense. The motivation is just to show what this organised construction governed by human beings that influences our lives significantly looks like when inspected through one rigorous set of analytical lenses. The only normative aspiration of this study is to provide tools to enable better arguments in democratic public debates. If the current version of PFC does not produce the social impacts we want in our societies, we must know what the people institutionally bound to the phenomenon are in fact sharing and taking for granted in their real-life contexts before anyone can effectively organise and steer it differently. This is also the reason why the title of this study includes the expressions ‘organisation’ and ‘governance’ in contrast to ‘social construction’. Should there be any democratic pressures for changing PFC anywhere in the world, I hope this study will bring some insights that help to understand what is actually changed and how changing it might reshape the world around us.

**Research questions, research agendas and the relevance of the empirical study**

The research questions of this study can be summarised as three key research agendas that have somewhat different levels of academic and practical relevance. For heuristic purposes, they can be titled as the methodological, the empirical, and the theoretical research agenda. Methodology addresses the question of *how* different phenomena can be studied, and thus the primary research question concerning the methodological agenda of this study is *how* we can analyse the social construction of PFC in any environment where funded pension arrangements might globally exist. Put differently,
the methodological agenda is to develop theoretical-methodological tools for providing an empirically comprehensive view on the social construction of pension investments in different environments and organisational settings. It must be noted that the research object of the study is for the reasons of research economy limited only to one category of actions: investments. Indeed, the study is not so much about political or economic geography of pension provision. Issues like pension benefits, liabilities, or income security are not discussed unless they have explanatory force concerning investment actions.

The methodology of this study can be best characterised as a theory-driven case study, in which theory rather passively relies on macro-level concepts like ‘pension fund capitalism’ and just provides necessary tools with which their social construction in real-life contexts can be studied consistently and systematically. This approach requires some elaboration at this stage. Firstly, the social theory used here is a middle-range theory that does not address or evaluate macro-level theoretical relevance of concepts like PFC, global finance or Varieties of Capitalism: it only operationalises these concepts for empirical enquiry and enables us to see what these concepts mean in real-life contexts that can be studied for instance as individual case studies or comparatively. Secondly, the study provides tools for analysing social construction of pension fund investments in a specific scale. These issues will be discussed in more detail in Chapters 2 and 5.

As the selection of case study strategy hints, the purpose of the study is not just to develop universal methodological development for studying the fields of PFC anywhere in the world, but a more specific one. The empirical and theoretical
research agendas provide the rationale and contexts for the case study. The second research agenda, the empirical one, is to take the first steps in broadening empirical studies on the social construction of PFC outside the relatively well-acknowledged Anglo-American institutional frameworks. It must be noted that this empirical agenda does not suggest any specific criteria for choosing a case, as the agenda here is to enable analysis and comparison of all kinds of arrangements. In this sense, the study is only exploratory and is meant rather to raise than to test theoretical hypotheses.

However, the third research agenda, the theoretical one, sets the enquiry on social construction of one field of PFC into a quite specific theoretical context and gives its exploration a very specific meaning in this study. The theoretical research agenda of this study is rooted in the question of what the financialisation of pensions has been like in Europe – that is, how European pension provision in different countries and environments has been integrated to the global ‘domain of finance’, whether the adoption of funded schemes imply that European pension funds are adopting the same organisation field-level institutional logics in investment making, and what kinds of limits might convergence and integration processes have (see Chapter 3). In other words, the case studied in this thesis is not just a more or less random sample case used for methodological development, but also an actual case of field-level institutional logics of financialisation of pensions in Europe.

Now, why choose Europe as the context for theoretical reflections instead of individual European or other countries in the first place? For one thing, Europe is interesting due to the sheer volume of overall pension assets, which is the closest point of comparison to the Anglo-American countries albeit still far from matching
that scale. But there is a theoretically more compelling reason. Europe provides a specific framework for integrating pension systems to global finance. Hay (2004) has argued that the project of integrating social actors to global domains is always contingent, typically political rather than economic, includes very likely countertendencies, and may end up in divergent rather than convergent results. Although European pension regimes have their particular and complex political-economic histories that have kept pension institutions diverse at the European level and predict many local contingencies in change processes, nearly every single European country has *politically* regarded funding as a viable and feasible component in recent pension reforms. In this sense, Europe is interesting as a research object due to its elastic internal institutional and political diversity, and its equally strong common projects, most importantly the European Union and the common currency euro.

However, Hay also argues that the establishment of common trajectories regionally is likely more effective in producing integration and convergent outcomes than direct integration of individual or groups of actors to global institutions. Indeed, finding common political directions in the European scale may play a crucial part in successful integration of individual pension schemes and in producing any converging outcomes at the European level. It is argued in the survey of literature in Chapter 3 that despite the European institutional and political heterogeneity and the plurality of pension schemes – including mature and relatively young pension funds with variable organisational forms between and within first, second and third pillar schemes – there are a few common institutional trajectories that can be found when we look at discursive changes and policy reforms that have been able to introduce effective
institutional change in or towards funded schemes. These characteristics are the introduction of Modern Portfolio Theory (MPT) based investment management practices, the introduction of private asset management in pension schemes of various pillars and the strengthening of independence in investment decision-making in funds managing the assets, and the enforcement of prudential regulations and risk-based supervision of the funds.

The theoretical research agenda suggests that we need a case of financialisation calls for some representative relations to the common European trajectory of financialisation. Because the theoretical approach of this study is rooted in the middle-range, the case selection cannot be based on macro-level theories like Esping-Andersen’s (e.g. 1999) welfare regimes or Varieties of Capitalism, but to developments, changes or theories at a specific institutional level. However, understanding European institutional development as both common trajectory and as persisting diversity suggests that the chosen case study does not need to be in all regards “positive” – using Gerring’s (2007) terminology: typical, most-similar, crucial, influential or pathway – in relation to any Europe-wide trajectories, but can be based on other, “negative” logics of representativeness – diverse, extreme, deviant, or most-different.

The chosen research object for the case study is the field of Finnish Pension Insurance Companies (työeläkevakuutusyhtiöt, hence: PICs) that implement a nationally mandatory earnings-related pension scheme TyEL. The field fits the methodological agenda very well simply because it is not known as well by pension scholars as for example the German, Dutch or Swedish schemes, and because it has
institutional curiosities that functionalist research based on Anglo-American trust funds can hardly recognise or address. The TyEL field is at first sight quite exceptional in the European context due to the very peculiar pension scheme characteristics and distant relation to European Union directives, and thus likely illustrates the extreme or deviant mode of case study representativeness in relation to the theoretical agenda. In other words, the case is an intriguing one as it tests the limits of the European project – if the common project is relevant in respect to these funds, it is likely it touches those funds that are closer to EU directives. It is argued in Chapter 4 that the scheme has followed most of the European trend of financialisation in principles even when institutional changes have not indicated abandonment of old solutions. The PICs have thus in fact shared a number of institutional changes that “positively” fit the theoretical agenda focussed on the Europe-wide trajectory in integrating pension funds to global finance.

Moreover, the field is typical in its logic of case study representativeness in relation to the trajectory in one domain. The scheme has been from its birth in early 1960s a public-private partnership (PPP), and it is among the most mature PPPs in European first-pillar pension provision. The public-private mix has become very common in over a dozen European first pillar schemes during the last decade, and they have been seen even problematic in the current European legislative frameworks (see e.g. European Commission, 2008; Briganti, 2008; Johanson and Sorsa, 2010). Private management is likely to become increasingly popular as public and private responsibilities are redrawn in the beginning of 21st century (Clark and Whiteside, 2005). Studying how public and private type institutions can be combined proficiently in pension provision and investment making provides valuable theoretical and
practical insights on the social consequences of the common European trajectory. Since the Finnish earnings-related scheme has been able to mature for half a century, there is hardly a more fruitful case study object to be chosen on this basis.

The Finnish case is also historically interesting as an empirical point of comparison to the Anglo-American PFC. The history of 20th century Finnish pension funding goes along the same timelines as the Anglo-American one, not along the more recent rise of funding in Europe. Finnish national pension funds were first born in 1930s, at the very same time when the design of modern Anglo-American funds was (re)drawn. The vast earnings-related TEL (now TyEL) funds were created in the early 1960s, over a decade before the large American ERISA-driven funds were born and started to bloom. The emergence of Finnish pension capital coincides with the rise of Anglo-American pension capital, but in a very different institutional and economic context, being a small, poor and developing country with a coordinated market economy, as the Varieties of Capitalism scholars (e.g. Hall and Soskice, 2001) might put it. This hints that the adoption of pension funds does not necessarily have much to do with the politics of the liberal political-economic regime, but may have very different kinds of motives behind it. This is why the case study is valuable from the methodological agenda of this study – it calls for a framework that may accommodate very different kinds of social structures and practices from the Anglo-American ones for explaining similar institutional outcomes.

Last but not least, case Finland is exceptional when we look at the scope of the social impacts pension investments have historically produced. Finnish pension fund capital has played a role of greatest importance in building the success story of Finnish
national economic development. Case Finland shows that mandatory but privately managed pension funding can be considered an effective national development strategy (see Kangas, 2006; Jäntti, Saari and Vartiainen, 2006). The earnings-related capital was central in establishing the infrastructure of the industrial society until 1980s through the so-called premium lending to the contributing employers and through investing funds to large investments, building sector and real estate (Kangas, 2006, 2007). Case Finland provides a valuable lesson on how pension capital can help to make a poor and backward agrarian developing country a prosperous one ranking among the highest both in Human Development Index and in economic competitiveness rankings made by World Economic Forum. The Finnish funds are still very significant in size, and likely continue to produce significant social impacts in the beginning of the 21st century. In the end of the first quarter of 2010, the PICs had in total 81.6 billion euro in assets under management (the total Finnish pension fund assets being around 130 billion), almost 48 per cent of the Finnish GDP in 2009, which can be considered quite exceptional for only one group of funds executing only a partly funded scheme.

The structure and narrative of the study

The chapter following this introduction chapter is the first of three literature review chapters. It is dedicated to developing the general theoretical-methodological framework for studying the social construction of pension investment agency, and the geographical variables that may explain pension investments and make them a distinct domain from other types of investments and investors. The chapter starts with a survey of literature on how the social construction of investment agency has been
recently discussed in social sciences, and what kind of methodological lessons this literature provides to the selection of theoretical frameworks for studying PFC. It is argued in Chapter 2 that investment as agency can be best understood as calculative and exchange practices, and related information processing practices, that materialise in markets trading on specific kinds of social relationships – financial products, that is. However, it is also argued that it is not only cultures of the domain of finance but also various different kinds of political and organisational institutions that bound pension investments to certain behaviours and make it a distinct domain in face of other financial activities. The recognition of these broader social institutions is essential in explaining pension investments.

It is argued in the second section of the chapter that the best way to address this issue is to study the institutional life of pension investments. The version of institutional theory used in this context relies on the pragmatist version of institutionalism that commits researchers to studying actions instead of relying on passive notions of agency like behaviour and shifts focus to shared and habituated dispositions that provide proficiency to actions. Institutional life is a concept that requires a specific level of analysis that range from organisational subsystems all the way to the world system and to informal institutional environments (Scott, 2008).

The choice of this level defines much of the approach to institutional geography (Martin, 2002), and is thus beneficial to elaborate already in this stage. While methodological nationalism and individual organisation level studies have brought some essential institutions into inspection, they are not necessarily too fruitful for this study. They are too narrow because the institutions of finance as a ‘structure of the
world’ supersede national borders and organisational boundaries, and too broad because there are not only national and organisational but many regional, local and even portfolio manager specific differences in European pension investments (Clark and Wójcik, 2007; Harrison, 1997). Rather, the question is how we can accommodate salient institutions at all these levels fruitfully to analysis. It is argued in the second section of Chapter 2 that the level of analysis that can best accommodate institutional lives and differences in levels from global to national and individual organisations, and that enables fruitful comparative analyses on salient institutional forces, is one of organisation fields.

In essence, Chapter 2 provides the theoretical terminology within which the rest of the study operates. The third chapter is the first one where the terminology is used. The purpose of the chapter is to present the two contexts, or, to be more specific, the ‘populations’ of which the empirical study on Finnish PICs serves as a case. The first section of Chapter 3 provides a literature review on the institutional life of Anglo-American PFC. It is argued that the otherwise heterogeneous Anglo-American PFC is broadly characterised in formal terms by a few specific regulative institutional forms, most importantly the trust-based organisational form and fiduciary legislation, and by specific kinds of organisational structures. In less formal terms, the institutional life of Anglo-American PFC is also characterised by a few shared dispositions in investment agency, including the choices between passive and active management, internal and external control, consistent or diverse philosophies, and options in corporate engagement. The purpose of the second section of Chapter 3 is to provide insights on what the financialisation of European pensions has been like. It is argued that although the institutional change in investment activities has occurred in variable
forms in European economies, there are some broad common political trends that can be recognised in these processes. It is argued that the introduction of funded elements to European pension schemes has also led to enforcement of pension investor-agents that use techniques of portfolio management, to empowerment of independence in fund governance, and to new prudential and risk based regulation and supervision paradigms.

The literature review in Chapter 4 moves the contextualisation from theoretical and methodological issues to a more real-life level context of Finnish PFC. The purpose of this section is to provide a context for the empirically studied ‘snapshot’ of the current institutional life, which is essential not least for understanding the meaning and strength of different institutional forms. The basic composition of funding in the Finnish overall pension regime is described in the first section of the chapter in order to increase understanding on different modes of funding present in the Finnish institutional context. The second section of the chapter provides an overview of the institutional path development of the institutional life of the TEL/TyEL investments from their beginning in early 1960s to the current framework. It is argued that the increasingly depoliticised TyEL investments have been formally reshaped many times parametrically at the field level, whilst the broader institutional role and purposes of the field have included more paradigmatic shifts, both with important political struggles between the social partners. In essence, the national financiers have been set into the common European trajectory and so turned into increasingly independent global portfolio investors.
Chapter 5 is dedicated to presenting the empirical research methods needed and used to study the social construction of PFC. It presents the data gathering methods, the data, and the analysis methods used in the empirical case study on the current institutional life of investments in the field of Finnish PICs. The data used in the study consists of over a dozen confidential close dialogue interviews (see Clark, 1998), textual data gathered in participatory observation, artefacts given to field actors in mandatory education, and thousands of pages of publicly available written material including legislation, government and pensions-related working group briefings, PIC annual reports, financial statements and PR material, and some pieces in public debates in main Finnish newspapers and magazines. The primary method for analysing the material is content analysis, which is suitable for qualitative data based primarily on these kinds of communicative actions. The research ethics is a great concern in this kind of sensitive area of study that not only covers billions of euros of investment capital but also a very small number of people operating in the field. The ethical perspectives related to this inquiry are discussed more extensively throughout the chapter.

The presentation of the empirical research findings of is divided to two separate chapters. Chapter 6 first discusses the organisational forms, institutional boundaries and governance systems that frame all the investment activities in and creates the boundaries of the field, whereas Chapter 7 shifts the focus on the questions of what are the central institutions that are in fact adopted field-wide in exchange, calculation and information processing actions related to PIC investment-making. The previous chapter is more focussed on the question of how contingency in the field is bounded and can be changed, while the latter is concerned with the dispositions currently
present at the field level. Chapter 6 is divided to three parts. The first section of the chapter presents a descriptive overview on basic formal aspects of the field including the central actors and flows (of information, services, financial contributions etc.). The second section is dedicated to the actors of the field and their institutionalised relationships, and has a strong focus on governance. The third section presents the boundaries that separate and distinct TyEL investments from other investors and directly enable and limit available investment styles. The section discusses the essential regulations, norms and other mechanisms of boundary control within which investment activity gets its form in individual PICs.

The institutional life of investments is discussed in Chapter 7. The chapter is divided to two sections. In the first section, the focus is on the field-level ideal type investment action processes based on the two embedded sub-case studies (see Chapter 5). As the PICs tend to share similar solutions in organising investment agency that have mostly subtle differences, the action process can be translated into a field-level ideal type description with specific variables. The second section of the chapter is dedicated to the field-level dispositions that materialise in these processes. The discussion of this section is categorised according to institutional forms found most salient in the data. It is argued that despite many PIC specific characteristics, there are a number of institutions in PIC investment decision-making that are in fact shared field-wide. There are some field-level logics that are behind investment choices as well as in the structures of action processes, for example the divisions to asset classes and corresponding teams. But there are also some tensions between different institutional forms, most importantly between discursive understanding of pension
investments as long-term activity that is experienced to be made impossible by solvency rules and other regulations.

The summary of empirical findings, methodological lessons, and theoretical conclusions are presented in the eight and the last chapter of the study. The chapter is divided to three short sections based on the three research agendas. The first section presents the overall empirical results on the social construction of the PIC field in comparison to the institutional life of Anglo-American construction and the historical development of the field. The second section is dedicated to methodological reflections asking what did the developed theoretical framework reveal, and how can it be used and developed in further studies. The third and last section discusses the theoretical conclusions arising from the study in relation to financialisation of European pension provision. It is argued that while European institutional diversity is likely to persist in some scope and the common project of financialisation of pension provision may remain limited, the European integration to global finance is not necessarily that different from the Anglo-American PFC when it comes to the questions that the adoption of PFC in general raises.
2. Studying the Institutional Life of Modern Finance and Pension Fund Investments

The purpose of this study is to explore the social construction of pension fund capitalism and, consequently, the social construction of investment making in different kinds of pension funds. This approach to investment agency makes a clear differentiation for example to behavioural finance in which individual collective investment choices and entire financial institutions are explained by individual-level psychology. The social constructionist approach suggests that agency cannot be understood without using social theory giving meaning to and explaining investment activities in social terms. This brings a variety of essential social relationships, structures and phenomena into inspection, including power, cultural meanings, and all kinds of collective practices with socially shared reasons. The purpose of this chapter is to discuss how the social construction of financial agency has been recently studied in social sciences in general, and how it can be theoretically approached from a geographical point of view and applied to pension investments.

The chapter starts with a literature review, which provides a set of issues that essentially need to be addressed when the social construction of investments are theoretically addressed. It is argued that the dominant functional approaches to finance as rational calculative behaviour in selecting investment vehicles have shifted towards more plural theoretical approaches to financial agency as calculation, exchange and information processing based actions. As already the title of this
chapter and the whole study suggests, the social theory discussed more extensively and used in the empirical study is institutional theory. The recent approaches to institutional theory have been found useful in case of strongly political and organised activities like pension provision. Given the recent methodological developments, however, the choice of institutional theory is all but obvious. Due to issues discussed in the first section, the version of institutional theory needs to be based on a broader conception of institutional theory than the mainstream version of new institutional theory. The main purpose of the section is to present the basic ontology of institutions as shared dispositions, and the methodological tools for analysing these structures in the scale of organisation fields.

2.1. Investment Agency as a Research Object

After the mathematical revolution in financial economics and in financial practices in 1960s, essentially starting from the Modern Portfolio Theory (MPT) based investment paradigm mathematically formalised by Harry Markowitz (see e.g. MacKenzie, 2006), financial investments in the capitalist economies became to be understood as professional portfolio management, as exchange of financial products on basis of relative prices, separated from commitment and usage of direct power brought by ownership, as the professionalisation of the ‘speculative investor’ seeking ‘shareholder value’ (Clark, 1981). The new paradigm relied on markets in asset allocation, selection and pricing, and took diversification to different asset classes, sectors, geographic locations, specialised portfolio managers and other service
providers as its utmost virtue. Investment decision-making was for decades
discursively understood in a specific ‘language of finance’ (Clark and Wójcik, 2007)
that framed all investments and management processes. It provided ‘a recipe book’
for decision-making with hierarchies and skill recognised by it, it excluded other
worldviews, it was authoritative by defining compliance and non-compliance to
mathematical models (thus implicitly selecting the proper investment objects), and it
was and continues to be written in English. The academic discipline of finance has
been dominated by a functional paradigm that has taken this language as granted in its
task for finding optimal investment behaviour.

While the ‘language of finance’ may continue to dominate the theoretical world of
finance handbooks (e.g. Fabozzi et al., 2002), it has in recent years given way to a
more complex and empirically based investment practice (Clark and Wójcik, 2007).
Financial markets and practices are now far more complex and differentiated than it
was previously thought possible. Financial products have expanded to include
investment in futures, derivatives and elements of social and economic life previously
considered impervious to market pricing, and financial expertise requires very
advanced quantitative skills, probabilistic reasoning and application of high-level
mathematics. The story of rapid technological change and financial inventions and
innovations is hardly anything new in the history of capitalist economies (see
Ferguson, 2008). The more important issue here is the breakdown of a somewhat
homogenic understanding of finance and the consequent emergence of discursive
plurality. This has raised gaps between financial theory and practice, and between
different financial theories as well as between different financial practices.
Geographers have highlighted that this disparity provides perhaps the most fertile research agendas for studying contemporary finance (Clark, 2006b).

At the same time, the new plurality has raised methodological and theoretical challenges for social sciences in defining proper research objects. These challenges have already broadened the discipline of finance from purely rationalist and functional explanations to psychological and institutional approaches. For example, behavioural finance has been welcomed in the mainstream of the discipline (e.g. Montier, 2002; Shiller, 2003, 2005), including pension studies (Mitchell and Utkus, 2004). At the most general level, finance has become ‘socialised’ as a research object, as the title of one popular blog puts it. This applies to various levels of analysis. Financial products and market have been regarded as social relationships, but now also the ‘tools for trade’ (Beunza, 2004; see also Hardie and MacKenzie, 2007) in the markets are considered to constantly change in their social nature. Social relationships and leadership issues have become seen essential in managing activities within investment organisations (see e.g. Clark and Thrift, 2004). Entire new academic fields have lately emerged to describe, analyse and explain the heterogeneous and complex social, cultural, material and technological life of the complex domain of contemporary finance.

Among the most influential fields within academia – not necessarily within practitioners – have been the so-called social studies of finance (SSF) (see e.g. MacKenzie, 2006; MacKenzie, Muniesa and Siu, 2007; Knorr Cetina and Preda, 2003).

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3 See the Socializing Finance blog of various social studies of finance scholars online at: http://socfinance.wordpress.com/ (accessed 23 June 2010)
2006). These studies appeal to various academic disciplines because they make a clear differentiation to the academic discipline of finance that continues to assume certain individualist modes of actions or actor rationality, and to political economy by denying uniform social causes and effects of diverse financial practices (Langley, 2008b). The theoretical approaches under the umbrella concept of SSF have been primarily poststructuralist, and drawn rationales for analysing financial agency from a broad variety of approaches and disciplines such as actor-network-theory (ANT), ‘microsociology’, anthropology of markets, technological studies, and geographic analyses. Especially the so-called ‘cultural economy of finance’ approaches (for an extensive review, see Pryke and Du Gay, 2007) have considered organisations not only exclusively social in nature but ‘hybrid’ assemblages including a number of physical, material, technological, cognitive and other features generating agency. For example for Callon (e.g. Callon, 1998, 2005; Callon and Caliskan, 2005), an economic agent is famously ‘made up of human bodies but also of prostheses, tools, equipment, technical devices, algorithms, etc.’.

The methodological point of departure in analysing the social construction of investment agency in SSF has been the understanding of practices of exchange, information processing, and calculation (e.g. in asset pricing and selection). Of course, as objects of interest they have been commonplace to the discipline of finance and to social sciences more generally for some time – the nature of market exchange for instance has been extensively addressed and discussed by social scientists, historians, and philosophers (e.g. Thielemann, 2000; Polanyi, [1944] 2001) during the last century of so. The novelty of the SSF approaches is based on understanding these tenets as specific kinds of social constructions.
The social studies have especially underlined that financial market exchange is different from exchange in other markets, which consequently makes financial investments a distinct research object from economic actions in other markets and fields. The ‘products’ of financial markets are produced by exchange actions (i.e. not exchanged after production). Indeed, financial products are not ‘embedded’ (see Granovetter, 1985) in networks, markets and other institutions: they form networks and are institutions. Financial markets are ‘internally differentiated, complex self-referential systems’ whose functioning, forms of action, and other mechanisms always pose questions in their own right (Knorr Cetina, 2007). Social relations in the domain of finance can be reduced neither to financial products like stocks or bonds nor to institutions of financial markets like stock exchanges, over-the-counter (OTC) markets and other central informational, formal and more or less regulated hubs of trading for assets. Rather, financial products, their selection methods and the exchange hubs are all different aspects of the same social relations.

Although these relations have been theorised from various perspectives, the key issue here is that these relations can be best empirically observed by looking at exchange actions, for exchange is the mechanism through which investors change and take positions in the world around them. Among other things this implies that different individuals in one investment organisation may in fact operate in a very different matrix of social relations than other in the same organisational framework, as there is much differentiation in forms and types of financial products and their markets (see Knorr Cetina, 2006).
The studies have underlined that financial markets are self-referential knowledge systems (Knorr Cetina, 2007; see also Marazzi, 2008, for an approach outside SSF). These systems include a great variety of forms in and potential consequences of information exchange, for instance non-market based reciprocal relations between different actors and speculative ‘exuberance’ (Shiller, 2005). Financial market reality itself is knowledge-generated, having virtually no existence outside the informational presentation of the market on the screen that is provided by news agencies, analysts, and traders themselves. The SSF have noted that financial models and schema may trap investors to certain behaviours in these kinds of market relations more or less independent of events outside the markets (Beunza, 2004). However, they also suggest that the “wider nexus of economic, social, and ‘lifeworld’ functions of knowledge” (Knorr Cetina, 2007) are unavoidable parts of markets and market behaviour, as any piece of information may end up being the cause of exchange. This is not to say that market relations and the ‘lifeworld functions’ of information used in them necessarily spread to all domains of life. Rather, they tend to be centralised where the cultures of specific actor-networks of ‘the domain of finance’ may exist (Langley, 2008b).

The cultures of finance are in great part globalist due to the nature of market information. Knorr Cetina (2007) has argued that financial markets have been set from the start to ‘the track towards globalisation’ by distinct historical developments, separation from producer markets, and their early deregulation. Geographers (e.g. Clark, 2006b; Clark, Dixon and Monk, 2009; Thrift, 1994; Corbridge, Thrift and Martin, 1994; Leyshon and Thrift, 2007; Sassen, 2001) have been very sensitive to the idea of coupling the local and the global aspects of finance, especially by focussing on
the cultural and other social ties between central actors in interconnected global financial centres like New York, London, Tokyo, Singapore, offshore financial centres and other local venues of global finance. Among other things, this suggests that investors may regard ‘home’ markets as quite different social relations than other markets they are less connected with.

While the SSF have not necessarily been too radical in theorising exchange or information processing but more relied on combining and building on previously fragmented academic debates, the approach to calculation has been perhaps more so. Although calculation provides a specific meaning to exchange of financial products and related information processing – it generates new kinds of social relations through financial products – it had not been exactly addressed as socially constructed for decades due to old academic division of labour between economists and sociologists (Stark, 2009). Calculation has only recently been seen as a socially constructed and material activity. For example, various sociologists have studied distributed cognition in calculative practices from this perspective albeit quite differently in context of finance (compare Callon, Millo and Muniesa, 2007, with Hardie and MacKenzie, 2007; see also Pryke and Du Gay, 2007, for discussion). In all these approaches, calculation brings organisational issues and their relation to broader market-wide social relationships to the very forefront of analysis of investment agency and financial relations.

Perhaps the most influential concept arising from the SSF in terms of calculation has been the notion of agencement. The notion, first drawn from Deleuze and Guattari (2004), includes a deliberate wordplay. To agencer is to arrange or to fit together,
which suggests an agent is an assemblage, arrangement, configuration or layout (Hardie and MacKenzie, 2007). The other side of the wordplay is *agence*, agency. Indeed, the notion of agencement is inspired both by Foucault’s *dispositif* (i.e. subjectivity enacted in a device) and by Bourdieu’s *disposition* (i.e. subjectivity in operating a device). Depending on the nature of the arrangements, framing and attribution devices, it is possible to understand agencies reduced to adaptive behaviours, reflexive agencies, calculative (or non-calculative) agencies, or disinterested or selfish ones. Pryke and Du Gay (2007) note that the notion of *agencement* is “an invitation to reflect on the hybrid nature of the practices that work through calculative agencies to put the flow into the flows of finance; it allows objects and people to be understood as assembled discursively and materially in practice”.

The methodological lesson that can be drawn from the SSF, which can be quite feasibly be summarised in the idea of *agencement*, is that any methodological approach to understanding the social construction of financial activities must pay close attention not only on what kinds of social relations financial products or their domains of exchange are but also on how calculative, information processing and exchange practices are actually enforced and materialised as agency in organisations. The post-structuralists might argue that it is less important where the variables for these domains are coming from than it is to see what kind of agency it generates. But this makes it easy to forget that the mechanisms that affect financial activity may actually have quite little to do with some prevalent cultures or models of exchange and calculation as such. They can be equally much about translating policies, legislation, marketing, management styles or paradigms, ethical guidelines or basically any of Callon’s ‘mediators between economy and society’ to the language of
calculation, exchange and information processing. This questions the seemingly apolitical nature of calculation. From Max Weber onwards, calculation has been regarded even as ‘essentially anti-political’ instrument (Barry, 2002).

It can be argued that the current normative legitimacy of finance is based on the norm that the ‘domain of finance’ is expected to consist of highly rational, technical and scientific practices, without paying too much attention to the politics on the targets to which this is used (Langley, 2008a, 2008c). The lack of political contestation has in part helped the separation of calculative practices of finance into a distinct social domain, and enabled the academic discipline of finance to rely on functional analyses that assume depoliticised investment activities. This is not to say the domain has no normative and political foundations. In the US for example, calculative portfolio investment and financial risk-taking became a legitimate and somewhat depoliticised area activity only in the 20th century via the moral technology of insurance (De Goede, 2004).

Indeed, when we look at institutional investors in general and pension investments in particular, studying financial agency only in terms of some specific cultures of finance seems to provide only the starting point in approaching social construction. A great number of different social institutions frame investments. To start with, pension liabilities directly affect calculation, regulations exchange, and consultants information processing. Pension systems are complex institutional arrangements with various stakeholder issues, political controversies and questions related to governance and management (Langley, 2008a; Clark, 2004). Just the political-institutional traditions, regulatory frameworks, and organisational forms are essential in framing
and characterising pension fund activities (Langbein, 1997; Roe, 2006). In order to analyse these and other more macro-level social frames and issues, we need further tools for understanding how these broader institutions translate into financial agency. Using the helpful notion of *agencement*, it is not only the financial models that reduce pension fund activities to adaptive behaviours, reflexive and calculative agencies: it is equally much the broader social institutions, and societal, political, governance and organisational issues and practices that play a major role here.

It can be concluded that the SSF do not imply that we should understand all investments exclusively as a part of some immanent cultures of hybrid actor-networks. Rather, the discussion above suggests that the theory used to study social construction of investments needs to fulfil two criteria in order to be able to fit broader social structures and agency fruitfully in analysis of investment agency. Firstly, a theory used must pay equally much attention to the question of how social structures are present and put in play in practices of calculation, exchange and information processing as it pays to the structures itself. This suggests that exclusively formal structuralist approaches are not too fruitful for understanding investments, and that we need a more process-oriented and action and actor centred approaches. Secondly, the approach must be able to accommodate different scales in order to be able to recognise information networks and processing methods from the level of separate global market flows to more organisation-specific social relationships and even to individuals’ lifeworlds. This suggests that neither macro nor micro level studies can address all the relevant social forms and relations that are generating financial agency. Rather, we need an approach that can accommodate influences at
various levels. This task can be best achieved with middle-range and meso-level theories (see Scott, 2008).

But can these two requirements be accommodated in analysis on social institutions? Does it imply that we should abandon structuralist social theory altogether and opt for a poststructuralist one? Having such shift would imply that most previous works of functionalist economists, political economists, economic sociologists, public policy scholars and scholars in various other academic fields would be if not ignorable at least in great part irrelevant. An alternative approach is to look for a theoretical synthesis that can build a bridge between different research paradigms and translate the results provided by previous studies to a new language. This is the choice opted for in this study. The challenge is that the two requirements expressed above are not easy to fit in any structuralist theory. It is argued in the proceeding section that the requirements can be nevertheless accommodated to one middle-range social theory that both recognises these two elements and is able to accommodate a variety of structuralist and functionalist studies in its framework. This theory is the pragmatist version of institutional theory, habitual institutionalism.

### 2.2. Investments, Institutions and Organisation Fields

The institutional turn took place in economic geography (and economics) in 1990s, following the turn in economic sociology and organisation studies a decade earlier. The turn can be simply described as “the recognition that the form and evolution of
the economic landscape cannot be fully understood without giving due attention to the various social institutions on which economic activity depends and through which it is shaped” (Martin, 2002). However, institutionalism is not a homogenic theory but a variety of different approaches to social theory. There are a few more or less separate institutionalist traditions: historical institutionalism, rational choice institutionalism, organisation theory, and sociological institutionalism (see e.g. Campbell, 2004; Crouch and Streeck, 1997; Hall and Thelen, 2009; Lounsbury, 2008; Scott, 2008; Streeck and Thelen, 2005). There are a few differences between these traditions. The scope of research interests in these traditions for instance ranges from slowly changing macro-level structures like national regulations in historical institutionalism to more rapidly changing uses of discourses in everyday social situations in the sociological variant of agency theory.

The institutional approach to geography has tended to be somewhat divergent in relation to these institutionalist traditions (Martin, 2002). This is the case with the research agenda of this study as well. Studying the institutional construction of pension fund investments in defined environments cannot be reduced to any of institutionalist traditions. On one hand, the research questions directly address investments as organised agency in different institutional environments, which suggests that institutional agency theory and institutionalism in organisational studies may be both relevant. On the other hand, the questions are not limited to social construction of agency, but extend to the broader societal role and understanding of this agency. This makes the question relevant to sociological institutionalism and, in some extent, to historical institutionalism as well. In this sense, the institutionalist traditions are not too helpful in addressing this question, and selection must be based
on other criteria. The two theoretical requirements presented in the previous section suggest that the selected theory must be able to explain how social structures and relations are put in play in calculation and exchange (and related information processing), and to accommodate institutions from various scales in analysis. Thus it is necessary to find the versions of institutional theory that address these two issues in a compatible form.

**Institutional theory and investment agency**

There are some features nearly all institutional theories share. Institutionalism as social theory aims at explaining a variety of issues like why actors behave the way they do in societies, how social structures interact, what organisations are, and why some practices persist over time. The point of departure for all institutionalist social theory is that social actions are embedded in, affected by and regularised through institutional forms: social structures that have reached a high degree of elasticity and resilience in social practices. These structures give meaning, constitute, enable and constrain courses of actions in society. Institutional structures are not determined functionally but have their own ‘laws of motion’, as Peck (2000) puts it. Institutions are created, renewed, maintained and changed only by actions (Scott, 2008). For example, a law is only an institutional form, not an institution, which refers also to what is in fact done on its basis. This not to say that the law would mean fundamentally different things for every single actor, that everyone would act differently or that the law could not be changed independent of actions based on it. But patterns of behaviour can never be exclusively determined by institutional rules or even predictably manipulated through direct changes in institutional forms like laws.
In causal terms, institutional forms can be considered even in strongest sense as probabilistic in relation to actions (see e.g. Crouch, 2007).

It is impossible to talk about institutional theory today without mentioning the broadly shared theories of institutional change that address the question of how different institutions change, interplay, and vary in strength. Institutional forms tend to have their own lives, and they can be tried to change as such. The change can happen politically in ‘recombinant governance’ (Crouch, 2005) or more incrementally and unintentionally even in conditions of active change efforts (see e.g. Campbell, 2007). In these terms, institutions can receive additional components (layering), be redirected to new purposes (conversion), fail to catch up with emerging needs (drift), and break gradually down (exhaustion) (Streeck and Thelen, 2005). But institutional change has also much to with agency. For example, an institutional form can be combined with other institutional forms (bricolage), combined with completely new ideas or non-local institutional forms (translation) in actions (Campbell, 2004). Actors tend to ‘make use’ of institutional forms differently, they can choose to act otherwise, to follow one institution instead of another, and try to change the usage of institutional forms, all of which promotes institutional change. In other words, while institutional forms may evolve more slowly, observable institutions change as actions change.

Some actors have better capabilities than others to change other actors’ behaviour via these mechanisms. These so-called institutional entrepreneurs are the innovating actors with best locations and thus most capabilities to affect their networks with new usages or introductions of institutional forms (Campbell, 2004). The micro-level mechanisms of institutional change also play a major role in providing understanding
on how different institutions interact and are used. Actors never face only one institutional form in their actions and all institutions do not necessarily or even likely constitute an equilibrium in which the weight of institutions affecting actions is static – institutional forms and practices tend to vary in strength, diffusion and scope. There is always the possibility that institutions interact so that they can be combined only in very specific ways in action processes, and some institutional forms cannot be necessarily fit to actions at all. They provide different kinds of incentives to renew themselves (e.g. they may be path dependent, referring to rewarding of old practices more than new ones), and in general give material and cultural incentives of various kinds and strengths for different choices.

The understanding of proper research agendas, the indefinite interdependence of agency and structure, and the strong focus on institutional change, is where the common characteristics of institutional theories end. Some theories are very much incompatible with the two requirements presented above. The first relevant issue here is the relationship between institutional forms and actions both in theoretical and methodological terms. In case of the former, actions have been regarded by (Weberian) methodological individualist institutionalists as subject’s externalisations of subjectivity, whose goal is to change the prevailing status of actor’s environment (see Campbell, 1996, for different approaches). More recently, sociological institutionalists (e.g. Gronow, 2008; Hodgson, 2006) have adopted definitions that resemble more Dewey’s (Dewey and Bentley, 1946) definition in which actions changing the environment are also about changing the subject itself as the environment already defines the social position from which the subject’s actions are made. The latter option is more suitable for this study, as the idea of trans-actions
suggest that producing impacts to investors’ environment is not only about deciding upon who gets money and with what conditions with characteristically calculative exchange practices, but also about taking ‘positions’ in social relationships so that it changes the environment exchange supposedly takes place.

Some methodologically holistic structuralists might argue that institutions more or less determine what expressions and directions actions driven by interests (also defined institutionally) may and will likely take and thus suggest that institutional forms are institutions. Methodologically individualist rational choice theorists on the other hand may think institutions as products of repeated individual actions that are not necessarily needed to be recognised in practice at all (Swedberg, 2003). In other words, the typical research agenda of institutional theory has been in either explaining individuals’ actions with social structures (i.e. dispositions via dispositifs) or in studying how institutions get born, renew and alter via actions (i.e. dispositifs via dispositions). Neostructuralist (Heiskala, 2003) and pragmatist (Gronow, 2008) strands of institutional thought, however, present institutions as a realm fully reducible neither to social structures nor to individual actions. Rather, they are structures located in-between them in action processes. These processes can be but are not necessarily initiated by institutional forms or individual decisions. These approaches come close to poststructuralist views in which the social world as well as individual actors are constantly in the making and in a perpetual state of becoming (see e.g. Callon, Millo and Muniesa, 2007), but only insofar as the existence and ‘own life’ of the institutional forms is not ignored or denied. The idea of structured action processes can feasibly address the question of how calculation, exchange and
information processing are actually put in play in organisations, why it is used in this study.

An important issue differentiating the institutional theories is the understanding on what kinds of institutional forms exist and how exactly they affect behaviours in the first place. Scott (2008) has provided an influential overall definition of institutions as comprised of regulative, normative, and cultural-cognitive institutional forms that, together with associated activities and resources, provide stability and meaning to social life. The neostructural institutionalists (e.g. Heiskala, 2007) have argued that these conceptions are not pillars but complementary conceptualisations of different institutional logics that should be differentiated in analysis if it has analytical value. Whether considered different pillars or different types of institutions, the three conceptions are quite different, and can be heuristically summarised as follows (see e.g. Gronow, 2008; Hodgson, 2006; Scott, 2008).

The regulative view concentrates mainly on legally sanctioned and other formal rules that coerce individuals to behave in line with institutional ends because compliance is instrumentally rational for actors (e.g. they are not sanctioned, they have incentives). Institutionalists in economics and rational choice institutionalists, most famously North (1990), usually embrace the regulative view of institutions. These scholars use notions like institutional equilibrium, and posit choice and repeated games as the mechanism of institutionalisation. Normative theorists, classic sociologists in essence, argue that purely instrumental rationality is not applicable whenever moral issues enter the picture. Thus the conception of institutions must be broadened to the normative domain. These norms – expectations, values, duties and other normative
entities actors face or at least internalise in socialisation processes – weigh on actors as moral obligations that simply have to be fulfilled. Cultural-cognitive or discursive\textsuperscript{4} theorists, often inspired by phenomenology, propose that even moral obligations are just one set of cultural schema, and emphasise the nature of institutions as knowledge schemas that are common beliefs about the nature of social roles and situations. The mechanism behind these institutions is mimesis, i.e. actors act in certain ways because these ways promote some understanding of the world and make actions understandable. The so-called new institutional theory, first discussed extensively by DiMaggio and Powell (1991) is based on this ontology of institutions.

The problem with these institutionalist traditions is that even the broadest version of mainstream institutional theory, the new institutional theory, seems to be very narrow in explanatory force when we look at the institutions of exchange and calculation. In terms of investment organisations as action processes, mimetic behaviour may continue to be an effective explanation, as investors tend to be very highly isomorphic in organisational structure (see e.g. Haigh and de Graaf, 2009). But this is not to say that mimesis explains actions. For example Stark (2009) has strongly criticised new institutional theory on the basis that mimetic behaviour does not explain successful investment behaviour in the constantly changing domain of finance. Rather, investors reflexively acknowledge that unless they question their models and, consequently, social relationships to other investors they will simply ‘lose their shirts’.

\textsuperscript{4} Gronow (2008) has re-titled cultural-cognitive institutions as discursive institutions because cultural-cognitive institutions are not only based on knowledge or ‘culture’ in sense of a given system of meanings and their relations, but are in nature discursively reproduced reciprocal typifications and actively typified knowledge.
In other words, investors are reflexively subject to Talebian uncertainty, in which social realities and their uncertainties are generated, categorised and typified theoretically (see Taleb, 2007). The problem with new institutional theory is not that it claims that investors would for example follow pricing schemas blindly (unlike Stark sometimes argues): as noted, it is very broadly recognised that actors make us of institutional forms in different ways. The problem is that new institutionalists cannot explain why any pricing schema exists as a taken-for-granted schema in the first place. Indeed, if investors cannot know what social schema they choose to follow as the social nature of the schema changes as rapidly as its different uses and modifications, how could they ever make an acknowledged choice to follow one?

### Table 2.1. Foundations of institutional theories. Source: Gronow (2008).

<table>
<thead>
<tr>
<th>The discipline(s) of institution theories</th>
<th>Regulative</th>
<th>Normative</th>
<th>Discursive</th>
<th>Habitual</th>
</tr>
</thead>
<tbody>
<tr>
<td>New institutionalism in economics and sociology</td>
<td>Old institutionalism in sociology and organisational analysis</td>
<td>New institutionalism in organisational analysis</td>
<td>Old institutionalism in economics (Veblen), pragmatism</td>
<td></td>
</tr>
<tr>
<td>Basis of compliance</td>
<td>Expedience</td>
<td>Social obligation</td>
<td>Taken-for-grantedness, shared understanding</td>
<td>Shared dispositions</td>
</tr>
<tr>
<td>Basis of order</td>
<td>Regulative rules</td>
<td>Binding expectations</td>
<td>Constitutive schemas</td>
<td>Taken-for-granted ways of acting</td>
</tr>
<tr>
<td>Mechanisms</td>
<td>Coercive Instrumentality</td>
<td>Normative Appropriateness</td>
<td>Mimetic Orthodoxy</td>
<td>Habitual Pragmatic</td>
</tr>
<tr>
<td>Logic</td>
<td>Rules, laws, sanctions</td>
<td>Propieties, obligations</td>
<td>Common beliefs, shared knowledge</td>
<td>Habits</td>
</tr>
<tr>
<td>Indicators</td>
<td>Legally sanctioned</td>
<td>Morally governed</td>
<td>Recognisability, culturally supported</td>
<td>Proficiency of action</td>
</tr>
</tbody>
</table>

Pragmatist institutionalists have a feasible solution to this problem. Gronow (2008) argues that institutions can be defined as shared dispositions. The meanings of dispositions are not necessarily fully acknowledged by actors: they may operate in certain ways without thinking too much about what they are doing. Actors think ‘if
need be’, if the actions simply are not proficient, for example if investment styles are not profitable enough to meet liabilities or that pricing schema do not generate expected results. Proficiency may be based on regulative compliance, moral appropriateness, or cultural comprehension as in the narrower versions of institutional theory. However, it may also be based on ‘gut feeling’, ‘instinct’ or other personal motives that investors might have. The reason is not essential here: it is the outcomes, what dispositions actually become to be considered proficient socially and shared by different actors. The habitual institutional approach is thus broader than Bourdieu’s habitus in the sense that the latter consists of particular kinds of habits with particular reasons (i.e. those relating to the reproduction of status distinctions). In this theory, the mechanism for institutionalisation is not mimesis but habitualisation of practices. Sharing can also be seen to include other institutional traditions: dispositions can be shared for example coercively through legislation, morally through norms and expectations that we have come to learn in our socialisation processes, or mimesis when actors try to act culturally meaningfully (see Table 2.1).

The theoretical approach to institutions used in this study is based on habitual institutionalism that argues that (investment) agency is about dispositions producing proficiency for (calculative, exchange, and information processing) activities that become institutionalised as socially shared and taken for granted ones through habitualisation. Dispositions reside in action processes where actors try to change their physical and social environments and social positions. In these processes, there are no attributions to ultimate, final, or independent entities, essences, or realities but multiple phases, descriptions and techniques. There are various institutional forms like regulations or norms, and other ideas that condition, give structures to,
characterise, and provide proficiency for actions in the processes, but they do not
determine any actions or even further stages in action processes. The approach leaves
the questions of how exactly dispositions come to be shared and habitualised open to
empirical analysis on action processes – it may be as well Excel spreadsheets or
algorithms as coercion or mimesis that make dispositions shared and adopted. Sharing
can also be acknowledged or preconscious, and positive or negative. Sharing a taken-
of-granted way of acting does not mean that it is always acknowledged or used.
Institutions change when actions lose their proficiency, when they have to be re-
thought. This may mean that more profitable or beneficial dispositions are simply
emerging and habitualised. But it may also mean that practices are made less
proficient, for example through new regulations that affect action processes. Although
the habitual approach starts from agency, it also gives much room for explaining
broad society-level institutional forms.

**Organisation fields as institutional arrangements**

Habitual institutionalism brings a new object of interest for geographical analysis:
proficiency. Proficiency forms different spaces in which shared and habituated actions
are fluent for different reasons and combinations of institutional forms behind them in
action processes. However, in order to discover these spaces empirically, we must
choose a scale of action processes in which shared dispositions and the modes of
proficiency are sought, and, consequently, to define the actors whose dispositions are
actually observed. In institutional economic geography, there are two types of scales
where institutions can be located (Martin, 2002). *Institutional environments* refer to
the community-wide systems of informal conventions, customs, norms, and social
routines that give cultural expression to economic actions and the formal, often legally enforced structures of rules and regulations, which enable, constrain and control these actions. Institutional environments are general frameworks affecting all ‘socioeconomic’ actions. In contrast, institutional arrangements denote the particular, actively governed organisational forms such as markets, firms, labour unions, city councils, regulatory agencies or even the welfare state, that arise from the institutional environment. There are various scales from organisational subsystems to the entire society with which institutional arrangements can be approached (Scott, 2008).

Clark (2006b) has suggested that the research agendas of the geography of finance must carefully avoid understanding environments of financial activities as passive constructions. The environments and cultures in which people find them and to which they contribute are necessarily ‘local’ in the sense that the geographical scale is the lived world of individuals and their immediate communities. But it would be misleading to say that people’s everyday lives are being “integrated from the bottom through to the top of the geographical scale” (ibid.). Such cultures, like the cultures of finance, are neither local nor autonomous, but political projects. This suggests institutional arrangements are the best choice here – recall the second requirement for an adequate theory of the institutional life of financial practices discussed in the previous section, which suggested that the theory must be able to include institutional frameworks in different levels and locations into analysis.

There is one level of analysis used in institutional organisation theory that studies the arrangement of interactions between various institutional environments and arrangements (e.g. different markets and states) and specified organised actors (e.g.
pension investors) in the meso-level. This level is one of organisation fields. Organisation fields are bounded by the presence of shared institutional frameworks like a common regulatory system so as to constitute a local and recognised area of institutional life. They present a level of study in which institutional forces are likely to be salient (Scott, 2008). In institutional theory, organisation fields are essentially about institutional frames that the organisations belonging to the field can make use of. A field is a set of institutional forms that can be used for various purposes, but also a more specific variety of action processes in which it sets the actors belonging to the field. The notion of organisation field refers to quite clearly demarcated dispositifs and to collective actions of organisations, which makes it more limited than for example Bourdieu’s fields whose institutional boundaries are spatially quite fluid and primarily related to individuals’ actions.

The concept of organisation field challenges geographical concept of environment that favours a passive construction of agents. It reminds that social contexts of specific economic actors are organised: not just random collections of resources and schemas, or constructs defined by disembodied dimensions such as complexity and munificence (Scott, 2008). At the same time, however, the concept of organisation field denounces the deterministic nature sometimes projected to individual organisational arrangements. As Whitley (2007) puts it, to suggest that the institutional constitution of actors is simply a matter of institutions guiding and enabling them is to ignore or downplay the significant role of societal institutions in constructing different types of collective socio-economic groups and organisations as particular kinds of actors that are able to carry out different kinds of activities in varied societal environments.
From a methodological perspective, organisation field constitutes (besides a field of proficiency and shared dispositions) an observable area of institutional life in very tangible terms, including key suppliers, resource and product consumers, regulatory agencies, and other organisations that produce similar services or products (DiMaggio and Powell, 1983). But it also refers to the existence of community of organisations partaking in a common meaning whose participants interact more frequently and fatefully with one another than with actors outside of the field. This suggests that studying organisation fields can be anchored to the frame or to the actors. Martin (2003) has observed a tendency to view organisation fields in three quite different meanings: as a purely topographical construct with simplified dimensions in which persons or institutions are positioned in analysis, as a more or less fixed organisation of forces, or as a ground for contestation or a battlefield for actors and practices. In the two former senses, fields can be seen as networks of actors within a fixed or at least relatively stable alignment of material, organisational and institutional forces (Levy and Scully, 2007). The third conception, the one used in this study, is anchored to actors instead of frames. It includes the idea that the meaning and even existence of all rules depend on how actors use and change them, which suits the institutional approach used in the study.

The actor-anchored conception of fields draws attention to at least to three different aspects of organisation fields as arrangements of dispositions. The first key question concerning in the organisation field architecture is governance. Governance refers in institutional terms to the setting of rules, the application of rules, and the enforcement
of rules, in which rules may be formal as well as informal (Kjær, 2004). In institutional arrangements, governance includes two analytically distinct but necessarily paired aspects of governance: formal (heuristically: what is to be governed) and operational governance (how is it governed) (Carmel and Papadopoulos, 2003). The formal aspect recognises the object of governance, in case of pension investors organisations that turn pension savings to invested assets for example as trust funds, insurance companies or buffer funds. In this sense, organisation fields as any institutional arrangements are “residues of conflict and structurations of power” (Korpi, 2001). The operational aspect captures the means (e.g. investment decision-making arrangements and who participates in them, direct regulative restrictions and rules concerning allocations, risk management etc.) with which investment agency is steered. This latter aspect regards governance especially as a mode of coordination of independent activities (Jessop, 1998). In context of organisation fields, the idea of the two aspects can be summarised as follows. Firstly, there is the question of how usage of power is organised within the field – in what relations and roles different actors are set in face of other actors in their dispositions. Secondly, there is the question of how the field architecture be changed: who can determine the redefinition of the field dispositions and how.

The second essential aspect is the issue of field boundaries. The boundaries of the field limit it to a recognised set of organisations engaged in similar function that shape field activity and definitions (Delbridge and Edwards, 2007). But they also form an essential relationship to internal rules. The permeability of boundaries increases the

5 In principle, all institutions, including institutions as shared dispositions, can be formulated as rules or imperatives if necessary (Hodgson, 2006). This should be not confused with the idea in regulative institutionalism that institutions are rules producing incentives.
possible institutional referents, thus providing fertile ground for growing alternative institutional logics of action within a given institutional field (see Lounsbury, 2008). These logics provide different belief systems that guide actions in field and provide a basis for legitimacy for the formation of new identities, practices and relationships within the field (Green, Babb and Alpaslan, 2008). Alternative institutional logics may open up field boundaries as well as reconstitute its power relations and governance structures. Returning to Korpi’s terminology, the firmer the boundaries are, the less there is need to re-politicise the ‘original conflict’ of the field. On the other hand, the stronger the boundaries are, the less there is room for innovation that is often crucial in solving emerging tensions and problems in the field.

The third issue is the highly political nature of institutional change. The concept of institutional work has highlighted this theme perhaps most potently in recent academic debates. The notion helps to understand how actors within the fields purposefully act, alone or in cooperation, with aims at creating, maintaining and disrupting the field-level structures that condition their life (see Lawrence, Suddaby and Leca, 2009). The concept of institutional work highlights three important issues: it highlights the awareness, skill, and reflexivity of individual and collective actors; it increases understanding of institutions as constituted in the more or less conscious actions of individual and collective actors; and, it adopts a perspective that suggests we cannot step outside actions as practices (Lawrence and Suddaby, 2006). Even those actions that are aimed at changing the institutional order of an organisational field occur in relation to the sets of institutionalised rules. The main strength of the approach is that it brings politics back to institutional analyses that have tended to be more ‘apolitical’ – it strips away the taken-for-grantedness from institutional research.
and directly addresses the core problem of how man-made products and events come to be perceived and represented as natural social orders (Lawrence and Suddaby, 2006).

Also institutional entrepreneurship has a specific meaning in context of organisation fields. In context of organisation fields, institutional entrepreneurship represents the activities of actors who have an interest in particular kinds of institutional arrangements and who leverage resources to create new institutions or to transform existing ones especially ‘from the within’ (Maguire, Hardy and Lawrence, 2004). The concept has been extensively theorised in recent organisation studies. For example, Perkmann and Spicer (2007) identify three types of projects in which institutional entrepreneurs engage themselves: in interaction projects, entrepreneurs relate to others in gathering support and building coalitions; in technical projects entrepreneurs theorise by identifying abstract categories and formulating notions of causal chains of events; and in cultural projects, entrepreneurs aim to frame institutions in ways that appeal to wider audiences.

All in all, the scale of organisation fields as the level of analysis for investment activities has at least three benefits. Firstly, it shifts research focus from the broad cultures of the domain of finance to the question how they are transmitted, translated and limited by institutional boundaries within which investors act in their everyday collective actions. In this sense, this theoretical-methodological framework can help to find relevant environments through which financial actions are locally regulated in practice. This brings us also to the second benefit. Organisation fields provide specific frameworks for understanding proficiency. For example, proficient activities within
the institutional boundaries of the field might not necessarily be proficient in broader society or in the domain of finance. Moreover, when proficiency of the field activities is threatened, institutions require reinvention, change or perhaps even decay. This suggests that the question of how to shape institutional boundaries and institutions of the internal life may be as essential in determining the success of its actors as the success within the old boundaries. Thirdly, the scale of organisation field suggests that investment agency is not only about organising activity in broad environments but also between different organisations. This enables analysis not only on personal but also organisational networks in the domain of finance.

However, in institutional theory, individuals are always the ones conducting actions, while organisations are the actors of organisation fields. This brings us to questions of collective action. It is caused by the beliefs and desires of the collective itself whether or not such beliefs and desires can be accounted for or explained in individualistic terms (Corlett, 2001). Using the notion of agencement, the organisation field framework in part reduces the collective actions to specific behaviours. Individual organisational structures are important institutional frameworks for action processes, but at the field level the only essential question is what kinds of overall collective actions they produce. In terms of investment agency, we are interested in seeing what kinds of practices emerge from organisations, not so much what their role is in individual organisation cultures. Nonetheless, in terms of empirical research methods, we must always first analyse and understand the action processes individual investor-organisations generate in order to address field-wide dispositions of calculation and exchange – we simply must know where to look for shared taken-for-granted ways of acting in collective actions in order to find dispositions at the field level. In
conclusion, when studying the habitual institutional life of organisation field, we must first look at the field frames and boundaries as action processes for collective actions, then the transmission of these processes to the action processes within the organisations of the field, and only after these the actual dispositions adopted within these frames and processes.

* * *

To wrap up, the purpose of this chapter has been to develop a theoretical-methodological model for studying the social construction of pension fund investments based on methodological debates in the social studies of finance in general and in geography of finance in particular. The key approaches in this model are as follows. First is the understanding of investment agency as organised collective actions of information processing and calculation related to, and exchange of financial products. The second is that the real-life social construction of these thematic domains of agency is understood in terms of habitual institutions: as habituated and socially shared dispositions that provide proficiency for investment actions in certain institutional arrangement. Proficiency is here studied in the scale of organisation fields that form certain spaces of proficiency that combine institutional influences from various environments and arrangements. The third key approach is that organisation fields set investors into certain action processes, within institutional forms, and to mutual relationships between the actors of the field that all need to be
recognised or addressed in order to achieve proficiency. However, the institutional life of investments is contingent beyond these frames, and the frame never dictates all aspects of proficiency. How the field frames and the dispositions adopted within these frames can be studied empirically in any particular fields with a case study strategy will be discussed more closely in Chapter 5. Before that, we use the terminology presented in this chapter for the literature review on the ‘population’ to which the case study is related.
3. European Pensions and the Institutional Life of Pension Fund Capitalism

Pension fund capitalism as a phenomenon belongs to the Anglo-American institutional history (see Clark, 2000, for detailed review). During the last decade or so, however, academic scholars have had few alternatives but to broaden the geographical scope of theories and enquiries. Vast pools of pension capital are generated in a rapid pace in economies outside the Anglo-American ones. In the end of 2007, just before the financial crisis hit pension funds, the OECD pension fund assets had reached USD 17.9 trillion in assets, representing about 64% of the total assets in all private pension arrangements. Of these 17.9 trillion, the United States still had by far the largest share with assets worth USD 10.2 trillion, but its share of the OECD total pension fund assets had shrunk by ten percentage points since 2001 as a result of faster growth among pension funds in other OECD countries (OECD, 2009). Furthermore, these OECD figures do not even include all public pension assets and all assets in other forms than pension funds, which are significant in size outside Anglo-America. For example the adoption of public pension reserve funds has led to the generation of in total USD 4.3 trillion in pensions related assets in various OECD countries, and the emergence of pensions-related Sovereign Wealth Funds (SWFs) are expected to take an important indirect role in pension provision globally (Monk, 2009a). Indeed, it is safe to say there are now great pools of pensions-related capital that have been generated in very different institutional environments from the Anglo-American economies.
This raises two important sets of questions that are addressed in this chapter surveying previous academic literature on these issues. Firstly, does the usage of pension capital differ from the Anglo-American funds in different institutional contexts? As the purpose of this study is to illustrate some actual and potential differences with the case study in the following chapters, the logical prerequisite for answering the question is to have some picture on the institutional life of Anglo-American PFC. The purpose of the first section of this chapter is to translate previous academic literature on Anglo-American pension investments to the language of institutional theory used in this study, and thus to provide a theoretically consistent point of comparison to the empirical case study on Finnish PICs. A reliable empirical account of the institutional life of Anglo-American funds would be, of course, something requiring decades of empirical enquiries, which is why the goal here is only to provide some theoretical hypotheses on the essential institutions that have characterised the organisation fields of these funds and made them distinct institutional domains of investment-making.

Secondly, the emergence of new funded pension schemes or new funded components to old pension schemes in so many economies begs the questions why and how. Does it for example mean that European and other economies are adopting the politics of Anglo-American pension regimes, or is it just because international investments are considered cheaper means for providing pensions than others? The emergence of funding is something that geographers, political scientists, sociologists and economists interested in pension funding have addressed in some length. The theoretical research agenda of this study is to see if there is a common project of financialisation at the European level concerning the political integration of local
pension schemes to global finance from perspective of investment making. It is argued here that while financialisation in general includes some common political aspirations concerning pension provision Europe-wide and beyond, it does not necessarily imply that all European pension schemes or funding mechanisms are actually converging institutionally towards these goals. In contrast, the strongest common developments at the European level have been more about investment methods and governance than about pension benefits or liabilities.

3.1. Mapping the Institutional Life of Anglo-American Pension Fund Capitalism

The world of Anglo-American pension funds is a very heterogeneous one – there are different types of benefits and funds, differing regulations at different levels and locations, different governance systems, to mention only a few examples. It could be argued that in the liberal regimes of social policy, there are almost as many types of pension schemes as there are differences in supply of and demand for them. Yet in some paradoxical way, when it comes to investment making, there are strong common institutional frames that Anglo-American funds share almost without exceptions. As Scott (2008) suggests, shared frames like regulatory frameworks are key features forming a recognised area of institutional life of an organisation field. In this sense, all Anglo-American funds can be understood to belong to the same organisation field. The life of this field has been called ‘fiduciary capitalism’ (Hawley and Williams,
2005) on the basis of the legal mandate called fiduciary duty that frames all pension fund activities. The purpose of this section is to survey previous literature in order to map some of the key dispositions shared by Anglo-American pension funds within this institutional life.

The challenge for mapping these key features in a literature review is that there have been only few more comprehensive studies at a level of analysis that have accommodated both macro-level institutional frameworks and more micro-level investment agency issues in analysis. The theoretical insights and research agendas outside debates on particular investment strategies or regulations have been in general somewhat narrow, and their translation to the institutional approach would be very laborious without points of reference to more comprehensive accounts. Fortunately, there are some more comprehensive works that are very helpful in this task. Clark’s (2000) functional and spatial ‘industry’ structure approach, which operates in the same scale as the organisation field analysis used in this study albeit with different terminology and more functional descriptions, can be directly translated to the organisation field level in coverage. The classic anthropological enquiry of O’Barr and Conley (1992) studying the cultures of nine US funds ethnographically is another work exploring common features in micro level, which can be furthermore directly translated to the habitual institutionalist terminology.  

6 Clark’s functional industry approach can be directly translated to field level dispositions with the requirement of clear mechanisms for sharing the social practices and positions. O’Barr and Conley’s approach is directly compatible with the institutional approach of this study with a similar remark: they define culture as shared beliefs, practices and underlying (i.e. not necessarily fully acknowledged) rationales, which can be translated to the language of shared dispositions as such when there are references to action processes.
These two works serve as the starting point for the theoretical reinterpretation of existing literature. As these two works are not too recent, and as the latter had a major impact to the pension fund activities (see Ambachtsheer 2007), they ought to be regarded primarily as starting points in time from which continuity and changes need to be confirmed with more recent updates to the observations presented in these studies. Indeed, although the approaches towards Anglo-American pension fund capitalism have been quite narrow, the attention has hardly been scarce in the recent years.

The institutional frameworks for pension fund investments have recently gained much academic focus lately for example in terms of pension fund governance (Boeri et al., 2006; Clark, 2004; Ambachtsheer, 2007; Cocco and Volpin, 2005; Ambachtsheer, Capelle and Lum, 2008), of pension fund investment regulation and changes of interest in it in formal-political system (Clark and Wójcik, 2007; Clowes, 2000; Langbein, 1997; Roe, 2006), and of more general habits, rules and norms framing and resources available to governance and decision-making practices (Clark and Urwin, 2008a, 2008b). The same applies to pension fund investment decision-making, investment schema and adopted corporate engagement practices in various disciplines in social sciences (Langley, 2008a; Mitchell and Utkus, 2004; Hebb, 2006; Clark and Hebb, 2005; Hawley and Williams, 2005; Del Guercio and Hawkins, 1999; Gillan and Stark, 2003; Clark and Strauss, 2007; Clark, Caerlewy-Smith and Marshall, 2006). This set of literature is here used as the main source for the survey, and as such, it has a weighed focus on the US funds rather than the UK funds. The following discussion is divided to three primary topics derived from the theoretical framework discussed in
the previous chapter: the field frames, the structuration of action processes, and the actual dispositions adopted within these frames and processes.

**Fiduciary duty as the organisation field frame**

The organisational form of trusts provided the historical template of economic organisation and behavioural guarantees to the Anglo-American pension funds (see Langbein, 1997, see also Clark, 2000). The understanding on the mandate of the trusts has changed over time, which is why history is not necessarily the best source for understanding the institutional life of today’s pension funds. The Employee Retirement Income Security Act (ERISA) (see Department of Labor, 2008), introduced in 1974, started a new era of American PFC. It was the most important regulation that redefined investment agency in Anglo-American pension plans towards the current form. ERISA was crucial in the process of legitimizing portfolio management and reinforcing the power of financial intermediaries (Montagne, 2007). ERISA gave a new mandate to those who manage and control the assets generated by the pension plan: it required the plans to establish a grievance and appeals process for participants to get benefits from their plans, and it gave participants the right to sue for benefits and breaches of *fiduciary duty*.

The fiduciary duty is the single most important Anglo-American framework for all pension fund activities and in this sense frames the organisation field of pension funds to a certain recognisable mode of actions. The fiduciary duty provides a personal duty for a fiduciary (trustee or trustees) but only a functional test for fiduciary’s behaviour – ‘procedural delegation’ as Montagne (2007) puts it. In this sense, ERISA produced
a new interpretation on the trust by limiting trustees’ responsibility to the strict function assumed in the name of the delegation, which “consists of extensive delegation to investment managers, whom the trustees oversee by verifying the means implemented, without imposing a performance bond but by multiplying the number of providers placed in competition” (ibid.). As result, pension funds can adopt almost any investment strategies and methods as long as they met the ‘best beneficiary interests’ represented in the functional test. This is why fiduciary duty can be best understood as a very broad regulative mandate to conduct not-so-specified variety of investment strategies and practices (Clark, 2004).

Indeed, ERISA introduced modern portfolio theory as the interpretation of trust protection without providing much insight on what kinds of portfolios ought to be constructed. Individual investments are judged against the composition of the entire portfolio, the liquidity and current return of the portfolio in relation to the cash flow requirements of the plan, and the projected return of the portfolio in relation to the funding objective of the plan. Investments are required to be diversified for example by investment vehicle types, geographic location, industrial sector and dates of maturity. The approach to regulation includes few direct constraints, and there have been in broader tradition very few direct quantitative and qualitative rules and regulations concerning pension funds asset management (Blome et al., 2007; McGill et al., 2005). For example, there are no quantitative investment rules apart from the famous 10 per cent ceiling on investment in the sponsoring company, but a few qualitative regulations that are typically enforced via litigation. Even so, the qualitative rules such as prohibited transactions between plan and parties of interest only mildly constrain investment behaviour. The principle-based and prudential
regulation supposedly maintains the ethical ties between pension fund trustee
decisions and beneficiaries (Clark, 2006a). However, the notion of ‘best beneficiary
interests’ is dependent on its interpretation. It has traditionally been interpreted in
courts as ‘financial interests’ but more recently also as ‘economic interests’ (see e.g.
Richardson, 2008). Heuristically it could be argued that proper investment targets can
be chosen on the basis of a factor other than the economic interest of the plan as long
as the targets are of equal economic value.\footnote{See Department of Labor letter to William M Tartikoff, Senior Vice President and General Counsel of
Calvert Group Ltd (May 28, 1998) – the Calvert Letter, as it is better known.}

The mainstream economic rationale on this kind of regulation suggests that principle-
based and procedural regulation should enable invention, innovation and a variety of
different investment styles and strategies when compared to investments under the
supposedly inflexible rule-based substantive regulations (see e.g. Davies and Green,
2008). Yet the results have been quite the opposite. Most US pension funds have
adopted and continue to adopt very conventional and conservative investment
strategies (Ambachtsheer, 2007; Ambachtsheer, Capelle and Lum, 2008; McGill et
al., 2005). This is caused by the timidity to break the mimetic lines of conventionality
(see Clark, 2000). In simplified terms, if everyone acts in line, it is always possible to
blame the market for bad performance, and if someone stands out of the crowd, the
accusations of breaching fiduciary duty are much more likely. Take asset allocations
for example: “the great bulk” of pension plan portfolios remain invested in common
stocks, intermediate and long-term bonds, money market instruments, group annuity
contracts, and other conventional investments and only very modest percentages may
be found in real estate equity and mortgages, oil and natural gas properties,
collectibles, options, futures contracts, foreign securities, and all other investment opportunities believed to offer the prospect of higher-than-average returns (McGill et al., 2005). Especially US pension funds rarely vest major stakes in hedge funds or use complex derivatives such as swap overlays to hedge their bond and stock investments (ibid.).

After ERISA there have been many changes in the macro-framework of US pension funds due to introduction of new acts and actors (see e.g. Blome et al., 2007; Watson Wyatt, 2007). This has reconfigured if not necessarily asset management methods at least various indirect calculations related to it and in more general terms strengthened the power of regulation. For example, under the new Pension Protection Act of 2006, US pension funds are required to fully fund their pension liabilities. Actuarial assumptions and valuation methods are prescribed by law, and the funding level will affect not only employer’s contribution, but also employees’ benefits. Furthermore, plan sponsors will also have to operate under a different set of accounting rules. Regulations are in many cases almost as fundamental as the types of pension plans in terms of affecting available investment practices (see e.g. Davis, 2002b; Stewart, 2005; OECD, 2010). For example in case of some participant-directed DC accounts, fiduciaries are required to provide pension plan participants basic information and instruction, and at least three alternatives from a broad range of investment options with different risk profiles. The regulations may affect these profiles very effectively. For example, liquidity based constraints directly link investments to the right for investors to withdraw funds as a lump sum or the current needs for regular withdrawals.

Of course, even when taking almost invisible bets, pension funds may become relatively big players in very small alternative markets such as art investment funds (albeit not necessarily very successful) (see e.g. Baram, 2005).
disbursement, the investment horizon to the planned liquidation date of the
investment, inflation sensitivity to the need to hold assets as inflation hedges, tax
considerations to the nature of trade-offs, and accounting rules to different portfolios
considered 'optimal'.

If we look at fiduciary duty as the characteristic boundary of the Anglo-American
organisation field of pension funds, we can explain some issues like the conservative
portfolio management paradigm. However, law is all but definitive even in this
context. O’Barr and Conley (1992, p. 95-97) noticed in the early 1990s that although
the ‘law is a pervasive influence in pension world’ and most pension fund personnel
seem to have ‘a set of clear-cut answers’ to the questions about law, the role of
fiduciary set by the law is ‘fraught with ambiguities and potential conflicts of
interest’. The law has in general left three gaps: ownership of the funds, socially
conscious investment, and sufficiency of diversification. In O’Barr and Conley’s
study, private fund executives usually understood their beneficiaries as mere distant
abstractions whose expectations were only assumed (e.g. not inquired or confirmed
empirically). Some executives regarded employer-sponsors as the ‘true owners’,
although many regarded funds as independent and immune entities.

The question of whether the law could dictate any investment policy was answered
differently from fund to fund and from executive to executive. For some trustees, law
dictated nothing else but common sense and prohibition to put all eggs in one basket,
thus leaving all decisions to the fiduciary. For others, ERISA truly implied a certain
kind of investment style. In most cases, however, the law provided “a convenient
vehicle for displacing the responsibility for choosing an investment strategy that
cannot be justified on other grounds” (p. 116). This is especially the case with so-called social investments. Some thought that fiduciary duty compels to follow only economic goals, but some – mostly fund lawyers – saw that it compels to be prudent in all meanings of the word.

The more ‘gaps’ or possible interpretations the law leaves, the more important the question of shared dispositions *de facto* becomes, and shifts attention towards other shared dispositions affecting investment actions. This is, of course, not to say that the type of pension plan or regulation would not be essential in terms of defining investment dispositions – they do have implications for asset management agency from symbolic terms of plan classifications to more substantive issues in formal governance. The design of available investment strategy options for individuals in DC plans is for example very crucial in determining the actual investment strategies and their outcomes (Mitchell and Utkus, 2004), whereas DB funds are not so much affected by these kinds of questions in operative governance. The heterogeneity of plans and regulations implies that the organisation fields of Anglo-American pension fund investments are albeit bounded by strong ‘fiduciary proficiency’ in terms of delegation and portfolio design, in other logics quite heterogeneous.

**Trustee decision-making as action processes**

The organisational templates of trust-based funds provide specific kinds of structures for investment action processes. There are three common types of decision-making arrangements for Anglo-American pension fund investments (Clark and Urwin, 2008a). The simplest type, usually found in small pension funds, is a system of
collective deliberation, in which pension fund board makes decisions on a routine basis with the support of a consultant and external service providers. The second type utilises an investment committee subject to final approval at the board relying on collective decision-making with the regular meeting schedule. The third type is using advocating and utilising real-time decision-making with in-house expertise. These types are important as they enable different tools for proficient investment management. For example, two first types may use strategic allocation to equities and bonds (and other classes), liability driven investment (LDI), alternative benchmarks and strategic allocation to alternative asset classes as investment management approaches. But only the third type may also use for example multiple active managers, wider risk budget flexibility, long-term mandates to capture skill term premium, and medium term dynamic strategic allocations.

Some governance structures also seem to provide more proficiency than others in controlling investments (see Clark and Urwin, 2008a). The funds that have for example clear missions and mission statements, responsibilities, accountability, and governance chains, perform better in respect to their duties. Investment philosophy claiming fund-wide support that aligns with operational goals and informs investment decision-making is more efficient. Investment manager selection with criteria of investment efficiency, alignment to the fund's needs to achieve sustainability of performance goals, and appropriate transparency of process, allowing for an assessment of the product according to its manager skills and market return drivers, is equally important. Usually there are three jobs, in hierarchical order, that are executing investment decisions in Anglo-American funds with broader governance structures: chief executive, a chief investment officer (CIO), and a staff of specialists
within each defined investment category (e.g. equities and fixed-income). Yet despite the ostensibly clear formal division of labour, governance, executive and operational functions are not necessarily separated from each other in practice (Ambachtsheer, 2007). Furthermore, the efficacy of control should not be taken for granted (see O’Barr and Conley, 1992).

Already O’Barr and Conley showed that there were discursive structures that undermined the structural effectiveness of governance: common myths, strong personal relationship management, and displacement of responsibility. Myths showed that private pension funds were not based on rational blueprints but historical contingencies that serve as the institutional basis for the organisation. Relationship management showed that nearly all structures are present in actions in which control was an illusion and personal characteristics played a more significant role, and thus made structures asymmetric in relation to different actors. The selection and evaluation procedures on portfolio managers for example was regarded as an effective, continuous control mechanism used by executives, but portfolio managers regarded them as situations that could be very easily manipulated. Displacement of responsibility was perhaps the most common feature to pension funds. Decisions were buried in the organisation bureaucracy, external portfolio managers were often blamed for nearly all kinds of setbacks, markets were blamed for bad performance, and fiduciary duties were blamed for the constraints they were (sometimes absurdly) suggested to provide. Accountability to the bottom line – not beneficiaries as such – was valued very high, but it had few if any consequences on actions.
Moreover, pension funds have shortfalls in governance like any organisations, thereby being vulnerable to the principal-agent problems, moral hazard problems and asymmetric information in general, which all make them vulnerable to contestation (Clark, 2004). These problems are also significant because there is empirical evidence (from DB funds) that insider-trustees tend to act in the interest of shareholders of the sponsoring company, and not necessarily in the interest of the members of the pension plan (Cocco and Volpin, 2005). Representation of stakeholders is a crucial norm in legitimatising Anglo-American pension fund governance, not least because beneficiaries’ subjection “is total: they must rely on the trustees and generally have neither the power to dismiss them nor the means to monitor them or influence their decisions” (Montagne, 2007). Plan participants rarely if ever play an active role either in the governance of pension funds or in the scrutiny of administrative and trustee decision-making – exit and voice are rarely directly available to plan participants (Clark, 2004).

The importance of representation of plan stakeholders is contrasted with expertise of trustees. Expertise has been seen as an important source of legitimacy to social institutions and organisations acting on beneficiaries’ behalf, although the importance of representation is arguably increasing rather than losing its significance in respect to expertise (Clark, 2007). There is much evidence that the financial skills of Anglo-American pension fund trustees are not necessarily considered sufficient for contemporary investment management (Clark and Urwin, 2008a, 2008b; Ambachtsheer, 2007; Ambachtsheer, Capelle and Lum, 2008), which is also recognised by the funds themselves (Watson Wyatt, 2009). Ambachtsheer (2007) suggests that the financial skills of most pension fund trustees fulfils hardly the basic
criteria of financial expertise and the majority of representatives tend to represent particular stakeholder interests rather than general interests. These issues are important, especially if Ambachtsheer’s view that US pension funds suffer from ‘serious silo problem’, is taken seriously. It must be noted, however, that this may have less to do with investments as such since pension funds do not always think about matching investments with liabilities as their main alignment but consider investments quite an independent and heavily external activity. As Ambachtsheer (2007) puts it, instead of being guided by ‘effective, integrative, dynamic balance-sheet risk management processes’, pension and endowment funds continue to operate largely by a series of ‘simple heuristics and rules of thumb’ supplied by external service providers.

As a hypothesis, it can be argued that proficient legitimacy of decision-making in trust-based funds is not based only on representation and expertise, but also on the relationships to external advice. The advice does not always promote proficiency, as actuaries tend to provide trustees with rosy assumptions about the economy and investment advisers with unrealistic projections about portfolio and liability development, and as investment managers suit more their own needs than their clients’ in giving information (Ambachtsheer, 2007). On the other hand, advisers do promote some discourses that can effectively improve proficiency. Most important of these discourses are Asset and Liability Management (ALM) (see e.g. Bauer, Hoevenaars and Steenkamp, 2006; Alestalo and Puttonen, 2006; Blome et al., 2007, for further definitions) and Liability-Driven Investment (LDI), albeit there are plenty of other very similar discourses used especially by the consultancy industry (see Stewart, 2005, for extensive review).
The shared dispositions in investments

Most Anglo-American funds perform three different kinds of tasks that are derived in great part from their legal mandate: administrative services, the determination of benefit eligibility and value, and asset management or advice. Administrative functions include the collection, tagging, and protection of pension contributions; benefit adjudication functions may include the determination of eligibility against plan criteria, the resolution of difficult cases, and the enforcement of procedures regarding the interests of plan sponsors and beneficiaries; and asset-management functions may include asset-liability matching and asset allocation (DB plans), the selection and evaluation of investment product providers, and advice for plan participants on their investment options and policies (DC plans) (Clark, 2004).

O’Barr and Conley (1992) suggested that the pension fund investment agency can be best understood as making decisions on four key areas in the investment process of trustee decision-making: asset allocation, active versus passive investment strategy, inside versus outside management, and consistent versus cafeteria philosophy. There was much variation in the responses to these questions, and the choices made were often unsystematic and had very different kinds of motives and rationales behind them, which suggests that the adopted dispositions in these shared domains somewhat vary in content. Clark (2000) later argued that Anglo-American pension funds considered having four decisions to make in investment management concerning uncertainty, fiduciary duty and cost constraints: whether to manage funds internally or externally; what proportion of funds are to be externally managed and if so decided,
for what goals; will they have few managers with long-term contracts (intensive
delegation) or many managers with short-term contractual relationships (extensive
delegation); and, concerning all these decisions, whether to switch mandates either
between competing investment managers or to bring the mandate back into the fund.

Both works noted that asset allocation is usually the only choice made in a very
systematic way. O’Barr and Conley further argued that it usually dominates further
practices. Total allocation was done at least yearly, but it could be reassessed and
rebalanced even in real-time. In case of investment philosophies, some funds had one
or two beliefs on how assets ought to be priced and traded, whereas some funds had a
‘cafeteria’ assortment of different beliefs on how investments should be conducted. In
case of equity for example, fund managers and investment companies distinguish
themselves in relation to the market for financial services by particular theories of
market value, including for instance ‘growth’ (i.e. taking advantage of expected short-
term stock price appreciation) and ‘value’ (i.e. taking advantage of expected long-
term stock price appreciation). For some, trading strategy takes advantage of short-
term mis-pricing of stocks and the relative irrationality of others, whereas some argue
that the basis for investment are economic ‘fundamentals’, particularly the long-term
prospects for industrial sectors as well as the economic prospects of whole markets
and economies (Clark and Hebb, 2005). The question of choosing between active and
passive investment strategy depends on the beliefs whether individual fund is able to
outperform market with careful security selection, which is usually thought to depend
on beliefs on efficiency of markets, and on the increase of equity value over time.
Internal managers usually work both as investment managers and analysts who focus on quite few specialised areas. It is still a feasible hypothesis that although internal management provides control over people (or their fees at least), not all funds want to engage in internal investment management. For instance, small funds cannot afford to lure well performing managers and support people to the funds. Those funds that prefer external management usually take for granted that internal management is ‘impossible’, and those who prefer internal management usually ‘cannot just understand’ why some funds are willing to pay so much for little performance (O’Barr and Conley, 1992). It is true there are some insights that give credit to both parties. For example, the selection of external managers is not necessarily too rational even for advocates of external management. Clark and Urwin (2008a) have noticed (in research and consultancy experience) that manager selection methods are in part based on previous performance, which logically has little to do with future performance but which still is sometimes considered an indicator of financial performance for the future.

These four domains – asset allocations, philosophies, manager selection and the selection between active and passive strategies – are everything but exhaustive, and there are likely numerous different kinds of investment practices shared by Anglo-American funds in lesser scale. It can be nevertheless regarded as a valid working hypothesis that these four areas continue to persist as field-level frames since the view has not been contested but rather restated in more recent literature (see e.g. Ambactsheer, 2007). One field of activity needs to be added to these more traditional domains, however. The question of what to do with the ownership of assets has become an important issue in the institutional life of today. The issue of ownership is
important as it may blur the division of the four domains, as passive indexing strategies and major stockholdings for example may be supplemented with very innovative styles in corporate engagement (Clark and Hebb, 2004). Corporate engagement and the demand for social responsibility from investee firms have become commonplace (Hebb, 2006).

In regulative terms, the so-called Avon letter confirmed that proxy votes are included in the fiduciary duty in US in 1988. Pension funds first took the role of watchdog in corporate governance, focusing mostly on proxy voting on investee firm resolutions brought forward by existing management rather than bringing their own ones to the table and acting themselves (see e.g. Del Guercio and Hawkins, 1999; Langley, 2008a; Marens, 2004). There has traditionally been a major difference in relation to ‘shareholder activism’ between public and private funds, however. Private funds have considered engagement to corporate governance rather a burden than an opportunity, and relied on outside managers’ judgement on the issue. They have supported corporate status quo and almost never voted against current management.

O’Barr and Conley (1992) summarised this behaviour by suggesting that private funds were bounded by a Golden Rule stating that funds should stay away from governing other companies if they wish to keep other actors away from their own practices. This norm has been everything but present in public funds with much political energy. Pension fund ‘activism’ has been mostly driven by massive US public sector pension funds like CalPERS – “the 500-pound gorilla/guerilla of shareholder activism” (Marens, 2004) – but also by some rare multi-employer private pension funds in which unions have had a major role (Langley, 2008b). Despite the
higher expectations of and stronger pressures towards corporate governance, private pension fund trustees have often continued to rely on their investment managers rather than taking interest in allocating the pension power in proxy voting and corporate governance in general (Ambachtsheer, 2007).

If we take these five thematic areas as the point of departure, what kinds of dispositions are proving proficient in these areas, then? Clark (2000) has suggested that investment decisions of pension fund trustees in these areas are habitually patterned. These dispositions can be called habits of prudence that regulate trustees’ burdens of risk and uncertainty in their obligations towards beneficiaries by marking the limits for deliberation of decisions. The most important dispositions are loss aversion and preference for certainty, complemented with the regret of lost opportunities and the preference for similarity in relation to other pension fund portfolios. These dispositions are conventional and affirmative; they not only sustain the practice of habitual decision-making actions but also mark the lines of conventionality, which requires deliberate suspension of habits when applying unconventional investment strategies. This implies that as long as the portfolios resemble other funds’ portfolios, losses are averted and investment decisions offer some degree of certainty, the activities are likely proficient and need not to be questioned.

Another pattern Clark noted were the strong norms of relationships that regulated trustees’ interaction with other agents such as consultants and investment managers. Most contested of these norms is reliance, the realisation that the trustees must trust individuals and institutions in carrying out the investment process. The second one is
reciprocity: trustees owe service providers for the benefit received. Loyalty is an essential related norm since higher-than-average returns may carry the likelihood of periods of lower-than-average returns. The third norm is respect by and for trustees who carry a burden of responsibility and who rely upon expert advisers for professional services. This implies that the trustees need to rely on the financial community, but they can also do it in certain ways that are not necessarily beneficial to the fund in every case but may be unavoidable if success is wanted in the longer term.

3.2. The Financialisation of European Pensions

Nearly all European pension regimes have changed significantly due to a great number of reforms introduced during the last two decades or so. The redrawing of public and private responsibilities and control has been one of the key issues in European debates over pension provision besides financial and social sustainability (Clark and Whiteside, 2005; Nyce and Schieber, 2005). Although having notable differences in reform trajectories (see Immergut, Anderson and Schulze, 2007), the most commonly observed features in European pension reforms have been the advancement or introduction of private management, individual DC accounts, and funding (Thompson, 2001). Public-private partnerships (PPPs) have become more common even in previously publicly executed first pillar systems (European Commission, 2008), and the introduction of defined contribution schemes, non-financial (NDC) or funded, have shifted the collective financial risks caused by
pension arrangements into social and economic risks born by individuals (see e.g. Whiteford and Whitehouse, 2006; Holzmann and Palmer, 2006; Barr and Diamond, 2008). Although with no doubt significant changes in European public policies and societies as such, the shifts of costs and risks to individuals and of management to private providers will unlikely change the world around us more than the introduction of funding. As Engelen (2003) puts it, as

the rise of pension funds, the growth of capital markets, the increasing sophistication and economic importance of the financial industry, the growing political clout of financial players, and the dominance of shareholder value as a new ideology of wealth creation appear to be reinforcing one another, the decision to shift the burden of pension provision from public to private pension plans and from a PAYGo to a funded regime is sure to set in motion far-reaching changes.

The introduction of funded pension arrangements has been considered a central part of a broader political transformation process in the global economy titled with the notion of financialisation. Financialisation as a general hypothesis concerning contemporary political-economic change refers to a variety of issues. Some see the academic interest in financialisation as simply shifting more focus on financial phenomena in general, some on their distributional implications that are detrimental to some groups, some their effects to international monetary system and others to their relation to financial crises (Epstein, 2005). For others, financialisation might be more about Anglo-Americanisation than anything else, as arguments concerning financialisation are pronounced the strongest in the US and the UK (Langley, 2004). The European economies for example have been expected to face three changes towards more Anglo-American economic structures: the presence of shareholder-value oriented investors, a sufficient amount of mobile capital, and an adequate level
of managerial discretion to increase factor mobility (Beyer and Hassel, 2001). For many others, this is hardly the best description. Some see financialisation as a more global development pattern as such. They argue that financialisation, although an open process, has led to a broad societal frame that can be described as ‘coupon pool capitalism’ based on ‘massification’ of household savings, securitisation (of everything), diffused ownership, and powerful group of financial intermediaries and (increasingly wealthy) people working in them (see e.g. Erturk et al., 2008). This framework serves as the location for the socially dominating modern-day capitalist conjunctures, both in terms of generating and interpreting events (Froud et al., 2000).

From a perspective better suited for habitual institutionalists, financialisation is not so much about any ‘macro-structural transformation’ than it is about aspirations to transform the institutional interface between credit and productive relations (independent of whether it implies rebalancing power relations or not). It is a hypothesis concerning unfinished and ongoing making of ‘financialised’ capitalism whose aspired dispositions are not simply derived from mainstream neoliberal economics or the interests of financial intermediaries but includes the theory and practice of Callon’s ‘mediators between economics and society’, the likes of management, accounting, advertising, marketing and insurance (Langley, 2004). In this project, PFC plays an important role, as the asset management methods and techniques pioneered by pension funds, and their investment management firms and actuarial consultants, have been ‘a crucial catalyst in the transformation of the theory and practice of financial management’ (Clark, 2000). Funded pension arrangements as the critical institutional nexus between global finance and our everyday lives both
empower finance and help to make the aspirations to make the world ‘financialised’ institutionally effective.

More importantly, financialisation is about connecting different domains of life so that they fit the cultures of the ‘domain of finance’ in everyday activities (Langley, 2008a). In this view, financialisation of pensions is primarily about redesigning the interface between old-age pension provision and the domain of finance, which may apply equally well to reforms in PAYG schemes as to those in funded schemes. There has been very little academic attention to the question of how exactly are fund arrangements institutionally changing and what kinds of new frameworks and dispositions are created when new funded arrangements are built or old ones reformed. While the introduction of funding may have typically included the adoption of DC schemes and the increase of private responsibilities, the analysis has often stopped to these issues without too much discussing what kinds of investors are being generated and what kinds of new political issues arise when pension provision becomes more investment-driven. These changes are important as they may change the nature of the overall project of financialisation inasmuch as the changes in the domain of finance might affect pension investments. This suggests that we must pay very close attention to the actual institutional change processes of pension systems and the generation of new investors instead of analysing changes in pension design exclusively as some kind of intrinsic parts of financialisation processes.

In this sense, financialisation of pensions can be defined as aspirations for new dispositions concerning the interface between pension provision and global finance, and as an institutional change processes to aspirations that in fact lead to the adoption
of some particular dispositions in investments. Before going to the new institutions in more detail, it is worth noting why exactly common aspirations related to financialisation are present in European pension reforms in the first place. After all, as noted by Hay (2004) common political trajectories are essential in integrating local institutions to global domains institutionally. Without looking at what aspirations are behind institutional changes, it is hard to see what kind of political project this common trajectory might be.

**The politics of funding and the aspirations of financialisation**

European pension policies have been mostly national issues, and policy pressures for changes in pension systems have come more likely from the government than for example the European Union that has played a relatively minor role even in market-based second and third pillar pension schemes that are subject to community law (Eckhardt, 2005). The open method of coordination in European social policy issues is also likely to have a small impact on national pension policies in an area in which European integration weak as such (De la Porte and Pochet, 2002). Despite this lack of central coordination, recent reviews on European pension system reforms (e.g. Zaidi, Marin and Fuchs, 2006; Vidlund, 2006) show that many EU countries have applied very similar reform measures to respond to the challenge of financial sustainability in concert. In pure number, most national reforms have been parametric, influencing the variables defining size and scope of schemes, rather than systemic reforms that alter the structure of the pension regime. From the perspective of pension benefits, pension eligibility conditions have been tightened and the indexation of pensions in payment has become less generous in various schemes, and many
schemes have linked benefit levels to changes in life expectancy (Whiteford and Whitehouse, 2006). The parametric reforms in 25 EU countries since 1995 have included changes (number of countries in parentheses) in retirement age (16), contribution rate (14), contribution requirements (12), benefit indexation (6), and pension formulae (15) (Zaidi, Marin and Fuchs, 2006).

The adoption of funded schemes or prefunding in tax-based and PAYG schemes has been the key institutional change when national reforms have been more systemic than parametric changes concerning pension benefits. The essential actors defining these kinds of changes in policies are very likely the same in most European pension systems. The governments, labour market partners, international community, and a few other actors have constituted the core actors forming these pension policies (see e.g. Immergut, Anderson and Schulze, 2007). The important issue here is that nearly all these central actors have shared the discourse concerning systemic challenges and their primary solution, funding, depending surprisingly little (albeit significantly) on the relative legitimacy or path dependencies of old pension arrangements (Myles and Pierson, 2001).

This raises one important question: what is it in the discourse suggesting that funded schemes are superior to PAYG and tax-based schemes that makes it so broadly shared and accepted by all kinds of politically relevant actors? The supposed superiority of funded schemes is primarily based on the idea of financial sustainability in terms of pension costs and future liabilities (Clark, 2003a), while ‘asset side’ arguments like the generation of pension capital to promote specific modes of economic development have tended to be secondary (see Kangas, 2006). Funding is seen instrumentally
superior to PAYG systems especially because it is expected to capture the financial performance and risk management benefits of global financial markets in contrast to for instance poorly performing European national economies and legacy cost exhausted American firms (see e.g. Ebbinghaus, 2006; Clark, 2003a).

However, as Engelen (2003) has argued, the praises of the financial benefits of funding in contrast to alternatives are usually coupled with two strong and suspect background assumptions: demographic projections and equity premium. Although the economic benefits of funded schemes are controversial for a variety of reasons, like the maturity structure of funds and potential US ‘exceptionalism’ in making demographic and economic future projections in pension studies, various non-funded pension systems have been deemed unsustainable based on demographic projections. However, the future demographics argument is not so much about financial markets having ‘better ability to pay’ for previously DB pensions in face of some future projections than it is about capturing the ‘more willingness to pay’ with DC schemes. After all, a shift in pension plan type does not very likely reduce the overall cost of ageing population (Thompson, 2001).

Thus answering to demographic projections with funding is not necessarily based on financial reasoning but to a coupling of two somewhat separate issues, funding and risk bearing. For some, shifting the risks from firms to households and the source of pension income from wage sums and firms to financial capital might look politically the only viable options in case there’s no collective will to bear risks collectively (by states or firms) by guaranteeing a final value for pensions (Clark, 2003b). But the individualisation of responsibility and risk for saving for retirement is also a clear
ideological choice for some advocates of funded schemes. The aspirations of adopting pension funding have been in great part about financialisation as subjectivity and moral code that enforce financial self-discipline with economic rationality, planning and foresight, prudence and social/moral responsibility as its virtues (Langley, 2004). As result, harnessing financial markets to serve DB arrangements or creating alternative arrangements to DC schemes in order to cope better with current demographic and economic projections have become somewhat intellectually marginalised with the notable exception of the adoption of prefunding to first pillar pension schemes.

The idea of capturing the so-called equity premium suggests that funded arrangements do not suffer from demographic stress at least to the same degree as PAYG systems thanks to enabling a specific interface in activities: equity investments. Aaron’s (1966) classic principle suggests that without generating returns exceeding the growth of the wage sum (and ultimately the regular level of interest rates), funded schemes are economically hardly an alternative even to pure PAYG schemes. The equity premium argument aspires to direct financial investments to better than average interest rate returns, to highly productive early stage firms, and to real investments directly employing and rewarding future generations in contrast to relying on basic interest rates. Yet it begs the question of how capturing the equity premium actually differs from other collective solutions and how stock markets could even resolve the dilemma of how to fund pension schemes. As Tickell (2003) puts it, stock-market-based pension schemes are unlikely to be a panacea because they just as much as state pensions rely upon an intergenerational wealth transfer – people who buy shares are making a claim on the fruits of the labour of workers in the future.
Even more importantly, it has not been widely recognised that there are causal linkages between funded pension arrangements, capital market inflation, and wider changes in the productive sphere, which cuts some of the validity of the equity premium argument. For one thing, the continuous growth of old pension funds and the emergence of new ones may cause not only too rosy expectations on future returns but also long-term capital market inflation (Toporowski, 2000). Equity premium arguments have been questioned by economists as the real economic consequences of inflating capital markets with pension capital has faced very much scepticism and pessimism (see Toporowski, 2000, and Engelen, 2003, for review). Even replacing the understanding of investments from long-only equity to a variety of modern-day techniques hardly makes this critique obsolete. It is for example possible to conceptualise finance as a zero-sum game and try to pay pensions by performing in this “game” better than other investors with hedge fund like activities – that is, to shift the burden of pensions from firms (as in equity) to financial community in general. But this again leads to similar logical problems as it would require effective and costly means of capturing the so-called alpha, the non-market development dependent performance premium. Even in this case, the more there are pension funds, the lesser the prospective gains arising from the activity can be.

Comparing the aspirations to increase funding to theses critiques, the financialisation of pensions can be deemed at least rhetorically asymmetrical. The aspirations are based on argument of ‘better pension provision’ but the new arrangements are very unlikely to rebalance the relations between the generated pension capital and the economy so that it would actually improve the existing mode of pension provision. In
this sense, financialisation of pensions as aspiration to increase pension funding is more about institutionally legitimising, financially fuelling, and continuously empowering global finance than it is about harnessing global finance to serve pension provision (Montagne, 2007). It is also more about shifting the financial and social risks of the activities in that domain to broad masses of individuals. What makes this overtly neoliberal argumentation so effective is not so much its popularity than it is the fact that the old pension regimes have been so successfully judged to be in crisis (Langley, 2004; see also Myles and Pierson, 2001).

Neoliberal as the aspirations might be, the institutional change processes where such political aspirations have been present gives a less straightforward picture. The change processes related to financialisation of pensions are initiated and enforced by different kinds of actors with very different political motives, they start from different development points, they include reforms very different in scope, they can reinforce old paradigms inasmuch as they can abandon or change them, and they can during the process open up new alternatives and aspirations (Dixon, 2009; Dixon and Sorsa, 2009). One illustrative European example is the increase of funding in Germany in the 2001 regulative reform. The reform introduced various funded arrangement options with limited investment restrictions, which can be seen somewhat as a paradigm shift in German pension provision (Schmähl, 2003, 2007). However, the reform did not dictate what the private side of the new public/private divide would look like, but only relied on a competitive market-oriented environment where mandated insurance companies, asset managers and industry-wide occupational pension schemes compete in the market for clients. While the rationale of these measures was indeed based on neoliberal aspirations, the actual results were less so.
One result was the emergence of MetallRente, a non-profit independent organisation jointly governed by the social partners, which was founded and began operations in January 2002. According to Dixon (2009), the political and institutional past was not a constraint but a valuable resource for MetallRente. The old Modell Deutschland was utilised to provide a collective institutionalised solution in a new competition-prized environment. As key points in German labour relations, IG Metall (Germany’s largest labour union) and Gesamtmetall (the German employers’ association for the metal working and engineering industry) have a natural communicative relationship with their respective members, which also provided a natural opportunity for the two organisations to become involved in pension provision and provide for their members options that serve a more attractive variety than the market in general might offer. Indeed, the inherited collective institutions provided a carrier for using the prospects and adopting the practices of the ‘global finance’, but the leveraging of coordination and scale as the inherited institutions once did generates friction on the supposedly neoliberal and market forces often associated with it.

In this sense, financialisation as adopted institutional change does not necessarily include abandonment of proficient institutional legacies. Aspirations cannot explain all the outcomes of financialisation processes especially if the reform measures include many contingencies. Of course, this is not always the case. The politics of financialisation can include much less institutional contingency and more effective measures than illustrated by the German reform. For example the Swedish reform of 1998 has been considered a neoliberal paradigmatic shift from social insurance towards diversified ‘massification’ of pension investments and individualisation of
risks politically as well as institutionally (see e.g. Roumpakis, 2009; Belfrage and Ryner, 2009). Sometimes the political changes are more difficult to interpret. It can be for example asked in what scope has the adoption of prefunding in the French first-pillar schemes illustrated an old *dirigiste* approach and old social goals only in a new area of activities brought under national control (see Dixon and Sorsa, 2009). All in all, if institutional change processes in European pension regimes are taken as the research, the introduction of funding does not necessarily appear a uniform neoliberal political project but as a heterogeneous and contingent trajectory.

**Enforcement of portfolio management**

About two decades ago, European pension investors had many typical national characteristics in using external investment management services (Harrison, 1997). The pension investors relied on quite specific service providers and sectors, mostly insurance companies. The common features to these old paradigms and changes in them have been well described by Davis (2002a). European pension investments have traditionally been strongly based on domestic bond investments due to the relative risk of taxation being imposed on equities, historic-cost-based accounting systems, portfolio regulations, and investor caution resulting from past experiences of equity risk. Spain, Germany and France have been especially sceptical towards international investment in general due to concerns about currency and liquidity risks and lack of information. Most markets for pension fund management in Europe were and in part still are dominated by a small number of banks and insurance companies.
Despite the unfinished steps towards institutional integration of finance at the European Union level (see Clark and Wójcik, 2007), there has been a great shift in investment paradigms throughout Europe. European pension investments are currently by and large based on portfolio investments diversified by asset classes and countries, and include many riskier investments than domestic bonds of the previous eras (e.g. Clark, 2003a; Boeri et al., 2006). Financialisation of pensions can be in great part (but by no means exclusively) seen as the enforcement of portfolio management. The separation of interest in properties of financial vehicles from the ownership of their underlying activities is important as it generates a new “field” for activities – calculative optimisation via all kinds of financial investment options (see e.g. Blake, 2006, for overview) – and gives even old typifications like domestic bonds or international investments new meanings. Valuation becomes the essential tool for activities, and information on investee firms and financial developments important resources in this field, which are all more or less alien to PAYG type pension provision.

One effect of this integration is that pension investors become differentiated by their approach to the portfolio management techniques in quite predictable ways. For example, a distinction and division between conservative, essentially including only well-known brands and blue chip companies, and speculative trend-following investment styles tend to be separated (Langley, 2004). In market parlance, investment strategies differ on basis on balance between ‘core’ and ‘satellite’ holdings. Pension funds are likely to vary in their ‘core’ holdings by their liability structures but in ‘satellite’ holdings more according to their risk appetites and beliefs. As for another example, pension funds tend to promote different benchmarks for asset
management performance. Pension fund contracting of external managers to outperform average market returns, measured in terms of the major stock market indices, may be for example set to 1 to 1.5 per cents (including not underperforming by a similar amount).

More generally, Engelen (2003) has argued that the four typical objectives of pension funds – the minimisation of risks, the maximisation of returns, ensuring liquidity, and the minimisation of costs – much dictates which investment styles can be adopted in practice. Moreover, the contents of these functions change over time during maturation of the funds. The gradual increase in the ratio of beneficiaries to contributors especially in mature final salary schemes translates into an increased need for relatively short-term investment horizon, which results in demand of more specialised and sophisticated asset categories and their combination in portfolio construction. On the other hand, these issues may have their strongest pronunciation in the trust-based funds.

Davis (2002a) argues that in Continental Europe as in the United Kingdom external asset managers have offered investment management services for overall portfolios rather than specialist advisory as in the United States, which may undercut differentiation in the terms above. In many European countries the bank of the second pillar pension fund sponsor has often served as the investment manager, and it has had quite few regards on performance or anything like core-satellite-divisions in investment management. Furthermore, as Davis continues, the manager selection process likely differs from the US where consultants tend to dominate it and which leaves tangible comparative criteria like benchmarks among the rare tools for
decision-making. For example in the Netherlands, members of the fund boards are typically investment professionals that have a background in academia or financial sector and who may manage the selection process themselves directly with quite different criteria than simple benchmarks.

These observations suggest some portfolio management techniques might come to differentiate pension funds even without their explicit acknowledgement. But this is not to say that pension funds would not provide acknowledged incentives for shaping the financial sector around them. Pension funds generate a tendency for stronger fragmentation of the market for financial services consisting of a low-risk, low-yield market populated by a handful of reputable firms on the one hand and a large number of high-risk, high-yield markets composed of a large number of highly specialised financial services providers on the other. Furthermore, the aggregate maturation of pension funds serves as a powerful incentive for the financial industry as a whole to consolidate to minimise costs and reap economies of scale, to provide specialisation to funds and expertise on fund mergers and other pension fund specific advisory, and, in general, to grow (Engelen, 2003).

It must be also noted that portfolio management may also include some paradoxes. The minimisation of risks for example occurs typically via diversification of assets over a large number of asset categories with complementary risk and return profiles. In the early stages of funding diversification may include various sectors and numerous geographical areas, or for instance internalised private equity teams. But in more mature funds primary vehicles are likely to be limited to the most liquid assets, fixed-income vehicles in central markets, and sophisticated hedging strategies that
ensure liquidity in most market situations. The paradox here is that whilst the life cycle of pension funds transforms their risk profile and hence their investment strategies from committed blockholders and potentially more adventurous long-term investor gradually into speculative investors with an increasing need for liquidity and cost-efficiency, their decisions to sell may influence share prices negatively. The shift away from long-term investments may actually end up in lowering the future expectations in the overall economy. In other words, pension funds must try to avoid becoming ‘prisoners of their own investments’ (Engelen, 2003). Such paradoxes are not likely to be avoided as new European pension funds mature, and they certainly generate new challenges for European political debates over supporting financial institutions.

**Increasing independence in fund governance**

One of the key trends in European pension reforms has been the adoption of private management. This has occurred not only in terms of increasing the importance of private pension schemes but also of increasing private management and implementation of all kinds of pension schemes. For example, traditional first pillar schemes are executed by private entities in Bulgaria, Denmark, Estonia, Finland, France, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Sweden, Switzerland and United Kingdom (Briganti, 2008). This development has in nearly all cases coincided with the introduction of funding (see e.g. Soede and Vrooman, 2008; Arza and Kohli, 2008; Ebbinghaus, 2006, European Commission, 2008; Immergut, Anderson and Schulze, 2007, for more detailed reviews). One part of this trend has been the making of privately managed funded tiers compulsory, either hard
(mandatory) or soft (possibility to opt out) (for detailed overview, see European Commission, 2008). These developments have also been complemented with introduction of market forces in defining the success of individual pension providers, which was well illustrated by the German reform discussed above (see Clark and Whiteside, 2005, for more cases).

If financialisation of pensions is understood in terms of adopting portfolio management based investments to finance pensions, it is also in great part about enforcing independence of preferably private management with competitive pressures among private providers. However, this does not necessarily imply convergence with the Anglo-American models of governance. The Anglo-American governance based on trusts and fiduciary duty combines some aspects in the both of the two ideal types of governance arrangements in pension plans: institutional and contractual (see Stewart and Yermo, 2008). Institutional funds are independent entities with legal personality and capacity, and hence its own internal governing board (or more than one board as in many European countries). Contractual pension funds consist of a segregated pool of assets without legal personality and capacity that is governed by a separate entity, typically a financial institution such as a bank, insurance company or a pension fund management company. The governing body of a fund set up in the contractual form is usually the board of directors of the management entity, though in some countries some key responsibilities are shared with a separate oversight committee. In Europe these ideal types can be found (see European Commission, 2010), the former being more common, but the trust and fiduciary types of funds still belong mostly to the Anglo-American world.
Indeed, the formal governance (i.e. what is to be governed) aspect of financialisation of pensions in Europe has been more about creating as autonomous or at least as independent private investor-actors as possible, whatever their formal types. This new form is, of course, nothing new to scholars observing neoliberal pension politics and governance (e.g. Myles and Pierson, 2001). However, the operational side of governance (i.e. how the funds are governed) has been somewhat ignored in academia in both Anglo-American literature (Monk, 2009b) and in European pension studies (see Roumpakis, 2009) that both have tended to understand fund governance in formal terms. This is not to say there would have been no debates concerning operational pension fund governance in Europe but only that these issues are rarely paired. For an exception, for example Boeri et al. (2006) have discussed a variety of agency problems broadly related to European fund governance. Among other things, they have directly suggested that Anglo-American funds with one-tier board structures suffer from a serious lack of transparency and supervision required operationally in the European context, while ‘the Dutch model’, the two-tier board structure – an expert board making investment decisions with a stakeholder supervisory board monitoring the choices – helps to control asymmetries and other agency issues.

Some formal governance issues have direct operational implications, of course. There are at least three such issues that are often brought up in academic literature. Any transnational investment strategy with internal management requires ability to coordinate decision-making centrally due to dispersed information flows and decentralised agency (Clark and Thrift, 2004). This suggests that an independent investor must be capable of effective decision-making and organisational alignment.
The cost containment pressures provide incentives to reap the benefits of economies of scale (Engelen, 2003). This suggests that it is essential for independent funds to use not only a variety of measures to succeed in competition over clients to grow but to use as cost-efficient governance structures and practices as possible while doing so. Independence also highlights the importance of legitimacy of activities on basis of expertise and representation, discussed already in the previous section (see also Clark, 2008).

On the other hand, operational governance issues cannot necessarily be drawn from the formal aspects of governance. Even in very different types of pension plans, institutional, contractual and trust type, the question of how to run funds is contingent (see Stewart and Yermo, 2008). What might be the European trajectory in terms of operational governance, then? A recent EC Green Paper (European Commission, 2010) notes that the EU Institutions for Occupational Retirement Provision Directive (IORP) and other frameworks are inadequate in terms of operational pension fund governance and thus likely to be reformed in the near future, which is why the current regulative EU framework is not necessarily too helpful here. Perhaps a more influential source for political aspirations concerning fund governance in Europe have been the OECD Guidelines for Pension Fund Governance (OECD, 2005a) approved as norms by numerous European countries as OECD members or as countries with an observer status. The guidelines primarily aim at finding a balance between public regulation and self-regulation (see below), but they also highlight some formal and operational aspects of fund governance.
According to the guidelines, the governance structure should ensure “an appropriate division of operational and oversight responsibilities, and the accountability and suitability of those with such responsibilities”. These norms concern in more detail identification of responsibilities, accountability and suitability, and the roles of governing bodies, expert advice, auditors, actuaries and custodians. In terms of operational governance mechanisms, it is expected that pension funds should have “appropriate control, communication, and incentive mechanisms that encourage good decision making, proper and timely execution, transparency, and regular review and assessment”. These norms especially concern internal controls, reporting, disclosure and redress.

Some hints for the future direction can be also found at the discursive level. A key discourse in defining the European operational governance paradigm has been the ‘best practice’ discourse (see e.g. Stewart and Yermo, 2008). For example Clark and Urwin (2008a) have presented a list of such best practices that can be summarised as three domains: organisational coherence, people and process. ‘Organisational coherence’ includes the clarity of mission, competent investment function with clear division of responsibilities and accountability, and a governance chain ‘with an appropriate time and resources budget’. ‘People’ include practices like effective leadership and delegation, selection of colleagues on basis of competence, and effective compensation practices. The ‘process’ includes strong investment beliefs and fund-wide accepted investment philosophy, strengthening of comparative advantages, risk budgeting ‘aligned to fund goals incorporating an accurate and integrated view of alpha and beta’, real-time decision-making systems, usage of external managers ‘through clearly defined mandates, aligned to goals, and selected
with rigorous application of fit-for-purpose criteria’, and a learning culture that ‘deliberately encourages change and challenges the commonplace assumptions of the industry’. The best practice discourse is important as it tries to overcome formal organisational differences in its implications. In this sense, it bridges the European trajectory to other trajectories.

The aspirations concerning the organisational control and decision-making over private organisations managing investment portfolios for pension provision can be summarised to be based on norms of effectiveness, internal transparency, and accountability. Effectiveness aspires for clear missions, mandates, responsibilities and incentives, internal transparency for clear communication channels and division of responsibilities, and accountability for clear limits for responsibilities (e.g. risk budgets) and decision-making chains. These three aspirations on operational governance become vital as the aspirations to generate formally independent, self-governing, private pension investors with their specific strengths (and weaknesses) that they can use either in competition or at least in internal decision-making. What makes these aspirations especially important in terms of redrawing the boundaries between public and private logics of governance in the European context is that they aim at generating actors that are somewhat atomistic and without cooperative channels typical to public administration more traditional to European pension regimes (Johanson and Sorsa, 2010).
Prudential regulation and risk-based supervision

The generation of independent pension investors has been coupled with striking a new balance between public regulation and self-regulation at the European level. One of key trends here has been the move towards a prudential approach to regulative institutions and risk-based approach to pension supervision (see OECD, 2010 for recent developments). The former is based especially on the IORP directive that sets a number of prudential principles for EU member countries to adopt as regulative paradigms and to ensure that they are applied by the funds belonging to the scope of the directive. The principles at least supposedly allow pension funds a freer range of investments than a strict rules and quantitative limitation based approach would.

Stewart (2010) has defined the risk-based approach to supervision as a structured process aimed at identifying the most critical risks that face each pension fund and, through a focused review by the supervisor, assessing the pension fund’s management of those risks and the pension fund’s financial vulnerability to potential adverse experience. This has involved the supervisory authority transitioning from checking detailed compliance requirements for the operation of pension funds to reviewing the internal decision-making processes and bodies of these funds. The agency-based supervision of pension investors have been if not adopted at least debated in nearly all European countries, and several European Union directives – in essence the insolvency directive of 1980, the life insurance directives, and the IORP directive – and national regulations have been drafted based on the prudential regulation paradigm (European Commission, 2008). In addition, the fair value accounting rules
have had a major impact to European pension provision by changing the understanding of the object and timeframes of supervision and control (Dixon and Monk, 2009).

The recent OECD working paper (Stewart, 2010) sets the most detailed discursive framework for the new regulation and supervision paradigm. Risk-management is defined as the process affected by an organisation’s board of directors, management and other personnel, and designed to provide reasonable assurance regarding the achievement of objectives in terms of effectiveness and efficiency of operations, reliability of financial reporting, and compliance with laws and regulations. These processes are in the working paper broken down into four categories: management oversight and culture, strategy and risk assessment, control systems, and information, reporting and communication. These domains contain a number of norms aspiring to align operations towards risk management goals. Management oversight and control culture includes norms concerning proper board operations, division of responsibilities, organisational structures according to the size and scope of organisation, and the application frameworks via codes of conduct. Strategy and risk assessment includes the adoption of risk strategies identifying risks, assessing likelihoods, outlining response mechanisms, and on-going monitoring methods. In addition, due to the increasing complexity of financial products, growing reliance on automated and integrated systems, online communication, and outsourcing arrangements, risk assessment is expected to include operational risks resulting from inadequate or failed internal processes, people and systems or from external events.

Investment risks are central in the new risk-based paradigm. An essential part of this concern is the requirement of a written investment strategy that should contain
investment objectives, asset allocation, diversification, liquidity needs, valuation methodology, use and monitoring of derivatives, ALM targets (where appropriate), performance measurement, monitoring and benchmarking, control procedures (including risk tolerances and risk monitoring procedures), and reporting format and frequency (OECD, 2006). Moreover, the investment strategy should be consistent with legal provisions (prudent person and quantitative limits) and the objectives of the fund at a minimum identifying strategic asset allocations, the performance objectives (and how these will be monitored and modified), any broad decisions regarding tactical asset allocation, security selection and trade execution. The investment strategy is also expected to stress that pension funds should only invest in assets and instruments whose risk the pension fund concerned can properly monitor, manage and control, which as norm is addressed especially for those alternative investments seeking the higher returns promised by products such as hedge funds without fully understanding the underlying risks involved (IOPS, 2008).

Indeed, the new risk and market based supervision paradigm shifts supervision to individual pension providers and gives supervisory agencies mostly the task to verify quality of the fund’s risk management processes and, if needed, to adapt its regulatory stance in response. This is not to say European supervisors would not continue to apply some qualitative quantitative limits and asset eligibility criteria that vary in terms of charges, investment objectives, reporting to the supervisory authorities and other such features specific to different pillars and schemes – they do (see European Commission, 2008 for details). Furthermore, there is less integration in the form of regulatory and supervisory bodies. European states tend to have one or several independent supervision and control agencies that can be independent or integrated in
the administration, financed through the general budget or via (mandatory or voluntary) fees and contributions from the supervised institutions (e.g. BaFin in Germany and FIN-FSA in Finland). Some countries also have dedicated authorities for supervising pension funds and another body charged with the supervision of insurance companies, albeit that the macro-level trend has been the unification of supervisory agencies to single authorities responsible for supervision of the entire financial sector (ibid.). The change in regulatory and supervisory paradigm has thus been more operational than formal.

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The purpose of this chapter has been to present the contexts with which the empirical case study of this thesis is contrasted. The first section discussed the organisation field level institutions characteristic to Anglo-American PFC, which serves as an empirical point of comparison for the case study. The fields of earnings-related second-pillar funds are very broad in size and coverage in the US and in UK, all bounded by only few strong and similar frames like trust laws, fiduciary duty and prudential regulations (depending on the location of the funds). The institutional frames are otherwise dependent on types of pension plan and location of the funds. Moreover, the fields include various local, regional and international influences and actors from regulations and regulators to stakeholder norms and external service providers. Yet there are a few characteristic institutions that provide proficiency in all these fields. The main action processes are related to trustee decision making, and main
dispositions to asset allocations, manager and investment style selection, and 
ownership practices. Elimination of fiduciary positions with certain procedural 
delegation and conservative investment styles, and reliance on external advice, have 
both proved to provide proficiency for most trustees, while the financial performance 
or stakeholder opinions may not have been that positive in all cases.

The second section presented the institutional changes characteristic to the process of 
financialisation of European pensions. Although much variation remains from one 
fund and country to another, the generation and reforms of European funded pension 
arrangements in general has included some common institutions concerning 
investment making. The investments are based on the norm of market-driven portfolio 
management that has risks and profits as its virtues, valuation and selection models 
and diversification methods as tools, and information and personal relationships as 
resources in a global playing field. The independence of investment making has been 
strengthened via privatisation and prudential regulations. The internal structures 
control the independent investment processes with the virtues of effectiveness, 
internal transparency and accountability, and the regulators and supervisors are 
increasingly shifting the responsibility to monitor these processes to the funds.

The empirical study of this thesis is related to the two themes discussed in this chapter 
as follows. As noted, the comparison of any form of PFC outside the Anglo-American 
institutional environment is interesting as such, because it may reveal alternative 
institutional logics of investments that functional analyses are unlikely to address 
sufficiently. Any case study that takes the Anglo-American institutions as a point of 
comparison also broadens our view on what PFC means. However, as it was noted,
the case selected is not only one of such pure curiosity. It is also a case of financialisation of pensions in Europe. As we can see in the following chapter, the history of the field of PICs has all the ingredients of this process. However, as we will see in the three last chapters of the study, the institutional pressures have their limits, and they are not without tensions when brought to the field-level institutional arrangements.
4. Exploring Finnish Pension Fund Capitalism

Institutional analysis requires much contextualisation. In order to provide basic understanding on the institutional life of pension investments of any kind, at least two issues need to be addressed. The first is the essential institutional prerequisite for pension fund capitalism: the generation of pension capital. Without funded or partly funded pension schemes or other invested retirement savings there is no pension capital. It is in part unavoidable to study how exactly funding is arranged in a pension scheme in order to understand pension investments: even though pension systems, contributions, benefits and other such issues are not the primary objects of this study, which is focussed only on investments, looking at them is important simply because many variables of funding directly affect the feasibility of many investment methods and practices (Davis and Steil, 2001). The second and more general issue is time. Although a snapshot of institutional life of pension investments may provide an explanation for many actions and behaviours, it does not exactly explain why some actors are involved in this activity and why some institutions are diffused instead of others. Questions like why are pension investments conducted by certain types of actors (e.g. trust-based funds, insurance companies or foundations) can hardly be answered with adequate explanatory force in other than historical terms.

It must be also noted that all pension institutions are results of political processes, and all pension investors are in nature political organisations. Political processes should not be understood as institutions of collective decision-making, but broadly as
politicisation of issues, as opinion formation and politicking, and, ultimately, as the processes where things are decided to be conceptualised, arranged or acted upon differently, as Palonen (e.g. Palonen and Lindroos, 2007) has highlighted. It is quite likely that the size, composition, and even embodied skills of pensions-related institutions reflect directly the historical political constituencies, opinions and compromises of the stakeholders in these institutions (Clark, 2008). Moreover, the compromises in solving political conflicts behind pension institutions continue to condition the institutional life of pension provision (Korpi, 2001). Institutional history is important in terms of understanding what kinds of political subjects and objects pension investors are and why they exist in the first place, but it is crucial for understanding why some dispositions may be so elastic and characterise investment making even for decades.

The purpose of this chapter, based on previous literature, is to set the Finnish pension insurance company (PIC) investments arising from the mandatory earnings-related TyEL scheme into these two contexts: the Finnish pension regime, or the regimes of funding to be more specific, and the historical development of TyEL investors and investments. The first section of this chapter introduces briefly the pension schemes belonging to the Finnish pension regime and presents some basic characteristics of their funding mechanisms and investments. It must be noted that the purpose of the section is rather to present key differences between the institutional frameworks generating Finnish pension investors than to provide a detailed analysis on the liability side characteristics of the schemes.\(^9\) However, the TyEL scheme is described

\(^9\) A more detailed account on all Finnish pension schemes can be found in these terms for example in Hietaniemi and Ritola (2007) or the more often updated Finnish Centre for Pension website (http://www.etk.fi).
in some more detail in order to provide better basic understanding on its funding mechanism.

The second section is focussed on the institutional history of investments in the TEL scheme, to which a number of other pension schemes were quite recently merged and transformed into TyEL. The institutional history of TEL/TyEL investments goes surprisingly much along the European story of financialisation: of changing nationally bounded investments with variable economic targets to internationally diversified portfolio investments optimising returns for pension provision. What makes the story of TEL/TyEL interesting in international comparison is that it hardly illustrates any regulative institutional path departure but very strong institutional continuity with only parametric reforms on different institutional forms framing activities. This section is based on previous studies and publicly available documents, which are somewhat limited to more formal aspects of institutions of the organisation field. Due to limitations caused by these materials, the narrative of the section is primarily based on change in institutional forms framing TEL/TyEL investments and on governance-related aspects of institutional change instead of individual-level investment dispositions or more incremental change mechanisms.

4.1. Funding in the Finnish Pension Regime

As noted in Chapter 3, the European pension politics have been only quite recently characterised by the endorsement of funding as an essential part of pension provision.
Finland has in this context been an early exception than a paradigmatic illustration of European pension regimes. The first national funds saw their birth already in 1930s. However, the Finnish pension regime is exceptional in international comparison more generally. Finland is perhaps the only country in the world where first pillar pension savings have been the largest, third pillar second largest, and second pillar the smallest in volume – with very clear demarcations throughout the last half century, according to one informant (see next chapter).

The volume of the first pillar is the easiest to explain. The second pillar of most European pension regimes is almost entirely legislated as the second tier of the first pillar in Finland. As result, the first-pillar earnings-related schemes covered over 2.5 million employees and almost 1.9 million pensioners in 2009 – that is, almost 85 per cent of the overall population and almost the whole adult population in a country with 5 million habitants. The second pillar schemes that were not drawn to the domain of mandatory pension legislation can be best seen as a legacy from the occupational schemes that dominated earnings-related pension provision before the introduction of the mandatory schemes in 1960s. The public schemes have in part economically, but even more importantly politically and discursively ‘crowded out’ collective second pillar arrangements. As one informant put it, the second pillar pensions have not been a part of ‘the official story’ but rather an actively neglected area from national pension strategies to everyday discourse.

The popularity of the third pillar over the second is more difficult to explain. It has been often argued that especially the lack of ceiling in statutory pension benefits has crowded out the need for supplementary pension arrangements in Finland (Lundqvist,
The Finns have been very antagonistic towards adopting pension schemes where risks are born exclusively by individuals (see TELA, 2007), which should predict that second pillar DB schemes ought to be more popular than the third pillar DC schemes. But the popularity of individual third-pillar savings has grown very rapidly during the last decade or so. In 1995 only 100 000 Finns had formally contributed savings to third pillar pension insurance policies but only a decade later, in 2005, the number had quadrupled to over 400 000 (Harju, 2008). The primary causes addressed to this development have been, in the order of priority, the improvement of savings possibilities (the increase in household wealth hypothetically being the first-order and availability of more diverse products the second-order determinant), more prevalent uncertainty (about public pension benefits, working careers and future consumption needs), and increasing awareness of the public debates on pension sustainability (Ahonen, 2008).

The simple explanation for the popularity of third pillar savings, which have also been given different kinds of tax benefits (e.g. all the contributions to defined regulated pension products are fully tax deductible up to a certain amount annually), is that Finns have regarded individual DC savings only as personal sources of extra income to the public tax-based and DB schemes that are considered by far the most important sources for retirement income (Korhonen, 2003). Third-pillar savings continue to be considered supplementary and only rarely complementary sources of income to public schemes, not means for instance for enabling early retirement or achieving lower taxation (Taloustutkimus, 2008). Despite having no regulative obstacles or disincentives for it, the second pillar schemes have not been adopted because the
schemes have not received political support that would outweigh the dominant two-pillar arrangement.

The main part of the Finnish pension policy narratives has been dedicated to the first pillar earning-related schemes. Although the schemes might seem expensive in international comparison, they are less so when their role is properly understood: they have been able to provide sufficient overall income, not just primary pension benefits for nearly all workers very cost-efficiently, albeit that this ability has been recently questioned (Niemelä and Salminen, 2006). The Finnish first-pillar earnings-related regime has been called a hybrid combining some elements of the Swedish model – basic pension security for all with earnings-related benefits on top for those with an employment record – and the decentralised Central-European ‘corporatist model’, where employers select the pension providers that execute the plans and that invest the assets (Hinrichs and Kangas, 2003). In terms of pension benefits, this means very low basic pensions supplementing the primary earnings-related pensions. The weight put on the earnings-related schemes implies that the Finnish regime is not exactly very beneficial for those without earnings. For those who are employed, the earnings-related regime in general and TyEL in particular are in Finnish literature typically portrayed ‘excellent’.

Whether the regime deserves the general praise or not, Finnish pension scholars have highlighted many strengths when evaluated against traditionally second pillar occupational schemes. Despite the costs, the regime is beneficial for or politically even ‘a reach of hand to the direction of employers’, as one interviewee put it, since the mandatory pension arrangements create neither competitive disadvantages nor
liability uncertainties for individual firms. The schemes cause no legacy costs or uncertainties for employers, as the amount of contributions is known in advance and paid as salaries are paid. Even the TyEL company funds (see below) that were in previous decades more like German book reserves or American large-employer funds have generated almost ignorable legacy costs. The regime is equally much a reach of hand for many employees. The earnings-related pensions are universal, fully portable, and legally guaranteed (i.e. not based on collective agreements or individual firms). They are collectively funded, benefits and liabilities accounted by individual employees, and all assets and liabilities controlled by competent professionals bounded with solvency and other rules supposedly keeping the pension promise safe.

There are signals that the public interpretation on the adjustments to ensure the sustainability of the first pillar schemes has been that the pensions are constantly cut (TELA, 2007), which has increased the popularity of third pillar schemes. The aim at avoiding insecurity is a potent force characterising the third pillar investments, as they are based by and far on low-risk investment styles (Taloustutkimus, 2008). In contrast, there has not been any ‘gold rush’ to the second pillar schemes. The supplementary collective pension schemes nevertheless exist and have stabilised their popularity over the years. In total, all collective second pillar schemes have in recent years covered around 200 000 employees and generated assets (not necessarily investment capital) for around ten billion euro. However, even these funds are typically related to the first-pillar arrangements. They can be regulated schemes that include workers belonging to the TyEL and The Seamens’ Pension Scheme (MEL), and the self-employed of the YEL scheme (see below), executed by company pension funds, or more informal schemes mostly executed by life insurance companies. Since
the forms of these schemes vary, they do not form equally clear organisation fields as the first pillar pension funds.

The Finnish first-pillar first-tier schemes do not include a funded component. Most importantly, the national pension scheme (Kansaneläke) offers a basic income for everyone who is entitled only to a small – in which case the scheme provides supplementary income up to a specified limit – or no earnings-related pension at all and who have live in Finland at least for three years after the age of 16. The benefits are in general very low. The scheme covers disability pensions (for those disabled between 16 and 64 years), unemployment pensions (for long-term unemployed persons aged 60 to 64 born before 1950), and, most importantly, the old-age pensions after the retirement age of 65 years, including the possibility to opt for a lower early old-age pension from the age of 62. Even so, the national pension scheme was actually a fully funded scheme in the era before the earnings-related schemes took over the pension regime in early 1960s. Whilst the scheme of that time had almost nothing to do with pension security and despite its current PAYG and tax sponsored nature, the national scheme plays a vital role in the history of Finnish PFC – in fact, the very basic infrastructures of the modern Finnish economy was built with the national funds in 1930s (Kangas, 2006).

**Funding in the first pillar earnings-related schemes**

All Finnish mandatory earnings-related pension schemes – or, first-pillar second-tier schemes – include a funded component of some sort. There are still a few different mandatory schemes in Finland despite the gradual process of homogenising the field.
The total amount of invested assets in Finnish mandatory and collective pension arrangements (i.e. first and second pillar funds) was EUR 124.9 billion at the end of 2009. The PIC investment capital (derived from TyEL and YEL) accounted for 62.5 per cent, other private sector funds, including the TyEL related company funds and industry-wide funds, the Seafarer's Pension Fund (MEK) and the Farmers' Social Insurance Institution (MELA), for 6 per cent, and public sector funds for 31.5 per cent of these assets (see Figure 4.1). In 2007, these funds accounted for 74 per cent of the Finnish GDP (63 per cent in 2008 due to high negative investment returns). The prefunding component was introduced to all mandatory public sector employee schemes in late 1980s and early 1990s to lower the pension contributions for the baby boomers’ retirement. The TEL/TyEL scheme and some other private sector worker schemes have been partly funded from their beginning.
There are a few public employees’ schemes. The Local Government Pensions Act (KuEL) primarily covers in total just below half a million employees, including officials and employees of the municipalities and federations of municipalities, and of limited liability companies where the municipalities own at least 90 per cent of the
shares. The State Employees’ Pensions Act (VaEL) in principle covers all state officials and employees and some of the personnel of the private organisations directly subsidised by the state, in total just below 200,000 employees. The pensions for Members of Parliament are determined by a separate act, which also includes most of the pensions of the representatives elected from Finland to the European Parliament. The pensions for members of the Government are based on a separate act. The Evangelical-Lutheran Church Pensions Act (KiEL) covers officials and employees of the Evangelical-Lutheran Church, parishes, the federation of parishes or other association of parishes. The act provides pensions for approximately 17,000 employees. There are also other schemes including the Bank of Finland pension scheme, which is often portrayed very generous in public discussion, and the Social Insurance Institution (KELA) scheme as well as the pension schemes of the regional government of Åland and the Orthodox Church.

The pension assets of public sector employees are primarily managed by five pension providers: the Local Government Pensions Institution (Kuntien Eläkevakuutus KEVA), the State Pension Fund (Valtion Eläkerahasto, VER), the Central Church Fund, the pension fund for the employees of the Social Insurance Institution, and the pension provider of the Bank of Finland. In the end of 2009, there was just below EUR 40 billion in assets in public sector funds. However, KEVA (approximately 24 BEUR) and VER (12 BEUR) are the only funds significant in size and comparable to the assets generated by the TyEL scheme. KEVA is in fact the third and VER the fourth largest Finnish pension capital base in volume after the largest PICs Varma (30 BEUR) and Ilmarinen (26 BEUR). Because of their size and their alternative logics of
pension funding to TyEL, these two funds are worth discussing in some more detail.\textsuperscript{10} Furthermore, nearly all the public sector pension services (albeit not all the funds) will be transferred under the management of KEVA in 2011, which is why this institution calls for special attention.

VER illustrates well the idea of European-style first pillar prefunding in which national budgets are supplemented with investment returns. It serves somewhat purely as a buffer fund for public pension liabilities paid from state budget, as it does not accumulate liabilities itself like the TyEL funds do but serves as a separate entity to which and from which public funds can be transferred. The publicly pronounced goal is to grow the asset base until it reaches 25\% of total state pension liabilities. The government can legally shift up to 40\% of fund assets to state budget annually. KEVA is in funding paradigm located between the TyEL providers that have individual liabilities and VER that has no liabilities unless so decided. KEVA is separate from municipal budgets but it has a centralised joint liability towards all the insured. This is more common to second pillar prefunding paradigm where a fund serves primarily as a flexible buffer fund strengthening the (potentially inflexible) PAYG sponsored DB scheme. All the collected contributions that exceed the direct pension payments are funded and all the investment returns are reinvested. At least if there are no further legislative reforms, the fund can basically choose itself when and how the funds are transferred to pension benefit payments.

Both funds have some special characteristics in terms of investment mandates. The VER investment making is primarily controlled via prudential principles, and has

\textsuperscript{10} The following presentation is based on the annual reports of 2009 for both companies.
around 20 employees managing the assets. At the most general level, the investments need to be secure, profitable, diversified and liquid enough to meet targets set in the annual investment plans. The basic allocation division between asset classes target is that there must be at least 45% of assets in bonds, at most 45% in equity (quoted stocks and funds), and at most 12% in other asset classes (primarily real estate, private equity funds and hedge funds). Although currently having a lower than normal risk level in its portfolio, KEVA has had, partly due to its funding paradigm that allows contingent usage of funds and thus subtly differs from the TyEL funds, a larger risk appetite than other Finnish providers. The long-term goal for annual real investment yields has been set to four per cents. The basic allocation somewhat differs from other Finnish investors. In 2009, the target allocation has been to include 50% in listed equity, 32% in bonds, 9% in real estate, 5% in private equity, 2% in hedge funds, and 2% in commodities. As in other Finnish funds, the investments are controlled with annually required investment plans that set the frames for investment decision-making. The KEVA staff base is significantly larger than that of VER.

Both investors are, typical to all Finnish pension funds, quite transparent in terms of reporting investment principles, but not necessarily so much in disclosing specific investment methods. In VER, nearly all investment vehicles, principles, and risk management principles are disclosed and visible in the annual reports. The direct equity investments are, for example, reported on a country-by-country basis, and fund investments according to types and currencies. The benchmarks for investment performance consist of indices. The investment policy is discursively based on sustainable development. This for example means that when two similar vehicles are considered, the one belonging to a sustainability index will be chosen in principle. In
addition, VER reports to use negative screening to avoid investments on alcohol, tobacco, weapons, pornographic, and gambling industries, and in general on investments in countries that do not respect the basic human rights and ILO principles on labour conditions.

In public debate, some have considered KEVA a sinister pension investor in Finland. Its CEO left the fund during the nation-wide election financing scandals and public debates in 2008–2010 after facing accusations over counterfeiting invoicing that supposedly proved personal links between convicted white-collar criminals, KEVA directors, and the centre party (Keskusta) heads of election financing (Pietiläinen and Vähäsarja, 2009). This reputation is not so much present in public investment transparency, as there is as detailed disclosure available on KEVA investments – including the disclosure on book and holding value of individual assets – and risk management principles as in case of TyEL providers. The investment methods are, however, discussed in somewhat less detail, and the KEVA annual reports are more focussed on describing investment conditions than asset selection and trading principles and methods.

In terms of governance, the funds are quite different in their structure albeit that they are both run in a tripartite manner. VER is in structure one-tier. The Ministry of Finance (Valtiovarainministeriö, VM) nominates the VER board, which consists of employer and employee representatives. The board duties are set by and described in detail in the law on VER (1297/2006). The Financial Supervisory Authority (Finanssivalvonta, FIN-FSA) supervises the VER operations. The governance structure of KEVA follows a two-tier paritarian paradigm in a somewhat complex
form. The Council, which is the highest authority, consists of 15 to 30 members with personal deputies and is formally nominated by VM for four years. But the municipal employers can directly nominate at least three “candidates-to-be-members” and the remaining candidates are nominated by the Association of Finnish Local and Regional Authorities (Kuntaliitto). The Board of Directors, which uses power over operational matters, includes six ‘ordinary’ members with deputies, and six additional members, of which at least one must be a lawyer familiar with related laws, one an insurance business expert, and one physician, each one having their own deputies with similar qualifications. The Board is required to nominate an investment advisory committee of ten members, of which one must belong to the Ministry of Employment and the Economy and one to a contracting organisation related to specific municipal collective agreements.

There are three mandatory schemes relevant in size for private sector workers outside TyEL, which is described in more detail below. The quite marginal Seamen’s Pensions Act (MEL) covers under 10 000 sailors and other personnel working on board Finnish commercial vessels in international traffic. However, the Seafarer's Pension Fund (MEK) had over 600 MEUR in assets in 2009. MEK is in regulative nature very similar to TyEL funds, and the governance structure is similar to KEVA. The fund is governed by a 13-member tripartite Delegation, the highest operational authority including or sometimes almost entirely comprising of representatives of the state authority, shipping companies and seafarer employee organisations, and the five-member Board, which makes investment choices and is generally responsible for the administration of the fund. The MEK investments are quite peculiar in allocations, as the fund had almost half of its investments (48 %) in
real estate and infrastructure investments in 2008. The fund also had roughly one fourth of its investments in bonds (28%) and in public and private equity (24%). Another if not marginal in terms of scheme coverage (approximately 90 000 insured) but small in terms of generated assets, The Farmers’ Pensions Act (MYEL), covers not only farmers as the name suggests but also academics and artists working on grants. Unlike most first pillar earnings-related schemes, the scheme receives state sponsorship of some significance. The Farmers' Social Insurance Institution (MELA) had only 118 MEUR in invested assets in late 2008. Of these, there was roughly 45% in fixed-income, 25% in equities, 24% in real estate, and 6% in other investments. The governance structure is similar to MEK.

The Self-Employed Persons’ Pensions Act (YEL) has a special relationship to TyEL because it is executed primarily by the PICs. YEL covers most of entrepreneurs, in number just below 200 000. There are only few differences in terms of pension contributions and benefits to the TyEL scheme. For example, the self-employed accrue pension rights on the basis of paid contributions as in TyEL pensions, but if contributions are neglected (which only exceptionally happens in TyEL) they will expire and the accrued YEL pension will be reduced (unlike in TyEL). In terms of investments, one difference to TyEL is that the self-employed cannot choose company pension funds but PICs or industry-wide funds as their pension provider. Otherwise, the YEL investments are an inseparable part of TyEL investments, which is why the discussion in the following chapters is fully applicable to them as well.
Funding in the TyEL scheme

The original Finnish earnings-related private sector workers’ pension scheme TEL was established in 1961 and enforced in 1962. Employees on short-term contracts (LEL) (1961), farmers (1974), other self-employed (YEL) (1974) and artists (TaEL) (1986) got their own separate mandatory programmes. TEL, LEL and TaEL schemes were merged into one scheme TyEL in 2007, which significantly simplified the Finnish pension regime. The scheme covers approximately 1.8 million current workers and over one million pensioners, in total over one half of the Finnish population, which is why it is by far the most important pension scheme in Finnish pension policy.

TyEL somewhat evades classification by pillars and tiers. From the perspective of a pension insurance scheme, it is a first-pillar, second tier, mandatory, DB, partly funded – one fourth of inflowing contributions are funded and the current total funding ratio is around 36 % – but primarily PAYG reliant pension scheme co-sponsored by employers (in broad-brush terms four fifths of contributions) and employees (one fifth). The reason that makes the TyEL scheme difficult to classify is the fact that it is executed and implemented by decentralised and competing private pension providers of different types: pension insurance companies, industry-wide funds, and company pension funds. The TyEL scheme can be best characterised as a public-private partnership, although it is worth noting that the state funding of TyEL scheme is at best indirect in nature and marginal in volume.
The TyEL scheme covers regular old-age pensions, early and deferred old-age pensions, part-time pensions, disability pensions, partial disability pensions, cash rehabilitation benefits, partial cash rehabilitation benefits, rehabilitation assistance and survivors’ pensions for a vast majority of Finnish private sector workers. Although a DB scheme, TyEL is not a final salary but an adjusted average salary scheme. The relationship between salary in any given point of career and the final pension cannot be easily calculated or predicted. The scheme is better characterised as a ‘notional defined benefit scheme’ or ‘accrued benefit scheme’ than as a classic final salary DB scheme where pension benefits are defined with a specified level in relation to salary.

The benefits are currently defined by all incomes throughout employees’ working careers. The contribution rates as the accrual rates depend on employee’s age. In 2010, the employees’ TyEL contribution is 4.5 per cent until the age of 53, after which it is 5.7 per cent of the wage sum (the employers’ pension contribution varied between 21.8 and 22.4 per cent depending on the total contributions paid by the company). The old-age pension accrues at the annual rate of 1.5 per cent of wage sum until age of 53, after which the rate is 1.9 per cent. After reaching the age of 63, the accrual rate is 4.5 per cent until the mandatory retirement age of 68, which is typically called the ‘super accrual’ incentive in Finnish literature and public debates. The old age pension also accrues at times of disability, studying, unemployment and part-time pension. The earnings are adjusted in line with a wage coefficient to the level of the year of the start of the pension.

In the partly funded TyEL scheme both the contributions and the pension benefits are divided into two financial components. The pension includes a funded component,
where assets are accumulated in advance and dissolved when the pension is paid out. The part of the benefits that has not been funded in advance refers to the pooled PAYG component. In the TyEL scheme, benefits that are partly funded are old age, disability, and unemployment pensions. Survivors’ pensions and part-time pensions are fully PAYG-financed, and the old-age pensions are partly funded as they accrue. Disability and unemployment pensions are funded when the pension payments actually start.

In order to alleviate the pressure to increase the pension contribution as the post-war baby-boomers retire, old-age pension funding has been increased since 2003 with a view to additional funding by 2013, which corresponds to 7.5 per cent of wages. Since 2005, old-age pension funding has been further increased by an amount that corresponds to contributions received as an increase to the employee contribution (1.2 percentage points in 2010) for insured persons who have reached the age of 53. The period in which funding component is derived from the contributions covers about four-fifths of a full work history. The funded old-age pension accrues at the rate of 0.5 per cent of the insured person’s earnings for the year in question without index adjustments.

During their most active working years, the future old-age pensions of employees aged 18–54 are funded individually albeit purely in terms of accounting meant to help defining future liabilities – that is, not like individual retirement accounts or notional defined contribution (NDC) schemes. It could be nonetheless argued that the technique used makes the scheme potentially prone towards these arrangements should there be political pressures for such reform. In all calculative formulae the
funded component is primary although the PAYG component is in volume much larger. This is why the idea of prefunded PAYG gives a wrong impression on the nature of the TyEL scheme. Rather, the TyEL is better characterised as a permanently under-funded scheme with individual liabilities that are complemented by a large and variable collective PAYG component – if the individually accrued funds are not sufficient (as they never are) to pay the regular pensions, the (certain) deficiency and some cases like the need for survivor or part time-pensions can be covered by variable collective contribution rates.

This arrangement is complex in terms of accountancy due to decentralised implementation of the scheme. Finnish workers tend to accrue pension rights and generate liabilities in more than one pension provider. Each pension provider is liable for the funded component of the individual pension accrued in the company, and thus the definition of the liabilities of each provider in pension payments requires extensive data processing. The pension liability of an individual pensioner is from an individual provider’s point of view simply the amount that on average suffices to finance the funded component of the pension in question from the starting point of the future pension (or, in case benefits are already in payment, from the calculation point of the pension liability) to the end of pension payments. The pension provider calculates with actuarial formulae the commitment related to the pension liability, the amount of technical provision (vastuuvelka), for each insured person. When technical provisions are calculated, a discount rate of three per cent is annually used as the technical interest rate defining the capital value of the pension. In addition to technical provision, the fund transfer obligation of pension providers – the amount of contributions they book to liabilities covered with investments – includes a
supplementary factor whose volume depends on the average solvency of pension providers (e.g. 18 per cent of average solvency of TyEL and MEL providers) and an equity return-linked provision that can also be negative.

The funding mechanism causes immediate dynamics between investment performance and pension costs. Indeed, investments have a more tangible relation to pensions than the idea of under-funded TyEL scheme presented above might suggest. The PICs, unlike other TyEL provider types, can pay client bonuses to their policyholders (i.e. employers) from their net investment returns exceeding the fund transfer obligations within certain boundaries (see next chapter). The client bonuses are not, however, very high. During the last five years, the total bonuses have accounted for 0.2–0.6 per cent of the TyEL wage sum. This suggests that the role of investments in the TyEL scheme is extremely limited on one hand but vital on the other. It is limited, as it is never translated into immediate improvements in pension benefits or to lower pension costs for the insured, and even the worst financial performance is not likely to affect anything but in extreme cases when PAYG contributions may need to be raised. But it is also vital, as it directly dictates in tandem with the accrual rates the development of the PAYG component in the long run. This is why long-term investment performance is a key political and economic question in the TyEL scheme.

11 The surplus from which bonuses can be paid can also be generated in other ways, most importantly from the savings on the overall administrative cost component of the pension contributions (see Hietaniemi and Ritola 2007, for details).
4.2. A Brief History of Finnish Pension Fund Capitalism: 
Institutional Change and the TEL/TyEL Investments

The history of Finnish pension fund capitalism starts from 1930s with the funded national basic pension scheme. As the history of the scheme investments has been already told and summarised elsewhere (see Kangas, 2006), the story of this study starts from 1962 when the Finnish law on statutory employment-related pension scheme for private sector employees (TEL) came into effect. Before TEL, the private sector pensions were dominated by occupational pension schemes. The new basic pension scheme of 1957 and TEL were meant to effectively replace the old basic pension scheme and all the occupational schemes. The new national basic pension system, now a pure PAYG scheme, was a political victory for and income transfer in favour of the agrarian population, whereas TEL began an era in which the labour market organisations were actively involved in the shaping of social policy and development of social security based on the insurance principle took centre stage (Niemelä and Salminen, 1999). Employees on short-term contracts, farmers, other self-employed, and artists later got their own separate mandatory programmes. All but one (YEL) scheme were later merged into TyEL in 2007.

The history of TEL investments starts from the original political conflict behind TEL, which created a strong institutional path that continues to characterise many of today’s activities in the field. The TEL system design was based on four-year-long
There were three initial main options for a new scheme: private provision with voluntary arrangements (basically a small reform to the old schemes), mandatory centralised system executed by reformed KELA, and decentralised mandatory minimum scheme with possibility to provide additional second pillar pensions. Although insurance companies were asked to help in drafting a new scheme, they refused to join the committee and deemed mandatory pension insurance ‘impossible’. There was nearly a two-year stop in the committee operations due to dissent on financing arrangements and more general resistance by the employers towards statutory schemes (Salminen, 1987). The final solution, the third option in the list, was finally accepted by the employers thanks to decentralisation and private provision of otherwise mandatory pensions. The committee report was turned into a parliament motion but not a government bill because the agrarian minority government was not willing to give one: they also left a minority report to the committee report. The bill was directly opposed only by the extreme left (SKDL), processed very fast, in two months, and put in effect as law in 1962.

From an institutional change perspective, the birth of TEL was in part about translating (by legal force) the new statutory variables to the existing company-based arrangements and insurance company frameworks (Lundqvist, 1998). The decentralisation of the implementation hindered the formation of a single large capital base, which in hands of employees would have created ‘pension fund socialism’ (see Langley, 2008b), a phenomenon feared by employers in all Nordic countries (Overbye, 1996). The employers wanted to ensure that the state has neither control

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12 The committee included one ministry, one Social Security Institution (KELA), and six labour market organisation (three employees’, two employers’ and one agrarian) representatives and three members of parliament from government-forming political parties.
over nor interest in decentralised fund investments, or in any other issues than mandatory pension benefit levels and regulations securing the adequacy of assets. This was in stark contrast to the politics that took place a few years earlier in Sweden. The labour union demands in Sweden had included universal pensions and funding under public control (Esping-Andersen and Korpi, 1984). In Sweden, the main labour union LO had turned down the employer demands for decentralisation primarily because it wanted to ensure the funds being available as public tools for economic policy. The employer opposition towards this solution was so stark in Finland that the main labour union SAK did not even seriously consider demanding it. The reason for the different outcome was not only that the labour unions were much weaker than their Swedish counterparts or that the political left was fragmented, but also that employers were convinced about the financial benefits from the decentralised system after carefully studying the Swedish reform and communicating with Swedish employer organisations (Salminen, 1987).

The funding element was based on broad consensus regarding shortage of financial resources as a primary obstacle for investments and job creation in the Finnish economy. High inflation was also a great incentive for borrowing pension capital (Pentikäinen, 1997). The Finnish scheme was born a public-private-partnership. The statutory scheme was and still is executed by PICs, company pension funds or industry-wide pension funds according to employer choice. The TEL system in general halted the growth of pension funds, which provided pensions for twice as many employees as industry-wide funds and six times more than insurance companies during the 1950s (Pentikäinen, 1997). Traditionally some large companies have had their own company pension funds, while most companies including almost all small
companies have insured their employees through PICs (Puttonen and Torstila, 2003). The PICs and their clienteles were tightly connected to financial blocks built around major banks and insurance companies, which reflected linguistic divisions, agrarian interests, and social democratic interests (Heiskanen and Johanson, 1985). In this sense, it could be argued that the competition between the PICs was not about market competition over customers but competition over political sympathies. Moreover, the limits of competition were clear as the PICs were based on a joint liability: in case a PIC ended up to bankruptcy, the other companies would inherit its liabilities.

There was an important political struggle in mid 1960s when the agrarian party tried to merge the TEL system with the basic pension scheme and to move assets fully under public control. This time it was not the employers but the workers that were outraged by this attempt and gave signals that were then interpreted as threats of general strike (see Pentikäinen, 1997). The outcome of the conflict was the increased cooperation of social partners, which gave TEL decision-making permanently a paritarian flavour. Only shortly after finding consensus in principle, the labour union SAK demanded in the so-called social partners' pension commission of 1971 that the paritarian principle – both labour market parties should have equal representation in all pension providers’ administration – should reach all pension providers and that they should participate more in asset management in practices as well. SAK urged company funds to be terminated and to increase the representation of labour unions in large pension insurance companies. These issues were renegotiated in the general incomes policy settlement TUPO – the traditional Finnish tripartite collective bargaining and economic policy-setting arena between central labour market organisations and the state – of 1974.
It was agreed by both labour market parties in the settlement that labour market party representation would be negotiated in coordination by Työeläkelaitosten liitto TELA (now Työeläkevakuuttajat), the pension provider interest group. From the beginning of 1975, each PIC ought to have four employer and four employee representatives in their supervisory boards (selecting the boards of directors), and two from each in the board of directors (Salminen, 1987). In industry-wide funds, the employers and employees could both nominate half of members of board, whilst in company funds the employers nominate two thirds of the members. This disparity was decreased by the requirement that in some fundamental issues (not including investment policy) decisions required five-sixths majority of the votes. These solutions started a two-decade long period of institutional stability in the TEL field.

**Investment targets and methods from 1960s to 1990s**

The so-called *premium lending* was by far the most important investment vehicle for the TEL funds from the early 1960s all the way to mid 1990s, accounting for 80–90 per cent of investments in portfolios in the early years. It was extensive in popularity and sophisticated in terms of financial innovation. The employer-sponsors could by a legal right borrow two thirds of their contributions as cheap loans with very little collateral. The interest rate for premium loans was fixed for over three decades and was not made fully market-based until 2006. The pension providers could directly receive the contributions from employers annually in bonds instead of cash. As the interest rate for the bond was the ministry-set technical provision rate of five per cent, and the annual amortisation rate seven percent of the remaining loan, the maturity of
the loan was theoretically almost unlimited. This increased the employers’ trust towards the pension system in general. The employees remained more sceptical. In 1971, SAK for example demanded the automatic premium lending system to be ceased claiming that the funds were used to cover operating costs of companies rather than productive investments.

Because the system was based on legal employer rights and automatic distribution of premium loans, the TEL providers could not simply opt for any investment strategy. As the contributions and premium loan instalments did not need to be used to pension payments due to early maturity development of the scheme, a part of the assets could be nevertheless used to various other targets. The PICs were the only providers making significant investments since the funds tended to keep the assets in the parent companies. The main non-premium-lending investment method was target-specific strategic loan allocation, the so-called investment loans, whose goal was job creation and improvement of general employment rate according to public policy targets, while the maximisation of profits was not a goal for investments at all in the first decades of TEL investments (Pentikäinen, 1997). As the goals were not related to any specific industries, but dynamic in relation to business prospects, and as the shortage of capital was massive, the employers “downright fought over the loans” (Pentikäinen, 2007).

Investment loans to the biggest contributing companies were the primary investment targets while other investments remained rather marginal (see Figure 4.2. for allocations from 1980s). In the 1970s and 1980s, about one-third of investments outside premium lending were directed at the heavy industry sector. In addition to
industry, PICs invested in the building sector (about 20 per cent of non premium lending investments) and directly to real estate (about 15 per cent) (Kangas, 2006). Especially in the third TUPO, the labour market organisations agreed that PICs would invest in rental housing production in 1972-73. Interestingly, in contrast to the idea of eliminating state influence to TEL investments, this caused the pension providers to be somewhat active in engaging themselves to state-sponsored housing investments until late 1980s when the scheme ceased to exist (Kostamo, 1997). The profits from real estate and building project investments remained rather low.

![Figure 4.2. Total allocations (as a percentage of total portfolios) of all TEL provider investments by asset class in 1980–2008. Source: TELA](image)

There were good reasons for PICs to have few investments in high risk assets. However, they had little to do with qualitative restrictions, as the TEL providers initially had only few blocked transactions or allocation ceilings. The popularity of the premium lending system simply made opportunities for other investments rare. Another mechanism preventing most importantly equity investments was the low
capital base. The principles in regulation of TEL providers have been based from the start on quantitative interpretation of risk management. The regulation of PICs has always resembled continental European style insurance regulation in form (Lindqvist-Virtanen, 2004). On the other hand, the PICs are not like typical European insurance companies, as their capital base is extremely low – even the largest companies managing tens of billions of euros today have less than 30 MEUR in their own capital. Despite high solvency expectations, the capital reserve requirements established in 1969 provided PICs much less reserves than for life insurance companies, which was justified on the basis of joint liabilities. It provided little capital reserves for any investment operations (HE 188/1995). Reserves in general were thought to be reserves for insurance, not investment risks (HE 241/1996). The mechanism was considered successful and consistent until early 1990s, when the arrangement faced severe critiques as technical provision rates needed more flexibility and other investment options were gaining more legitimacy (see below).

The two fund types did not have such capital reserve requirements but were more like Anglo-American funds with the difference that they could invest much more in parent companies. In case of those funds that executed additional second-pillar pension insurance, the company funds did not need to hold particular assets to cover any pension liabilities before 1991, when the requirement was set to 75% of current and future pension benefits by law. Moreover, the parent company was required to contribute the company fund only the amounts needed to cover cash flows. This was

13 In the pre-1997 TEL funding rules concerning PICs, an annual nominal discount rate (rahastokorko) of 5 percent of investment returns was transferred to the funds. The technical provision (laskuperustekorko) was de facto a minimum investment yield requirement and de jure the base rate for the premium loans. The yields between these rates were used to pension benefit payments, and the yields exceeding the technical provision rate were used almost fully to lower the employers’ pension contributions.
also possible in case of TEL insurances as long as ETK provided a credit guarantee for the asset deficit.  

The company and industry-wide funds did not have basically any direct restrictions in terms of asset classes and allocations – they could use bonds, loan incomes, stocks, shares, mutual and other fund units, real estate, land, reinsurance incomes, tax refunds, material objects, cash, and even hydroelectric power plants, besides any other assets STM would approve, to cover their liabilities (HE 188/1995). While the funds could have made various different kinds of investments, in contrast to PICs, they in fact did not. This ability was important mostly in political terms. Many groups of small employers saw that PICs invested their assets only in the biggest companies and planned having industry-wide funds to ensure their own capital availability. However, the PICs have been influential opponents when it comes to such demands. They simply created a new earmarked credit instrument, union loan agreements (liittolainasopimus), to respond to these competitive pressures (Pentikäinen, 1997).

In mid 1970s, a new goal for investments emerged parallel to the economic development paradigm. The rate of pension contributions became to be understood as a tool for counter-cyclical economic policy (Kostamo, 1997; see also Salminen, 1987). In 1975, the target level of TEL pensions was set to 60 per cent of wages after regular postponement of the issue (and increases in pension costs in general) in labour market agreements (Lundqvist, 1998). The policy of lowering TEL contributions in the future caused much tension between the finance ministry and the pension

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14 The guarantees were explicitly meant to replace solvency requirements and were mandatory for both fund types. The formerly ETK function went bankrupt in the recession resulting from the Finnish banking crisis and was privatised in 1994 as the insurance company Garantia.
providers. The ministry even planned obligatory investment targets and suggested the abolition of premium lending system, which sparked stronger cooperation between pension providers and labour market organisations on one hand but also political parties as channels for influencing the ministry on the other (Kostamo, 1997). The politics of contribution level was there to stay. This is not to say it had not been a long-term concern from the beginning. According to Pentikäinen (1997), the original principle in creating the TEL scheme was that Finnish businesses should not be subject to higher contribution rates than their rivals in other countries.

To sum up the early days of TEL investments, they were not only supposed to buffer against the adoption of employer-sponsored statutory pensions but to broadly improve national economic competitiveness for decades. Whilst the national pension system assets were used to basic infrastructure (roads and electricity) and forest industry investments in Northern and Eastern Finland before the TEL was born, the TEL funds were invested to more urban targets (industry and trade). TEL funds helped to readjust industry and trade to international competition and greatly influenced changes in production structure especially after 1967 (Niemelä, 1994). Premium lending fuelled economic growth in general, the client bonuses improved the financial conditions of the few firms that did not need the loans, and investment loans enabled productive and labour-intensive business projects. Investments to housing or other state-led projects and equity investments to take over corporate control were minimal. Indeed, Finnish PFC in form of TEL investments was never about ‘social investments’, ‘pension fund socialism’ or maximum portfolio returns: it was about boosting private economic development and national economic competitiveness.
Financialisation of pension capital: the investment reforms of 1990s and 2000s

The TEL scheme was legitimate in almost every respect until early 1990s. There were two primary reasons for the loss of legitimacy in TEL investments at that time. The first one was the governance failures in the ‘casino years’ of late 1980s. In the year 1980, premium loans still accounted for over 60 per cent of all investments, and when bond investments, investment loans and cash were added, they constituted about staggering 95 per cent of all investments. Even so, significant amounts of TEL capital were blown as the financial bubble burst. PIC Eläke-Kansa had to cover losses arising from international reinsurances and so-called Kouri deals (both including e.g. suspect activities in tax havens), and went eventually bankrupt after a decade of litigation. Its assets had been used to prep up finances of the EKA group that owned the Kansa insurance group, which called for re-evaluation of the relationships between PICs and insurance groups and financial blocks more generally (Pentikäinen, 1997).

The second reason was the new allocation structure. When the deepest recession any OECD country had seen since the Second World War hit Finland, nearly 40 percent of all TEL investments were directed at Finnish government bonds in first half of the 1990s. This was regarded as inconsistent in relation to the goal of enhancing Finnish corporate sector’s capital availability. Some might argue that the old investment constraints had institutionally exhausted the capabilities to fulfil the old and elastic targets. On the other hand, after the financial and money markets were liberalised in late 1980s the TEL capital was set a completely new context, primarily availability of capital and competition with private international capital. The employers were also afraid that international capital would take over Finnish businesses, and had a strong
interest in having stable Finnish ‘anchor owners’. There were internal changes in PICs as well. The leaders of largest Finnish companies had now conquered the major PIC Boards of Directors. As one of my interviewees who joined a PIC in late 1990s said, there was ‘nobody who knew anything about investments’ before the social insurance expertise had started to be replaced by more professional finance personnel in the early 1990s. In 1993, the employee stakeholder interests in investments had also changed when the TEL contributions became to be shared by both employers and employees (like the employers had demanded from the beginning), which raised the issue of profits back to the political agenda inside the companies.

TEL investments became a central issue in public debate. The collapse of *Eläke-Kansa* triggered a broad public debate on how exactly pension funds should be invested (Kostamo, 1997). The debate was very lively and colourful. For example in mid-1990s, the SMEs and self-employed wanted to abandon the questioned funding component of the system in order to lower the contributions (until as far as to 2007) to ease the rough times (Vuoristo, 1996). The new financial conditions led to a new discursive understanding within the TEL field. Financial markets were gaining preference over premium lending and investment loans, internationally diversified portfolios over national dependencies, and cutting costs of baby boomer generation retirement with short-term investment over securing national capital supply in times of low demand for premium loans (Työmarkkinoiden keskusjärjestöjen eläkeneuvotteluryhmä, 2006). What made this change dramatic culturally was the complete loss of faith in planning and effective governance so strong in 1960s and 70s. The beginning of 1990s saw many traditional institutions of Finnish economy to vanish and the broadly shared experience of insecurity to step in (Soikkanen, 1998).
The great transformations in the Finnish financial system created a normative vacuum as the traditional blue, red and "green" (agrarian) capital either disappeared or was merged to international capital.

On the demand side, premium loans became almost obsolete and investment loans much less popular when the financial markets were opened and liberalised. The change in demand for premium loans was especially rapid: the loans accounted for 63 per cent of all PIC investments in 1980 in contrast to only 15.4 per cent in 1997 (see Figure 4.2). The TEL providers had no alternatives but to increase investments in other targets. However, due to their scarce capital reserves they had few options but to invest most of incoming contributions in government bonds. This target was essential from the perspective of the Finnish economy as it helped to save the state from the recession and to revitalise the economy to a new ICT-driven growth track in the mid 1990s. Despite these merits, the new allocation schema was broadly considered to be against the original rationale for investments (HE 241/1996). New investment risks and new kinds of future uncertainties needed to be tackled. When it was becoming clear that Eläke-Kansa would collapse, the social partners and the largest PICs decided immediately to start debating about new possibilities for investment rules and practices. The reforms were to be designed in two overlapping fronts.

New investment rules and practices were to be negotiated in the so-called Puro workgroup, named after the Ilmarinen CEO Kari Puro who chaired the meetings, then formally titled the ‘Pensions negotiation group of central labour market organisations’ (Työmarkkinoiden keskusjärjestöjen eläkeneuvotteluryhmä). The group was initially formed in early 1990s in order to discuss the sharing of contributions between
employers and employees. The group, comprising of central labour market representatives as primary members and the CEOs of the two biggest PICs as expert advisors, had now been given a broader mandate. Puro group was to be very powerful in setting the future agendas with its consensual outcomes that rare dared to denounce – it has been argued in popular media that politicians gave power to this ‘pensions mafia’ (Seies, 2006). It was based primarily on informal mandates and achieved a strong status as an able institutional entrepreneur. The investment rule reforms of 1997 and later in 2007 were both negotiated in and by the group, and their results more or less rubber-stamped by the parliament as such.

The other front was the more general legal reform process on the general legal mandate of the pension provision, whose main goal was to clarify the organisational independence and the endogenisation of risks to operational management in the conditions of EU membership and questionable corporate governance cultures (Louekoski, 1997). This process was initiated by a report written for the parliament by Mr. Matti Louekoski of Bank of Finland. Some parts of this process had however already been started in TUPO agreements of early 1990s.

It was clear for all parties involved in the Puro group that the primary institutional constraints for any new investment focus were the old funding and coverage rules that provided little solvency and thus operational room for the PICs. There was also broad support for the ideas that the investments ought to be more subjected to market discipline, the supervision of beneficiary interest enhanced (to meet something like prudential standards), and the beneficiary voice to be better heard in investment decision-making (Louekoski, 1997). The explicit reasons for reforms that were stated
first in the government bill were the new conditions in the investment environment and interest rate levels (HE 241/1996). There was now a clear discursive understanding about investments and their environment, but no clear consensus on the proper solutions and new arrangements. The consensus became eventually clear. The goal of the reform was simply seen as to give a broader mandate in the execution of the current system in a more portfolio-diversified yet cost-efficient manner. The Puro group report ended up into a government bill (HE 241/1996), and suggested various further reforms further discussed in the Louekoski report.

According to the bill, the extra investment yields could be used in increasing providers’ capital reserves and other targets (client bonuses) according to solvency zones. The reform thus introduced one application of a public traffic-light supervision method common to financial sectors in Nordic countries in which the extent of public control was based on solvency zones and the zones were based on portfolio theory based risk-adjustments and allocations between asset classes. The end result also introduced a new mechanism within the liabilities, which could be used to buffer individual PIC losses with collectively buffered assets. The reform gave Supervisory Boards elected by annual shareholder meetings a major role as operational supervisors of PIC BoDs.

The Louekoski report addressed especially the responsibilities and decision-making in investment management (see Louekoski, 1997 for details). The report also discussed various alternative organisational forms. It included four broad options, but

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15 From 1997 to 2006 the TEL fund liabilities were increased annually by a nominal 3 percent discount rate with an adjustment factor. In order to improve the solvency in the short term, the law included that the yields between nominal discount rate and technical provision rate were moved to the capital reserves instead of liabilities for 2–3 years in the late 1990s.
recommended a model in which TEL providers would continue to be based on separate laws and old provider types. This option was considered legally the most consistent, albeit not solving some constitutional problems on who owns the assets because it made a clear demarcation of PICs from both limited and insurance companies. The main argument against other options – the centralised public administration, centralised private provider, and an investment fund model – was that the decentralisation was beneficial due to the to-be-increased competition, and that the old provider types more cost-efficient than external management in the investment model. Competition was supposed to guarantee the development of provision models and so to provide indirect benefits for all the insured. The new law on PICs based on Louekoski report basically concentrated all issues that made PICs different from insurance and limited company law in terms of corporate governance and more general mandates and constraints (HE 255/1996).

The accounts and asset management of PIC were now to be independent from insurance groups and other influences both formally and in personal relations and individuals’ status. The solution adopted relied on gradual change towards increasing financial professionalism. Most importantly, the reform introduced a 10 per cent ceiling in share vote ownership and/or voting rights in other PICs (later banned altogether) and finance sector businesses under public supervision without permission from STM. This was intended to reduce financial concentration and TEL provider control over the finance sector. The law introduced new competence qualifications for CEOs and BoDs of PICs. The former should now have qualified experience on social insurance, investment management and business management and the latter must include much investment expertise. The role of BoDs was strengthened: they had to
prepare all important issues for the annual shareholder meetings and their members were reserved a right to address in the meetings. The role of internal debates and dissent in BoDs was also highlighted by the requirement of two-thirds majority (previously simple majority) consent when annually required investment plans were made. The labour market organisations were given a mandate to nominate one auditor.

The shift towards independent, portfolio design prized financial professionalism took place without losing the old paradigms and without changing anything in ‘the liability side’ of pensions or the paritarian representation in governance in any major sense. The shift was based on new ideas quite independent of developments elsewhere: in the preparatory documents other countries or non-local practices are rarely discussed in detail. In this sense, the financialisation of the TEL system was a local affair first rooted in cost containment targets of 1970s pension policy and later based on market-driven norms concerning proper investment targets. In the reports, there were numerous references to international markets as opportunities. The narrative concerning the 1997 reform is based on arguments on changes in external conditions and objective consensus, but not on changes in local norms. By simultaneously slightly broadening the mandate and loosening constraints, small regulative changes enabled the new financial professionals to produce a paradigmatic change in how the old norms and discourses were used in investment practice. In brief, the national corporatist economic development project was turned into professional portfolio management for pension provision because the pension providers could do and did so.
Pension providers fulfilled the promises of the reform with high investment performance. The conditions of the TMT boom provided over 10 percent annual real investment returns in 1998–1999. The crash of the bubble caused low and even slightly negative investment returns in 2000–2002, but from 2003–2007, the annual real returns returned to the level of 6–10 per cent. The growth in pension fund size was very significant in 2003–2007 as TEL/TyEL assets grew from 57.3 BEUR in 2003 to 82.2 BEUR in 2007. The decade following 1997 was in absolute terms marked by sharply increased equity investment and stable investment in Finland (30 BEUR or so) and, in relative terms, increasing foreign investments. While the PIC investments became very rapidly more foreign equity based and pioneering in alternative classes, the other fund types had a less drastic shift in allocations between different asset classes. Even so, also the funds that relied almost entirely on domestic assets still in late 1990s rapidly diversified their assets internationally in early 2000s (see Figure 4.3).
Figure 4.3. Pension insurance company, company fund and industry-wide fund investment portfolios by asset classes\textsuperscript{16} and currency areas in 2000–2008. Source: TELA.

The quick shift towards international portfolio investments in early 2000s was hardly a surprise. Kangas (2006) suggests the financial liberalisation and opening made international focus easier first, then the eurozone membership eliminated currency risks that were previously a major concern, and finally the critique on low domestic investment yields provided a legitimisation for the shift of Finnish investments to international investments. Global finance penetrated Finnish pension fund capitalism culturally as well. For example, pension investors started to monitor indices all over the world as their benchmarks. There was a continuing discussion in the field on the proper normative use of the assets, which concluded that the main task of the pension

\textsuperscript{16} Shares include investments in mutual equity funds, hedge funds and private equity. Since 2004, investments in money market funds are included in money market investments instead of bonds.
scheme was to safeguard future pension promises, and as foreign investments appeared to give better dividends they were also regarded as safer investments. It must be noted, however, that new weightings in different asset classes do not yet imply diversification at the field level. For example in 2004, about half of the TEL investments were in bonds, but up to 90 per cent of the bond portfolio in Finnish, French and German sovereign bonds. Although the goal of portfolio investments was to diversify against the performance of a single national economy, this kind of investment behaviour only implied a new kind of dependence on performance of European states and firms.

There were a few important discursive changes before the next investment rule reforms were made in mid and late 2000s. Competition between TEL providers became an important issue. Aims at higher returns, more tailored service provision and cost-efficiency as means for competition were supposed to prevent concentration in the sector (STM, 2002). Again, this would require even more solvency, which was one of the reasons behind new reform on investment regulation. On the other hand, a report commissioned by STM on the risks faced by the TEL system (Kausto, 2002) suggested that investment risk management ought to be managed more in the system design in the future than at individual company level that had been significantly enforced. In 2006, the so-called Rajaniemi report (Rajaniemi, 2007) raised various other issues directly concerning asset management in context of competition. It noted a clear shift from insurance provision to ‘investment fund’ ethos. Perhaps the most effective argument was that there still was no clear distinction between internal (funds) and external (PICs) management of assets in relation to parent companies in the system at least at the regulative level. The laws on both types of funds were to be
re-evaluated and later combined in legal mandate. This shift was not too drastic, as both types had lost much of their popularity. There were other very detailed suggestions in the report as well, including the suggestion to make investments in real estate and property funds easier by changing the tax treatment and making pricing more transparent, a matter that still has not been solved. TEL was changed into TyEL in beginning of 2007. The most important feature of this shift from the asset management side was that the dedicated fund taking care of all non-TEL private sector earnings-related investments was transformed into a new PIC, Etera.

The more specific changes in TyEL provision were again commissioned by the Puro group and the STM set expert group led by Mr. Louekoski. The last task for the Puro group was to discuss how the TEL/TyEL provider solvency and balance rules could be reformed in order to increase riskier and more profitable investments, and how more of the investments could be targeted to Finland, whereas the second Louekoski mandate was more technical, that is, to clarify the legal mandate of PICs in respect to new law on listed companies and insurance companies. The 2006 Puro group report (Työmarkkinoiden keskusjärjestöjen eläkeneuvotteluryhmä, 2006) illustrates par excellence the end results of the shift of financialisation that started in the 1990s.

The first shift present in the report is the enforcement of financial professionalism within PIC investment functions to a more separate domain in relation to the paritarian legacy of governance. The report stated that the post-1997 regulations were inflexible and ‘far too detailed’. One conclusion drawn in the report was that the

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17 This was the last one commissioned by Puro group most importantly because CEO Puro retired from Ilmarinen.
investment allocations were suboptimal in terms of risk-taking, and thus equity and alternative investments needed to be increased and solvency improved with new (merged) solvency and balance rules, this time common to all provider types.

Again, there would be an increase in capital reserves. A part of liability transfers were made dependent on collective equity investment performance. The simulated projections on the share of equity investments implied a 20–25 per cent of total portfolios in the long-term, and the new informal target was set to 35 per cent. Somewhat ironically, the new regulations that were supposed to abandon too complex rules included unforeseeably complex mathematical formulae in order to define more realistic legal risk levels of individual investments for new financial products such as structured investments and hedge funds, further complemented with a prudential duty to classify all investments according to their real risks. In other words, the control over TyEL assets was to be not only more prudential but also detailed and increasingly modern portfolio theory based. In this sense, the financialisation of TEL/TyEL capital occurred in two stages: it was first locally integrated to a global domain in investment practice but only a decade later controlled in ways better corresponding the new practice.

The second shift was related to a more general political rebalancing of the relationships between economic policy and the financial sector. The Finnish national economic competitiveness paradigm was replaced with an understanding of Finland as rather a passive environment for investments than an active target to be developed with investments. This implied a new operational weighting for the TyEL providers, in which the PAYG component became in investment policy quite distant from the
funded part. For example the employment rate was no more considered the primary target in Finnish politics on investments. It was now dominated by the idea of making increases in domestic investment dependent on the foreign investors’ opinions on the investment environment – on how global finance priced the Finnish market. Domestic investments could be explicitly increased only if Finnish financial markets were ‘deepened’, for example if tax policies were more investor-friendly, households increased savings in equity, or Finnish firms were publicly listed much more often. The report explicitly states that pension capital cannot be used to make decisions over the economy (which is done by firms). The new financialised culture of TyEL investments could thus use power over Finnish economy through investment and corporate engagement decisions only if all businesses first decided to do so.

Some current random walk model simulations show that long-term uncertainty of investment returns is now lower than before the investment rule reform implemented in 2007 (Risku and Kaliva, 2009). Thus the reform will at least in some economists’ eyes reduce the need to increase pension contributions in coming decades without significantly increasing the risk of the highest possible contribution levels of the scenarios. On the other hand, the pension contributions are still expected to rise in the near future. The Finnish Centre for Pensions and Statistics Finland have suggested in their few latest projections that the overall TyEL contribution rates will rise from the current 21 per cent of the overall wage sum to 25 per cent around 2025–2030, assuming a four per cent real returns for investments. The same projections also show that demographic change will be a challenge – at least without extended periods of high economic growth, higher numbers of immigration, and improving productivity
and wage levels – as the dependency ratio is expected to rise from current 25 per cent to 45 in 2030 given the current demographic trends.

Moreover, the reform also increased uncertainty and potential volatility of the contribution level by introducing the dependency on realised stock investment return. Risku and Kaliva (2009) have suggested that many problems could be tackled with the variables of the funding system, for example by making controlled annual increases to pension contributions to match the expected long-term levels. On the other hand, this would eliminate the ability to adjust pension contribution levels, which are not only technically the most flexible part of the TyEL scheme but also considered essential ‘environmental factor’ of total employment costs that the new political paradigm of luring global capital to Finland has so much highlighted. Although these debates are with no doubt relevant, they tend to undermine the inevitable conclusion arising from past reforms: the success of the TyEL scheme has become politically and institutionally more dependent on global financial markets and on how well the TyEL providers actually manage their assets to reap the investment yields needed to upkeep the financialised mode of pension provision.

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Institutional analysis always requires some understanding on the broader institutional environments and the more specific institutional histories and change patterns if we wish to overcome mere description of institutional forms and reach any analytical
rigour. This chapter has shed light on the different forms and mechanisms of the first institutional prerequisite for pension fund capitalism, funding, present in the Finnish institutional environment. Case Finland would probably be a very interesting one if we wished to analyse the institutional arrangement of pension fund capitalism in a national scale, as there is a great variety of different funding paradigms from pure national buffer funds through the collective liability based municipal employees’ fund to different forms of individual liability based private-sector employee funds. When we look at the funds at the organisation field level, it is the decentralised TyEL scheme and the PICs more specifically that are the most interesting ones from an historical perspective.

One of the main purposes of this chapter has been to show how the Finnish TEL/TyEL funds in general and the PIC investments in more specific have been ‘financialised’ from national economic growth and investment inducing capital to global portfolio investors, whose goal has been now primarily limited to lowering the overall pension costs. The professional portfolio management and international diversification practices emerged when the pension providers were provided more room for such activities. These paradigms and their empowerment in terms of principle-based regulation and risk-based supervision were introduced in regulation and supervision much later. However, it has been strongly highlighted that this project was not originated by new political forces like World Bank consultants, neoliberal ideologues or politics related to European integration, but by the key stakeholders of system. Nor did it imply any major abandonment of old proficient solutions like paritarian governance systems or solvency-based regulation of a decentralised scheme. Some institutional forms like the preference for domestic investments were
also all but abandoned – they were just transformed to other types of forms like social responsibility norms. Without understanding this history, it is hard to see why some institutional forms continue to dominate the field. Before going to these forms, however, we must look at the empirical research methods we need to analyse them.
5. Empirical Research Methods, Data and Research Ethics

The research questions of this study imply a theory-driven research paradigm where theoretical frameworks not only open a set of phenomena and questions to be studied and answered in empirical research but also the theory-laden concepts and methodological lenses through which these phenomena are studied. The questions addressed in this study are what is the organisation field level institutional construction of pension fund capitalism in different environments like, and how locally generated pension capital is invested in financial markets and why some investment dispositions are shared and adopted instead of others in these fields. The theoretical underpinnings of the key concepts, most importantly shared dispositions and organisation fields, were discussed in Chapter 2. The purpose of this chapter is to see what kinds of direct implications and requirements the methodological and theoretical discussions of the previous chapters set for empirical research methods. Data, analysis methods and research ethics are also discussed in this chapter as parts of the presentation of the method used.

In very broad-brush terms, the empirical research agenda of this study can be well approached with the methods of a theory-driven case study research strategy. Such case study strategy can be generally characterised simply as a research strategy in which single or multiple empirical in-depth studies increase the empirical knowledge on theoretically observed or constructed phenomena, and helps to develop and
increase analytical rigour to theories. In this study, the case study of the organisation field of Finnish PICs is meant to provide more empirical knowledge on the institutional organisation of PFC in the population of financialised pension systems in Europe. The research strategy used in this study relies on the version of case study strategy developed by Robert K. Yin (2009). In heuristic terms, Yin’s version of case study strategy has some characteristic elements throughout the research process that starts from research plan and design, and ends after research preparation and data collection to implementation – that is, to the analysis of data and sharing the research results. Before going to the implementation stages of the strategy, a few things concerning research plan and the validity of case study approach in executing it must be briefly noted.

The first issue is that theory-driven case study approach is valid for only specific types of research plans (see Yin, 2009). Firstly, the research must be based on research questions that do not merely describe phenomena, but ask analytically how and why some contemporary phenomena empirically occur in the real-life contexts that bound the phenomena. Secondly, the case study strategy is appropriate only in those cases where the researcher cannot significantly affect the functioning of the research objects. Thirdly, while the case study approach can address technically distinctive situations with many more variables of interest than individual sources of data suggest, it can do it in a valid sense only if there are multiple sources of evidence and possibilities to use the benefits from prior theoretical propositions to guide data collection and analysis.
This empirical study fulfils these three basic criteria very well. The study is in nature analytical with its goal to explain investment activities with institutional theory (see Chapter 2). The researcher has no direct power over the functioning of the field of pension investors studied and no personal links to the Finnish PICs apart from the interview interventions made in this study. In addition, the study is based on theoretical insights to the importance of the phenomenon and to selection of the case (see Chapter 1), on theoretical hypotheses on the broader social context and characteristics of the phenomenon (Chapter 3), on the previous studies concerning the historical development of the real-life context of the phenomenon (see Chapter 4), and on sufficient sources of empirical data that can be triangulated (see below).

The second issue is that the case study strategy is best suited to empirical inquiries that investigate a contemporary phenomenon, in depth and within its real-life context, when the boundaries between phenomenon and context are not evident. The notions of institutional life and organisation fields indeed call for enquiry on the real-life contexts in depth, and the idea of action processes further suggests that these real-life contexts cannot be avoided in empirical analysis. The theoretical research agendas include the idea that the boundaries between the local dispositions, European institutional developments, and global finance, are all but evident. In fact, it can be very feasibly argued that the methodological research agenda of this study is exactly to enable some demarcations between the phenomenon (institutional life of pension investments in one organisation field) and its contexts (actor-networks of global finance and the European project of financialisation) in empirical analysis.
However, the theoretical and methodological reflections also provide direct implications for formulating the strategy. Most importantly, the reason for choosing the Finnish PICs as the observed case is based on both deviant and typical modes of case study representativeness, as noted already in Chapter 1. Another important implication concerns validity independent of the choice for the research object. The habitual version of institutional theory discussed in Chapter 2 implies a commitment to observing action processes where individuals’ taken for granted ways of acting turn to shared and habitualised dispositions. In organisation fields, however, the dispositions are not about dispositions adopted by individuals but by organisations. This suggests that any method used must be firmly rooted in understanding actions in contexts of individual organisation and field-level action processes. Individual actions ought to be understood only as methodologically required objects whose theoretical meanings are derived from collective dispositions.

In addition, as the organisation field framework suggests, these collective actions are already conditioned by specific types of actors, their mutual relationships, dispositions and boundaries, through and within which collective actions get specific meanings and types of proficiency. These theoretical lenses see individuals’ actions as the domain where institutions can be found but they can be considered proficient field-level institutions only after their proficiency is first understood in terms of collective actions taking place in a specific field of institutional forces.

It must be also noted that organisation fields as the unit of analysis is to ask whether an issue is shared field-wide, ranging from necessarily acknowledged constitutive frames to more contingent and even latent modes of sharing. Indeed, the primary
object of this study is the field-level collective dispositions that Finnish PICs share at the field level – not all dispositions of all PICs. This is why the empirical results should not be evaluated on the grounds of whether the construction presented exhaustively describes some individual organisational cultures – they do not – but of whether some ways of acting are in fact shared field-wide and taken for granted or not in the collective actions, and of whether some dispositions are missing or not. Similarly, the normative evaluations and discursive meanings of and explanations for different field-level dispositions are likely to vary in individuals’ minds, but it is not in the aims of this study to evaluate the individual interpretations of these dispositions. The goal is only to see what ways of acting have become taken for granted and shared by the PICs as collective actors – not their individual employees.

Case study design

In organisation field analyses that are purely anchored to frames (e.g. products), case study design is quite simple: just study the frames. However, the actor-centred institutional approach to organisation fields points towards a case study design with more specific methods. In this design, the level of analysis is the organisation field, but the unit of observation is the individual organisation. This enables two different valid designs: it is possible to opt for an inductive multi-case analysis on the dispositions of all the constituent organisations of the field, or for a single-case analysis on the field-level dispositions that may include variation. The study follows the latter option in order to highlight the representativeness of the field in relation to other fields, not the representativeness of individual PICs to the field. In this design, the field is as shared dispositions directly regarded as an object of a single-case study,
which is in part derived from material shared by all PICs. However, as organisation-specific enquiries on action processes are needed in order to be able to validly discover dispositions, the study also includes embedded sub-case analyses. The choice of single-case with few embedded cases is based on research economy and the availability of data – only two pension insurance companies decided to join the in-depth interviews. This methodology is economic as it is able to provide information on the field boundaries, set dispositions and field-level relationships in a field-level scale that all actors universally share in making pension investments, and to have a somewhat extensive review on the elastic dispositions that the members of the field have adopted. However, it only provides qualified information on how field-level frames and other institutional forms are in fact habitualised in potentially organisation-wise divergent action processes, which is why it should be understood by no means as a universal field-wide description on how the field is understood within organisations.

The data and inferences arising from the data need to be linked to the propositions as part of case study design. The institutional theory used here suggests that the primary criterion for drawing inferences from actions to serve as proficient field-level institutions is that the elastic ways of acting are actually habitualised and shared by the PICs. The key issues here are 1) to provide clear demarcations between those activities that are shared field-wide as constitutive frames for activities and those shared contingently, and 2) to exclude from analysis those activities that are either not shared and taken for granted at least latently by the PICs or have no point of reference whatsoever in investment processes. As it will be argued below, the inferences drawn from different data sources are specific to data sources, not to research questions,
which is why the first issue can be best addressed in research reporting. This issue is highlighted in the basic narrative of the research report. Chapter 6 covers the institutional forms as frames that define the field and its specific actors, resources and relationships. These forms have clear mechanisms of sharing and they are contingent in substance, but not conceptually in relation to the field, since they generate and set boundaries of the field frame. Chapter 7 covers both the embedded sub-case analyses on the action processes in two PICs in which field-level institutions materialise, and the field-wide dispositions that have materialised in these types of processes (see below).

The second issue is a more complex one. The research design whose goal is to select relevant dispositions can be primarily evaluated on three domains: construct validity, reliability, and external validity.\(^\text{18}\) Construct validity is in case study strategy built with three tactical choices on the usage of evidence: using multiple sources of evidence, establishing a chain of evidence, and having key informants review draft case study report. The first two are here applied as such in case of the contingent institutions within the field of PICs. The field frames as such are more limited in this respect, since they are both abstract and mechanism-specific. For example, if there is one law dictating some specific direct quantitative boundaries for investments, there is little need for further sources or chain of evidence, as the text of the law is (the artefact form of) the boundary. The institutional status of the data sources will be discussed in more detail below. Those interviewees and informants in the two PICs

\(^{18}\) It must be noted that there is a fourth domain in general case study approaches: internal validity. But it applies only to research designs aiming at causal explanation. Even if thought as causal factors in large statistical data, institutional forms as variables are at best probabilistic, not deterministic. Moreover, habitual institutional analysis is based on action processes, contingent dispositions, and various views on agency. This approach includes multiple modes of explanation in contrast to merely causal explanations (Heiskala, 2003).
who asked to see the case study report, have been able to see it before publishing (and have in addition confirmed that the research report does not violate the agreement on research ethics).

The basic idea of reliability in case study approach is that a later investigator would end up with the same findings and conclusions in the same framework. The primary issue in context of this study is that the embedded sub-case analysis cannot be replicated as such, because the data is in part confidential (see below). However, the organisation-specific sub-case analyses are primarily meant to discover only the structured action processes where taken for granted ways of acting materialise, whilst the unit of analysis are not the processes but the actual ways of acting. There are a number of other sources of data that enable single-case inferences. This suggests that the reliability of the study is dependent on whether a later investigator would end up with the same results concerning the field when combining the commonly shared single-case data with his/her own sub-case study data. This suggests reliability needs to be enhanced with means that concern inferences, not so much with full transparency in gathering of the embedded sub-case data. However, the sub-case analyses usually require replication logics to improve external validity – establishing the domain to which a study’s findings can be generalised – which in single-case studies is achieved primarily by theoretical elaboration. The confidentiality of sub-case data suggests that external validity must be confirmed with other means.

In order to improve both external validity and reliability, the implementation of the case study is based on Yin’s source-specific case study protocol that enhances the transparency of the research process even when possibilities to report the data are
limited. In general it consists of four elements that may differ by data source: 1) an overview of case study project, 2) field procedures, 3) case study questions and 4) a guide for case study report. Before going to source-specific protocols, a few general things concerning the protocol must be noted. The overview on project objectives, the relevant readings by the researcher, and the guide for the report have been all discussed in the previous chapters of this study so that the reader of the study can understand them. The idea of protocol suggests an overview is important also in guiding the research and making the approach acknowledged by the human research subjects needed to answer one set of research questions. This has been ensured in two specific ways in interviews: with a research plan summary provided to interviewees (PIC investment personnel) and with a written consent between the interviewer and interviewees before the interview. The procedures more generally refer to the presentation of researcher’s credentials, access to the case study “sites”, language pertaining to the protection of human subjects, sources of data, and procedural reminders. These issues are discussed below in context of different data sources addressing different parts of the research questions.

**Data sources and source-specific protocols**

Case study questions define much of the proper sources of information for answering each question. The case study questions can be at the organisation field level divided to two sets that in this context are 1) to what kinds of dispositions all Finnish PICs are set and how are all their investment actions framed, and 2) what kinds of ways of acting in investments are taken for granted and shared by the Finnish PICs as collective actors. In a theory-driven case study paradigm, the theoretical framework
dictates appropriateness of sources. The institutional theory framework used in this study shifts attention towards field frames, actions and action processes and suggests that all the data used must have a reference point to these domains: the data needs to consist of investment actions as such, or to describe or illustrate a way of investing or a frame for these actions (investments being defined as the calculative, exchange and information processing practices).

The first set of case study questions can be in great part answered by studying specific institutional mechanisms with source-specific protocols. For example the regulative institutional forms can be directly traced to official artefacts, most importantly national laws, ministry rulings, and Financial Services Authority (FIN-FSA) regulatory guidelines. Although they are potentially enforced differently in action processes, they serve as frames for activities as such. The selection of these publicly available documents is based on the FIN-FSA website that lists all the legislation and regulatory guidelines concerning PIC activities. The other types of frames are based on the material provided by the Finnish Pension Alliance TELA. Among other things, TELA has publicly available textual material directly addressing and generating field boundaries for investments, including triennial surveys on attitudes towards TyEL investments (Työeläkeasenteet), and explicit responsible investment and ownership policy guidelines for the PICs. However, TELA also provides all new PIC Board members a mandatory training concerning the field operations. Since the training is directly rooted in both field-level frames (i.e. legal obligation) and purposeful actions in which these frames are brought to field insiders (i.e. boundary control), it not only serves as a rare source of data that both addresses the first set of case study questions
par excellence and provides a reliable source for field-wide dispositions as it is in fact shared by all the board members of all PICs.

I attended the training as a direct participant-observer, having informed all the other participants on my role as an observer. I attended the education during the first half of 2009, including the annual TyEL investment seminar held at PIC Varma. In addition, I participated in a special education arranged by TELA to the Pension Power in Finland research team (led by Dr. Jukka Lassila of The Research Institute of the Finnish Economy ETLA) as an observer already in late 2008. The education was according to the informants ‘more reflexive’, primarily governance-focused, and included overview on how the education had developed over time. The aim of the participation in all these events was not to produce ethnographical observational data, but to gain access to an extensive amount of archival data, analysed as narrative texts in the study, with specific institutional meanings – these artefact-frames are textually shared by the PICs. The data includes in total hundreds of pages of PowerPoint slides, other written documents, and two books provided in the education. The notes from oral presentations are used as supplementary (not replaceable or exchangeable) data to this material, mostly because no investment related presentation or discussion differed in explicit content from the written material. In case some presenters have said something that is not included in the textual material, these sources are cited in the research report as informant data (e.g. “as one informant put it…”).

The second set of questions requires material on action processes from which dispositions can be discovered. Whilst much of the publicly available data can address many end results of actions shared by all the PICs (see below), it cannot address all
the action processes. Indeed, an empirical enquiry on action processes often requires data that can be obtained only within case-specific institutional and ethical constraints, and this study is no exception. The case in question actually provides quite strict restrictions for an empirical enquiry. Neither the TELA education nor the PIC investment processes are available to the general public. However, the PICs also operate under business secrecy and are by law not allowed to give any information belonging under this rule to other than legally specified actors, they have great amounts of investment capital, and they are very few in number and well networked but competing. This suggests that an enquiry on investment processes can be illegal, it can cause financial harm for the companies (e.g. in case other investors are able to anticipate specific trades or if some competitive advantages are revealed), and personal harm for the individuals interviewed if they are directly recognised (e.g. in case they are very critical towards their superiors) unless the enquiry is explicitly limited.

The first of the aforementioned limitations is enough to remove the possibility to use direct observational data, because it would necessarily reveal facts on for example asset pricing schema and the economic status of companies. Instead, the enquiry relies on a case study related method that has been developed to address exactly this kind of institutional and ethical constraints in context of geography of finance, and can despite these kinds of limitations promote theoretical innovation – the close dialogue interviews (see Clark, 1998). The basic idea of the method is that theoretical knowledge and ideas can be ‘checked’ and tested in unstructured and loosely structured interviews even when interviewers and interviewees have special knowledge on the matters or have close and complex relationships (caused e.g. by
business secrecy). In this type of interviews, the medium of exchange is the object of research as such. The interviewees “hold the cards”. The roles of the interviewees (the conversationalist, the buyer/seller, the insider, and the player) described by Clark are somewhat illustrative in interviewee opinions towards the interviewer in this study as well. Some interviewees regarded the interviewer a friendly colleague and used quite technical expert and insider terminology, while others were more sceptical towards my purposes or abilities to understand their activities and goals. The most typical attitude towards (although not necessarily illustrative on the content of) the interview was the explicit unwillingness to speculate on possible reasons for some activities and only to provide accurate “facts” about the interviewee’s or his/her organisation’s everyday activities.

This embedded case study consisted of in total 15 close dialogue interviews in two PICs (eight in one and five in the other PIC, the CIOs being interviewed twice as the first and the last interviewee) that joined the study after I had approached the companies first via CIOs or leading portfolio managers in TELA investment-related seminar and secondly via emails confirming the invitation. The interviews of this study were based on written consent between the interviewer and the interviewees not to discuss any issues falling over the legal boundaries for information sharing. The interviewees included one chief executive officer (CEO), two chief investment officers (CIOs), nine managing team directors or senior portfolio managers, and one

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19 Two companies decided not to join the study without giving any specific reasons, and two, after some consideration, by appealing to tight schedules (during the financial crisis) or low individual gains from participating in the study. One PIC, Pensions-Alandia, was excluded from the enquiry from the start due to lack of publicly available data.

20 This was further strengthened in case of the other sub-case PIC that required the interviewer to sign an agreement not to provide any information that might compromise the financial or economic status of the company, being basically identical to the written consent with the exception of defined monetary liability in case of breaching the agreement. The PIC has confirmed that the study complies with the agreement.
back office team director. In addition to these interviews, there was in total three complementary interviews on three CEO or director level interviewees in one other PIC and two other key organisations in the field.21 The data arising from interviews consists of written notes taken from them. The interviews were not recorded to ensure the safety of the human subjects from potential accusations of crossing the legal boundaries and from any possibilities to uncover the identity of individuals with criminal means. All the handwritten notes were rewritten with text processing software, all the files password-encrypted and stored in secure servers. The interviews took place in the PIC meeting rooms, and lasted from one to two hours. All the interviews were conducted between May and August 2009, most of them taking place in late May and early June.

The close dialogue interview choreography was designed as follows. The interviews were loosely structured, and the interviewees were in fact active in steering the interviews to different directions. The interview questions followed a twofold structure. In the first stage of interview, all “warm-up questions” concerned the everyday working activities of the interviewee (e.g. how your working day is structured, what tasks do you usually perform on a daily basis). This stage provides general information on the organisational role of the interviewee and, as immediate reactions on questions concerning the very meaningfulness of everyday life, on the most broadly internalised investment dispositions. The second stage concerned the more interviewee-specific dispositions, meaning for instance that the bond portfolio managers were asked questions concerning bond investments. The strength of close

21 The identities of the interviewees are not presented in this research report, and the evidence (the written consents) on the interviews has presented only in the viva.
dialogue interviews is that, in contrast to ethnography, both parties share a certain amount of specific information and discursive frameworks already before the interviews and so the interviews can be used to fill gaps in knowledge and deepen the existing basic information of the interviewer.

The formulation of the questions was based on a more specific schema. My existing specific information was based on both the data and its analysis presented in Chapters 4 and 6 in this study, including the websites, annual reports, financial statements and related appendices of the PICs in question, but also on the information provided by TELA education where many investment issues were discussed. This information provided PIC-specific information concerning most importantly asset allocations and some disclosed investment policies and schema. In addition, the interviews in the two PICs started with CIO interviews, so there was much information about the organisational structure of the investment teams, overall strategies and collective investment beliefs before interviewing the portfolio managers. These features were used in steering the interviews towards specific directions in the second stage. Although the formulation of most issues like decision-making schema and investment tactics were quite specific to organisation structures, there were some issues addressed to all the interviewees in the second stage. The common questions based on previous information typically concerned time (after the peak of financial crisis), the usage of derivatives and classification of assets, and the role of PIC portfolio managers in broader financial networks (as suggested by the discussion in Chapter 2).

Besides relying on interview data, some of the adopted dispositions – the end products of action processes – can be studied rather simply from publicly available material.
The PICs disclose a great amount of data in their annual reports, financial statements and appendices to these documents due to regulative requirements and common agreements. One PIC, *Pensions-Alandia*, the smallest of these companies, provides virtually no information online, which is why it is in most parts excluded from the study. In practice, the PICs list all their direct investment vehicles and funds (typically by country and asset class), the relative overall stock in investee firms (some add the share of votes), and the book and fair value of these investments.\textsuperscript{22} The PICs also classify investments in listings very similarly, with a minor exception of *Eläke-Fennia* that classifies ETFs as foreign stocks instead of funds. The PICs tend to define their key risk positions in individual securities and list the real estate projects that they consider the most important in their annual reports.

The annual reports and statements are as communicative media typically directed to stakeholders (most likely investors) but should not be understood as technical disclosure: they are purposeful communicative actions whose discursive contents need to be analysed carefully (Yuthas, Rogers and Dillard, 2002). All these texts are as artefacts certain kinds of actions shared by all PICs. To be more specific, the laws already require these reports and thus serve as enforcements of regulative institutions, but because the contents of these reports are more contingent and can refer to investment activities in very different ways, the institutional contents of reporting cannot be read from the law. As the definition for investment activities relies on the idea of calculation, exchange and information processing, material selected to the

\textsuperscript{22} It must be noted that the meaning of having both book and fair value calculations must be understood more substantively than as a regulative requirement. One PIC for example argues in its annual report that the goal of the TELA reporting guidelines is to make the regulative notion of real risk visible to the public. Moreover, having both values are useful for evaluating the performance of at least the long-only investments.
analysis needs to have a point of reference on these criteria. In addition, the reports are also informative on the organisational structuration of investment processes, which is why they are in some contexts used as indicators of action processes rather than dispositions.

The reports studied here include the annual reports, financial statements, and their appendices from the year 2009 (unless otherwise stated) from the six PICs that provide these materials online. The annual reports, financial statements and their appendices are available for download online typically in PDF format but for example in case of Eläke-Veritas, the annual report part is only browsed online. All material is available in full form in Finnish and in Swedish, albeit that some of the versions in English are narrower in scope. This is the reason why the Finnish versions of the reports are used here instead of the English ones, whose existence is nevertheless important to note in order to enhance reliability of this study. Heuristically, the larger the company, the more pages there are in the reports. In addition to these reports, there are some publicly available data sources that provide some secondary information on the PIC investment action processes besides the disclosed information in these reports, including the publication of written investment principles and policies, and organisational descriptions in PIC websites, and some media representations. These sources are used as complementary sources named but not cited in the text.

According to Yin (2009), in most cases, three different sources of data are heuristically (if not exclusively) diverse enough to provide valid case study information. However, as the institutional meaning of different data sources differs in
this study, they are diverse enough only when triangulated. All the data sources should thus be considered complementary and supplementary. For example, the TELA education material was used to formulate some interview questions, and thus has a direct relationship to interview data. The annual reports and the TELA education also have numerous same themes, and have many points of reference to regulations studied otherwise independently. These sets of data can thus be considered sufficient in coverage and, as argued above, consistent in face of the requirements set by the case study questions to provide a valid starting point for analysis of the data. This and the reporting of the inferences arising from the data are the last topics of this chapter.

**Content analysis, inferences and reporting**

All the data described above is analysed with content analysis looking at narratives presented in the data. The version of content analysis used here is based on Klaus Krippendorff’s (2004; see also Bock and Krippendorff, 2009) model of content analysis aiming at discovering institutional processes by analysing communicative media and actions. In this model, patterned practices can be discovered by typifying contents according to reported actions and actors participating in these processes, and by studying how alternative ways of doing things are narrowed or excluded in narratives. The inferences arising from analysis are based on recursion and (multiple) institutional interpretations on typifications of repeated themes and arguments. However, since some institutions tend to remain hidden unless proficiency for one reason or another dissolves and the institutional explanations usually become accessible through the very communications that invoke them, content analysis method is necessarily very highly medium and context dependent. The properties of
The medium of communication in which an institution is constituted have profound effects on the existence and the development of that institution, and communications tend to reinforce the very institutional explanations and rules by which they are created and disseminated. This suggests that the narratives presented in the data are logically taken for granted ways of acting only in those very action processes serving as the medium for communication – they are not necessarily present in all investment activities. Content analysis is also very dependent on the theoretical framework used. The inferences that are drawn from the data sources cannot be repeated outside the theoretical framework without translation and reinterpretation. In the framework used here, the inferred typifications illustrate institutions as thematic, field-wide habitualised and shared dispositions.

This approach that is used in all stages of the analysis requires further elaboration in two areas. Firstly, the habitualisation of practices as dispositions means different things in different types of data. Dispositions can be generally inferred from communicative actions by focussing on two features: repetition within and in different sources of data, and the narrowing of choices from the absence of mention of alternative ways of being or doing things. The latter can occur with more active explicit neglecting or more passive repetitive reasoning, which were both well present especially in interview data. For example of the former of these avenues, one interviewed manager said: “you cannot figure out social responsibility in cash flow analysis”. For example of the latter, the idea that “pension funds are long-term investors” was repeated in different contexts in numerous sources, and nobody explicitly considered pension investments as short-term speculation.
However, it must be noted that recursion and narrowing of some logics serve different meanings in different types of data simply because the institutional meaning of the medium in the field is different. For example, repetition has less immediate behavioural consequences than the implied ways of compliant or criminal behaviours in the context of laws. In annual reports, in contrast, repetition in describing practices might give more accurate explanation for some dispositions than rhetorical exclusion of irrelevant logics. As the organisation field serves as the unit of analysis, the role of the studied medium in the field is another issue causing differentiation. In the examples above, the studied actors are the immediate objects of the communication medium in the former, and subjects behind the medium in the latter. Heuristically, the two sets of data include somewhat different weightings on observed indicators of habitualisation: narrowing in rules concerning PIC activities and in TELA education material, and repetition and exclusion of alternative logics in other sources of data.

Secondly, in the theoretical framework of this study, sharing does not refer in simplistic terms to mentioning some issues in same contexts or media. Rather, sharing requires a tangible or at minimum latent reference point in action processes either as acknowledged dispositions as such (e.g. all companies invest in equity) or as usage of some form in varying action processes (e.g. all companies follow the norm of loyalty by providing favourable loans to their customers). In context of content analysis, this has some implications concerning the analysis on the source of data. Sharing a disposition can be either traced to the appearance of the same theme in an isomorphic text-artefact (e.g. annual report) or to appearance of a similar description or contextualisation of an isomorphic disposition (e.g. bond fund selection) in different sources. Practiced dispositions are rather easy to discover in those communication
media like laws that have behavioural implications, but in communication media like annual reports, the interpretation of some practiced theme being isomorphic requires some interpretation. The criterion used here is that it has a similar relationship to investment processes, for example being a variable in asset pricing or manager remuneration schema. All dispositions are not, of course, practiced. Latent dispositions are also included in the repeated themes or serve as themes in the narrowed logics of action, be they positive (included) or negative (excluded), but have no current uses in action processes.

While content analysis on texts can, with these remarks, give quite accurate information on the shared dispositions that characterise and serve as tangible explanations for proficient actions at the field level, it gives us all but sufficient information on the real-life contexts within organisations. The role of the close dialogue interviews is essential here. The notes taken from them are essential sources for data for analysing proficiency so that it combines action processes and dispositions. Since the interviews do not serve as institutionalised media as such, the presented narratives need to be understood as external interventions, as potential breaks in proficiency as such. This may reveal some dispositions that would be otherwise difficult to access, but on the other hand it includes some research ethical challenges. Studying a social construction in this way is always a fragile task because it not only presents a set of underlying beliefs of the research objects but also inevitably creates a new construction as well (see Schein, 2004). Pension investments have been particularly sensitive in this respect – witness for instance Ambachtsheer’s (2007) remarks on the fury O’Barr and Conley’s classic anthropological study on cultures in US pension funds raised within the “industry”.
The selected level of analysis, the organisation field, is less prone to such issues than micro level studies. Even when studying organisation fields, it is clear that new knowledge about the field can serve as an instrument for insider-actors to improve their institutional status within the field. Of course, there are much more rigorous questions related to research ethics that have relevance in this study. The ‘real-life context’ addressed in case study strategies always raises context-specific ethical issues. This is especially important in case of pension fund that may directly address the welfare of millions of workers and pensioners, and have massive amounts of capital at stake. In case of PICs, competition and “small circles” of the field limit the usage of the interview data and the reporting of research results. This kind of research setting requires clear boundaries also for data processing and reporting.

The inferences from the interviews are drawn in a way similar to other sources (see below), but with special conditions set by research ethics. All the companies have clear characteristics that might easily lead field insiders to be able to single others out from the research report. In order to protect the participating organisations from financial or competitive harm and the individual interviewees from personal harm, the organisation specific action process narratives will not be separated and described individually in detail, but as one ideal type based on inferences from various data sources. The research results are reported so that they do not present longer direct quotations or reveal the exact number, roles or personal characteristics of people working in an investment team when any team is singled out with some criteria (e.g. asset class). As the action processes are primarily inferred from the interviews via narratives captured to the notes, the ideal type can include elements some companies
might find alien. This is why the process description is supplemented with cited descriptions from publicly available data sources in order to provide a clearer chain of evidence regarding the field-wide relevance of the ideal type.

The content analysis procedure can be summarised in case of all data sources as follows. According to Krippendorff (2004), the procedure consists of six stages: unitising, sampling, coding, reducing, inferring and narrating. Unitising in terms of sampling, recording and context units have been categorised source-specifically as discussed and elaborated above. Sampling refers to limiting observations to a manageable subset of units that are (in qualitative research) conceptually representative of the set of all possible units, and reducing to making efficient representations of the data. In this study, sampling of and reducing the primary textual data to smaller sets is not vital as the number of PICs and their data studied is very limited.\textsuperscript{23} In case of the communication media in which PICs are its objects, sampling, reducing and coding themes from data sources is based on explicitly presenting the narratives that provide an explanation for exchange, calculation and information processing actions. The inferences are categorised by thematic contents primarily according to their different data sources, although some overlapping remains (e.g. derivative policy requirements). In communication media where PICs are the subjects behind the material – websites, annual reports, financial statements and appendices, interviews – coding and inferences are based on manual coding. All the narratives that included a point of reference to investment actions were underlined (facts about investment processes) or highlighted (issues present in investment processes), and

\textsuperscript{23} It must be noted that the embedded sub-case analyses can be in some scope regarded as sampling measures. Time is another issue present here. The timeframe selected as the sampling criterion is the period from early 2007 onwards due to regulative reform enforced that time, while all previous material is discussed as contextual historical frames in Chapter 4.
marked with one (typical narratives) or two (deviant narratives) exclamation marks in relation to other PICs.

The empirical research results are reported and narrated in two stages. Chapter 6 consists of three sections. The first section is not exactly meant to analytically infer any investment dispositions from the data, but only to present an overview of actors and flows that form the field of Finnish PICs. The second section discusses the composition of the field in terms of organisational arrangements and the institutions of decision-making concerning the field architecture. This section is based on various data sources and divided thematically to different actors and/or mechanisms through which field-level influences translate into actions in individual PICs. The third section presents the inferred investment boundaries within which investments must be made. The third section is somewhat exceptional to other sections in this study as it is directly divided according to different data sources with specific institutional logics.

In Chapter 7, the first section presents the ideal type narrative of PIC investment action processes, based on two embedded sub-case analyses and complemented with publicly available material, and generalised as an ideal type description for research ethical purposes. This process provides a number of stages in action process in which different field-level dispositions discussed in the proceeding section can be used and enforced as institutions. Of course, this process is a set of dispositions and a research result as such, but is here regarded for methodological reasons only as a process where forms inferred from other data sources can materialise as proficient practices. The second section of the chapter is dedicated to the typified field-wide dispositions based on inferences from the PIC documentary and interview data.
6. The Organisation Field of TyEL and the Pension Insurance Companies

The purpose of this chapter is to present the organisation field of Finnish TyEL investments as the institutional forms the PICs necessarily share, while the next chapter is focussed on the question of what dispositions they in fact adopt. Using a familiar analogy to a game, this chapter is about the fields, players and rules of the game, while the next discusses the playing strategies and styles the players have adopted. The organisation field also defines the roles of and relationships between different players, referees and other actors in the field, the boundaries within which the game must always be played, and the institutions in which the rules of the game and the game more generally can be changed. Unless we understand some of these rules, we cannot even follow all relevant game events. In this case, the rules of the game are not only formal rules that are decided upon in an organised matter. They are in great part informal and sometimes only preconsciously acknowledged by the players until their play is explicitly disturbed one way or another. In addition, the notions of institutional work and entrepreneurship suggest that decision-making on the rules is rarely about rational and organised reformation: the rules are constantly maintained, renewed, renegotiated and changed in every move and event in the game. This issue gives organisation fields a characteristic that the analogy of game cannot quite capture. The organisation field is ‘in motion’ (Cyert and March, 1963) even when the game is on.
The chapter is divided to three parts. The first of the three sections is meant to provide a short overview on the key actors and flows in the field as presented in official system descriptions (Korpiluoma et al., 2006; in English, see Hietaniemi and Ritola, 2007). Using the analogy of game, the overview only illuminates the TyEL playing field and its players for further inquiry, which is a feasible strategy to approach analytical questions in pensions-related fields (see Clark, 2000, for usage in the Anglo-American context). The second section is focussed on the ‘rules of the game’ for PIC activities. This includes both the designated players and their relationships within the field, and the positions of different players from which attempts to change the game arise. The third section is crucial for understanding the boundaries within which the investment game in particular takes place in the field. It captures the direct boundaries within which PIC investments are necessarily conducted in terms of exchange, calculation and related information processing. Whilst the two first sections are more general frameworks for field activities in which investments may become – and have become, as it was shown in Chapter 4 – essential issues, the last section is exclusively limited to investments.

6.1. Mapping the TyEL Field: Key Actors and Flows

The TyEL field consists of three sets of actors that have somewhat different roles in the field. Using the analogy to game, these actors can be called players, referees, and supporting institutions. Players are the actors that play the game; they operate within the field boundaries and play within the rules of the game to achieve results in the
scoreboard (in this case, get new clients). Although the rules determine much of how the game is played and give boundaries to game strategies, they do not dictate the results nor define the tactics the players may use. Some referees participate in the game within the playing field, although not playing the game, and some referees reside in the sidelines of the game. Their function is to see that the rules of the game are followed and if not, to provide sanctions for non-compliance. The supporting institutions – league associations, teams, managers, coaches, statisticians, masseurs, and so on – ensure that the players are able to play the game. They stand outside the boundaries of the playing field that is reserved for players, but are essential actors in the game each with their own roles.

The first set of actors, the players, to which the field analysis in this study is primarily anchored\(^\text{24}\), consists of the pension providers selected by the employers who take the mandatory insurance policy for their workers. There are three available types of authorised pension providers in the TyEL field: pension insurance companies (PICs, työeläkevakuutusyhtiö, 7 in 2010), company pension funds (eläkesäätiö; 7 ‘B-funds’ executing TyEL and YEL, and 17 ‘AB-funds’ executing TyEL, YEL and voluntary second-pillar pensions in 2009), or industry-wide pension funds (eläkekassa, 8 executing TyEL/YEL in 2009). In context of investments, the actual players are the individuals working in these organisations that can be best seen as teams. There are three different types of teams that play the same game but not exactly in the same league. To be more exact, only the PICs have a league: others do not even compete formally.

\(^{24}\) The expression “the field of PICs” used in following chapters refers to the TyEL field from this perspective. That is, the field as from the perspective of PICs only.
Currently, the vast majority of insurances and assets are in PICs. The two largest PICs *Varma* and *Ilmarinen* cover policies on about a half of all the insured and have by far the largest pool of funded assets – with certain combined criteria they can be considered holding about 70 per cent of the overall market. They also have strong ties to largest financial groups offering TyEL insurance and marketing their ‘pension product’ (*Ilmarinen* to *OP-Pohjola* insurance and banking group, *Varma* to *If* insurance group and the *Nordea* banking group). The other five pension insurance companies are (in alphabetical order) *Eläke-Fennia*, *Eläke-Tapiola*, *Eläke-Veritas*, *Etera*, and *Pensions-Alandia*. Of these five companies, all but *Etera* belong to a broader financial group providing other insurances or, in case of *Tapiola*, also banking and wealth management services.

*Pensions-Alandia*, which has been excluded from most of this empirical enquiry due to lack of available data, is a small company operating mostly in the Aland Island (*Ahvenanmaa*, in Swedish: Åland), an autonomous part of Finland. *Eläke-Veritas* and *Pensions-Alandia* are the only limited joint stock companies, others being mutual companies (see the next section). *Eläke-Veritas* has its headquarters in Turku but also some investment functions in Helsinki. *Eläke-Veritas* co-operates with *Pensions-Alandia* in Åland. *Eläke-Tapiola* has its headquarters in the Tapiola area in Espoo (the neighbour town of Helsinki). Other companies are Helsinki-based. *Varma* and *Ilmarinen* are located very close to each other in Salmisaari (Western Helsinki), *Eläke-Fennia* in Kamppi (Central Helsinki), and *Etera* in Pasila (Northern Helsinki). The headquarters of all the other players discussed below are also located in Helsinki.
The mandatory nature of the TyEL scheme dictates a number of fixed issues that are variable in many other pensions-related fields, most importantly the “product”, the insurance contract defining pension benefits and pension provider liabilities. This is why being a PIC is not necessarily too complex as a business. As Varma puts it in its annual report, it has “one office, one line of business, legally defined products, a low number of employees when contrasted with the turnover, and a low number of investment transactions when contrasted with the overall assets”. The fixed tasks include collection of pension contributions from employers and employees, awarding and payment of the pensions within the given regulatory framework, and investments of the assets with the contributions exceeding the immediate pension benefit payments. They are even coerced to provide these services, as they are obliged to take any customers who want to have the TyEL insurance in their company. The pension providers as individual entities have very little effect to the ‘liability side’ of the field functions, which is almost exclusively a matter of field-level coordination. The ‘asset side’, however, brings contingency to their activities especially in terms of choices made in investments. Despite being legally coerced to provide certain services, the pension providers legally own all their assets: they are just required to collect contributions, invest assets and pay benefits by the law at least in ‘normal situations’ (see Kallio, 2005).25

The second set of actors, the referees, consists of public bodies mandating and overseeing the activities. The TyEL pension scheme is based on law, which suggests that the Finnish parliament is among the key actors providing the field its basic form.

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25 In defined special circumstances when assets are divided among the shareholders and the owner of the guarantee capital, the latter are entitled to their investment and reasonable returns, whilst the rest belongs to the policyholders as part of their stock of insurance that must be used to secure the interests of the insured (see Kallio, 2008).
However, unlike government agencies, it is not an actor within the field. The Ministry of Social Affairs and Health (Sosiaali- ja terveysministeriö, STM), or, more specifically, its Department of Insurance, is the main government actor supervising the TyEL scheme in terms of formal governance. The ministry for instance gives concessions for operation for new pension providers, confirms their articles and rules, and in general hold the highest power to define what actors are fit-for-purpose to operate in the field, and, in case they are not, how they can become one. Operative supervision belongs to the mandate and competence of Finanssivalvonta, the Financial Supervisory Authority (FIN-FSA). Besides TyEL, FIN-FSA oversees Finnish banking, insurance and investment services, and pension scheme implementation more generally. The PICs contribute mandatory payments to finance the operations of the FIN-FSA. In addition to these actors, Finnish Competition Authority (Kilpailuvirasto, CA), the public competition watchdog, has been active in pointing out deficiencies in the competition among pension providers. The competition authority is not an intrinsic part of the original control regime in the TyEL field but rather an actor that has crossed the field boundaries with its general national mandate in promoting competition and supervising the application of competition law.

The third set of actors, the supporting institutions, consists of private entities coordinating a number of issues in the field and supporting the functioning of the scheme. The primary coordination body within the field, Finnish Centre for Pensions (Eläketurvakeskus, ETK) controls various parameters of the system with labour market organisations’ support. It is the primary body mediating and storing information especially on pension contributions and accrued benefits. Its operations
are covered by the pension providers. Using the analogy to game, it is the league association that keeps the game rolling. The Finnish Pension Alliance (TELA, Työeläkevakuuttajat,) is the “players’ association” of pension providers, which coordinates their common opinion-formation in reform committees and coordinative bodies besides other more fixed coordinative tasks. Eläkesäätiöyhdistys (ESY) is the association of funds, albeit also a member of TELA. ETK, TELA and The Bank of Finland create statistics and conduct research on the scheme. The largest central employee (SAK, STTK, AKAVA; the central organisations of blue-collar, clerical, and academically educated workers, respectively) and employer (EK, the Confederation of Finnish Industries) organisations are the main owners of the teams and the league, albeit that the Federation of Finnish Enterprises (Suomen Yrittäjät) has relevance especially in YEL-related matters.

There are also some actors whose role cannot be easily described by the analogy to game. The PICs collectively own a reinsurance company called Garantia Ltd, and private and public pension providers in cooperation with ETK a developer of pension information systems, Arek Ltd. Some of referees and supporting institutions are ad hoc discussion groups with specific mandates and agendas for resetting the rules of the game. The labour market negotiation groups provide a high-level forum for the overall development of and handling of the disputes within the field, thus having competence over formal and operational governance of the field. There have been various temporary and more or less permanent ad hoc groups, committees and other bodies that prepare reform suggestions, make statements on development needs, and clarify system characteristic interpretations if need be or otherwise requested.
Before going to the roles and relationships of all actors in the field, and to all other field-level governance issues in the next section in more detail, it is beneficial to present some overview on the central flows between the actors. The primary financial flows in the field are contributions paid by employers and employees, flows to investments and returns from them, the client bonuses that PICs can provide to their insurance policyholders (i.e. firms) from their capital reserves and profits, and the pension benefits paid by the pension providers to the pensioners. While these financial flows of the scheme are rather simple, the perspective of decision-making on these flows and the informational flows in the field give a much less simplistic picture on the flows and relationships. STM annually defines the contribution rates and many other variables based on the calculative principles of the TyEL law. The employer chooses where contributions are directed (i.e. where it will insure its employees).

The amount transferred to the funded component is dependent on the calculation of the fund transfer obligation, whose calculative bases are first prepared by ETK in cooperation with the pension providers and then confirmed by STM. The individual employees’ last pension provider grants and pays the whole pension, which implies that it must receive funds from other providers (including private and public sector providers). So the provider also calculates the liabilities of other providers towards it based on the nation-wide pension registry maintained by ETK. The deficiencies in pensions are covered with the joint liability PAYG component of the contributions, which closes this circle. However, as the pension providers invest their assets, the flows spread to the service providers in the financial sector in the middle of these flows. The providers are supervised by the FIN-FSA that requires great amounts of data from the provider operations. Although this schema is already complex and
includes various contingencies, there is even more complexity when we look at the institutional composition of these and other less straightforward and more ambiguous relationships between the actors, which is the topic of the next section.

6.2. The TyEL Field: Rules, Relationships and Governance

The TyEL field is a prime example of a field-level analysis suggesting that the questions concerning boundaries of the entire field cannot be separated from the life within the field. There are a few external macro-level mechanisms that bound and can change the overall field architecture. Perhaps the most prevalent force here is the European Union decision making. Finland gained an exception from the life insurance directive for the private implementation of TyEL when the country joined the EU in 1995 on the basis of execution of a national public policy. Some developments both within the EU and in other EU countries have put the TyEL system under a new kind of scrutiny, however. For an example on the former, the EU services directive has been regarded as a mechanism potentially affecting some aspects of the TyEL framework (Kari and Pakaslahti, 2003). In the latter case, as many European countries have started to adopt features of the mixed public-private system of mandatory pension provision (European Commission, 2008), rethinking of EU regulations may lead to re-evaluation of the Finnish scheme as well. Yet no interviewee or informant considered EU regulation but a distant threat of mainly scholarly importance.
The threats included in the changes in EU regulations cause some tangible tensions to the basic architecture of the field. The key challenge thematically is the unclear line between competition and collaboration. The legislation on competition that is applicable to PICs refers (primarily) to the stipulations provided by the Treaty Establishing the European Union and (secondarily) to the national act on restriction of competition, in both which the TyEL scheme has a special status. The tension between the TyEL field and EU is rooted in aims at harmonising the latter with EU law, which constantly changes the special status of the TyEL field (Hietaniemi and Ritola, 2007). Put bluntly, the competition must be carefully defined and limited so that EU regulations cannot apply to the TyEL field even though legislation in general is aligned with the regulations.

Competition is a domain in which external influences get mixed with internal relations in the field more generally. The Competition Authority (CA) has been active in trying to control the entire TyEL field. The tension between the pension providers and CA originates from the dual role of pension providers in implementing both legally imposed social policy objectives and PIC business activities that also aim at generating profits. The actual controversy arises from the level of cooperation between supposedly competing pension providers, although the PIC mandate should allow them more cooperation than in standard competitive market arrangements. CA has criticised cooperation in defining principles for premium lending (1997), in defining the fees paid to investment brokers (2000), and in setting the principles of calculation (2009). It has also produced more extensive initiatives to increase competition among the pension providers (2005).
Historically, the mix of cooperation and competition was not considered a problem in a closed financial community, and the sensitivity to issues hindering competition has been recent. One recent development project issued by STM aimed at finding possibilities to increase competition (Rajaniemi, 2007). The external threats based on competition issues are acknowledged in most of the official reports made within the field. There have been two main types of suggested reactions should there be a strong force like EU regulations requiring systemic change. According to the first type, a single (public or private) provider could execute pension provision (Kausto, 2002). According to the other type, pension provision could be centralised but all assets then externalised to multiple investment funds, which would clarify the boundaries for and change the actors participating in competition (Rajaniemi, 2007).

Another similar domain where external forces mix with internal life of the field has been the questioning of system parameters based on constitutional grounds. The constitution can be in part considered a technical project that institutional entrepreneurs like government actors can use to improve their positions within the field. The Finnish constitution dictates that only public authorities should be allowed to take care of tasks that include significant use of public authority. The interpretation of ‘public authority’ has been that it involves the use of physical force in dealing with citizens, but a possible broadening of the conceptual area of ‘significant public authority’ poses a direct challenge for the functioning of private pension providers (Louekoski, 2005) and for ETK, a private entity that in fact already possesses a

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26 This possibility of removing competition via monopoly was more recently brought to Finnish public attention by the retired head of STM insurance department, Tarmo Pukkila, who heavily criticised the current form competition between pension providers as ‘waste of money’ (Iivonen, 2009).
mandate on the use of physical force as it holds a right to impose a search on the premises of the employer (Myllymäki, 2009).

**Setting the field: rules for changing the rules**

The nature of political conflict in the original formation of TEL, discussed in Chapter 4, continues to explain many characteristics of today’s TyEL field. Most importantly, the understanding of TyEL field as a product of labour market agreement continues to be very broadly shared in the current field. One regular commentator (Louekoski, 1997) has aptly stated that the TyEL decision-making is best characterised so that labour market parties have always made the agreements and the “notes have been made in form of law”. As Kangas (2007) puts it, this illustrates the continuing Finnish paradigm of ‘markets against politics’ in contrast to the classic understanding of Nordic welfare regimes as ‘politics against markets’. The pension providers have historically been reluctant to allow any state representation in operational governance (Louekoski, 2005). Both the labour market actors and pension providers have regarded all attempts to increase political influence in pension policies as attempts to ‘socialise’ the pension system. In case of investments, one informant formulated this normative position well by saying that the most common threat to pension funds in the world is the finance ministers. Indeed, the logics of the entire field have been primarily drawn by the central field insiders, in essence the labour market parties who participate in governance of all key actors in the field.

In contrast to the common first-piller second-tier classification that would suggest that the parliament is the key actor defining the operations, the field insiders think that the
scheme only has legislated formal mandate and guarantees, and only social partners can legitimately make decisions over the scheme. This leadership has been renewed by actively maintaining the immunity to state authority in normative struggles but also discursively in public debate with means that sometimes may approach discourse manipulation (see van Dijk, 2006). For example, the editor-in-chief of the Työeläke magazine, the main professional magazine in the field has put it, if you “regard the earnings-related pension as an extension of salaries, it is in that case the money of labour market parties, of employers and of working people, which is managed by pension insurance companies”, and continues that no government “would in reality want to violently grab money that belongs to someone else” (Kalliomäki, 2009, translated by VS). This is a big ‘if’. It is questionable whether a defined accrual scheme can be ever considered an extension of salary in the first place. Moreover, in regulative terms, the TyEL assets are not in fact owned by employers or employees but the pension providers. This also begs the question whether forcing employers and employees legally to pay contributions to private providers includes no ‘violent grabbing’ of money from anyone whatsoever.

The immunisation of state authority was recently illustrated in the ‘social TUPO’ of the financial crisis of 2008-09. The government and the labour market parties have agreed in principle that the actual retirement age should be raised in following years, albeit in different forms and despite the fact that most Finns do not exactly accept raising the retirement age – 61 per cent of population directly opposed the idea in 2007 (TELA, 2007).27 The centre party (the agrarian party) led STM tried to set a

27 Employers have called for higher retirement age de jure mostly in terms of eligibility, and the employees have highlighted the importance of raising the retirement age de facto. Currently, the TyEL retirement age is flexible between 63 and 68 years. The employers have been quite radical in their
committee that excluded the labour market parties to prepare new legislation to achieve this goal. Labour market parties in neither side accepted the government’s suggestion. The main employer association expressed that this was not something the government could do by its own right, and the blue-collar employee associations even gave an implicit threat of general strike in case the group started working without paritarian labour market representation. After negotiations, the *Resolution between labour market parties and government* (2009) clearly stated that the central labour market organisations would dictate the ways in which the reforms were made. The ministry-led committee was to be replaced by a paritarian group. The impotence of the ministry has been brought to public attention in other cases as well. For example, in December 2007, STM demanded that pension providers should not pay bonuses to their clients but to keep their capital reserves stronger during the period of financial crisis. Despite the plea, all the major PICs paid client bonuses in 2008.

Another characteristic that has been renewed throughout the history of TEL/TyEL is the elasticity of decentralisation, both in implementation and coordination. The typical public defence of decentralisation of implementation presented in PIC annual reports is the argument that competition generates incentives to make operations more cost-efficient and profitable even though competition can be hardly called fully transparent in these respects. Decentralisation is also an appraised field-insider norm that was brought up by many interviewees. The main virtue of the decentralised investments in contrast to the centralised fund model was in the interviewees’ eyes the ability to evade moral hazards of the latter. In context, of decentralised coordination, the

suggestions. In contrast to the OECD suggestion of 65, the CEO of the central employer association EK has promoted a raise in the minimum mandatory old-age retirement age from 63 directly up to 67 years (Aaltonen, 2009).
renegotiation of the entire field cannot always be located to institutionalised bodies but it nevertheless follows one typical schema that bounds the processes. Basically all the macro-level coordination of the field architecture is if not consensually decided at least debated in mandated and decentralised *ad hoc* groups (see below). But there is always one group that is mandated to or at minimum strongly expected to rise above others.

Currently, the leading group is the *Eläkeneuvoteluryhmä* (literally ‘Pensions negotiation group’, led by CEO Jukka Rantala of ETK), which was born in 2009 by the resolution mentioned above. The negotiation group provides a high-level forum for the overall development of and handling of the disputes within the field. The composition of the group is similar to but not the same as previous functionally isomorphic groups: it is more multi-stakeholderist and convened by a coordination-related, not implementation-related body. The group has in practice a two-tier structure when mandated to discuss reforms, including the representative group of key shareholders and a consultative expert group including a great variety of stakeholder representatives and experts from various fields of expertise. Having hardly getting its work started, it is already feasible to argue that the role of the Rantala group might be changing in the near future or it may be dissolved altogether (i.e. not re-mandated to any preparation), which is why it is difficult to say whether it illustrates continuity or change in, or even decay of an institutional legacy altogether.

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28 However, as one informant put it, some consider this new composition a ‘hoax’, and believe that the informal negotiations are still held in the old Puro group fashion by the highest level figures of central labour market organisations and large PIC executives. Although some of the interviewees strongly believed this was true, no one confirmed the continuing existence of this culture.
In early 2010, there was a lively public debate and even a ‘news drama’ on raising the retirement age and extending working careers in Finland. The Rantala group was given a very limited mandate to negotiate how these goals could be achieved and how the pension system could support them, but it failed to draft any conclusions due to labour market party conflicts and a too narrow mandate. This raised some expectations towards the government to take the lead in the reform, but the government has this far refused to do so. There are good incentives for not doing it, as some political interests get more room or are better pronounced than others. Traditionally, the largest employee association (SAK) has strong links to left-wing parties in general and the social democrats (SDP) in particular, and the main employer association (EK) is tightly connected to the conservative party. This is why it was a surprise when the finance minister Jyrki Katainen of the conservative party (Kokoomus) called for increase in government leadership, albeit that it was no surprise in the historical context that their government partner centre party (Keskusta) was critical towards the group results (Sutinen, 2009).

Since the three major Finnish political parties have for some time had roughly equal support and number of seats in the parliament, it is very difficult for any of the three parties to form a majority government on its own. If any of these two parties form a government, it will have a difficult time to generate consensus that differs from labour market partner consensus – at least without the threat of halting the Finnish economy. A related reason behind the inability of the government or the parliament to influence the field is that there is little to gain politically from such efforts. Indeed, the TyEL scheme is politically path-dependent on labour market bargaining. The combination of relative legitimacy and sustainability of the TyEL scheme does not provide
incentives for dissenting or antagonistic political intervention. If difficult decisions such as lowering benefits or raising the mandatory retirement age are to be made, politicians are not likely to claim credit for these measures but shift blame by letting labour market partners decide on the major pension policy issues. The developments especially in the Bismarckian pension regimes illustrates well that the lack of trade union and opposition participation is election-wise a risky strategy for a government-led policy (Schludi, 2005). All in all, whatever the government composition is, it will have few incentives to start political bargaining.

From the perspective of investments, the labour market driven but decentralised order in field governance has been in some flux for another reason. The case here is the adoption of a temporary law relaxing the solvency criteria to prevent fire sales of assets during the financial crisis of 2007–08, which is a slight boundary crossing in the assumed labour market driven order. According to one informant, neither the ministry nor pension providers extensively consulted the labour market partners to change the rules but took their own initiative. The ability to change an investment boundary condition in rapid ministry-led project has somewhat blurred the traditional order in two respects. It has shown that the relationship between STM and PICs is more immediate and potential in causing institutional changes than the self-understanding in the field suggests, at least when the issues on hand are considered legitimate by the social partners. It has also showed that investments as an area previously considered centrally non-coordinated par excellence, needs central coordination in conditions of increasingly financialised pension provision. Hypothetically, financialisation has increased the need for rapid, effective and flexible central coordination when the regulations are not sufficiently flexible. This was a
major theme especially in the recent reviews on the solvency regulations (STM, 2010a, 2010b).

There is a constant fear in the field that any increase in political control over PICs would lead to disastrous investment policies, and the only thing that definitely prevents this from happening is decentralisation of implementation. It is true that the PIC boards and investment functions constantly receive suggestions from all kinds of public figures and firms to use the funds to not necessarily too feasible economic projects. However, in institutional terms political control has little to do with decentralisation: if there was a single public entity in form and run in practice like a PIC, it is hard to imagine the threat of political control would be any different from the current scheme. Moreover, the companies were historically decentralised to embrace, not to avoid political control, as they were decentralised to the hands of different financial blocks. Decentralisation is now defended on basis of risk management (“not having all the eggs in one basket”) in contrast to previous fears of large capital bases of pension fund socialism. For example, for one interviewee, decentralisation essentially meant that you do not need to repeat all the mistakes made by others. Yet there are very few avenues for actually improving the knowledge about others’ mistakes besides publicly available information – competition with business

29 Some interviewees saw that the PICs still have political connections. Ilmarinen and Varma were thought dominant political actors by their own right. The CEO position of both companies has been traditionally considered a reward position for the old STM insurance section heads – until Tarmo Pukkila, being a “renegade” centre party member. The former was considered having strong ties with the co-operative movement and social democrats – the CEOs previous to current have been influential social democrats – and the latter to Finnish ‘big capital’ and its interests and political connections. Eläke-Veritas was thought to have extremely strong ties to the Swedish-speaking Finland and the Swedish People’s Party (RKP). Eläke-Tapiola was considered conservative investor with mostly rural sympathies. Etera was considered basically a dropout from all decision-making with no party or corporate political connections – one interviewee called it the only ‘truly independent’ PIC for this reason.
secrecy and blocked information exchange hinders, not strengthens this aspect of decentralisation. Similarly, those who think the two largest PICs are ‘too big to fail’ and have too much to say over the field may fail to see that, perhaps apart from the one or two smallest companies, all PICs are ‘too big to fail’ due to joint liability in bankruptcy. Although the defence of decentralisation is stark, it is not necessarily always a consistent one.

**Coordination within the field: roles and relationships**

One of the many official reports (Kausto, 2002) addressing the TyEL system development posed the question of where is the power nexus of the system and explicitly responded: nowhere and everywhere. Indeed, no single actor within the field – the government, the parliament, ministries, administrative agencies, labour market organisations, beneficiaries, policyholders or pension providers – have an absolute say in the functioning or reforming the pension system. It is, rather, a field of intersecting forces where coordinative power is decentralised. This suggests that the PIC activities and especially their governance cannot be understood by focussing only on the governance of PICs as individual organisations or on the developments in the overall field architecture. In contrast, we need to understand the internal coordination mechanisms, roles and relationships within the field.

As noted, decentralisation is present in the field in two forms, both as decentralisation of implementation to various organisations and as decentralisation of coordination. In the former sense, decentralisation refers to the employers’ ability to choose different provider types and, in case a PIC is chosen, the provider out of seven companies. This
brings some relevant issues for understanding coordination in the field. Most importantly, it gives the market mechanism a great say in defining success in the field. On the other hand, there is the joint responsibility on liabilities among pension providers. The primary aim of this arrangement is to ensure the security of pension provision at all times. Joint responsibility is an ex post facto collaborative arrangement, and does not require coordination among the pension insurers. It is not in the interest of other providers to let any of the rivals go bankrupt, as the joint responsibility requires other companies to take care all of the liabilities and possibly only part of the assets of the terminated company.

As result, pension providers are set only into two limited modes of mutual competition. Firstly, there is competition in popularity between pension provider types. The employer selection of the provider type is in nature dyadic, and all choices illustrate different avenues of power over and benefits provided by the organisational type. The organisational forms do not directly compete with one another in a level playing ground – an employer establishes a company fund or allows establishing an industry-wide fund if it wants to, and neither entity competes with other types, other similar funds, or PICs. They are in logic exclusive. Employers shut down the company fund or secede from the industry-wide fund if they opt for a PIC for the same employees, and the other way around. Employers can choose other pension provider types that provide different avenues for control, which suggests that whatever the balance is, it is always dependent on employer choice. In industry-wide funds, the employers can basically nominate at most half of members of board, but in company funds they nominate at least two thirds of the members. Although these disparities have been somewhat decreased by new regulations implying that in some
fundamental issues decisions require five-sixths’ majority of the votes (excluding investment policy), company funds are controlled by the employer who also bears somewhat more risk than in other types (see Kallio, 2008).

It must be noted that control has not interested employers for some time now – not even those with core skills in the domain like Evli Bank, a Finnish investment and wealth management bank that has recently dissolved its company fund. In fact, a great number of company funds have been recently dissolved and the asset bases moved to PICs. Some informants argued that the loss of popularity has much to do with modern-day business norms that imply commitment only in core function in the name of efficiency. Perhaps a more tangible argument would be that in comparison to the ‘old days’ when investments could be used to more firm-specific investment targets like hydroelectric power plants in case of industry, the new paradigm of portfolio investments on one hand provides few immediate economic gains for individual firms and on the other requires so much expertise that opting for alternative fund types must have special reasons and conditions shared by only few Finnish firms.

There have been two explicit explanations the loss of popularity presented in recent public discussion (e.g. MOT, 2010; Helsingin Sanomat, 2009). The first is the ability to liquidate the accumulated extra capital reserves. The accumulated assets covering pension liabilities cannot be transferred from a PIC to another but under strict regulations supposed to decrease short-term speculative behaviour among the client firms. The transferred assets have been in general quite low so that the expenses of changing the provider would be higher than in case of upholding current contract with one of the PICs. However, the accumulated reserve capital in the existing company
funds has often significantly extended the legal requirements of capital reserves needed in changing pension provider. In such instances, liquidating pension fund is very lucrative. This possibility provided direct financial incentives during the financial crisis for employers to capture this premium – for example for Neste Oil it was 50 MEUR (Blåfield, 2009). The second cause deepens the explanation for the timing of this shift, as some companies dissolving the funds were not hit particularly hard by the crisis. The head of ESY, the association of funds, has publicly defended the fund system by calling for more equal reserve requirements and the STM has been working on legislation reform to do this. This defence has been somewhat counter-performative, as some employers have rather interpreted is as a countdown for closing the opportunity window for dissolving the funds than as a beneficial levelling of the playing field between different provider types.

Secondly, there is the competition on clients between PICs. As there have been no academic or other publicly available studies on the criteria employers use in selecting the provider this far, the discussion here is more limited to formal aspects of competition. Since the product of the field is fixed, there are only a limit number of means for competition on clients. In the official reports, the client bonuses are by far considered the most significant means in PIC competition. The basic idea is that better than expected investment returns allow pension providers to return some of the premiums to the policyholders (i.e. employers). In practice, all the interviewees in PICs who discussed competition between the companies defined it more or less ‘fierce’, as one put it. However, the client bonuses were considered merely one important mechanism in competition. The competition has often more to do with more symbolic issues: with ‘looking good in all respects’, as one interviewee put it.
Some think that the popularity of marketing partners dictates the success of a PIC, while for others the selection is increasingly dependent on what insurance brokers ask. Either way, competition enables various contingent criteria, some of which have been considered unhealthy.

This especially applies to some supplementary services to decrease incapacity to work or disability, which are both financed from the collective disability pension component. These services are primarily related to the projects that policyholders have already or are at least committed to having them. Using the amount promised to these services as means for competition in broker mandating has recently caused some public controversy. The university reform that came in effect in 2010 brought the Finnish university personnel born in and after 1980 under the TyEL scheme. Varma, which won all the universities, offered the largest sums for this purpose, but it could take Varma a hundred years to actually accrue enough legally approved funds to cover the service promise to universities, which is why FIN-FSA has started to inspect the brokerage practices (Pietiläinen, 2010).

Decentralised implementation creates a need for centralised coordination roles for the supporting institutions. Some actors have centralised roles in the coordination of field activities. Two of these are especially relevant. The Centre for Pensions (ETK) has a system-wide or global coordination role in the Finnish pension regime as a whole. In practice, ETK also participates in the preparation of the pension legislation. ETK is broadly considered “a liaison body” (Hietaniemi & Ritola 2007), a ‘non-authority’ that has government, employer, employee, as well as pension provider presentation in its governing bodies. The labour market partners have a majority in the governing
boards of the centre, and pension providers cater for the costs of operation. ETK operates primarily on the ‘liability side’ of pensions. The coordinating role of ETK is connected especially to the division of liabilities between pension providers.\textsuperscript{30} ETK has quite little to do directly with investments with the slight exception of its research department that has included investments as a theme to the research program of 2010–2014.

In contrast to the ‘global’ role of ETK distant from investments, the second centralised actor, the Finnish Pension Alliance TELA, has many centralised local roles in coordination and much relevance in investment issues, for example in terms of maintaining boundaries for investment activities by social responsibility and ownership policy guidelines (see next section). The Alliance formally serves as the coordinative body of pension provider opinion formation and the representative of common interest. TELA regularly follows developments in investment environments globally and discusses these and many other issues with pension providers in TELA investment working group that consists primarily of PIC CIOs or other investment directors.\textsuperscript{31}

Calculation bases are a good example of a centralised coordination mechanism in which an ostensibly technical coordination role may actually become to affect investments and competition between pension providers substantively. The calculation bases are mathematical formulas that concern a great variety of issues in

\textsuperscript{30} To define the liabilities of each provider requires extensive data processing. ETK holds a registry of the accrued pensions as well as information of the amount of the pension premiums that pension providers use to determine the actual cost for each individual provider. From 2007 onwards AREK Ltd., which was separated from ETK curiously because technical data maintenance was considered a non-core function for ETK, has registered the earnings data used to award pensions.

\textsuperscript{31} For example, the author has given a presentation on his research project at a group meeting.
the scheme like discount rates, capital values of assets and liabilities, and actuarial and statistical assumptions on mortality development and numerous other such features. The calculation bases are significant in relation to investments, as they define how much client bonuses PICs can pay and how much capital reserves pension providers need to have. ETK is in charge of calculation of the solvency borders and fund transfer obligation – in fact, it is the only core task of ETK in using centralised coordinative power related to investments. TELA also has a formal coordination role in preparing the calculation bases. The role is related to the composition of pension contributions, in which case TELA is responsible for one key section.\(^{32}\) Although STM can accept or reject the outcome of ETK calculations, it is customary that ‘under normal circumstances’ ministry does not alter it (Huhtanen, 2006).

In context of competition, calculation bases are important as they divide provider-specific and collective costs. The contributions allocated to the operative costs of the pension provider and the costs resulting from uncollected contributions together form a part of the collective pension contributions for all pension providers. This practice makes it difficult for the policyholder (i.e. employer) to evaluate the quality and efficiency of their provider, and especially their tangible effects to client bonus levels. The part that is intended to cover the uncollected premiums has most often been kept high enough to cover the losses and collection fees, which is why pension providers lack the incentive for efficient collection of contributions (Rajaniemi, 2007). In the conditions of a fixed product (i.e. TyEL insurance), the coordination of such formulas can be viewed as cartel type activity that potentially hinders competition among the

\(^{32}\) The section consists of insurance mathematicians of all major insurance companies as well as representatives of STM and ETK. TELA gets a mandate from insurance companies and then applies for confirmation from STM.
pension providers, or at least shifts focus from efficiency to other issues like investment performance and supplementary services. One TELA section and the pension insurance committee of Federation of Finnish Financial Services, the Finnish financial sector lobby, have called for more pension provider specific calculation bases in defining scheme execution costs instead of focussing on competition issues (Kivisaari, 2007).

In case of decentralisation of coordination, decentralisation refers to the various development mechanisms that exist in the field. Focus on formal regulative decision-making structures, according to which all preparation is supposedly made by STM and decisions made by the parliament, does not take into account that the actual preparations and key normative decisions have already been made outside numerous democratic arenas and are very rarely contested in the parliament at all. Even centralised bodies like ETK and TELA are set to and operate in decentralised bodies when coordinating and developing field activities. It can be even argued that the coordinative power of central actors in a significant scope resides in groups that operate between different actors in the field, not in fixed functions or bodies as such. These bodies are set by STM, pension providers, ETK and labour market parties. ETK lists annually all the public working groups that have anything to do with pension reforms. The number of groups is impressive. The report of 2010 (Helenius and Kortesoja, 2010) for example lists four finished reports (and their publications), six ministry-set, two industry-set, and three other temporary working groups, and three ministry-set, one labour market party-set, and dozens of other permanent working groups that have some relevance concerning parameters of the TyEL scheme (the group titles are translated in Table 6.1).
It can be inferred from the TELA education material that the decentralisation of coordination to ad hoc groups is justified primarily on two virtues: representation and expertise. Representation essentially means that all stakeholders, including labour market organisations, pension providers, STM and other ministries, ETK, TELA, KELA, and many other institutions that are considered relevant by the actors setting the groups, are represented in using voice and/or receiving knowledge from the coordination and discussion groups. It is needed, because developing policies concerning many actors operating within the same framework would be impossible so that all relevant people were present in discussions. Expertise is required in a complex field where no single actor can define all the relevant issues for debate in all thematic areas. This requires broad acknowledgement of different system variables and perspectives to their actual functioning. The ad hoc structure supposedly gathers the ‘best experts’ on individual topics around the same table.
<table>
<thead>
<tr>
<th>Temporary Working Groups</th>
<th>Permanent Working Groups</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ministry-set groups</strong></td>
<td>EU-issues Committee, preparatory section 25</td>
</tr>
<tr>
<td>Pensions Forum</td>
<td>EU-issues Committee, preparatory section 27</td>
</tr>
<tr>
<td>Politics of Ageing research project</td>
<td>Industry-wide fund and company fund group</td>
</tr>
<tr>
<td>Negotiation group on Rehabilitation</td>
<td></td>
</tr>
<tr>
<td>Depression prevention project (MASTO)</td>
<td></td>
</tr>
<tr>
<td>Immigration and emigration related social security development group (MAASTO)</td>
<td></td>
</tr>
<tr>
<td>Earnings-related supplementary pension fund legislation preparation group</td>
<td></td>
</tr>
<tr>
<td>Labour market failure prevention measure coordination group</td>
<td></td>
</tr>
<tr>
<td>Elderly and Pensions issues negotiation group</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Groups internal to pension regime</strong></td>
<td></td>
</tr>
<tr>
<td>Pension Record coordination group (OTEGO)</td>
<td></td>
</tr>
<tr>
<td>VILMA-record follow-up group</td>
<td></td>
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<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Labour market organisation set groups</strong></td>
<td>Labour Market Central Organisations’ Negotiation Group (so-called Rantala group)</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Other groups</td>
<td>Nordic Social Statistics Committee</td>
</tr>
<tr>
<td>The Negotiation Group for Pension issues (set by KELA board)</td>
<td>Social and Health Sector statistics cooperation group</td>
</tr>
<tr>
<td>Insurance supervision negotiation group</td>
<td></td>
</tr>
<tr>
<td>Entrepreneurs’ negotiation group (YNK)</td>
<td></td>
</tr>
</tbody>
</table>

The supposedly decentralised coordination is everything but decentralised when we look at the composition of representatives in these groups (see Johanson and Sorsa, 2010). ETK has omnipresence in these groups and for example one TELA representative sits in over half a dozen groups. Perhaps the best concept to describe the ostensibly decentralised coordination arrangement is the generation of pensions elite, a strongly limited and well-networked group of representatives (not individuals as such) present in coordination. The notion suggests that some actors like ETK have a great potential for institutional entrepreneurship in principle because of good locations in organised interactions. In practice, however, the effective change with institutional entrepreneurship is more limited, as the field-wide change is expected to be discussed by the labour market parties who discuss issues rather at the level of Rantala group than in individual thematic groups. Another reason is that coordination is strongly conditioned by past measures and strong regulative logics cutting the ability to introduce new practices. These mechanisms can be called automatic adjustment factors, which are legacies of previous coordination actions that condition coordination, and which significantly change various parameters in the field.  

As result, although the elite might be able to affect the discursive insights in various groups, they are very unlikely to be able to produce new interpretations of the strong regulative institutions. Instead, the elite network provides a fertile ground for

33 For example, the so-called life expectancy coefficient is a mechanism that affects the amount of the old-age pension and a method to prepare for increasing longevity. It is applied for the first time in 2010 for those born in 1948 and after. In brief, if average life expectancy continues to increase, the life expectancy coefficient will reduce the monthly pensions. The coefficient of each age cohort is based on calculations made by Statistics Finland, drafted by ETK (or ETK-led groups) and accepted by STM annually.
generating alliances for *institutional work efforts*: different parties can find common opinions and potential alliances in coordination. Among other things, this suggests that ETK is a non-liaison body only insofar as it uses its role as one. It could even aggressively try to redefine issues in the field in its role (which is nothing to say about its interests for doing so). The divergent conclusions on the legal role of ETK in previous studies (Myllymäki, 2009; Arajärvi, 2006; see also Huhtanen, 2006) further point towards political controversies concerning the omnipresent role of ETK. Increased government control over ETK brought by constitutional pressures could for example bring the excluded politicians and political parties who traditionally have had strong views on investments inside the field to find new alliances for institutional work.

**Investments: field-level supervision and governance**

Despite the fact that there have been some redefinitions in and concerns over formal governance, and the possibility of redefining the field-level approach to investments in the pensions elite as discussed above, investment governance has been primarily grounded in the individual organisation level – the PICs make their own investment decisions, and there is no coordination in the field level. The field-level governance issues are more limited to very general level boundaries that are in technical terms set by the parliament and STM while normatively drafted by reformation-mandated top authority in the field. However, the supervision over investment making has been allocated to the field level, to government regulatory body *Finanssivalvonta* (FIN-FSA). FIN-FSA was born when the Insurance Supervisory Authority (*Vakuutusvalvontavirasto*) and the old Financial Supervision Authority (*Vakuutusvalvontavirasto*)
(Rahoitustarkastus) merged in 2009. The PIC interviewees welcomed this development warmly especially since the old insurance authority was considered to lack expertise on PIC investment issues that the FIN-FSA supposedly has.

While the government has been in many terms excluded from setting the rules of the game and given a more technical role in coordination within the rules, it is very strongly present in the controlling and overseeing bodies. FIN-FSA is formally organised under the Bank of Finland. The board of the new FIN-FSA consists of five members one of which is appointed by STM and one by the Ministry of Finance (VM). This said, the governance of FIN-FSA are regulated in detail by law (878/2008) and include for instance expertise competency requirements and direct regulations on mutual relationship of governing bodies (Bank of Finland Bank Council, the BoD, the executive director etc.), which suggest that the government is unlikely to hinder the neutral arms-length bias of the supervisors at least without legal disputes.

FIN-FSA has a broad mandate in controlling pension providers. At the most general level, it supervises all the activities of providers and participates in regulatory development. It has a strong legal right to request and receive information from pension providers. It can also sanction non-compliance with different kinds of fines and public notices, withhold the management operations, and even temporary and permanent cancellations of operational permits. The FIN-FSA and its predecessor have for example conducted close inspections of governance structures of PICs in recent years. The regulator has nevertheless been concerned especially with changes in management methods, for example with the decision-making models in which
investment managers are given broader mandates than in previous arrangements in which investment decisions were made by hierarchically higher-level bodies (like the current investment committees, see below). As some of the interviewees pointed out, there have been no major concerns or even hints for non-compliance in the field.

FIN-FSA guidelines concerning pension provider activities are quite extensive. For instance, the most general level regulatory guidelines for insurance companies include quite detailed guidelines (ca. 200 pages) and specific instructions for PICs. The guidelines concern six different domains: general principles, governance and financial statements (including e.g. competence requirements, internal supervision, risk management, auditing, accounting, and annual report disclosure), technical provisions and solvency (with dedicated chapter to PICs), financing, supervision, and special regulations. Because the contents of the guidelines are in great part related to investment boundaries, they are discussed in more detail in the next section.

Saying that there is no field-level coordination over investments is not to say that the field would not affect investment decisions. The interests of different actors towards investments are aligned asymmetrically in the field architecture. The most important asymmetry in this alignment has been one between employer and employee contributor interests. As the employers’ fear over the expansion of foreign ownership in Finland has eroded, the main employer concern in the current context has been almost exclusively the amount of pension costs. In the current institutional framework, this refers to better effective real returns, be it in terms of higher gross returns or lower operating costs. The employee side of the coin is not as straightforward. Currently employees’ contribution to pension costs underlines their
implicit interest in keeping down the pension costs, but their part of the contributions is not variable according to PIC investment performance since the mechanism of client bonuses only concerns employer contributions. This gives more room for other targets and interests.

For an example of issues arising from this asymmetry, there is the traditional question of domestic investments. As the employees have often argued, investments in domestic firms could directly increase employment, which would directly serve the collective interest of the employee organisations and, in part, the whole TyEL scheme. Employers on the other hand are sceptical towards this arrangement, because it generates centralisation risks for portfolios. The problem with employee argumentation has been that the argument is much dependent on the demand side unless all the capital was allocated to public projects (which they are not suggesting). Indeed, there have been adequate sources for financing the demand in most sectors and in most businesses in different development phases where PIC assets could be best invested (see Työmarkkinoiden keskusjärjestöjen eläkeneuvotteluryhmä, 2006).

The positive economic impacts of investments are dependent on individual investment targets and methods in portfolio investment paradigms, and since these questions belong to the individual provider level in the TyEL field, the asymmetrical interests are likely to provide quite unfruitful tensions between different interest groups and between field-level and individual organisation level issues.
Pension insurance companies as agents

The concept of organisation field draws much attention to its players. In case of pension insurance companies (PICs), the organisations are directly derived from the very field boundaries. PICs are based on the special Act on Pension Insurance Companies (354/1997) and only in those areas it does not cover, on the general Insurance Companies Act (521/2008). A PIC handling statutory earnings-related pension insurance has to have a concession granted by STM, which may include special conditions meant to safeguard the interests of the policyholders (employers) and the insured (employees). The PICs cannot offer any other type of insurance than the Finnish pension insurance under TyEL and YEL, and related reinsurance. A PIC can be founded by one or several natural or legal persons. At least half of the founders have to be resident in the European Economic Area unless STM grants an exemption from this rule. The minimum basic capital required for a pension insurance company is 5 million euro. Foreign insurance companies may not engage in Finnish statutory pension insurance as such, but any foreign corporation or natural person may establish a separate PIC in Finland. So far, no foreign insurance company is engaged in earnings-related pension insurance in Finland. As PICs are bound to mandatory pension provision only, they do not offer an avenue for accessing the Finnish insurance market more generally.

One key field-level institutional form defining PICs as financial actors is that it must be separate from other activities. If a PIC is a member of a broader financial group, the statutory earnings-related pension insurance has to be kept legally separate from the group’s other insurance activities. Similarly, the assets of the PIC have to be kept
separate from the assets of companies that belong to the same company group, and the annual accounts of the PIC may not be included in the consolidated accounts of another company. The financial management and payments traffic of the PIC must be arranged so that assets are not used for the same purposes in the same company group as the PIC. The separation from other activities is not only a matter of accounting. Indeed, investment agency must be as such sufficiently internalised and executed by sufficiently large investment personnel. Power can be delegated from PIC boards and executives only to members of investment personnel that cannot have a job contract or other binding contract generating dependency with another entity (company, trust, foundation etc.).

According to the FIN-FSA guidelines, investment personnel must have sufficient expertise to make all the decisions themselves so that external services are not needed. Moreover, all external services need to be bought rather than externally mandated (or contracted). In this sense, the Anglo-American choice between internal and external control over investment managers has in the TyEL field been already made in the design of PICs. The PICs are nonetheless allowed to buy a variety of supplementary external services, including asset management vehicles (i.e. funds), investment and legal advisory, IT, real estate management, and some similar services. The FIN-FSA guidelines allow only some investment-related services, including market analyses, company profile analyses, and credit reports and ratings. The extent of internal asset management varies from company to company, but typically all companies aim at managing all the assets internally and by using external advisory services. Ilmarinen for example reports managing 80 per cent of all its investments internally in full
scope, using external services in emerging market, private equity, and hedge fund investments.

For the sake of simplicity, it can be argued that PICs are allowed to buy all services that do not bear the investment risk, which must be directly born by the PIC decision-makers. Supplementary joint ventures with other publicly supervised financial sector firms are also allowed, as long as they are based on detailed contracts explicitly stating among other things the mandate and scope of the venture, the principles and limits of investment activity (including goals, risks and allocations), reporting duties, fees, and termination conditions, and they do not cover ‘a significant part’ of total PIC assets.

The formally required administrative structure of PICs follows some ingredients of the traditional – and only traditional as Finnish listed companies dominantly use one-tier governance models (Securities Market Association, 2008) – Finnish model of two-tier corporate governance. The structure includes not only a Board of Directors (BoD) and general shareholder meetings but also a Supervisory Board (SB) overseeing the BoD activities. At the PIC annual general meetings company shareholders have the voting rights in accordance with the Insurance Companies Act, albeit that the composition of the shareholders depends on the company type (see below). The role of the SB elected at the general meetings is set very narrow by the legislation on limited companies: the SB nominates the members of the Board of Directors (BoD), confirms their compensation fees, and oversees the BoD and CEO (nominated by the BoD) activities. A PIC must also have separate committees on elections, appointments, compensations, and audit. For example, the election
committee makes proposals concerning remuneration and nomination of the members of the SB to the general meeting, and proposals concerning the remuneration and nomination of the members of the BoD for the SB.

The BoD operates on majority decision-making protocol but when decisions concern guarantee capital or investment plan related issues, there must be a two-thirds majority of votes. All companies define the size, member eligibility criteria, and member tenure time of SBs and BoDs – as all other governance options allowed by the law – in their Articles of Association (see Table 6.2). There is only subtle variation in requirements. Ilmarinen for example formally requires the members of SB to study the pension decisions and investment activities in the company. The articles are quite narrow in content and do not usually include issues outside special legal requirements for PICs. They for example do not have explicit policies concerning gender issues, neither in direct normative terms nor indirectly in relation to the general laws concerning gender equality, which do not apply to any corporate boards unless the companies so decide.

Although structurally isomorphic, PICs are far from other Finnish companies when it comes to the composition of governing bodies. Labour market relations are deeply embedded in them. The SB and the BoD have to have by law representatives for the insurance policyholders and the insured chosen from the candidates suggested by the central labour market organisations. There has to be an equal number of such representatives for the employees and for the employers, and their total number has to be at least half of the total number of members in the SB and BoD. In the election committee, half of the members are representatives of the policyholders and half of
the insured. However, the members in these bodies do not represent their background organisations but are by law independent from them – they only represent the ‘best interest’ of the PIC. There are no substantial obstacles for their mutual coordination as long as they are all concerned with the success of their respective PIC. Labour market BoD candidates are introduced by and other candidates nominated by the nominating committee, whose selection methods slightly differ between companies.34

Outside these representation requirements and SB and BoD members of one company that can never be members of other PIC boards, anyone can be a BoD member as long as the formal competence requirements are met. In informal normative terms, the only excluded members are those working for the Finnish government. The law defines competency requirements for the BoDs and the managing director, the CEO, as well. All board members must have a ‘good reputation’ (e.g. no criminal background), and the boards as collectives are expected to have good knowledge on the pension insurance sector and on investments in general. PICs can define some additional criteria like maximum age for and expectations as to study investment-related issues towards the board members. All new board members need to attend the legally required education, which is by government approval provided by TELA. The PICs arrange extra education for their BoD members – some companies for example take the boards to meetings with investee firms and fund managers.

34 Two companies nominate the president of SB as the president of the NC. The one additionally nominates the insured representative as the vice president of the NC and selects two other members from employer and two from employee candidates, and the other selects two to four members from either SB of BoD. One company selects four members from the SB and two from the BoD. Three companies select six members either from SB or BoD.
The managing director, the CEO, has been given a specific role in the law. The CEO may not function as managing director of a credit institution or investment services company in the same company group or financial and insurance conglomerate as the insurance company. The CEO cannot be a member of the SB or the BoD of the company, or the head mathematician of the company. The CEO must personally know pension insurance and investment, and business management in general well, and also has more special formal conditions, which are presented in more detail in FIN-FSA guidelines (under section 4.1C).

The types of PICs vary in terms of ownership, and thus the composition of those using votes in annual meetings. The type also affects who will profit from the insurance activities. According to the law, a PIC can be a joint stock company or a mutual insurance company, or a public insurance company in the accordance with the Finnish Companies Act. There are five mutual PICs and two joint stock PICs (i.e. Eläke-Veritas and Pensions-Alandia, the two smallest of seven PICs). The ability to generate profits to shareholders is extremely limited in latter company type. To be more specific, in both company types, the profits generated by investment activities must be first used to cover technical provisions sufficiently and to pay out client bonuses according to the limits and ceilings presented in Chapter 4. Only after this is it possible to pay out dividends to shareholders in public companies. As result, the dividends are extremely modest. For example Veritas, the larger of two public companies, paid dividends only worth less than one basis point (0,7 MEUR) from its overall profit of 811 MEUR in 2009.
The differences between the two dominant organisational forms have been found relevant in academic literature. For example, Hansmann (2000) argues that the lack of clear ownership in mutual life insurance companies has resulted in management accumulating excessive capital within the organisation. What might apply to US life insurance industry does not usually apply to the Finnish pension insurance industry, however. In fact, the major PICs adopted the mutual form after the relaxation of investment regulations in 1997. It can be argued that the more prudent organisational form has provided more legitimacy for riskier investment policies that have been promoted in the field level.

In the limited joint stock companies, shareholders are simply all who buy company stocks through a book-entry system, albeit that buying and selling stocks must be informed to FIN-FSA beforehand (for details, see 1062/1979, 7 §). The shareholders of mutual companies consist of the policyholders (TyEL employers and YEL self-employed), the insured (employees of TyEL employers) and, if companies choose, the guarantee capital owners and the reinsured. All mutual companies have decided to recognise the guarantee capital owners and none has recognised the reinsured as shareholders. The mutual companies can also choose to define shareholder status so that the insurance policy must have been in force up to three years in order to be a shareholder. The voting rights of each company shareholder in annual general meetings somewhat varies in mutual PICs (see Table 6.2). The companies allocate votes to the insured firms according to the amount of their pension contributions. The law prescribes that all votes per insured firm have to be shared between the policyholder and the insured representative so that it reflects the shares of pension contributions. This means that policyholders get roughly about three fourths and the
insured one fourth of the votes. However, each insured firm has according to the law at minimum two votes, in which case one is allocated to the policyholder and one to the insured representative. This rebalancing mechanism ensures representation of both parties from smaller firms.

Three mutual companies have a policy that voting rights are directly allocated according to the amount of pension contributions. The minimum number of votes for a firm is two, in which case one is given to the policyholder and one to the representative of the insured. Two companies have decided to allocate votes so that they first allocate initial votes, three for a policyholder and one for the insured representative one. The guarantee capital owners also get varying number of votes, but the share of votes guarantee capital owners have is if not marginal at least minor. In their websites, Varma reports that their guarantee capital owners represent less than 2 per cent of votes in annual meetings and Eläke-Tapiola reports this share having always been less than 5 per cent. The vast majority of votes are held by TyEL firms in contrast to YEL firms. This is not to say there is formal centralisation of power. The law states that representatives may use proxies and this right cannot be constrained, but rather interestingly that no representative or proxy can actually vote with more than 10 per cent of total votes present in the meeting. Put differently, the centralisation of voting rights is prevented in very strict terms.
<table>
<thead>
<tr>
<th>Shareholder Meetings</th>
<th>Varma</th>
<th>Ilmarinen</th>
<th>Etera</th>
<th>Eläke-Fennia</th>
<th>Eläke-Tapiola</th>
<th>Eläke-Veritas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guarantee capital shares</td>
<td>71</td>
<td>13,672</td>
<td>80–320</td>
<td>10</td>
<td>320,000</td>
<td></td>
</tr>
<tr>
<td>Minimum number of votes per policyholder</td>
<td>1*</td>
<td>3</td>
<td>3</td>
<td>1*</td>
<td>1*</td>
<td></td>
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<tr>
<td>Minimum number of votes per insured representative</td>
<td>1*</td>
<td>1</td>
<td>1</td>
<td>1*</td>
<td>1*</td>
<td></td>
</tr>
<tr>
<td>Amount of paid pension contributions (in EUR) providing one vote per insurance</td>
<td>2000</td>
<td>750</td>
<td>2000</td>
<td></td>
<td>N/A</td>
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<tr>
<td>Amount of paid pension contributions giving a vote to YEL policyholder</td>
<td>2000</td>
<td>3000</td>
<td>2000</td>
<td>1700</td>
<td>70</td>
<td></td>
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<table>
<thead>
<tr>
<th>Supervisory Boards</th>
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<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Members</td>
<td>28</td>
<td>28</td>
<td>28</td>
<td>28</td>
<td>5–40</td>
<td>16–36</td>
</tr>
<tr>
<td>Tenure and changes**</td>
<td>3 yrs, at most 10 changed each year</td>
<td>2 yrs***, half changed annually</td>
<td>3 yrs, at most 10 changed each year</td>
<td>3 yrs***, one third changed every year</td>
<td>3 yrs, at most 12 changed each year</td>
<td></td>
</tr>
<tr>
<td>Max age for nominee</td>
<td>–</td>
<td>67</td>
<td>67</td>
<td>–</td>
<td>66</td>
<td>64</td>
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</table>

<table>
<thead>
<tr>
<th>Boards of Directors</th>
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</thead>
<tbody>
<tr>
<td>Members of board</td>
<td>12</td>
<td>12</td>
<td>12</td>
<td>10–12</td>
<td>3–16</td>
<td>4–12</td>
</tr>
<tr>
<td>Deputies</td>
<td>3</td>
<td>4****</td>
<td>4</td>
<td>4</td>
<td>3–8</td>
<td>3–6</td>
</tr>
<tr>
<td>Tenure and changes</td>
<td>3 yrs, 4 members changed each year</td>
<td>4 yrs</td>
<td>2 yrs</td>
<td>3 yrs, 4 members changed each year</td>
<td>3 yrs</td>
<td>1 yr</td>
</tr>
<tr>
<td>Max age</td>
<td>–</td>
<td>67</td>
<td>–</td>
<td>67</td>
<td>66</td>
<td>66</td>
</tr>
<tr>
<td>Vice presidents</td>
<td>1–</td>
<td>2</td>
<td>1–</td>
<td>1–</td>
<td>1–</td>
<td>1–</td>
</tr>
</tbody>
</table>

* in case the small policyholder gets the minimum of votes per one insurance, i.e. two, one is given to employer firm and other to the insured – otherwise regular relative sharing applies

** starting from the shareholder meeting in which nominated

*** can be shortened if necessary to manage sufficient change

**** deputy can be personal and nominated for specified member(s) of board

***** if more than one, the insured representative must be nominated as the first vice president

Table 6.2. Shareholder voting rights, and Supervisory Board and Board of Directors’ composition and eligibility criteria in selected pension insurance companies in 2009. Source: Johanson and Sorsa (2010)
6.3. *Boundaries of Pension Insurance Company Investments*

Organisation fields are in great part about boundaries framing actions to institutional referents that make the field a recognisable and distinct domain. As it has been noted in this chapter, the activities in the TyEL field are in general bounded in many different ways. In this section, the focus moves to the direct restrictions, framing norms, and other institutional boundaries within which PIC investment activities as calculative, exchange and information processing practices are set. Although historically divergent, the PIC investment boundaries are only subtly different from the other fund types because their frameworks have been significantly homogenised during the last few decades. The following discussion is thus in most parts directly applicable also to the investments of all pension providers.

The law on PICs (354/1997, hence: TVYL) overrules parts of the Finnish law on insurance companies (521/2008) that otherwise applies to PICs (and makes them face general regulations like guidelines for anti-terrorist and anti-money-laundering measures). The PIC accounting principles and standards for example differ in many parts from other insurance companies. The PIC BoDs are, as all Finnish insurance companies, required to organise internal monitoring, control, and audit, which is enhanced by other requirements some of which have PIC-specific details.\(^{35}\) This is not to say they are completely divergent. Take for example accounting. The adopted accounting measures related directly to investments like write-offs, valuation changes, 

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\(^{35}\) See FIN-FSA website for a list of all laws affecting Finnish insurance company activities: [http://www.finanssvalvonta.fi/fi/Saantely/Lainsaadanto/Kotimainen/Pages/Default.aspx](http://www.finanssvalvonta.fi/fi/Saantely/Lainsaadanto/Kotimainen/Pages/Default.aspx) (in Finnish – the English version does not include PIC rules)
and fair value calculations of all PICs follow TELA guidelines that do not significantly differ from the mainstream finance sector practices. Other accounting practices, typically real estate valuations as highlighted in annual reports, explicitly follow FIN-FSA requirements. In this sense, the PIC accounting is not necessarily that different from other investors operating in Finland. Some PICs, for example Varma and Eläke-Tapiola, also follow the IFRS standards where applicable, which makes the financial statements more albeit not fully comprehensible internationally. The same applies to more specific issues in financial statements and statistics.36

The primary focus in this section is on the requirements that bound PIC investment behaviours to certain varieties and in part make PIC distinct from other actors in the domain of finance. The section is divided thematically. The first issue discussed are the general norms in the regulatory framework that set the most macro-level boundaries for investments, that is, the need to be profitable and secure. The second set of issues is based on the FIN-FSA guidelines (Financial Supervisory Authority, 2008), the main direct regulatory mechanisms specifically bounding PIC investments. These issues are investment plans, solvency rules (including balance rules and short term recovery plan rules), investment classification rules (and related supervision methods), and regulations concerning derivatives. Each boundary is discussed under its own title with the exception of the regulations concerning derivatives that are discussed in context of investment plans because they rely on the same logics of governance according to which PICs must set their own boundaries and because derivative policies must be reported in the investment plans. The rest of the section is

36 Eläke-Tapiola for example explicitly reports to use in its valuations the so-called Dietz method that weights individual cash flows by the amount of time that those cash flows are held in (or absent from) the portfolio.
dedicated to less formal and other than regulative logics setting boundaries for PIC investments, most importantly active boundary control and the guidelines concerning responsible investments.

**The ambiguity of profitability and security**

There is arguably only one legal guideline that frames all the PIC investment actions regardless of specifications. The TyEL law states that all the assets must be invested ‘profitably’ (in Finnish: *tuottavasti*) and ‘securely’ (*turvaavasti*). Although this prudential principle can be seen as a strong boundary for PIC investments, it is very vague in content without case-specific legal interpretations and makes other laws, statutes and mechanisms to form the most tangible boundaries for the field. There have been no clear definitions or court processes that would have formally demarcated appropriate behaviours. The norm can be thus perhaps best understood as a general guideline requiring optimisation. As a mandate, the rule is not like fiduciary duty but more a frame for more specific boundaries. Some may see it as a terrible mandate – as one interviewee put it, you are expected to beat all the indices by far in good years and to make tangible profits even in the worst possible years. As there is no field-level coordination defining how much risk should be taken in order to fulfil these criteria, there have been, not surprisingly, many debates on the proper risk levels and return targets in all working group reports preceding the solvency rule and other regulative reforms.

There is a broadly shared understanding that one strong expectation dominates all investment activities in the field. It is the expectation of four percentage point average
real annual investment returns. This theme was present in a great majority of interviews, most potently in CIO and CEO level interviews. The mere existence of the norm is curious. Having no regulative basis is one thing, but the target is not even defined as an explicit normative goal in any law, government bill introducing current laws, social partners’ demand, or even recent working group reports – it is only mentioned as a possible, realistic and reasonable goal. The average PIC annual real investment returns during the decade 1997–2007 were 5.4 per cent, and roughly over four per cent also between 1997 and 2009 (STM, 2010b), so the policy is at least in historical terms quite reasonable, realistic and achievable. Its normative basis can be traced to the discussion of the optimal system-wide investment risk level goals mentioned in the reports and government bills of the 2007 solvency rule reform. In discursive terms, the four per cent policy has a material representation as the default component in the future projections scenarios ETK periodically drafts. Although it is only one scenario among others, the three and five per cent scenarios, it has surprisingly much force in framing the understanding on the relationship between investment performance and the pension costs within the field as well as in public debate.

For PIC investment functions, the four per cent norm includes ambiguities and in some cases even hypocrisy because the room between the formal solvency architecture and the return expectations is considered very narrow. The question has much to do with asset allocations. In case the proportion of listed and private equity is kept as low as 10–20 per cent of portfolios in general or at least in periods of lower economic growth (or low capital market inflation, it should be noted), there are, at least in the interviewees’ eyes, few means to achieve the goal in the long term while
remaining solvent. In practice, this means PICs would need to invest heavily in alternative assets like raw materials, commodities, real estate and hedge funds besides the more conventional targets.

The ambiguity is related especially to hedge funds. While some PICs have found hedge funds as the vital source of alpha and a means to control correlations in their portfolios, there has been much scepticism towards this asset class in the Finnish public domain especially by a few influential journalists in the main nation-wide newspaper, *Helsingin Sanomat*. The scepticism has been brought to the discussions within the field for example by one minister and by some more conservative PICs. Some interviewees considered the scepticism in general ‘an intellectual bankruptcy’ and more particularly blamed some politicians for hypocrisy in promoting a higher risk level at the level of overall portfolios while trying to curb risky individual vehicles and all investments in other than conservative ‘long only’ assets.

The PICs may indeed feel uncomfortable between the high return expectations and the prohibitive normative frames. Some portfolio managers have a strong feeling that they cannot follow their investment beliefs. Some companies have suggested in the numerous working groups of the field that hedge fund investments could very feasibly cover 15-17 per cent of overall PIC portfolios. One interviewee suggested that if a couple of PICs followed their own investment beliefs, they could have even one fourth of overall portfolios in hedge funds. It must be noted that also those who rely on more long-term long-only based investment beliefs feel that they cannot follow their beliefs, as ‘you have to be solvent every day’ even though ‘you could design a portfolio that holds for decades’, as one interviewee put it.
These issues are present in the regulative framework as well. The admittedly (see STM, 2010b) pro-cyclical nature of the solvency rules makes it very difficult to carry equity risks over financial cycles, which was considered by the interviewees a small tragedy. The funding mechanism also causes tensions between PICs. The equity-liked buffer in the fund transfer obligation means that the ‘system carries the risk’ (as various interviewees put it) only in terms of equity returns. This implies that equity investment plays a separate role from all other investments in the field, as PICs must take other companies’ equity strategies into consideration in specific when creating their allocation strategies. These kinds of issues make the finding of optimal risk level both at the overall field level and at the level of individual PICs difficult. Such uneasy feeling in may lead for example into increasing antagonistic mutual relationship between the PICs and erode the legitimacy of the system in the eyes of investment professionals. One interviewee well illustrated this attitude by arguing that current form of “competition” in conditions of the equity-linked buffer and the solvency requirements set by the average performance of all PICs only keeps the investments suboptimal and causes some better performing PICs to ‘pay coupons’ to competitor activities.

There is one underlying problem behind all the questions related to risks and returns: the asymmetry in how financial professionals and pension scheme stakeholders understand risk. Financial risks and returns go hand in hand throughout the field, from individuals to PIC annual reports and laws: more risk also means more opportunities for better returns. Yet according to a great number of interviewees the risks tend to be seen almost exclusively as negative issues, not opportunities in some stakeholders’
eyes. Individual companies may easily translate risk-taking in very different terms than the ‘system architects’. Especially in the past, PIC BoD members have been albeit not risk-averse in collective terms sometimes in individual level very sceptical towards investment risks despite their confidence on investment personnel to effectively manage the risks. This may provide the field-wide risk discourses even a more negative interpretation at the individual PIC level.

The problems are also in part discursive. The field insiders often regard the regulative framework as a political compromise between requirements of investment professionalism promoted by the PICs and of social policy concerns promoted by pension system architects. This causes tensions, because the picture rarely suits the reality. For one thing, most people working in the investment functions understand their role more as executives who enforce the scheme than as actors who try to influence the architecture based on their interests. Even when this is not the case, it must be noted that the investment functions do not have any common interest regarding the regulative framework. The last reforms have caused disappointments and divergence of opinions and interests within the field. A good indicator of this is the reform measures suggested personally by some interviewees. One measure suggested was to increase equity investments by increasing the significance of equity-linked buffer in the fund transfer rules regardless of whether it would have negative effects to competition. For others, this was not the solution but the problem in the first place. In their view, this characteristic should be rather abolished altogether in order to make PICs more dependent on others’ choices. Some argued that the solvency margins should be made more flexible by providing liquid longer-term borders, but others saw that the entire solvency rule approach should be abolished in order to
enable long-term investments. It is hard to see what the common interest of the investment functions could be when the views are this much divergent.

**Investment plans**

One of the main field-level mechanism generating boundaries for investments is the requirement of PICs to make their own boundaries within which to operate – in quite Foucauldian fashion of governmentality (see Dean, 2007), some might argue. The mandatory annual investment plans are required and regulated in content by law (especially TVYL 28 §). The intention of the plan procedure is to secure ‘the safety, yield, realisation, diversity and sufficient diversification of the investments’ (Hietaniemi and Ritola, 2007). The BoDs approve annually the investment plans that are also sent to the FIN-FSA for supervisory purposes. The plans must be updated regularly. The investment plan must be effectively available to all formal stakeholders and delivered to the president of SB and to auditors. The investment plans are long documents: dozens of pages with extensive appendices. The appendices for example include descriptions of the organisations, consisting for instance of somewhat detailed descriptions of investment teams (by asset classes), job descriptions and mandates, more general organisation structures, decision-making structures and processes, and principles and practices of disclosure and internal control. The plan also provides information for decision-making. For example, the head insurance mathematician of each PIC is required to give a written report to the BoD on the legal requirements on investments in respect to technical provisions, which must be also included in the BoD meeting protocols. In other words, the investment plan does not solely rely on
The investment plan must include various general themes: the general principles of alignment of investments, the target yields of investments in the short and long term, the general diversification targets, the principles of organising currency exchanges, the liquidity targets set to investments, the general security principles of investments, and the principles of using derivatives including the definition on what kinds of derivatives the company considers lowering investment risks. The BoDs must evaluate and review these principles and targets at least annually. The boards also need to address changes in conditions in which plans are executed. The conditions include the state and development of operational environments, the risks concerning changes in value, expected returns, and security of investments and currency flows, the return and liquidity of investments and currency flows required by the technical provisions, the ability to bear risk in short and long term, and the estimates on development on solvency position. These evaluations and conclusions arising from them must be included in the BoD minutes.

The investment plan is in institutional terms an artefact that embeds a great variety of regulative institutions, which cause much data processing and may even imply specific job descriptions within the investment organisation or norms concerning external relations. More generally, the requirement for the plan defines specific discursive institutions that must be internalised in order to make the plan. For example, the PIC BoDs are required to define, within broad legal frames, the risks involved in all individual investments and the cumulative limits for different kinds of
risks, both including the usage of derivatives and all direct and indirect currency exchange rate risks. Some of these discourses force the boards to understand very highly technical questions.

The guidelines for usage of derivatives are a good example here. The board must make a written decision on the principles of using derivatives, and to present all the goals of, rules limiting, and risks hedged with derivatives. Despite counterparty risks and defaults, the PIC is always legally considered the responsible subject for the outcomes of its actions when derivatives are used. The boards must annually provide FIN-FSA an evaluative report on the usage of derivatives and on its effects to the solvency border. This report must include information on all derivatives used to other purposes than immediate lowering of risk related to a specific investment vehicle, the fair value effects of derivatives to the annual profits by asset class, the derivative risk taken with hybrid instruments and structured investments and its effect to solvency border (unless the structured capital has no guarantee), and a report on the effectiveness of all derivatives. All the derivatives must be also classified according to their purposes.

Besides derivative policies, the investment plans must for instance include reports on all the external financial service providers used, which promotes general awareness of external service provider actions. In case of external service providers, the boards are required by the law to decide explicitly how much it decides upon investment-making and how much it delegates and to which different levels of the organisation, and they must ensure that they get written reports on delegated investments made, their role in and their effects to the total allocations. It could be argued that in this sense the
investment plan distantly resembles the Anglo-American ‘procedural delegation’ paradigm in mandating. Indeed, as long as the BoDs make their plans correctly and make the required decision on principles, they can eliminate much of the legal (financial) responsibility on their activities. The difference between this and the Anglo-American paradigm is that the investment plans make PIC activities transparent and accountable to all stakeholders, not only to beneficiaries.

**Direct restrictions and ceilings**

Like Anglo-American funds, PICs currently share few direct qualitative restrictions in investments, and discussing them is a brief encounter. Basically any asset can be used to cover technical provisions at least in a securitised form. However, the PICs have a few quantitative restrictions that differ from the Anglo-American context where there are primarily only ceilings for investments in parent companies (5% in UK pension plans and 10% in US DB plans). These quantitative regulations address the size of individual risk concentrations, counterparty risks, and geographical allocation of investments. The regulations can be divided to regulations controlling investments as such and investments in relation to liabilities. In the former, there are two important constraints meant to prevent too big stakes in individual companies and are in effect unless FIN-FSA approves exceptions. The first one forbids buying a majority equity stake in any company that is not related directly to TyEL provision, though all stakes in other PICs are forbidden. Only insurance companies, TyEL provision related entities, and real estate companies are excluded from this rule. The second one forbids PIC (including their subsidiaries) stakes exceeding 10 per cent of overall stocks, shares or partnership interests, or of the voting rights provided by them, in publicly
supervised credit or other specified financial institutions except in case of sales organisations that are responsible of selling the PIC’s insurances. This rule aims at preventing the centralisation of financial sector and more generally the centralisation of shareholder power to pension capital.

The second set of effective rules prevents centralisation of risk in relation to liabilities. At maximum 10 per cent of technical provisions can be used to investment in a real estate vehicle that is dependent on one property, and at maximum 5 per cent to any one entity in any investment class or vehicle type excluding EEA/OECD government issued or guaranteed bonds. The 5 per cent rule also applies to the whole class of debt instruments without collateral or guarantee, again excluding sovereign debt instruments. Counterparty risk is also controlled in relation to liabilities. The regulation relies here on the virtue of public control. At most 15 per cent of technical provisions may be covered in non-publicly traded securities excluding real estate investments and bonds or debts issued or guaranteed by public bodies. These limitations can be on FIN-FSA’s permission temporarily raised to 20 per cent if it does not danger diversification (whose limits can be defined by the FIN-FSA). Geographical constraints are significant as well. There is a limitation to non-euro denominated assets, whose goal has been to curb exchange rate risks (1114/2006). The maximum relative amount of investments not denominated in euros is 20 per cent of technical provision. Similarly, PICs can invest at maximum of 20 per cent of technical provisions to specific investment classes defined in classification rules (see below).
The solvency rules

Solvency is one the prime questions in the institutional life of PICs. It is an essential discourse in PIC annual reports. Some PICs even name entire sections in the reports with the title of solvency, and all PICs report the improvement of solvency position as the key goal and/or the key achievement of investment activities in 2009. Solvency is illustrated as an issue that needs to be managed even daily if necessary and weekly or monthly in any case. Solvency rules are important because they define the limits for the entire investment portfolio and, as they are based on fair value accounting, because they mark the boundaries to the market conditions. However, they are also important organisation-wise because they set boundaries for independent PIC operations: the companies can be externally controlled if their solvency drops below specified levels. Indeed, solvency rules are among the strongest regulations bounding PIC activities.

The solvency of PICs is defined in the regulatory framework in the following manner. PICs cover the technical provisions through their investments. The proportion of the investments that exceeds the technical provisions is the pension provider’s solvency margin, with which providers prepare for the risks included in the investment operations. Technical provisions have been calculated from contributions with an annual nominal discount rate of 3 per cent. This interest rate has been set low and it will be achieved in investments in most years. Due to the very low discount rate, investments would generate large surpluses unless additional measures were taken. Since the beginning of 2007, the overall fund transfer obligations of each provider have been defined besides the nominal discount rate by a weighted average of the
average solvency and realised equity returns for all pension providers in order to increase funding of old-age pensions. The value of the collective equity linked buffer fund can be positive or negative, at most five per cent and at minimum minus ten per cent of technical provisions. Thus technical provisions are either increased or reduced on the basis of the realised share returns of all pension providers.

The solvency margin is compared with the so-called solvency border that depends on the pension provider’s investment allocation (see below). The border is dimensioned so that the probability of the pension provider being unable to cover its liabilities within a year is extremely low. Regardless of the pension provider’s investment allocation, the minimum level of the solvency border is 5 per cent of technical provisions. In case of PICs, the so-called normal zone holds when the solvency margin is more than but under four times the solvency border. In the normal zone, the distribution of client bonuses is based on the regular formulae. Permanent exceeding of the upper limit of the zone is not permitted, which suggests PICs cannot hoard capital but they must pay client bonuses. If the solvency margin exceeds the maximum amount for a second year in a row, the company has to increase its client bonus transfers by one third of the sum exceeding the maximum amount. If the solvency margin falls below the solvency border, a company cannot pay client bonuses at all. If the solvency margin is less than two-thirds of the solvency border, the company has to file a plan to improve its financial position, and if the solvency margin falls below one-third the company has to file a short-term financing plan with the FIN-FSA. It in practice drives the company under direct FIN-FSA control.
The PICs have a hostile relationship to the solvency rules, as they set the companies into a relationship that can be called, as two interviewees put it, ‘game theoretical’. Since the amount of capital reserves of PICs is dependent on the solvency of other companies, it is impossible for a PIC to formulate independent long-term solvency strategies in investment portfolios. In other words, all the PICs must include others’ actions into considerations – especially equity investments, thanks to the fund transfer obligation design – which significantly curbs the possibilities for radically different investment strategies especially in terms of basic allocations even though strategy diversification is one of the key justifications for decentralization today.

At the time of writing this report, the solvency rules became even more problematic. In 2008, the government introduced a temporary two-year exception law that changed the solvency rules. The government bill (HE 180/2008) was supposed to prevent fire sales of shares. This was directed especially at Finnish ones, as it is stated in the bill, bringing a nationalist but unrealistic flavour to the decision because, according to one informant, the liquid assets that could in fact be sold and whose fire sales were thus prevented were European large stocks, not Finnish. One key argument behind the reform was to maintain solvency. Retrospectively it is easy to say that this argument was not perhaps as credible as it was at the time. Varma for instance reports that its solvency would have been well adequate even without the law. The overall reserve capital of Varma would have been 19.9 per cent of technical provisions in 2009, 2.2 times the solvency border. In absolute terms, the amount of reserve capital would have been more than three times the minimum requirement in that case. Also Eläke-Veritas reports that its reserve capital would have been an adequate 16.4 per cent without the law (with the law it was 21.3 per cent, three times the solvency border).
The bill introduced various changes to the regulatory environment. It directly raised the stock return buffer to 10 per cent of the fund transfer obligation in contrast to original gradual change model, where the component would have reached the level years later. The fund liabilities were also increased only by the nominal 3 per cent rate independent of solvency ratios or investment performance. Effectively, due to negative stock returns, this meant that capital was transferred from the funds to reserves in accounting. At the same time, however, the bill made it possible for PICs to include the so-called EMU-buffer temporarily in the solvency margin. The EMU buffer refers to *tasausvastuu*, a short-term buffer that hedges against changes in pension contributions and which is accounted to the PAYG component, not the funded one. Joining the European Monetary Union was expected to raise the short and middle term volatility in total wage sum and, consequently, the pension contribution rates in Finland. This possibility was hedged against with the EMU buffer.

The problem is that the temporary law, which was continued by two more years until the end of 2012 (Rantanen, 2009), set another variable to the game-theoretical mutual relationship. PICs now had not only to anticipate the solvency development and equity investments of other PICs but also whether they should (and whether others do) include the EMU buffer to capital reserves or not in their strategy. This is important because the success of the choice now is equally much determined by the new regulations as they are by market developments. If the buffer is included in capital reserves, it means a PIC can opt for a riskier strategy, and if not, then for a lower-risk portfolio. If the future rules include the buffer, the PICs that have not followed the riskier path will have missed the market opportunities. If the rules are
strictly, the ones that have adopted a riskier strategy are prone to radically readjust the portfolios whatever the market conditions at that time. In this sense, the solvency rules work in great part against the idea of independent decision-making in investments.

**Investment classification and diversification rules**

The calculation of the solvency border of each pension provider is based on certain investment classifications. The law defining asset classifications (1114/2006) also includes a general guideline for diversification policies, which are expected to address the security, rate of return, convertibility into money and general qualitative ‘diverseness’ of investments. The classifications are important frameworks for investments in at least two respects: they tie investment allocations to solvency control and serve as the primary method of internalising risks in portfolio design to the funding mechanism. The direct legal restrictions on investments are in principle based on the legal classifications but only in principle, because the PICs must also prudentially classify all investments according to the actual risks of the vehicles.

The law suggests the PICs to follow the classification rules unless the financial risk of instruments differs from the legal framework, and typically, according to many interviewees, PICs tend to take the legal classifications as granted ‘until exceptions arise’. These kinds of legal frames must be acknowledged and all actions must be reflected through them whatever the real risks were and however they were in fact classified. The discursive aspects of the classification are important as they define the lines of conventionality for understanding when the ‘real risk’ is too far from a legal
category to be put under it. These kinds of boundary issues are most visible in the reporting rules that require the PICs to report their solvency border based on both their own classifications and legal classifications, and the total amount of assets (in real value) that are transferred from legal class-based typologies to other classes.

The classifications defined by the law address the financial risks related to different asset classes. The investments are divided groups on the basis of investment type (debt certificate, bond, share etc.), currency (euros vs. others) and geographical area (OECD and EEA vs. other countries.). There are indicators describing expected returns, return dispersion as well as correlations for all these groups. Investments are legally divided into five asset classes: money market instruments, bonds and debt certificates, real estate, shares, and other investments. Each class is further divided into categories, where currency and the location of the investment are of great importance (see Table 6.3). All derivatives must also be included in the classes that they match best in correspondence to the underlying security type and in risk characteristics. The level of the solvency border is affected by each category’s expected return, deviation and return correlations. The border is calculated from technical provisions with a multiplier \( p \) that is based on a complex mathematical formula (see 1114/2006) that is interestingly written explicitly in the law, not in the FIN-FSA guidelines as many other formulae. In many respects the legal rules are generating very firm geographies and financial assumptions. For example on the former, the OECD/EEA investments are in general less risky than other investments – even in cases where the underlying entities are OECD-based wherever their economic activities may locate. As for the latter, the equity premium is for example considered
quite high even in context of highest of the suggested textbook equity premiums (see Fernandez, 2009).

<table>
<thead>
<tr>
<th>Investment Class</th>
<th>Class Categories</th>
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<th>Deviation</th>
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<td></td>
<td>EEA/OECD insurance company or credit institution bonds, in EUR</td>
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<td></td>
<td>EEA/OECD other private bonds, in EUR</td>
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<td>2,5</td>
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<tr>
<td></td>
<td>other bonds, in EUR</td>
<td>3,5</td>
<td>3,0</td>
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<tr>
<td>Bonds and Debt Certificates (maturity &gt; 1 yr)</td>
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<td>other bonds, in EUR</td>
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<tr>
<td></td>
<td>other EEA/OECD properties</td>
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<td>other properties</td>
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<td>other investments</td>
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</table>

Table 6.3. Investment classification according to the law (1114/2006).

The classification rules are further enforced by the requirement of PICs to have their own board-approved principles for classification, and all decisions on these principles must be made in written form. The board must supervise the usage of classification principles and classification practices constantly, and report them annually. The
classes in PIC classification policies must be detailed enough so that all investments can be classified, and all vehicle types belonging to the category must be explained. This applies to all kinds of indirect and structured vehicles like mutual and hedge funds as well. The policies must include explanations for all classes and for why some group is considered homogeneous. The classes refer to asset classes in quite conventional sense but as the FIN-FSA guidelines point out, they can also be based even on individual investment vehicle types (e.g. certain kinds of hedge funds). The classifications reported in fact are not as detailed, however. For example Varma reports to divide its assets according to real risk only to four classes – fixed income, equity, real estate and other investments including hedge funds and commodities. This is, of course, not to say that subcategories would not exist outside the public disclosure. The PICs nevertheless provide little information on how the weight in different categories has changed. Eläke-Veritas is somewhat an exception here. The relative amount of assets classified to five categories it uses is reported annually, including a comparison to the previous year.

The ability to classify investments according to real risks has been very beneficial especially for those PICs that have invested heavily in hedge funds. The classification according to real risks has lowered the solvency border of Varma by 169 MEur according to its annual report – that is, approximately one per cent lower than the legal classification would suggest – for this reason. Some interviewees had observed that the classification issues are not usually considered but rather passively until any potential shortage of capital emerges. Although radical differences between the classification methods and methodologies have not yet emerged, it is probable that the differences in investment classification between the PICs evolve and grow over time.
especially because some PICs have found active classification measures very beneficial. One curiosity that is likely to emerge from this divergence is the redrawing of the ‘geographies of risk’ effectively present in the legal classifications. For example, the legal classifications suggest that proximity increases the quantitative control over investment risks. The fixed income instruments not denominated in euros are all included in a category where volatility is defined by a blunt 4.5 per cent. Since this category hardly applies to all currency areas (compare e.g. US government bonds with East Asian high yield corporate bonds), it is clear that the boundaries of this category can be fairly easily spread, the category divided, or assets simply moved to other categories.

**Publicity, social responsibility, and boundary control**

Besides frames for activities within the field, organisation field boundaries are demarcation lines that make a specific field of activity separate and distinct from other fields. The regulative mechanisms discussed above are serving both functions, since they are both mandatory for all and PIC-specific in content. There are, however, other boundaries that distinct the PIC activities from other domains of life. Some boundaries can be traced to the pressing public interest in their activities. The most important forum for public debate on the field issues is newspaper and magazines albeit Finns think the most reliable sources of information on pensions-related issues are the expert sources of KELA and ETK, and the television (TELA, 2007). The field insiders have a strong understanding that the self-understanding of the TyEL field needs to be renewed in the media because the public ideas tend to be ‘wrong’. This theme was brought up especially forcefully in one informant’s presentation: the PIC
actions will raise public interest and, most of the time, the comments the directors will hear will be based on false knowledge or assumptions about the system (a well-illustrating comment from a regular newspaper letters section commentator was provided).

The TEL/TyEL investments have been extensively discussed in public in newspaper articles, editorials and letters of all major Finnish newspapers for almost half a century now. For example, a search in the internet-based archive of the main national newspaper, *Helsingin Sanomat*, which included two keywords in Finnish (*eläkeyhtiö* and *sijoitus*, the everyday abbreviations of ‘PIC’ and ‘investment’, respectively), returned 475 articles in which both terms were mentioned only in the time period from 1990 to late October 2009. Only the few latest investment-related discussions at that time included a great variety of issues like critique on solvency rule-setting processes (27 October 2009), speculation whether real estate investments will diminish in PIC portfolios (24 October), reports on good investment performance (24 October), discussion on improving expectations on economic development and consequent increase in PIC equity allocations (16 October), report on improving investment returns (21 August), and debates on the possible ban of hedge fund and other investments considered too risky (21 August).

There have been some recent civil society discussion and contestation as well. FinnWatch, a Finnish corporate watchdog, published a report (Simola, Pykälä and Mäkelä, 2010) that contested the investments in a few classes and securities. The report contested the entire classes of tax haven and offshore financial centre based funds and of investments in undemocratic countries, arguing that channelling
democratically decided nationally mandatory pension savings to funds with special
tax status or to undemocratic countries is unethical. Investments in weapons, alcohol,
tobacco and gambling industries and companies with connections to manufacturing of
nuclear weapons were also questioned. Some PICs also responded to the criticism at
the FinnWatch website (FinnWatch, 2010).

The law controls many aspects of PIC disclosure. The PIC annual reports, financial
statements and the detailed appendix information of the statements give a very
thorough picture of PIC activities. Investments, on the other hand, also belong to the
domain of business secrecy. While nearly all individual investment targets and their
mark-to-market value are disclosed in name, any detailed information like security or
fund characteristics and derivative contracts, and selection or pricing practices are
hardly ever presented in the financial statement appendices but belong quite firmly to
the domain of business secrecy. When such information is given, it comes through
controlled channels. Only statistics created and research conducted by ETK, FIN-FSA
and Bank of Finland are somewhat automatically granted exception of the rules,
whilst all other inquiries to investments must be approved by STM and the PICs in
question. TELA has a special status concerning the knowledge on investments. It
generates long-term statistics (based on legally approved information) and provides
quarterly insights on investments and their performance directly based on their
members’ views.

In organisation fields, some actors tend to have a special role in mediating
information and making assumptions about the environment external to the field
within the field. In this respect TELA is perhaps the single most important ‘boundary
controller’ in the field of PIC investments. Its triennial *Työeläkeasenteet* study, literally translated as ‘earnings-related pension attitudes’ study, is among the most rigorous devices for knowledge production about the relationship between the field and broader societal environment. The study is made in cooperation with TELA and the TNS Finnish branch (*TNS Gallup*) and it is based on approximately 1000 interviews. The study polls various opinions and expectations, for example estimates and desires for future pension benefits, appropriate retirement age, the legitimacy of the system, and possibility to keep up the current benefit levels.

The poll includes some investment-related themes. For example, one question asks whether employees should be able to choose a part of investments and bear these risks individually. Although 57 per cent of interviewees think that it is right that employees select a part of the investment target, which also defines a part of the benefits, roughly only one fourth of the interviewees are actually interested in using this possibility. One third in addition accepts but is not interested in it. The most direct normative question related to PIC investments is one that states: “I trust that pension providers who control earnings-related pension funds invest earnings-related pension capital securely and well”. Finns are quite confident that pension providers have at least this far done a good job: 20 per cent of the population strongly agree, 45 per cent somewhat agree, 25 per cent somewhat disagree, and only 7 strongly disagree with the claim. There is, however, some variation between different population groups in scepticism. In terms of gender, women (38 % disagree with the claim) are more sceptical than men (27 %). In terms of political affiliations, the Left Alliance and Green Party supporters (both 39 %) are more sceptical than the three main party supporters (24–32 %). Geographically, the habitants of Northern Finland (40 %) and
Uusimaa, the province around Helsinki capital area (37 %), are more sceptical than others. Perhaps most importantly, the entrepreneurs and the self-employed (42 %) are much more sceptical than other employment groups, and pensioners, students, and the unemployed (46 %) are more sceptical than any of those within the workforce. This in part may help to understand why the question of should there be more investments allocated to real investments to improve Finnish entrepreneurship and employment is a typical political question related to PIC investments outside the Helsinki capital area.

Perhaps the most important single issue in boundary control of the TyEL field altogether is the question of normatively appropriate investment targets. When the solvency rule reform of 2007 was drafted, the social and health committee of the Finnish parliament included in its official statement that TyEL funds must be invested in socially responsible manners to socially responsible targets. However, as one interviewee put it, TELA is the one that ‘keeps the social responsibility issues on agenda’. Indeed, TELA provides direct normative demarcations in respect to proper investment activities emerging from the field and controls these boundaries. It expects its members to adopt certain codes and guidelines that are specific to them and distinguish Finnish pension investors from other fields. TELA has guidelines for responsible investment (RI) and active ownership (AO) that are both publicly available. The RI guidelines (TELA, 2008) were originally drafted in 2006 and reformed in the beginning of 2008. The additions made concern the incorporation of UN Principles for Responsible Investment and some updates to the contextualisation – in essence that Finnish funds have diversified investments mostly outside Finland in recent years and will continue to do so at a greater pace. According to the RI
guidelines, the AO guidelines (TELA, 2006) of 2006 are not overruled by the newer RI guidelines. The RI guidelines were available online in late 2009 both in English and in Finnish, but the OA guidelines in Finnish only.

The RI guidelines are important mechanisms for boundary control in a few ways. Most importantly, they seek legitimacy for the field activities from macro-level institutional frameworks that go beyond immediate shareholders or stakeholders, define avenues through which responsibility of investment practices might be evaluated and how it should be interpreted inside the field, and most importantly introduce direct normative boundaries. The macro-level frameworks that the guidelines recommend all Finnish pension funds to adopt include United Nations Principles of Responsible Investment (PRI) and the UN Global Compact. The guidelines highlight the importance of pension system and Finnish parliament’s emphasis on RI issues during the 2006 reforms in defining pension PIC responsibilities. The guidelines enforce a certain hierarchy for responsibilities. The hierarchy is set by legislation demanding for profitability and security, and it ought to be enforced as responsible investments: “investors of pension assets must place the primary focus on expected returns and security in all investment decisions”. Furthermore, the “costs of responsible investment must be reasonable in relation to other investment costs incurred by the pension insurer”.

Although the duty of setting responsibilities is of each provider, the guidelines expect transparent consistency in RI. While “each pension insurer can define principles covering its investment operations, it is also important to specify how the principles will be applied when selecting investments, during ownership and when divesting”.

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The guidelines provide many schema through which different impacts can be created and RI executed, including negative screening (i.e. to leave some investment vehicles considered irresponsible outside portfolios), indexing (i.e. investing passively in indices that leave some specified stocks outside the portfolio) and various corporate engagement strategies. They provide a discursive division between investment and divestment strategies, and provide categories on conducting RI in different stages of investment processes. They also suggest that different investment vehicles enable different mechanisms of influence. For example, “rising investments in indirect instruments, e.g. hedge funds, are posing a challenge in terms of responsibility, since investments in such instruments are less transparent, and offer fewer possibilities for owner influence, than direct investments”. The guidelines put much weight on individual funds’ own capabilities to evaluate the responsibility of their activities.

One very clear normative boundary for investments is that pension assets “must not be investment in illegal activities, or activities that are either directly or indirectly in conflict with international agreements on human rights and basic freedoms”. Furthermore, the “transparency of an investment target’s operations and a sound understanding of investment instruments are important prerequisites for ensuring that the principles approved by the pension insurer can be taken into account in practice”. In other words, investment vehicles implying an engagement in illegal or inhuman activities, or are not transparent, should not belong to the domain of PIC activities. The guidelines also provide some related discursive legitimatisation on RI by suggesting that the environmental, social and governance considerations in investment and ownership activities related to these principles affect financial performance, and that “there is no evidence to indicate that responsible investment reduces returns”.

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The active ownership (AO) guidelines provide more detailed discursive frameworks for ownership activities. The point of departure is that ownership of listed companies is usually widely dispersed, which makes their governance systems important for investors. PICs are investors that have a special ability to focus on these issues and they are expected to do it. The guidelines explicitly aim at providing a categorisation of issues that ought to be taken into account in individual funds’ ownership policy considerations. The guidelines introduce some understanding about the environment in which PICs operate. For example, the guidelines promote pension investors to note the Finnish legal and self-regulatory (e.g. the stock exchange) foundations in defining investee firms’ good governance, and highlight the need to pay careful attention to transparency, activism and incentive systems of investee firms. The transparency concerns are not too detailed, as it is only briefly noted that pension funds ought to pay attention to communication methods of their investee firms. The same applies to incentive systems.

However, the guidelines explicitly introduce one related normative boundary: it is only exceptional performance that should be rewarded with significant bonuses. There are other explicit expectations in the AO guidelines. For example, they enforce the priority hierarchy set in RI guidelines by demanding for maximum long-term profits within the defined risk frames. But the AO guidelines take a step further from these concerns. They provide an expectation for Finnish pension funds to invest in domestic companies (on the basis of parameters of PAYG system performance) with active and long-term engagements.
Although the guidelines provide a clear boundary demarcation from other fields, they are in many respects quite conventional in terms of avenues of ownership influence. AO guidelines set six thematic areas of investee firm properties in which member funds are expected to pay attention: proxy voting, the participation in shareholder meetings, the participation in board nomination processes (before the shareholder meetings), the composition of investee firm boards, the rewarding systems, and the capital structures. Proxy voting is defined as the most important and effective ownership activity, albeit contrasted with the need to constantly communicate with other shareholder groups and investee firm boards and executives.

The guidelines are very explicit in defining board nominations as the primary means to promote shareholder value. The main criteria for board member selection should be expertise, experience and sufficient time for the task, and it is recommended the investee firms to use nomination boards in nomination processes. The question of whether it is consistent to have own shareholder representatives in the investee firm boards should be always carefully evaluated. Another similar process that is addressed in AO guidelines is the selection of auditors. The suggestion to demand information from investee firms is also directly linked to the means of affecting investee firms. The guidelines recommend pension funds to demand investee firms to give necessary information (on e.g. unusual proposals, proposals concerning rewarding systems and proposals on board nominations) about shareholder meetings to all investors well in time, and to provide all relevant governance structures, mandates and rewarding practices in their annual reports and among other communication media.
There are also direct instructions supplementing some of these aspects in the guidelines. The first one is the design of incentive systems. The rewarding and compensation systems ought to be designed so that they steer executive interests in line with shareholder interests in the long term. Exceptional rewards should be given only when management performance is exceptional. The second is related to dividends and repurchases of shares. Pension funds should demand for clear dividend policies serving shareholder targets and that repurchases ought to be reported in annual reports and public websites. Interestingly, the guidelines mention that shareholders increasingly demand share repurchases and that pension funds ought to pay close attention to decisions affecting capital structures, but not for what exact purposes. These two features do not explicitly include the norm towards which the means should be used or the specific rationales why these issues are important instead of others, but merely rely on strong background assumptions: that all long term shareholder interests really can be served with financial incentives and that general dividend and repurchase policies can serve some specific interests.

* * *

This chapter has shown that the field-level formal institutional architecture in and through which the Finnish pension insurance companies operate is quite impossible to understand with the classification of pension systems through pillars and tiers. While the pension benefits and ‘operational guarantees’ indeed belong to the national first pillar, the governance of the field is based on paritarian and collective decision-
making more familiar to second pillar systems, and the assets to the competition-prized and internally managed arrangements familiar to the third pillar schemes. Moreover, there are a few almost fundamental field-level issues that need to be recognised in order to grasp any understanding on proficiency of PIC investment activities. These issues include the organisational nature of PICs as agents, the somewhat antagonistic and confused mutual relationships between the PICs, the main regulatory mechanisms controlling investment activities, most importantly solvency rules and certain allocation ceilings, the relationships between PICs and other actors that enable PIC activities in the field, and the strong norms that prevail in the society and that are transmitted and formalised to the field through various institutional forms. Moreover, although these issues are salient at the field-level, they are also likely to influence PIC activities in various levels and, as we will see in the next section, it is indeed very difficult to cross the boundaries of the field at any level of activities.

The chapter has also shown that the organisation field of PICs is quite different from the fields of Anglo-American PFC. For example, PICs are insurance companies and controlled as such with solvency requirements, which is all but similar with the fiduciary duty bound and trust-based Anglo-American funds. Finnish PICs also compete on clients and internal managers unlike Anglo-American trustees whose beneficiaries are already defined but they can opt for many kinds of external services and internal organisational solutions. However, it must be noted on basis of this and Chapter 4 that it is not only the contents of the field frames and boundaries but also the politics or the social significance of the field architecture that differs in the Finnish and the Anglo-American environments. The utmost importance given to solvency and
other ‘boundary conditions’, as they are called almost without exceptions in all the Finnish literature, is something very typical to the politics of PFC in Finland despite the evident lack of political accountability in the politics over these ‘conditions’. It could be even argued that the PICs are actually less prone to normative contestation than Anglo-American trust funds, because the ability to change the field architecture is always a feasible political option unlike the contestation of fiduciary duty altogether.

Moving towards addressing the questions of finding the proficient investments as information processing, calculation, and exchange in the next chapter, it is worth summarising the lessons from this chapter to two issues, which are difficult to avoid at least in designing PIC investment schema. Firstly, the field-level architecture dictates that PICs are in great part independent investors, but whose highest authorities are necessarily the pension system stakeholders, and the requirement for public legitimacy high. These stakeholders are likely to have relevance in PIC operations, while the great public interest in PIC investments is very likely to affect if not every investment decision at least discourses they are able to use in their public communication, which is in part also enhanced by self-regulatory pressures concerning responsibility criteria and ownership policies from TELA and by competitive pressures. Secondly, the investment activities are firmly bounded to short-term activities and close control. Solvency requirements change constantly, which requires much liquidity and thus leaves only limited room for long-term strategic investments. Investment choices are also dependent on other PICs’ actions regarding equity investments and solvency developments. Financial sector investments and investments in a few other classes mentioned above must remain
modest, and a PIC cannot become the majority owner of any company. These two issues suggest that despite their large responsibilities and liberties in investment choices, PICs may sometimes be powerless over the frames within which they operate.
7. The Institutional Life of Pension Insurance Company Investments

Whilst the previous chapter was about the institutional forms in which PICs are more or less necessarily set, this chapter is about seeing what kinds of dispositions these forms generate and what other ways of acting become shared and taken for granted in the investment processes of PICs. As it has been strongly highlighted in the previous chapters, we must first study the action processes of investment making in individual PICs in order to find dispositions in the organisation field-level. For reasons of research ethics discussed in Chapter 5, the action process is described here as an ideal type that can have organisation-specific solutions in different stages of the process. Although hardly a universally valid method, the approach suits the field in question well, as many stages of the processes like the annual PIC investment plans are already written in the field architecture. The ideal type is based on two embedded sub-case study interviews and publicly available data, which may put more weight on some issues and less on others than descriptions based on studying all the PICs individually would. This is important to note more for methodological than for theoretical reasons – after all, as the institutional approach here suggests, it is the dispositions adopted in, not the action processes of individual organisations that explain actions at the field level. Nonetheless, the description in the first section of the chapter should not be used in further studies on Finnish PIC investments without critically evaluating how important each stage of the field-level ideal type might be in individual companies.
It is argued in the first section of this chapter that PICs share similar organisational arrangements generating action processes for investment making but not completely isomorphic ones, which suggests that there are indeed different alternative solutions in the ideal type. The common features are nevertheless strong, and provide quite few strongly divergent solutions in making investment choices in terms of exchange, calculation and information processing. On the other hand, there are a few differences between the PICs in investment dispositions, as it will be argued in the second section. At the field level, these differences can be analysed as variations of dispositions in shared thematic areas of investor-identities, asset classifications (in terms of both securities and markets), security selection or ‘stock-picking’ within these classes, ownership practices, and social responsibility considerations. These areas are the topic of the latter section of this chapter. Besides these themes there was one important thematic area that was continuously brought up by the interviewees: the financial crisis of 2007–08. Since the crisis questioned the proficiency of some of the dispositions otherwise present in the interviews, the issue will be discussed separately at the end of the section.

### 7.1. PIC Investments as Action Processes

It is difficult to provide a clear institutional starting point for PIC investment action process, as it would be more or less arbitrary in respect to the overall process – investments are made as the pension contributions flow into PIC accounts. In terms of calculation and exchange, however, the most feasible possibility is to anchor the
analysis institutionally to the investment plans. The plans set the basic allocations between asset classes and the strategies used in investment-making processes more generally. As noted in the previous chapter, there are institutions that condition this starting point and generate dynamism to previous investment choices in the field. Most importantly, the fund transfer obligation defines how much is needed in terms of asset value to cover the technical provisions that year, and solvency rules at a more general level define the floor and the ceiling for the sheer amount of investments in relation to risk. The investment plan drafting process also reaches long to the previous year. The first preparatory drafts may be created as early as the preceding summer, and the BoDs may discuss it already in early autumn. The plans are revised and final versions drafted in cooperation with the BoD and the investment functions at the end of the year. The role of the board depends much on situation and issues at hand. For example in 2008-09, the boards were due to financial crisis very active in the revision process.

Anchoring analysis to the investment plans sets actions into a certain chronology where the process starts from executing the plan to drafting and revising a new one based on experiences of the old one. Heuristically, the PIC investment functions are responsible for executing the plan, that is, for conducting all investment actions based on the firm but adjustable mandates set by the plans. The boards are in their everyday life more focussed on supervising the activities, confirming larger bets, and readjusting the mandates than on making any investment decisions in terms of exchange as such. Understanding the organisation of the investment function is thus essential for understanding the action processes of investment making. The investment action processes are in this sense much about generating more or less
independent mandates for the overall function, its teams, and individual portfolio
managers whose beliefs, trading schema and other dispositions are essential in giving
the form for the field-level institutional life. On the other hand, the decisions over the
mandates, decision-making within and between teams, and the control of overall
activities are essential in characterising the limitations, dynamisms and capabilities
that these mandates can bear. The narrative of this section is divided in these two
themes.

It must be first noted that the PIC investment decision-making is institutionally quite
different from both the single-tier Anglo-American pension funds and the Dutch two-
tier fund (i.e. expert executive board and representational supervisory board). From
the perspective of investment decisions, it could be argued that PICs actually have a
three-tier governance model. The model is based not only on the BoD (approving the
investment plan and making strategic decisions) and the SBs (overseeing the board
operations), but also on the tier of internal investment function. Furthermore, the
investment function is very much multi-layered. The Chief Executive Officer (CEO)
and the Chief Investment Officer (CIO) have an essential role as direct expert brokers
between the BoDs and the investment function. The investment decisions are also
supervised more formally by investment committees (see below) and less formally by
‘investment issues groups’ typically consisting of CEO, CIO and other managing
investment directors, who gather especially when longer term strategic allocations
prove inflexible or unfeasible for market conditions. In this sense, the PIC investment
decision-making has at least five, six or more relevant layers already within the
company. This is why for example the effectiveness of board leadership can be much
less important an issue than CIO or investment team leadership or, more generally,
the institutionalisation of different avenues of control in activities than in Anglo-American funds.

It must be also noted that in all sources of data used in this study there were references to the understanding of investments being in the hands of ‘true professionals’ who are ‘top-notch’ in all skills and capabilities, as one interviewee put it. This was rarely only a description but also a praised norm: these kinds of professionals should decide upon investments, and the boards should only give them the strategic frames. The role of the boards is to provide legitimacy to activities primarily in other terms than investment expertise. A good example of the issue of legitimacy is that although the labour market parties have the mandate to nominate one half of the BoDs, they might have even more weighed key stakeholder representation in the boards. For example one PIC has for some time had social partner ‘favourites’ forming two thirds of the board and only one third coming from the ‘group of important clients’.

This is, of course, not to say that the investments skills of boards would not be relevant. The PICs organise internal education on investments to the boards, themes ranging from macro-level market developments and regulatory changes to more specific education on responsible investments. In this sense, there are processes aiming at combining investment expertise to the business and other skills of the boards. The representativeness at the board level also brings legitimacy for investments, as there are no stakeholder consultative groups that would provide legitimacy for and improve information flows concerning PIC activities in this domain. Such groups exist in most other areas of activity.
Investment functions and teams

The investment function of PICs is typically divided to different lines, for example: to securities, other investments, and investment administration as reported by Ilmarinen. However, the lines are not necessarily that essential as actors as such in investment making. The existence of lines can only refer to an existence of an intermediate director between investment teams and the CIO. Having more steps in the hierarchy is typical only in larger companies, and talking about investment lines is fruitful only in that context. In contrast, it is the investment teams that have most to do with everyday information processing and exchange of financial products in all PICs. The division of teams is somewhat company-specific, but the typical division of teams is based on asset classes – typically equity (or ‘capital markets’), fixed income, hedge funds (or ‘alternative assets’ including them), real estate, private equity, and credit (i.e. direct lending) or ‘client finance’.

The teams consist of portfolio managers and analysts. Individual managers are responsible for bearing primary investment risks in terms of asset selection and sufficient analysis at minimum. The directors of the teams are especially in smaller companies also portfolio managers in their team, so they are not exclusively “organisational managers” but portfolio managers responsible of both their own and the teams overall performances as well. The independence of investment teams is based on risk budget type mandates complemented with direct risk-related restrictions, for example individual bet volume ceilings (or other guidelines to individual bets or trading) or variable tactical allocation frames whose usage can be
agreed with the team/line director and the CIO. The team directors ensure that limits are followed and that individual portfolio managers more generally follow their own tasks and mandates.

The division of labour within and the composition of teams vary in PICs, and the number of staff in the teams is much dependent on the size of the company. Especially in smaller PICs, dedicated overall teams for each asset class do not quite exist, but have only two or three managers dedicated to specific assets with shared organisational resources. For example, private equity does not necessarily belong to an investment team at all but may be managed by a portfolio manager whose analysis functions are shared between capital market (e.g. trading) and credit (e.g. analysis, consultation) teams. As for another example, there may be an alternative assets team whose portfolio managers and analysts invest in various classes (typically including hedge funds), but which may use the equity team for fund analysis.

The bigger companies can use more sophistication in designing dedicated functions so that teams have both vertical and horizontal functions in the line structure. For example, whereas bigger companies may use dedicated, vertically multi-level tactical allocation teams, smaller companies usually have few alternatives than to allocate such tasks as horizontal functions to team directors. Most directors or managers in any case may have horizontal functions independent of company size. For example, a hedge fund manager may also be a strategist, ‘a court consultant’ for the directors, or have duties belonging more to the middle office than front office functions.
The composition of teams is also much defined by their approach to investment making. For example an equity team can consist of portfolio managers whose operational areas are divided by sector (e.g. finance, heavy industry), markets (e.g. Finland, US, European, Nordic) or/and vehicle types (e.g. direct listed equity, equity funds, sometimes private equity funds), and who may use external analyst services or be complemented with internal team analysts. Similarly, a bond team may consist of money market, low-risk, investment grade, and high-yield managers in different number depending of what instruments are strategically preferred. The fixed income team managers’ duties may also include tasks like currency risk hedging, duration position management, or fund exploration. Fixed income managers typically have complementary expertise on macro issues, duration positions, or more micro-level issues like different bond types (e.g. triple-ABS, investment grade, high yield, structured) that are not written in the formal division of labour.

Making investments is very much about portfolio managers and analysts sitting in front of a few flat screen monitors and making trades, following services like Bloomberg, keeping their eye on events like OPEC communications or ECB forecasts, watching flickering security prices in the screens, listening to latest market news, consulting external service providers, answering and using the phone all the time (e.g. to contact or to be contacted by back office functions), opening, processing and closing Excel spreadsheets, and trying to cope with ridiculous amounts of information in equally ridiculous numbers of email, as one interviewee put it. The portfolio managers may sit at a desk with other teams and own team analysts, or work in separate offices albeit this happens rarely outside direct lending and real estate
teams. This is important as the individual asset class portfolio is typically based on individual decisions made via informal team-wide communication, where individual managers seek for confirmation and approval from other team members. In the desk setting, communication happens in real-time whereas in the office setting it is more about *ex post facto* confirmation. Either way, the teams have formal meetings or more informal ‘brainstorming sessions’ in a separate room for example weekly or biweekly (depending on asset class and the theme of each meeting) in order to summarise the week’s events, think about tactics and strategy, and to take care of administrative duties. Inter-team meetings are typically based on periodical needs, for example on allocation strategy evaluations.

The front office teams typically have few hierarchical elements in their structure albeit they may have vertical functions in the larger companies. As result, the more informal intra-team and inter-team horizontal issues are somewhat essential in characterising investment action processes instead of vertical chains of decision-making at the team level. Yet the informal division of labour within teams includes so much variation team and PIC-wise that it is impossible to have an ideal type picture of it at the field level. Moreover, there are typically many ‘institutional brokers’ connecting different teams that are not necessarily immediately visible for any outside observer. For example, all portfolio managers are likely to have if not completely different at least only partly parallel areas of expertise, but only some managers also have capabilities to stand in to other duties if needed (e.g. due to holiday season). Some portfolio managers may for example have more expertise and responsibilities in

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37 Even in cases where the bond and the lending teams are physically and culturally distant from each other, they typically share much expertise and information in informal communication. The lending team may for instance confirm spot market prices from fixed income managers.
selecting funds and some in executing direct investments, while some managers may have extensive duties in both areas. These issues suggest it is difficult to say anything conclusive at the field level on what kinds of action processes teams have internally. This question should be addressed primarily at the individual organisation level in further studies.

One such issue can be nevertheless recognised. The size of the teams is essential in defining the ability to be involved in active management. In smaller companies, the overall investment function (including teams and administrative personnel) can consist of some 30 people, front office teams having only two or three portfolio managers each, whereas in large the number can be significantly larger depending on who is included in calculations. Some asset classes require much more resources than others in conditions of mandatory internal management. For example real estate is demanding as an asset class because of the great variety of variables like rent contracts, material conditions and other issues that are laborious and difficult to evaluate. A real estate team can require besides the team director at minimum a portfolio manager that serves as the nexus to the broader investment function, an assistant taking care of trading and other laborious tasks, a lawyer, a financial manager taking care of reporting and paying taxes among other things, and building managers that have the necessary skills to be closely involved in projects in order to function proficiently as an investment team. Similarly, complex products like structured bonds may cause the need for more resources in the back office functions.

Allocation to and through funds is an important question for team directors as the

38 It must be noted that the overall number of staff in all PICs is quite large albeit variable according to the PIC size. For example the largest PIC Varma had over 600 employees in the end of year 2009, and the second smallest PIC Eläke-Veritas only about 130.
resources to explore funds are limited especially in smaller companies. Funds are important mostly in asset classes that are costly to manage internally like high yield bonds, private equity, and equity listed outside Europe.

<table>
<thead>
<tr>
<th>Varma</th>
<th>Ilmarinen</th>
<th>Eläke-Tapiola</th>
<th>Eläke-Fennia</th>
<th>Etera</th>
<th>Eläke-Veritas</th>
<th>Pensions-Alandia</th>
<th>In total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall assets (MEUR)</td>
<td>29928,5</td>
<td>25179,9</td>
<td>8473,4</td>
<td>6165,5</td>
<td>5227</td>
<td>1857,8</td>
<td>207</td>
</tr>
<tr>
<td>Investment returns for assets in fair value in 2009 (%)</td>
<td>14,1</td>
<td>15,8</td>
<td>13,5</td>
<td>10,1</td>
<td>10,3</td>
<td>10,8</td>
<td>15,5</td>
</tr>
<tr>
<td>Investment management costs (MEUR)</td>
<td>15,9</td>
<td>14,1</td>
<td>6,4</td>
<td>7,6</td>
<td>6,4</td>
<td>3,5</td>
<td>0,8</td>
</tr>
<tr>
<td>of overall assets (%)</td>
<td>0,053</td>
<td>0,056</td>
<td>0,076</td>
<td>0,123</td>
<td>0,122</td>
<td>0,188</td>
<td>0,386</td>
</tr>
<tr>
<td>Overall operating costs (MEUR)</td>
<td>126,6</td>
<td>121,4</td>
<td>65,7</td>
<td>51,7</td>
<td>47,3</td>
<td>20,1</td>
<td>1,9</td>
</tr>
<tr>
<td>of overall pension contributions (%)</td>
<td>3,7</td>
<td>3,8</td>
<td>4,7</td>
<td>4,7</td>
<td>8,8</td>
<td>5,4</td>
<td>6,5</td>
</tr>
</tbody>
</table>

Table 7.1. Assets, investment returns, and operating costs of pension insurance companies in 2009 (all figures in fair value as 31 December 2009). Source: TELA.

Especially the smaller PICs may face a trade-off between cost efficiency and diversification in some asset classes. Most of the smaller companies mention the cost containment pressures they constantly face in their activities in public relations material. For example Etera reports having had ‘special focus’ on the issue in recent years in its annual report. Cost containment pressures also influence issues like currency risk management, which is especially in smaller companies based on more passive position taking or risk limiting than active derivatives or currency trading. However, it must be noted that the PICs are very cost-efficient in their investment
making. This is especially visible in the two large companies: the overall operational costs of investment functions in Varma were only 5.3 basis points (0.053 %, 15.9 MEUR) and in Ilmarinen six basis points (0.06 %, 14.1 MEUR) of all assets in 2009. The main operating costs come from other organisational divisions and domains, and the overall operating costs are on average over 4 per cent of contributions annually (see Table 7.1.).

The investment teams are internally supplemented by middle and back office functions. Middle office functions are not necessarily exclusively dedicated teams like in larger investment companies (or the large PICs, depending on how the boundaries of the function are drawn), but can equally well refer to a specific combination of tasks (e.g. performance of overall portfolio structures, supervision of limits, derivative positions) of some portfolio managers (e.g. hedge fund managers, strategists) operating in tandem with front office operations. Some typical middle office tasks like valuations may be equally well situated exclusively in the back office. According to some director-level interviewees, the division of middle office functions depends on organisational structures and the ‘legacies’ of proficiency.

Back office functions in contrast are typically dedicated functions with clear division of labour among the team members with few possibilities to share different tasks (e.g. it is next to impossible to have summer holiday stand-ins). In larger companies, the divided tasks are more specified than in smaller companies. Back office jobs are very much technology-bound (most importantly spreadsheet-based) and schedule-tied (e.g. registration of events, daily valuations, information storage structuring, reports, and accounting tasks made in a given date and hour).
The back office work is very routine-based but requires awareness in monitoring within very demanding schedules. Reporting requires much personally acquired (albeit also FIN-FSA monitored) skill and competence to evaluate large thematic totalities, as reports are targeted to people looking at the issues from very different perspectives. The high role of yield histories and structures is perhaps the key issue making PIC back office functions different from other investor types, as the PICs tend to have longer histories and more weight on strategic investments. The work is very unidirectional – the front office decides, and the back office does. Yet back office functions serve as a key nexus between the front office, other organisational domains, and the regulatory frameworks. Back office team members may also evaluate portfolio managers’ understanding on investments risks and challenge portfolio managers’ views on whether they understand specific instruments – not least on basis of FIN-FSA classification guidelines whose interpretation may be quite different in portfolio manager understanding. The need for reclassifications is discovered by back office functions that also execute the reclassifications if so decided by investment committees or BoDs. Back office work is also very much integrated to the development in the institutions of global finance as PICs invest in very broad asset classes and new instruments. The emergence of new derivatives instruments in portfolios for example requires very much labour in order to comply with the regulative frameworks.

In addition to internal front office investment teams and supporting services, external services play a significant role in investment action processes. Heuristically, PICs use external assistance exactly as much as the legal framework requiring internal
management allows. Broker and other direct trading-related services can be for example acquired from investment banks, and analysis services from numerous different sources. The usage is not completely problematic albeit that the problems are in nature quite positive. PICs are offered many kinds of services that it is not necessarily too easy to choose the good ones. On the other hand, it seems that the norms of reliance and loyalty that regulate the relationships between service providers and pension funds in the Anglo-American world do not quite apply in the Finnish context. Some portfolio managers considered most of the analysis services or analysts in general ‘utterly useless’. Some experienced interviewees had already in their early careers realised that ‘there are no gurus in this domain’ and some ignored external advice altogether as they considered it incompetent (‘they are trying to sell fridges to Eskimos’, as one interviewee put it). Most interviewees had in their opinion found the skill to ask the right questions and to get the right advisory services – and to ‘avoid the American bullshit’, as one interviewee put it.

External advice may nevertheless play an important role in two domains: exploration of new markets, and forced renewal of insights to old ones. The former domain simply means that active exploration of new markets takes much time and human resources in internal management although asset management in these markets may be less costly when familiar. The latter domain suggests external advice may be for example used to test the validity of old insights in smaller teams where investment beliefs may be easily taken for granted. Furthermore, in some asset classes requiring much expertise like hedge funds, PICs have either the necessary in-house expertise or/and very close and elastic relationships with one or two external partners. The partners can have a more passive and executive (e.g. keeping databases on funds,
contacts, costs etc.), or a more active (e.g. advice on fund selection) consultancy role. The close relationships to external advisors change the nature of investment management to more monitoring and reporting based practices. For example, while some PICs conduct the hedge fund Due Diligence (DD) measures by themselves, some rely entirely on external services, which may also cause some important differences in understanding what actions mean in that asset class.

**Governing and controlling investment actions**

Although in principle mandated as independent actors, the decision-making in the investment function and in teams is very much controlled. There are quite different mechanisms for vertical control over activity in different companies, which can be summarised in ideal type description as two alternative approaches to control. In some PICs, decision-making is more layered in order to bring expertise to decision-making from various organisational levels, while in others the decision-making processes are more based on mandating portfolio managers with broad responsibilities. Albeit that the former is at least hypothetically more typical the larger the company is, selecting the approach has not so much to do with PIC size – also smaller companies may opt for multi-layered control. Although the former has at least in CEO and CIO eyes indisputable strengths for example in promoting organisational learning and proficient information flows, the latter can be preferred by portfolio managers. This said, almost all interviewees considered their organisations flexible in terms of accepting new ideas and sharing information, and very effective in controlling operational and other risks. Some interviewees who had long experience in other financial sector businesses
considered the sharing of information to be much more effective in their PIC than in their previous employers.

The control mechanisms for investments include something that can be called hierarchical mandating: all the actors have specific mandates, and the higher the actor is in organisational hierarchy, the more flexible the mandate is. New real estate investments are a prime example of investment targets that are so large that they need to be directly evaluated by the BoDs.\textsuperscript{39} Although the real estate teams may have even quite high risk budget type variable limits counted in tens of millions of euros for individual trades, larger projects tend to break these overall team limits. The CEOs are likely to have if not directly at least via the investment committees and groups (see below) a mandate to broaden the overall investment function mandates within the range agreed with the BoD. Perhaps most typically, the CEO confirms changes in basic allocations if so suggested by the CIO and team directors. The CIOs also have certain qualitative and quantitative authorities within the overall function and can thus reset the mandates between teams.

It must be noted, however, that the CEO and the CIO may also have some roles beyond the investment function mandates especially if the questions are related to other than immediate asset selection and trading issues. For example decisions on corporate engagement issues typically belong to CIOs who are often contacted by other investors, albeit that sometimes communications are directed straight to the CEOs. Even though the adopted measures are operationally handled by portfolio

\textsuperscript{39} Real estate sales, on the other hand, may have very broad limits and still belong to the mandate investment teams.
managers and analysts or even communications officers in different organisational
division, and even though they are likely to be given advice by external advisers (e.g.
on taking stance in proxy voting), the connections outside the organisation are always
mediated by the chief executives.

The CEO and the CIO have an important role in the mandate hierarchy. The CEO is
typicaly seen as the leader of the overall organisation, who delegates tasks for
investment functions but does not participate in everyday decisions. The CEO has
thus more a controlling and mediating than a decision-making role. The CEO gives
regular updates to the BoDs in board meetings, although in more specific issues this
may be a task for the CIO. The CEO participates in investment decision-making
typically more informally in investment committees and groups and in leading groups
that consists of all directors of the company, all headed by the CEO. But the CEOs of
different companies have somewhat different profiles in terms of participating in
investment decision-making. As one interviewee put it, CEOs have no need to or
interest in intervening in investment functions that consist of ‘people, who know how
to do their job in normal conditions’. But CEOs may also be needed in real-time
decision-making in not so normal conditions like the financial crisis of 2007–08. CEO
engagement in investment issues is thus very context-dependent and in part also
dependent on how the division of duties between the CEO and the CIO is arranged.

Besides having an essential role in financial decision-making, the CIOs have a strong
role in defining and changing the organisational cultures in investment functions. In
historical terms, the financialisation of PIC investments could hardly have occurred
without CIO leadership. As one interviewee put it, in 1997 ‘few people used the same
language’, which was overcome by strong CIO influence in generating common understanding on financial performance benchmarks, solvency performance and competition strategies. One interviewee noticed that it would have been impossible even to imagine current ‘sophisticated investment fund type PICs’ in late 1990s, which suggests that the CIOs have been able to quite drastically change the institutional nature of the entire field.

The CIOs have also brought new influences to broader organisations, for example the compliance functions that among other things ensure that investee firms comply with investment policies and that the investment function complies with the overall regulative framework and more specific FIN-FSA guidelines. The interviews also suggest that the more effective the CIO leadership had been in defining the direction of control and risk management cultures, the happier the investment teams were with them. Otherwise, the role of the CIO in everyday investment activities changes over time and by events. There are CIOs that may have time to time been present even in desks for longer periods of time in some smaller PICs, but they are more likely to be committed to developing strategies, presenting the company, and executing a great number of other duties in numerous meetings in their own offices and in major financial centres all over the world. The CIOs have a central role in broader organisational functions like risk management. Internalising internal auditing, controller, and compliance functions to everyday investment management is a complex process, which is why being a CIO was considered by many interviewees (albeit notably not by one CIO) a demanding and potentially consuming job.
There have been big cultural changes in controlling investment teams during the last decade or so. Previously investment decisions were very much static and rule-bound within PICs, but the current developments point towards adopting more flexible risk budget type limits with broad deviation ranges (that are not, however, necessarily as flexible in daily limits). The change in mandating has also been complemented with a change in supervision cultures. Investment performance was monitored in the heaviest formal terms annually and informally periodically before the reforms of late 1990s. Now these timeframes are relevant only in case of investments with low liquidity, mostly real estate. In case of liquid capital market investments, the proper performance monitoring timeframe is on average much closer to weekly than annual reviews.

The new control mechanisms are now more generally based on complex mathematical tools with variable timeframes. Varma for example reports having monthly reports on the developments in maximum risk levels, on Value-at-Risk (VaR) measures (by asset class) and their contributions to the overall risk, and on all liquidity concerns with mathematical formulas explicitly defined complex. The BoDs are also provided comprehensive reports including a great variety of quantitative measures on a monthly basis by the controller functions of the companies. This suggests that the mathematical skills of the boards and executives are constantly tested in the current institutional life of PICs.

A new control paradigm in PIC governance can be also found in the actual decision making structures. The broad adoption of new kinds of investment committees during the last decade or so is a key case here. The committees serve as the nexus between
strategy, investment plans, and boards on one hand, and the investment functions and tactical choices on the other. The investment committees especially in larger companies may be located clearly between the investment functions and the CEO, as the committees prepare the suggestions that the CEO may further present to the boards. For example in Varma the publicly reported composition of the committee is based on line and/or team directors. In this setting, the committee may for example discuss issues of investing in vehicles that have not existed in the portfolios before and present their discussions to the boards. Smaller companies differ in their approach. Eläke-Veritas for example reports having the CEO and investment, controller, and actuary function representatives in the committee. In this kind of setting, the committee is clearly located between the investment function (including its directors all the way up) and the board. In terms of ideal type minimum description, the composition of the investment committee includes at least the CIO, team directors, and controller division directors, who meet monthly or at least a few times a year to assess how the investment plan is executed.

According to some interviewees, the committee operations improve flexibility and dynamics between strategies and everyday operations especially in terms of bringing the broader business issues to the awareness of the investment teams. As there have been many other mechanisms for bringing investment issues to boards, the committees have arguably helped to strengthen communication especially in the other direction. From the investment decision-making perspective, the committee serves another important function: it enables the CEO, the CIO, and team directors to aggregate common opinion. The strategic debates between the investment function and the BoD that benefit the most by becoming more flexible than the rather
periodical investment plan drafting process would suggest. The investment committees may meet and have met more informally for example biweekly if considered necessary.

The new control paradigm is in discursive terms very much risk-based. The FIN-FSA requires board-approved risk management principles and plans from PICs besides the more detailed investment risk management plans included in the annual investment plans. The organisation of the risk management typically belongs to all organisational levels albeit that the CIOs are usually the most concerned with these issues. There are some significant differences in approaching formal organisation of monitoring, however. Smaller companies may have dedicated investment risk functions outside or at least in the outliers of investment functions monitoring investment making, whereas in larger companies supervision has more nuanced division of labour between a few dedicated functions. This is especially valid for actuaries, who tend to have a similar role in evaluating the correspondence of strategic risk levels and risk positions materialised in investments, but may belong to controller functions or have dedicated teams or even divisions in larger companies.

The differences in terms of organising risk management within the functions are subtler. For example team directors are responsible for managing and supervising the trading limits of their teams, and CIOs (and other directors) for creating the overall risk management procedures within the function (and teams) basically in all PICs. The substantive differences can be found more often in the reporting schema. While the daily trading limits and mandates are likely to be controlled by the directors, it may for example be the responsibility of compliance officers of the investment
functions to report the executives on a weekly basis or whenever trading limits are significantly exceeded.

It must be noted that there are some differences in the division of labour between risk management mechanisms in different PICs. For example, the organisational position and the size of controller functions that are based on quantitative control based on risk assessments (e.g. VaR, scenarios) and more general economic development supervision is variable somewhat in line with the overall PIC size. Some controllers may have more immediate individual-level interactions with middle office functions while some are independent and reliant mostly on the exchange of reports. For another example, companies also put different weight on the so-called compliance functions (see e.g. Lenglet, 2004, for organisational characteristics of compliance functions in the financial sector). Although legal compliance has been a central issue for TyEL providers for decades, the dedicated organisational compliance functions are quite recent. For example, Eläke-Fennia (according to its Annual Report of 2004) started the preparation of this function in 2004. Compliance functions are more typically parts of the investment organisation than dedicated divisions.

Compliance officers may refer either directly to individuals in various functions who ensure that the activities in that function comply with laws and other norms, or only functionally to directors that work as the brokers between internal control functions and external service providers evaluating the compliance performance of the company. The role of these tasks is to ensure that all investment activities comply with external and internal rules and standards in qualitative terms. Although the functions are often in the hands of lawyers, the compliance is not restricted to
immediate legal regulations or other field boundaries concerning pension provision. It can mean, for example, ensuring that investment processes comply with the UN Principles for Responsible Investment -related policies or that the Finnish firms in which the PIC has invested have accepted the Finnish Corporate Governance standards.

To conclude the section, it is worth noting some issues concerning the control over investment making at the level of individuals regardless of the team or other formal organisational structures. The investment functions are aligned towards the strategic goals of PICs with both formal regulative arrangements like remunerations and mandates and more symbolic and discursive mechanisms like common values and common (as one interviewee put it, sometimes ‘turbulent’) deliberations in different organisational levels. Remunerations of individuals are the most tangible and elastic institution in this respect, as the remuneration schemes have not at least in most PICs radically changed in recent years. The goals in remuneration schemes vary both qualitatively and quantitatively, but are more or less based on financial and solvency performance in relation to benchmark indices, individually set goals, and the performance of other PICs in these areas. Timeframes are also variable. Eläke-Tapiola for example reports that the timeframe of its strategy in compensations includes, besides certain not so much time-based criteria, some three-year goals (< 30 % of the premium) and annual goals (< 40 %).

\[40\] This said, there have been some debates in the PICs to realign the remunerations to better correspond with absolute financial performance. On the other hand, the financial crash of 2008 implied quite low compensations for many investment managers, which produced pressures to re-evaluate the compensation schemes to the opposite direction in some PICs. There have also been some aspirations to tie other organisational divisions to the same targets with the investment functions (or the other way around), which typically do not share the same performance-based salary schemes.
Heuristically, the CEO and CIO level remunerations are more extensively tied to strategic goals than portfolio managers, the team directors situating variably between them. The performance-tied remunerations are typically defined as multipliers of regular salaries. For example *Ilmarinen* defines in its annual report the maximum performance premium to be six times the normal salary. The compensation schemes for the investment function somewhat vary by companies, as some put more weight on base salaries and some on performance premiums. It is common understanding that the PIC investment managers tend get lower incomes than other financial sector actors, for example brokers, but all interviewees were nonetheless happy with their salaries.

### 7.2. The Shared Dispositions in Investment

The end products of PIC investment actions are easy to observe at least in broad-brush terms of exchange, as the PICs are exceptionally transparent in their public communication by listing nearly all their assets and investment vehicles. The purpose of this section is to report the dispositions that are behind, give meaning to, and explain these actions. These dispositions range from prevalent and meaningful practices to more latent and preconscious ways of acting. The discussion starts with the basic strategies and identities of different PICs and then continues to more thematic domains where the identities materialise. It must be noted that the titles should not be understood only as dispositions that all PICs share as such, but also as thematic domains under which divergent dispositions can be placed.
Investor-identities and strategies

The people working in PICs tend to regard themselves as specific kinds of investors. Following this identity provides a justification for activities and thus strengthens proficiency in investment making. The collective self-identities of individual PICs is a convenient starting point for reporting dispositions that have relevance at the field level, since they get very specific meanings at this level. Sometimes the PIC identities are presented more as an identity of the field. PICs have defended the decentralised system with the idea that it improves the capital availability in Finland. *Etera* summarises this argument well in its annual report: it is the Finnish capital, securities and real estate markets that benefit from decentralisation to different investors with different beliefs and views. For one interviewee, the benefit of decentralisation was to ensure capital availability to Finnish firms in all market situations (although not explaining how this would differ for example from a large single-fund model). As for another example, the PICs identify themselves as very successful investors compared to other financial sector actors. Indeed, the PICs have gathered many financial industry awards. *Eläke-Tapiola* for example was awarded the *Best In-house Investment Team Award* in Finland by the *Investment and Pensions Europe* in 2009.

Some interviewees considered their employer to have specific identities as field players, both in terms of strategies (e.g. longer term investor as typical Finnish equity investors, more active bond management or larger bets in real estate than in other PICs) and organisational issues (e.g. smaller equity team). According to the
interviews, size is the single most important feature in PIC identities. This can be confirmed by looking at the annual reports as well.

The largest PICs focus either on their broader social role (Varma) or on their competitive performance (Ilmarinen). Varma explicitly wants to be the ‘best investor’ of all PICs albeit without giving any explicit definition in that immediate context. The company later refers to high profits and ‘progressive’ risk management, which is defined besides the more typical portfolio management and risk management process issues explicitly as secure guarantee policies, careful valuations, and reliable matching of assets and liabilities. The company also presents itself as a long-term and highly solvent investor, who wants to improve Finnish business life with building sector investments that improve employment rates, capitalisation of (in IPOs) and direct lending to Finnish firms, and active and engaged ownership – to be an “anchor owner” that is exceptionally transparent by being the only PIC reporting all its actions accurately four times a year. Ilmarinen states that its goal is to be the most competitive and best performing investor, whose goal is to develop its investment organisation in order to improve skills, organisational innovativeness, well-timed allocation decisions, ability to seize new investment opportunities and vehicles, preventive risk management, and in general reliability and efficiency of investment processes. This competitive active investor identity has some field-wide credibility as the field insiders tend to regard Ilmarinen more as a hedge fund than an insurance company.

The smaller companies have variable approaches to investment strategies, but it is all but visible in all public communication. Eläke-Tapiola and Eläke-Fennia are the
extremes in this case. The former publicly highlights careful analysis, independence and autonomy as their key characteristics, and responsibility as the driving norm for investments. Eläke-Tapiola for example reports that around 70 per cent of its equity portfolio is selected on the basis of investee firm responsibility in energy consumption or/and production and in usage of raw materials in production, trade, transport and waste management, and that two thirds of the investee firms are substantively aiming at slowing climate change. The field insiders regard Eläke-Tapiola as somewhat risk-averse investor that is reluctant to invest in complex assets like hedge funds. Like in case of Ilmarinen, field insiders know Eläke-Fennia for its active approach to investment making including many hedge fund investments both in number and in size of the bets. On the other hand, the company publicly defines itself also as a long-term investor whose goal is to maximise returns in the long term at a given risk level, to optimise the risk-return-relationship in general, and to remain solvent in all market situations. The characteristics that differentiate it from other companies in its annual reports are not related to active investments but to the aim to be the most cost-efficient of PICs, and the central role of investments in its annual corporate responsibility report. Despite opposite approaches to investment strategies, the representations of the social roles of the companies hardly differ.

The other small companies highlight quite few investment-related issues in their annual reports. Etera highlights responsibility above all other issues in its search for PIC identity. In case of investments, this according to the company means equal analysis on economic, social and environmental issues in (long-term) investment operations. The company tends to highlight less symbolic and more tangible issues in context of investments. One example raised in the annual report is the investments in
hospices and ‘senior homes’, which cover in total 12 per cent of the real estate portfolio. Eläke-Veritas is explicitly a long-term investor aiming at stable returns and moderate risk levels. In the recent years, the company has had on average more weight in real estate investments and less in equity than most PICs. However, the company reports to have hired three new equity managers, which may imply changes towards more equity-based allocation in the forthcoming years. Its CEO characterises the investment strategy “relatively defensive” in the annual report of 2009. The company dedicates in its web-based annual report much more space to describe its client services than investments.

The TyEL scheme architecture is not too helpful in making any investment beliefs or identities major factors in PIC competition due to the lack of transparency – as one interviewee put it, there are no means for clients or any outsiders to know whether the PIC investment strategy is performing well or not. On the other hand, competition plays an important role in making some parts of the broader identity tangible for the investment functions. For example, strategy-related remunerations are typically tied to financial performance in comparison to other PICs than for example to getting new clients. There are also beliefs in the field that competition may play a sinister role in investment management. For example, one interviewee was certain that (other) PICs did much window-dressing in their investments always right before the official quarterly publication of investment performance and allocations in order to look either divergent from or convergent with other PICs in basic allocations, whichever might serve the company’s purposes at that time. Although this argument was broadly recognised although only rarely defended by interviewees who brought up the topic, it may have some credit, for the logic can be found in other means for competition:
client bonuses. One interviewee told that in a recent year one PIC had reported a certain amount of client bonuses, and certain other companies followed suit deciding their compensations to be 0.01 percentage points higher than the first company. Eventually one company further added a 0.01 on top of that amount. Many interviewees considered this kind of competition ‘childish’ especially in those years such as 2008 when bonuses are low and raise little interest among the clients.

**Allocations, investment strategy and risks**

The separation of asset classes is an important habitual institution that characterises all the investment activities in the field. The division of classes is present in many domains. The PICs follow similar classifications in terms of organisational team divisions, as noted in the previous section. Classifications also characterise the investment strategies of PICs and, at a more general level, the investor-identities of PICs that materialise in the basic allocations between asset classes. The question of basic weight in different asset classes is among the most salient issues that run through the organisations from strategic to tactical level and from board level collective deliberation to everyday activities of individual managers. The strategic weights of allocations are defined in investment plans, but in some cases in annual reports as well. For example *Ilmarinen* divides the basic target allocation of 2009 so that 30 per cent should be in listed equity, 35 per cent in bonds, 12 per cent in real estate, 12 per cent in direct loans, and 11 per cent in other investments (which have not quite materialised, see Table 7.4). One issue that was constantly brought up in almost all portfolio manager level interviews was the belief on how much allocations actually matter in contrast to ‘stock-picking’ (see below) in defining expected returns.
When given an explicit expression, the typical belief was that allocations defined 80 per cent and security selection 20 per cent of investment performance.

The weight of investments in different classes has significantly changed in the field during the recent decades. As noted, the decade from 1997 onwards was marked by the conscious shift of strategy towards riskier and non-domestic investments. During the last few years, the change has had more to do with the market conditions than such changes in strategy. Most notably, the stock market slump caused a major decrease of the equity class and the credit crunch in practice re-introduced the class of premium lending (see Figure 7.2). In the end of 2007, before the financial crisis, the PICs had 44.4 per cent in equity (see Table 7.3), but only 31.4 in March 2010 (see Table 7.4). The weights PICs put to different classes are divergent but not so far from each other (see Table 7.4). In the end of March 2010, the weight of fixed income ranged from 43.1 to 58.7 per cent and of equity from 22.4 to 31.1 per cent in the PIC allocations. The most notable difference is in hedge fund investments, where two PICs (Eläke-Fennia and Varma) have over 10 per cent weight in the class and others no or only marginal bets. There are also only two PICs with any investments in commodities.

\[\text{The presentation at the TELA website does not include the allocations of Pensions-Alandia. In the end of 2009, it had 3.5 \% in loans, 53.6 \% in bonds (but none in fixed income funds), 3.7 \% in money-market instruments, 28.7 \% in equity, 9.8 \% in real estate, and 0.7 \% in other investments.}\]
### Figure 7.2. Investment allocations to different asset classes in PICs 2004–Q1/2010 (in percentage points). Source: TELA.
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<tr>
<td></td>
<td>Million €</td>
<td>%</td>
<td>Million €</td>
<td>%</td>
<td>Million €</td>
</tr>
<tr>
<td><strong>Loans</strong> (*1)</td>
<td>8 160,8</td>
<td>10,6</td>
<td>6 151,2</td>
<td>9,5</td>
<td>2 781</td>
</tr>
<tr>
<td><strong>Bonds</strong> (<strong>1, 2)</strong></td>
<td>28 904,2</td>
<td>37,5</td>
<td>27 019,5</td>
<td>41,6</td>
<td>26 358</td>
</tr>
<tr>
<td>&quot; incl. fixed-income funds&quot;</td>
<td>2 283,2</td>
<td>3,0</td>
<td>1 561,5</td>
<td>2,4</td>
<td>2 511</td>
</tr>
<tr>
<td><strong>Other money-market instruments and deposits</strong> (<strong>1, 2)</strong></td>
<td>2 784,1</td>
<td>3,6</td>
<td>3 940,3</td>
<td>6,1</td>
<td>2 411</td>
</tr>
<tr>
<td>&quot; incl. fixed-income funds&quot;</td>
<td>650,2</td>
<td>0,8</td>
<td>0,0</td>
<td>0,0</td>
<td>2 895</td>
</tr>
<tr>
<td><strong>Equities and shares</strong></td>
<td>27 105,5</td>
<td>35,2</td>
<td>18 635,2</td>
<td>28,7</td>
<td>34 372</td>
</tr>
<tr>
<td><strong>Real estate</strong> (<strong>4)</strong></td>
<td>10 030,6</td>
<td>13,0</td>
<td>9 212,5</td>
<td>14,2</td>
<td>8 281</td>
</tr>
<tr>
<td>&quot; incl. mutual funds and UCITS&quot;</td>
<td>1 424,5</td>
<td>1,8</td>
<td>1 389,9</td>
<td>2,1</td>
<td>842</td>
</tr>
<tr>
<td><strong>Other investments</strong></td>
<td>51,7</td>
<td>0,1</td>
<td>0,0</td>
<td>0,0</td>
<td>0,0</td>
</tr>
<tr>
<td><strong>Investments, total</strong></td>
<td>77 036,9</td>
<td>100</td>
<td>64 958,6</td>
<td>100</td>
<td>77 485</td>
</tr>
</tbody>
</table>

1) Includes accrued interest
2) Long-term fixed-income funds are included in Bonds and short-term fixed-income funds are included in Other money-market instruments
3) Includes deposits booked under Investments in the balance sheet
4) Includes mutual fund shares and investments in comparable UCITS that invest in real estate and real estate companies.
UCITS = undertakings for collective investment in transferable securities

Table 7.3. Investment allocations to different asset classes by all PICs in 2005–2009.
Source: FIN-FSA.
<table>
<thead>
<tr>
<th></th>
<th>Eläke-Fennia</th>
<th>Eläke-Tapiola</th>
<th>Etera</th>
<th>Ilmarinen</th>
<th>Varma</th>
<th>Eläke-Veritas</th>
<th>PIC average and total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed income</strong></td>
<td>55,1</td>
<td>58,7</td>
<td>52,3</td>
<td>48,2</td>
<td>43,1</td>
<td>50,9</td>
<td>48,3</td>
</tr>
<tr>
<td>Loans</td>
<td>7,7</td>
<td>4,5</td>
<td>9,9</td>
<td>12,1</td>
<td>12,2</td>
<td>2,2</td>
<td>10,5</td>
</tr>
<tr>
<td>Government bonds</td>
<td>25,2</td>
<td>25,9</td>
<td>15,5</td>
<td>14,7</td>
<td>16,5</td>
<td>22,1</td>
<td>17,7</td>
</tr>
<tr>
<td>Other bonds</td>
<td>17,6</td>
<td>27,1</td>
<td>26,9</td>
<td>20,6</td>
<td>13,2</td>
<td>22,5</td>
<td>18,7</td>
</tr>
<tr>
<td><strong>Other fixed income instruments and deposits</strong></td>
<td>4,6</td>
<td>1,3</td>
<td>0,0</td>
<td>0,8</td>
<td>1,2</td>
<td>4,1</td>
<td>1,4</td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Listed</td>
<td>22,4</td>
<td>30,1</td>
<td>31,1</td>
<td>26,8</td>
<td>29,2</td>
<td>29,0</td>
<td>31,4</td>
</tr>
<tr>
<td>Private equity</td>
<td>19,7</td>
<td>28,0</td>
<td>26,6</td>
<td>33,2</td>
<td>24,2</td>
<td>27,2</td>
<td>27,4</td>
</tr>
<tr>
<td>Unlisted</td>
<td>1,1</td>
<td>1,5</td>
<td>3,3</td>
<td>2,4</td>
<td>3,5</td>
<td>0,7</td>
<td>2,6</td>
</tr>
<tr>
<td><strong>Real estate</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct</td>
<td>11,8</td>
<td>11,2</td>
<td>14,0</td>
<td>10,3</td>
<td>14,9</td>
<td>18,9</td>
<td>12,7</td>
</tr>
<tr>
<td>Indirect</td>
<td>10,1</td>
<td>9,4</td>
<td>11,0</td>
<td>9,0</td>
<td>12,8</td>
<td>16,7</td>
<td>10,9</td>
</tr>
<tr>
<td><strong>Other investments</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hedge funds</td>
<td>10,7</td>
<td>0,0</td>
<td>2,6</td>
<td>4,7</td>
<td>12,8</td>
<td>1,3</td>
<td>7,5</td>
</tr>
<tr>
<td>Commodities</td>
<td>10,7</td>
<td>0,0</td>
<td>1,8</td>
<td>2,3</td>
<td>12,3</td>
<td>1,3</td>
<td>6,5</td>
</tr>
<tr>
<td>Other</td>
<td>0,0</td>
<td>0,0</td>
<td>0,8</td>
<td>0,0</td>
<td>0,5</td>
<td>0,0</td>
<td>0,2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100,0</td>
<td>100,0</td>
<td>100,0</td>
<td>100,0</td>
<td>100,0</td>
<td>100,0</td>
<td>100</td>
</tr>
<tr>
<td><strong>Million EUR</strong></td>
<td>6 424</td>
<td>8 984</td>
<td>5 399</td>
<td>26 333</td>
<td>30 794</td>
<td>1 953</td>
<td>79 886</td>
</tr>
</tbody>
</table>

Table 7.4. Basic allocations of six largest PICs (as 31 March 2010, in market value). Source: TELA.

The understanding on the relationships between different classes may significantly differ from one company to another. For example the choice to allocate to bonds and equities are typically considered dynamic in strategy, which is hardly unusual, but direct lending can be also considered dynamic in relation to real estate investments. There are two typical dispositions whose variation explains differences in allocation weightings. The first one is the understanding of strategic allocation design as a
matter of balancing three basic investment risks: equity risk, credit risk, and duration risk. The first one is primarily related to the stock market development, the second to the debtors’ ability to pay, and the third to changes in interest rate levels. These risks are not regarded as only mathematically observable risks isolated from the real-world contexts. On the contrary, the risks are weighed in various different terms in relation to qualitative developments in the global economy. They are addressed differently in basic allocations by the boards and in strategic and tactical allocations within the asset classes by the investment functions. From the investment functions’ point of view, controlling these three risks is essential if not in selecting every single security at least in most decisions.

Of course, there are other risks the PICs are concerned with as noted in the previous sections. For example liquidity risks are typically categorised as one risk type among others in annual reports (among dozens of other risks), but it has less relevance as a separate category explaining basic allocations because all investment activities (and models used in them) are considered to include the risk. The PIC portfolio construction is at all levels very much about risk management. The risk discourse is very strongly present in all PIC annual reports, and themes related to risks are repeated on nearly every single page of all the reports. The risks are divided in somewhat different ways, but essentially the idea is that all individual risks, however conceptualised, belong as parts to more comprehensive risk management paradigm. Broad economic and insurance related risks and the organisation-wide operational risks are discussed extensively. In case of explicit investment risks, some companies

42 There are only few exceptions in the discursive understanding of risks between the PIC reports. Perhaps most importantly, Varma raises one risk that is not typically mentioned in the reports, the ‘model risk’, which refers to the possibility that the models used in investments and other domains do not necessarily reflect the reality they are supposed to describe.
are more explicit in defining the ways to assess market risks than others (typically VaR, stress tests, risk scenarios, and simulations), and may even report the software tools they are using. The three most prevalent risks that have strong operational meanings in investment making are typically mentioned also in annual reports. Inflation risks, credit risks and liquidity risks and their management mechanisms are mentioned as well. For example Ilmarinen reports to monitor short-term liquidity risks by reflecting its investment portfolio against average daily trading volumes of its investment vehicles.

PICs highlight the coverage regulations (see previous chapters) as the source for understanding and the avenue for managing centralisation risks. Some interviewees added that the regulative framework provides incentives to use tactics and derivatives to optimise solvency, not returns. According to most annual reports, currency risks are managed with derivatives consistently mostly in case of some bonds, but some PICs report that their approach to equity derivatives is also ‘more active’. The interviews suggest that this might refer more to selectivity than to active hedging of all equity investments. Other risks are presented to be raised by investment making regardless of the regulations. Counterparty risks are for example managed with quantitative tools like credit analysis (in direct lending) and simulations (e.g. derivatives), and qualitative tools like credit ratings (bonds), reporting, and international agreements (e.g. ISDA in OTC derivatives). Political risks are understood as issues related to equity and bond vehicles essentially in emerging market investments.

According to most PIC annual reports, the explicit habitual starting point to risk management in portfolio design is simply the optimisation of investment portfolios
according to expected returns of different asset classes, the deviation and volatility of
returns, and correlations between the classes. Most of these expectations and some
macro-level VaR calculations are also presented in this context.\(^{43}\) VaR is a good
example of the tools with which risk management is organised in various levels. Some
uses of the VaR tools are reported in the annual reports. Eläke-Veritas uses it in a
classic sense by defining the maximum amount of its overall portfolio that is at risk
within a month within 97.5 per cent probability (4.9 per cent in the end of 2009).
Varma uses VaR (as the highest possible loss within the 97.5 probability) in defining
the maximum risk levels of its investments.\(^{44}\) Ilmarinen reports to use VaR for
instance as a method for defining its maximum risk level in relation to solvency
position (to be more exact, the maximum probability of five per cent to the decrease
in reserve capital to the solvency border within two years).

The second disposition concerns the decision on the balance between different
timeframes. All interviewees had a very clear stance: pension funds ought to be long-
term investors but the current regulatory framework makes the investment time
horizon everything but long. Indeed, there seems to be much will in PICs to increase
long-term (over-the-cycle) investments that are considered currently impossible
within the regulatory framework. Some PICs even mention this in their annual reports
by explicitly noting that the solvency rules generate activities that are very short in
their timeframe. In these overall terms, the long-term frame is mostly present in

\(^{43}\) For example Ilmarinen defines the expected returns and volatility of listed stocks to 7.5 % and 17.5
%, bonds to 4.5 % and 3.6 %, real estate to 5.7 % and 8.4 %, and direct lending to 4.3 % and 2.7 %,
respectively. The expected return of the whole portfolio was 5.7 % and standard deviation 7 % in 2009.
The long-term overall yield expectation is six and deviation expectation eight per cent.
\(^{44}\) The method used is that in case listed equity investments and some hedge fund investments
decreased 25 per cent in their value, the amount of reserve capital will remains one VaR above the
minimum capital requirement, that is, two thirds of the solvency border.
defining basic strategic allocations and in selecting some large long-term projects like building or infrastructure projects, and very little so in everyday capital market investments. Deciding the balance between long-term strategic investments and shorter-term investments nevertheless affects weightings in the changing allocations.

However, it is sometimes difficult to see whether a question is strategic or tactical when trading liquid assets. For example a decision whether to invest in reissued bonds or not when offered can be easily considered either of these domains. When the timeframes are understood not at the level of strategy but within the timeframes shared by the investment functions, we can find common features in PICs. All PICs for example use some kind of tactical allocations. The allocations are typically based on reassessment of the three basic risks over time. The timeframes of these allocations differ from one company to another and according to market conditions. For example, whereas the normal timeframe for tactical assessments might be for some portfolio managers somewhere between one and three months, during the financial crisis in 2008 it might have been only days.

Individual managers also face both short and long term issues in their everyday routines. For example, the managers are expected to provide longer term insights on the market developments in their security class albeit that team directors are more often expected to build a more comprehensive picture on the whole asset class. Individual managers also may have smaller individual tactical risk budgets within the team budgets, which according to one team director ‘keeps managers motivated’. It could be feasibly argued that tactics tend to have the most important role in individual managers’ eyes. This theme can be confirmed in relationships to external advisers.
Although advisers are given solid frames concerning the strategy and philosophy of
the PIC when mandated, their tactical advisory is always listened to – and sometimes
asked for.

**Asset classes**

All asset classes have particular properties in PIC understanding when the allocations
are decided. The classes discussed here in more detail are equity (including private
equity), fixed income, hedge funds, credit, and real estate. Equity investment plays an
important part in PIC investments – many interviewees, with very different
organisational statuses, even considered the weight of equity allocations the prime
question of PIC investments altogether. The ideas of equity premium and equity risk
are important for the investment functions, and they underline all equity investment
decisions in relation to the overall portfolios. The regulatory framework, in which the
fund transfer obligation is affected by equity performance, is also important especially
from the directors’ perspective focussed very much on questions of solvency.

The allocation to equity is always shortly followed by the questions of how the
investments are divided geographically, and should the investments be direct or fund
based and active or passive. Especially in smaller PICs, passive Exchange-Traded
Funds (ETFs) have a major role in equity investment philosophy. If the goal is to
simply add beta-based – that is, correlated to overall market development – equity
weight in allocation, it can be done the easiest by investing in ETFs. ETFs also serve
as ‘buffers’ that enable quick adjustments of liquidity risks in the portfolio level
without the need to rely on the laborious active portfolio rebalancing. However, this
also causes an important asymmetry to equity investment dispositions: whereas it may be easy to move from capturing alpha with stock-picked portfolios (‘genuine portfolios’, as one interviewee put it) to beta-prized and cost-efficient ETF investments, it is quite difficult to re-establish ‘genuine’ portfolios with more risk appetite.

One of the key dispositions of PICs in terms of equity allocations is the legacy of investing heavily in Finnish listed equity. Some might argue that the question of whether to invest in Finland or not is not a question at all for PICs; the questions are more about should individual stocks have over or underweight in relation to the OMX indices or not in the equity portfolio. It must be noted, however, that even though the PICs have major portfolio-based stakes in domestic listed equity, higher concentrations are quite rare and have special motives behind them. In 2009, Ilmarinen for example had only 2 (1) stakes where their share of the investee firms exceeds ten and 13 (14) that exceeded five per cent of the overall shares (voting rights), and apart from a major Pohjola insurance group – which is the marketing partner of the PIC – none of these investments were among the largest single bets in the equity portfolio. Varma also had only 13 bets that exceeded the five per cent mark in this class and none above ten per cent, and only one bet of exceptional size in the class: the 800 MEUR stake in its partner-in-marketing, the Sampo insurance group. Although PICs are major owners of Finnish equity, they are everything but ‘pension fund socialists’.

The direct PIC listed equity investments are extremely Eurocentric, especially if Russia is included. Take Ilmarinen and Varma for example. Ilmarinen had direct
ownership only in eight US public companies in 2009 – one less than in Dutch and four less than in Italian companies. Varma directly invests in as many (four) companies in the US as in Greece, which is perhaps even more illustrative. The listed equity portfolio of Varma is 75.3 per cent European (including 46 percentage points in Finland) in general. On the other hand, the largest single equity bet Ilmarinen has is in SPDR Trust Series 1 ETF – Standard & Poor's Depositary Receipts ("spiders" in the parlance of finance), exchange-traded tracking stocks for the S&P 500, that is – which suggests that the US market is just approached more with funds than directly. Varma also has a major stake in the fund. In fact, the Varma equity portfolio has in total 16.6 per cent of US equity in risk-adjusted terms when both fund and direct listed equity investments are considered. In this sense, saying that PIC equity investments are Eurocentric refers only to active and direct investments.

Private equity portfolios are the most familiar for the largest PICs in general albeit that some smaller companies (notably Etera) have equally large relative stakes in the class for strategic reasons. Private equity may also have a supplementary role to direct loans in ‘mid-investor’ style investments or as results of client suggestions (if not always substantively as parts of “investment packages”). Otherwise, according to some interviewees, private equity investments of PICs do not differ from other Finnish private sector private equity investments. Although relatively large direct bets may be typical in the class of domestic private equity, some PICs tend to keep the bets relatively low also in this class. Varma for example had only four investments exceeding the ten per cent mark in 2009 despite a few bigger stakes in listed equity. Eläke-Tapiola had an opposite approach. It (the parent company) had only three
investments in listed equity with more than five per cent of the total stock, but eight in private equity.

What is common to PICs in the class of *fixed income* is the special focus on ‘the big picture’. The big picture has many representations like the relationships between specific bond types and risks (e.g. sovereign bonds and credit risks), but the basic question right after the basic allocation weight is to define the position in relation time (i.e. to set the target duration rate for the portfolio). The modified duration of the bond portfolios in the two largest PICs, *Varma* and *Ilmarinen*, was 3.2 years in end of 2009. The smaller PICs, however, had somewhat longer durations. The duration of smaller companies varied between 3.6 (*Eläke-Fennia*) and 4.63 years (*Pensions-Alandia*). The variation in the duration of PIC portfolios is significant but almost negligible in contrast to the bond portfolios of the TyEL company pension funds, which varied between 0.31 and 6.40 in 2008 (Financial Supervisory Authority, 2009). The duration of all portfolios was rising during the year 2009 as the share of money market instruments was decreased. It must be noted, however, that for example *Eläke-Fennia* reports keeping the duration of other bonds stable (at 4.0), which suggests that the bond investment strategy might not have radically change outside this tactical rebalancing concerning one category of bonds.

The bonds are typically managed internally. When bond funds are used, they tend to include only bonds that are costly to manage internally, for example high yields, emerging market, convertible bonds, and more complex structured products. Some PICs have traditionally had conservative approaches to fixed income investments. In recent years, sovereign bonds and Nordic corporate bonds have been permanently
broadened to many varieties of direct and fund-based high yield bonds, broader European and emerging market bonds, and sometimes even asset-backed securities. Although the sovereign bonds continue to be the key bonds in PIC portfolios, corporate bonds have become popular as well. For example the largest PIC Varma had one third of its bond portfolio in corporate bonds, and Eläke-Veritas even 46 per cent in 2009.

One reason behind the new approaches has been the 2007 solvency rule reform that enabled more diversified approaches to fixed income. On the other hand, some PICs continue to have more conservative strategies than others. This has much to do with cost containment pressures. For example intra-day trading or sovereign bond futures trading that require daily activities have been appraised by very few PICs. But such choices can also have much to with heuristic risk management strategies. Many fixed income managers especially in the more conservative PICs have a guideline to invest in corporate bonds that are at least investment grade in their rating, which cuts some of the need to look for bond fund investments altogether. This hardly qualifies as a practiced field-wide disposition, as PICs in fact invest in all kinds of bonds in terms of credit risk levels. Moreover, some less conservative PICs have introduced new thinking on risk by at least attempting to increase hedge fund style long-short-styles in bond investments in order to fight the tendency of PICs to make rapid losses every time the interest rates are on rise.

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45 *Eläke-Veritas* for example has reported the contents of its bond portfolio by credit ratings. In 2009, it had 53 per cent of its bond portfolio in AAA rated bonds, 5 % in AA, 26 % in A, 7 % in BBB, and 9 % in bonds with other ratings. *Eläke-Fennia* reports A as the average rating of the bond portfolio.
The Finnish regulatory framework has enabled investments in hedge funds that are domiciled in offshore financial centres or tax havens, which marks a great difference between Finnish PICs and most European pension funds. Some PICs have been more proactive in hedge fund investments, whilst for others it is a more recent affair brought by general interest in the asset class – as some interviewees considered, it was ‘the boys in the town’ or ‘Aleksanterinkatu’ (the “Wall Street of Helsinki”), or other PICs who ‘necessitated’ the investments in this class. Especially Varma and Eläke-Fennia have been proactive in this class, the former having invested the most in hedge funds in absolute terms during the recent years and the latter having had stakes in over 80 individual funds only in 2009. On the other hand, most PICs regard hedge funds an (avoidable or preferable) asset class while Ilmarinen has more an ‘internal hedge fund culture’ with complex intra-market trades.

As noted, hedge funds are a mixed blessing for PICs. On one hand the class offers for the proponents the possibility to capture alpha, to reduce the correlation of the overall portfolio in relation to market development, to control the relationship between different investment risks, and in general to aim for higher performance expectations. Most interviewees considered hedge funds everything but a difficult asset class because the risk premiums involved in their investments have been well known and anticipated. In this light, the public contestation of hedge fund investments on basis of their opacity is inaccurate, as the PICs that invest in hedge funds have received all the information they need. On the other hand, hedge fund investments raise the PICs to an antagonistic public spotlight. Some PICs have evaded the entire class, stating publicly that they do not want to be involved in an asset class they do not understand. The experiences in this class have nevertheless been positive in most PICs, which is not
necessarily the case with other alternative investments like commodities (most importantly raw materials) that have been only somewhat recently introduced to PIC portfolios and that have caused very mixed experiences on their performance at least in case of long-only investments.

One illustrative example of the ambiguous nature of the hedge fund asset class is related to the fact that some PICs have been able to classify their hedge fund investments according to their real risk profiles into much lower risk categories than implied by the legal classification. This measure has direct solvency-related benefits, and it is typically done when capital reserves are considered low. Even the FIN-FSA has provided positive incentives to reclassify hedge funds after one PIC allegedly had started to classify all hedge fund investments under one category. Yet the boards may remain very cautious towards using this possibility. Although the risks of hedge fund investments might be classified lower than expected, it may in public domain be interpreted as hiding, not disclosure of real risks.

Direct lending, including premium lending, is a very traditional asset class in the field of PICs. The timeframes of credit are long – 5, 10 or 25 years – and liquidity low. This makes allocations to credit and real estate quite different from other classes. As one interviewee put it, it takes decades to build a good credit portfolio. Having credit arms at all is not evident even for those pension funds that do not have solvency-based limitations. Besides premium lending, the reason for the existence of direct lending in PICs is based on two norms, the provision of complementary finance in Finnish markets, and client proximity and loyalty. The former refers to the idea that PICs are on one hand not likely to be the first candidates for financing real
investments, but on the other very important actors in ensuring sufficient finance for investments in Finland. The question PIC credit arms easily ask, as one interviewee well crystallised it, is why a PIC would provide anyone loans if the market has not done it already. This is in part a normative choice, but is also rooted in the tendency of PICs not to operate as sole lenders of any economic projects. The tradition of ‘investment loans’ continues even today by packaging premium and other loans together as credit products.

Although PIC credit today closely follows market pricing and conditions in contrast to its past, the negotiations between companies and the clients are not necessarily so much market-driven but bargained: it is very much loyalty-prized, and big clients’ wishes are carefully listened. Loyalty can be seen especially as a norm dictating that when the demand exceeds the supply it is very unlikely that client applications will be the first ones turned down. The PIC lending activity is not about competing in loan margins against other financial sector actors: it is more about finding good investments for the overall portfolio and finding synergies with client needs. This is one reason why investment loans and credit portfolios in general have been in a long-term relative decline. The other is that credit provision simply follows demand for the product. For more than a decade before the financial crisis in the autumn of 2008 there was a long and stable period of low demand for credit products. After the recession of early 1990s most PIC investment functions believed for these two reasons that the role of credit arms will slowly and permanently diminish – which it did, as some credit portfolios decreased even to one tenth in absolute size in comparison to the early 1990s.
Real estate has a particular role in PIC portfolios because the bets are high, targets all but liquid, and depreciations may affect the overall investment performance significantly. The neutral strategic weight of real estate in all PIC portfolios is around 10 per cent. Otherwise, there are subtle differences between real estate investment approaches in different companies. Some PICs have a more portfolio-based approach to real estate with less direct building or maintenance related pricing expertise, whilst especially those companies with larger strategic individual projects tend to have more in-house expertise on the class. The portfolio management paradigm in real estate investments is a more recent paradigm compared to the direct project financing that has been prevalent for some forty years now.

One reason for the novelty of the portfolio approach is that only the EU accession and developments in the union have made the sector transparent enough for PIC investments. Another reason is that the Finnish tradition of having limited partnerships as the basis for real estate management is laborious in governance aspects and expensive. A related, publicly debated issue, which has even driven Finnish investors furious towards the (‘authoritarian’, as one interviewee put it) Ministry of Finance, is the tax treatment of real estate funds, which has not allowed the generation of Anglo-American style low tax REIT funds that investors tend to find beneficial. The positive side of this development has been the direct involvement for example in building and infrastructure projects with the Finnish public sector, which has produced real estate investments with low correlations to other real estate markets. On the other hand, the average correlations between the Finnish real estate and other markets have increased for some years now, and the focus on direct projects
has had more to do with PICs fairing rather bad in property bid competition in comparison to international real estate speculators with sky-high bids.

**Selection and pricing: general dispositions**

As all asset classes are understood having a specific nature, it is hardly a surprise that dispositions in security selection and pricing are very much asset class dependent. However, there are some typical logics throughout different asset classes. Cash flow analyses, ‘hard’ numeric data and mathematical models form the essential core of individual asset selection and pricing in PICs. The ‘fundamentals’, economic or otherwise, dominate security selection. As one interviewee put it, ‘it’s all about value investing’. However, it is rarely a homogeneous equity pricing strategy because the managers in teams tend to use their own favourite models. Similarly, in bonds, there may be quite homogeneous beliefs concerning ‘the big picture’ of the world economy but many differences in beliefs on short-term issues in different bond types. Moreover, in both these classes, investments are typically based both on economic fundamentals and on varying supplementary qualitative concerns, for example governance systems and juridical issues.

Heuristically, the more financially risky an asset is considered, the more focus there is on the qualitative aspects of the vehicle. For example the loan conditions of high-yield bonds are usually checked much more carefully than in case of investment grade bonds. The logic is especially strong in fund selection. Hedge funds as somewhat illiquid assets are especially demanding, as the funds need to be assessed with various criteria. It always requires long analyses, time, skill and education, and sometimes
even positive examples elsewhere in the world (e.g. US university endowment funds) for portfolio managers to find the right funds.

The mode of diversification and the relationship between alpha and beta are other features that characterise asset selection in most classes. Some managers rely heavily on core-satellite-type portfolios where the ‘borderline over-diversified’ core beta, as one interviewee put it, is supplemented with distant satellites of more exotic alpha. Some managers consciously avoid the core-satellite method, for example by neglecting funds of funds altogether. Managers with more alpha-driven philosophies build their own ‘genuine portfolios’ that mix the approach. For these managers, as for those who wish to reap economies of the scale, the primary investment risk is not to have too centralised but too diversified portfolios – for example 20–30 companies may be too much in one equity portfolio and 20 funds in a hedge fund portfolio. Especially in case of funds, ‘you do not want too many names’, as one interviewee put it. Over-diversification is nevertheless considered a secondary concern. For example, if hedge fund investments provide lower correlations to equity and credit risks in the overall portfolio, over-diversification is hardly considered a problem in that class. In this sense, diversification must be primarily understood first as optimising (quantitatively and qualitatively) the overall portfolios and only then as optimising the individual class or security type portfolio.

Geographically, the PIC investments are global but anchored to the “core” of direct and fund-based Nordic and European investments and supplemented by the “satellites” of mostly fund-based American (all classes), Russian (real estate), emerging market (various classes) and offshore domiciled (hedge funds) investments.
The portfolio manager level interviews suggest that there has been a somewhat clear shift from Nordic to European investments in the core selection. This is not because the managers would know European companies better than the Nordic ones, as the latter have caused surprises in recent years, but because it is becoming more difficult to find other than high correlations between Finnish and Nordic companies. Moreover, the eurozone markets have more liquid assets available and no currency risk when compared to the Nordic countries of which none other than Finland belongs to the eurozone. At least direct equity investments to other Nordic economies are somewhat likely to become rare in the future, as Finnish companies provide similar characteristics but with an information premium (see below).

One question I typically asked in the interviews was that what kinds of factors get managers interested in individual securities. The typical answer was the relative advantages, both as the investee firms’ advantages in relation to its competitors and to the role of the investee firm in the investment portfolio. The advantages depend on the asset class and vehicle type. In real estate, for example, investment opportunities that provide as stable return flows as possible are the simplest objects invoking interest. Another typical factor raising manager interest in selecting equity, fixed income and other funds, is the access to some specific markets. Fund selection more generally has a few typical field-wide dispositions. For example, PICs look for funds whose managers have good personal and performance reputation, and they must have an investment philosophy that is consistent with the PIC strategy. On the other hand, there are some differences how funds get selected procedurally. The funds can be ‘procured’ but also selected on other grounds in a very supply-driven manner, albeit that in these cases managers at least tend to check the fees of their fund investments.
annually. In part these practices are related to the legislation that has eliminated the usage of external managers, which brings issues more typical to manager selection present to fund selection.\textsuperscript{46}

There are similar dispositions in avoiding some investments. Personal and DD issues are key characteristics behind the funds that PICs tend to avoid. For example Asian, Russian and Chinese hedge funds are considered less reliable than US, UK or European funds even when they all invest in emerging markets or operate in markets considered institutionally less developed.\textsuperscript{47} Problems in DD directly screens away funds in hedge fund, private equity, real estate and in some scope in all other classes as well. Most managers avoided large-scale leverage, sustaining volatility, potential hazards regarding to risk management (e.g. fixed income spread focussed hedge funds, complex structured ‘quant-made’ vehicles), and socially potentially illegitimate targets (e.g. aggressive vulture funds) in both fund and direct investments. It could be argued that negative screening of investment vehicles is rarely based only on quantitative virtues of portfolio diversification and more often on qualitative risks whose observation is habitualised in past personal and collective experiences albeit that some interviewees considered this explicitly more common sense than personal skill.

There are also some dispositions that are in nature negative: that is, shared by explicitly not having some disposition. One of these dispositions is the lack of

\textsuperscript{46} It must be noted that it is also possible for example to invest in some hedge fund with dynamic risk budgets and limits in the mandate, which makes the division between mandated managers and fully external funds blurred. This said, these practices are considered rather exceptional in the field.

\textsuperscript{47} Reliability does not, of course, imply that other issues are considered to be in order in these funds. For example some managers consider UK-based hedge funds consistently too volatile.
organisation-wide philosophy for using derivatives at least for other purposes than solvency management. The need for using derivatives is typically based on individual manager choices dependent on market developments. Some managers have ‘patent solutions’ or ‘desk drawer packages’ for using derivatives if necessary. Derivative tactics may for example address longer term and short-term financial cycles in managing credit risk and some tactics aim at hedging against inflation, which both are used in mid-term solvency control. In a shorter timeframe, index-linked futures may be used to avoid rapid index fluctuations. PICs have traditionally used primarily futures. Now, they use all kinds of derivatives like options, swaps, swops, swaptions and so on, but still in a quite conservative fashion. A good indicator here is that derivatives change the overall allocations very mildly. For example Ilmarinen, one of the more active users of derivatives, reports that the derivatives lowered its equity weight only by 2.5 percentage points in 2009.

**Selection and pricing: asset class specific issues**

Equity investment is based on rather clear division of labour between portfolio managers who follow their own models and selection criteria. For most equity managers, equity pricing is by and large about beta, not so much about event-based alpha-driven stock picking. Cash flow analyses serve as the point of departure for equity investments, although sometimes instincts, statistics and even heuristic visual aids (although no interviewee had an identity of a ‘chartist’) may provide valuable fuel for decision-making. Stock-picking is often supplemented by personal skills and experiences that are difficult to quantify. For example in selecting equity funds, having a ‘feeling of a good idea’ may prove as valuable as the investment philosophy,
costs and people of the fund. In this sense, cash flow analysis hardly explains all the equity investments. All interviewed equity managers nevertheless used some kinds of cash flow analyses. It seems that the alternative investment style notions like ‘growth’ were prevalent in the world of PICs last time in the 1990s.

In addition, there are a few qualitative issues that raise general interest in equity managers. Readjustments of relative advantages of businesses in their competitive environments raise much interest and changes in longer-term considerations on business prospects changes interest in different sectors. Questions from more specific contexts like how the Finnish pulp industry will perform in ten years time to very general questions from ageing societies to climate change are everyday issues in equity investments. This is not to say there are firm beliefs that climate change for example will change the world altogether, but that climate change will definitely change the investor-projected value of different companies.

Private equity investments resemble much of listed equity investments although more fund-based especially in smaller companies. According to one interviewee, the managers focus relatively more on choices made by other PICs in this class than in others, which is caused by the observation that publicly available annual profits tell investors nothing about private equity experiences. Only internal rates of return can provide such picture. Investments in this class are best characterised by dispositions of constant gathering of information on possible funds and constant screening of the potential ones. This can be done very effectively even despite lack of official information as also less official information is largely available to PICs. Private equity managers tend to divide their responsibilities geographically or/and by sectors.
Cash flow analyses are the regular tools in direct pricing, but it typically also includes qualitative tools that vary from one manager to another. PICs in general tend to avoid pro-cyclical and heavily sector-based funds. There are typically few ethical or other negative screening criteria for private equity vehicles and funds. The negative screening criteria typically include the ‘usual suspects’, for example weapons, pornography and gambling. The usage of derivatives is rare in this asset class.

Direct private equity targets are usually in nature strategic and selected internally, but may be managed externally in which case PICs confirm the providers are properly regulated and supervised. The managers and external service providers, whose selection is crucial as PICs have found only few suitable active providers and tend to regard regular analysts quite useless, can for example create opinions on targets and funds and rank them geographically and by styles. As in other fund types, people and transparency are considered the primary virtues in private equity funds. The operational environment of PIC private equity investments has somewhat changed in recent years as private equity funds have started to market themselves very actively to PICs. However, fund investment styles that raise interest among private equity portfolio managers is very much dependent on real market conditions, not just the philosophies of fund managers. For example, there has been in recent years much talk about mezzanine funds (in practice preferred stock funds) in this class, but it has raised little attention without rigorous products in the field.

Fixed income pricing is much dependent on particular markets and their state, so it is very difficult to say anything universal about the pricing and selection dispositions. Managers in general differ in their attitudes towards the class. Some individual
managers feel comfortable only in state of constant pessimism in order to avoid the
‘essential downside risks’ of bond investments that provide so little ‘upside’. The
nature of markets also varies by bond types. For example sovereign bond trades
resemble auctions providing little room for pricing tactics whereas corporate bond
credit spreads may be wide – sometimes so wide that they require careful pricing in
order to avoid influencing the overall market. The weight of criteria from economic
fundamentals to political risks also differs very much according to different bond
types.

There are only two domains where any common criteria can be found in this class.
The availability of information plays an important part in domestic bonds that are
almost exclusively based on internal management. Without having sufficient
information and sometimes information most other investors are not expected to have,
domestic bonds are not likely to end up to be selected. In fund selection, the common
feature is the focus on people behind the funds as in other classes. On the other hand,
there are quite specific avenues for confirming the potential success of the funds’
philosophy and for screening good candidates in this class. For example, funds with a
negative track record throughout their existence are usually avoided even though
portfolio managers do not choose funds on basis of their past performance.

Selecting hedge funds is much about finding the need for them according to other
classes by monitoring market spreads, events, and existing investment vehicle
weights. Economic fundamentals play a smaller part in (at least other than long-only)
hedge fund investments than in other classes, and influences from domains like
behavioural finance and observed deficiencies in trading schema are more important
in determining hedge fund choices. Commodity investments are also typically connected with broader hedge fund positions and consulted with commodity trading advisors (CTAs). The hedge fund portfolio managers tend to look for funds in the areas of personal expertise they have (e.g. equity derivatives or volatility based funds) in order to gain comparative advantages. Some managers avoid funds of funds while for others they are preferable for diversification purposes. Traditional multi and macro funds are familiar to most PICs, and more exotic funds may include seeding, catastrophe premium, asset-based-lending, and microfinance funds. In practice, the PICs invest in the whole spectrum of hedge funds at the field level, but not necessarily in individual PICs.

Selecting hedge funds includes an exceptionally strong focus on DD issues: as one interviewee put it, ‘it’s people first, concept second’. Most interviewees considered the PIC DD operations very rigorous and reliable. Funds whose DD issues have not been checked or otherwise yet monitored can be shortlisted and later selected when the risks and investment methods are properly understood. Some use internal control and others external advisory in DD operations, and neither party necessarily understands the other’s approach. External advisory is very often used, typically from large service providers. Managers may use some rules of thumb like checklists to confirm that asset management, governance and auditing are properly arranged in potential funds.

The loans and premium loans have quite little to do with financial market style investing, as they are based on applications (including syndicates and procurements), credit ratings and risk evaluations (typically by using external services), collateral
evaluations, loan purpose evaluations, and the making of the offer on conditions that
the client may accept or not. Although PICs have lists of lending products for
marketing purposes, client financing is still about negotiations and having dozens of
client meetings daily. ‘It’s a blazing job’, as one interviewee put it, as calendar days
fill up well in advance or the previous day at latest. Decision-making is based on
consensus between credit managers, and the riskier the potential investee firms are
considered, the more analysis is needed to back consensus. There are a few common
issues present in selecting the targets. The PICs are not willing to be ‘permit agencies’
(as one interviewee put it) who select their debtors in any other than financial
grounds. This is not to say financial analysis does not have qualitative features. The
economic projections of projects and their fundamentals need to be in order and
guaranteed.\textsuperscript{48} Credit is not provided to criminal activities or to any activities that
might have relations to white-collar crime such as tax evasion or money laundering.

It could be argued that the PIC real estate investments have a core-satellite-structure
but with an inverted content on basis of liquidity. The core consists of less liquid
domestic real estate investments with strategic weight, typically accounting for the
majority of the real estate portfolios, supplemented with diversified satellite
portfolios. The allocation is usually categorised further to large commercial properties
that which may also be more specific like shopping centres or even individual
projects, other commercial properties (e.g. office buildings, hotels), residential
properties, and some smaller categories with more or less fluid boundaries. The

\textsuperscript{48} This refers to bank or asset-based guarantees. For example Varma states in its annual report bank
guarantees are the primarily required form.
overall volatility of the real estate portfolio can be controlled with investing in residential properties and more liquid prime properties.

The real estate portfolios have limited international diversification in terms of funds, and both domestic and international investments are much limited to the largest urban areas. Varma for example reports to prefer residential real estate that is located near rail traffic mostly for environmental reasons. This also has broader motives, as the theme was present in some interviews as well – the PIC real estate investments tend to be allocated only to locations where people and businesses move and reside in volume. The other motive behind this preference is the willingness to keep the utilisation rate of the real estate as high as possible, which has been considered a successful strategy in many PICs. The PICs invest in REIT type funds internationally (most importantly in EU countries, US and Russia) with strategies somewhere between typical Core and Core Plus strategies. Fund selection is based on similar methods to other asset classes, although some interviewees were very strict on the criterion of having the same real estate philosophy as the PIC.

**Financial networks, social roles and ownership**

Investing in Finnish domestic targets has traditionally been one of the key political questions in the field of PICs. Yet the overweight of domestic investments is a curiosity from the perspective of diversification. PIC portfolio managers tend to be sceptical about it from portfolio theoretical perspectives but they nevertheless accept it. Why? Perhaps the most important factor explaining the overweight on domestic investments is the major ‘home field advantage’, as one interviewee put it. One
interviewee summarised this advantage by noting that while the Finnish market is so ‘narrow, thin and short’ that all listed firms outside the largest ones include very significant liquidity constraints as investment targets, it is interesting for PICs since it is not possible to ‘play with varying consensus expectations’ in the market. The Finnish equity market in other words provides a fertile ground for value investments – at least as long as the PIC capital does not disturb or excessively inflate the Finnish equity market. The returns on domestic equity have been – at least on the basis of PIC annual reports in which the theme was mentioned – relatively high in comparison to OMX Helsinki indices in the recent years, which implies the strategy has been successful.

Another phenomenon that supports the ‘home field advantage thesis’ is the easy availability of information. As one interviewee put it, globalisation broadens the markets but narrows down possible targets, which increases the need for reliable information. The domestic investments provide an ‘information premium’ especially in relation to Nordic and European equity investments. The premium was a prevalent theme in most interviews. The equity managers considered it very easy to gain ‘sufficiently’ information on Finnish companies without excessive measures. Nearly all interviewees, almost independent of their organisational status, considered PICs having a central position in the Finnish financial networks they significantly benefited. They do not need to make the phone calls, as they are the ones who are called when new information on Finnish companies, as one interviewee sketched.

Working in a PIC investment function was regarded as having a position with an exceptional view on the Finnish markets. Especially the credit arms have a very high
position in Finnish financial networks and can use their information premium very effectively in business evaluations and loan offers. PICs offer an ideal position for a portfolio manager also in case of hedge fund investments – although not as investment environments, as Nordic hedge funds are mostly ‘man and Bloomberg’ style ‘dictator-driven’ boutiques, as one interviewee put it. At the same time, some interviewees considered working in a PIC to include a burden. Some interviewees felt they must justify their activities to outsiders all the time, as the outsiders had strong opinions but little knowledge on investments or pension provision in general, and some said that those public figures that knew the least about investments were given the most media time. ‘Everyone is interested in your activities, but knows hardly anything about it’, as one interviewee summarised the position of a PIC employee.

The financial crisis of 2007–08 revealed at least two different aspects on how central the social role PICs actually have in the Finnish financial sector. Firstly, the TyEL capital is essential in providing raw financial fuel for larger economic projects such as economic revitalisation or infrastructure projects, or projects in which state ownership of companies is restructured (including privatisation). It may be difficult for a PIC to join for example a large infrastructure project as a major independent contributor due to fact that the ‘strategic side’ of the PIC portfolios, the big projects with low liquidity, has been quite crowded already. But it may be equally easy when PICs only provide complementary capital to or when the financed project has guarantees from public actors like Finnvera or Tekes. Secondly, PICs are investors with perhaps the best resources and capabilities to assess individual economic projects in Finland due

49 Finnvera Plc. is a specialised state-owned company that provides loans, guarantees, venture capital and export credit guarantees to businesses having links to Finland. Tekes, the Finnish Funding Agency for Technology and Innovation, is at least arguably the most important public funding source for research, development and innovation in Finland.
to long tradition in this area. Finnvera and Tekes for example have much less tangible expertise in this area and in some scope even require PICs to fulfil their own roles effectively. It could be argued that even when PICs provide supplementary capital with premium lending and client financing to projects primarily financed by other sources, they are hardly ever merely passive sources of capital but necessary and complementary sources of skill and information.

There are some other prevalent institutions that characterise the contemporary social role of PIC investments. There are some general level nationalist flavours in the PIC investments. One interviewee even explicitly argued that capital has a homeland. For a few interviewees, being a mandatory national pension scheme implied that all activities related to TyEL have to be regarded as nationwide economic and social policy issues. Among the main issues here were those considered affecting pension costs: the employment rate, wage levels, retirement age, and longevity. Although PICs have operations in the areas of working welfare, working ability and rehabilitation, these are hardly issues considered in investment practices. Employment and growth, in contrast, are. It can be interpreted on basis of a few interviews that there is much will in PICs to increase investments in smaller businesses and early-stage firms in order to increase real investments and promote job growth in Finland. The regulative framework of PICs makes such investments somewhat difficult for reasons of liquidity and solvency. The supply for these opportunities in Finland is also scarce. Some private equity managers had had negative experiences with the financial performance of earliest stage firms during their personal careers (in PICs or elsewhere), which has kept allocations to these securities quite low. One informant also suggested that there has been a well-established understanding in the field that
there are already adequate sources of financing for Finnish firms regardless of the PIC investments.

The case of communications service provider *Elisa* provides one illustrating example concerning the contemporary political role of PICs in Finland. The PIC *Varma* stroke an unusual deal with the state when it bought over 15 per cent of *Elisa* stock in 2008. It announced shortly after the trade that it has agreed with the state that the latter must buy over one half of the stock by *Varma* if the company decided so. The mainstream interpretation was that the Finnish state used *Varma* to drive out Icelandic investors from *Elisa* to ensure state influence over an important strategic sector. Another popular interpretation is that the Icelandic investors tried to restructure the governance structures in the firm, which was not something the PICs wanted. In the former interpretation, TyEL capital is surprisingly flexible as a tool for Finnish public policy when public guarantees or deals are made despite its apparent regulatory limitations, while in the latter it is among the key driving force behind the Finnish corporate governance system. Either way, the role of PICs in the governance of the Finnish economy is broad and potent.

The PICs are in general active in their approach to ownership. *Ilmarinen* for example reports participating in 90 per cent of Finnish investee firms’ annual meetings and having twelve processes aimed at changing investee firm behaviour in 2009. *Varma* reports having regular communications with investee firm management between the annual shareholder meetings. One reason for this is the central role in financial networks – the ‘need for shareholder activism spreads extremely fast’, as one interviewee put it. Another reason is the established and valued connections to all
levels of Finnish business life: it is simply easy to engage in corporate activities. The PICs also have much cooperation in corporate engagement.

Most companies have explicit policies on proxy voting and transparency. The reported ownership policy process is discursively divided to different stages in most annual reports. Typically, the PICs report to first analyse and form opinion on the existing proposals, and evaluates whether new proposals are needed. After this, the PIC communicates with other investors and plans the process for active engagement efforts, and eventually gets in contact with the investee firm directors, boards or, if needed, other employees, and debates the issues by for instance visiting the firms. In terms of dispositions, the reports do not quite extend beyond this symbolic and all but substantive description. Some PICs argue that the topics discussed are very wide and cannot be specified in context of annual reports, while others give some details on issues that have been discussed with investee firms. Ilmarinen for example reports having conversations thematically on work and environmental safety issues and on extractive industry activities in Western Sahara.

Often PICs are illustrated as ‘universal owners’ in the Finnish business life. However, it must be noted that as the size of individual bets are more limited than in early 2000s, the PICs can be hardly thought as a financial block as such. When we look at the relative amounts of listed domestic equity, there are only three Finnish listed firms (Kemira, Lassila & Tikanoja, and Technopolis) whose overall PIC ownership exceeds 15 per cent of the total stock although eighteen where it exceeds the 10 per cent
Furthermore, the strongest norm concerning corporate engagement presented by two interviewees was that the single largest individual investor of a listed company must always be in control of activities related to annual shareholder meetings – either ‘in charge of’ or at least to serve as ‘the negotiation hub’ in all corporate governance measures. While the PICs are happy to participate in corporate governance efforts and affect investee firm behaviour whenever it provides any tangible value for them or serves their other interests, they are not necessarily willing to take the costly responsibility of building investor blocks to shareholder meetings. Indeed, some companies report that all ‘shareholder activism’ can be justified only when it improves financial returns and requires almost no time resources. Some companies also note that responsibilities apply only in close relations like in home markets, and that trying to affect investee firms simply gets too difficult whenever moving away from Finland.

**Social responsibility**

Social responsibility (SR) is among the most common discourses used in the public relations material of PICs, and it has some relevance concerning investment dispositions. Some companies even call their reports ‘annual report and responsibility report’, and others have published separate SR reports either periodically (during the annual reports or every two years). There are a few issues that characterise all the reports. The discourse is closely related to broader social roles and relationship of

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50 This includes voting and non-voting-right shares, which suggests that the PICs have even less votes in the annual meetings. The companies in which ownership exceeds the ten per cent mark are Akitia Bank, Aldata Solutions, Alma Media, Leverator, Marimerkko, Nokian Renkaat, Okmetic, Pohjola Pankki, Pöyry, Ramirent, Sampo, Suominen, Talvivaara Mining, Tekla, Tiimari, Uponor, Wulff-Yhtiöt and YIT.
PICs. For example, *Eläke-Fennia* reports all the stakeholder expectations that it has observed to face in its activities and *Etera* explicitly lists all the norms and guidelines that it follows in its operations, most of its business partners, and most networks and projects that it belongs to. Another set of references the SR discourse typically includes are the broader international processes related to SR, for example the UN Principles for Responsible investments (PRI), Global Compact and, in case of reporting, the Global Reporting Initiative (GRI). For instance *Ilmarinen* also reports being involved in the Carbon Disclosure Project that evaluates the effects of climate change to investment issues. Being parts of these processes broadens the SR agendas from more local and national level issues to global questions. Good performances in these processes are reported as well. Some PICs for example report that they have had ‘excellent’ annual evaluation results from PRI.

PICs typically highlight the Finnish legal origins of most if not necessarily all their responsibilities in their annual reports. Basically all companies highlight profitability, customer satisfaction and good (or tailored) services for customers, stakeholder relation management, preferable working environments, and other features familiar to corporate responsibility discourses. Every company provides extensive information about their governance structures and investments, and underline the issue of transparency. One interviewee crystallised the approach by saying that transparency is a valued norm as such in the field, and it would be ‘cowardly’ not to be completely transparent when listing investments. PICs rely much on external standards in their separate SR reports or chapters dedicated to SR in annual reports despite limitations for adopting some of these standards (e.g. GRI). No company relies on any single definition of socially responsible investments, and they all report being compliant
with various standards (TELA recommendations and e.g. UN Global Compact, PRI, and ILO standards).

All the studied PICs categorise SR issues to economic, social and environmental responsibilities more or less explicitly. The contents of these categories have only subtle differences between the companies. The social and economic responsibilities are in every company more or less directly related to pension provision. The typical definition for economic responsibility is investment making, doing it as such, not as any specific kind of approach to investments. It is only later in reports when the meaning of or approach to responsible investments is defined.

The responsibility for executing the pension system is typically seen as the primary social responsibility but with slightly different connotations. Some extend this responsibility to a more general responsibility to execute Finnish social policy in general and some mention the engagement in the political development of the pension system as an essential responsibility, whereas others remain more limited to describing their own functions like customer and online services and the performance of the company in these functions. Working life and working capacity issues and services are essential contents for these responsibilities. Working conditions of own employees is the second typical issue that is discussed in all the annual reports in context of social responsibilities. Indeed, the PICs are happy to report that their employees are equally happy in their jobs organisation-wide. The PICs can be also involved in more or less charitable engagements to or partnerships with social activities such as supporting youth, environment, senior citizen projects, and research projects.
Environmental responsibility is perhaps the most divergent of these three categories, as most responsibilities in other categories are in content defined in some content already by the law. Most companies report that the environmental footprint of their main activity (explicitly ‘paperwork’) is almost insignificant in environmental terms, but they still have been focusing on the environmental impacts of their office buildings, which they also report quite extensively. The dominant idea in environmental responsibility lies in the environmental impacts of real estate – both in terms of real estate investments and own office work.

Investments are present in the SR discourse in quite limited terms. The policy documents on socially responsible investment are usually short, unlike ownership policy documents. There are strong expressions of principles and long descriptions of what PICs aim at doing with investments (e.g. increasing the long-term shareholder value of investee firms or improving Finnish employment) and that they comply with various standards, but only scarce or no information on how these policies are actually implemented in investment actions. For example almost all companies report that SR issues are ‘integrated’ to or are ‘a part of regular analysis’ but only one provides a more detailed process description. No company describes what information they are exactly looking for when analysing potential investee firms.

There are actually very few dispositions that are disclosed in the publicly available material. Eläke-Veritas, as most PICs, reports that it does not invest in illegal activities or activities that are not in line with international human and basic rights agreements. For another example, Varma states in its annual report that it always
favours Finnish companies if yield expectations and qualitative criteria are similar in different targets. Otherwise, the expressions used in policies and reports are very general level remarks like in case there are problems with investee firms, the PICs consider selling securities, or that portfolio managers evaluate the responsibility issues in their portfolios directly or by using external advice (e.g. annually or twice a year). Similarly, PICs provide information about their external service providers and their position in investment process (e.g. information provision or audit) but do not necessarily tell anything about what kinds of information or evaluation results they receive, what the criteria used are, and how the information or the results are used in investment processes.

How are SR issues put in practice in investment agency, then? Environmental, social and environmental issues (the ESG issues) required by the PRI for example belong to the portfolio manager duties, albeit that analysts are more likely to monitor investee firm developments and compliance functions ensure supervision. The managers are rarely proactive in corporate governance issues because their resources tend to be very limited. It is often repeated in the annual reports that the idea of responsible investment varies from asset class to another. Typically SR issues have most to do with equity and bonds. For example Varma reports to evaluate only these portfolios periodically from the perspective of SR.

The equity manager interviews suggest that equity has been sold on basis of unethical activities although never in case of Finnish firms operating in Finland, as one interviewee pointed out. Suspect developments and structures in investee firm corporate governance have also led to selling of stocks, and are in general regularly
avoided by PICs. Perhaps most tangibly, in (the extremely rare) cases where two financially equal investee firms are considered, the one with tangible long-term CSR agendas and frameworks is much more likely to be selected by portfolio managers. Even so, portfolio managers are not willing to try to improve the investee firms’ SR. Producing impacts in SR issues through investment activity has been seen difficult especially in value investing – as one interviewee put it, ‘you cannot see social responsibility through cash flow models’. Portfolio managers prefer acting themselves responsibly as prudent and profitable investors over looking at investee firm SR issues.

Some portfolio managers regard the integration of ESG issues in general as inconvenient and even damaging if it does not translate into significant increase in resources. It is thus hardly a surprise that the CIOs and directors in general have experienced difficulties to integrate some SR issues in investment practices. In some PICs this may have much to do with normative legacies that have deemed ethical considerations unnecessary and rather embraced democracy both as public definitions over appropriate investment behaviours and as the duty of legislators to directly ban inappropriate business activities. Some PICs have highlighted in the few latest annual reports that they try to avoid investing in emerging market bonds, since they cannot necessarily guarantee human rights and other standards adopted in investments. In most companies, however, the limited resources and cost containment pressures are sufficient to limit integration.

Cost containment pressures are also essential in case of SRI and ethical funds. The funds have been tested, but they have provided little value for PICs in general. From a
PIC point of view, SRI funds tend to be ‘ridiculously expensive’ in relation to their ‘vague’ investment philosophy. For example one interviewee was offered a popular SRI fund with the method of negative screening, total costs (TER) of one and half per cent, and inclusion of 85 per cent of a related index. The kind reply to the offer was that the interviewee could personally create such fund with TER costs with one tenth of the costs and with a much more rigorous screening philosophy.

It must be noted that costs are not always considered the prime obstacle for integration of ESG issues in investments: it may be information as well. This was well summarised by an interviewee for whom any corporate malpractice is easy to observe in Finland not least as ‘we can read it in the front page of *Helsingin Sanomat*’, but almost impossible to be confirmed especially outside the developed countries: ‘how can you know whether an Indian company is responsible for polluting some source of water or not’. In this sense, it is ineffective to use even negative screening, arguably the simplest of integration methods. This is why screening methods adopted by individual managers both in equity and corporate bond investments have typically excluded only clear-cut sectors like tobacco, gambling or weapons.

Despite the antagonistic attitude towards more symbolic SR issues in investment functions and the consequent scepticism towards responsible investment more generally, the integration of more effective ESG measures are in developing process and PICs are willing to commit in transparent auditing processes in all possible areas. ESG factors are already present in basic analyses on some assets, especially governance issues in all assets, funds or direct, and in compliance functions. Screening methods are used and at least debated in investment teams, and ownership
policies are constantly turned into practices. The PICs have joined the PRI and started to assess their performances, and there have been at least plans to increase BoD and investment function education on ESG issues. The communications divisions have also been seen helpful in developing SR related communications. Environmental factors have become essential in all real estate investments and building projects. PICs are for the most extensive environmental certificates for their real estates. The experiences on environmental issues in real estate have according to some interviewees been very helpful in bringing in environmental concerns to broader investment functions. On the other hand, the same interviewees tended to see environmental concerns erode in portfolio manager mindsets during the financial boom years.

The financial crisis of 2007–08

From a theoretical perspective, habitual institutions are the easiest to discover in situations where the proficiency of dispositions is questioned or threatened. The financial turmoil of 2007–08 questioned the PIC investment functions’ dispositions during the period of the empirical study. The crisis was an important theme in all interviews even before I had the chance to ask about the crisis. The financial crisis with no doubt caused institutional change, but the changes have not been so radical (at least this far). An illustrating example was given by one interviewee who said that the crisis hardly surprised any of the investment teams of their company. Although some teams had witnessed much quite unanticipated spreads – the first surprising spreads had actually occurred before the crisis – especially in their fund investments, which
had changed some attitudes to the underlying asset class, there was no substantial change in pricing methods.

In order to understand the changes in investment dispositions it must be noted that some investment practices were affected much more directly by the changes in the frames of the field than in the financial market conditions. This makes it difficult to account for some changes. For example, whilst the crisis did not lead to significant changes in the mandates of equity managers, some equity managers felt that it would have been difficult to buy stocks in late 2008 due to the uncertainty caused by the law even more than to the state of the market (albeit noting retrospectively that there were hardly any interesting stocks to buy at that time). The credit crunch also caused a sudden surge in the popularity of premium loans – ‘the hit product of 2008’, as one interviewee put it – which made it laborious to provide some loans, as the credit mandates had to be quickly readjusted. The readjustments did not necessarily happen too accurately due to great uncertainty concerning the rise of popularity and to the sudden scarcity of credit teams’ resources that were engaged with the premium loans. No interviewee had nevertheless faced too much trouble in shifting allocations, which suggests PICs are still very well equipped to cope with changes in popularity of premium loans.

Some changes had also more to do with individual organisation level action processes than with field-level investment dispositions as such. The investment teams felt the crisis in their organisational settings most importantly in form of increasingly controlled mandates, stricter trade limits, or/and strategic decision-making in vertically very integrated and coherent communications. The bond managers were
first in the spotlight when the crisis broke, and their daily activities became closer to strategy deliberations. The lively debates in investment functions also questioned old dispositions. There were for example some disagreements in adjusting the duration of the bond portfolio towards more aggressive tactics after the worst crisis waves. Some PICs had had disappointing experiences in structured investments, which lead to increasing scepticism to the class among the more experienced (‘middle-aged’, as one interviewee put it) bond managers, but not necessarily among analysts or external service providers. The crisis in general changed some manager attitudes towards external service providers, most importantly investment banks that had besmirched their reputation (e.g. by offering terribly performing funds), which has lead to some reduction of external services altogether. In these kinds of cases, institutional changes are coupled with organisational changes and cannot be purely explained by personal insights and beliefs.

The PICs survived the financial crisis financially quite well. One PIC even put it in its annual report that there has been no corresponding ‘survival story’ elsewhere in the world. The year 2009 was considered “a record year” by some PICs shortly after reported having “the worst year ever” in 2008. The value of overall PIC investments dropped from 77.5 BEUR to 65 BEUR between the end of 2007 and 2008, but rebounded back to 77 BEUR in the end of 2009. The slump was bad for all PICs. The value of PIC overall portfolios diminished during the year 2008 by 12.5 per cent on average, ranging from losses of 7.2 per cent (Eläke-Tapiola) to 19.2 (Etera).

In fact, the financial performance of the PICs was in comparison to benchmarks impressive during and after the crisis. This was true especially in case of equity and
Finnish domestic investments. Eläke-Tapiola for example reports generating an overall yield of 45 per cent for its listed equity investments in contrast to the global benchmark index (MSCI World) rise of 27 per cent. Varma achieved an increase of value of 53.8 per cent for its domestic listed equity investments in 2009 while the OMX Helsinki index rose less than 20 percentage points. The hedge fund performance was also impressive especially in the early 2009 when markets were still bearish. For example Varma reports achieving 36.9 per cent returns for its distress fund type hedge fund investment for the whole year, and Eläke-Fennia reports generating constant stable yield for its hedge fund investments throughout the year and having no single month with negative returns. All classes were not, of course, as profitable as equity or hedge funds. The private equity and direct lending performance was modest. Eläke-Fennia for example reported private equity losses of 18.8 per cent and anticipatory lending losses of 1.1 MEUR. Real estate returns remained modest for most PICs. The market in general faced many changes, as there was investment demand only for A-class real estate, but supply primarily for riskier targets, as Eläke-Fennia crystallised it in its annual report.

But what explains the good relative performance of PICs during and after the crisis in institutional terms? The explanation has much to do with history and personal experience. Some interviewees regarded the financial history of Finland as the key factor for PICs to survive financial crises. These interviewees titled the cultural history of Finnish financial sector a history of ‘banana republic’ of finance, whose networks still in 1980s consisted of a small group of ‘intelligent teenagers’ speculating on Helibor and Euribor spreads, as one interviewee put it. The experienced portfolio managers could sense what was coming because leverage was
nothing new to them: they had already seen what the liberalisation of finance and opening of financial markets caused in Finland in late 1980s and early 1990s. The PIC portfolio managers knew how to interpret these oddities and they could see where the Icelandic jet-set investment bankers, ‘the prices will never fall’ arguments of Fannie Mae representatives, and the indications on the UK and Spanish housing booms were going to lead.

In institutional terms, the anticipation of the crisis thus had much to do with mimesis. Some of the mimesis was about interpreting financial innovations through past experiences. In the years preceding the latest crisis, portfolio managers had witnessed a few years of (failed) marketing attempts of investment banks promoting complex structured and leveraged products with many pages of mathematical algorithms and automatic trading schema based on tens of thousands of daily trades. The reason why many portfolio managers avoided these products as well was that they were not ready to commit themselves to something they, or the investment banks selling the products, as many added, could not understand. Most managers actually did understand complex products and the latest market trends very well – they just did not understand why anyone would like to be a part of them.

The credit arms are an illustrating example here. Credit arms had seen the crisis coming because of ‘utterly unrealistic levels of leverage’ that was learned to be fatal in the recession of early 1990s, and which was why the credit arms did not participate in highly leveraged projects that cash-fuelled banks were happy to finance. This was also a challenge for the credit arms, as they needed to stay in the boom-time markets that did not provide projects responding to the PIC credit philosophy too well. It was
thus equally much a risk not to get involved in different kinds of projects as it was to be engaged in ones with complex financial arrangements. The experience of the beginning recent crisis could not be observed by the criteria of previous Finnish recessions, since the previous crises were filled with legal controversies and claims whereas the recent one was not. This is where interpretation comes into play with the old schema. One interviewee had witnessed a minor (and unique) calculation error in a PIC package loan offer. The margin of the loan offer was much higher than the market-based interest rates and margins, but the client was still more than happy to sign the deal. For the interviewee, this one single deal – ‘the best deal’ of his career – was a direct indicator of a deepening recession.

Many interviewees had seen a few financial cycles and considered the crisis more a ‘lost six months’ than anything like a profound crisis of capitalism. For some director level interviewees, however, the financial crisis was a more traumatic event, as nearly all the choices that had to be made at that point were strategic. What usually was considered tactics was now pure strategy. For some PICs, the only goal was to survive the crisis in terms of solvency, which implied a strong rebalancing of portfolios to lower risk. As the markets quickly bounced back to growth track, the PICs had again to readjust portfolios to capture the fruits of the new rise. This task was considered anything but easy by many interviewees. It was in part due to organisational disagreements within investment functions but more importantly between the functions and the BoDs. Especially increasing the weight of equity was considered difficult, albeit that nearly all PICs managed to capture very much of the growth. In some PICs, this situation brought allocation issues from the board to investment committee level and left only the legal requirements to boards, and thus turned the
strategy-tactics division upside down. Suddenly, all strategic choices became tactical. The bounce increased the importance of stock-picking.

Nearly all annual reports mention that the shift took place in March 2009, from which on PICs started to increase the risk and weight of listed equity in portfolios in general, and to dissolve their derivative positions. There were some subtle differences in how the weight of equity portfolio was increased. *Eläke-Tapiola* for examples reported to have increased its investments in global corporations with good competitive positions because they witnessed a groundless decline in their stock prices in the previous years, and in emerging market investments. Some PICs, in contrast, invested in less selective but geographically more limited ETFs. In some annual reports of 2009, low interest rates and the threat of inflation are mentioned as the key immediate risks in the investment environment, whereas others highlighted longer-term issues related to real economy. For example *Varma* considered unemployment as the key challenge to PIC operations, as employment has a central role in defining the overall pension costs in the short term, whereas *Eläke-Tapiola* highlighted the importance of low level of demand and changes in industry structures in developed economies and *Veritas* the importance of US-China debt and trade relationships.

Many interviewees were convinced that the crisis changed some aspects of PIC investments permanently. Some interviewees expected that the reactions to market developments would be faster in the future. Many suggested that the rosy assumptions given by corporate executives about the future in boom times will be evaluated much more critically than ever before. At the most general level, there is now a push towards more ‘back to basics’ value investment and simpler basic portfolio.
construction approaches to investments in capital market products; that is, a return to equity risk, credit risk, and duration. There is now little collective confidence towards a variety of phenomena from specific ‘black box’ products to the more general level issue of leverage. Some interviewees argued that the pressure to avoid leverage has more or less permanently changed the approach to real estate and in some scope hedge fund investments where ‘core’ of the class was found very beneficial in relation to overall PIC portfolios but the ‘satellite’ or ‘value added’ approaches based on leveraged products within the classes less so. The pessimism towards leveraged growth has also raised some field-level debates on how to adjust broader investment strategies of all PICs in case there is a longer period of economic low growth or even decline (see STM, 2010b), and there are many concerns within PICs over where exactly the future demand both in real economic and in financial market terms will come from.

Some risks have also gained more attention than before. Country risks have become essential in bond investments, but not only because of PIIGS.\(^51\) For example, some managers who had strong opinions about the security of Nordic bond markets have found European investment grade bonds and high yield bond funds more preferable than ever before. The crisis revealed the stronger than assumed correlations, the previously hidden links to beta, and the severity of liquidity problems of hedge funds, which caused re-evaluations in this asset class as well. Some individuals in the field have also argued that hedge funds should always generate absolute returns to defend their place, which is why crisis showed that the asset class is in crisis. On the other

\(^51\) PIIGS refers to countries with problems to convince investors of their ability to pay back sovereign bonds, namely Portugal, Italy, Ireland, Greece and Spain.
hand, the hedge funds still performed rather well in risk-adjusted terms when compared to the supposedly riskless bonds that defaulted.

It is still difficult to say whether all changes have been permanent or not. For example in the mid 2009, the PICs were still very uncertain in respect to their direct lending activities simply because the client firms were not doing well. The law enabled the PICs to require full bank-provided financial guarantees, real collateral, or other feasible guarantees or collateral to back premium loans. The first of the list had not been the leading policy for a while, but the requirement was used by at least by some PICs during the financial crisis. The typical reason was that any material collateral would have been too laborious to price in volatile market environments and that the credit teams were already occupied with a great number of applications – they would have no time for pricing the collateral. During the worst period of credit crunch the bank guarantee policy was hardly a problem for client firms because the banks happily guaranteed any loans they could not provide due to their lack of cash. However, when the real economic crisis hit the businesses worst after the immediate financial crisis, the banks now had cash but could provide loans or guarantees due to pessimistic business expectations.

To end the chapter, it is worth noting here that the typical narrative in the public domain was that the popularity of premium lending saved many Finnish businesses during the credit crunch. This ‘national buffer finance’ argument has some credit, as no interviewee had noticed either any specific sector or business type (size, export dependency etc.) specific borrowing behaviours. Even so, given the inability of banks to provide guarantees for premium loans, premium lending has not been able to
provide credit to Finnish companies in all market situations. It has perhaps been to ensure capital availability in a financial crisis, but not in a full-blown economic one.
8. Conclusions

The purpose of this chapter, the last of the study, is to sum up the empirical research findings and to draw theoretical and methodological conclusions from the previous chapters. The chapter is divided into three short sections according to the three research agendas of this study. The first section draws methodological lessons from the study, and discusses the benefits of habitual institutional theory and organisation field analysis provide for geographical analyses on social construction of pension fund capitalism and other financial arrangements. The second section sums up the empirical research findings and draws some more practical conclusions concerning the institutional life of Finnish PIC investments. The last section discusses the theoretical relevance of the research findings in the context of financialisation of European pensions.

**Studying pension fund capitalism: methodological reflections and research agendas for the future**

The approach to studying social construction of pension fund capitalism has methodologically stood firmly on two legs in this study: habitual institutionalism and the scale of organisation fields. Habitudinal institutions are dispositions that individuals socially share, the commonly taken for granted ways of changing the world around us. As such, in contrast to descriptive studies, studying dispositions in investments is about studying elastic activities that actually produce impacts in investors’ environments. But dispositions are not just habits: they are practices that provide
proficiency in action processes where various actors and dispositions affect our behaviours. In this sense, institutions of investment are not about any investment preferences or styles. They are about styles that in fact ‘work’ and can be conducted feasibly, be it because it must be done (regulative forms), it is morally the right thing to do (normative), it is meaningful (discursive), or it just happens to work for some other socially shared reason. The scale in which proficiency and explanation of activities have been approached in this study is not individual organisations but organisation fields. Fields form specific institutional lives: they have particular kinds of actors and set dispositions. But organisation fields are structurations and sources of proficiency for collective actions. This suggests that we need to understand organisational action processes in order to find out what field-level proficiency is like in individuals’ minds. These two approaches have been combined this far in neither economic geography nor economic sociology, which is why it is worth noting the benefits this combination has had in analysis in more detail.

In the context of PFC, the notions suggest that explanation for pension investments can be analysed on three different fronts. Firstly, we can simply look at the dispositions of investment as calculation, exchange, and information processing that characterise activities of individuals working in pension funds without paying too much attention to organisational issues or frameworks. We can study these dispositions at the level of organisation fields by seeing which dispositions various individuals who work in organisations partaking in common functions and meanings share. For example, we can say that the Finnish PIC portfolio managers tend to commit themselves to profitable relationships with organisations called hedge funds because they have calculated that the monetary relationships correlate less than other
potential relationships with the current relationships they are committed in their portfolios, although only after checking the trustworthiness of the people of the fund. We can also say that individuals working for most Finnish PICs tend to do this much more often than those working for the Anglo-American trust-based pension funds that do not as often use portfolio managers in this class. This kind of analysis is likely to be found fruitful by those who wish to understand the material and social life of global finance in the micro-level. But the explanation for these activities remains somewhat scarce. Why exactly are there some portfolio managers that engage in these relationships in the first place? Where are the calculation practices that show some positions should be taken coming from and why? Such questions cannot be fruitfully answered without looking at the organisational level.

Thus, secondly, we can look at the collective action processes of pension funds where these kinds of dispositions can be adopted. Again, we can study these issues at the field level simply by studying which processes organisations tend to share. For example, we can say that the investment activities of all Finnish PICs are characterised by very similar classification of assets to different categories and, in significant albeit perhaps much narrower scope, by similar divisions of the investment functions to teams that are expected to build own portfolios. Furthermore, these domains are conditioned by solvency management, understanding on the proper risk levels of different classes, all kinds risk management measures, and numerous other things teams are required to take into account as parts of collective action process in order to be proficient. Of course, some divergence remains. The investment teams have mandates, which are adjusted time to time for example by investment committees or tactical allocation teams, and which include institutions like
remunerations that give direct incentives to adopt certain kinds of dispositions. The changes in these kinds of domains, where actions are controlled within organisations, are not at least very likely to occur at the same time or for the same reasons.

In field-level comparison to PICs, we can for example say that the Anglo-American pension fund collective actions have more to do with trustees giving investment advice to plan members (DC schemes) or defining specific mandates for external managers and selecting the managers with specified performance expectations, where the governance systems of the funds provide essential limitations for creating these mandates and strategies (DB schemes). Even this simple comparison shows that field-level frames and action processes help to characterise the nature of the collective actions quite comprehensively, and extends the explanation of individuals’ dispositions to the requirements set by their mandates and other positions in collective action processes. However, even this level does not help to address all relevant questions.

The third front, the meanings that the organisation field level provides for the investment dispositions, is needed if we wish to understand why some shared dispositions provide proficiency in the first place. For example, the Finnish PICs are required to have internal management, and the principles for portfolio design are greatly affected by the solvency rules, which are on their behalf defined on the basis of average solvency of all PICs. The PICs also have to think about other companies in terms of competition and regulative requirements. Without taking into account the regulations and activities of other PICs, the investment strategies and even individual level dispositions might never be sustainable. Without paying attention to social
responsibility issues, customer wishes, or stakeholder demands, the investment practices are likely to raise difficult questions. Similarly, the Anglo-American pension funds have to use specific manager selection procedures and cannot stand out of the crowd of other pension funds in terms of style preferences if they wish not to be contested on the basis of breaching fiduciary duty. Unless they trust and rely on the advice given by their consultants and other external service providers, they cannot build sustainable investment practices either. The funds in both environments have to strike a balance between own beliefs and strategies with others’ actions and expectations.

Research on these three fronts provides valuable information on the social construction of pension fund capitalism from different perspectives at the organisation field level. Although theoretically fruitful analysis requires enquiries on all these fronts, separating them is helpful for recognising some future research agendas for the geographic analysis on PFC in at least three domains. First of all, the framework simply enables comparative analysis at all three levels. Separating the levels enables us to build theoretical models from narrower empirical analyses by contextualising them to these different levels of explanation. However, the scale of organisation fields also suggests that we can demarcate relevant spaces that can be compared: it illuminates spaces where potential varieties of PFC are likely to be found. We can study the investment dispositions of pension funds, their organisational frameworks, and the organisation fields they constitute in different environments, but we can also take a step further and to map different kinds of fields on basis of these domains. For example, investment dispositions of individuals may be very similar throughout Europe, but at the same time local organisational arrangements and organisation field
frameworks may be giving these shared dispositions quite different meanings and purposes.

Secondly, the methodology can be used to critically study PFC with the notion of proficiency. We can ask why some practices are proficient and why they are not. Is it because individuals just do not acknowledge them or want to engage in some other activities? Is it because the collective action processes of individual funds do not allow or enable some dispositions? Or, is it because the funds cannot accommodate some dispositions even if they wanted or knew how to do it because their field prohibits them or give incentives to act otherwise? Again, we can extend the critical questions to even broader themes, to ‘regimes of proficiency’ and to the question of how to renew proficiency. For example, if the generation of funded arrangements leads to capital market inflation and makes financial performance meagre or impossible to achieve in sufficient scope in the long run, can we transform the activities to more proficient ones at the individual portfolio manager, organisational or organisation field levels? Similarly, if environmental change will curb economic growth in the future, can we enable proficient investments in some or perhaps in all these levels? Do some fields differ in these answers, and can some fields adopt reforms more effectively in different levels than others? If the answers to these kinds of questions imply that we cannot make investment practices proficient in these conditions, then it might be necessary to ask whether broader institutions of financial capitalism can be sustainable in general. But before such conclusions are made, the methodology suggests that we can first try to find solutions with empirical analysis.
Thirdly and lastly, the methodology has provided tools for understanding the relationship between the organisation fields of pension investors and the actor-networks of the domain of finance. Studying the institutional life of organisation fields of pension investors provides information on what services, actors and cultures are institutionally related and bound to pension investments. For example the Finnish PICs are not using but limited external advisory services because the regulations prohibit the usage of external mandating, and they connect to the markets directly as buyers of specific kinds of financial products. But the organisation field level inquiry also goes deeper in analysis with the idea of proficiency. For example, the Finnish PICs are allowed to seek profits with all kinds of financial products in all markets – they can connect themselves to any financial relationships in the domain of finance – but the risks of different products affect the solvency positions of the PICs in different ways, which makes some relations preferable to others. Proficiency of integrating in global finance is, of course, not only a product of regulation. Although hedge funds provide opportunities for PICs to manage their solvency positions effectively, the antagonistic local attitudes towards hedge funds questions the benefits provided by this class altogether. Discursively, using the notion of social responsibility in public relations may help to gain legitimacy for investment activities, but the local values and principles related to the discourse are everything but easily translatable to the schema of global portfolio management. Following some locally habitualised pricing and selection schema may provide proficiency only for limited periods of time as the global market environments change. But sometimes exactly these old practices and insights may be the most valuable assets for pension funds, as the example of PIC success in the recent financial crisis showed.
These observations suggest that proficiency in more specific organisation fields and the actor-networks of finance do not necessarily go in tandem. This especially raises the question of long-term institutional compatibility. Can it for example be that some forms of legitimacy that is required locally for pension fund activities can never be proficiently achieved in the global actor-networks of finance? But these observations also lead to another question: what exactly is proficient in the domain of finance? And what kinds of organisation fields does the domain of finance consist of? Studying the habitual institutions of and the organisation fields in the domain of finance helps to understand different regimes of proficiency in the domain, and shows where boundaries between different institutional lives are drawn – are they drawn between sectors, national borders, financial products or perhaps some different investment styles? In this sense, the notions of habitual institutionalism and organisation fields may be useful in studying broader questions in the domain of finance than social construction of pension fund capitalism.

**Pension insurance companies and the financialisation of Finnish pension provision**

The pension insurance companies that execute the mandatory TyEL pension scheme are the largest and the dominant block of pension capital in Finland. When looking at all Finnish pension arrangements, only the assets generated by the public sector mandatory schemes are even distantly comparable to PIC capital in the overall size. The risk-averse complementary third pillar savings and the not-so-averse public sector buffer funds should not, of course, be ignored in analysis. Even so, it is the organisation field of the TyEL funds that give pension fund capitalism in Finland its
most characteristic and, in one sense, unique features. Historically, one such feature is the composition of the public-private partnership, where pension insurance is fixed and activities supervised publicly, but which is coordinated by private entities, executed by competing private providers, and governed by the social partners. Another feature is the multi-layered governance systems that combine paritarian representation (in boards and supervisory boards) with professional investment expertise (in various tiers). In investment methods, the premium loans have given the PICs the exceptional ability to finance the Finnish business life while staying organisationally at arm’s length and having little capital reserves.

Perhaps the most intriguing feature in the institutional life of PICs is the special combination of supposedly alternative paradigms like public administration and corporate governance, competition and collaboration, quantitative rules and prudential principles, sophisticated portfolio management and only partial funding, stakeholder representativeness and immunity to democratic politics, to mention a few such dualisms. For one thing, these paradoxes bring much institutional dynamism to Finnish pension politics (see Johanson and Sorsa, 2010). But these paradoxes also show that alternative approaches to PFC can exist. Case TyEL serves as a powerful “mythbuster” in international debates. It shows that having a nationally mandatory pension scheme with a funded component does not necessarily lead to party political control over the funds. More generally, it shows that a public scheme does not necessarily have much to do with democracy. In terms of pension politics, the case shows that successful funding and innovative investments do not need to imply abandonment of DB schemes or of coordinated redistribution of wealth between generations – global finance can be harnessed to serve old purposes. The case further
shows that having funded schemes based on portfolio management does not necessarily imply a vast redistribution of wealth to the financial sector, but can be kept cost-efficiently in hands of financial professionals internally. It shows that financially sophisticated and innovative classes like hedge funds and structured financial products can be present in insurance companies controlled with quantitative rules, and that quantitative rules do not necessarily make investments conservative but can even give incentives to invest in alternative classes. It shows that successful large bets in direct credit, infrastructure projects and private equity that have had tangible real economic outcomes can be fitted even in rigorously constructed short-term biased portfolios.

The investment dispositions of PICs can be in simplistic terms formulated as three shared basic questions that must be addressed in order to make investments proficiently, and that the PICs may answer somewhat differently. Firstly, the PIC boards must decide how to allocate their capital to different asset classes in order to fulfil regulative requirements, to give investment teams their mandates, and to generate meaningful investment strategies in the first place. The allocation gives the PICs somewhat different investor profiles, but even more in terms of how they relate to individual classes and to the average solvency position of the companies than of what kinds of overall strategies they choose to follow based on their beliefs. Secondly, they must decide how to approach security selection within these classes in order to generate meaningful roles for portfolio managers. The further the investment vehicles are from Finland and the more resource consuming the vehicles are, the more probable is the selection outsourced to funds or avoided altogether. Although security selection includes compliance measures and sometimes screening on basis of social,
political and all kinds of qualitative criteria in different classes, the political stance in this area of activities is dominantly market based. Thirdly, there is the question of how to handle external expectations in order to keep activities legitimate. Some expectations come from other investors demanding investor activism, some from clients who want money, and some from all kinds of societal actors who have come up with a wonderful target for investments. Although all these expectations must be addressed in one way or another, the solutions must never compromise the labour market organisations’ will, the norm of profitability, or the competitive positions of the company.

When compared more closely to the Anglo-American PFC, the organisation field of PICs has both common and divergent formal characteristics in terms of shared dispositions (see Table 8.1.). Both fields for example are characterised by the dispositions of asset classifications and allocations and striking the balance between passive and active management in different classes. The two fields also have common characteristics with different institutional explanations. The PIC portfolios resembled each other significantly before the recent financial crisis, but unlike in Anglo-American funds where similar portfolios are explained more rigorously by mimesis, the similarity can be in case of PICs explained by the quantitative rules and the low incentives to adopt competitive profiles on basis of investment strategies and beliefs. What makes PICs distinct from other domains in finance is their special focus on solvency, which among other things causes a very close focus on the relationship between management of assets and investment team mandates. The PIC investment activity is more generally defined perhaps even more by quantitative virtues of portfolio management than the Anglo-American prudentially regulated funds. This
can be seen as well in regulation as in asset selection and risk management within the PICs.

<table>
<thead>
<tr>
<th>Actors in the field</th>
<th>Anglo-American pension funds</th>
<th>Finnish Pension Insurance Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Role in pension provision</td>
<td>Variable according to pension schemes</td>
<td>Fixed implementation of mandatory pension scheme</td>
</tr>
<tr>
<td>Constitutive frames</td>
<td>Fiduciary duty, trust law</td>
<td>Special-purpose laws Paritarian decision-making</td>
</tr>
<tr>
<td>Mutual relationships of key actors</td>
<td>Mimetic</td>
<td>Competition and collaboration</td>
</tr>
<tr>
<td>Main investment boundaries</td>
<td>Few blocked transactions Prudential principles Variable regulations concerning funding</td>
<td>Few blocked transactions Solvency rules Public and stakeholder expectations Active boundary control</td>
</tr>
<tr>
<td>Main investment dispositions</td>
<td>Mandating external and internal managers (DB) Investment advice (DC) Asset classification and basic allocations</td>
<td>Comprehensive portfolio management by expert internal managers Asset classification and basic allocations</td>
</tr>
<tr>
<td>Primary sources of proficiency</td>
<td>Profitability or/and the elimination of fiduciary position Reliance on external advice Legitimacy of decision-making</td>
<td>Profitable investments with rigorous risk management Solvency management Competitive performances Stakeholder expectations and social responsibility</td>
</tr>
</tbody>
</table>

Table 8.1. The basic characteristics of the organisation fields of Anglo-American pension funds and Finnish pension insurance companies.

Financialisation has been one of the key forces in the recent history of Finnish pension fund capitalism. If financialisation is understood in terms of integrating old-age income and savings to the domain of finance with portfolio investments, it describes the development in the PIC investment practices during the last decade or so very well. PICs diversify their portfolios internationally, they invest heavily in
“alternative” asset classes and complex financial instruments – although it must be noted that there is nothing “alternative” in credit or hedge funds for PICs – they have refined management cultures that enable consistent alignment of investments, and they have advanced corporate engagement policies and practices, to mention a few issues. They share investment dispositions like the investment risk management of basis of three basic portfolio design risks (equity, credit and duration risks). On the other hand, connecting to the domain has not implied following of all its detrimental trends that the experienced portfolio managers in classes like credit and equity have successfully avoided. Financialisation also applies to their regulatory environment, where the paradigm has become more principle and risk based, and supervision has come to include more expertise on developments in the domain of finance.

Yet financialisation has not implied abandonment of old legitimate solutions. The principle-based regulation has been strengthened, but not in terms of replacing solvency rules that continue to ensure the sustainability of pension provision in the eyes of many field insiders despite its apparent influence on proficiency. The independence of PICs as portfolio investors has been strengthened with more flexible mandates for PICs as collective actors and for investment teams within the investment functions, but the heavy, multi-layered governance system that has brought so much legitimacy for PIC activities has not been abandoned but strengthened. The ability to effectively diversify PIC portfolios to a variety of financial products has been improved by improving PIC solvency positions, and the regulations addressing PIC operations have become slightly more principle and risk based, but neither has changed in paradigm. Case Finland shows that sometimes it is enough to provide just
some additional institutional room for the cultures of global finance in the existing legitimate arrangements, and they will flourish.

What makes the financialisation of the Finnish TyEL scheme perhaps most relevant in international comparison is that it has not implied any paradigmatic shifts in pension politics. Despite the vast pools of capital generated and the various parametric reforms in the benefits and accrual mechanisms, the TyEL scheme still is in its core a defined benefit pay-as-you-go system where the risks are born collectively. Moreover, the scheme serves as the primary and in great part sufficient source of old-age income for a great number of Finnish pensioners. The scheme has not been without criticism, of course. Some commentators have questioned it on the basis of unfair distribution of costs between generations and others on the basis of expected rise in mandatory pension contributions (the worst-case scenario being around 5 percentage points). The paritarian governance system of the scheme has been criticised for its inability to effectively curb future costs for good reasons albeit that the mandates the ministries have give to paritarian groups could deserve more of this critique. Even so, the institutional changes in the TyEL scheme suggests that the politics of financialisation has been at least for now limited more to the adoption of PFC than, with the exception of social responsibility discourses, to having all the virtues and moral codes in the politics of financialisation.

Indeed, case TyEL suggests that financialisation can be more about redesigning the relationships between pension capital and the productive economy than about rebalancing the relationship between old-age income and the domain of finance. There are a few thematic areas where rebalancing between pension capital and the
productive economy can be found. Firstly, the PICs have stepped down from their role as captains of Finnish economic development, first from the role of main capital providers and later in early 2000s from the role of largest ‘anchor owners’ of Finnish firms. True, Finnish firms are still often preferred in PIC investments and the investments more generally may have some nationalist and even patronising characteristics of previous times, but it is now less for political or strategic economic reasons – it is for the knowledge premium brought by excellent positions in financial networks and the close connections at all levels of corporate governance in Finnish companies. All the dispositions of PICs can be read in the language of portfolio management. Be it regulatory frameworks, understanding on individual corporations, broader cultures or any institutions that might affect the properties of financial instruments, the most important thing that matters are the instruments: everything must be translated to the practice of portfolio management where the practice prevails. Of course, this is not to say that this is always a prevalent norm: ethical issues (e.g. screening of tobacco), customer demands (e.g. product packaging) and rare investment opportunities (e.g. infrastructure projects) that cannot always be fully approved by the language sometimes override the norm. But even these cases can be easily translated to the language of portfolio management.

Secondly, the imperatives of diversification, liquidity and risk management steer PIC capital towards new investments and social relations. More and more often the investment targets previously business as usual are now strategic choices that cannot be legitimised with the virtues of portfolio management, and so PICs have become more dependent on other sources of legitimacy. It requires preferably guarantees by public bodies or at least very binding relationships with clients (with the fear of losing
them to their competitors) to get PICs committed to larger business projects. This is hardly dramatic, as there is market-based finance available for businesses everywhere outside pension capital. At the same time, however, PICs have exceptional abilities and skills to analyse different kinds of economic projects with their decades of experience, which makes many Finnish funding bodies very much dependent on PICs. It can be even argued that PICs now live in a more binding symbiosis with various Finnish public and semi-public financial actors than ever before. Indeed, it is worth reminding that financialisation as integration to the global domain of finance does not mean globalisation – it can also reinforce local and national social roles.

Although the recent reforms in the field framework have somewhat improved proficiency of portfolio investments from the late 1990s, the financialisation of the TyEL pensions as the redesign of the interface between pension and global finance has also caused new tensions in the field. Some more symbolic issues like the scepticism of the PICs towards the financial skills and expertise of STM could be rather easily overcome by bringing in people with understanding on both investments and pension provision to the ministry. But all tensions can hardly be solved with such easy solutions. First and foremost, the solvency rules are under great pressure at least in principle – many field insiders are still surprisingly happy with solvency-based regulation paradigm – as the PICs feel that long-term investment strategies that reach over the financial cycle are next to impossible to formulate effectively. Competition is another difficult domain. It has produced tangible incentives to improve cost-efficiency, but at the same time the unclear means for competition have made competition mostly symbolic and generated new tensions within the field.
The greatest tension, however, is created by the ambiguous politics of attempting to improve investor independence in principle while in practice making the PICs more dependent on each other’s choices. The mechanisms that are supposedly safeguarding the pensions at the system level – the equity-linked buffer in fund transfer obligation, the solvency requirements based on average solvency, and the ability to include PAYG assets in capital reserves – at the same time make it difficult for individual PICs to follow their own investment strategies. There are no patent solutions to overcome the tensions caused by these rules, and the suggested solutions to this commonly observed problem are often pointing at opposite directions. Some want to abandon all collective measures and be more independent, while some argue that the only way to be able to achieve optimal returns in the long run is to strengthen the collective mechanisms of risk bearing. Some combinations of changing solvency rules so that they are more PIC-specific, removing the possibility to use the PAYG assets in solvency calculations as fast as possible, and re-evaluating the current form of the fund transfer obligation might of course improve proficiency of PIC practices.

But why exactly are the problems formulated in this manner in the first place – why is there a trade-off between investor independence and pension security? The reason is the arbitrary but elastic discursive division between pension provision and investment making in the field. The division is based on the argument that investment making is, if not necessarily alien or incompatible with, at least a difficult domain of activities to accommodate the original purposes of pension provision. Investments are often translated as the selfish interest of the PICs, while all other functions are executing the common good. But investments hardly serve any more selfish purposes than other functions, and they are hardly separate from or alien to pension provision in any
sense. In other words, the financialisation of pension provision has not yet changed all the norms and discourses of pension provision in the field. The more general level problem here is that the issue of solving the current inconsistencies in the field gets mixed with these kinds of normative legacies and other field-level architectural issues so that they make the evaluation of the current practices difficult.

The praised norm of decentralisation is a good example here. The main justifications for decentralisation from the perspective of investments is that competition keeps the costs of the scheme low and “diversified governance” helps to avoid mistakes and political coups. But is this really the case? True, competition probably helps to improve cost-efficiency in a decentralised scheme. But how about in comparison to a centralised scheme – are not the largest PICs with economies of scale simply by far the most cost-efficient? True, having many funds may help to avoid the mistakes some funds make – but why, then, are the PICs operating under business secrecy, dependent on choices of each other, and investing largely in the same vehicles? If all PICs diversify their portfolios in the same or strongly correlating targets, are supervised by the same risk-based mechanisms, and have joint liability that makes almost all companies too big to fail, then what kinds of virtues of financial or political risk management might the seven boards exactly have instead of having only one? Indeed, it is getting increasingly hard to defend the current scheme architecture consistently within old discourses. But it may be even more difficult to break these lines of conventional thinking as the field has shown immense capabilities to renew its institutional legacies over decades.
Lastly, it must be noted that financialisation has had some impacts on the broader social role of PICs. Portfolio investments that provide limited influence over investee firms and require much expertise have diminished the interest of social partners and political parties for using the capital to political purposes. But it has not necessarily changed the broader public attitudes towards proper investment targets. The problem here is that whatever the demands might be, in conditions of financialised pension provision, they need to be translated to the language of portfolio management (and prudent and rigorous risk management). Portfolio management can, of course, produce tangible social impacts with mechanisms like positive preference orders or negative screening in primary markets like credit, or with direct actions like corporate engagement measures. These issues have been brought up in the field especially in context of the social responsibility discourse whose policies have materialised as tangible practices mostly in real estate investments, domestic corporate governance and international bond investments. However, integration of any policies into practice of portfolio investments has few incentives in the current field formation. For example, translating external expectations to the language of portfolio management in investor identities could be a potential means for competition, but it is still very difficult to evaluate what kinds of tangible impacts companies actually produce with their investments and nobody yet knows how much Finnish firms might be interested in considering such features as competitive advantages when choosing their insurer.

Even more importantly, the cost-containment pressures constrain all possibilities to dedicate more resources to such issues within the PICs, and the difficulty of integrating any kind of activism to portfolio investments culturally may provide obstacles for doing it even when wanted. If there are demands for integrating some
social responsibility concerns or any other expectations to the institutional life of the field more extensively than with virtues of portfolio diversification, it cannot happen effectively or at least proficiently outside symbolic measures at the level of individual funds. Put simply, due to competition and other antagonistic relationships, the expectations that address the overall field must be internalised as field-level mechanisms in order to promote any substantial change. For example, it is unlikely that demands to implement more effective corporate engagement strategies or evaluations on the social and environmental impacts of investments can be effectively handled at the individual company level due to cost-containment pressures. Having for example a publicly funded body that would equally benefit all the PICs might be the only way to relieve any kind of potential tensions between public demands and financialised portfolio management.

**European pension fund capitalism and the politics of financialisation**

One of the key trends of the last few decades in European pension provision has been the generation of pension capital with the adoption of funded or prefunded pension schemes. This capital is managed in portfolio management style by mostly private entities that have a prudential principle-based mandate and whose supervision is meant to effectively manage the risks involved in their activities. Portfolio theory based pension fund capitalism has landed in Europe, and European pension provision has become more dependent on global financial markets. On the other hand, the quantitative and qualitative differences in pension formulas, investment regulations, governance systems, and various other thematic domains that shape the interface of
portfolio investments continue to vary from one country and pension scheme to another. It would be thus a bold statement to say that some specific European variety of PFC that should be as social construction conceptualised with some fundamentally different terms in the European context than in the Anglo-American context has emerged. The more essential question at the European level is what exactly does the common political project of adopting PFC mean and what changes it produces as such. The empirical case study on Finnish PICs has provided some valuable insights in areas of portfolio construction, independence of investors, principle based regulations, and risk-based supervision. Most importantly, the case study shows that pension investors are likely to share common issues and tensions in all these areas.

Perhaps the strongest political fear related to the generation of portfolio capital is, besides the enforcement of undemocratic institutions, capital market inflation and the failure of pension promises due to financial crises it may ultimately produce. One of the main concerns here is that while new pension funds can invest effectively in early stage firms and concrete economic projects, the mature funds can only invest in the most liquid vehicles and markets, ultimately pushing the prices towards irrational expectations (Engelen, 2003). The Finnish case shows that these concerns do not necessarily have so much to do with maturity. The funded liability structures of TyEL providers do not change as the funds mature: it is the PAYG component that changes. Case TyEL shows that liquidity needs can be controlled in pension scheme design, and discourses like Asset-Liability Management (ALM) can be sometimes fairly irrelevant in face of local liability structures. One interviewee for example told that his company had made an ALM exercise that suggested investing over 60 per cent of
the overall portfolio in listed equity in 2007, which would have driven the company to the brink of bankruptcy in the next year.

On the other hand, this is not to say that the problem of liquidity needs would be resolved in the field of PICs. In contrast, the case study raises the question whether the problem can be ever evaded in the first place. The TyEL funds have not been historically able to invest in start-up business equity due to low solvency ratios, and even though the solvency position has been improved from late 1990s onwards, the solvency rules have effectively curbed the possibility to conduct broad long-term investment strategies. Rather, the long-term investments have been enabled historically by the innovative premium lending and investment loan arrangements and more recently by the consensus-driven Finnish financial markets. Case TyEL thus shows that the relationship between maturity (of liability structures) and investment allocations is by and large contingent. But so is the possibility of to invest in other than the most liquid of assets. The ability to promote economic growth with pension capital is dependent on many institutional variables that need to be addressed at the European level before making definitive conclusions on basis of maturity. Case Finland shows that there are no easy solutions to this problem. The PICs have become the prisoners of their domestic investments at least in some scope, as the debates on the temporary law on investment rules showed, and they cannot easily adopt any long-term over-the-cylce strategies.

As noted above, the relationship between the Finnish PICs and the productive economy has significantly changed during the last few years due to portfolio management paradigm. The main lesson from case Finland is that pension capital may
continue to produce significant impacts on the economy even if the political interest in using the capital to economic targets significantly decreases after consensually agreed portfolio management methods have been introduced. But the social impacts of the TyEL investments point in part to the opposite direction than usually thought in international context. The portfolio investment paradigm has already changed much of the relationships between European investors and investee firms at the European level more broadly. For example, corporate governance and reporting systems have changed rapidly (Clark and Wójcik, 2007). In the Finnish case, however, the impacts have had less to do with changing Finnish systems than they have had with conserving them. This suggests that the social consequences of pension investments may have even conflicting directions at the European level. Indeed, it is not necessarily the counter-tendencies of common political projects that cause differentiation in the adoption of PFC in Europe: it may be the internal controversies as well.

A related theme in this context is that the political incentives to make the European economy more portfolio investor friendly have significantly increased as pension provision has become more investment-dependent. However, case TyEL shows that the financialisation of pension capital has not lead to the increase of the size or importance of the social role of the overall financial sector. It has only lead to the improvement of the position of PICs in financial networks – PICs have become ‘sophisticated giants’ that do not need costly external advice to survive or succeed. In other words, the financialisation of the TyEL scheme has not implied empowerment of finance but the empowerment of PICs in finance. This suggests that having pension funds do not need to imply legitimisation of the domain of finance unlike some
theorists like Montagne (2007) might argue. Indeed, case TyEL shows that becoming dependent on portfolio investments in pension provision does not necessarily need to imply political dependence on serving all the interests of the financial sector. But at the same time, the interests of massive individual pension funds may become so strong that governments have few options to follow the interests of these actors.

It can be argued that increasing independence of pension investors also requires increasingly high levels of legitimacy. For one thing, case TyEL and the German examples show that legitimacy can be based on normative legacies like paritarian representation even in new contexts and organisational frameworks. Case TyEL suggests that different virtues can be combined rather successfully. The adoption of the organisational form of mutual insurance companies has increased representation even when investment functions have become more expertise-prized and independent. On the other hand, the institutional life of PICs shows that formal independence potentially brought by privatisation and principle-based regulation does not necessarily imply habitual independence in collective actions. The solvency rules and fund transfer obligation have made PICs dependent on each other’s choices and performances. The private implementation of a public scheme does not mean that the funds would be outside public spotlight, political demands or binding stakeholder expectations. Indeed, increasing independence by generating private pension investors does not necessarily imply independence from some social roles or other broader than regulative institutions.

Case TyEL thus suggests that it must be always asked from whom are pension investors becoming more independent when their formal independence is
strengthened. Regulators, ministries, political parties, and finance sector service providers are only one side of the coin in case of PICs. The increasing independence of PICs has all but implied independence from social partners, broader societal expectations, NGOs, public sector financiers and guarantors, and, through competitive pressures and regulations, from each other. This suggests that increasing independence does not necessarily imply convergence with the Anglo-American ‘fiduciary capitalism’ unless other social institutions converge with the Anglo-American world. Studying the independence of pension funds as agents must be always supplemented with views on how independent the portfolio managers within the funds in fact are. The case of PICs shows that even the teams with broadest mandates are constantly controlled in various ways with rules that are unlikely to vanish even if quantitative rules in the regulatory environment would.

Indeed, case Finland shows that empowering pension funds with principle-based mandates does not necessarily mean that they can operate within the mandate independently however they like, but also that increasing independence in mandates may actually lead to stronger dependence on other institutions. Principles do not necessarily replace rules: they may as well just move the rules from the regulative environment to somewhere else. It is nevertheless possible that the rule-based regulations are increasingly discursively understood to conflict with the principle-based regulations Europe-wide. Even the TyEL field that combines these two domains ostensibly well by having the prudential duty to classify investments according to their “real” risks while defining the solvency requirements via rules that give these classifications specific meanings, is not without problems in the field insiders’ eyes.
Risk-based supervision and risk management paradigms more generally are at first sight very difficult to criticise especially if pension insurance or pension provision more generally is understood in terms of social risk management. But all risk management arrangements create new risks, give old risks new meanings, and potentially magnify system-level risks (see De Goede, 2004). Internationally diversified portfolio investments offer one feasible strategy for decreasing dependencies on the national and local levels in management of the risks of old age. But this only brings new risks from macro-level global financial crises and increasing correlations between financial products in different markets to more micro-level failures to capture sufficient yields and too costly management strategies to be managed. The Finnish TyEL scheme has coped well with this challenge from the perspective of pension provision. In the ‘permanently underfunded’ scheme, the risk of bad investment performance and other investment failures are not born by pensioners but the contributors – the risk is not that people will lose the value of their pensions, but that the costs of running contributions change. How the costs are divided between firms and employees in such event is a political question for the labour market parties. But even this technically flexible (although politically contested) arrangement has a major downside: it is pro-cyclical in nature. The pro-cyclical nature is related to financial cycles, as it translates financial downturns into lower client bonuses – not so much to economic downturns, because the required contributions decrease as the wage sums decrease. This suggests that even arrangements that ostensibly cope well with individual investment risks may also include mechanisms that make the overall scheme very vulnerable to systemic risks.
On the other hand, case TyEL shows that pension assets can be managed with a very close focus on operational risk management. One part of the financial success story of the Finnish PICs has been the high level of risk management skills by the experienced portfolio managers and innovative CIOs. However, the PICs may be even somewhat exceptional in the European context here. The cost-containment pressures pension investors are likely to face Europe-wide implies minimal organisation structures at least for some observers. Case Finland shows that the strong requirement for internal management in the PICs does not have to lead to high costs. But how, then, have the PICs been able to lure the experienced and skilled financial professionals to their investment functions? It is definitely not remunerations, ethical values or independence, as salaries are lower than the sector average, as activities are always in public spotlight, and as control over decision-making and cost-containment pressures are strong. Rather, it is the exceptional position of PICs in the Finnish financial sector: they offer possibilities few other actors can offer. Rigorous internal risk management may thus require many kinds of incentives. In PICs, the incentives are from portfolio managers’ and analysts’ perspective carrots that enable seizing interesting new investment opportunities every day. But especially the CIOs may regard the incentives much more as major challenges to cope with – as sticks that hit you between high expectations, competitive pressures, and game theoretical reasoning on one hand and the limited resources, short timeframes and volatile market conditions on the other. All in all, having a comprehensive focus on risk management is contingent and context-dependent, and there are no magic formulas for it.

To conclude, it must be reminded that the generation of relatively independent portfolio capital implies convergence only if the pension investors adopt similar
dispositions. It is only one possibility that pension investors converge in their approaches to calculation, exchange and information processing so that they decide to do so. It is possible that in this domain convergence and divergence is much more dependent on individuals’ beliefs concerning different investment environments than it is about differences in organisation-specific collective actions – although the homogenic ‘language of finance’ has lost its ground, it would be unwise to underestimate the power of finance when it comes to its ability to impose strong discourses for individual portfolio managers. However, at the level of organisation fields proficiency may override the languages of finance and provide other sources of institutional legitimacy. Some elastic Europe-wide characteristics like the importance of the first and second pillar savings and quantitative control of pension investments are likely to produce regimes of proficiency different from fiduciary capitalism. But so are the questions of portfolio management, independence, regulation principles and risk management very likely to raise shared questions similar to fiduciary capitalism in the new organisation fields of PFC Europe-wide. How can we ever translate local norms to the difficult language of portfolio management, provide legitimacy for increasingly independent actors who bear so broad responsibilities, and effectively manage the new risks pension fund capitalism generates? Case TyEL shows how difficult it is to answer or to avoid these questions. How local discussions and institutional arrangements answer to these questions will very much define what the European (varieties of) pension fund capitalism will be like in the future.
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