German Alternative Investor Landscape
Pension plans, Pension funds & CTAs

25 YEARS BAI diversification matters.

Introduction

At the end of last year, the BAI Investor Survey 2021 was published and received wide attention. This publication is part of a sequence of detailed carve-outs about different investor types in the German Alternative Investor Landscape – with a clear view on the occupational pension provision: “Pensionskassen” – from now on referred to as pension plans, “Pensionsfonds” – from now on referred as pension funds and Contractual Trust Arrangements – from now on CTAs

In times of demographic change and an increasingly aging society, the statutory pension system in Germany is coming under pressure. Against this background and the low-interest-rate environment posing a challenge in meeting pension obligations, occupational pension provision is more and more essential. We show that with an allocation of 22.9%, pension plans, pension funds & CTAs are slightly above-average rates compared to all institutional investors in Germany investing in AI. Due to supply bottlenecks and commodity price increases, we experienced rising inflation. The Russian invasion and ongoing war in Ukraine lead to further increases in energy prices. We are currently experiencing a dramatically changing macroeconomic environment with uncertain economic development and high inflation forcing central banks worldwide to react. It is of enormous social importance to understand how the situation affects the occupational pension sector in Germany. This requires a report on the status quo of AI in the field. We, with this, provide such a status report – showing which alternative asset classes investors in the area are investing in, how their strategic asset allocation looks like and is going to change, for which reasons they have been investing so far, and which challenges have been perceived. The data shows where there is potential to catch up compared to Germany‘s average institutional investor landscape and where the sector is already ahead. This is always against the background of the study’s retrospective nature and the fact that the data may be undergoing changes at the moment.

In addition, we take a look at the area of ESG among investors in the field and what role impact investing already plays. Also, using data from EIOPA, we show that while Germany has the second biggest market for occupational retirement provision in the EU, there is significant potential to catch up in AI in this field. Only regarding Private Equity Funds, German occupational pension provision has an above-average allocation in European comparison, lagging behind in Real Estate, Infrastructure, and Other Alternatives.

Structure and representation of the pension plans, pension funds & CTAs

In this report, we take a closer look at allocation. We are going to answer the following questions about how German pension plans, pension funds, and CTAs are invested in alternative asset classes:

1. Why do pension plans, pension funds & CTAs invest in AI?
2. Which alternative asset classes do pension plans/ pension funds & CTAs invest in?
3. Which alternative asset classes show increases or decreases in the number of invested pension plans, pension funds & CTAs?
4. To what extent are pension plans, pension funds & CTAs invested in AI, and what are strategic asset allocations?
5. What are the main challenges for pension plans, pension funds & CTAs in AI?
6. How do pension schemes build exposure to alternatives?
7. What role does ESG play for pension plans, pension funds & CTAs?
8. Which ESG strategies do pension plans, pension funds & CTAs use?
9. How does occupational pension provision in Germany compare to the rest of Europe concerning AI?

In many cases, occupational pension provision in Germany is financed through pension plans; and pension funds. They are classified as „institutions for occupational retirement provision“ (IORPs) for regulatory purposes.

Furthermore, there is the model of a so-called pension trust or CTA, which makes it possible to separate pension obligations from the balance sheet. In contrast to pension plans and pension funds, they are not subject to supervision or control by the insurance supervisory authority. In the following, we use the abbreviation IORP (pension plans and pension funds) & CTA for the three ways of occupational pension provision.

Pension plans, pension funds & CTAs together are the second largest investor group in the BAI investor survey 2021, only behind insurance companies, with 30%, 31 out of 104 investors participating. Our survey covers an estimate of around 45 % of the total assets under management pension plans and pension funds in German, according to Bafin data. For CTAs, there are no data available. However, we have an estimated high coverage of the entire CTA landscape in Germany.

The IORPs & CTAs surveyed have an estimated average of around EUR 7 billion in Assets under Management (AuM). However, the distribution is uneven, and the median lies below EUR 5 billion AuM.

1. Why do pension plans, pension funds & CTAs invest in AI?

According to our data, pension plans, pension funds, and CTAs invest in AI for multiple reasons. But primary motivations are a good risk-return ratio and the possibility of using AI for portfolio diversification (both more than 80%). Besides that, a central motivation is that AI assets provide illiquidity and complexity premia - significant drivers basing return for their occupational pension provision. The low-interest-rate environment, which poses a challenge in meeting pension obligations, was frequently named a reason for AI investments (51%) – while the inflation hedge did not play a role yet. A fact that might change from this year on due to the changing macroeconomic environment.

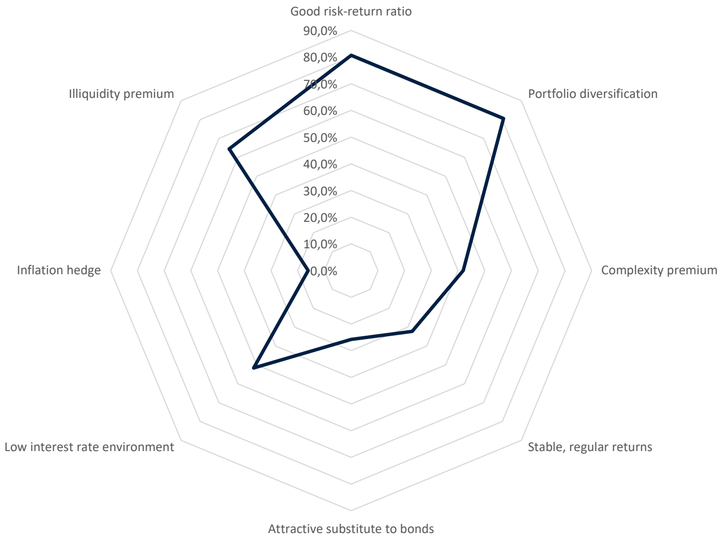

Figure 1: Main reasons for Pension plans, Pension funds & CTA to invest in AI

2. Which alternative asset classes do pension plans/ pension funds & CTAs invest in?

Our data shows that in occupational pension provision, participation rates[1] are significantly higher in liquid alternatives and hedge funds than the average of institutional investors in Germany; the difference is as much as 15 percentage points for hedge funds and 10 for liquid alternatives. Real estate equity also shows significantly more investors invested than the cross-section of the institutional investor landscape in Germany. Concerning all other asset classes, they still have to catch up compared to their peers. Thus it can be said that the more traditional asset classes among AI are dominant. Real estate has a long tradition as an anchor of stability in pension plans' and pension funds' portfolios and was not necessarily perceived as AI for a long time.

1 Share of all investors invested in the respective asset classes

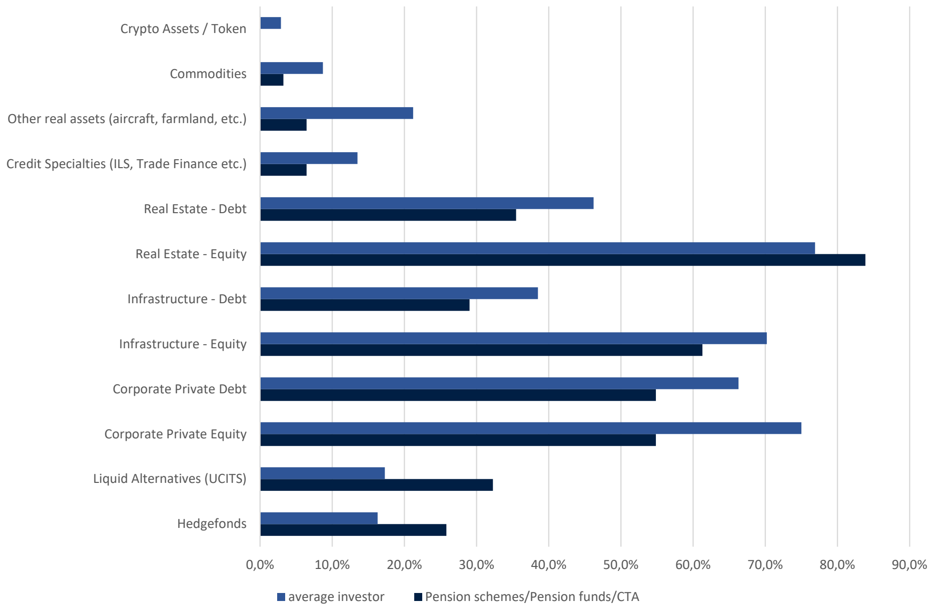

Figure 2: Participation rates

3. Which alternative asset classes show increases or decreases in the number of invested pension plans, pension funds & CTAs?

German institutional investors from the occupational pension sector converge towards other investor types regarding their investment in AI: Thus, they plan to exit those asset classes in which an above-average share is invested – Hedge funds and Liquid Alternatives (Figure 3). With this emerging turn away from Liquid Alternatives and Hedge Fund strategies, they follow a trend observed among many investor types. However, we argue this might have been caused by the macroeconomic environment with low-interest rates and low inflation. The upcoming stormy times with rising inflation and interest rates, possibly causing difficulties for traditional asset classes, such as equities and bonds, as well as high volatility, will seed the necessity to hedge unexpected risks. Therefore, from our perception, Liquid Alternatives and Hedge Funds are a valuable additional source of return in this macroeconomic environment.

The asset class that most investors claim they want to leave are commodities. However, the conditions have fundamentally changed since the survey. Against the backdrop of rising inflation and the Russian war of aggression in Ukraine, we are experiencing an enormous increase in commodity prices. Regarding whether the high inflation rates in the euro area and the USA are a temporary phenomenon, more and more voices assume a longer-lasting higher level of inflation. In this case, analysts are forecasting a sustained boom in commodity prices.

It remains to be seen whether this changed environment will also influence the strategic orientation of investors. For Real Estate Equity, the number of invested IORPs & CTAs is expected to stay constant, possibly due to the already very high participation rate. Driving the catch-up process compared to other types of institutional investors, other asset classes show increasing expected participation rates – with the highest dynamics in Corporate Private Debt.

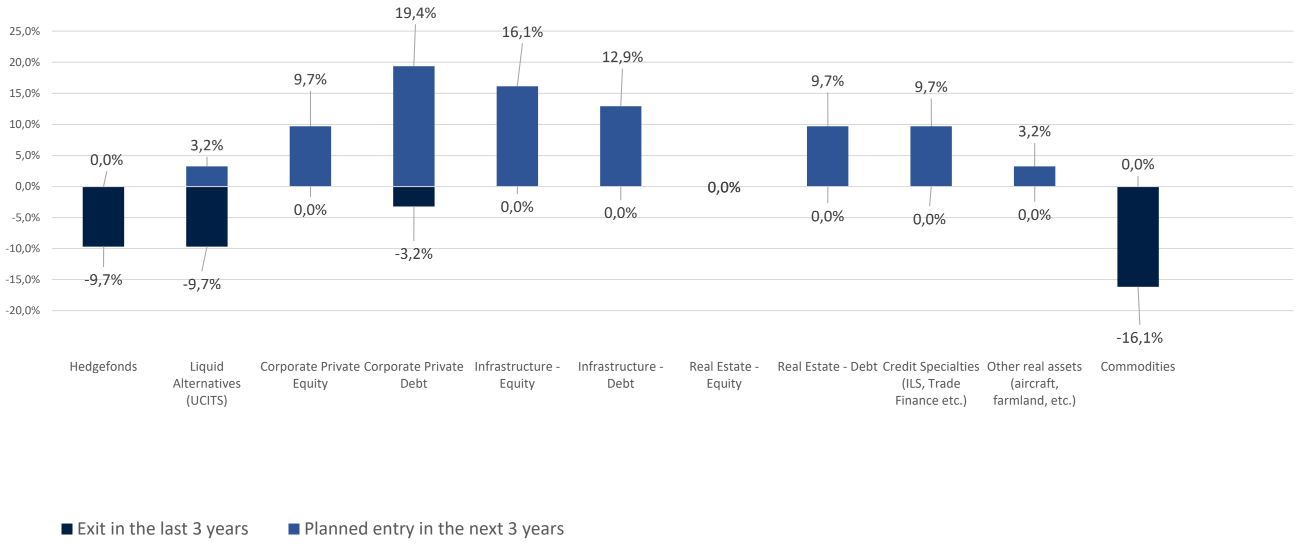

Figure 3: Proportion of Pension plans, Pension funds & CTAs that have exited or plan to enter the asset class

4. To what extent are pension plans, pension funds & CTAs invested in AI, and what are strategic asset allocations?

Current asset allocations show that AI already plays a crucial role in IORPs & CTAs' portfolios. The average allocation in AI is 22.9%, slightly above the average of all institutional investor types in Germany. However, so far, this is mainly driven by the comparatively very high allocations in Real Estate Equity. Nevertheless, we can see a significant dynamic with an expected increase of AI in SAA of 2.5 percentage points in total – more than the average of German institutional investors. While investors in the occupational pension provision sector plan to decrease their allocation in Real Estate Equity, an increase in asset allocation is planned for all other major asset classes. The most significant planned increase in allocation in absolute terms of 1.4 percentage points is emerging in Infrastructure Equity (Figure 4).

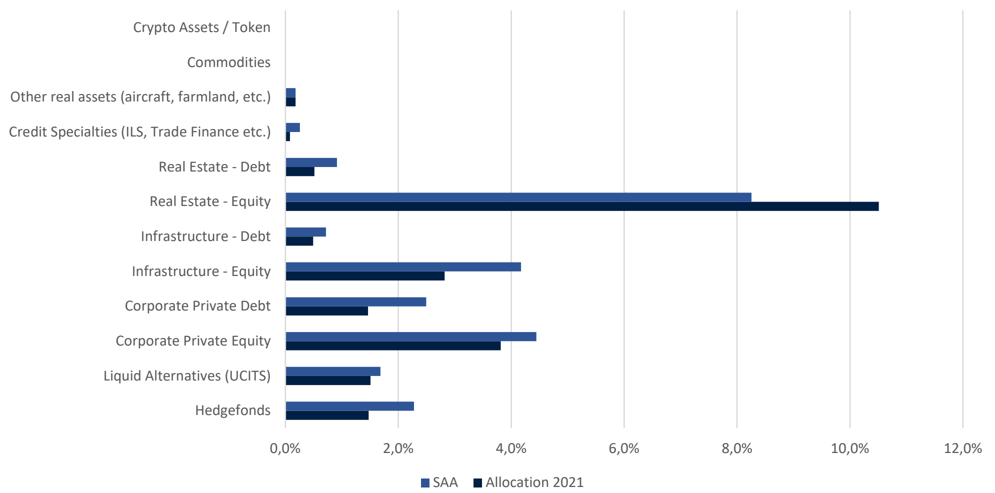

Figure 4: Approximate current allocation and SAA of Pension plans, Pension funds & CTAs

5. What are the main challenges for pension plans, pension funds & CTAs in AI?

Pension plans/ pension funds and CTAs see very similar challenges regarding AI (regarding the essential illiquid assets classes) compared to the average of all German institutional investors surveyed: The issue of dry powder is seen as the biggest challenge in the upcoming years (40 %), which is not surprising given historic highs of dry powder in the AI sector. “Exit environment”, “Performance” and “Regulation” follow with around 24% each. Compared to other investor types – such as insurance companies – the occupational pension provision sector seems to struggle less with regulation. The survey answers were given at the end of 2021, so it remains to be seen how the emerging changed macroeconomic environment will affect challenges.

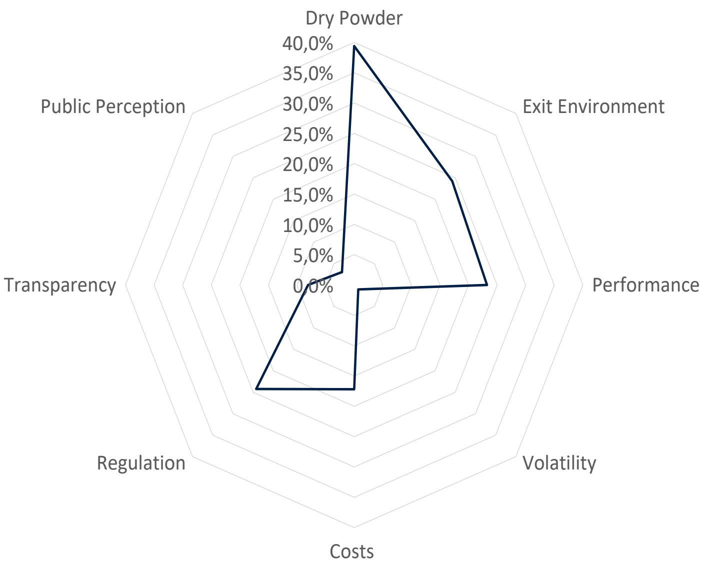

Figure 5: Main challenges in the coming years (in the asset classes Corporate Private Equity, Corporate Private Debt, Infrastructure Equity, Infrastructure Debt, Real Estate Equity, and Real Estate Debt)

A more detailed analysis of challenges for investors shows they are significantly dependent on the asset class. While Dry Powder is an issue for 65% of the invested pension plans/ pension funds/ CTAs in Corporate Private Equity, this is only the case for 19% in Real Estate Equity.

On the other hand, while regulation is named a challenge in Infrastructure Equity and Infrastructure Debt from 47% and 56%, respectively, this is significantly less the case for all other asset classes.

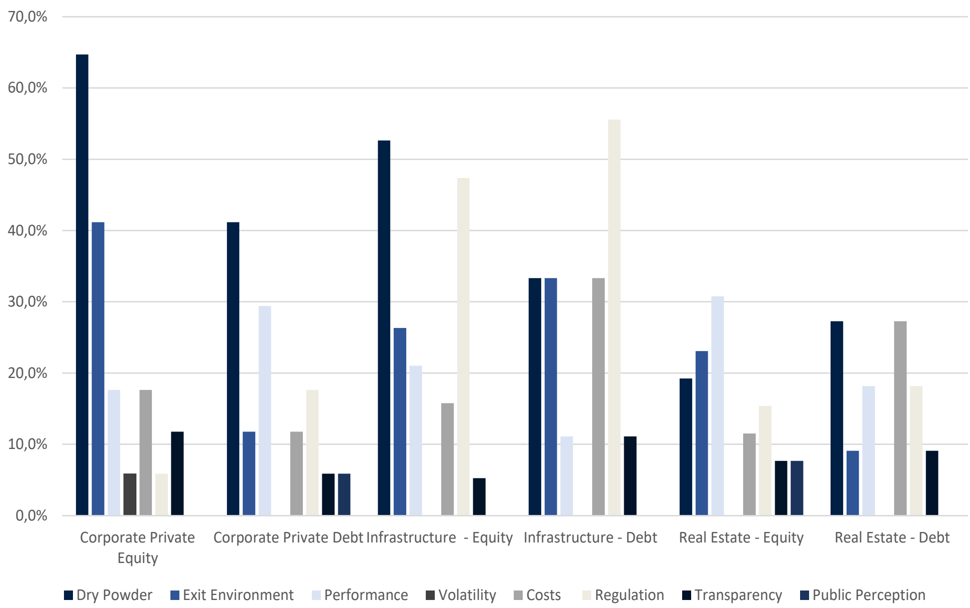

Figure 6: Main challenges in the coming years by asset class

6. How do pension schemes build exposure to alternatives?

How they invest in AI is dependent on the asset class. However, for each asset class, single funds are used primarily, with shares between 33% in the case of Hedge Funds and 71% in Corporate Private Debt. Also, the Fund of Funds plays a crucial role as an investment vehicle. Therefore, due to their comparatively smaller size, pension plans/ pension funds and CTAs invest still less diversely than other institutional investors, for example, insurances (c.f. the BAI publication German Alternative Investor Landscape – Insurance Companies[2]). Only for Real Estate Equity, where Fund of Funds do not play a role, a significant share of investors uses other vehicles – 31% direct investments and 19% single investments.

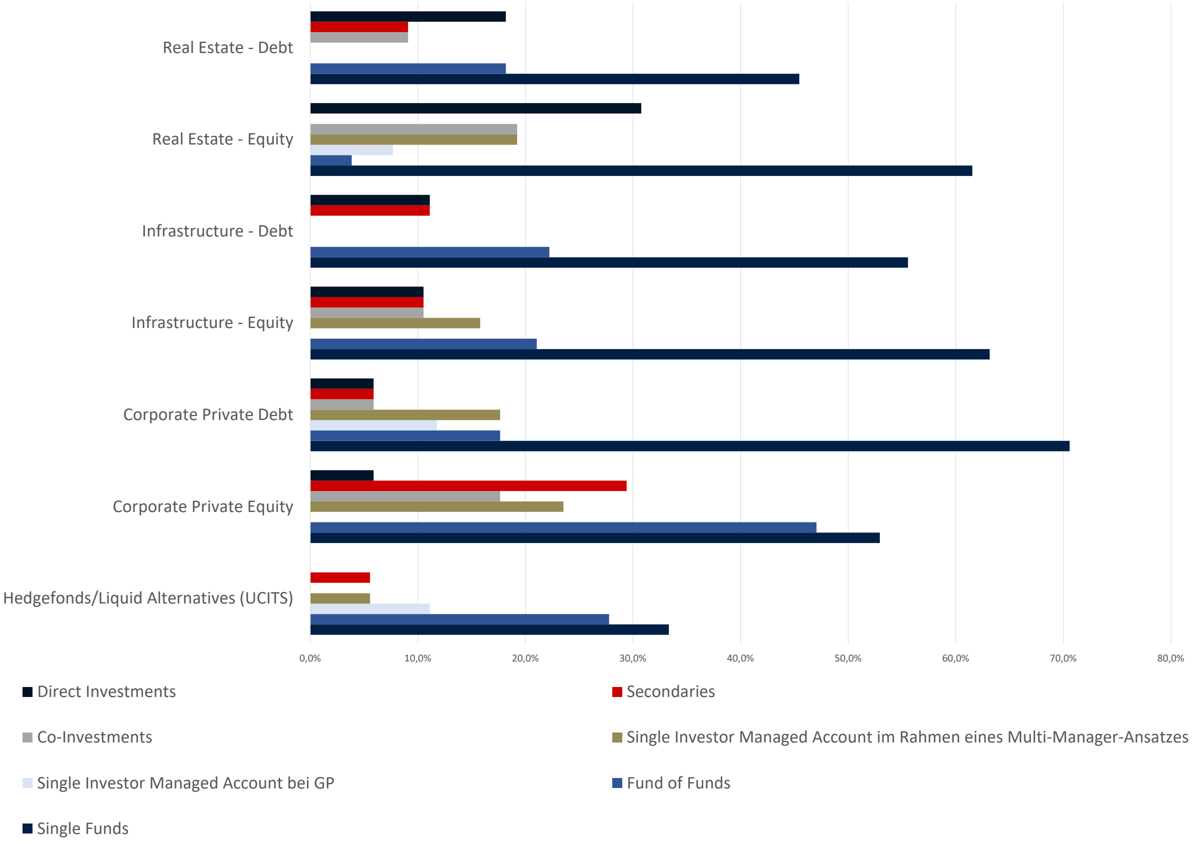

Figure 7: Investment vehicles in AI for Pension plans, Pension funds & CTA

7. What role does ESG play for pension plans, pension funds & CTAs?

The topic of ESG also plays a central role in occupational pension provision. In relation to the average of all German institutional investors surveyed, pension plans, pension funds, and CTAs pursue an ESG strategy significantly more often (76%) (Figure 8).

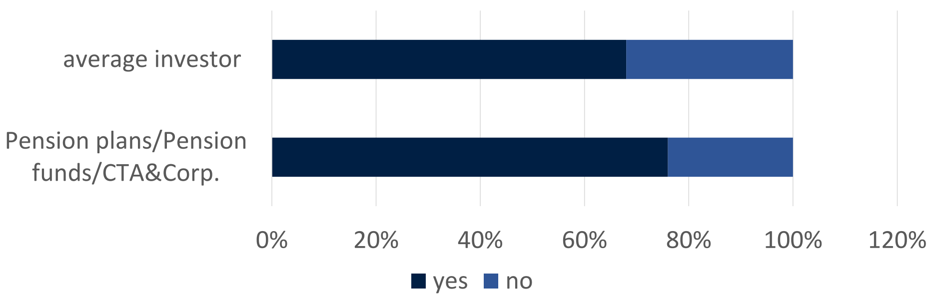

Figure 8: Proportion of those Pension plans, Pension funds & CTAs. pursuing a targeted ESG strategy

2 https://www.bvai.de/fileadmin/Veroeffentlichungen/BAI_Publikationen/BAI_Investor_Survey/German_Alternative_Investor_Landscape_NEU_17_03_14_54.pdf

The main reason to invest in ESG compliant AI is avoidance of reputational risks with 79%. But 63% of the surveyed investors claim to have an intrinsic interest. The same share has recognized the importance of ESG in risk management regarding investment risk – a factor that has received little attention so far in general. Despite the increasing regulation in the area of ESG – for example, pension funds in Germany are supposed to make sustainability risks transparent within the framework of the (European) Sustainable Finance Disclosure Regulation – regulation is only a secondary motivation for ESG among pension funds (Figure 9).

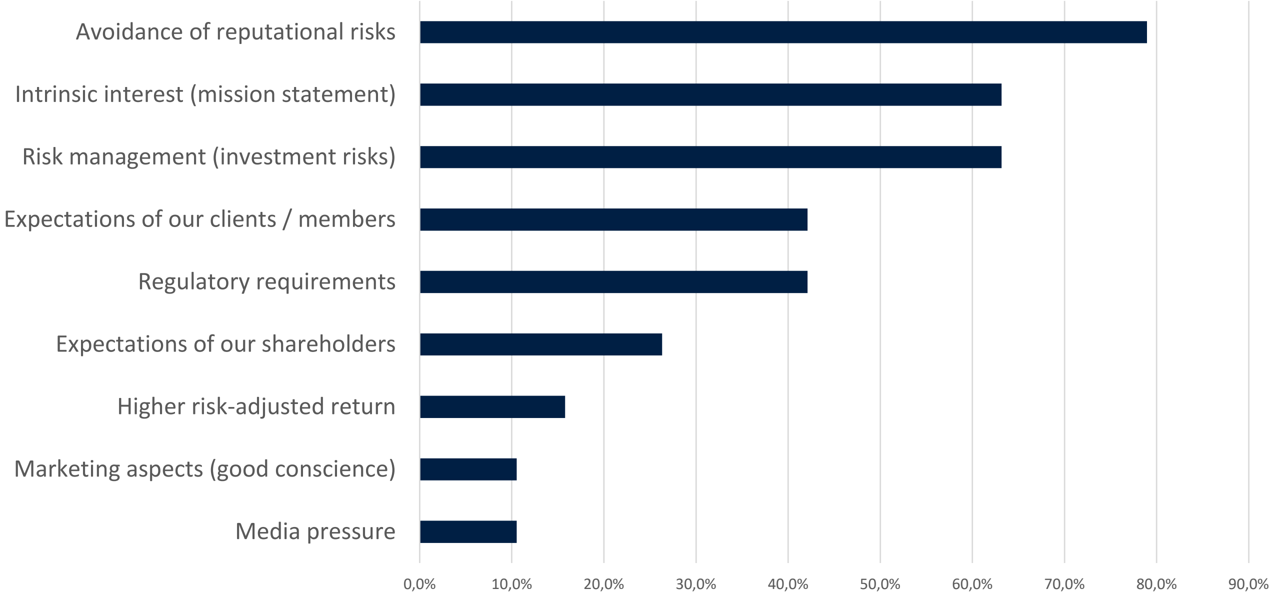

Figure 9: Reasons to invest in ESG-compliant AI for Pension plans, Pension funds & CTAs

The majority names environmental issues as the most significant ESG-risk factor (the E of ESG), with a small margin ahead of governance risks (G) and social risks (S) (Figure 10). Similar to pension schemes (c.f. Alternative Investor Landscape – Pension schemes), they are not as exposed to media and are dependent on marketing to focus more on members‘ interests than other institutional types of investors.

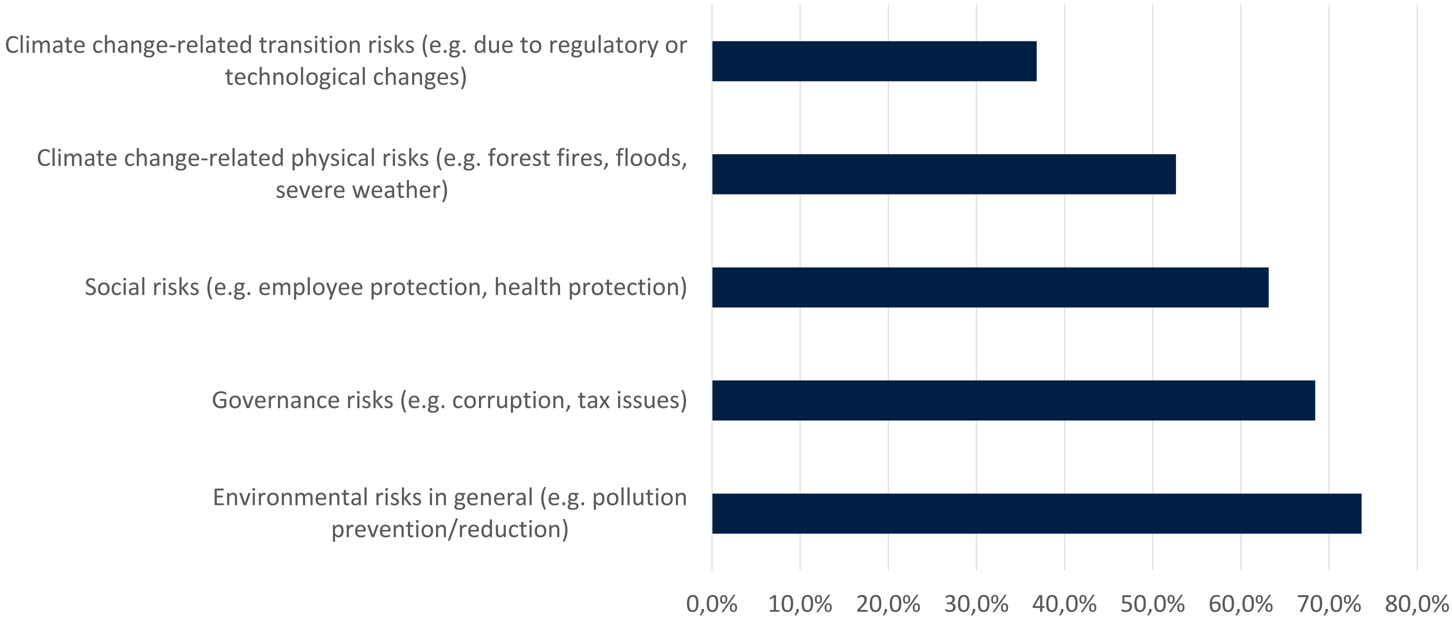

Figure 10: Proportion of Pension plans, Pension funds & CTAs citing factor as a most considerable ESG risk

8. Which ESG strategies do pension plans, pension funds & CTAs use?

The statement to pursue an ESG strategy is one thing, but the interesting question is that of the concrete implementation. As ESG strategy, most interviewed investors name the attempt to integrate ESG aspects into investment decisions using indicators (74%), followed by exclusion criteria for non-ESG-compliant assets (68%). Almost half of the investors are already operating impact investment – significantly more than the average of German institutional investors (37%) (Figure 11).

Figure 11: ESG strategies among Pension plans, Pension funds &CTAs

9. How does occupational pension provision in Germany compare to the rest of Europe concerning AI?

For Occupational Retirement Provision (IORPs), which are pension plans and pension funds in Germany, international data exists, making it possible to compare the sector in Germany to the one in other European countries. EIOPA – the European Insurance and Occupational Pensions Authority – publishes data on occupational pension provision in a European comparison[3]. In terms of volume, Germany ranks second in the EU, with 10.8% of the capital stock. Per inhabitant, this corresponds to only about EUR 2,800. The Netherlands is the undisputed leader here, with a share of 73.8% of the EU capital stock and EUR 91,000 per inhabitant. Even if Germany is still in the upper midfield in a European comparison, the example of the neighbouring country shows what potential is still there is in occupational pension provision.

3 https://www.eiopa.europa.eu/tools-and-data/statistics-and-risk-analysis/occupational-pensions-statistics_en

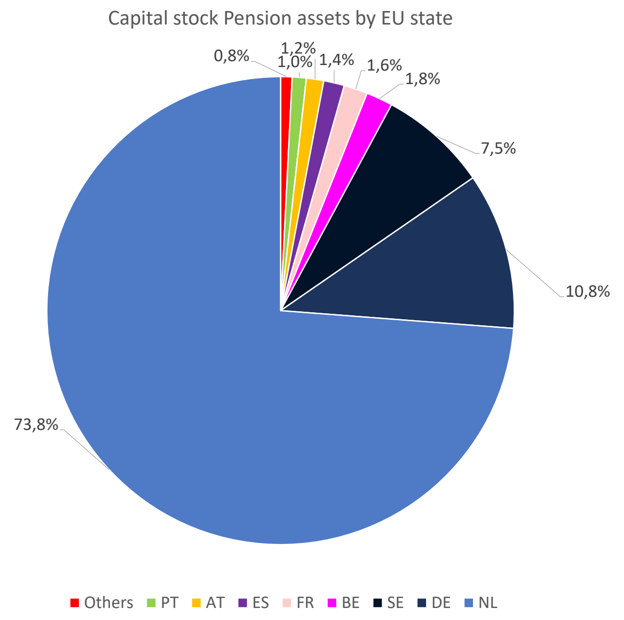

Figure 12: Assets in European Institutions for Occupational Retirement Provision by EU Member State

The data show that Germany‘s allocations to alternative investments in occupational pension provision have to converge with other European countries. Under the category of Collective Investment Undertakings, EIOPA lists the allocation in Alternative Assets – Real Estate Funds, Private Equity Funds, Infrastructure Funds, and Alternative Funds. The latter is defined as “collective investment undertakings whose investment strategies include hedging, event-driven, fixed income directional and relative value, managed futures, commodities, etc.” In the case of real estate funds, with 3.3%, Germany is clearly behind the European average of 5.2%. The same holds for Alternative Funds, where the allocation in Germany is 1.2%, compared to 1.85% in the European average. The Netherlands leads the way with 6.2%. The least popular category is infrastructure funds, with only 0.1% in Germany and only 0,65% on the European Average. German occupational pension provision has an above-average allocation regarding Private Equity Funds, with 1.6% – 0.47 percentage points above the average. However, other countries like Austria and Spain have a higher allocation – Finland is leading in this regard with a 5.3% Private Equity allocation.

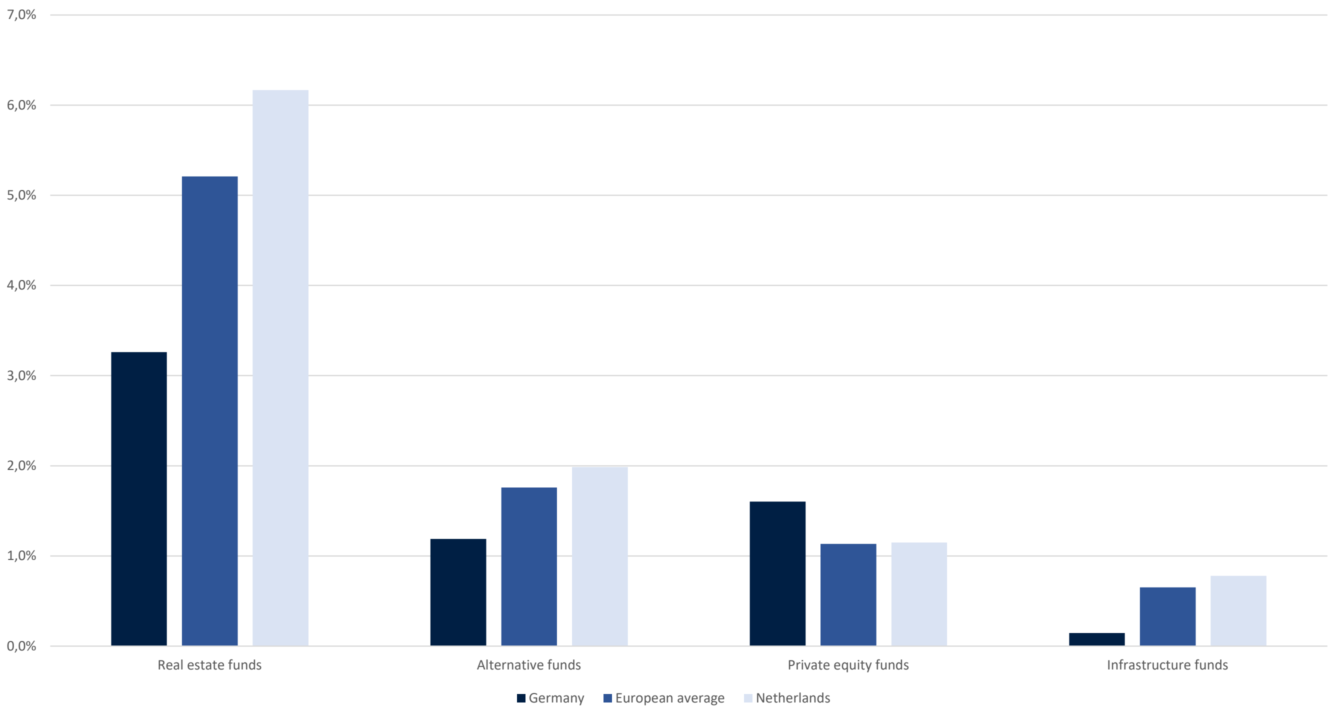

Figure 13: Asset allocation of German Occupational Retirement Provision in international comparison

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Quellen:
1) EIOPA: https://www.eiopa.europa.eu/tools-and-data/statistics-and-risk-analysis/occupational-pensions-statistics_en, accessed: 01. Juny 2022
2) BAI Investor Survey

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