MidLincoln Research

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Pension Fund Capitalism and its Russian Marx.

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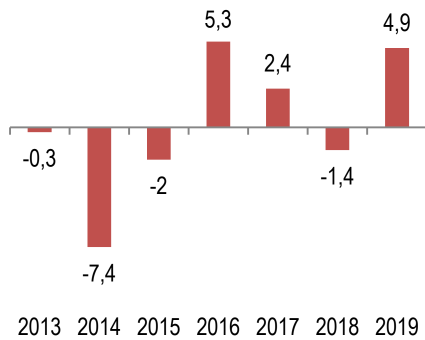
Country	PF in Equity %	PF in Bills and bonds %
United States	33.1	22.3
United Kingdom	23.3	36
Canada	27.3	31.9
Australia	43.5	15.2
Netherlands	30.7	45.6
Japan	9	30.4
Switzerland	30.1	30.4
Denmark	25.8	29.3
Sweden	12.4	14.4
Brazil	21.5	54.3
Korea	2.7	42.5
Singapore	0.1	
Germany	6	48.9
France	38.1	22.4
Israel	15.5	63.5
Mexico	17.9	78.7
Italy	21.4	45.5
Chile	38.1	60.9
Belgium	47.8	44.1
Spain	14.6	44.8
Finland	42.3	24.5
Ireland	25.3	45.6
Russia	6.9	76
Colombia	35.1	52.3
New Zealand	36.1	23.6
India	13.1	68.6
Peru	38.4	51.5
Portugal	11.7	75.2
Poland	82.4	8.3
Norway	37.1	54.4
Iceland	35.3	40.4
Thailand	22	65.8

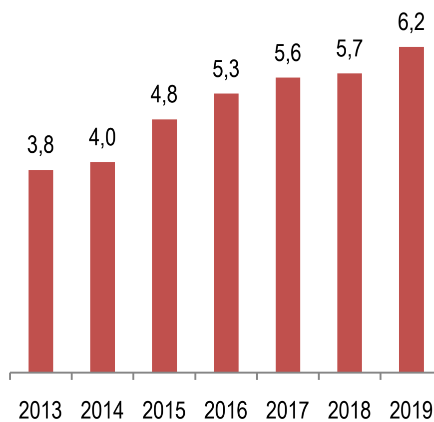
Source: OECD (2020), Pension Markets in Focus 2020,www.oecd.org/finance/pensionmarketsinfocus.htm

- OECD released its latest set of data on pension funds
- According to OECD data money in various pension vehicles totaled 50.5 trln USD in 2019 worldwide.
- 30% of total are invested into equities corresponding to 15.2trln USD
- 27% are in bonds or 13.5 trln USD
- Cash and various repo is 1.6 trln or 3% of total
- The other 40% of total are in custom solutions and other instruments (not sure exactly what these instruments are)
- 15.2 trln USD in equities is a staggering figure. It corresponds to 32.5% of market capitalisation total global investible equity universe.
- On various estimates total global free float of investible universe is 58-60%, so the equities in pension funds represent over a half of total global free float.
- Pension funds are a cornerstone of an attempt to build a welfare state, almost fully realizing the Marxists ideas for working class owning the means of production.
- "The history is repeated twice first as tragedy and second time as a farce" is one of the famous Marx's quotes and whether it is applicable to this shift of ownership of global equity or means of production needs to be examined and the effectiveness of pension funds in driving capitalism is yet to be measured.
- The tragedy of revolutions of the beginning of 20th century in attempts of proletariat to conquer means of production was substituted for highly regulated proxy process in which mostly non for profit institutions (and in many cases state owned) manage the funds that belong to active labor force and retired people.
- The professionalism of pension fund managers is very high as well as compliance and fiduciary standards.
- The regulator in every country has strict investment guide lines for pension fund managers.
- So overall it's not a farce as in Marx' quote.
- Some may argue that the white-collar workers benefited the most from the welfare capitalism and not the blue-collar but it is not hugely important.
- Ironically the size of pension fund and share of ownership of pension funds in equities is highly skewed towards developed markets with long history of capitalism.
- Emerging markets share of pension funds in equities is far modest. E.g. in Russia Russian pension funds own 7bn$ in equities which is around 1% of total Russian market cap (on 2019 figures). 35% of Russian equity is state owned.

Russian Real Rates of Return for Pension Funds



Total assets in Russian Pension Savings Plans Rub trln



- All of the welfare states were created by policies. There are different models for policy making, but they all imply that a portion of income of current work force is collected routinely and it is accumulated in a special coffin. Sometimes it gets collected separately of income tax, sometimes it is part of the income tax system. The same with distribution – sometimes its distributed directly from the government budget and sometimes it distributed from the separate pension fund. There are also plenty of voluntary pension programs in every country and they are also regulated.
- In above mentioned Russia for example a hybrid system was in place. Portion of income was accumulated in special pension fund. But there was never enough money to pay current pension obligations from pension fund income alone, so the budget covered some portion of the pension obligations.
- While in the last 6 years Russian government changed the policy. It kept collecting a portion of income destined to the pension fund. But kept it within budget revenues as tax without sending these funds further into pension fund. It kept paying current pension obligation deficit from the budget.
- On one hand this development was negative for the AUM of pension funds in Russia because they stopped receiving their usual annual contributions. On the other hand they have increased their focus on its current funds under management and have started producing some very good returns.
- At the same time the CBR started targeting inflation and this allowed the pension funds in Russia start showing positive real rates of return whereas most of the time in the past Russian pension funds rates of return were below inflation (when inflation was consistently double digit)
- Better performance of Russian pension managers also coincided with shift in corporate governance policy and generous dividend distribution in both private and state owned Russian companies.
- Russian pension managers are usually compact teams of multi assets focused professionals. The same team managing equities, FX, fixed income and repos. An example of Russian pension manager asset allocation would be 7-12% in equities, 7-12% in USD, 40% in ruble bonds and 40% in money markets with the idea that equity volatility will be hedged by FX exposure.
- Currently Russian policy on formation of pension funds is in transition while funds accumulated in various pension savings plans in Russia are substantial – totaling 6.2 trln rub in the end of 2019 or 99.5 bn in USD terms.
- Russia's other investment coffins are National Welfare Fund which is just sovereign welfare fund, and it deals with budget surpluses and deficits from oil price volatility it is not part of the pension system (its current size is 180bn$). It is not investing in Russian equities normally. Its only equity investment is in Sberbank which it bought from central bank.
- There also CBR reserves, but they are mostly cash and gold and invested abroad. NWF is also part of CBR reserves. Without NWF CBR reserves total 430 bn$ (end of 2020 figures)
- Another substantial investment pool besides CBR reserves, is Russian state property fund which manages equity stakes belonging to the Russian government there is at least 280bn$ (in Moex prices on liquid portion of its portfolio) worth of assets AUM but it also contains a portion of not traded

equities such as Rosatom, Russian railways, defense names and etc.. And it must be generating 20$bn annually in dividends from its portfolio. That income goes into the government budget.

- At first glance the difference between state managed and pension funds managed is paper-thin. Just as there is a difference between privately owned and state owned in Russia especially when it is related to legacy Soviet assets privatized or not privatized in the 90ties.
- There is currently not much difference in the way state runs Rosneft, Gazprom, Alrosa, Rosatom and Sberbank from the way how Severstal, NLMK or Lukoil is managed. In fact given the investment climate, state companies could be less risk averse (more prone to take risk) in investing in Russia and growing their business domestically than privately owned companies who prefer to diversify away from domestic markets or just take cash. But that is not a normal cause of events and is a consequence of the state of Russian investment climate. May be private companies are a notch better in the way they are managed, but the difference is blur, and is not feeding through the overall metrics. And this is only regarding companies with Soviet legacy assets. The companies formed by post soviet entrepreneurs like Tinkov and Volozh offer completely different set of values.
- Not only it is difficult for privately owned companies running soviet legacy assets to compete with SOEs in the current investment climate. The funds required to grow their core businesses are enormous.
- For example the replacement cost of Severstal assets on various accounts including its downstream assets is 125b$ (a figure provided by a fellow metals and mining analyst). Whereas Severstal market cap is 18.7bn$
- Of all the metals and mining tycoons only Vlad Lisin built new blast furnace in post soviet times increasing NLMK capacity by c.15% and spending 3-4bn$ on the project 18% in its current market cap terms of 20bn$.
- Growing assets of Soviet legacy companies in the current interest rate environment is slightly easier, but when the interest rates were double digit, it was merely impossible. No investor will provide 125bn$ to build new Severstal from scratch.
- Russian pension funds investing into soviet legacy metals and mining assets are for dividend sake only, and not for growth.
- In oil and gas the picture is slightly different. Oil companies need to keep replacing assets in order to stay afloat. E.g. Lukoil (figures are from Lukoil presentation) replaced 85% of soviet legacy asset and Novatek originally operating Gazprom legacy assets built a completely new company. But even in the oil and gas sector building new refining capacity proved impossible by capital needs. Only one Russian vertically integrated company built new gasoline plant – Tatneft in a miracle development. The large independent oil refinery recently built amassed over 3bn$ associated with construction and is in distressed mode currently.
- The regulator overlooking Russian pension funds is quite strict. The pension funds are barred from investing into companies domiciled abroad, even if they have share floating on Moscow exchange. So Yandex, Tinkov and Polymetal are not in the portfolios of pension managers.
- No policy making can be quick, most of it needs to be well thought through, weighed and analyzed for consequences.
- The short span of time that Russia lived in the post soviet environment did

allow it to built a welfare state. The education and healthcare is for the most part free, the sickness, disability and unemployment is somehow covered and some pension income is provided.

- The shift to the market economy also solved the delayed deficit problem of the Soviet Union.
- But the delayed savings problem is more opaque.
- In Russian privatization process most families were able to privatize the flats in which they lived and a little bit of stock now possibly worth like a second hand car. Their cash savings were written off to hyperinflation. Yet 70 years of unpaid labor and delayed savings resulted in creation of asset pools if marked by market value worth 1.5trln USD and marked by replacement cost worth 10trln USD. 7bn$ of which in Russian pension funds portfolios.
- And again, the span of existence of the post soviet Russia is too short for any test of policymaking but hopefully the history which first played out as tragedy in Russia will not be repeated again as farce.