NORDIC FUND SELECTION
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Arne Vagn Olsen

Interview with Lífeyrissjóður verzlunarmanna's CIO

- Nordic approaches for shareholder influence
- The PRI's Martin Skancke on ESG trends and new strategy plan
- Finnish and Swedish investors discuss hedge fund allocations

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MEDIA GROUP

Further steps on the long path towards full ESG integration

Arne Vagn Olsen, chief investment officer of **Lífeyrissjóður verzlunarmanna**, talks about diversification challenges, stepping up to protect the Icelandic krona during the pandemic and the pension fund's latest investment to help with the ESG integration work.

By: **Caroline Liinanki**

About two and a half years ago, Arne Vagn Olsen left the north of Iceland for a job in the capital as chief investment officer of the country's second largest pension fund: Lífeyrissjóður verzlunarmanna, the Pension Fund of Commerce. Its ISK 1013 billion (EUR 6.5 billion) in assets is almost four times larger than at his former place of work, the pension fund Stapi located in the northern Icelandic town of Akureyri, where he spent six years as chief investment officer.

"One of the reasons I wanted to join this fund was that it has a large and very interesting pool of assets and a pretty large footprint in Iceland," explains Arne Vagn Olsen. "So to some extent, you get better access to interesting conversations and deals than at a smaller pension fund. But being as large of a player in the Icelandic economy as the Pension Fund of Commerce, the scrutiny is higher. Everything the fund does is more newsworthy than what it was at my previous fund. That's good and bad, depending on how you look at it." With around 16 per cent of its assets invested in domestic equities, Lífeyrissjóður verzlunarmanna is one of the largest shareholders in many listed Icelandic companies.

Arne Vagn Olsen has had something of a dream start to the job. The pension fund posted record real returns of 15.6 per cent during his first full year as chief investment officer. Despite the difficulties that the pandemic has brought for such a tourism-dependent country as Iceland, 2020 still turned out to be a very good year for the pension fund with real returns of 10.8 per cent. "The last two years have been exceptional," says Arne Vagn Olsen. "But as much as I would like to, I can't really take credit for that. This is the result of the long-term strategic allocation of the fund as well as good returns of individual assets. I may have played some small part but it was really due to the people before me, as well as the CEO and the board."

ARNE VAGN OLSEN

AGE: 49

EDUCATION: BSc in business administration and management,The University of Akureyri; MBA, Copenhagen Business School

CAREER:

2018	Chief investment officer, Lífeyrissjóður verzlunarmanna
2012	Chief investment officer, Stapi lífeyrissjóður
1999	Head of marketing and sales, Icelandic Securities
1999	Managing director, Taekifaeri Venture Capital Fund
1998	Marketing manager, UA Seafood Group
1997	Production manager, UA Seafood Group

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– Arne Vagn Olsen, Lífeyrissjóður verzlunarmanna

The pension fund's assets have grown dramatically just during Arne Vagn Olsen's tenure. New inflows into the pension fund combined with good returns has resulted in a growth in assets of around 40 per cent over the past two years. "We don't really have any liquidity issues and the pension fund is still growing, so we can invest for the longer term. We have a significant exposure to equities and we're also committing more to alternative assets than before. So it's a very good position to be in from the point of managing the portfolio," he says.

Arne Vagn Olsen, who is half-Danish, spent his early childhood in Denmark but moved to Iceland when he was eight years old. He left Reykjavik for Akureyri when he met his wife and then lived in the north of Iceland for around 25 years. Before entering the financial industry to work at venture capital fund, he worked as a production and marketing manager at a seafood plant. "When we moved to Reykjavik two and a half years ago, it was to some extent like coming home. This is where I spent my teenage years. So it has been quite good and I'm happy with the change," he says.

In comparison with Akureyri's 18 000 inhabitants, Reykjavik is almost a metropolis with close to 220 000 living in the capital region. Asked if it has been a big difference working at a pension fund in the capital, he responds: "The majority of the financial industry is, of course, in Reykjavik, so you meet more of your peers. From that perspective, it's easier. But it's not all bad being up north. Sometimes it can also be good to have a bit of distance between yourself and your peers, so there are pros and cons."

One of the main trend among Icelandic pension funds in recent years has been the increased focus on ESG integration. For many Icelandic pension funds, the responsible investment work really took off in 2017 when changes to the Icelandic pension fund regulation were made, requiring them to take ethical considerations when investing. Iceland SIF, the Icelandic sustainable investment forum, was launched shortly after and has contributed greatly to bringing sustainability high on the agenda.

Lífeyrissjóður verzlunarmanna has, however, been somewhat ahead of the curve. The pension fund has, for example, been a PRI signatory since 2006. Still, its efforts have intensified further in recent years. One of the pension fund's most recent moves has been signing up to MSCI's ESG ratings platform. Having gone through and scrutinised different ESG providers, it finally settled on MSCI, becoming its first Icelandic pension fund client.

"I think this is a reflection of how seriously we take ESG and we're very happy with being MSCI's first pension fund client in Iceland when it comes to ESG. It's a pretty big step for us – MSCI is not giving this away for free. This will help us to take further steps with ESG integration in our portfolio and to screen investments further on a company level, for example in terms of carbon footprint. It will enable us to understand our portfolio in much more detail than we were able to before – it basically gives us access to data that we didn't have before," he says.

The plan is to use the ESG data for both its domestic and foreign holdings. The pension fund manages domestic assets internally but uses external managers for its foreign exposure. "A larger part of our portfolio is now invested in non-Icelandic assets and that's where we need more tools to monitor and manage the assets. MSCI will help us to do that in an easier and more transparent way than we could before," he says.

One issue, however, for Icelandic investors is the shortage of ESG research available for domestic companies. Arne Vagn Olsen explains that part of the pension fund's discussions with MSCI has been around pushing for more Icelandic companies to be included in the research. Those demands were given momentum by MSCI's decision to include Iceland in its frontier market index in a few months, which means that it will have to start screening Icelandic companies anyway. Arne Vagn Olsen notes that MSCI's data on Icelandic companies currently is pretty limited but expects the picture to have changed by the end of this year.

Iceland as a frontier market country may sound somewhat bizarre. However, Arne Vagn Olsen notes that this classification doesn't really reflect anything about Iceland in terms of government and economy. "The stock market is just fairly small in size compared to other markets," he comments. Over time, the MSCI inclusion should lead to greater inflows into the Icelandic equity market but initially, only a small number of companies will be added to the index.

The Pension Fund of Commerce will also use the ESG data from MSCI to revise its company exclusion list and expects some changes when it comes to exclusions over the coming months. When it comes to its external managers, the pension fund has already revised some of its segregated mandates as well as swapped some funds to the ESG equivalent. Going forward, Arne Vagn Olsen expects the fund to appoint some additional ESG-focused external managers for its foreign asset portfolios.

In general, Arne Vagn Olsen observes that integrating ESG is far from an easy and speedy process, not least considering all of the different rating systems and the different data providers. "That makes the ESG integration very challenging and complicated but at the same time, it also gives a lot of flexibility. But it does take a lot of work to understand and decide on what we want with the portfolio, what our members want and whether we should exclude certain sectors, so there are many aspects to this. The work of integrating ESG into a portfolio will take years to implement, so it's complex work but at the same time necessary work," he says.

Another main trend in recent years among Icelandic pension funds has been the increase in the amount of foreign assets. The pension funds have been keen to improve the level of diversification of the portfolios after the removal of the capital controls, which were in place following the financial crisis. This severely limited their ability to invest abroad for a number of years. The plans of adding more foreign assets did, however, come to a temporary halt as the pandemic hit. In order to protect the stability of the Icelandic krona, the pension funds agreed with the central bank to cease all new investments abroad for a period of time during last year. The agreement was first for a three-month period and then extended for another three months, lasting between March 17 and September 17 all in all.

"The outlook was very uncertain and it wasn't that big

of an issue for the pension funds to just hold back foreign currency investments," says Arne Vagn Olsen. However, he emphasises that this should not be interpreted as a return to capital controls since this was not a legislative measure but a voluntary agreement. He adds that it didn't really disrupt the Pension Fund of Commerce's plans as it only lasted for a fairly short period. The pension funds were also still able to honour their contractual agreements within the alternatives space, such as commitments made to private equity funds abroad.

One problem for Lífeyrissjóður verzlunarmanna is the limit on how much Icelandic pension funds are allowed to invest abroad. With some 44 per cent of its portfolio invested in foreign assets at the moment, the pension fund is closing in on the 50 per cent cap on foreign currency exposure. Arne Vagn Olsen notes that it is possible to have a larger foreign allocation than the limit but this would require hedging the currency exposure back to ISK.

The Icelandic pension fund system is also very large in comparison to GDP, which is another factor that makes it difficult and potentially risky for the pension funds to invest too much in the domestic market. Arne Vagn Olsen is hopeful that the 50 per cent limit will change over time. "That's a change that needs to happen on the legislative level but in my mind, it's very easy to argue for why the cap should be increased. There will be different opinions on that but due to the growth of the pension fund system, we need to be able to diversify more outside of Iceland. We're not there yet but I think it will happen," he says.

Nevertheless, the pension fund continues with its plans of increasing its foreign exposure, for example within the alternatives space. From a Nordic perspective, it has a relatively modest allocation to alternative assets of around 4 per cent, mainly within private equity but also including some infrastructure and property funds. Icelandic pension funds haven't had the same problem as investors in other Nordic countries of very low or even negative interest rates and Icelandic government bonds have been a fairly decent investment over the years. However, decreasing interest rates in Iceland may force pension funds, just like their peers in the other Nordic countries, to take on more alternative assets as a substitute to government bonds.

Lífeyrissjóður verzlunarmanna is keen for some alternative investment opportunities to arrive in the domestic market as well. "One of the things we've been waiting for and looking at is infrastructure investments in Iceland," says Arne Vagn Olsen. "That's a type of asset we would like to have in our portfolio. We also need to upgrade the infrastructure in Iceland – get better roads, for example. I think the pension fund system is a pretty natural partner for that, so we're hoping to be included in discussions with the government. Having said that, the price needs to be right – as always."

So far, the Pension Fund of Commerce has mainly had foreign equities and alternatives on its agenda but is currently eying fixed income investments abroad, which Arne Vagn Olsen expects to become a bigger part of its portfolio. "The fixed income investments we've had abroad so far has mainly been very short-dated government bonds but as our overseas portfolio is growing, we will diversity both into alternative assets and bond funds. I expect us, for example, to invest more into multi-sector funds within the credit space. In the end, it's all about trying to get best long-term returns with the least risk," he says.

A unique feature in Icelandic pension fund's portfolios from a Nordic perspective is the mortgage loans the funds are providing to their members. As these loans have grown rapidly in popularity among the members, some of the commerce pension fund's peers have been concerned about the loans becoming a too big part of the portfolios. Lífeyrissjóður verzlunarmanna, which currently has about 10 per cent exposure to mortgage loans, is, on the other hand, quite pleased with its allocation. Arne Vagn Olsen calls it "a very good investment" with fairly low risk and good returns. Furthermore, he explains that the pension fund can steer the amount of loans, for example through pricing, but adds that the allocation can be a bit volatile as the loans can be paid up by the members at any time.

"In the end, I think it comes down to whether you're compensated for the risk you're taking and we have a pretty robust model for pricing these loans," Arne Vagn Olsen says. "I think it has been a win-win, both for funds and members. And I think it's quite a healthy asset class to have, as long as you can control it. You don't want the exposure to be too low or too high but there's always that sweet spot that you want to be in." Asked whether the pension fund is currently in that sweet spot, he responds: "Yes, we are."