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Research Update:

Finland-Based Työllisyysrahasto, The Employment Fund Affirmed At 'AA+/A-1+'; Outlook Stable

September 25, 2019

Overview

- Työttömyysvakuutusrahasto, The Unemployment Insurance Fund (TVR) has integrated the activities of the Education Fund into its mandate to form Työllisyysrahasto, The Employment Fund (EF) at the beginning of 2019.
- We believe that the expanded activities did not have any effect on the relationship to government and we maintain our view of an almost-certain likelihood of receiving extraordinary support from the Finnish government, based on EF's continued integral link and critical policy role to Finland, and therefore equalize our ratings on EF with those on the sovereign.
- We are affirming our 'AA+/A-1+' ratings on EF.
- The stable outlook reflects that on Finland.

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Rating Action

On Sept. 25, 2019, S&P Global Ratings affirmed its 'AA+/A-1+' long-term and short-term issuer credit ratings on Finland-based Työllisyysrahasto, The Employment Fund (EF). The outlook is stable.

Rationale

We equalize our ratings on EF with the ratings on Finland (AA+/Stable/A-1+). This reflects our expectation of an almost-certain likelihood that the Finnish government would provide timely and sufficient extraordinary support to EF in the event of financial distress. We believe that the almost-certain likelihood of extraordinary government support for EF, which we consider a nonseverable arm of the Finnish government, will endure and is not subject to transition risk. We, therefore, do not assess EF on a stand-alone basis.

On Jan. 1, 2019, The Unemployment Insurance Fund (TVR) integrated the Education Fund's activities into its mandate to form the EF. Aside from TVR's original statutory responsibilities, the EF holds the responsibilities for Adult Education Allowance. These activities are minor in the overall scheme of EF. The expansion of activities only marginally affects the financials and, as we understand, was predominantly made to gain administrative efficiencies. we believe that including the Education Fund does not have any impact on EF's role and link with the government, nor on its financing operations, because the Education Fund already received the majority of its funding from TVR. EF's operations continue to be subject to supervision by Finland's Financial Supervisory Authority (FSA), onto which the assimilation of the Education Fund entailed no changes.

In accordance with our approach for rating government-related entities, we base our assessment of an almost-certain likelihood of government support on EF's:

- Critical role for Finland, as the sole entity responsible for defining and managing the Finnish earnings-related unemployment insurance scheme together with adult education allowance; and
- Integral link with the Finnish government, as indicated by the government's strong supervision and control over EF.

EF is an independent institution established by law. It is managed within a comprehensive legal framework with operations tightly monitored by the government through the Ministry of Social Affairs and Health (MSAH). EF's main task is to finance and manage Finland's compulsory earnings-related unemployment insurance schemes. In this regard, its two key functions are to collect unemployment insurance premiums and use them mainly to finance unemployment benefits and fund pensions accrued during periods of unemployment. Each year, EF submits a proposal on the amount of unemployment insurance premiums to the Ministry of Social Affairs. This proposal is not binding for either the ministry or parliament, but so far, parliament has always approved the premium levels in the proposal.

EF's highest managing body, the supervisory board, is appointed by the central government and consists of both employer and employee organization representatives. The unemployment insurance contributions (UIC) has been equalized between employees and employers since 2018 and the board's composition has changed to reflect this to have equal representation from both employees and employers, both contributing 1.5% as of Jan. 1, 2019. For 2020, EF's board of directors has proposed a reduction of UIC rates to 1.25% of payroll, illustrating the strong financial position of EF and the still-solid Finnish labor market.

Following the transition into EF, the duties of the previous Education Fund were transferred to the Act on the Financing of Unemployment Benefits. We believe adding the fund's operations had only a marginal impact on EF's financials but enforced its already-integral position in the Finnish social security system. We maintain the view of EF as a nonseverable arm of the government, reflected in its status as an indirect public administration. Because EF has the role of a public administration, it is treated as a public authority and therefore must comply with the same rules as public authorities. This status not only underlines EF's integral link with the government, but also implies that if it did not exist, a government body would be needed to manage its duties. Underlying EF's critical role for the government is its execution of a core responsibility for the central government, which is ultimately responsible for the unemployment schemes and determines EF's functions and funding sources.

Given its critical role in the execution of key public policy, we believe that if EF needed extraordinary financial assistance, the government would take pre-emptive actions and provide adequate and timely support. On a few occasions, the Finnish government, without any preceding request from EF, has granted extra funds to EF's budget, via the Ministry of Finance, to manage higher benefit payments during periods of very high unemployment. In doing so, it relieved EF from having to propose hefty premium increases.

EF's financial performance mirrors the economic and employment conditions in Finland. Changes in employment and unemployment rates therefore affect both its revenues (premium income base) and expenditures (unemployment payment base). However, because EF has the tools to propose premium levels, differences between actual employment and unemployment rates compared with its forecasts determine its performance, rather than year-to-year changes in those statistics.

We expect Finland's economic cycle to cool in 2019 and 2020 after a three-year long cyclical boom. After its peak in 2016-2017, Finland's economic growth markedly slowed in 2018, when output expanded by 1.7%, a sizable slowdown from 3.0% in 2017. In the first half of 2019, most high-frequency indicators suggest that the economy's growth momentum has stalled on the back of slowing external demand, still-muted private consumption, and contraction in fixed investment amid lower business confidence. For 2020-2022, we expect the economy to expand in line with its potential growth rate at around 1.2%.

Nevertheless, we observe that Finland's labor market has demonstrated strong development over the past three years, with rising wages and higher employment levels, currently at 72%, the stated target set by 2015-2019 government. Notably, the expanding economy has strengthened the labor market and unemployment dropped to about 6.2% in July 2019. As a result, EF's financial performance has strengthened notably over the past three years. We believe the underlying labor market dynamics will stay beneficial over the coming two years.

In accordance with the Act on the Financing of Unemployment Benefits, EF maintains a business-cycle buffer generated from the difference between its income and expenses. This buffer is to safeguard its solvency and even out changes in unemployment insurance contributions caused by trend cycles in the national economy. EF seeks to ensure the sufficiency of the business-cycle buffer by setting unemployment insurance contribution rates at an appropriate level, using diverse forecasting methods. However, if the buffer is depleted, EF must maintain liquidity, for example, by issuing debt. Overall, EF benefits from strong access to loans and capital market funding, and in 2015 the European Central Bank accepted the company as an issuer under its Public Sector Purchase Program.

Following the weak national economic performance in 2014 and 2015, the maximum limit on this buffer increased temporarily to correspond to benefit payments of a 7% unemployment level rather than the previous 5%, which is the level set in the permanent legislation. The social partners have proposed a change to the business cycle buffer to be equal to cost of 6 % unemployment, equivalent to €1.75 billion, in addition to extending the possibility of the buffer to exceed the maximum amount for a two-year period in situations where the economic growth is expected to materially weaken. We expect a decision in the second half of 2019, with the change in force by Jan. 1 2020. We expect EF's net earnings for 2019 could reach €500 million leading to a net position at about €1.5 billion by year-end 2019. This is closing in on the maximum limit of the business cycle buffer, which amounts to €1.75 billion, corresponding to the expenditure necessary for 6% unemployment.

According to its investment principles, EF is required to invest an amount equal to one month's expenses (about €300 million) in liquid money market instruments maturing in less than a year. As of June 2019, EF's investments and other financial assets amounted to €2.1 billion, compared with €1.7 billion at year-end 2018. In addition, EF maintains the Finnish FSA's permission to borrow to secure its liquidity. It covers its funding needs primarily through a €300 million commercial paper program and a €400 million revolving credit facility, both of which are unused. EF is paying its remaining debt maturities organically from its cash flows, and after 2019, we expect that no long-term debt will remain on the entity's balance sheet. Nevertheless, a new National Incomes Register launched at the beginning of this year. This, alongside a new model for the unemployment insurance contribution systems--whereby contribution payments to a greater extent will be based on realized wages rather than advance payments--could result in a need for EF to temporarily bridge cash flow positions until the new model fully settles.

Outlook

The stable outlook reflects that on Finland. We do not see any scenario that would realistically lead us to change our assessment of EF's critical role for and integral link with Finland over the next two years. We therefore expect the ratings on EF to move in line with those on Finland.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed	
Tyollisyysrahasto, The Employment Fund	
Issuer Credit Rating	AA+/Stable/A-1+