

IV OTHER FINANCIAL MARKETS

Investment funds

Since the end of September 2006, the **yield** of investment funds has been influenced by the rise in key interest rates, the rapid increase in stock prices and the subsequent global correction at the beginning and in the summer of 2007 (see Figure 1). This mostly affected the yield of equity funds, which rose to 32% as a moving average by the end of September, despite having fluctuated up and down. The increase in key interest rates also entailed a rise in the average yield of money market funds that posted the highest result in four years at the end of September with 3.3%. In end-September, the average yield of interest funds – 3.2% – was nearly three times higher than last year's average.

The growth of investment fund **assets** started to decelerate in spring owing to the high comparison basis and stock market corrections. By the end of September, it had declined to 48% year-on-year (see Figure 2). At the end of July – before the turbulence in financial markets – the volume of investment fund assets reached its record high level with 25.6 billion kroons. At the end of September, after a major correction of stock prices in August, it

displayed signs of growth again and amounted to 24.9 billion kroons.

The **return on assets** contributed 46% of the year-on-year growth of investment funds. The rest, approximately 4.4 billion kroons, was new investment capital, which has increased by nearly a third compared to last year. Most of it was invested in equity funds in the amount of nearly 5.2 billion kroons, which is almost twice as much as a year ago. The assets of money market funds that had shrunk by nearly a quarter by the end of September diminished due to the outflow of 1.2 billion kroons. This was somewhat compensated by the improved yield of these funds. Despite the multiplication of the yield, new capital nevertheless accounted for approximately 90% of the asset growth.

The share of residents among the shareholders of equity funds dropped even further from 59% a year ago to 54%. Less than half of them, that is 43%, were private persons.

The **share of foreign assets** in total fund assets started to increase slowly in the fourth quarter of 2006 and comprised 80% in end-September 2007

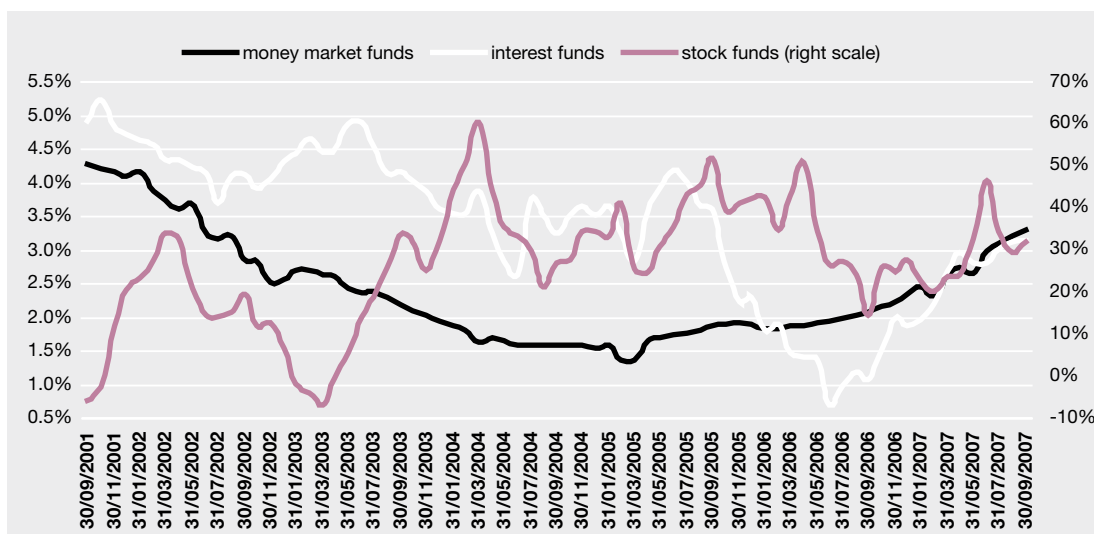


Figure 1. Average yield of investment funds

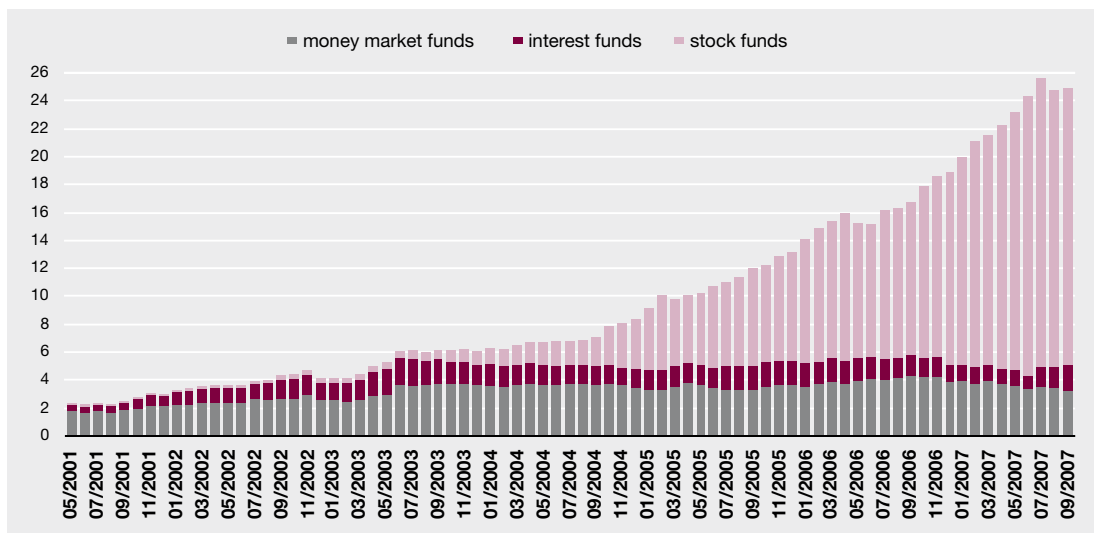


Figure 2. Volume of investment fund assets at end-month (EEK bn)

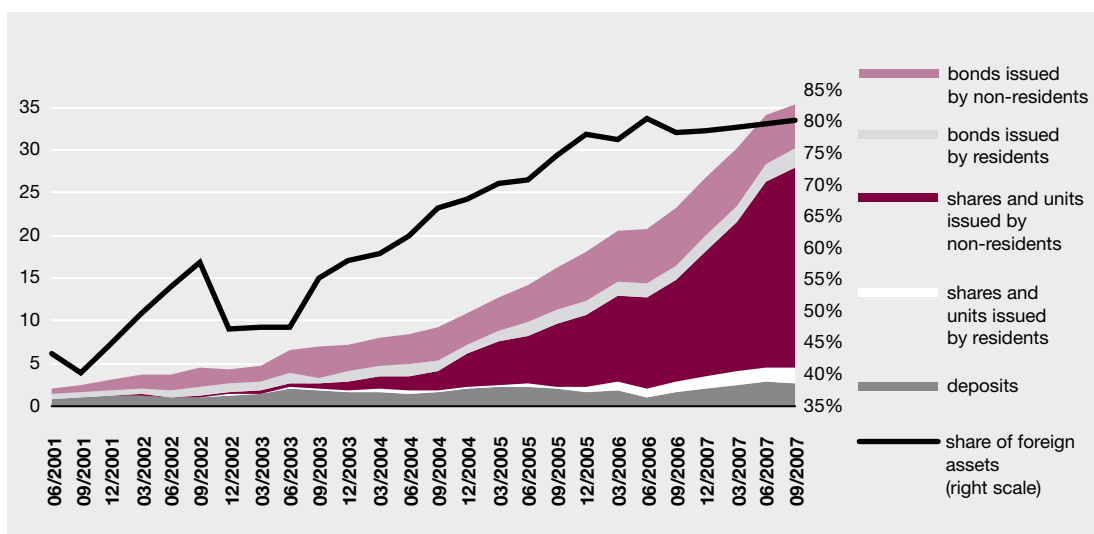


Figure 3. Structure of investment and pension fund assets (EEK bn) and share of foreign assets at end month

(see Figure 3). This occurred primarily on account of investments in the shares and other equity of non-residents. By the end of September, their volume had nearly doubled over the year – by 11.6 billion kroons. Investments in the European Union markets grew by nearly 60%: from 76% a year ago

to 78% of foreign assets by the end of September (see Figure 4). The total value of instruments issued to the Estonian equity, bond and fund market among the assets of investment and pension funds registered in Estonia decreased to 11%; i.e., to 3.9 billion kroons.

The pension funds registered in Estonia increasingly prefer to invest in other funds (see Figure 5). At the end of September, all pension funds had invested in investment fund shares or units, whereas third pillar pension funds had invested over two thirds and second pillar pension funds over half of their assets into other funds. Although

at least half of equity and interest funds had invested in other funds, the value of investment remained relatively modest: 10% in the case of equity funds and 4% in the case of interest funds.

Six new equity funds and two new interest funds added to list of investment funds during the

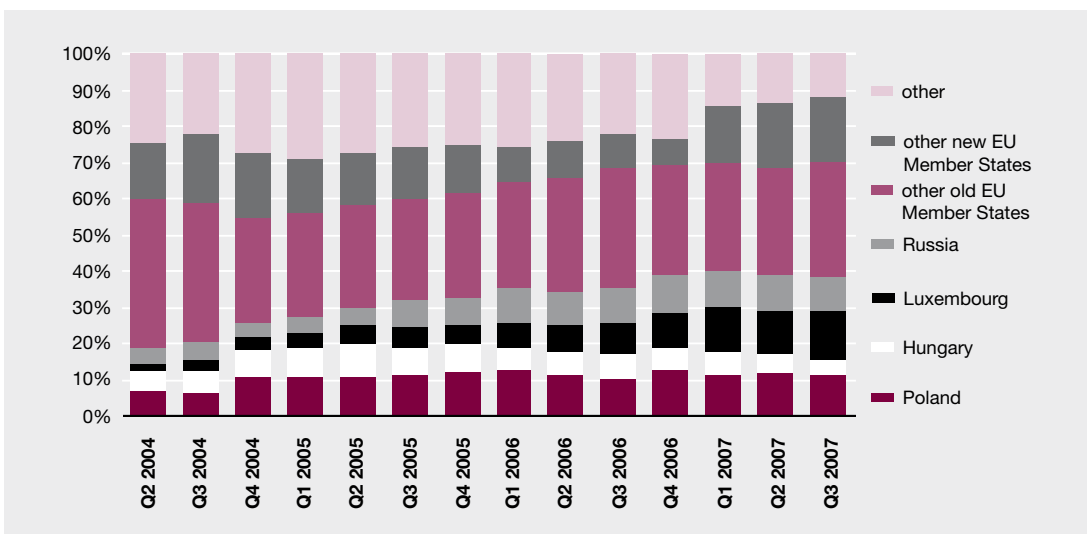


Figure 4. Foreign investments of investment and pension funds by residency at end of period

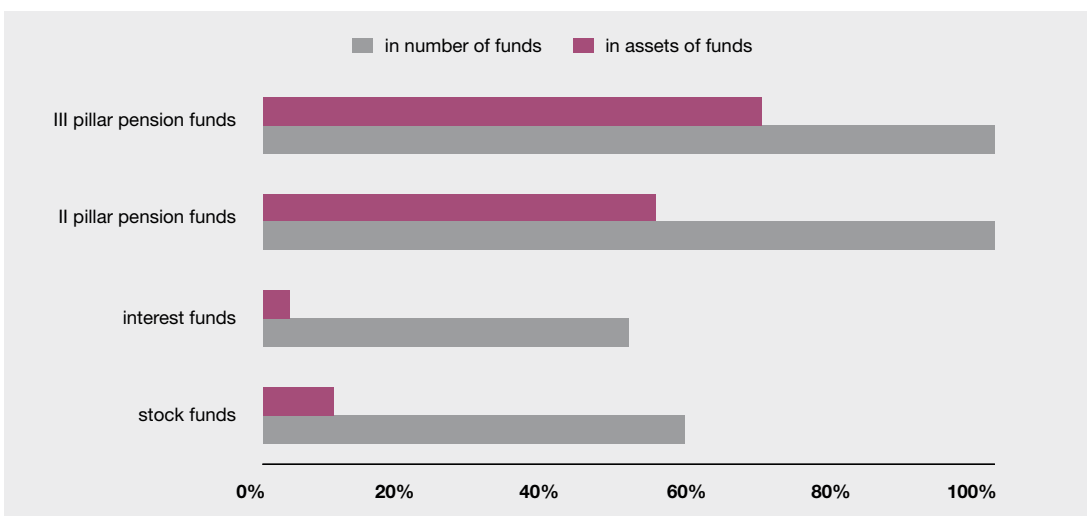


Figure 5. Share of investment fund assets and number in other funds as at 30 September 2007

last half-year. New equity funds included the funds of Sampo Pank and LHV, and AS Avaron Asset Management that received its licence on April 1. At the end of September, their shares composed 4.6% of the total equity fund assets. The total volume of interest funds, however, grew by more than a fifth owing to the launch of Hansapank's Private Debt Bond Fund and Sampo Pank's Fixed Income Strategy Fund. The most popular investment regions of the new equity funds include Central and Eastern Europe. The assets of interest funds have been primarily placed in debt instruments in the European Union.

Pension funds and insurance

At the end of October 2007, the number of subscribers to the **second pillar** of the pension system amounted to approximately 553,000 persons; i.e., about 60% of the labour force. During the past year, the volume of the second pillar funds grew by 54% (3.6 billion kroons) and stood at 10.2 billion kroons towards the end of September.

About 41,000 persons (nearly 4.5% of the labour force) had subscribed to the **third pillar** pension

funds by end-October 2007. Within the year, the total volume of the third pillar pension funds grew by 68% (400 million kroons). At the end of the third quarter of 2007, the volume of the third pillar together with pension insurance stood at 3 billion kroons, the share of pension funds comprising 32.8% of that.

The **structure of pension fund assets** followed the trend of previous quarters. The percentage of investment fund shares and units in the structure of second pillar pension fund assets increased even further (see Figure 6). A year ago they comprised 34%, whereas this year 54% of assets have been invested in the funds (see Figure 6). Fund investment is a positive development, as it helps to hedge risks.

At the end of the third quarter, the percentage of investment fund shares and units had increased also in the investments of third pillar pension funds on account of other instruments: from 50% to 68% (see Figure 7). In terms of countries and regions, the percentage of Western European countries in pension fund assets has climbed within the past year. Central and Eastern European countries, on

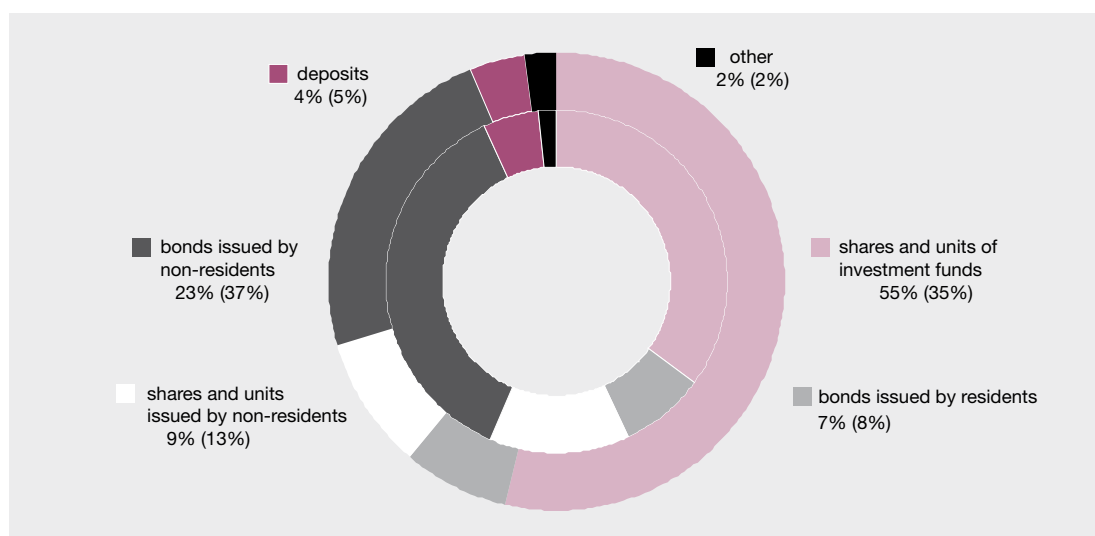


Figure 6. Structure of II pillar pension funds' assets as at 30 September 2007 (position on 30 September 2006 indicated in brackets)

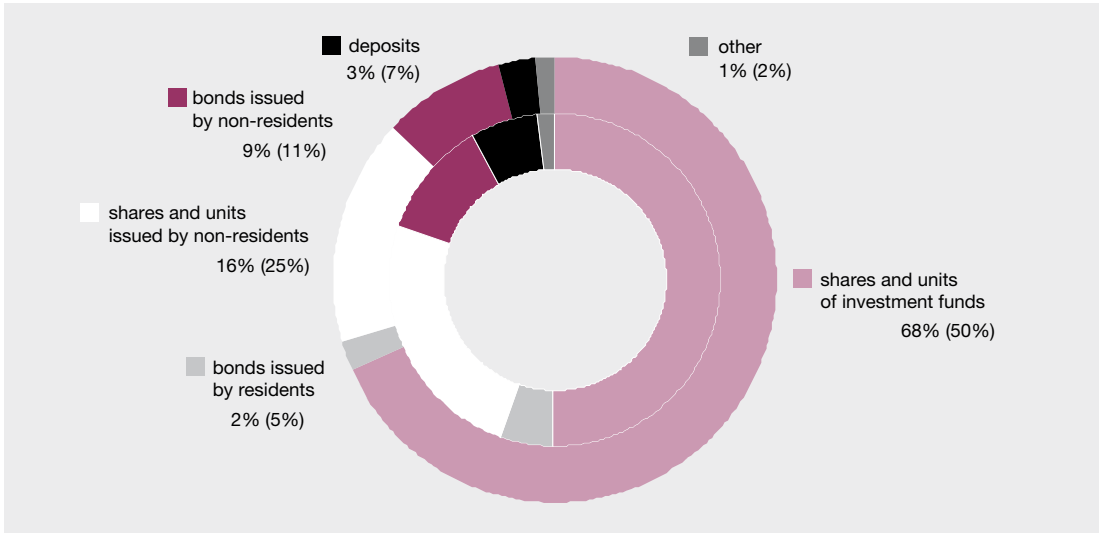


Figure 7. Structure of III pillar pension fund assets as at 30 September 2007 (position on 30 September 2006 indicated in brackets)

the other hand, have witnessed a downturn in investment (from 36% to 29%).

The **annual yield** of Estonian pension funds has remained in line with the developments in global financial markets. Despite remarkable corrections in the financial markets, all pension funds have nev-

ertheless recorded positive yields during the year (see Figure 8). The yield has generally remained very good, as the favourable global economic situation and the reform of Estonian pension system that introduced pension funds have well overlapped. However, a future drop in the yield cannot be ruled out.

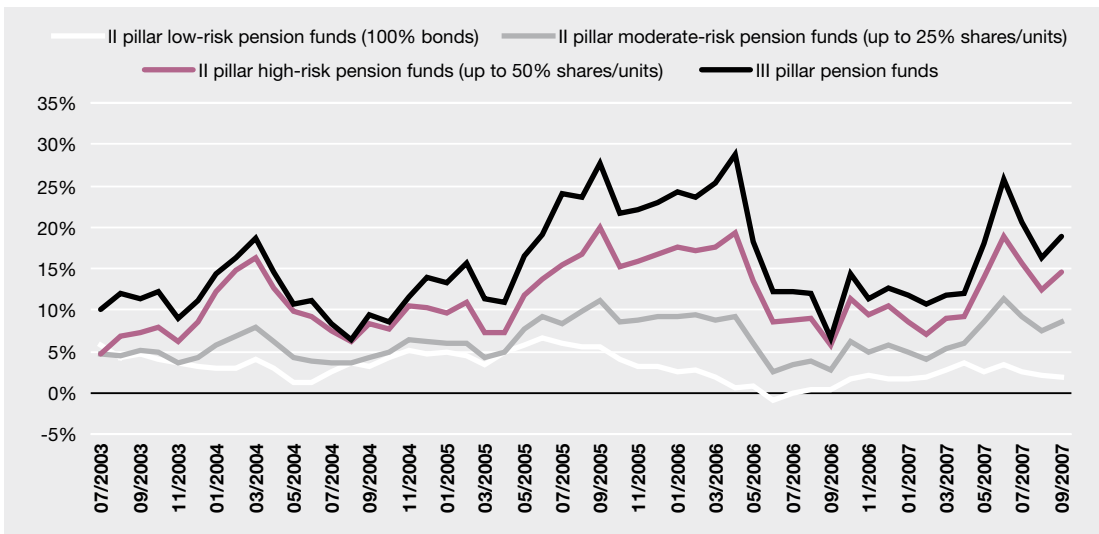


Figure 8. Annual yield of pension funds at end-month

Insurance

Life insurance

This year's developments in the life insurance market can generally be characterised by the establishment of European companies in Estonia. This means that some life insurance companies coordinate their activities in the Baltic States via companies established in Estonia. Last year (from the fourth quarter of 2006 to the third quarter of 2007), the **profit** of life insurance companies, including life insurance companies operating as European enterprises, totalled 201 million kroons. This exceeds last year's figure by more than three times.

The **gross premiums** collected this year on insurance contracts concluded only by Estonian residents amounted to 1.8 billion kroons. During the year, the volume of collected gross premiums increased by 26.5%. The largest contribution to growth came from unit-linked life insurance gross premiums, which increased by 44% (see Figure 9).

The **balance sheet total** of life insurance companies stood at 7.8 billion kroons at the end of the

third quarter of 2007. Year-on-year, it grew by 3.2 billion kroons, that is by 49%. The investments related to unit-linked life insurance contracts comprised 52% of the balance sheet total of life insurance companies at the end of the third quarter. During the past year, these investments have increased by 2.3 billion (130%). As for the **structure of investments** made to cover other insurance contracts, the share of stocks and other securities has risen (from 32% to 45%) and that of bonds and other fixed-income securities has fallen (from 51% to 40%).

Non-life insurance

In 2007, the **profit** of non-life insurance companies reached 406 million kroons, exceeding the figure for 2006 by 4%.

The distribution of the **market shares** of non-life insurance companies has changed considerably with the year, mostly because of tighter competition. The property insurance company established by one bank has done especially well and has grown its market share by as much as 8% during its first year of activity.

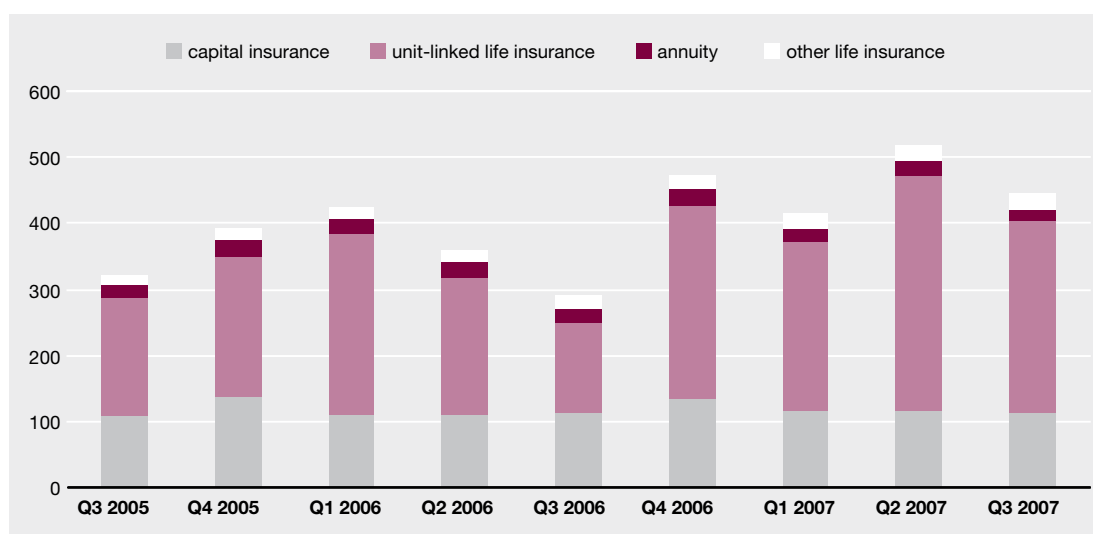


Figure 9. Gross premiums collected by life insurance companies (EEK m)

The **gross premiums** collected by non-life insurance companies with the year amounted to 3.6 billion kroons and exceeded the year-ago figure by 19%. The largest contribution to growth came from the insurance of land vehicles (y-o-y growth 25%) and private property (21%; see Figure 10).

The **balance sheet total** of non-life insurance companies was 4.8 billion kroons at the end of the third quarter of 2007, having grown by 1 billion kroons (24%) year-on-year. The investments of non-life insurance companies accounted for 87%

of the balance sheet total – approximately as much as in the previous year. The percentage of shares and units in **the investment structure** is on the rise (in the first quarter of 2007, shares and units comprised 6.8% and in the third quarter already 11.4% of investments), whereas that of bonds and other fixed income securities is decreasing (from 73% in the first quarter to 66% in the third quarter). Nevertheless, we can again conclude that the investments of non-life insurance companies are relatively conservative.

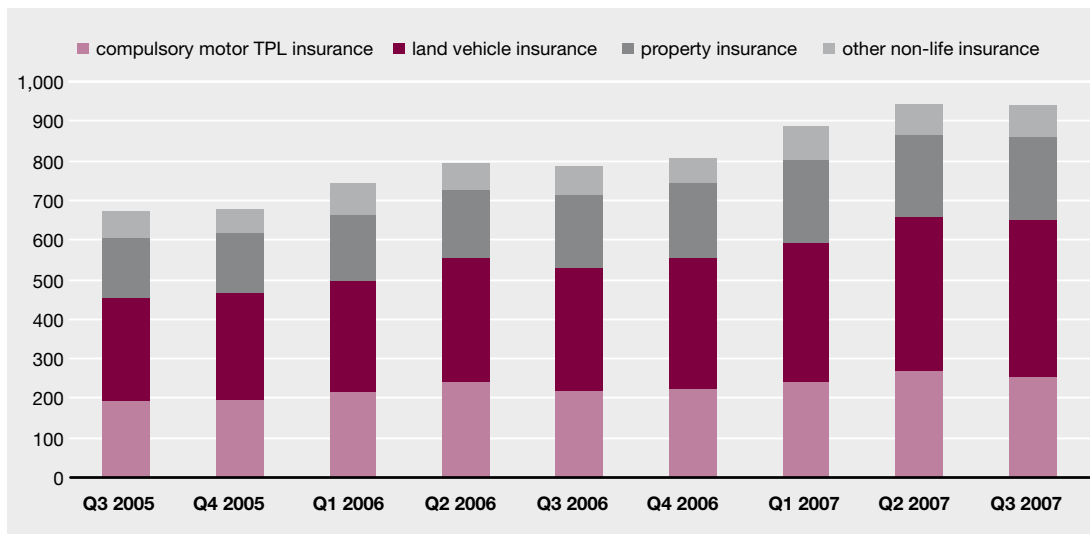


Figure 10. Gross premiums collected by non-life insurance companies (EEK m)