IV OTHER FINANCIAL MARKETS

INVESTMENT FUNDS

The **yield** of investment funds has been influenced by the rise in key interest rates since late March 2006, the rapid growth of stock prices in the second half of 2006 and the subsequent correction at the beginning of 2007 (see Figure 1). This mostly affected the yield of equity funds, which increased to 24% as a moving average by the end of March after having fluctuated slightly up and down. Along with the rise in key interest rates also the average yield of money market funds grew, reaching its highest level in three years at the end of March with 2.6%. At the end of March, the average yield of interest funds (2.7%) stood about twice higher than last year's average.

The **asset growth** of investment funds accelerated slightly in autumn 2006 thanks to the growing volume of equity funds, but by the end of March faced a year-on-year deceleration to 39% due to the high comparison basis and the stock market correction (see Figure 2). The volume of investment fund assets reached a record 21.4 billion kroons at the end of March. 40% of the year-on-year growth of investment fund assets stemmed from the yield of assets and the remainder, 3.6 billion kroons, consisted of new capital. Most of the new investments were placed in equity funds, amounting to an annual 4.2 billion kroons. Meanwhile, the growth of money market fund assets was entirely based on price growth. However, the increase in the average yield of interest funds did not alleviate the decrease in the volume of assets by a third, conditioned by the outflow of money from these funds.

The share of residents among the shareholders of equity funds decreased from approximately 60% last year to 55% by the end of March 2007. Less than half of the residents (44%) were private persons. Only about 12% of money market funds belonged to residents. From among non-residents, investors from Latvia and the British Virgin Islands invested quite a significant amount of capital (equal to that of Estonian investors). Most of the owners of interest funds (90%) were residents, of whom slightly over a third were private persons.

The **share of foreign assets** in the volume of fund assets started to climb moderately in the fourth quarter of 2006 and stood at 79% at the end of March 2007 (see Figure 3). The share of foreign assets in the volume of fund assets has primarily been fostered by investments in the shares and units of non-residents, which increased by 80% (by 5.7 bn kroons) with half a year until the end of March. Investments in EU markets grew from 64% last year to 76% of foreign assets (see Figure 4). This was mainly caused by the accession of Bulgaria and Romania to the European Union. During the past year, the markets of EU Member States witnessed the greatest growth in terms of investment, especially Luxembourg, the United Kingdom, Romania and Poland, and also Serbia which received 70% of the new foreign investment. The total volume of instruments issued to the Estonian stock, bond and fund markets has decreased to 11% of the assets of the investment and pension funds registered in Estonia, i.e. approximately by 3.5 billion kroons. Thus, by the end of March the year-on-year growth of these investments decelerated to 38%. At the same time, investments in listed shares grew by almost 60% within the year, reaching nearly 1.5 billion kroons by late March.

In the past half-year, **three new equity funds** were added to mutual funds: the SEB Active Fund of Funds, the SEB Balanced Fund of Funds and the Trigon Active Alpha Fund, whose assets accounted for 5% of the total volume of equity funds at the end of March. Considering the investment goals and risk level of the funds of funds, 80% of the assets of the SEB Active Fund of Funds and 35% of the SEB Balanced Fund of Funds are invested in equity instruments. The assets of the Trigon Active Alpha Fund are placed in Central and Eastern European, Russian and Turkish securities. Furthermore, as of April 2007, it is also possible to invest in the equity funds of AS Avaron Asset Management that

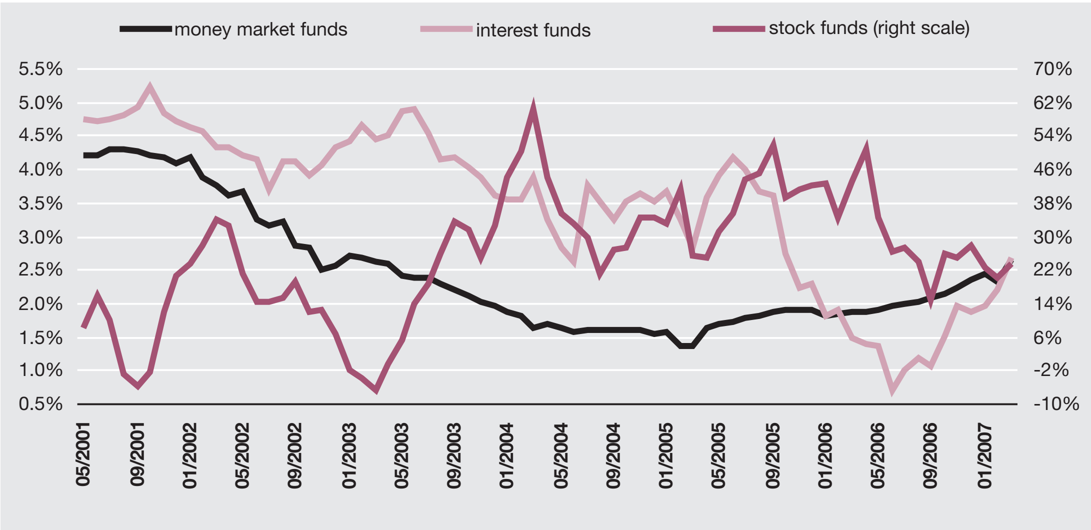

Figure 1. Average yield of investment funds

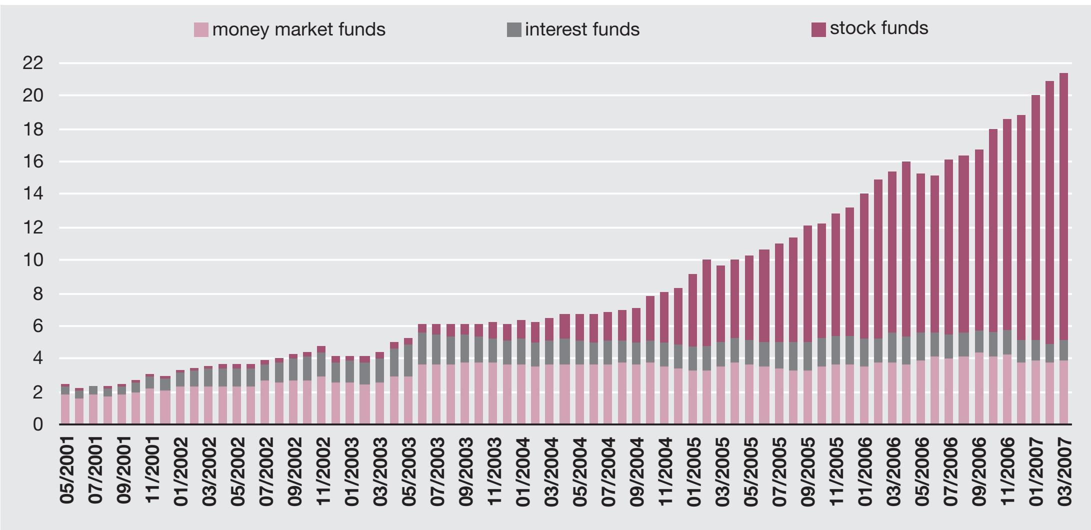

Figure 2. Volume of investment fund assets at end-month (EEK bn)

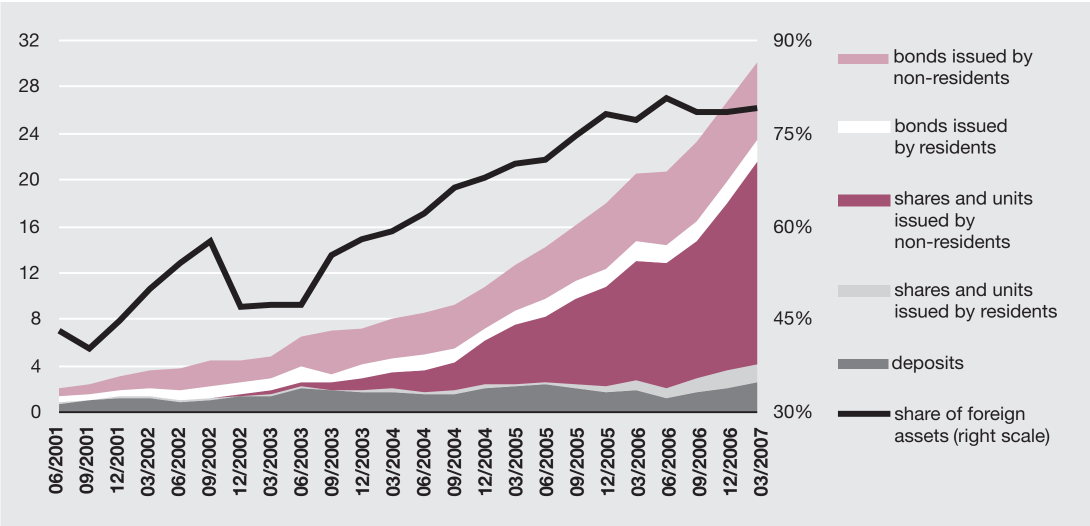

Figure 3. Structure of investment and pensions fund assets (EEK bn) and share of foreign assets (%)

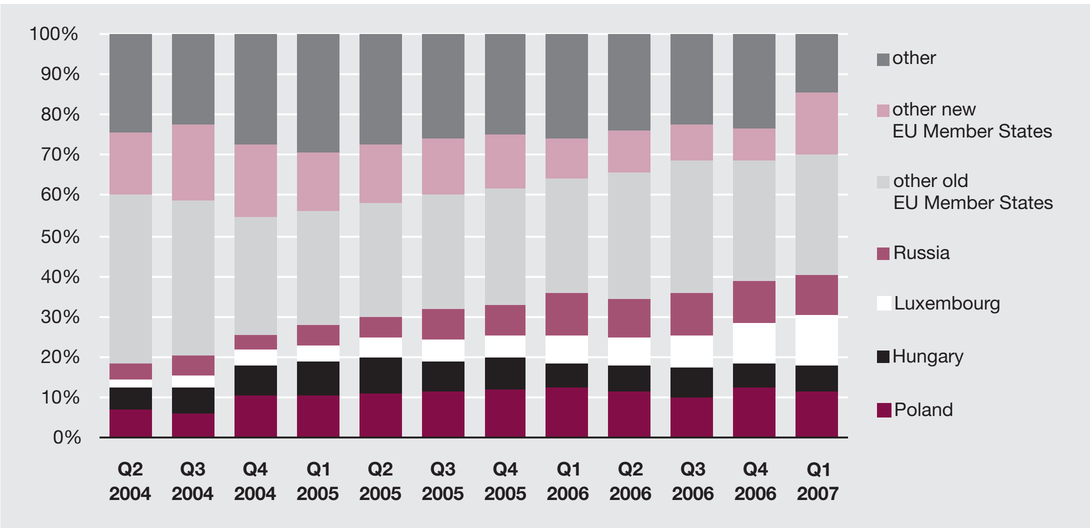

Figure 4. Foreign investments of investment and pension funds by residency at end of period

received its licence to operate as a fund manager in December 2006. Its equity funds include the Emerging Europe Small Cap Fund and the Balkan Fund.

PENSION FUNDS

At the end of April 2007, the number of subscribers to the **second pillar of the pension system** amounted to approximately 530,000 persons, i.e. about 58% of the labour force. The total volume of the second pillar funds increased by 56% (by 3 billion kroons) within the past year and stood at 8.3 billion kroons at the end of March (see Figure 5). At the end of the first quarter, the total volume of the second pillar pension funds comprised 27.2% of the financial assets invested in investment funds by households (compared to 25% a year ago). 14% of the year-on-year growth of the pension fund assets stemmed from the yield of assets and the rest, amounting to approximately 2.6 billion kroons, was new capital placed in the second pillar pension funds.

The number of subscribers to the **third pillar** reached nearly 32,000 persons by April 2007, accounting for approximately 3.8% of the labour force. The total volume of the third pillar funds grew by 57%, i.e. 302 million kroons (in March 2006, the growth in the volume was 10% smaller). 20% of the year-on-year growth of the third pillar funds derived from the yield of assets and the rest, 241 million kroons, was contributed by new capital. Including pension insurance, by the end of the first quarter of 2007 the third pillar posted nearly 2.65 billion kroons in volume, with pension funds comprising 31.4% of that.

The developments of recent quarters in the **asset structure** of pension funds have continued. The share of investment fund shares and units in the asset structure of the second pillar pension funds has increased even further. While a year ago they comprised 34%, this year 45% of assets have been invested in the funds (see Figure 6). Meanwhile, the percentage of units and shares, as well as bonds, has decreased.

By the end of the first quarter, the importance of investment fund stocks and shares in the investments of third pillar pension funds had also increased on account of other instruments: from 44% to 56% (see Figure 7). This development was well expected, as different investment fund options have greatly diversified recently (see "Investment funds"). In terms of countries and regions, the share of Western European countries in pension fund assets has grown during the past year: from 46% last year to 56% in the first quarter of 2007. The importance of Central and Eastern European countries, on the other hand, has diminished from 36% to 30%. Although the year-on-year yield of pension funds has recovered from the impact of the correction in last year's May, none of the funds have been able to achieve the previous record results (see Figure 8).

At the end of 2006 and the beginning of 2007, the issue of reviewing and amending the legislation regulating the operation of pension funds cropped up. The elaboration of the three-pillar pension system had mainly focused on guaranteeing the sustainability of the pension funds by laying down tariff rates and procedures for switching pension funds or transferring units. Owing to the specifics of the pension system and possible market failures, it is now considered essential that the principles of laying down management fees be reviewed and the procedures for switching mandatory pension fund units and the first contribution to a new fund be simplified. The exact contents and nature of the amendments will be specified by mid-2007.

INSURANCE

Life insurance

Similarly to 2005, the profit of life insurance companies stood at 147.6 million kroons also in 2006. Three out of five life insurance companies concluded the year with positive results.

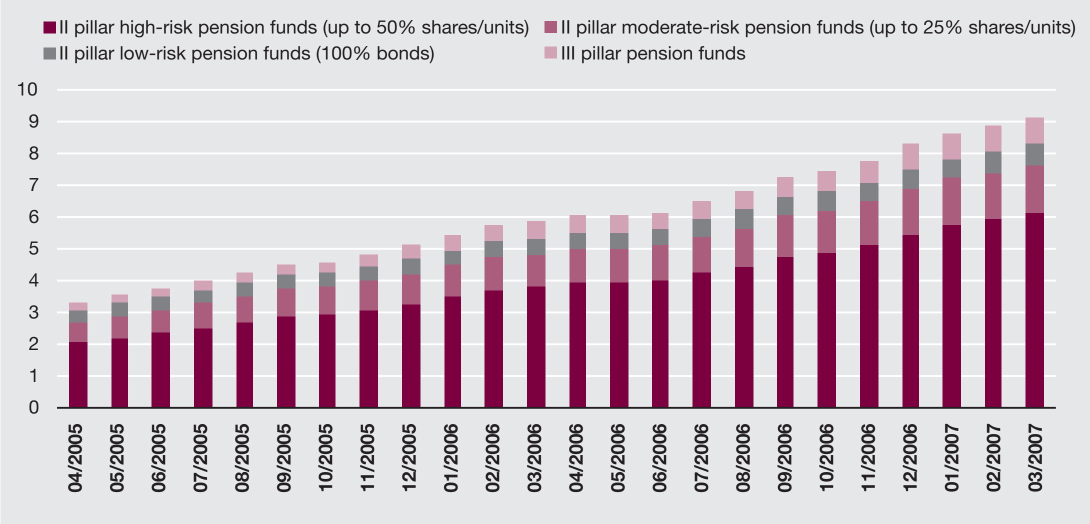

Figure 5. Volume of pension fund assets at end-month (EEK bn)

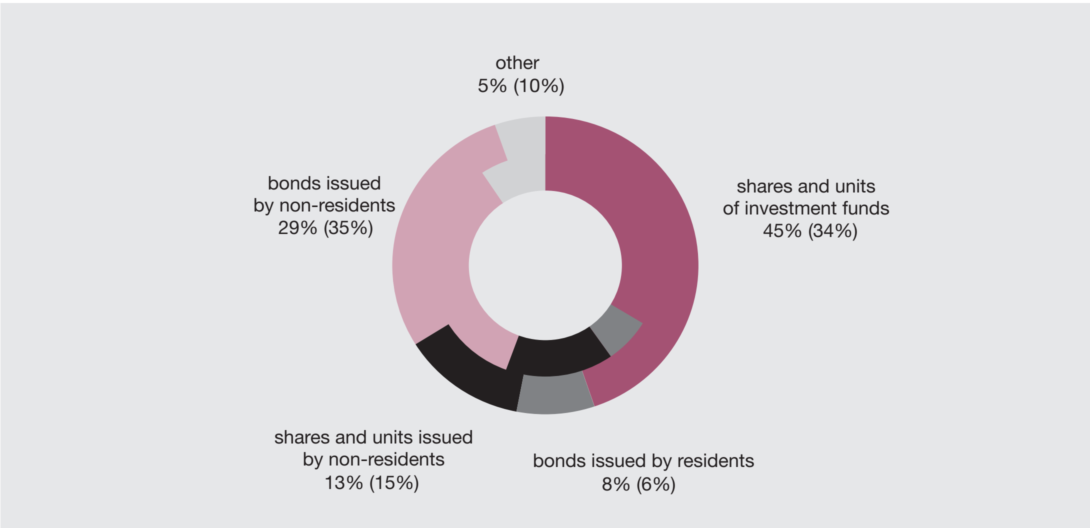

Figure 6. Structure of II pillar pension funds' assets as at 31 March 2007 (position on 31 March 2006 indicated in brackets)

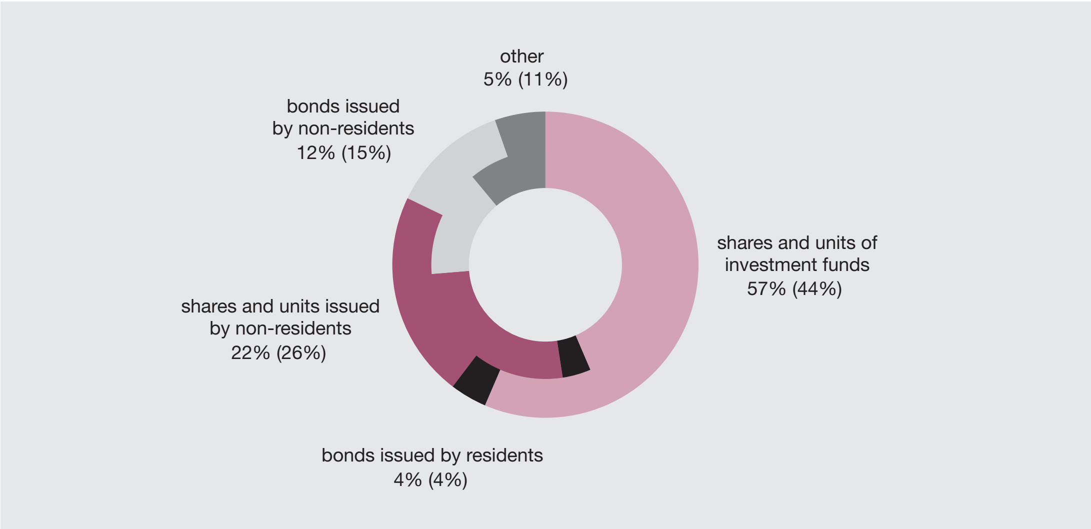

Figure 7. Structure of III pillar pension fund assets as at 31 March 2007 (position on 31 March 2006 indicated in brackets)

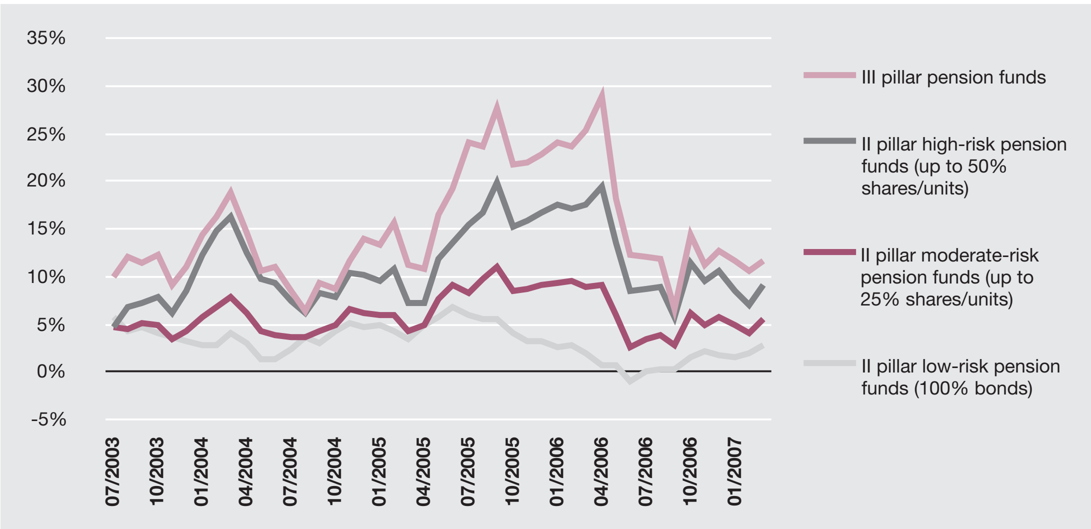

Figure 8. Annual yield of pension funds at end-month

The year-on-year growth of **gross premiums** (from the second quarter of 2006 to the first quarter of 2007) in the life insurance market reached 20% (see Figure 9). In absolute terms, 1.5 billion kroons worth of gross premiums were collected. Most of them were unit-linked life insurance contracts (year-on-year growth 31%) and pension insurance contracts (year-on-year growth 1%).

The balance sheet total of life insurance companies stood at 6.5 billion kroons at the end of the first quarter of 2007. During the year, it increased by 2.4 billion kroons, i.e. by 57% (see Figure 10). At the end of the first quarter, the investments of unit-linked life insurance comprised 47% of the balance sheet total of life insurance companies, having grown by 1.5 billion kroons (93%) year-on-year. As for the structure of investments made for covering other insurance contracts, the share of stocks and other securities has risen (from 32% to 40%) and that of bonds and other fixed-income securities has decreased (from 59% to 47%). The reasons may be the extension of the maturities of life insurance contracts and products, which diminishes the need for liquid assets, as well as the riskier behaviour of life insurance companies.

Non-life insurance

Similarly to 2005, the **profit** of non-life insurance companies stood at 432 million kroons in 2006. Return on equity was 21%.

Owing to new market participants, the concentration of the insurance market has decreased: in the first quarter of 2006, three major insurance companies controlled 82% of the market, whereas in the first quarter of 2007 the respective indicator was 80%.

The **gross premiums** collected by non-life insurance companies during the past year reached 3.3 billion kroons, having increased by 18% year-on-year (see Figure 11). As the greatest contributors to the growth of gross premiums were the insurance of land vehicles, private property insurance and third party motor liability insurance, the increase of gross premiums may still be explained by the generally favourable economic situation and the rapidly increasing volume of loans. In 2006, nominal GDP growth reached nearly 20% and it may be concluded that the growth of the non-life insurance market was slightly smaller than the previous year's nominal GDP growth. In the past year, 1.75 billion kroons of insurance benefits were paid, which is 22% more than the year before.

At the end of the first quarter of 2007, the assets of non-life insurance companies totalled 4.4 billion kroons, having grown by 1 billion kroons (30%) during the last year. The **investments** of non-life insurance companies accounted for 87% of the balance sheet total, i.e. approximately as much as the previous year. The structure of investments is undergoing the same developments as in earlier periods: investments are mostly made in bonds (73%) and their share is rising steadily. Meanwhile, investments in shares and other securities have decreased even further (from 12.6% in the first quarter of 2006 to 6.8% in the first quarter of 2007).

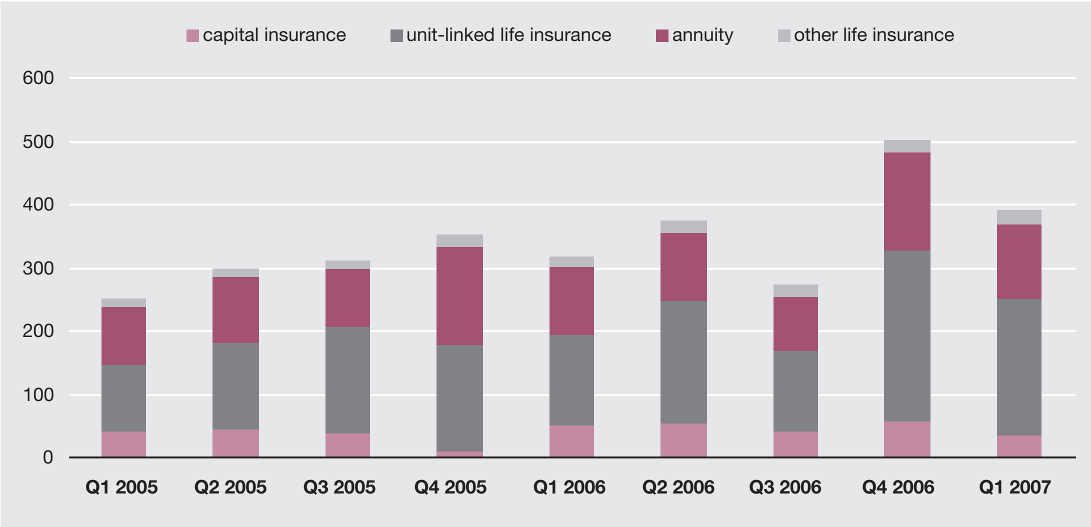

Figure 9. Gross premiums collected by life insurance companies (EEK m)

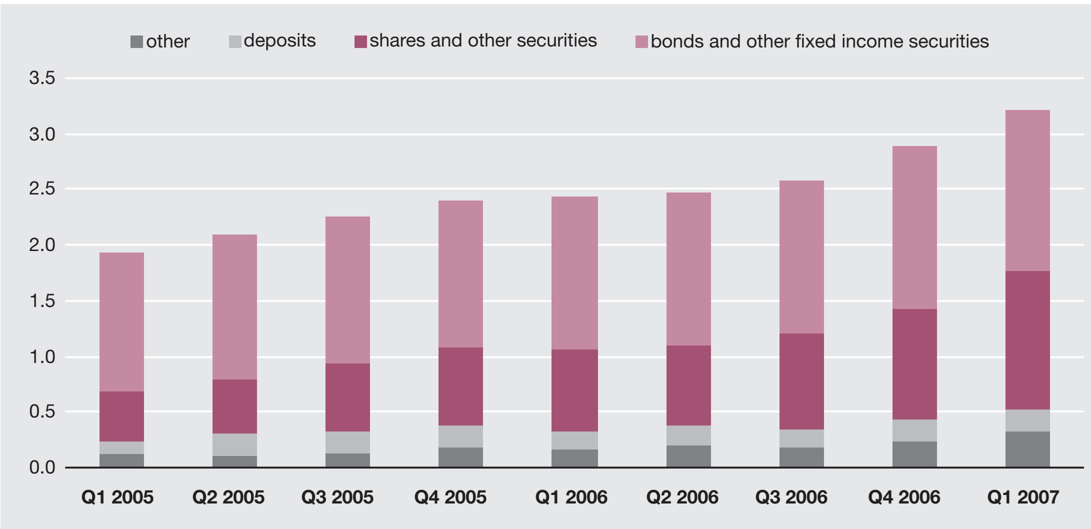

Figure 10. Investment structure of life insurance companies (EEK bn)

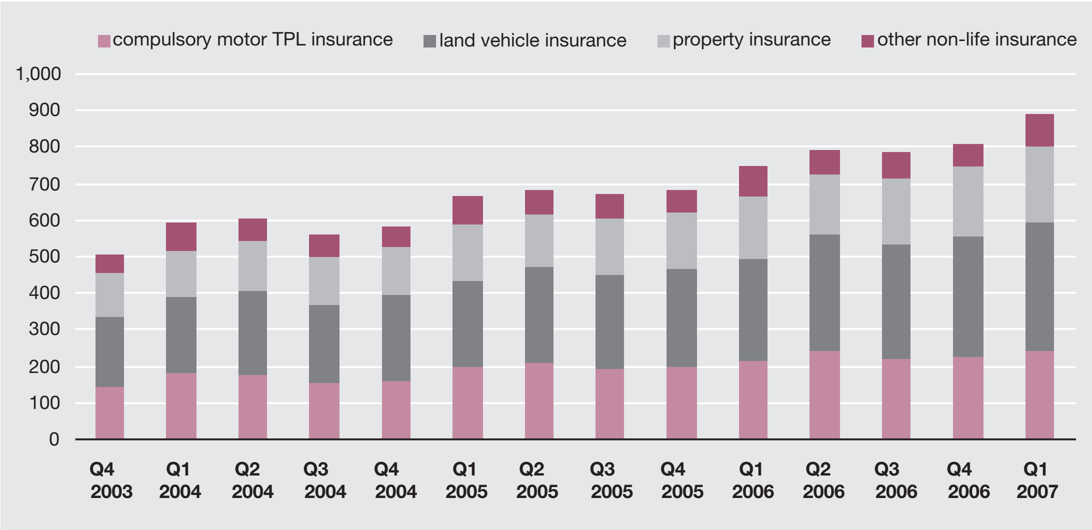

Figure 11. Gross premiums collected by non-life insurance companies (EEK m)