V
OTHER FINANCIAL MARKETS

Investment Funds

Owing to consistently low money market interest rates and spurred by delayed interest rate growth expectations the yields of money market and interest funds fell in 2003 (see Figure 5.1), and in line with the decline in total corporate and household savings also the rapid growth in investment funds' assets that had started two years ago slowed down in the second half of the year. Due to soaring real estate prices, both companies and households preferred real estate investments with their higher returns, meanwhile the savings behaviour of households was also shaped by contributions into the pension insurance system.

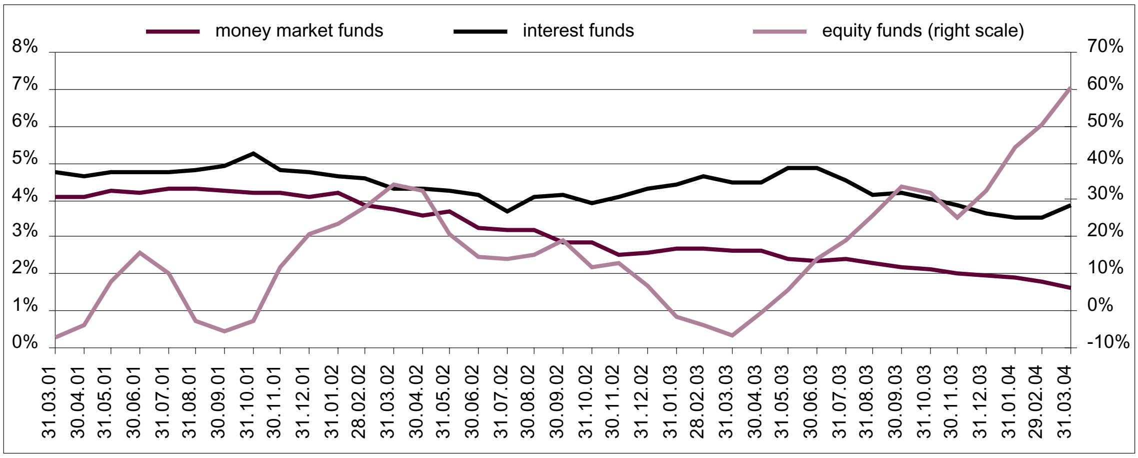

Figure 5.1. Average yield of investment funds (%)

Investors' interest was still primarily focused on the **money market fund** units offering stable returns and liquidity. While at the beginning of 2003 also **interest funds** demonstrated solid growth, in the second half of the year the sustained rise on the stock exchanges in Central and Eastern Europe and the recovery in global stock markets boosted the yields of **stock funds** and spurred interest in stock investments. This translated into a slowdown in the growth of interest funds during the year and a multiplication of equity fund assets amounting to a billion kroons (see Figure 5.2). The supplementary 360 million kroons added at the beginning of 2004 almost balanced out the equity fund assets with the interest fund assets. Besides residents, also non-residents have actively purchased equity fund units.

The share of foreign assets in the funds' assets, which had declined in the second half of 2002 reached its previous level at the end of 2003 (see Figure 5.3). The funds invest 80% of their resources in the markets of old and new EU Member States. Impacted mainly by equity funds, the second half of 2003 was marked by an inclination to invest more in the markets of the new Member States as well as the United States (see Figure 5.4). The total volume of instruments invested in the local stock, bond, and fund markets amounted to 1.35 billion kroons (including 235 million kroons worth of shares and units), i.e. 18% of the funds' assets.

Pension Funds and Insurance

As a continuation of the successful period of signing up with the **II pillar of the pension system**, the mandatory funded pension funds accumulated the contributions of all those who had joined the system in 2002, and as a result the volume of mandatory funded pension funds soared to nearly one billion kroons

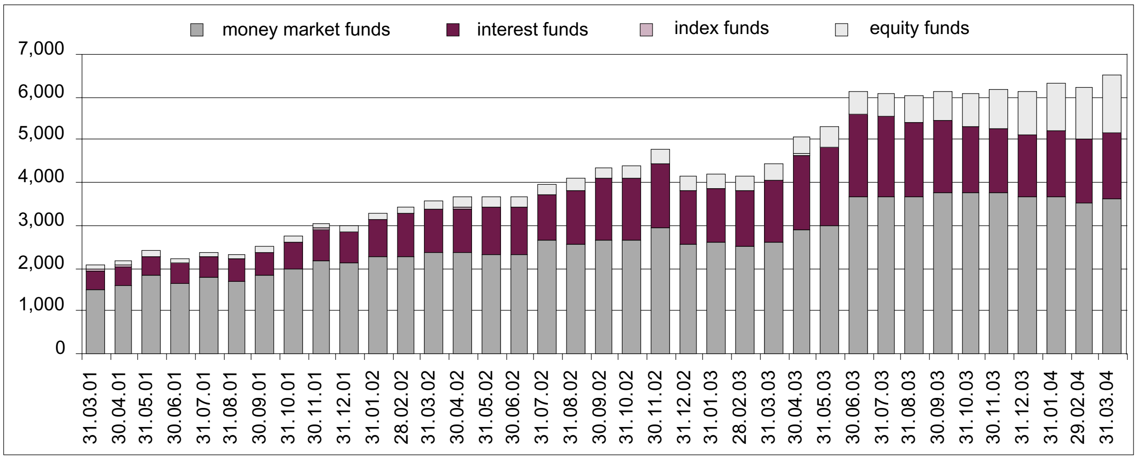

Figure 5.2. Volume of investment funds assets (EEK millions)

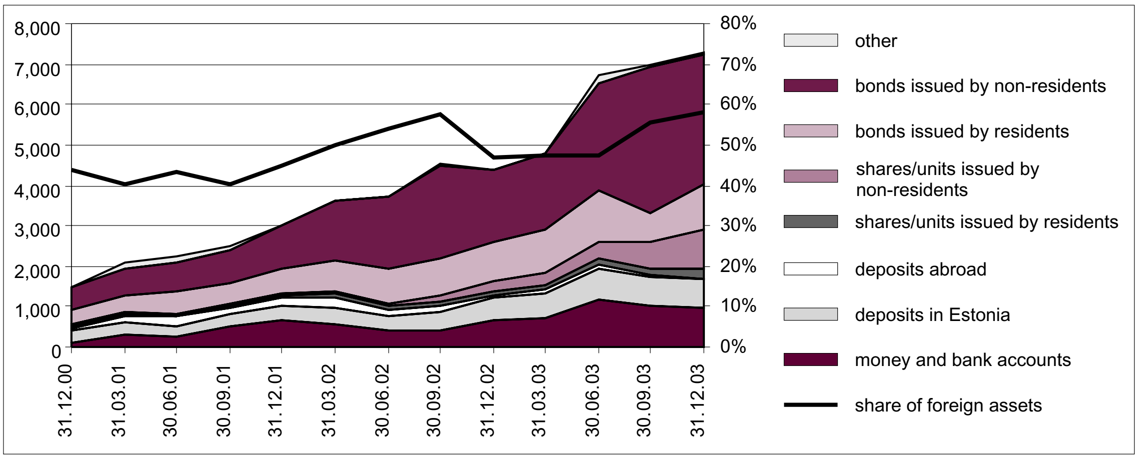

Figure 5.3. Structure of investment and pension funds and the share of foreign assets (%, right scale)

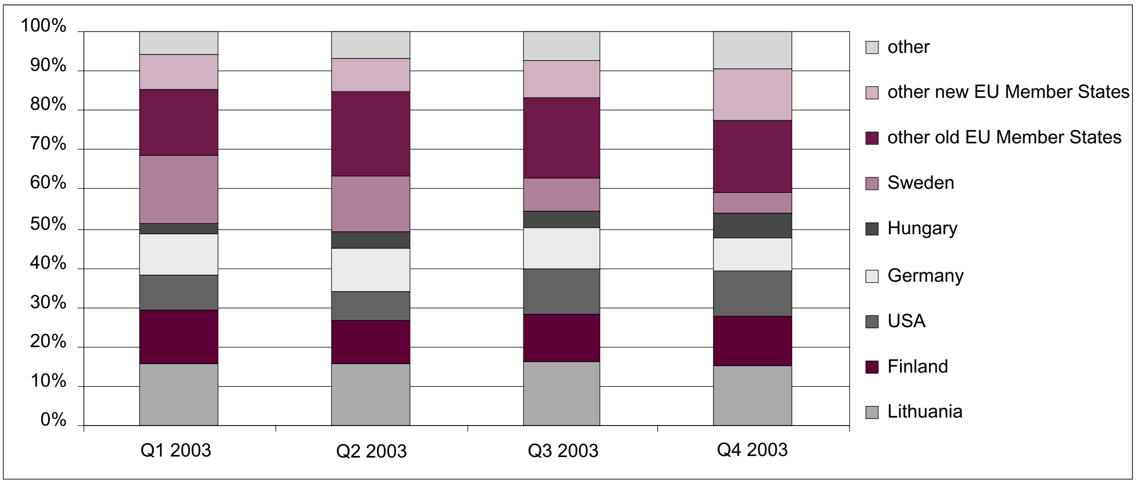

Figure 5.4. Foreign investments of investment and pension funds by residency

by the end of the year. By 31 October 2003 another 143,000 people had joined the II pillar of the pension system, therefore at the beginning of 2004 more than 350,000 employees, i.e. 60% of the working population could start contributing to mandatory funded pension funds. According to the data issued by Pensionikeskus (Pension Centre), the average gross income of residents who had joined the mandatory funded pension system by the end of 2003 was 6,577 kroons per month. Thus, depending on the number of contributors, growth in the II pillar funds since March 2004 can be predicted to be 115–140 million kroons per month, and the total volume of the funds at the end of the year should be 2.3–2.6 billion kroons, i.e. 2% of GDP (see Figure 5.5).

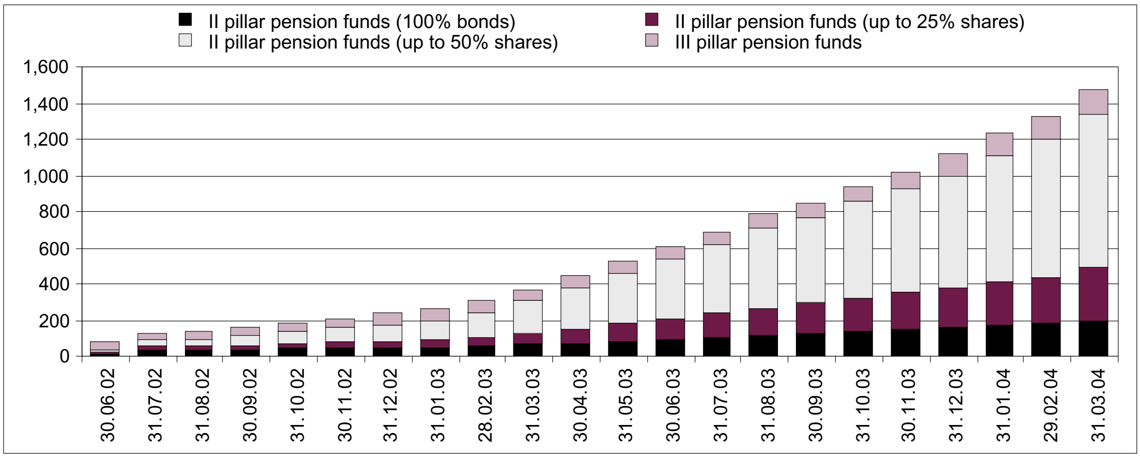

Figure 5.5. Volume of pension funds' assets (EEK millions)

75% of the assets in the II pillar pension funds have been placed in the more liquid foreign markets while the volume of local shares amounts to just 58 million kroons. Therefore one can assume that the II pillar pension funds have contributed only marginally to the rise in the local stock market. In the last two quarters of 2003 it was the acquisition of foreign shares and bonds issued by residents that increased rather than that of local shares (see Figure 5.6).

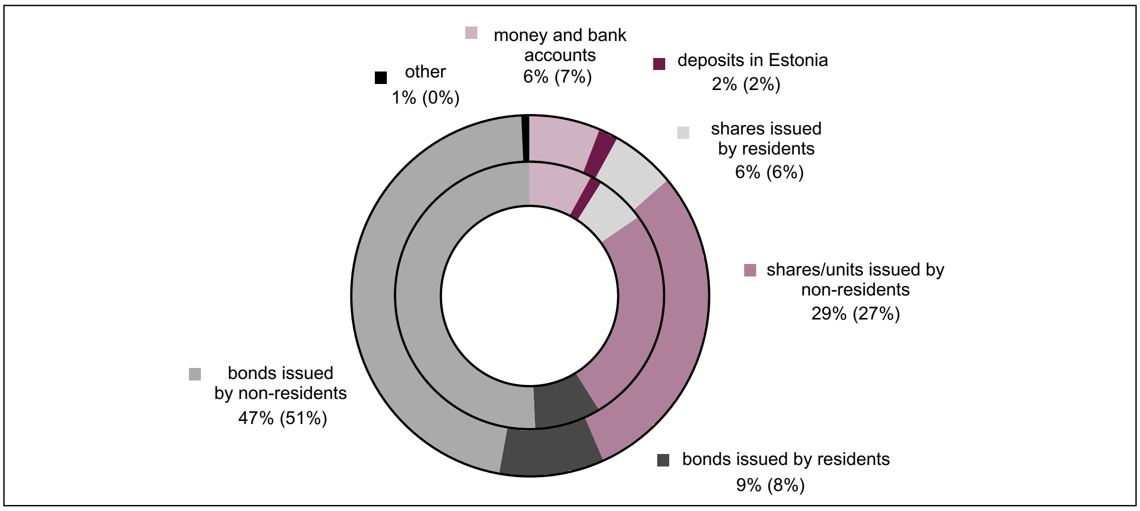

Figure 5.6. Structure of II pillar pension funds' assets at end-2003 (position on 30 September 2003 indicated in brackets)

At the end of the first quarter of 2004 the number of those who had signed up with the **III pillar of the pension system** stood at some 64,700, i.e. 10.7% of the working population, and the volume of assets in the system amounted to 750 million kroons (of which the insurance contracts reserve made up 670 million kroons).

The III pillar investments have mostly taken the form of insurance contracts with funds accounting only for 11% of the pillar, which is why the assets of supplementary funded pension funds stood at just 127 million kroons at the end of the first quarter in 2004. Of supplementary funded pension investments approximately half have been placed in foreign markets, i.e. around a third less compared to mandatory funded pension funds (see Figure 5.7). The underlying reason probably lies in higher transaction costs arising from the small size of the III pillar funds. Therefore the assets of the III pillar funds are more open to the risks of the local securities market, even though the total volume of shares, units, and bonds issued by residents is very modest (32 million kroons).

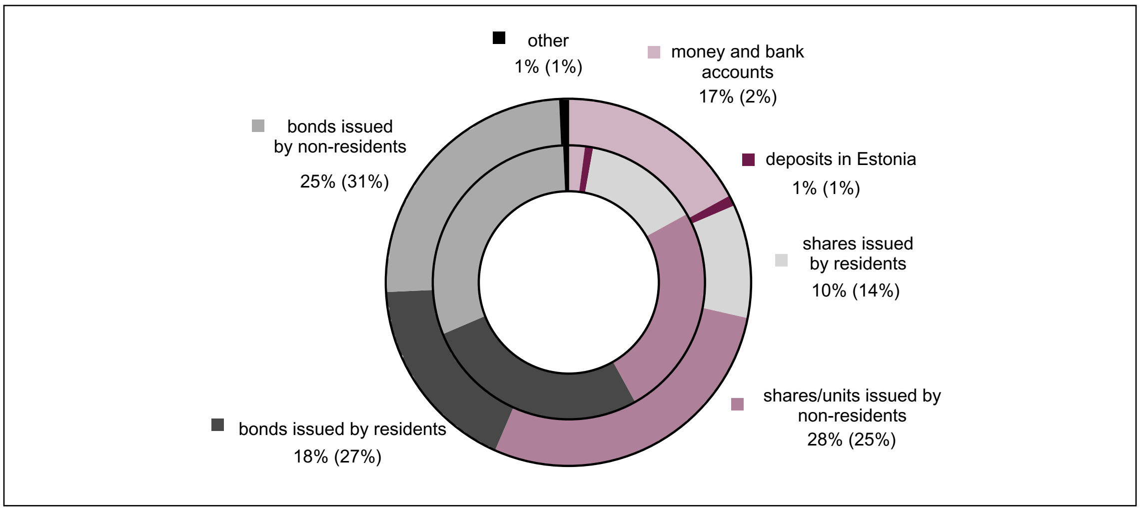

Figure 5.7. Structure of III pillar pension funds' assets at end-2003

Insurance Companies

The increasing domestic demand and the spread of voluntary pension insurance have accelerated growth in the insurance market. According to preliminary unaudited data, **profits from life insurance** soared 3.6 times in 2003 – to 62 million kroons[1] while return on assets grew from 1.6% to 3.7% in a year. This was underpinned by a rise in operating volumes and growing investment earnings, which was related to the changes in financial investment reporting by insurance companies.

Insurance companies collected 570 million kroons in gross premiums in 2003, i.e. 30% more than in 2002 (see Figure 5.8). The overall volume of life insurance premiums was boosted by the premiums collected under unit-linked and endowment insurance policies, which also included tax-deductible pension insurance products. Making use of life insurance contracts for investment purposes has become increasingly popular since it has several benefits compared to alternative facilities[2], and companies have sought to satisfy growing demands by launching several new products.

Contrary to the developments in the Estonian life insurance market, the EU insurance sector has been struggling with low profitability caused by the disproportion of assets and liabilities[3] arising from the large share of long-term contracts with guaranteed interest. Regardless of the recovery in the stock markets, the interest paid on guaranteed-return liabilities of the EU insurance companies is still higher than the current market rates, thus reducing the profitability of insurance companies.

[1] Even though all life insurance companies posted a profit in 2003, their profitability was different.
[2] For example, shares or fund units in an investment portfolio covered by an insurance policy can be replaced without paying taxes on the return. A standard investment portfolio does not provide that option.
[3] The average return on assets in the EU life insurance sector in 2002 was -0.25%.

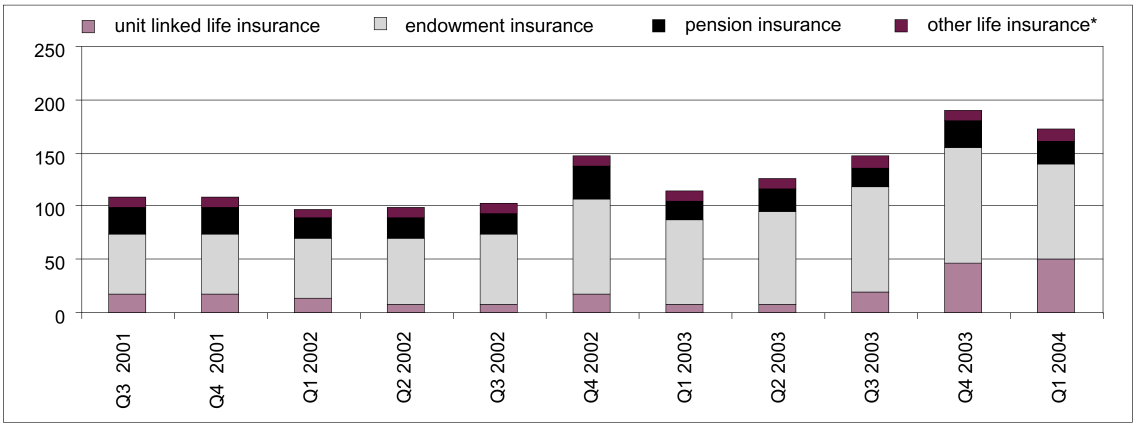

Figure 5.8. Gross premiums collected by life insurance funds (EEK millions)
* incl. marriage and birth insurance, term and whole life insurance, supplementary insurance, and other life insurance

Completion of the reorganisation of the **non-life insurance market** was reflected in the significantly improved profitability, which – according to preliminary unaudited data – soared 3.7 times in 2003 compared to 2002, i.e. to 178 million kroons[4]. Return on assets went up from 2.7% to 7.5% in a year, which was supported by growth in collected premiums as well as the increased efficiency arising from better-managed costs and rising volumes. The profitability was also impacted by improved investment earnings, which in turn were underpinned by a change in the financial investments accounting principles.

Increasing non-life insurance premiums indicate a thriving real estate market and successful car sales (see Figure 5.9). In 2003, insurance companies collected gross premiums worth 2.1 billion kroons, i.e. 25% more than in 2002. Meanwhile premiums collected under the voluntary motor insurance facility more than doubled. Of other types of insurance, premiums from general liability insurance, which cover mainly speciality-related (notary, auditors, etc.) and employer liability, outpaced the overall growth rate in the non-life insurance market.

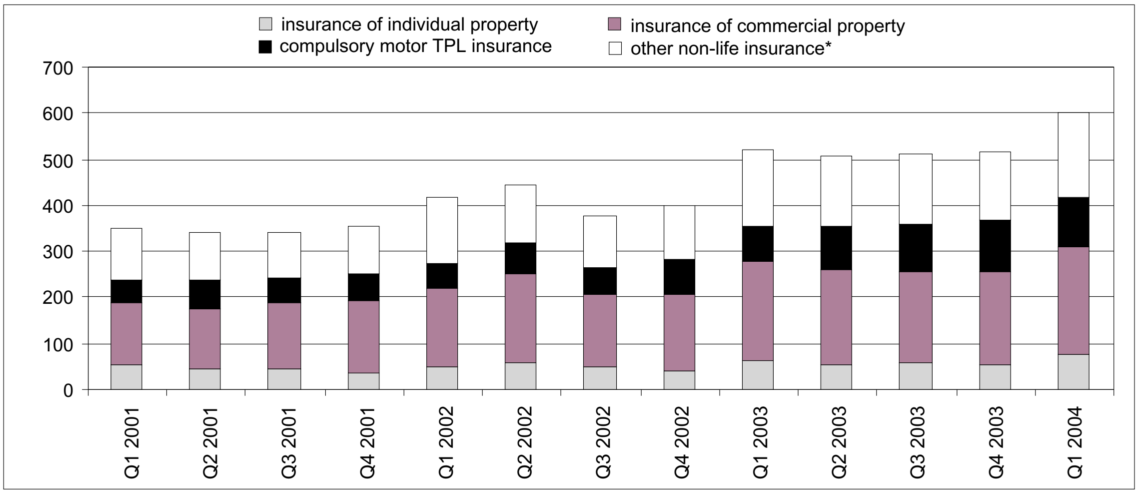

Figure 5.9. Gross premiums collected by non-life insurance companies (EEK millions)
* incl. accident and sickness insurance, travel insurance, insurance for pecuniary loss, goods in transit insurance and other non-life insurance

[4] The profitability in the non-life insurance sector was also very different. The only company to post an annual loss was Nordicum Kindlustus, which took over the portfolio of Nordika Kindlustus, which had terminated its operations in 2002.