V
OTHER FINANCIAL MARKETS

Investment Funds

Since the end of March 2005, the **yield** of investment funds has been affected mainly by the rapid growth of developing markets, which has been boosted by foreign investment inflow, decreased risk premiums and an increase in commodity prices (see Figure 5.1). The development of East-European and Russian markets during the past half-year as profitable investment regions brought about a rise in the yield of equity funds registered in Estonia to 52% on average by the end of September as the sum of four consecutive quarters. However, the average yield of these funds fell in October as a result of investors withdrawing profit, the expectations of a rise in key interest rates, and a robust increase in stock prices. Market experts consider the decline to be short-term and based on emotions. Expectations of an increase in the key interest rates of major industrial regions are probably also the cause for the rise in money market fund yields, which reached 1.9% by the end of September – the record high of the last 21 months.

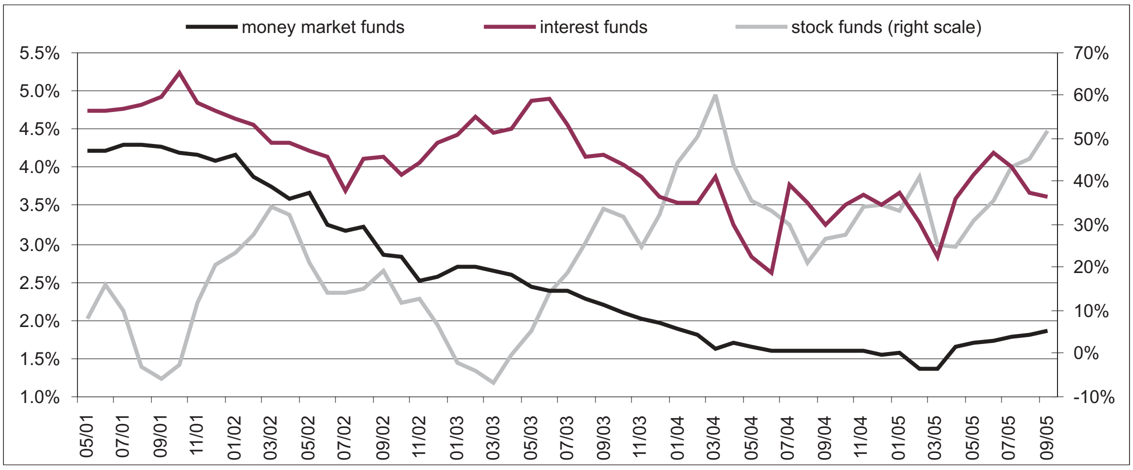

Figure 5.1. Average yield of investment funds (%)

As a result of all the above, the **growth of investment fund assets**, which had lasted for several years, accelerated substantially, reaching almost 80% by the end of September, year-on-year (see Figure 5.2). Because investors prefer riskier but more profitable equity investments instead of the shares of money market funds, which provide more stable yield and higher liquidity, investment fund assets increased mainly due to the manifold growth in the volume of equity fund assets. The volume grew from 2 billion kroons at the end of September 2004 to 7.1 billion kroons at the end of September 2005. Compared to equity funds, the merely 23% annual growth of interest fund assets has been considerably slower and the volume of money market fund assets has decreased almost 10%. Taking into account the capitalisation of funds, 60% of equity investors were residents, almost half (48%) of which being private persons, at the end of September 2005.

The **share of foreign assets in the volume of fund assets**, which has been growing since 2003, reached nearly 75% by the end of the third quarter of 2005 (see Figure 5.3). 67% of foreign assets were invested in the EU markets (see Figure 5.4). Due to the oil price rise and the decrease of risk premiums, the largest investment growth was observed in the markets of Russia and the new EU Member States, providing a yield much higher than average. The markets of Poland, Lithuania and Hungary were especially popular. The total volume of instruments issued in the Estonian equity, bond and investment fund market amounted to 12% (1.9 billion kroons) of the assets of the investment and pension funds registered in Estonia. This marks an increase of more than a third compared to the end of March 2005, which includes a 50% growth of investments in domestic shares and units, reaching 335 million kroons by the end of September.

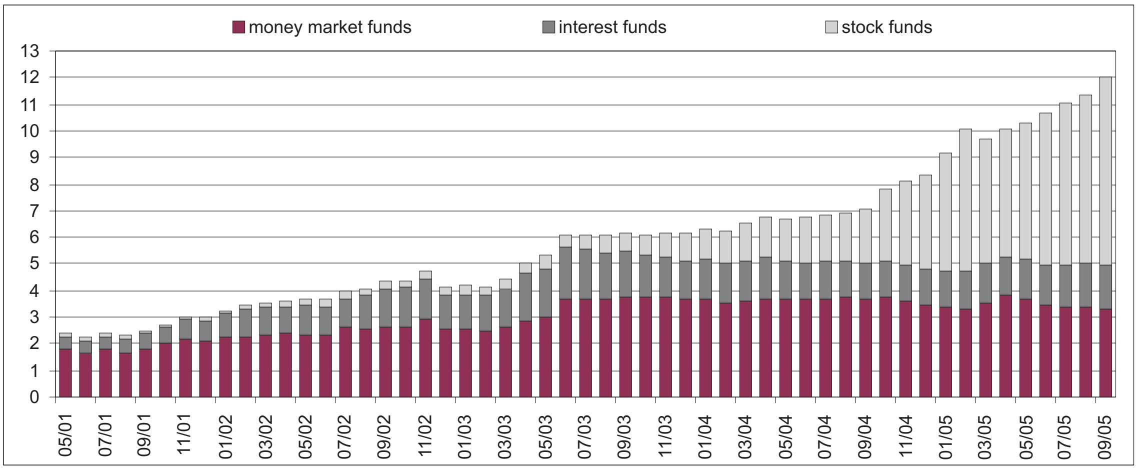

Figure 5.2. Volume of investment fund assets (EEK bn)

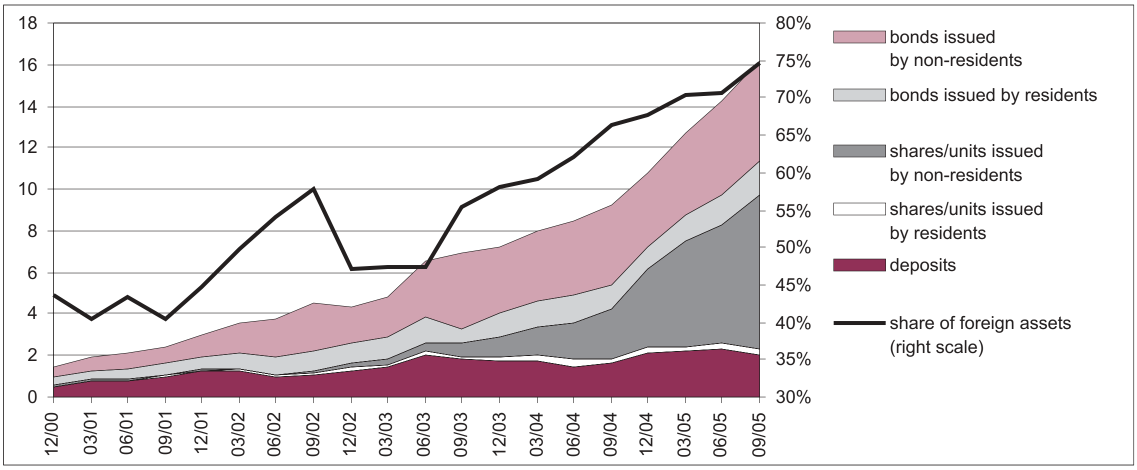

Figure 5.3. Structure of investment and pensions fund assets (EEK bn; left scale) and share of foreign assets

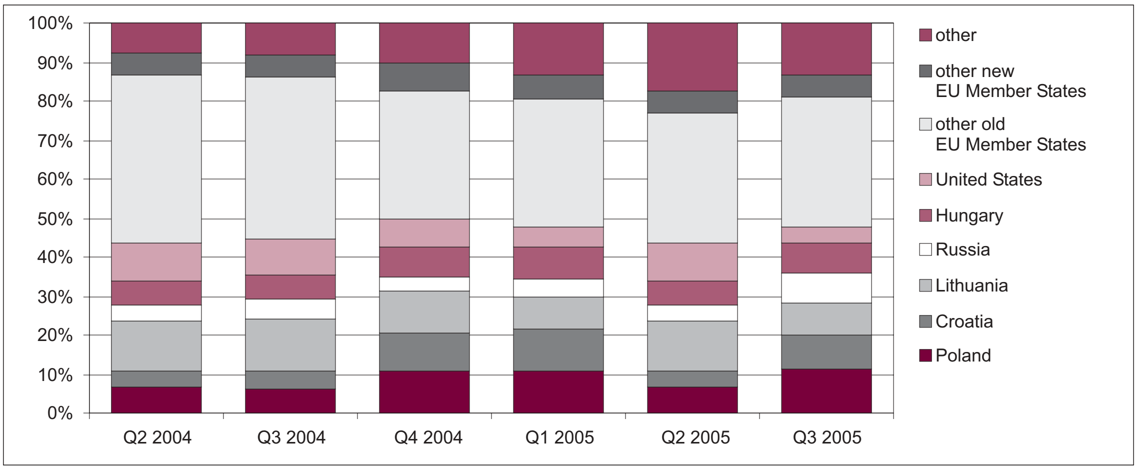

Figure 5.4. Foreign investments of investment and pension funds by residency (as at end of period; %)

Pension Funds and Insurance

By the end of October 2005, 475,400 people had joined the second pillar of the pension system, which accounts for 78% of the employed (73% in May 2005).

The volume of the second pillar funds grew to 4.2 billion kroons by the end of September 2005. As the monthly growth has been faster than projected at the beginning of the year, the total volume of pension funds exceeded the expected annual volume already at the end of the third quarter. Should the growth rate of pension funds maintain its fast pace also in the last quarter, the total volume of pension funds might reach about 4.8 billion kroons by the end of the year. Next year, the growth in the volume of the second pillar pension funds is expected to double. While until now the volume has increased mainly due to the payments of new subscribers, in the future the growth of funds will mainly depend on the wage growth of current subscribers (see Figure 5.5).

By the end of October, nearly 85,000 persons (14% of the employed) had joined the third pillar and its total volume was 1.4 billion kroons. The breakdown of third pillar funds and insurance is changing. While the volume of the third pillar funds amounted to 15% of the total volume of the third pillar by the end of September 2003, its share had risen to 24% in September 2005.

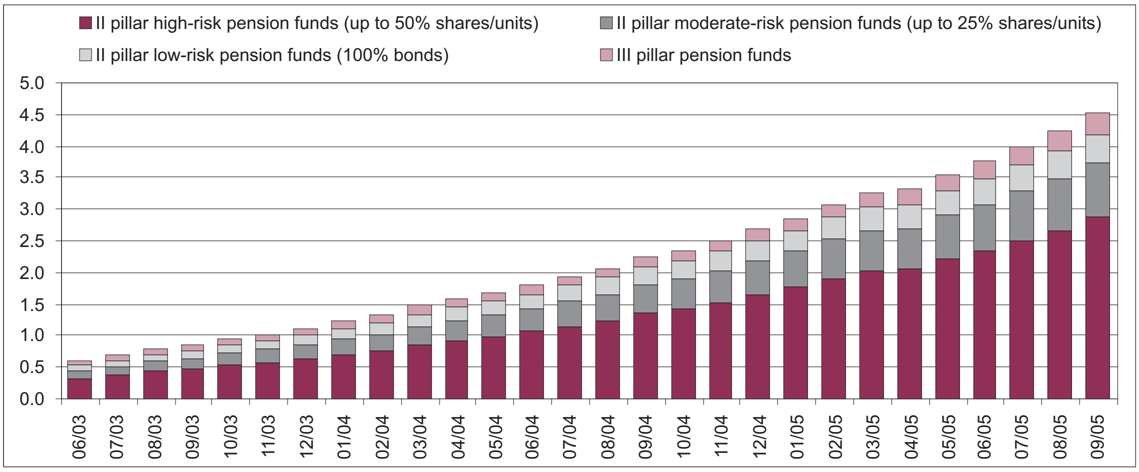

Figure 5.5. Volume of pension fund assets (EEK bn)

Pension Fund Assets

87% of the assets in the second pillar pension fund assets had been placed in foreign markets by the third quarter of 2005; the share of units and shares has grown notably, year-on-year (see Figure 5.6). This stems from consumers' preference for higher risk funds and stronger growth of these funds. The structure of the third pillar pension fund assets reflects similar changes – the share of assets invested in foreign markets has grown (while at the end of the third quarter 2004, 73.5% of assets were invested in foreign markets, in the third quarter of 2005 the respective indicator stood at 83.7%) and so has the share of units and shares (see Figure 5.7).

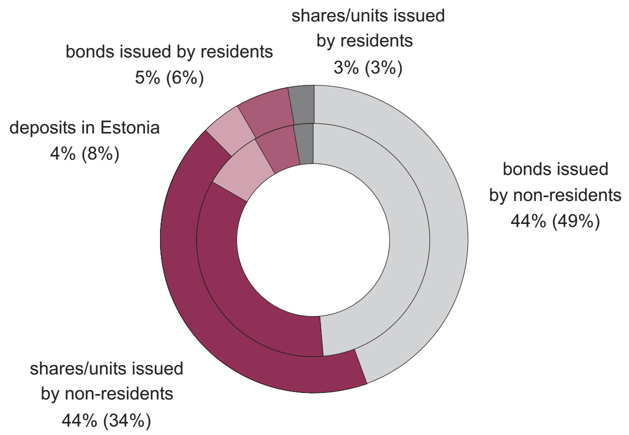

Figure 5.6. Structure of II pillar pension fund assets as at 30 September 2005 (position on 30 September 2004 indicated in brackets)

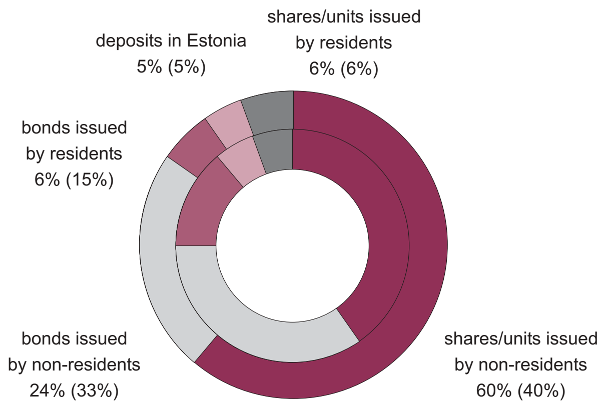

Figure 5.7. Structure of III pillar pension fund assets as at 30 September 2005 (position on 30 September 2004 indicated in brackets)

Yield of Pension Funds

Pension fund volumes grew faster than expected as a result of remarkably high yield of these funds (see Figure 5.8). Among the second pillar pension funds, higher risk funds that may invest up to 50% of the resources in shares delivered the highest yield, whereas funds that invest 100% in bonds had the lowest yield. While in previous years the differences in the yields of the second pillar funds have been relatively stable, in the last months the differences in the yields of funds with different risk level have started to grow. Looking at the Sharpe's ratio[1] in case of different fund types (high, medium, low-risk), the indicator of high-risk funds is still better. However, taking future risks into account, it might not continue this way.

[1] The Sharpe ratio is used to characterise how well the return of an asset compensates the investor for the risk taken. When comparing two assets each with return < R > against the same benchmark with return Rf, the asset with the higher Sharpe ratio gives more return for the same risk. Investors are often advised to pick investments with high Sharpe ratios.

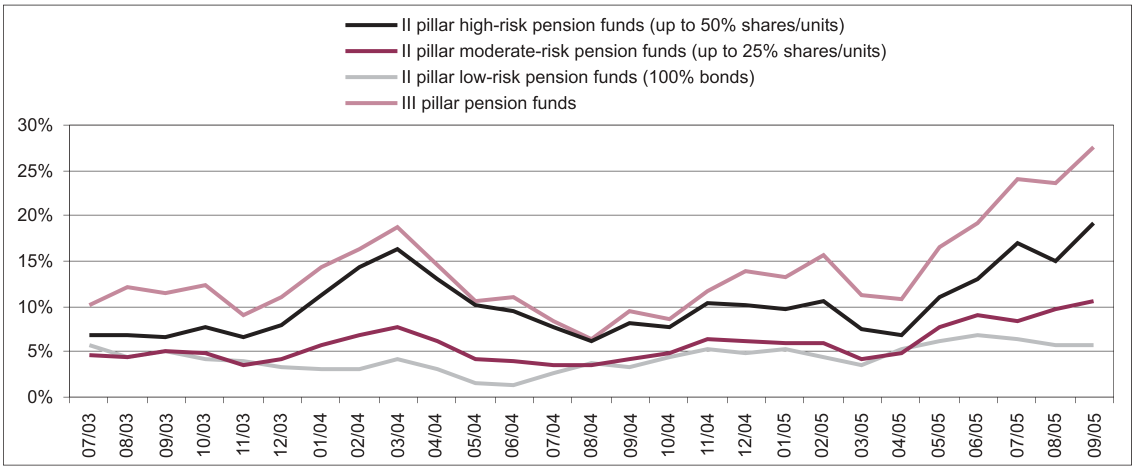

Figure 5.8. Average yield of pension funds as at end of month (%)

Insurance Companies

Institutional Changes

The QBE Insurance Group announced on 17 December 2004 that it had signed a contract to purchase Nordicum Kindlustuse Eesti AS from the Tryg Vesta Group. As of 20 April 2005, the new name of the insurance company is QBE Kindlustuse Eesti AS. QBE is Australia's largest and one of the world's 25 biggest insurance and reinsurance companies. The annual volume of its insurance premiums is over 5 billion euros and it has over 7,000 employees worldwide.

Life Insurance

The growth rate of the **life insurance market** has increased over the last year (i.e. the fourth quarter of 2004 and the first three quarters of 2005) compared to the previous year, reaching 49.2% (40.8% the year before). Growth accelerated in the second quarter, probably due to faster growth in the volume of housing loans issued. Year-on-year, life insurance companies collected gross premiums for the total of 1.1 billion kroons.

The volume of gross premiums grew the most in unit-linked life insurance and particularly on account of capital saving insurance. While in 2004 gross premiums of unit-linked life insurance amounted to 30.3% of the total gross premiums collected, in 2005 this indicator was 48%. At the same time, the share of capital saving insurance decreased from 51.8% to 38.9%. The gross premiums of unit-linked life insurance increased due to third pillar pension system products, which belong to the category of unit-linked life insurance (see Figure 5.9).

The market share of life insurance companies has remained relatively stable. However, life insurance companies that are subsidiaries of banks have increased their market share and that of other life insurance companies has declined over the last year.

The volume of investments of life insurance companies was 2.03 billion kroons at the end of the second quarter of 2005, which accounted for 69% of the balance sheet of life insurance companies. The companies differ very little as to their investment structure – they all have invested mostly in bonds and other fixed-income securities. With the first two quarters of 2005, the share of this type of investment has somewhat declined and that of deposits of credit institutions has grown. These two types of investments form almost 75% of the total investment volume of life insurance companies. While in 2004 the share of higher risk investments – shares and other securities – grew in investment portfolios, in 2005 the share of this type of investments has remained the same, which indicates that insurance companies have started to prefer lower risk investments despite the favourable conditions on the stock markets (see Figure 5.10).

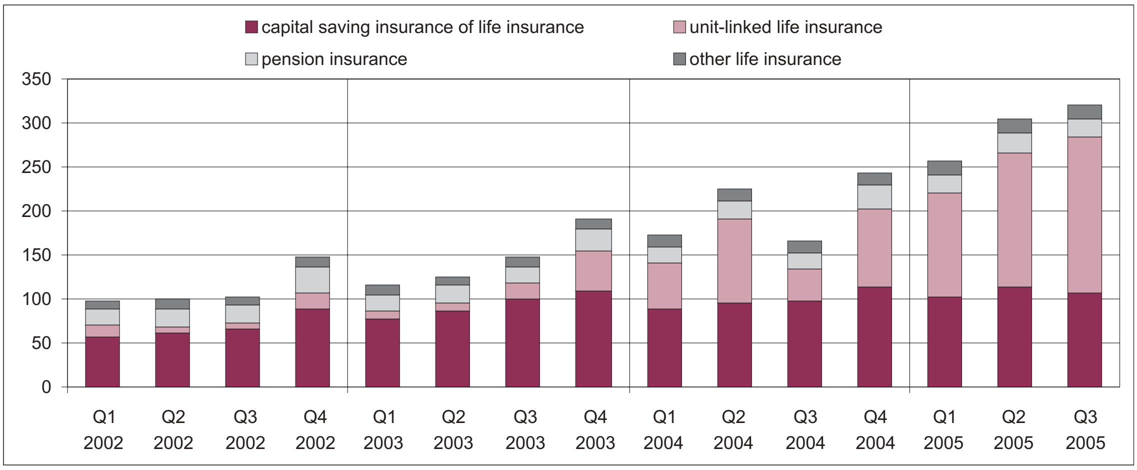

Figure 5.9. Gross premiums collected by life insurance companies (EEK m)

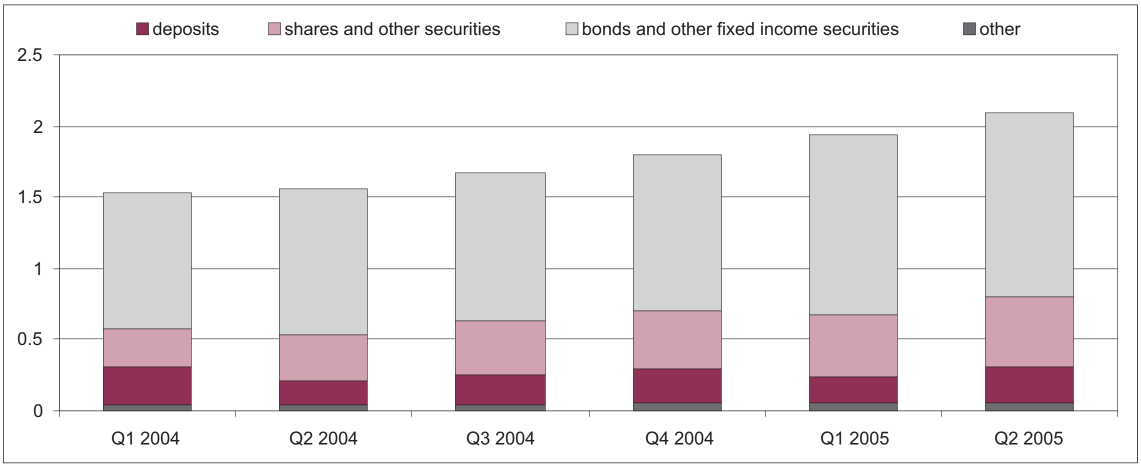

Figure 5.10. Investment structure of life insurance companies (EEK bn)

Non-life Insurance

The development of the **non-life insurance market** has remained stable over the last year and the market shares of insurance companies have remained practically unchanged, year-on-year.

Gross premiums collected by non-life insurance companies have increased 13.5%, year-on-year, whereas the growth of gross premiums has slowed down compared to the 18.4% rise in 2004. Supported by the continuously favourable economic environment for housing loans and car leasing, the sale of insurance premiums for property and motor vehicle insurance to private persons grew the most, year-on-year (27.9% and 18.9%, respectively; see Figure 5.11).

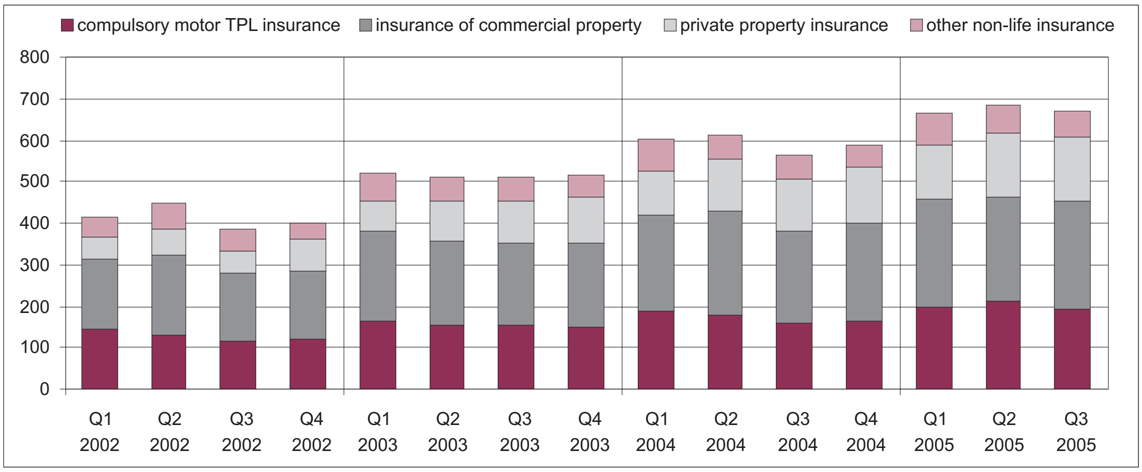

Figure 5.11. Gross premiums collected by non-life insurance companies (EEK m)

The investment volume of non-life insurance companies was 2.4 billion kroons at the end of second quarter 2005, which accounted for 84% of the balance sheet. The investment structure of non-life insurance companies varies greatly. In larger companies, majority of investments are in bonds and other fixed securities, while in smaller companies funds have been placed in deposits held in credit institutions. The average investment return was 3.1% in the first two quarters of 2005, which is somewhat less compared to the previous year (3.7%). At the same time, the investment yields vary across insurance companies: the yield of non-life insurance companies with higher risk investment strategies has been larger than that of the insurance companies preferring conservative investment strategies (yields range within 8.32% and -8.3%). In general, about 64% of the investments of non-life insurance companies were placed in lower risk bonds and other fixed-income securities in the second quarter 2005 (see Figure 5.12).

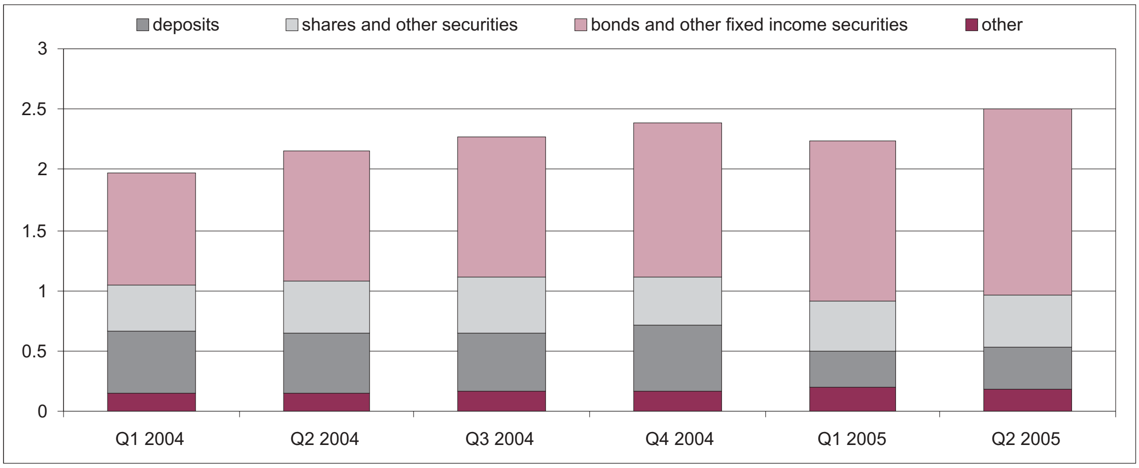

Figure 5.12. Investment structure of non-life insurance companies (EEK bn)