

OVERVIEW OF ILMARINEN'S OPERATIONS AND FINANCIAL PERFORMANCE 1 JANUARY TO 30 JUNE 2009

Operating environment

As a result of the global financial crisis, the economy has continued to develop weakly during the first part of 2009 all around the world, and unemployment has been strongly increasing in many countries. In Finland, the economy has also taken a clear downward turn while unemployment has started to increase sharply. The marked slump in exports has been a particular factor in the weakening economic trend in Finland. The economic indicators measuring both consumer confidence as well as the future outlook of businesses have remained poor.

As a result of the global financial crisis and recession, the values of different types of assets sharply declined during the latter half of 2008, and this downward trend continued to a certain extent during the first months of 2009. However, the share prices on major stock exchanges have risen at record speed. By the end of June, the prices have increased by several ten per cent from their bottom levels. At the same time, the credit risk margins have become clearly narrower, resulting in a marked increase in the market values of fixed income instruments carrying a credit risk. During the spring, the market interest rates have also decreased to record-low levels in many countries. Consequently, the returns from share and interest investments have significantly risen during the second quarter of 2009. In contrast, the returns from indirect real estate investments and capital investments have generally been rather poor.

The weak trend in investment markets during autumn 2008 resulted in a rapid decline of the average solvency ratio of employee pension insurance institutions. Therefore, a temporary act was enacted. It entered into force on 22 December 2008, containing certain amendments aimed at supporting the solvency ratio. In conjunction with this, the interest credited to technical provisions is 3.0 per cent in 2009. On 20 May 2009, the Ministry of Social Affairs and Health appointed a broadly based committee and a separate expert committee to establish the needs for reforming the solvency regulation of employment pension institutions. The committees are to complete their work by 31 March 2010.

In early winter, there was much discussion on the need for and possibility of increasing the official retirement age in order to extend people's working careers, as well as on the necessity of such a change. Following the discussions, the Government and major labour market organisations agreed on 11 March 2009 that policy decisions are to be prepared by the end of 2009 aimed at credibly increasing the expected retirement age of over 25-year-olds by three years by 2025. This work is carried out by a pensions negotiation group formed by major labour market organisations, in co-operation with representatives of the Ministry of Finance and the Ministry of Social Affairs and Health.

Underwriting and pensions

The rapidly weakening trends of the real economy also put an end to the long period of excellent growth of Ilmarinen's customer base. At the end of June, a total of approximately 474,000 employees were insured under a TyEL policy and approximately 52,600 self-employed persons under a YEL policy. This makes the total 526,600 insured people, or approximately 6,000 less than at the end of the previous year. The TyEL payroll of the insured people for the whole of 2009 is expected to be about 3 per cent less than in the previous year.

It is estimated that in 2009, Ilmarinen has maintained its market position at the previous year's level. The company's premium income in 2009 is expected to amount to approximately EUR 3.2 billion, or 0.8 per cent less than in the previous year.

Ilmarinen paid out pensions to approximately 277,000 recipients in June compared with 274,000 at the end of last year. The retirement of baby boomers and the weakening employment situation increase the number of pension applications. During January–June, Ilmarinen received about 25 per cent more applications than in the previous year. The balance of this increase was on old age pensions and disability pensions, and it was reflected in the number of new pension decisions already made. The number of such decisions was about 11,000, which is about 10 per cent more than a year earlier. Ilmarinen's pension expenditure for 2009 is estimated to be EUR 3.0 billion.

Breakdown and return on investments

At the end of June, Ilmarinen's investment assets totalled EUR 22.9 billion at current value. As a result and active decisions, the proportion of equities decreased to 23 per cent. Of the investment assets, fixed income excluding loan receivables accounted for 48, real estate 11 and loan receivables 14 per cent. The demand for premium loans continued to increase early in the year, albeit at a clearly slower rate than in the latter half of 2008. The share of hedge fund investments was 2.4 per cent. At the end of 2008, Ilmarinen's investments totalled EUR 20.9 billion, of which 42 per cent was fixed income excluding loan receivables, 29 per cent equity, 12 per cent real estate, and 13 per cent loan receivables.

In line with Ilmarinen's long-term investment strategy, the company aims to keep a significant portion of investments in equities. Under the current difficult market conditions, however, the equity allocation has been kept at a lower level than the long-term objective. Given the market situation the company's solvency is good. The higher-than average equity allocation in Ilmarinen's portfolio is also along the lines of the amended objectives made in recent years to the regulations concerning employment pension investments.

The return on Ilmarinen's investment portfolio at fair value rose to 6.6 per cent during the first half of the year, compared with -4.9 per cent in January–June 2008. The good return on investments was in particular due to an increase in share prices and the dramatic increase in the values of fixed income instruments carrying a credit risk. The second quarter of 2009 was the second-best quarter ever in Ilmarinen's history regarding investment returns.

The return on Ilmarinen's equity investments stood at 8.8 (-13.3) per cent during the first half of the year. Ilmarinen's bond portfolio yielded 10.4 (-0.6) per cent, while the figure for other financial market instruments and deposits was 0.9 (2.2) per cent, loan receivables 2.1 (2.4) per cent, and real estate investments -0.9 (2.4) per cent. These return percentages are for January-June, and they have not been converted into annual returns.

During the first half of the year, the return on listed equities was 12.7 per cent, unlisted shares 0.9 per cent and capital investments -23.4 per cent. The return on hedge funds was 4.3 per cent. Direct real estate investments generated a return of 2.7 per cent and real estate investment funds -18.2 per cent. The occupancy rate of real estate owned by Ilmarinen remained good and was 95.2 per cent.

The investments asset allocation and returns shown in this section are in line with the classification on the basis of investment risk. The figures compliant with the official classification applicable to the financial statements of employment pension institutions are presented in the appended tables.

Financial performance

The net return on investments rose to EUR 1,413 (-1,255) million. The interest credited to technical provisions amounted to EUR 532 (453) million. The investment result, calculated as the difference between the two figures above, amounted to EUR 881 (-1,709) million.

The result of the underwriting business for January-June stood at EUR -1 (10) million. At the end of June, Ilmarinen's equalization provision amounted to EUR 993 million after having totalled EUR 994 million at the end of 2008.

Loading profit was EUR 13.4 (12.0) million. The ratio of operating expenses to the expense loading components available for them remained at a good level, amounting to 77 (79) per cent. Ilmarinen aims to both provide the services needed by its clients and manage pension fund assets as cost-efficiently as possible.

The overall result from underwriting activities, the investment result and loading profit was EUR 893 million, while the overall result for January-June 2008 was a loss of EUR 1,687 million.

Solvency

Earnings-related pension insurance companies can rely on solvency capital as a buffer against fluctuations in investment values and returns. Ilmarinen's solvency capital increased from EUR 2,673 million at the end of 2008 to EUR 3,568 million by the end of June. The solvency ratio, i.e., solvency capital in relation to the technical provisions used for the assessment of solvency, was 18.2 per cent at the end of June, compared with 14.0 per cent at the end of 2008. These figures comply with the temporary act that entered into force on 22 December 2008 and are therefore not directly comparable with figures indicating the company's solvency at earlier points in time.

The VaR (Value at Risk) figure indicating the risk involved in Ilmarinen's investments in securities was EUR 725 million at the end of the period. This means there is a 97.5 per cent chance that market value will not decrease by more than EUR 725 million in one month. A decrease in the value of investments of this size would have dropped the solvency ratio at the end of June by 3.7 percentage points. At the beginning of the year, the VaR figure was EUR 698 million.

The adequacy of solvency capital is measured by its size in relation to a number of monitoring limits. Ilmarinen has drawn up its investment strategy so that, over the long term, solvency capital can be expected to fluctuate between the solvency border and the maximum limit for solvency capital, which is four times the size of the solvency border, helping the company to maximize the long-term expected return on its investments within these limits.

Halfway into the year, solvency capital was 2.9 times higher than the solvency border. At the end of 2008, this ratio was 2.0. During the first part of the year, the solvency border decreased from 7.0 per cent to 6.4 per cent.

As of the beginning of 2007, technical provisions also include a new item, a supplementary insurance liability tied to income from shares, which increases the technical provisions as the value of a pension institution's listed equity investments increases and decreases them as these decrease. This item is intended as a buffer for share prices, and in line with legislation, its development is the same across all pension institutions. The item has been negative following the steep decrease in prices last year. As a result of increasing share prices, this item had at the end of June a reducing impact of EUR 558 million on the technical provisions, i.e., smaller than at year-end when it was EUR 779 million.

Governance and personnel

At the end of June, the company employed 577 people, of whom 553 were permanent employees. The corresponding figures a year earlier were 581 and 544.

On 1 April 2009, the company's Annual General Meeting appointed nine new members to the company's Supervisory Board. The persons elected in line with the proposal of the election committee were Anne Berner, Ilkka Hämälä, Pasi Kallio, Kari Kauniskangas, Timo Kohtamäki, Kalle Leinonen, Jussi Pesonen, Riitta Tiuraniemi and Juha Vanhainen.

Future prospects

The positive trend in stock and interest markets has continued during the latter part of 2009 which has further improved the returns of Ilmarinen's investment portfolio. However, there are risks associated with the general economic developments that may cause fluctuations in both the stock and interest markets later in the year, thus having a negative impact on the returns of Ilmarinen's investment portfolio. However, the worst now seems to be behind in the investment markets when seen from the perspective of a holder of an extensively diversified investment portfolio, such as Ilmarinen.

Compared to the economic situation, the company's solvency position is good. Because of this, the company will have good opportunities for continuing to pursue a return-oriented investment strategy in the future as well.

The average annual return on Ilmarinen's investments at market value during the last five years has been 3.3 per cent. From the beginning of 1997, when the provisions regarding employment pension companies' investment activities were changed to encourage risk-taking, the average annual return has been 5.4 per cent, or 3.6 per cent in real terms.

The close cooperation with OP-Pohjola Group has continued, enhancing Ilmarinen's ability to provide its corporate customers with a high-quality service.

The debate on pension policy is focused around the actual retirement age and the estimated increase in pension costs. In January, the major labour market organisations agreed on a gradual increase of the employment pension contribution during the years 2011–2014 by a total of 1.6 percentage points, but the poor employment situation is likely to leave clear pressures to increase the contribution percentage even after this. The effects of measures aimed at postponing retirement are also only likely to start

showing after the employment situation has improved. A study is also underway regarding the necessity to possibly start capping top pensions and its compatibility with the Finnish employment pension system. According to earlier studies, statutory capping of pensions would do little to curb the increase of pension costs and would lead to a more uneven level of total pension cover while also increasing administrative costs.

Helsinki, 20 August 2009

Harri Sailas
President and CEO

The figures in the interim report are unaudited figures for the parent company. The data concerning the situation at the end of March released on 22 April 2009 is available in the news archive on the company's Web site at www.ilmarinen.fi. Ilmarinen will publish its annual report for 2009 in week 8.

Attachments: Key figures and tables (pdf)