

OVERVIEW OF ILMARINEN'S OPERATIONS AND FINANCIAL PERFORMANCE 1 JANUARY TO 30 JUNE 2008

Operating environment

The financial market crisis caused by problems in the US mortgage market in summer 2007 spread across the world during last autumn and the beginning of this year, increasing uncertainty in the global capital market. During the crisis, interest rates and particularly credit risk margins have increased considerably. This has decreased the value of fixed-income investments and deteriorated the results of the financial sector and institutional investors significantly. As a result of the crisis, share prices have also declined sharply across the world, particularly during the first half of 2008. In addition, the increase in oil price, weakening of the US dollar and increasing inflation have contributed to the decrease in share prices by increasing market uncertainty and nervousness. Therefore, investors' income for both share and fixed-income investments has been weak due to the difficult market situations at the beginning of the year.

Even though the problems of the US mortgage market have little direct impact on Finnish economy and the Finnish financial market, the general economic situation has slackened at the beginning of the year. Consumer confidence in the future is now distinctly lower than a year ago. In addition, in the Euro zone and the neighbouring areas of Finland, the Baltic States in particular, the economic situation has deteriorated at a particularly rapid rate. This also slackens the short-term economic outlook for Finland.

The unfavourable development of investment markets has decreased the average level of solvency of statutory pension providers. As a result, the supplementary multiplier of pension liabilities, which regulates the growth of employment pension funds, decreased from 3.03 to 1.58 per cent from the middle of the year, and the interest rate used in insurance premiums decreased from 6.25 to 4.75 per cent.

No changes have taken place in the legislation concerning the contents of earnings-related pension insurance or pension insurers' operating environment since the enforcement of the Employee Pension Act (TyEL) at the beginning of 2007. With regard to the 2005 pension reform, the most significant matter characterising this year has been sending pension record extracts of earnings-related pension data to all people who have been engaged in gainful employment in the private sector or operated as entrepreneurs.

The SATA committee is preparing an overall reform of social security. Earnings-related pension is excluded from the scope of the committee's work, but various reciprocal dependencies between earnings-related pension cover and other forms of social security can be expected to affect the result.

Underwriting and pensions

During the period, the number of Ilmarinen's clients increased by more than 2,000 corporate and entrepreneur clients. At the end of June, a total of approximately 460,000 employees were insured under a TyEL policy and approximately 53,000 self-employed persons. This makes the total 513,000 insured people, which is over 40,000 persons more than at the end of the previous year. The TyEL payroll of the insured people for 2008 is expected to increase by more than 15 per cent on the previous year.

The growth in the customer base has been exceptionally high, and growth in the volume of customers' operations, smooth sales of new insurance particularly in 2007 and a large portfolio transfer to Ilmarinen from a pension fund on 1 March 2008 contributed to it. The growth will strengthen Ilmarinen's market position considerably. The company's premiums written in 2008 are expected to increase to approximately EUR 3.2 billion, or 14 per cent up on the previous year.

A pension record extract will be sent to all by letter in 2008. It is Ilmarinen's responsibility to send records to approximately 720,000 insured people. By the end of July, more than half of these records had been sent, and the task will be complete in October. As of April, those insured at Ilmarinen have been able to check their own pension records through a pension record Web service, which Ilmarinen launched as the first employment pension company. The objective is for those insured people who use the pension record Web service to be able to notify that they are giving up the pension record sent by letter as of 2009. At the present time, it seems that the number of contacts arising from the pension records will remain slightly less than what the company prepared for in its customer service.

Ilmarinen paid out pensions to approximately 270,000 recipients in June compared with 263,000 at the end of last year. The number of new pension decisions made in January-June was about 11,000, which is almost 8 per cent more than a year earlier. Ilmarinen's pension expenditure for 2008 is estimated to be EUR 2.7 billion.

Breakdown and return on investments

At the end of June, Ilmarinen's investment assets totalled EUR 25.2 billion at current value. As a result of active decisions and falling share prices, the proportion of equities decreased from 47 per cent to 40 per cent. Of the investment assets, fixed income excluding loan receivables accounted for 45, real estate 10 and loan receivables 5 per cent. The demand for premium loans has increased to some extent as a result of the changed market situation. The proportion of hedge funds included in equities was kept at 3 per cent of Ilmarinen's investments. At the end of 2007, Ilmarinen's investments totalled EUR 23.7 billion, of which 38 per cent was fixed income excluding loan receivables, 47 per cent equity, 9 per cent real estate, and 5 per cent loan receivables. The proportions reported above correspond to the official classification of investment assets. The distribution according to risk is reported in the annex.

According to Ilmarinen's long-term investment strategy, the company aims to further increase the proportion of investments in equity, in the long term. Under the current difficult market conditions, however, their share has been kept at a level lower than the long-term objective. The company's solvency is still good and sufficient to withstand the risk related to fluctuation in share prices. The high proportion of share investments is also in line with the objectives of the changes made during recent years to the regulations concerning employment pension investments.

The return on Ilmarinen's investment portfolio at current value decreased to -4.9 per cent during the first half of the year, compared with 5.3 per cent in January-June 2007. This was mainly due to the weak development of share prices and an increase in interest rates.

The return on Ilmarinen's equity investments stood at -11.1 (12.6) per cent during the first half of the year. During the same period, the OMHEX weight-limited index decreased by 19.6 per cent, the S&P 500 index decreased by 11.9 per cent (in euro 17.7 per cent), and the EuroStoxx 50 index by 23.8 per cent. Long-term interest rates went up during the first six months of the year, which decreased the return on Ilmarinen's bond portfolio. The return on Ilmarinen's bond portfolio stood at -0.7 (-0.5) per cent, while the figure for other financial market instruments and deposits was 2.2 (1.8) per cent, loan receivables 2.4 (2.2) per cent, and real estate investment 2.5 (3.9) per cent. These returns are for January-June and they have not been annualized.

The return on listed equity investments was -14.6 per cent, unlisted equity investments 13.3 per cent and capital investments 0.1 per cent. The return on hedge funds was 1.5 per cent. Direct real estate investments generated a return of 2.6 per cent and real estate investment funds 1.1 per cent. The occupancy rate of real estate owned by Ilmarinen increased to 94.4 per cent.

Financial performance

The net return on investments decreased to EUR -1,255 (1,245) million. The interest credited to technical provisions amounted to EUR 453 (511) million. The investment result, calculated as the difference between the two figures above, amounted to EUR -1,709 (734) million.

The result of the underwriting business for January-June stood at EUR 10 (-42) million. At the end of June, Ilmarinen's equalization provision amounted to EUR 928 million after having totalled EUR 918 million at the end of 2007.

The loading profit amounted to EUR 12.0 (6.5) million. The ratio of operating expenses to the expense loading components available for them improved during the first half of the year, amounting to 79 (87) per cent. Ilmarinen aims to 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 showed a loss of EUR 1,687 million, while the overall result for January-June 2007 was EUR 699 million.

Solvency

Employment pension insurance companies can rely on solvency capital as a buffer against fluctuations in investment values and returns. Ilmarinen's solvency capital decreased from EUR 6,069 million at the end of 2007 to EUR 4,473 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 22.3 per cent at the end of June, compared with 32.5 per cent at the end of 2007. During the last ten accounting years, the solvency ratio was the highest, 41.3 per cent, at the end of 1999 and at the lowest, 16.2 per cent, at the end of March 2003.

The VaR (Value at Risk) figure indicating the risk involved in Ilmarinen's investments in securities was EUR 593 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 593 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 3.0 percentage points. At the beginning of the year, the VaR figure was EUR 827 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 limit and the maximum limit for solvency capital, which is four times the size of the solvency limit, helping the company to maximize the long-term expected return on its investments within this limit.

Halfway into the year, solvency capital was 1.9 times higher than the solvency limit. At the end of 2007 the ratio was 2.0. The solvency border decreased from 16.3 per cent to 12.0 per cent during the first half of the year. The decrease was due to a decrease in the risks of the company's investments and a decrease in the supplementary multiplier of pension liabilities.

As of the beginning of 2007, technical provisions also include a new item tied to equity income, 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 steep fall in share prices meant that this item amounted to EUR -120 million at the end of June.

Governance and personnel

At the end of June, the company employed 581 people, of which 544 were permanent employees. The corresponding figures a year earlier were 576 and 547.

On 8 April 2008, the company's Annual General Meeting appointed six new members to the company's Supervisory Board. In accordance with the proposal of the Election Committee, the new members were: Aulis Ansaharju, Jarmo Hyvärinen, Jukka Laaksovirta, Kristian Pullola, Jari Sarjo and Merja Strengell.

Ilmarinen's Board of Directors appointed Timo Ritakallio as Deputy CEO, President, Investments. He began his duties on 1 August 2008.

Future prospects

The weak development of the investment market and the steep decline in confidence indicators are signs of a worsened economic situation. The weakening development of market conditions is likely to continue at least during the rest of the current year.

After June, Ilmarinen's solvency capital in relation to technical provisions has varied above the level of 20 per cent. Compared to the economic situation, the company's solvency position is strong. 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 6.7 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 6.6 per cent, or 4.8 per cent in real terms.

The cooperation with OP-Pohjola is well-established and strengthens Ilmarinen's service ability.

The debate on pension policy is focused around the level of actual pension cover and the estimated increase in pension costs. It is not yet clear what will be the general view conveyed by the employee pension records on the actual level of the employment pension cover. This can be expected to have a significant impact on various stakeholder groups' future attitudes on pension policy.

Helsinki, 18 August 2008

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 18 April 2008 is available at the news archive on the company's Web site at www.ilmarinen.fi. Ilmarinen will publish its annual report for 2008 in week 9.

Attachments: Key figures and tables (pdf)