

OVERVIEW OF ILMARINEN'S OPERATIONS AND FINANCIAL PERFORMANCE 1 JANUARY TO 30 JUNE 2007

Operating environment

The global economy has remained on a favourable growth track, and the Euro zone has also seen rapid growth. The Finnish economy has outperformed the average growth rate in the Euro zone. Meanwhile, the increasingly difficult situation in the U.S. housing market, with its repercussions, is causing sustained uncertainty in the financial markets and is expected to affect the economic outlook at the end of this year.

Since the end of the review period, the financial markets have become even more jittery and the positive stock market development seen in the first half has been replaced by significant share price and interest rate fluctuation. The credit risk markets are especially suffering from stronger disturbances, and the situation in the loan markets may be considered highly exceptional.

The new Employee Pensions Act (TyEL) came into force on 1 January 2007. This second stage of the overall reform of earnings-related pension, which was launched in 2005, will considerably simplify customer insurance practices. At the beginning of 2007, a number of legislative changes took effect concerning the improvement of the risk-bearing capacity of employment pension institutions, the covering of technical provisions, solvency capital requirements and the administration of pension insurance companies.

Insuring and pensions

The enforcement of the new Employee Pension Act (TyEL) did not present any problems at Ilmarinen. This highly challenging major reform took a total of three years to plan and implement. Ilmarinen is now also able to insure those earnings-related pensions that were previously insured under the Temporary Employees' Pensions Act (LEL) and the Pensions Act for Performing Artists and Certain Groups of Employees (TaEL). A new online service designed for temporary employers was introduced at the beginning of January. The new service has attracted a growing number of users every month, and by the end of the review period the number of contributions from temporary employers made to Ilmarinen totalled 1,350.

At the end of June, a total of 393,000 employees were insured under a TyEL policy and approximately 50,000 self-employed persons. This was almost 7,000 more insured people than at the end of the previous year. Ilmarinen performed better than anticipated in the review period in terms of the sale of both TyEL and YEL insurance policies.

Ilmarinen also performed very well in terms of transferring customers from one company to another: the insurance decisions made in the first half increased the net number of Ilmarinen's TyEL and YEL insurance policies by more than 2,000. A significant proportion of these came from Ilmarinen's existing customers who are taking advantage of the opportunity provided by the legislative change to organise their employment pension policies with a single company. The positive performance in the review period is further strengthening Ilmarinen's position in the SME sector in particular.

To improve pension services, a customer service centre was opened at the beginning of April, which took over the responsibility of managing the online services provided to customers and pensioners.

The purpose of this organisational change was to ensure that the telephone and online services support each other, and to ensure improved operational efficiency.

Ilmarinen paid out pensions to approximately 260,000 recipients in June compared with 258,000 at the end of last year. The number of new pension decisions made in January-June was about 10,200, which was 3.0 per cent more than a year earlier.

Ilmarinen's pension expenditure for 2007 is estimated to be EUR 2.5 billion. Earnings under TyEL of the insured employees in 2007 are estimated to be 6.3 per cent higher than earnings under TEL in 2006. The company's premiums in 2007 are expected to rise to EUR 2.7 billion.

Breakdown and return on investments

At the end of June, Ilmarinen's investment assets totalled EUR 24.5 billion. Equities accounted for 45 per cent. Fixed-income investments excluding loan receivables accounted for 42 per cent, real estate investments for 8 per cent and loan receivables for 5 per cent of investments. At the end of 2006, Ilmarinen's investment assets stood at EUR 23.0 billion, with fixed-income investments other than loan receivables representing 46 per cent, equities 39 per cent, real estate investments 10 per cent and loan receivables 5 per cent.

Hedge funds, included in equities, accounted for 2.8 per cent of Ilmarinen's investments at the end of June, compared with 1.4 per cent at the end of 2006.

Ilmarinen has continued to increase its equity investments in line with its investment strategy. The company's strong solvency allows it to withstand the risk associated with share price volatility. Increasing the proportion of equity investments is also in line with the objectives of the changes made to the regulations concerning employment pension investments.

The return on Ilmarinen's investment portfolio at market value rose to 5.3 per cent in the first half compared with 1.4 per cent in the January to June period in 2006. The increase in return could be largely attributed to the favourable development in share prices in the first half.

Return on equity investments was 12.6 (5.0) per cent in the first half, whereas the OMHEX weight-limited index increased by 18.0 per cent, the S&P 500 index rose by 4.3 per cent (in Euro terms), and the EuroStoxx 50 index increased by 11.3 per cent. Long-term interest rates were up in the first half, which pulled the return on Ilmarinen's bond portfolio slightly into the negative. From January to June, the return on Ilmarinen's bond portfolio stood at -0.5 (-1.4) per cent, while the figure for other debt securities and deposits was 1.8 (1.2) per cent, loan receivables 2.2 (2.2) per cent, and real estate investment 3.9 (2.9) per cent.

The return on listed equity investments was 12.4 per cent, unlisted equity investments 12.8 per cent and capital investments 20.8 per cent. The return on hedge funds was 7.3 per cent. Direct real estate investments generated a return of 3.6 per cent and real estate investment funds 6.1 per cent. The occupancy rate of real estate owned by Ilmarinen increased to 92.5 per cent.

Financial performance

The net return on investments rose to EUR 1,245 (305) million. The interest credited to technical provisions amounted to EUR 511 (478) million. The investment result, calculated as the difference between the two figures above, amounted to EUR 734 (-173) million.

The result of the underwriting business for January-June stood at EUR -42 (14) million. The negative result could be attributed to the fact that a special discount will be given in 2007 on previously accumulated surplus. At the end of June, Ilmarinen's equalization provisions amounted to EUR 868 million after having totalled EUR 910 million at the end of 2006.

Loading profit amounted to EUR 6.5 (10.5) million, accounting for approximately 13 (22) per cent of the expense loading components available for operating expenses. Ilmarinen's objective is to achieve continued improvements in cost efficiency. The decrease in loading profit in 2007 resulted partly from the fact that some of the expenses of the Finnish Centre for Pensions have been reallocated to be financed from the expense loading component, and partly from the fact that the costs associated with the construction of a shared earning register for the employee pension system began to realise to a significant extent starting from 2007.

The overall result from underwriting activities, the investment result and loading profit, i.e. the overall result, showed a profit of EUR 699 million, while the overall result for January-June 2006 showed a loss of EUR 149 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 increased from EUR 5,828 million at the end of 2006 to EUR 6,507 million at the end of June. The solvency ratio, i.e. solvency capital in relation to the technical provisions, was 36.2 per cent at the end of June, compared with 33.7 per cent at the end of 2006. The VaR (Value at Risk) figure indicating the risk involved in Ilmarinen's investments was EUR 819 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 819 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 4.5 percentage points. At the beginning of the year, the VaR figure was EUR 574 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 2.2 times higher than the solvency limit. At the end of 2006 the ratio was 2.4. The solvency limit depends on the risk level of the company's investments. For calculation purposes, investments must be classified, and under legislation that entered into force at the beginning of 2007, this classification follows the real risk involved in investment, whereas before the legislative reform the classification followed the legal form of the investments.

As of the beginning of 2007, technical provisions also include a new item serving as a buffer for share price fluctuations, namely provision for bonuses tied to equity income. At the end of June, it was EUR 38 million.

Governance and personnel

At the end of June, the company employed 576 people, of whom 547 were permanent employees. The corresponding figures a year earlier were 568 and 538.

On 29 March 2007, the company's Annual General Meeting appointed five new members to the company's Supervisory Board. These were Hannu Leinonen, Tarja Lankila, Jarmo Mikkonen, Sinikka Mönkäre and Jaakko Nevanlinna.

Future prospects

It is difficult to forecast the development of the investment market for the remainder of the year. The recent unrest in financial markets has been reflected on the equities markets and resulted in significant price fluctuations. If the credit markets fail to normalise soon, the uncertainty will begin to affect the real economy, causing a risk of curbing the favourable global economic growth.

After June, the solvency capital in relation to technical provisions has varied between 37.2 and 32.3 per cent. Thanks to its strong solvency position, Ilmarinen will have good opportunities for continuing to pursue a return-oriented investment strategy in the future. The return on the company's investment portfolio, characterised by a share-weighted investment strategy and moderate interest risk, will largely be determined by share prices and the development of interest rates.

The average annual return on Ilmarinen's investments at market value during the last five years has been 8.4 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 7.7 per cent, or 6.1 per cent in real terms.

Ilmarinen is currently carrying out major projects aimed at improving cost efficiency and customer services. In 2008, employment pension companies will start sending employment pension statements to their customers. This improvement, which will be enforced to increase the transparency of earnings-related pension security, will require significant investments from the entire employment pension system and Ilmarinen alike.

The extensive cooperation with OP Bank Group launched in autumn 2005 has translated into an increase in the number of customers and a stronger market position. The cooperation will significantly strengthen Ilmarinen's already solid competitive position.

Helsinki, 29 August 2007

Harri Sailas
President and CEO

The figures in the interim report are unaudited figures for the parent company. Ilmarinen will publish its annual report for 2007 in week 8.

Attachments: Key figures and tables (pdf)