Q2 2018 overview of investment firm sector

The number of investment firms operating on the Estonian market as at Q2 2018 was five.

Kawe Kapital received the authorisation of an investment firm in Q2 2018, as a result of which the number of investment firms operating on the market increased to five. Kawe Kapital operated as a management company before obtaining the authorisation of an investment firm. Kawe Kapital provides the securities portfolio management service.

Key indicators	Q1 2018	Change	Q2 2018
Volume of customer assets	886 mln €	?	1 bln €
Volume of assets of investment firms	52 mln €	?	55 mln €
Profit	2,4 mln €	?	3,1 mln €
Gross income	11,4 mln €	?	11,8 mln €
Return on equity (cumulative, annualised)	21,2%	?	23,6%
CET1, consolidated	33,3%	?	34,87%

The volume of the assets of the clients of investment firms managed by local investment firms increased by 14% in Q2 2018 and amounted to one billion euros. The assets of the residents of Russia and Belize increased the most, comprising 68% and 19% of the total assets of clients, respectively. Residents of Saint Kitts and Nevis appeared in the client base for the first time with assets worth 5 million euros. The share of Estonian clients in total assets of clients was 2.1%.

The investment firm sector earned a net profit of 3.1 million euros in Q2, which is 30% more than in the previous quarter. The sector earned 2.3 times more profit in the first half of the year than in the same period in 2017. The annual return on equity of the sector in the first half-year was 23.6%.

Investment firms earned 11.8 million euros of gross income, i.e. 4% than in the previous quarter, but profitability was high in Q1 as well. Most of the income was earned on consultation transactions, interest on loans granted and exchange rate differences.

The cost base and profitability of the sector remain high for the second quarter in a row. However, it must still be kept in mind that the business models of investment firms are associated with heightened risks and earning high profits may not last for a long time.

The average capitalisation of the sector improved in Q2 as a result of the addition of 2017 profits to own funds. The consolidated Tier 1 Common Equity ratio of the sector increased by 34.87% in comparison with the 33.73% registered at the start of the quarter.

In relation to the various heightened risks in the operations of the investment firms, the Financial Supervision Authority has established an extra capital requirement for investment firms in addition to the regulative capital requirements established on the basis of Pillar 1. Total additional capital requirements comprised 12.5 million euros as at Q2. Considering the aforementioned additional capital requirements, investment firms must maintain 2.2 times more capital than required by the Pillar 1 capital requirement.

Main developments and risks

- The sector's income and profitability remained at a strong level in Q2, which was comparable to Q1.
- However, market risks in the sector are still high and the strong profitability may not last for a long time and be volatile.
- The main risks of investment firms lie in the management of substantial volumes of non-resident assets and the acquisition of high market risk via off-balance sheet instruments.
- Some of the investment firms operating on the market may be open to the Brexit risk considering their connections with investment firms operating in the United Kingdom.
- The risk of non-compliance with regulation is a significant risk factor in the case of investment firms. The level of internal control of the financial institutions operating in the sector must be increased in comparison with other sectors.

Quarterly reviews of the investment firm sector

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