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Dokumendid

[Finantsinspektsioon Annual Report 2018 \(pdf, 1.24 MB\)](#)

[Overview of the Estonian financial market 2018 \(pdf, 0.62 MB\)](#)

Honourable President of the Riigikogu, Distinguished Members of the Riigikogu.

We are presenting the annual report of Finantsinspektsioon in accordance with the Financial Supervision Authority Act. The annual report covers the main events, trends and actions in the Estonian financial market and in financial supervision in 2018.

It is always a pleasure for me to present the annual report of Finantsinspektsioon to you, the legislative body of the citizens of Estonia. May I wish the 14th Riigikogu strength and wisdom.

Kilvar Kessler, Chariman of the Management Board of the FSA (Photo: Riigikogu)

I would like to start my presentation by briefly discussing what sort of institution Finantsinspektsioon is, after which I will focus on the strength of the Estonian financial market, and what we are doing well. I will end by looking at the risks and shortcomings that we can see and sense at Finantsinspektsioon. Time limits mean a choice has had to be made of which topics to cover.

Finantsinspektsioon is a joint institution of the Estonian state and the central bank. We stand apart from the ministries and the systems under them, and this ensures we have sufficient independence in our supervisory activities to meet international standards.

Finantsinspektsioon carries out supervision over the banking, insurance and securities markets. **We also monitor compliance with some 450 – yes, you heard right, 450 – different legal acts and guidelines by the biggest 180 or so subjects of supervision.** We have 87 members of staff to do our work, which makes us the smallest financial supervision institution in the European Union by staff size.

The central role of Finantsinspektsioon under the Financial Supervision Authority Act concerns stability and trust in the financial market. **The Estonian market has been fairly stable, and market participants are solvent, which gives people confidence that the financial market will be**

successfully able to do its work of circulating the lifeblood of the economy and bearing risks. Estonia was one of only four countries in the European Union that did not need to support one of its own banks or other financial intermediaries during the financial crisis of 2008. Estonian society has not had to spend a single cent on this, in contrast to the billions of euros that we have given to help our friends elsewhere in Europe.

Finantsinspektsioon is not the consumer protection bureau, a forum for resolving disputes, or a court that can resolve individual arguments between consumers and providers of financial services. We protect the interests of depositors, insurance clients and others by monitoring the capital, organisation and management of financial intermediaries, ensuring that the financial services they provide are legally correct, and that those services are appropriate for the business model and risks of the provider. In this way we protect all consumers at once.

Finantsinspektsioon is not an investigative body that launches criminal proceedings when crimes are suspected, gathers evidence or presents evidence against the accused in court. Our role as a financial supervisor is very different from that of an investigatory agency. We look at money-laundering risks in terms of the stability and reliability of the financial market for example, and whether the risk control organisation of banks or other financial intermediaries are adequate given their business and the risks they have taken on. We need to consider whether the internal barriers within a bank or payment institution are too high for clients hoping to commit crimes to be able to climb over. Regulation in this area is not so empirically precise that we could immediately identify the weaknesses in a system. A lot depends on the quality of information, how much a subject wants to cooperate, the methods used, and above all the experience of the supervisor. And it is this experience that we use to help the investigatory authorities where possible and where necessary in handling complex breaches of the rules in the financial market. I believe that our cooperation, and especially the bilateral exchange of information, with various state authorities is very important in handling multifaceted risks.

One of the main roles of a financial supervision authority is to direct the subjects of supervision to control and manage their own risks better. The law has given us several tools to do this with, especially our ability to impose obligations and limits on subjects of supervision. An example is the annual additional capital requirement for the banks, which is the outcome of proceedings that take six months. These proceedings assess the business model, management, risks in all areas, and funding of the bank. This is then all interpreted as a score that can be adjusted and used to find the amount of additional capital needed to cover risks.

Or equally, the legal compliance of the significant shareholders and members of the management board of a financial intermediary can be assessed, for which it is often necessary to consider personal reputation or issues of financial capacity.

A large part of the Estonian financial market is made up of banking groups. A difference can be drawn between the 3-4 larger universal banks, and the smaller banks. One factor that is common to all of them is their very strong capitalisation, while their loan losses are low, meaning they have generally lent responsibly. There can be no complaints about the general level of digitisation, and banking in Estonia is among the most highly digitised in the euro area. **Last year, we were one of the few banking supervisory institutions to run internet bank tests, in which we tested an internet bank in controlled conditions against various incidents, including cyber attack.** The results were better than expected, and the bank acted immediately to deal with the weaknesses found. We also see a desire to work on other areas that need improvement, and we encourage the banks to invest in these areas.

This year Luminor was created by the cross-border merger of several different credit institutions in Estonia. Luminor is Estonia's biggest bank, and it also bears risks from Latvia and Lithuania. **The banking portfolios in those countries are even larger than that in Estonia, which means that supervision has to be able to comprehend and monitor cross-border risks in order to avoid and resolve crises.**

The Baltic, Scandinavian and European Union financial supervisors and other interested parties put their heads together last year and war-gamed an imaginary financial crisis in the region at the start of this year. Like the armed forces, it is good practice for financial supervision institutions to test their capacity by war-gaming from time to time. The results of the exercise have been analysed, weaknesses addressed and feedback given to participants. The general conclusion was that the Estonian institutions that took part in the exercise handled their tasks very well.

A significant event for the whole euro area happened in 2018 when the European Central Bank withdrew the operating licence from Versobank at the application of Finantsinspeksioon after thorough consideration. This credit institution had for a long time been in serious breach of anti-money laundering rules, and had ignored the injunctions from the supervisor to improve its behaviour. By doing this, Estonia gave a very strong signal that it would not tolerate banks involved in suspicious activities. Several years earlier, in 2015, Finantsinspeksioon had made Danske bank close down its similar activities in Estonia.

Prior to this no bank had been closed in Estonia in the 21st century, and Finantsinspeksioon had almost lost its experience of how to handle such cases. The successful outcome of the Versobank case and smooth handling of its resolution together with the Guarantee Fund, and the compensation of deposits showed that the framework for crisis management in Estonia works for resolving such cases, and the cooperation between different domestic authorities worked well. **Weak points did emerge, such as the need to integrate the work of Finantsinspeksioon and the Guarantee Fund more.** We have already started to work on this.

We should also talk about risks and shortcomings. Two of them. **Alongside its routine supervision, Finantsinspeksioon ran a special project for all the banks providing payment services in Estonia from autumn 2018 to spring 2019 in order to fight against money laundering.** On the positive side we can say that the risks from serving non-resident clients have been reduced. Most of the banks are taking the reduction of risks and better risk control seriously.

There were however weaknesses in the systems of the banks and in the risk sensitivity of their risk control. Effectively they were applying the same anti-money laundering proceedings to the most basic user of their services as to weapons exporters. At the same time some major risks that were identified were later neglected. **The law and Finantsinspeksioon would like to see control systems for risks and sensitivity, where the largest potential risks are handled most thoroughly, while ordinary clients who are already known to the bank are treated more gently.** I could say this even more simply, that Finantsinspeksioon would like to see a professional attitude within banking. Nothing more than that. The current systems are very mechanical though and in places they are vulnerable. The banks are making good profit and there is no reason not to invest in the systems needed. Making such changes would put them ahead of their peers, and would help promote the image of e-Estonia.

Secondly. **We have been highlighting since 2004 to our partners that the monetary fines in the financial sector have no impact.** They have risen over time from 3200 euros to 32,000 euros and in some cases even to 400,000 euros, but these numbers are not enough of a deterrent for big,

professional financial intermediaries. Let me explain more clearly.

The options available to us in our toolbox for applying punishment have two functions. The first is to deter bankers and other financial intermediaries from taking on excessive risk and breaking the law, and to prevent bankers breaking the law, it has to be clearly unprofitable for them to do so, meaning that fines must be larger than what can be earned. The second function is that the fine should compensate the public for harm caused by the breach of the rules. In the financial world our society, like everybody else, relies on the values of trust and good reputation. Real-life examples show that financial intermediaries can easily earn money by taking on risks that are excessive or lead to the law being broken. If the risks are realised though, the good reputation of the whole of society suffers. Though the harm this causes is very hard to estimate, it can be very, very large in monetary value, but we can only ask for 32,000 or 400,000 euros as compensation for this harm depending on the circumstances. And equally as nonsensical is that if the harm is caused in other countries too, the society that is protected is the one that demands the largest fines. There is no doubt that the rates of fines need to be raised a long way in Estonia for them to achieve what they are supposed to.

It is probable that most of us in this room are parents. This means we know that we should react at the first reasonable opportunity if naughty behaviour by a child breaks the rules. We tell the child off and we explain. We certainly do not sit and think about things for a week or for a month and then react once the child has long since forgotten about the incident. But this is the effect that misdemeanour proceedings in the financial sector have. The misdemeanour framework is designed to handle simple incidents and to protect ordinary citizens. Wrongdoing in the financial sector is as a rule much more complex and those doing wrong are financial actors who know the sector, are well resourced, and are powerful. Combine this with the cocktail of dogmas around corporate legal liability in Estonian criminal law and the result is a procedure that is very complex – for which read expensive – and time-consuming. **Finantsinspektsioon believes, and we have been saying so for five years now, that such a process does not work. It needs to be ripped up root and branch and replaced with a simpler process.** We are here to propose drafts for this to the government anti-money laundering commission, and other important state agencies and institutions have already expressed their support for our position on this.

Members of the Riigikogu!

The core function of Finantsinspektsioon is to maintain financial stability, and to look after the integrity of financial markets as a whole and their transparent functioning. The 2018 annual report of Finantsinspektsioon that I am delivering to you describes how this core function was fulfilled in 2018, Finantsinspektsioon's 16th year of operation.

Thank you.