
Kilvar Kessler's presentation to the Riigikogu of the Finantsinspektsioon annual report for 2022

20. June 2023

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. As this is a new composition of the Riigikogu, the XV Riigikogu, I will start with a few words about Finantsinspektsioon.

The essential legal role of Finantsinspektsioon is to ensure stability and trust in the financial market.

We monitor whether the organisational control of the subjects of supervision matches their business model; whether they have enough capital of good enough quality to cover their risks; how their financial services are developed and marketed; and whether the people who own and manage financial intermediaries meet the legal requirements. We also resolve crises and decide on fines for transgressions. Finantsinspeksioon does not investigate criminal activity nor resolve individual disputes, and it is not a court of law.

The work of Finantsinspeksioon is managed by a four-member Management Board, and we had 112 staff at the end of 2022. We made 201 management decisions and 214 administrative rulings in 2022. The Management Board issued nine authorisations and withdrew eight. Finantsinspeksioon applies over 700 legislative acts and guidelines to 140 subjects of financial supervision. Companies we supervised own or manage around 80 billion euros of assets.

Finantsinspeksioon is not part of the system of state institutions operating under the Government of the Republic Act. We operate independently under the Financial Supervision Authority Act, because international standards require us to be an independent institution. The independence of Finantsinspeksioon is similar to that of central banks and courts and this is one reason why I am reporting today to you as the legislative branch.

I will now speak a little more about the two main sets of issues that faced Finantsinspeksioon in 2022, then I will look at the risks in 2023, and I will end by proposing that the parliament create a financial ombudsman to give consumers better protection.

The work of Finantsinspeksioon was affected very much by the largely unexpected massive increase in intensity in the war in Ukraine on 24 February 2022. War and other serious crises leave the financial supervisor facing an ugly picture of possible risks. People might become very nervous and start to withdraw massive amounts from bank accounts, causing a run on even healthy credit institutions that are operating normally. This is what we call liquidity risk. Hostile actors may attack the infrastructure of the e-state and financial intermediaries so that society cannot access the services it needs. This is cyber risk being realised. Pariah states may abuse the financial system to buy the technology and other things they need. The financial supervisor sees this as a breach of international financial sanctions. Our own businesses may be strangled because sanctions and other obstacles mean that companies can no longer trade with their earlier partners and regions, and this could cause some businesses to become insolvent. For Finantsinspeksioon this means that credit risk has been realised and the quality of credit has deteriorated.

Finantsinspeksioon was the first financial supervisor in the euro area to map the risks from the war in Ukraine, covering cyber risk, liquidity risk and issues of compliance with sanctions, and credit risk. Immediately before the war started, we were directing the focus of market participants onto managing those risks. We stopped the operations of the only market participant that was strongly connected with risks from Russia, and ultimately withdrew its authorisation. After the war started we held daily, then weekly and monthly meetings with market participants depending on their risk environment. We introduced special reporting and produced regular monitoring analysis to assess the need for immediate supervisory intervention.

We can conclude today that the risks from the war were mapped out in time, measured and managed in cooperation with the financial sector and other institutions so that society and the economy were able to function in 2022 without interruption.

The second major topic that Finantsinspeksioon faced in 2022 was the assessment by an

international mission of Estonia's capacity to fight against money laundering.

Ending shady banking in Estonia has been a priority for Finantsinspektsioon since 2014, and this work was very complex and involved the closure of two banks and several payment institutions. We issued requirements and bans. This of course did not please those who were earning well from shady banking. During the large-scale clean-up it may have been that the banks treated some individual clients in a way they did not at all deserve, and this all gained a lot of public attention and a lot of public discussion.

It is standard international practice for countries to assess one another for their capacity to fight against money-laundering, and it was Estonia's turn to be assessed in 2022. We had managed to minimise the massive money laundering risk within quite a short time, mainly through financial supervision of the financial sector, but a lot of information reached the public after a long delay, giving the impression that Estonia was not coping well with money laundering. This meant that we had to prepare very thoroughly for the assessment, involving the financial sector and acting thoughtfully.

The team that assessed Estonia last year were incredibly thorough in their work. They had 82 interviews in Estonia during their visit, and Estonia produced more than a thousand pages of written answers to their questions. The results of the assessment were released in the final report at the start of this year. The report shows that Estonia still has some weaknesses in its anti-money laundering system, such as issues with criminal prosecutions and risks around crypto assets, but overall the assessors found that Estonia's capacity to act against money laundering is good, especially in the banking sector. Such an assessment was the result of good cooperation and professional attitudes from the assessors and from the subjects of the assessment.

Looking forward in 2023, what is in store for us? Firstly, the Estonian financial sector and state administration is quite well digitalised, and I do not see us turning back from the route we have chosen. Our e-state and e-finance mean a lot of attention needs to be focused on the technological risks of financial intermediaries to manage them well and ensure that those risks are not realised in a way that throws any individual financial intermediary, let alone the system as a whole, off the rails. Finantsinspektsioon is a valued partner and centre of excellence in the euro area for managing technological risks, and specifically ICT risks. We will continue to build and deepen those skills, working independently and together with other institutions.

Secondly. I said in my presentation to the parliament on 2 June last year that there was a serious risk of stagflation in 2022 if high inflation was accompanied by poor growth or even a decline in the economy. The report published on 23 May 2023 summarising the visit by the delegation of the International Monetary Fund noted that Russia's invasion of Ukraine caused very high inflation, blockages in supply chains, and slower growth in the economies of Estonia's main trading partners. The IMF considered that this together with the incomplete fulfilment of the budget in 2022 led the country into stagflation.

Continuing in my role of oracle, I would argue that the main risk affecting the financial market in 2023 is inflation and the corresponding monetary policy and fiscal policy steps taken in response. These topics have many different aspects and present a wealth of political options.

The priority for Finantsinspektsioon in this is not to argue for or criticise particular political choices, but above all to manage the risks that come with those choices. To monitor the quality of credit for example. Credit risk will probably increase in 2023, so there will be more cases where borrowers do not comply with the requirements of their contracts as they should.

Estonian folk wisdom says that you should mend your sledge in the summer and your carriage in the winter, and Finantsinspektsioon is guided by this principle in setting preventative requirements in advance for banks to hold additional funds as buffers to protect depositors. Finantsinspektsioon required credit institutions to hold a further 824 million euros in funds as buffers for 2023 to increase their resilience to risks. In broad terms, the banks could currently cope with 3 billion euros of losses without breaking the legal requirements for capital adequacy.

The state can better set the protective net for debtors to account for the new wave of the economic cycle. Rising interest rates make it harder for borrowers to service loans, and so it would be wise to look now at the framework of rules that are applied to debtors who fall into difficulties. The framework is usually made up of the conditions for social support, the network of debt counsellors, the Code of Enforcement Procedure and the Insolvency Act, and the standards for resolving disputes.

I will dwell for a moment on dispute resolution, because Finantsinspektsioon has observed in its work that consumers are not always able to defend their own rights well enough. There are various human factors that stop people defending their rights, but I think they can be reduced to a couple of arguments. First, nobody wants to go into a dispute against a much more powerful opponent if they can possibly avoid it. They often give up even if they are in the right under the law. Second, people in financial difficulties do not have the financial capacity for a dispute, especially if there is a risk they may have to pay the court costs of their opponent.

The adversarial proceedings generally used in civil court cases do not make this any easier, but rather make it worse. That consumers have actual access to resolution for disputes, and that there is consequently recognition that the financial sector is functioning in a legally correct way is a fundamental basis for the stable and correct operation of financial markets. For these reasons we think there should be a financial ombudsman and that it should work at Finantsinspektsioon.

Having the ombudsman operate at Finantsinspektsioon would give the ombudsman specific skills in the field. Even more than that, working at the financial supervisor would give the ombudsman a unique ability to understand the internal side of the organisation of the subject of financial supervision that is involved in a dispute. This would then give a more complete picture of what is needed to resolve an individual dispute, going beyond the strict limits of the terms of the contract. Together with the ability of the ombudsman to carry out investigations, this would balance the power of the parties in otherwise adversarial proceedings.

The work of the ombudsman could be financed from the Finantsinspektsioon budget. Obviously Finantsinspektsioon does not receive a single cent from the state budget. Consumers who are bringing complaints would not have to fear costs spinning out of control or high financial barriers to bringing a case. The permanent activity of the ombudsman and its independence under the law, together with the guarantees given for work, which are similar to those of a financial supervisor or a judge, mean that the market cannot influence the ombudsman, and so they reduce the actual or perceived conflict of interests of the ombudsman. This would give people the confidence they need that the ombudsman is a trustworthy resolver of disputes. So I really hope that the state will listen to our proposal for an ombudsman and that we can work together smoothly to pass the laws needed quickly and get the institution set up and operating.

Members of the Riigikogu.

The Supreme Court has found in its cases that economic and financial stability is needed for the Estonian state to be able to execute its constitutional obligations. It has also found that financial

sustainability is a constitutional value in Estonia.

The core function of Finantsinspektsioon is to maintain financial stability, and to look after the integrity of financial markets and their transparent functioning. The 2022 annual report of Finantsinspektsioon that I am delivering to you describes how this core function was fulfilled in 2022, Finantsinspektsioon's 20th year of operation.

Thank you for your attention.

Kilvar Kessler