Q3 2018 overview of investment firm sector

Five investment firms operated in Estonia as at the end of Q3 2018.

Key indicators	Q2 2018	Change	Q3 2018
Volume of customer assets	1 mld €	?	0,9 mld €
Volume of assets of investment firms	55 mln €	?	56 mln €
Profit	3,1 mln €	?	2,1 mln €
Gross income	11,4 mln €	?	10,2 mln €
Return on equity (cumulative, annualised)	23,6%	?	21,4%
CET1, consolidated	34,87%	?	30,87%

The volume of client assets managed by local investment firms decreased by 10% in Q3 and amounted to 0.9 billion euros. As investment firms mostly operate on a cross-border basis, the majority of client assets belonged to non-residents. Clients from countries of a higher risk of money laundering were observable in the client base.

The amount of open market risk exposures of investment firms increased sharply, by 27%, in the quarter, forming 153% of the equity of investment firms. The market risk of investment firms was high and taking the risk has a significant impact on the profitability of investment firms.

The profit earned by investment firms in Q3 was considerably lower compared to the previous quarter. 2.1 million euros of profit was earned in the quarter, i.e. 31% less than in Q2. Despite the decrease in profit in Q3, the profitability of investment firms over nine months remained at a good level – investment firms earned 40% more profit in the first nine months of the year compared to the same period in 2017.

The gross income of investment firms in Q3 was 10.2 million euros, i.e. 10% less than in Q2. The sector earned less service charges from consulting and from securities brokerage; the revenues from fair-valued instruments were also lower. The biggest type of income of investment firms was income from trading fair-valued assets, which provided almost 70% of the gross income.

The annual return on equity of the sector in Q3 was 21.4%.

Investment firms were sufficiently capitalised in the end of Q3, with all firms meeting the own funds requirement.

In connection with the higher risks present in the activity of investment firms, Finantsinspektsioon has laid down further capital requirements for investment companies in addition to the regulative capital requirements established based on Pillar 1. The aim of the further capital requirements is to ensure that investment firms hold a sufficient amount of own funds to cover the risks. The level of meeting the additional capital requirement decreased from 179% to 166% in Q3 in connection with an increase in risk assets.

Main developments and risks

- The income base of investment companies decreased in Q3, but moderately. Less income was earned in the form of service charges from consulting and from trading with fair-valued portfolio.
- In spite of the significant drop in the profitability of investment firms in Q3 and the lower gross income compared to the quarter before, the income base and profitability of the sector remain at a good level.
- The main risk factor for investment firms are the business models which are built on taking a high market risk. Due to the high leverage, even a small shock in the financial markets can cause large losses. Taking a higher market risk calls for efficient risk management systems which can respond quickly to changes in the market.
- Some investment companies operating on the Estonian market may be exposed to the risk of Brexit, taking into consideration their connections with investment firms operating in the United Kingdom.
- As the majority of the services of investment firms are sold outside of Estonia and the services are mostly provided to non-residents, there are remarkable operational, compliance, and money laundering risks.

Quarterly reviews of the investment firm sector

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