Q1 2019 overview of investment firm sector

In the first quarter of 2019, there were five investment firms operating in Estonia. There were no branches of foreign investment firms operating in the Estonian market, but Estonian investment firms had considerable business abroad.

Key indicators	Q4 2018	Change	Q1 2019
Volume of customers assets	674 mln €	?	636 mln €
Volume of assets of investment firms	60 mln €	?	65 mln €
Profit	2,9 mln €	?	0,05 mln €
Gross income	11,4 mln €	?	8,8 mln €
Return on equity (cumulative, annualised)	21,5%	?	0,4%
CET1, consolidated	33,29%	?	30,97%

Investment firms had client assets of 636 million euros under management in the first quarter. The value of client assets continued to decline in the first quarter and was down 6% in the quarter. The main fall was in client assets from Belize. Estonian clients had only a small share of total client assets at 3.4%.

The investment firm sector earned 8.8 million euros in gross revenue in the first quarter, which is 23% less than in the previous quarter. The biggest fall was in income earned from trading derivatives assessed at fair value. There were also falls in other types of income, including service fees from consultation and intermediation fees for securities transactions. The decline in the revenue base may have been caused by low levels of activity among clients.

The largest part of the revenue base of the sector is income from trading derivatives with market exposure. Trading portfolio positions require active management and so are a relatively volatile source of revenue, meaning fluctuations in profitability are quite common.

The sector earned net profit of 48 thousand euros in the first quarter and the return on equity was 0.4%. The profitability of investment firms was markedly less than in the previous quarter, when the sector earned 2.9 million euros in profit and the return on equity was a strong 21.5%. The sharp drop in profitability was mainly caused by the narrowing of the revenue base by 23% and by the rise of around 9% in administration costs.

The aggregate CET1 figure for the sector fell to 30.79% at the end of the first quarter of 2019 from

33.29% at the start of the quarter. The minor fall in capitalisation came from growth in risk assets, which was caused by the increase in positions with market exposure. Among those exposed positions there was growth in positions with equity, currency and trading exposures. Although the equity of the sector was increased by 23% by adding last year's profit to equity, risk assets grew even faster and so capitalisation has in total declined.

Finantsinspektsioon has set elevated additional capital requirements for investment firms. This means that many investment firms have only a small buffer of own funds despite the high capital standards, and are not able to take on any additional exposure.

Main development trends

- The revenues and profitability of the investment fund sector are volatile because they are heavily dependent on income from trading.
- Although the sector earned record income and profits in 2018, profitability fell to almost zero in the first quarter of 2019.
- A large part of the profit is earned by taking on market exposure positions, which require constant active management.
- Serving mainly non-residents and holding the assets of non-residents means there is elevated risk of money laundering.
- The large volume and complexity of the regulations that apply to investment firms are a challenge for Estonian market participants with slim organisations.

[Quarterly reviews of the investment firm sector]

Page last edited on 08/08/2019