



Finantsinspektion

**FINANTSINSPEKTIOON OPERATING STRATEGY
2019-2021**

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FINANTSINSPEKTSIOON OPERATING STRATEGY 2019-2021

A. Vision

We are an influential and adaptable institution.

B. Mission

We maintain confidence in the financial market by conducting financial supervision in the public interest and resolving financial crises.

C. Values

Certain. Professional. Open minded.

D. Strategic goals

Our goal is for the financial market to be stable, reliable and open to innovation

1. For the goal of stability we concentrate on three challenges:
 - 1.1. Estonia has an effective safety net for the financial market to prevent and resolve financial crises
 - 1.2. Participants in the market have large enough financial buffers to hedge their risks
 - 1.3. Market participants have internal control systems that suit their business models, especially in relation to combating money laundering
2. For the goal of reliability we concentrate on three challenges:
 - 2.1. Market participants have fit and proper managers
 - 2.2. Market participants have transparent and effective funded pension products
 - 2.3. Finantsinspeksioon has an effective but responsible enforcement policy
3. For the goal of openness to innovation we concentrate on two challenges:
 - 3.1. Market participants have modern information technology infrastructure, including that needed to minimise cyber risks
 - 3.2. Finantsinspeksioon recommends or makes changes to outdated rules or updates them

E. Our principles in doing our work

We show our values in our contribution to international cooperation. We support increased integration of European Union financial markets and the distribution of risks rather than concentration of those markets. We want to avoid excessive regulation, but we support strong institutions, centrally based if necessary. We contribute to the analysis of possible new areas for supervision. We promote communication with stakeholders and public awareness by providing regular, relevant and clear information on our activities and on financial markets and services.

1. SOURCES OF THE STRATEGY AND ITS ASSUMPTIONS

1.1 The legal basis for the Finantsinspeksioon operating strategy is the Financial Supervision Authority Act.

Under § 7(2)1) of the Financial Supervision Authority Act, the Finantsinspeksioon Supervisory Board approves the operating strategy at the proposal of the management board. Under § 18(3)1) of the same act, the management board submits the strategy to the Supervisory Board for approval in issues relating to the management and organisation of activities.

1.2 Factors affecting the financial sector

1.2.1 Growth is slowing in the Estonian economy and the main financial risks in Estonia relate to revaluation of risks in the Nordic countries and to the real estate sector in Estonia, both of which affect above all the liquidity buffers and capital buffers of the banks.¹

The Estonian financial sector is inevitably affected by global processes such as climate change and changes to the natural environment caused by human activity, changes to the demographic structure and population in different regions, tensions in international relations, and terrorism. Covering these factors in greater detail in the current document would, however, go too far beyond the assumptions and background analysis needed for a strategy.

The Estonian economy has grown during the period of the current strategy, but forecasts expect that growth will slow during the next strategy period. The Eesti Pank economic forecast for 2016-2018 finds the Estonian economy to be in its best shape since the economic crisis. The strong growth in the economy will fade in the years ahead, as foreign markets grow more slowly and available production capacity in the economy becomes exhausted. Lower investment will reduce the potential for growth in the years ahead.

The summer 2017 economic forecast of the Ministry of Finance found that Estonian GDP growth accelerated strongly in the first half of the year to 5.2%. Hope for even faster growth was earlier given by the rapid improvement in confidence throughout the European Union from the end of 2017. The growth was supported by stronger domestic and foreign demand and by corporate profits. After years of low growth, a temporary rise in the rate of growth is quite normal, and the forecast expected the Estonian economy to grow by 4.3% that year and by 3.3% in 2018.

The summer 2018 economic forecast of the Ministry of Finance found that the economy was doing well and the risks to it were low. Foreign demand was strong, encouraging Estonian exporters to grow. The level of investment by companies was low, though the amount of research and relevant activity was increasing rapidly. Real GDP growth was expected to be 3.6% in 2018 and close to 3% after that. The Ministry of Finance forecast showed real GDP growth slowing in subsequent years.

The European Systemic Risk Board (ESRB) has consistently identified three main risks to financial stability in the European Union in its annual reports of recent years:

- Revaluation of risks in global financial markets. This risk has remained the most important and has held stably at a high level;
- Weaknesses in the balance sheets of banks, insurers and pension schemes. This risk is the second most serious;
- The ability of states, businesses and households to pay their debts. This risk is the third most serious.

The Financial Stability Reviews of Eesti Pank for 2016 to 2018 identified the main risks to financial stability in Estonia. If financial markets assess that the risks to the Nordic economies or banking groups have increased, the liquidity risk of the banks operating in Estonia will increase and with it the risk to the financing of the economy. Reduced economic activity in the Nordic countries will have a negative effect on the income of Estonian exporters and their ability to service loans. The reviews also consistently identified risks, partly due to the low

¹ This document does not as a rule link to its sources.

interest rates, that arose from excess demand and price rises in the real estate market, which could damage the quality of the loan portfolios of the banks if the cycle were to turn. The third source of risk is the pressure on competitiveness and profitability from wage growth, which could damage the quality of the loan portfolios of the banks if the cycle were to turn.

1.2.2 The legal framework is reaching a peak of complexity, the regulated financial sector is becoming concentrated, the share of technological risks is rising, and supervision is becoming a part of a larger system

The phase of active changes being made to harmonise the legal framework of the European Union after the financial crisis is coming to an end. Notable influences on the design of the framework in future will be the actions of the US administration and also Brexit. The majority of the legislation regulating the Estonian financial market comes from directly applicable European Union law, and the share of exclusively Estonian law is shrinking. The European Union legal framework is becoming ever more complex, and is being constantly extended by the practice of implementation of the law. Equally though, local risks such as cryptocurrencies and crowdfunding require local regulatory solutions, which may encourage competition, but may also lead to increased regulatory arbitrage.

The election cycle heightens political risk, especially through the media, as politicians try to differentiate themselves from one another. This may lead to reform of systems that are important for the financial sector and society as a whole, such as pension systems and anti-money laundering measures. The state of international relations means that additional standards are required to counter money laundering and terrorist financing, and to uphold international financial sanctions.

Deepening and widening regulation means additional compliance and administrative costs for financial intermediaries, which then puts pressure on the profitability of smaller market participants. This may reduce competition, and lead to smaller market participants in particular taking on additional and excessive risks. The reforms may also lead to a redistribution of market share.

Given the limited scale of the Estonian market, the trends in the financial sector will mainly be towards development of the legal framework and technology. For this reason, increased concentration and regional consolidation may occur, especially in banking. Financial indicators for the large banks indicate a particular lack of competition in credit issuing. Consolidation also means that part of the risk from other countries is relocated to come under the safety net of the Estonian financial market. If there is too much concentration it is not impossible that large international financial intermediaries will attempt to enter the market.

Another consequence of regional consolidation is a rise in the share of branches operating in the Estonian financial market, especially in insurance. Under European Union and Estonian law this means that people in Estonia will be served by financial intermediaries who fall under the regulators of foreign countries, including in important areas such as traffic insurance, mandatory funded pension schemes, and settlement of securities transactions. A temporary interruption to or termination of the provision of the services could increase the public expectation that the Estonian authorities will take full control of the operations of branches. In contradiction to this, mistrust towards states and governments is increasing in the form of political populism.

The unsatisfied demand that arises because of narrowing competition in the regulated market will cause the numbers of actors in unregulated markets or grey areas to increase. These may be savings and loan associations, payment institutions and creditors rather than credit institutions, and while this may be good for competition overall, it can be dubious in terms of consumer protection. Some of the actors in the less regulated areas are at a stage of development where they would like to enter regulated financial markets and come under financial supervision.

Cheaper computing power and technological development mean that market entrants are better able to keep costs down. Alongside the increase in digitalisation within companies, ever more important processes and systems are being outsourced, some in the form of cloud technology. Digitalisation gives advantage to first-mover platforms and in this way it may restrict competition. Furthermore, new technology brings new types of risks, and transferring to or joining different systems is a source of risk. The digitalisation of the state as a whole poses an important risk to the financial sector, as was seen in the ID card incident of autumn 2017.

The European Union continues to want to take some tasks and responsibilities from member states to the centre, though the real supervisory work will remain local. Local supervisory authorities are being integrated as part of a pan-European organisation. This boosts the skills of the local supervisors in complex questions in the financial market, and it makes it easier to maintain the independence of financial supervisors from local lobbying. At the same time though, this takes risk management and decision-making further away in time and culturally, and risks in small economic regions may not necessarily attract sufficient attention within a large system, or may be treated with measures designed for a much larger scale, which could have unintended consequences. The supervisory authorities themselves will come increasingly under quality control from the centre, which will increase the costs for the institutions and create longer chains for consultation and decisions, which will slow development of the market or give an advantage to the unregulated sector of the market.

1.3 The risks recognised by Finantsinspeksioon to the market and to its own organisation

Finantsinspeksioon collected the opinions of market participants and its own staff on risks to the financial sector and how better to map them. Various levels of management of Finantsinspeksioon were involved together with members of staff from different departments with different positions, and associations of market participants were also brought in. The most common responses were distilled out of the written answers that were received, and the main topics relevant for this document follow.

The most frequently mentioned of the three biggest risks for the European Union was the one-size-fits-all nature of legislation, which includes the failure of crisis resolution standards to meet expectations. Political risk was also mentioned, especially external competition with other regions and internal competition between member states. The third European risk was slower growth in the economy.

One of the four biggest risks given for Estonia was the large share of ICT and especially the location of critical infrastructure abroad. A second that was frequently mentioned was market concentration, including scaling across the EU in such a way that the risks remain within the local safety net and branches. The other two risks were the centralisation of decision-making within Europe, and defrauding of customers.

The strengths of the Estonian financial sector were its financial strength and the absence of legacy issues, its high level of efficiency and digitalisation, the close relationship with Scandinavia through ownership of the banks, and the simplicity of its services. Weaknesses that were noted were the centralisation and concentration of banking, the excess of regulation and arbitrage, and the exposure to ICT risks.

Market participants said that the strengths of Finantsinspeksioon were its legally required political independence and neutrality, its competence, its readiness to cooperate, the accessibility of its staff, and its clear communication with market participants. The weaknesses of Finantsinspeksioon were the small size of the organisation and its lack of resources, and its reluctance to set policy. It was also said that its attitude to supporting innovation could be better.

1.4 The earlier strategies and trends of Finantsinspeksioon's actions allow it to set new strategic goals. The operating strategy that preceded this one focused on the right areas of risks and its unceasing application has meant the risks have been managed in the best way possible for Estonia.

1.4.1 Summary of Finantsinspeksioon strategies

Since starting its activities, Finantsinspeksioon has issued five strategy documents. The first one, for 2001-2003, covered the merger of three institutions. The merger was completed and in 2005 the new institution that had been formed through the mechanical merger process was reconsidered to make its use of resources more efficient and to ensure it operated without conflicts of interest, and to create a supervisory institution operating using the twin peaks model.

The second strategy for 2004-2006 focused on making European Union regulations function smoothly in Estonia and getting Finantsinspeksioon to work as part of the union. The strategy focused on ensuring the stable development of providers of financial services, and secondly on protecting the interests of consumers by increasing the transparency of financial services. Although for various reasons Finantsinspeksioon as the

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supervisory institution did not succeed in halting the credit boom during these years, all parties were warned about the risks and the first steps were taken towards introducing appropriately risk-sensitive capital requirements. During this period supervision over services was introduced and the ability to deal with market abuse was tested. The first steps were also taken in promoting consumer education and financial literacy. Finantsinspektsioon started to understand the committee system of the European Union and gain some insights into its ability to influence the processes there.

The emphasis in the third strategy, for 2007-2010, was on increasing the preponderance of preventative supervisory methods in the overall work of Finantsinspektsioon. A central place was also given to increasing the transparency of financial services and consumer understanding, and to boosting the international competitiveness and attractiveness of the Estonian financial sector. The global financial crisis that hit in autumn 2008 had a serious impact on how the strategy was implemented. At the same time though it made it easier to create the legal basis for preventative supervisory methods and transparency of services. Finantsinspektsioon ran its routine SREPs and worked well with other countries in the region to resolve with minimum losses for Estonian society the critical issues that had arisen in the activities of financial intermediaries, including the conflicts of interests at financial intermediary organisations. Victories in important court cases confirmed that Finantsinspektsioon could handle complex financial cases together with law enforcement agencies. The promotion of consumer awareness was raised to a new level, especially through the launch of a consumer education website, and by bringing this function away from services supervision and directly under the control of the chair of the management board.

The fourth strategy, for 2011-2015, focused on increasing supervisory capacity and on Finantsinspektsioon's cooperation with other partners, and it emphasised the role of Finantsinspektsioon in advising and guiding consumers.

The fifth strategy, for 2016-2018, set separate priority actions in capital and services supervision and crisis resolution. The focus in capital was on the creation of the European Single Supervisory Mechanism (SSM), business sustainability, and internal control systems. Services concentrated on countering money laundering and on consideration of the life-cycle of services in the creation and provision of financial services. The priority in crisis resolution was the creation of the European Single Resolution Board (SRB), and the preparation of crisis resolution plans for the banks.

1.4.2 Conclusions on the implementation of the strategy

Experience of the drafting and implementation of earlier strategies shows that priorities should be worded quite generally to preserve flexibility in a rapidly changing environment and to allow key issues to be kept in focus, and this wording can be given more detail in the annual work plans. Reports on the activities of Finantsinspektsioon are given to the Supervisory Board every quarter, as required by law.

The goals that are achieved are mainly those where Finantsinspektsioon has some control over the variables, meaning that supervisory results are achieved more than regulatory ones for example.

Taking an integrated and cross-sectoral approach to financial market risks unites the staff of the organisation and encourages internal cooperation. The risk of a conflict of priorities must be considered, as legally required activities must be carried out, and strategic priorities cannot always take precedence. The strategies of partners also need to be considered.

1.5 The strategic priorities of partners allow Finantsinspektsioon to frame its own strategy

Finantsinspektsioon is legally a part of the SSM and the SRB, and its most important partners domestically are the Ministry of Finance and Eesti Pank. The Ministry of Finance as the regulator plans and executes the national financial policy. The central bank helps maintain stability in the financial system and carries out prudential supervision of the financial system at the macro level, and it helps ensure the efficient operation of payment systems by overseeing them.

The Eesti Pank strategic goals for 2018-2022 that most affect the statutory mandate of Finantsinspektsioon are that Eesti Pank stands ready to carry out its functions in a crisis, and that it is an influential expert on new

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financial technology that affects the payment environment and financial stability. The first of these requires serious attention to cyber risks and the resilience of payment systems and the financial sector, while cooperation with Finantsinspeksioon is directly mentioned in the strategy with reference to new financial technology.

One of the objectives in the development programme for 2018-2021 of the Ministry of Finance is a competitive and reliable financial environment. The ministry sets a number of quite precise and technical targets for this to be achieved, such as the share of financial intermediation in GDP, the real long-term return on second pillar pension funds, the integration of non-euro area Nordic countries in the banking union, and similar.

The priorities for the SSM for 2019 are credit risk, with NPL guidelines and lending standards; risk management, which covers internal models, ICAAP and ILAAP, IT and cyber risk, and liquidity stress testing; and activities with multiple risk dimensions, such as Brexit, trading risk and asset valuations.

The main priorities of the SRB in 2019 are improving the resolution of credit institutions, making the resolution framework more comprehensible and effective, and preparing and implementing effective crisis management.

2. EXPECTED RESULTS OF THE STRATEGY

2.1 The strategy contains vision, challenges, values, strategic goals and the principles for executing tasks

In setting its strategy, Finantsinspektsioon started from the experience of drafting and implementing the previous strategies. It also considered the strategies of the SSM and SRB, as responsibilities given by the European Union centres and by Estonian law must be met. The strategies of partners also need to be considered. The work by Finantsinspektsioon in drafting the strategy comes in three blocks of vision, challenges and values; strategic goals; and the principles for executing tasks.

Given how interwoven the different segments of the Estonian regulated financial market are and that Finantsinspektsioon has responsibility over all this market, all the market segments of banking, insurance and the securities market are covered by this strategy, though no distinction is made between them at the general strategic level. The importance of mandatory funded pensions is noted as an exception.

The terms of the strategy and its performance indicators are given in general terms, in brief, and in a form that we believe can be achieved. The strategy gives signals to market participants, the public and our external partners.

The strategy is based on the requirement of the Financial Supervision Authority Act that Finantsinspektsioon have primary responsibility for financial supervision and crisis resolution. It also covers other important roles such as promoting public understanding of financial services and financial products, or contributing to legislation.

The strategy does not give detail on the resources and organisation that are needed for these tasks, and nor on potential changes to them. Partly this is because the regulatory framework and the duties of Finantsinspektsioon have changed substantially, with raised public expectations in certain areas such as prevention of money laundering, funded pension systems, or the sustainability of information technology systems, while the nature of supervised entities has changed, and the addition as a subject of supervision of the large bank Luminor, which has branches in Latvia and Lithuania, requires a large amount of work by the financial supervisory institution.

The new requirements of the European Union need us to be ready to move quickly with new tasks and requirements for deposit guarantee schemes, while the Guarantee Fund is operating using a paybox model that was set up at the start of the century and was quite reasonable at that time. Practice has shown that successful cooperation between the Guarantee Fund and Finantsinspektsioon is absolutely vital. The considerable pressure that the SSM and SRB put on our staff is also of note, and this has substantially increased the amount of administration and archiving because of the requirements for internal procedures, documentation, confidentiality and so on.

The organisation and the supervisory model of Finantsinspektsioon largely date back to 2005. In a changed external environment Finantsinspektsioon has much broader rights and the increasing scope of supervision poses challenges for better management of the risks from supervised entities. Finantsinspektsioon has one of the smaller staffs of any financial supervisor or crisis resolution institution in the member states of the European Union, and this means that each member of staff has a relatively important part to play in making sure that supervision is fair, objective, relevant and transparent. It emerges from this that not only are additional employees needed, but the organisation of financial supervision needs to be mapped, the supervisory models analysed, and the organisation improved to help in meeting the strategic goals. It is probable that the clauses in the Financial Supervisory Authority Act on conflicts of interest and the internal audit will need to be updated.

2.2 We maintain confidence in the market in the public interest by being certain, professional and open-minded in our work

Our vision is for Finantsinspeksioon to be an influential and adaptable institution. This means above all that market participants must have a clear understanding and confidence that the activities of Finantsinspeksioon are based on the law, we are guided in our work by the targets and principles in our strategy, and our activities can affect behaviour or have economic consequences. Our partners can have confidence in us, can rely on our work, and can trust our assessments.

Being adaptable comes from the challenges facing Finantsinspeksioon in adapting to new regulations or market conditions, and from being able to plan flexibly and rapidly and react to changes that occur. Being adaptable also means reacting to the market and to risks in a broader sense, rather than taking an independent active role in prescribing business models for the market. If it is necessary to do this, Finantsinspeksioon can participate with its own inputs.

We want to maintain our influence and our ability to adapt, and above all to achieve better organisation of work assuming that our legally defined tasks remain the same and the necessary labour resources are increased (staff positions and staffing requirements are covered in a separate document). We will with good faith keep the wage levels of different groups of employees and experts at a level that is comparable to the average in the financial sector, depending on the exact nature of the work. We must also acknowledge that individual specialists in certain specific areas will need to be paid a significantly higher salary, primarily in ICT.

Our mission is to maintain confidence in the financial market by carrying out our statutory duties in the public interest. Maintaining confidence means that the regulated financial market operates correctly and lawfully. Access to the market will be granted to those who can meet the standards and appreciate their role, and market participants must be guided and motivated to behave lawfully. The managers of market participants are suitable for the job; the architecture of their organisations requires them to be fully aware of the risks they take, to do so appropriately, to have sufficient capital to cover the risks, and to treat consumers of their services lawfully. Market participants must be ready to resolve crises, and their exit from the market cannot excessively harm the rights of creditors or the interests of taxpayers.

We also maintain confidence that those who, in a broader sense, breach the standards or take on excessive risk will be dealt with in such a way that they are no longer motivated to break the rules or take risks, so that the whole of the market does not suffer because of them.

Finantsinspeksioon acts in this in the public interest, and within the framework and procedures of the law. Finantsinspeksioon does not resolve individual arguments or protect the subjective rights of individuals, and it always follows the principle of proportionality in achieving its goals.

The values of Finantsinspeksioon staff are set out in various documents, but they can be briefly summarised in the strategy as professionalism, certainty and open-mindedness.

Professionalism means having the knowledge, skills and experience needed for work, and abiding by professional ethics. The code of ethics of Finantsinspeksioon sets out public trust and ethical principles as requirements for professional ethics. Public trust is principally a question of loyalty, while the ethical principles are honesty, competence, independence, objectivity, respect, discretion, balance, and a sense of duty, which are values that should be applied in all dealings. For this reason these values are not listed separately in the strategy but are gathered together under professionalism.

A value that is separately listed in the strategy is certainty. Supervisory practice has shown that competing interests and stakeholders must be treated clearly under the law. Equally, procedure must be followed in relations with parties, and the content of individual cases may also need to be considered. Such a process requires focus, clarity and decisiveness. Certainty also means the courage and initiative to solve problems by untangling knots that have previously resisted all loosening. Supervision that is uncertain, susceptible to influence or prone to dramatic shifts does not promote confidence in the financial market.

Open-mindedness is added to the values and comes from our vision. The adaptability in the vision calls for open-mindedness in receiving and processing information. Open-mindedness certainly does not mean refraining from criticisms or ignoring risks, but rather a more careful collection and analysis of information.

2.3 Strategic goals

The strategic goals emphasise the important values of the financial market, which are stability, reliability and openness to innovation. These are derived from the statutory objectives of financial supervision and were confirmed by mapping of the market, the analysis of development trends, lessons learned from past strategies, and supervisory experience.

The sources and assumptions of this strategy have placed more emphasis than previously on preparations to handle the risks arising from slower growth in the economy. This has led to the goals of having an effective security network, sufficient buffers at supervised entities, and a responsible policy of enforcement. The requirements for suitability of managers and internal control systems have remained the same as in the previous strategy, including in the area of preventing money laundering. On top of objective changes in the economic environment, a second significant source of failure at an unsuccessful supervised entity can be mistakes, neglect or bad faith in management and in defining, measuring and controlling risks. The issue of preventing money laundering has become ever more topical given the changing foreign policy environment and the large cases that have emerged.

The aim of modern information technology infrastructure is largely unchanged, but in this strategy period the risks and trends of digitalisation will require financial supervision to focus ever more on this area.

More thorough supervision of the funded pension system is driven by the trend of economic growth, the risks of revaluation of assets and the increasingly cross-border nature of the system at a point where new participants are joining the system and payouts are becoming increasingly topical alongside contributions.

2.3.1 For the goal of stability of the financial market we concentrate on three challenges

2.3.1.1 ESTONIA HAS AN EFFECTIVE SAFETY NET FOR THE FINANCIAL MARKET TO PREVENT AND RESOLVE FINANCIAL CRISES

Expected actions and results:

1. Finantsinspektsioon has signed an agreement with the Guarantee Fund for the provision of services so that the Guarantee Fund may better achieve its statutory goals, especially in times of crisis, in such a way that Finantsinspektsioon's ability to do its work would not be impaired, but rather the effective merging of the activities of the two organisations would create economies of scale;
2. Finantsinspektsioon and the Guarantee Fund have created and submitted to the Ministry of Finance proposals for changes to the law that would allow the two institutions to work together on to a firmer legal basis;
3. Finantsinspektsioon has been involved in the crisis management exercises of the supervisory institutions of the Baltic and Nordic region, has analysed the results of the exercises, has made the necessary changes to its organisation, processes and systems, and where needed has made proposals for changes to legislation;
4. As the resolution authority for the Estonian credit institutions under its jurisdiction, Finantsinspektsioon has clearly defined within the extent allowed by law resolution cases and bankruptcy cases and the corresponding optimal Minimum Requirement for own funds and Eligible Liabilities (MREL) rates. Finantsinspektsioon has guided the SRB in setting intragroup MREL policy.

2.3.1.2 PARTICIPANTS IN THE MARKET HAVE LARGE ENOUGH FINANCIAL BUFFERS TO HEDGE THEIR RISKS

Expected actions and results:

1. Finantsinspeksioon has considered the risk environment and reviewed and improved the Supervisory Review and Evaluation Process (SREP) for the Less Significant Institutions (LSI) in its jurisdiction in Estonia, and the Supervisory Review Process for Estonian insurers;
2. During the phase where market participants are entering and acting in the market, Finantsinspeksioon applies capital requirements that take a more conservative view of the risk environment, though if necessary it can work with the central bank to consider the state of the real economy and competition;
3. Finantsinspeksioon requires that there be sufficient liquidity buffers and that they function within a formal framework, especially for financial intermediation groups operating across borders;
4. Finantsinspeksioon charts the components of credit risk management, such as assignment of claims and financing of collection companies, so that it may better understand the risks in the secondary market, and it also regularly stresses the definition of resilience in the credit portfolios of the banks.

2.3.1.3 MARKET PARTICIPANTS HAVE INTERNAL CONTROL SYSTEMS THAT SUIT THEIR BUSINESS MODELS, ESPECIALLY IN RELATION TO COMBATING MONEY LAUNDERING

Expected actions and results:

1. Finantsinspeksioon has reviewed the internal control systems of supervised entities with riskier business models, has assessed the functioning of the system, the sufficiency of resources and corporate governance, and has where necessary made recommendations to supervised entities or required them to bring their actions in line with the law or to reduce risks;
2. Finantsinspeksioon has constantly charted the risks to the financial sector from money laundering prevention, including the risks from cryptocurrencies, and has released information on them where this does not interfere with financial supervision or break the law, and has taken supervisory measures to minimise risk;
3. Finantsinspeksioon has signed an agreement with the Financial Intelligence Unit for planning work, assessing risks and organising data exchange so as to make its work more effective.

2.3.2 For the goal of reliability of the financial market we concentrate on three challenges

2.3.2.1 MARKET PARTICIPANTS HAVE FIT AND PROPER MANAGERS

Expected actions and results:

1. Finantsinspeksioon has analysed the internal processes of riskier supervised entities for their assessment of management suitability and selection procedures, and has where necessary made recommendations to supervised entities or required them to bring their actions in line with the law or to reduce risks;
2. Finantsinspeksioon has prevented people who do not meet the legal requirements from taking positions at regulated entities or from controlling business, or has had such people removed from their position or their ownership.

2.3.2.2 MARKET PARTICIPANTS HAVE TRANSPARENT AND EFFECTIVE FUNDED PENSION PRODUCTS

Expected actions and results:

1. Finantsinspeksioon has reviewed the processes for creating and offering funded pension products in the funding phase, has assessed their operation, and has where necessary made recommendations to supervised entities or required them to bring their actions in line with the law or to reduce risks;
2. Finantsinspeksioon has reviewed the application and implementation of due diligence policies and NAV calculation processes for fund investments in the funding stage of funded pensions, has assessed their operation, and has where necessary made recommendations to supervised entities or required them to bring their actions in line with the law or to reduce risks;
3. Finantsinspeksioon has assessed the processes and systems of the pensions register administrator with emphasis on cyber risks, business sustainability and personal data protection, and has where necessary made recommendations to supervised entities or required them to bring their actions in line with the law or to reduce risks;

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4. Finantsinspeksioon has assessed the risks from components of the mandatory funded pension system being located abroad in terms of the expected operation of the system, and has made proposals for managing these risks.

2.3.2.3 FINANTSINSPEKTSIOON HAS AN EFFECTIVE BUT RESPONSIBLE ENFORCEMENT POLICY

Expected actions and results:

1. Finantsinspeksioon has made proposals to the ministry responsible for changes to the law that would allow the behaviour of professional financial intermediaries subject to supervision to be brought quickly, simply and effectively under the guidance of the financial supervisory institution;
2. Finantsinspeksioon has an enforcement policy that applies under the principle of equal treatment to all areas of supervision, including the market for new financial products such as crypto assets;
3. Finantsinspeksioon has analysed its own capacities and internal processes and where necessary has made changes to its organisation, employment structure and processes to allow enforcement procedures to be used as effectively as possible under the law and the most appropriate punishments to be decided on.

2.3.3 For the goal of openness to innovation we concentrate on two challenges

2.3.3.1 MARKET PARTICIPANTS HAVE MODERN INFORMATION TECHNOLOGY INFRASTRUCTURE

Expected actions and results:

1. Finantsinspeksioon has charted the critical information technology infrastructure and identified the risks, and has where necessary made recommendations to supervised entities or required them to bring their actions in line with the law or to reduce risks;
2. Finantsinspeksioon has directed supervised entities and through them their partners to reduce the duration or number of outages in the provision of broad consumer services such as payment services, motor insurance or stock exchange transactions to retail clients by steadily improving their information technology infrastructure, and has where necessary proposed changes to the law to achieve this;
3. Finantsinspeksioon has drawn up and applied a supervisory policy in consultation with market participants under which the introduction by a supervised entity of IT solutions that are new but are sufficiently secure will see a reasonable relaxation of the assessment and application of the requirements for market entry for that entity, except where the supervised entity was responding to a violation of the law or in matters of personal suitability.

2.3.3.2 FINANTSINSPEKTSIOON RECOMMENDS OR MAKES CHANGES TO OUTDATED RULES OR UPDATES THEM

Expected actions and results:

1. Finantsinspeksioon has made proposals to the ministry responsible for how to handle crypto assets and other innovative financial products in the market with regulation, supervision, enforcement and so forth.
2. Finantsinspeksioon has identified rules that pose an unreasonable obstacle to financial innovation and has made proposals to the Ministry of Finance for changing or removing them.

2.4 Our principles in doing our work

In our international cooperation we want to continue our active role in communicating within the decision-making bodies at European Union institutions. In the current strategy period we have demonstrated our values of certainty and professionalism by creating a precedent in the SSM for the withdrawal of an operating licence from a credit institution mainly because of breaches of the standards for preventing money laundering. By following and applying our values we have created a transatlantic partnership that we plan to deepen in the coming strategy period. Our work with the Commission on details of crisis resolution planning for small banks and the introduction of the regulation defining MREs has produced a relatively reasonable solution for small Estonian banks.

In our work in decision-making bodies and working groups we continue to focus on topics that are important for Estonia, as the small size of the market means we do not have enough skills to cover every single area and topic and it is not efficient to be involved in absolutely everything. The topics that are important for us become clear during ongoing dialogues with stakeholders and from the assessments of our experts.

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A major problem that is described in this document is the amount of regulation and the negative impact this has in reducing competition and moving services into the unregulated grey area. Mainly for this reason we are in favour in the European Union of bringing down the current barriers between the markets of member states for the provision of financial services. This would make the financial markets more homogeneous, but at the same time there would be space alongside the very large actors for smaller ones as well. We rather see that the benefits of dividing and diversifying risks, including diversification through the number of market participants with different business models, are greater than those from convergence and concentration of risks and markets. Achieving this requires constant analysis at the European Union level of the current legal framework and bottlenecks in it, and a more critical eye towards new regulatory initiatives.

Finantsinspektsioon believes that the financial market will not be cleaned up nor the risks there managed better by having numerous standards, but rather by having strong institutions that apply the standards to particular situations. If institutions are weak, then having numerous standards gives a competitive advantage to those who apply them less forcefully. In a single market it is important that competitive advantage is not created through the member states. For this reason we are in favour of strong and if necessary centralised institutions in key areas, or the creation of such institutions.

Alongside the many regulated financial intermediaries operating in the Estonian market are those whose activities are less regulated. This includes savings and loan associations and crowdfunding platforms. On top of these, the public supervision model could also need to chart, analyse and optimise external auditors, especially those of institutions operating in the public interest. The insurance conciliation body set up by the Estonian Motor Insurance Bureau to settle insurance disputes has started work well, and the consumer disputes commission operates at the Consumer Protection Board. This has resolved relatively few out-of-court disputes concerning payment services, investment, savings and credit, next to its work with other disputes. Finantsinspektsioon is ready to help in analysing possible new areas for supervision and in setting positions on the usefulness of regulation and supervision, including setting up an out-of-court settlement body to deal with disputes concerning payment services, investment, savings and credit.

Financial supervision cases with a broader reach have indicated that important groups of stakeholders may have insufficient information on the nature and activities of financial supervision. Finantsinspektsioon believes that this needs to be systemically dealt with as a priority. The previous strategy to this one placed substantially more emphasis on relations with lobby groups and important domestic and foreign partners. As that strategy period ends, we have learnt from the shortcomings that have recently become apparent and have turned more attention to relations with media organisations and political parties. We find the communication with stakeholders should be deepened and made more systematic in the coming strategy period in order to support the good reputation and image of financial supervision.

Finantsinspektsioon informs the public about the risks of financial services, as this supports the supervision and resolution functions. It is by law one of Finantsinspektsioon's responsibilities to promote public understanding of financial services and financial products, and Finantsinspektsioon believes that the educated and aware consumer is a part of a fair and secure financial market. Consumer awareness is the first line of defence in the supervision of services.

Finantsinspektsioon plans to continue developing a website giving independent information on financial matters in order to achieve the goal of better public understanding of financial services. Such a website is a good way for giving warning to consumers of various dangers and for comparing prices. Finantsinspektsioon also plans to host information and training events jointly with the private and public sectors.