



FINANCIAL SUPERVISION AUTHORITY
ANNUAL REPORT 2007



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Beginning of financial year: 1 January 2007
End of financial year: 31 December 2007
Main field of activity: Exercising financial supervision
Management Board: Raul Malmstein, Andres Kurgpõld, Kaido Tropp, Kilvar Kessler (since 01.01.2008)
Auditor: AS PricewaterhouseCoopers

Financial Supervision Authority annual report for 2007

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I ● Address of the Chairman of the Management Board

Dear reader,

The financial world has been witnessing revolutionary developments since the summer of 2007. The stable growth of securities markets and the liquidity and stability of capital markets have been substituted by the instability of markets and a considerable growth in the price of money. Though these revolutionary developments have occurred on global markets, they have not left untouched also our national economy, i.e. the small open economy where the financial sector is closely integrated with Nordic financial markets. Rapid growth in economy is being substituted by the cooling down of economy, posing new and greater demands to market participants and to the financial supervision. The Financial Supervision Authority has done everything it could in order to ensure the stability and credibility of the Estonian financial sector in the face of an ever more challenging environment.

In 2007, we paid increasingly more attention to analyzing credit and liquidity risks of banks. Besides this additional analysis, we increased the role of various stress-tests both for credit institutions and insurance companies. Furthermore, I would like to emphasize the work done by major banks in implementing the risk-sensitive capital adequacy framework. The Financial Supervision Authority's task has been to assess the quality of this works and their risk management process. We are conducting comprehensive procedures for this purpose and the number of on-site inspections has considerably increased. It is important to note that the Financial Supervision Authority has increasingly improved its cooperation with supervisory agencies of its

adjoining countries, in particular with its Swedish colleagues. The efficiency and rapid development of the Financial Supervision Authority was highly ranked also by the IMF mission that was completed at the beginning of 2008 and that was focused on analyzing and assessing the Estonian financial stability framework.

We have continuously paid the attention to the improvement of anti-money laundering processes in banks. In this end we have conducted several on-site inspections during which we have been primarily focused on the implementation of "know your client" principle in case of non-resident companies registered in low tax regions. *Riigikogu* passed the new Money Laundering and Terrorist Financing Prevention Act on 19 December 2007. In the light of this new law, we are planning to increasingly improve the supervision over the adherence to legislation.

In 2007, we also commenced publishing reports on financial services that are aimed primarily at increasing the transparency of market. We continue to contribute into the promotion of consumer education. We seek to develop both the content and format in our consumer education portal www.minuraha.ee in order to bring complex issues closer to people and make them more understandable to consumers. Besides, we have translated our consumer education portal also into Russian, trying thus to provide balanced and objective information on issues related to financial services also to those Estonian citizens whose native language is not Estonian but who form a considerable part of service consumers.

As far as the securities market is concerned, it is important that the market witnessed the emergence of new issuers of securities despite of difficult market conditions. The substitution of rapid growth in the stock exchange with the fall in the last quarter of 2007 probably enforces the investors to re-evaluate their risk tolerance and the time horizon of investments. The adoption of the new Securities Market Act harmonizing *inter alia* the EU Financial Markets Directive MiFID was a very important event in the light of future developments. The Directive was aimed at improving the transparency of capital markets and both the rights of investors and the due diligence of financial service providers. We continue to take interest in issues related to the implementation of the new act also in 2008.

I would like to thank my colleagues for their good work!

Sincerely

A handwritten signature in black ink, appearing to be 'R. Malmstein', written in a cursive style.

Raul Malmstein
Chairman of the Management Board



2. Confirmation of the Financial Supervision Authority's Management Board

In Tallinn, 14 March 2008

This Annual Report was prepared by the Management Board of the Financial Supervision Authority and is submitted for approval to the Supervisory Board of the Financial Supervision Authority. The Annual Report is presented to the *Riigikogu*.

This Annual Report includes the following documents of the Financial Supervision Authority:

Management Report
Annual Report of Revenues and Expenditures
Balance Sheet
Auditor's Report

The Management Board of the Financial Supervision Authority confirms that all facts presented in the Annual Report are correct and the Annual Report of Revenues and Expenditures of the Financial Supervision Authority is in conformity with the Financial Supervision Authority Act and applied calculation principles.



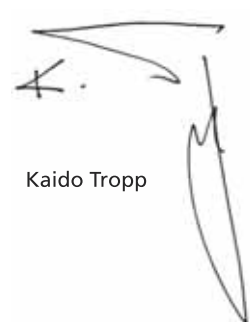
Raul Malmstein



Kilvar Kessler



Andres Kurgpöld



Kaido Tropp

3 • Financial Supervision Authority's Management Report

3.1. Short description of the Financial Supervision Authority

The Financial Supervision Authority is a financial supervision agency with autonomous competence and a separate budget, conducting financial supervision in the name of the state and being independent in its activities and decisions. The objective of the Financial Supervision Authority is to protect the interests of clients and investors by safeguarding their financial resources and thereby supporting the stability of the Estonian monetary system. Besides ensuring the stability of the Estonian financial sector, the objective of the Financial Supervision Authority is to increase the credibility and transparency of the financial sector. The Financial Supervision Authority also aims at contributing to the effectiveness of the financial sector, and its task is to ensure the functioning of an efficient, fair and competitive financial market. Work aimed at reducing systematic risks and preventing the abuse of the financial sector for criminal purposes is of major importance.

The Financial Supervision Authority's Strategy 2007–2010 which was approved by the Supervisory Board at the end of 2006 sets the following main objectives for the Financial Supervision Authority's activities: raising cross-border supervisory capabilities; growth in the proportion of preventive supervisory methods; raising the awareness of customers of financial services; an open communication and working culture; and the efficiency of activities and minimal bureaucracy through ensuring the competitiveness of the Estonian financial sector at the international level.

3.2. Management and organization

3.2.1. Activities of the Supervisory Board

The highest management and supervisory body of the Financial Supervision Authority is the Supervisory Board whose competence includes planning the activities of the Financial Supervision Authority and controlling its management.

Members of the Supervisory Board

As at 31 December 2007, the Supervisory Board of the Financial Supervision Authority included:

Chairman::

- **Ivari Padar**, Minister of Finance

Members:

- **Andres Lipstok**, President of the Bank of Estonia
- **Matti Klaar**, Honorary Swiss Consul in Estonia, insurance expert
- **Ruut Mägi**, Auditing expert
- **Andres Sutt**, Vice-President of the Bank of Estonia
- **Veiko Tali**, Deputy Secretary General for Financial Policy at the Ministry of Finance

3.2.2. Activities of the Management Board

Resolutions of the Supervisory Board

In 2007, the Supervisory Board held four meetings and a joint meeting with the Supervisory Board of the Bank of Estonia.

The Supervisory Board approved the 2006 Annual Report and the profit of the financial year within the amount of 4,007,670 kroons which was refunded to supervised entities in proportion to supervision fees paid by them for the financial year.

Due to the expiry of term of office of the members of the Management Board on 31 December 2007, the Supervisory Board decided to appoint Andres Kurgpõld and Kaido Tropp as members of the Management Board also for the following three years. The Supervisory Board decided to raise the number of members of the Management Board by one member, appointing Kilvar Kessler as the fourth member of the Management Board.

The 2008 budget of the Financial Supervision Authority in the amount of 60,720,973 kroons was approved and a proposal made to the Minister of Finance regarding the 2008 rates for the supervisory fee shares calculated on the basis of assets.

In planning the activities of the Financial Supervision Authority, the Supervisory Board drew attention to the importance of such issues as loan standards and credit and operational risks, as well as to the need for strengthening the cooperation with foreign supervisory agencies and to the importance of anti-money laundering activities.

The activities of the Financial Supervision Authority are managed and organized by the Management Board, which consists of four members and is simultaneously the management body and the administrative body. The Management Board has competence over the organization of all activities of the Financial Supervision Authority and making decisions related to the financial supervision.

Members of the Management Board

As at 31 December 2007, the Management Board of the Financial Supervision Authority included:

Chairman:

- Raul Malmstein (appointed as from 16 January 2006);

Members:

- Kaido Tropp (appointed for the third term of office as from 1 January 2008),
- Andres Kurgpõld (appointed for the third term of office as from 1 January 2008).

The term of office for the Chairman of the Management Board is four years and for the members three years.

Resolutions of the Management Board

In 2007, the Management Board held 57 meetings and made 125 administrative decisions: 7 precepts, 4 decisions for setting fines due to misdemeanors, and one decision regarding the closure of misdemeanor procedure. Among other decisions, 6 financial institutions received an activity license or a supplementary activity license, 45 providers of financial services were registered – mainly investment fund rules or amendments thereto and 10 listing particulars.

Priority issues for the Management Board included credit and liquidity risks, anti-money laundering and prevention of terrorist financing, as well as consumer education in financial services. The activities of the Management Board were focused on strengthening the administrative capacity and credibility of the Financial Supervision Authority, ensuring the stability of service

providers and maintaining the competitiveness of the Authority in labor market.

Core issues included also applications for using Internal Ratings Based Approach (IRB) and Advanced Measurement Approaches (AMA) for calculating capital requirements for operational risk, which were proceeded together with the Swedish Financial Supervisory Authority.

The Management Board headed towards using a more open supervisory model, whereby several administrative decisions relating to misdemeanors committed in the financial sector and made for protecting the interests of shareholders were publicly disclosed.

Members of the Management Board – areas of responsibility
The Supervisory Board of the Financial Supervision Authority appointed Kilvar Kessler as the fourth member of the Management Board as from 1 January 2008

Raul Malmstein, the Chairman of the Management Board, is responsible for strategy development, organizing the general management and activities of the Management Board, ensuring effective functioning of all supervisory activities and coordinating them, coordinating institutional development and national cooperation, coordinating international and public relations and international cooperation, organizing internal audit, organizing staff training and ensuring the functioning of internal communication.

His direct area of responsibility covers the following positions:

- Head of Communications
- Head of Human Resources
- Internal Auditor
- Coordinator of International Cooperation
- Assistant to the Chairman

Kilvar Kessler, the member of the Management Board, is responsible for the functioning and development of Market Supervision and Enforcement Division and Legal Department, including for coordinating the supervision of securities market and coordinating and preparing, if necessary, supervisory legal issues, developing the regulative environment of the financial sector, developing statements on financial and supervisory policy within his area of responsibility or together with other members of the Management Board, and directing international cooperation in his area of responsibility.

His direct area of responsibility covers the following divisions:

- Market Supervision and Enforcement Division
- Legal Department

Andres Kurgpöld, the member of the Management Board, is responsible for the functioning and development of Prudential Supervision, including for the supervision of credit institutions, insurers, investment firms and other supervised financial institutions, focusing on the monitoring of risks of supervised entities, their solvency and other prudential aspects. He is responsible for the process of market entry and market departure and ensuring that managers and shareholders are fit and proper, for developing the regulative environment of the financial sector, developing statements on financial and supervisory policy, focusing on capital regulation of supervised entities, for the process and development of regular reporting, and for directing international cooperation in his area of responsibility.

His direct area of responsibility covers the following divisions:

- Prudential Supervision Division
- Prudential Policy and Financial Reporting Division

Kaido Tropp, the member of the Management Board, is responsible for the functioning and development of Business Conduct Supervision Division and Administrative Services Department, including the supervision of financial services, for developing the regulative environment of the financial sector and statements on financial and supervisory policy in his area of responsibility, for organizing the notification procedures in case of cross-border services, the process of anti-money laundering and prevention of terrorist financing, budgetary process of the Authority, functioning and development of administrative services, developing and implementing IT security policy and procedures, and for directing international cooperation in his area of responsibility.

His direct area of responsibility covers the following divisions:

- Business Conduct Supervision Division
- Administrative Services Department

3.2.3. Organizational development, personnel policy and training

The objective of the personnel policy of the Financial Supervision Authority is to ensure high supervisory standards in the Authority's work, based on competent staff. In this end, the Financial Supervision Authority has developed its motivation mechanisms and training and recruitment policies.

As at 31 December 2007, 70 positions had been created in the Financial Supervision Authority and 64 positions thereof had been filled. Employment contracts had been suspended with 9 employees for the duration of parental leave. There were no major changes in the organizational structure or composition of staff in 2007.

43 women and 21 men were employed in the Financial Supervision Authority at the end of 2007. The average age of employees was 35 years. The core staff includes financial analysts, risk managers and lawyers. 98% of employees are with higher education qualifications. As at the end of 2007, 2 employees were enrolled in the Bachelor's Study Program, 7 were enrolled in the Master's Study Program, and 5 in the Doctoral Study Program.

Labor market changes that took place in 2007 are characterized by a more complicated recruitment situation. The Financial Supervision Authority regards highly its employees, offering motivating compensation packages and investing in the training and professional development of its employees. The wage policy of the Financial Supervision Authority is based on the principle that average wages have to be competitive on the labor market of the financial sector. The average wage was 21,211 kroons in 2007. Besides the wage, also other motivation factors became more important, e.g. internal climate and reputation of the organization. The Financial Supervision Authority contributed increasingly to the development of these values. The Financial Supervision Authority ranks very high also its cooperation with students and institutions of higher education, in order to make its recruitment policy more effective.

Values of the Financial Supervision Authority as an organization include competence, openness and decisiveness.

Training of employees

Planning of training is based on training and development needs of each and every employee. In 2007, employees of the Financial Supervision Authority participated both in national and international training events. Furthermore, also professional in-house training events were organized. Training expenses accounted approximately for 7% of salary expenditures. Training expenses per employee amounted to 18,892 kroons (including travel expenses). National in-service training programs were offered mainly for lawyers. Financial auditors, financial analysts and actuaries had to take advantage of international training opportunities, as virtually no national in-service training programs were offered in these areas.

The Financial Supervision Authority ranks the future development of its employees very high and offers them practical training opportunities in foreign supervisory agencies and other international organizations engaged in financial supervision.

3.2.4. Summary by the Internal Auditor

The position of an Internal Auditor of the Financial Supervision Authority has been created pursuant to the Financial Supervision Authority Act. The Internal Auditor is subordinated to and reports to the Management Board. The Management Board of the Financial Supervision Authority directs the activities of the Internal Auditor by approving the Internal Auditor's strategic plan for four years as well as more detailed working plans for every quarter. The mission of the Internal Auditor of the Financial Supervision Authority is to assist the management in achieving the goals of the organization in the best possible way and at reasonable cost.

The Internal Auditor followed the principles of the IIA Code of Ethics when planning and performing his activities. He followed international internal auditing standards to the extent possible and reasonable in a small organization. As in previous years, the Internal Auditor was able to perform his tasks independently and objectively.

In 2007, there were no significant changes in the Internal Auditor's main tasks or his organization of work, and his collaboration with the Management Board was excellent. The Management Board discussed and is discussing the Internal Auditor's memoranda and audit results when these are presented, as well as the Internal Auditor's statement of operations and his summary of major risks on a quarterly basis.

The Internal Auditor's activities in internal auditing area were mainly based on his Strategic Plan 2007–2010, based on which the Internal Auditor audited mainly the following two areas in 2007: core activity of the Financial Supervision Authority i.e. carrying out financial supervision, and the internal life and organization of work within the Authority. The most important areas covered by audits of the Authority's core activity included the evaluation of procedures for handling license applications of credit institutions and insurance companies; evaluation of the organization of information exchange between the Authority and foreign financial supervision agencies; evaluation of on-site inspections, cooperation with law enforcement authorities, and advisory guidelines providing guidance to the activities of

supervised entities. The most important areas covered by audits of the Authority's internal life and organization of work included the evaluation of adherence to the Code of Ethics, organization of communication and information exchange, risks of legislative process, as well as the organization of IT work.

The Internal Auditor discovered no cases of significant misuse or misapplication of funds nor any significant violations of budgetary discipline during the audits of the Authority's internal life and organization of work and the proceedings conducted by the Internal Auditor in 2007. Management and control systems of the Financial Supervision Authority functioned, to a large extent, as might have been reasonably expected. The level of discipline was high when implementing decisions of the Supervisory Board and the Management Board, as well as directives from the Chairman of the Management Board. The Internal Auditor considers that the Management Board provided continuous support to raising the reputation and credibility of the Authority and to improving its competitiveness on the labor market.

The rules for the prevention of conflicts of interests functioned according to the requirements provided by law, and the officials of the Financial Supervision Authority regarded the prevention of conflicts of interests with adequate sense of responsibility. Nevertheless, six years of experience show that it is in the interests of legal clarity and legal certainty to change the existing legislation on the prevention and detection of possible conflicts of interests.

The Internal Auditor recommends that the Authority should in 2008 focus *inter alia* on the quality improvement of the analysis on the impact of legislation when preparing and coordinating draft legislation and drafting advisory guidelines. The Authority should also focus on the improvement of cooperation with law enforcement authorities in preventing, discovering and proceeding financial crimes and effecting administrative coercion. Furthermore, the Internal Auditor suggests paying attention to the prevention of emergency situations within the financial system in cooperation with the Ministry of Finance and the Bank of Estonia.

3.3. Supervisory activities

3.3.1. Issuing new licenses and registering prospectuses for public offers

Issuing of licenses

In 2007, the Financial Supervision Authority issued permits for the commencement of activities to:

- AS SEB Enskilda to operate as an investment fund;
- AS Trigon Alternative Funds to operate as a fund management company;
- AS GILD Property Asset Management to operate as a fund management company;
- AS GILD Fund Management to operate as a fund management company of venture capital funds.

The following market participants extended the package of financial services they are offering and the Financial Supervision Authority issued respective supplementary licenses:

- AS GILD Financial Advisory Services – a supplementary license to offer the following services: trading for its own account and guaranteeing the issue of securities;
- AS Hansa Varakindlustus – a supplementary license to underwrite the following non-life insurance classes: accident insurance, sickness insurance, motor third party liability insurance, financial loss insurance.

In 2007, the Financial Supervision Authority issued a permit to AS Seesam Elukindlustus to merge with Latvian and Lithuanian insurance companies that belong to the same group. As a result of this merger, a European Company named Seesam Life Insurance SE (abbreviation from Latin words *Societas Europaea*) was established with its head office in Tallinn.

A European Company is formed by a parent undertaking that has branches in one or more member states. The main difference between a European Company and any other type of company is that the European Company can change its country of registration without facing significant regulatory requirements.

Seesam Life Insurance SE is the second European Company besides SE Sampo Life Insurance Baltic that is supervised by the Financial Supervision Authority.

Table 1. Licenses issued in 2007

| Field of activity | License holder |
|-------------------------|---|
| Investment fund | AS SEB Enskilda |
| Investment fund | GILD Financial Advisory Services (supplementary license) |
| Fund management company | AS Trigon Alternative Funds |
| Fund management company | AS GILD Property Asset Management |
| Fund management company | AS GILD Fund Management |
| Insurer | AS Hansa Varakindlustus (supplementary license) |

Branch licenses (freedom of establishment)

Branches of financial institutions of European Union (EU) Member States operating in Estonia can offer any of the financial services which they are authorized to offer in their home country. The supervision of such financial institutions from other EU Member States is based on the principle of mutual trust. The supervisory agency in the country of origin is responsible for supervising such branches. Branches are not subject to local capital requirements and restrictions. Nevertheless, branches have to follow Estonian legislation, guidelines of the Financial Supervision Authority and public interest requirements.

Despite this, the Financial Supervision Authority still requires supervisory reports from all branches of foreign credit institutions, in order to examine how the activities of these branches may affect market participants acting on the basis of a license issued in Estonia. Where a foreign financial institution offers its services in Estonia through a subsidiary undertaking, the Financial Supervision Authority exerts full supervision over this subsidiary undertaking.

In 2007, financial institutions registered in other EU Member States established three branches in Estonian.

Two market participants authorized in Estonia established branches in other European countries. One of them, Seesam Life Insurance SE, established branches during the formation of the European Company.

Table 2. Branches established in 2007

| Field of activity | Branches in Estonia | |
|--------------------|----------------------------|---------------------------|
| Credit institution | Allied Irish Bank PLC | branch in Estonia |
| Credit institution | Bank DnB Nord | branch in Estonia |
| Non-life insurance | QBE Insurance (Europe) Ltd | branch in Estonia company |

Table 2a. Branches established in 2007

| Field of activity | Branches in other European countries | |
|--------------------|--------------------------------------|----------------------------------|
| Credit institution | Balti Investeeringute Grupi Pank AS | branch in Lithuania |
| Insurer | Seesam Life Insurance SE | branches in Latvia and Lithuania |

Table 3. Major holdings acquired in 2007

| Field of activity | Subject | Applicant |
|--------------------------------|----------------------------|---|
| Stock exchange operator | AS Tallinna Börs | Borse Dubai Ltd (<i>indirect holding</i>) |
| Stock exchange operator | AS Tallinna Börs | Nasdaq Stock Market Inc (<i>indirect holding</i>) |
| Fund management company | ERGO Varahalduse AS | ERGO Elukindlustuse AS |
| Fund management company | ERGO Varahalduse AS | ERGO Lietuva Gyvybes Draudimas |
| Fund management company | AS Avaron Asset Management | OÜ Avaron Capital |
| Credit institution | AS Sampo Pank | Danske Bank A/S |
| Credit institution | AS SBM Pank | Marfin Popular Bank Ltd |
| Central register of securities | AS Eesti Väärtpaberikeskus | Borse Dubai Ltd (<i>indirect holding</i>) |
| Central register of securities | AS Eesti Väärtpaberikeskus | Nasdaq Stock Market Inc (<i>indirect holding</i>) |

Major holding proceedings

Persons who wish to acquire a major holding in a financial institution that is authorized in Estonia must meet the so-called fit&proper criteria. The main requirements are: impeccable business reputation, transparent business relations and the ability to ensure prudent management of the company. If the Financial Supervision Authority considers that the respective person does not meet these criteria, it is entitled to prohibit the acquisition of a major holding.

In 2007, the Financial Supervision Authority conducted 9 major holding proceedings. Two applicants out of seven were Estonian residents, three were EU residents and two were from third countries. The Financial Supervision Authority made a confirmative decision in all these cases.

Provision of cross-border services

Financial institutions authorized in other European Union Member States need not apply to the Financial Supervision Authority for a license to provide financial services in Estonia. The provision of cross-border services may commence after the foreign supervisory agency has informed the Financial Supervision Authority of the financial institution's wish to offer its services in Estonia and has communicated the information required by legislation.

In 2007, the rapid growth of the number of providers of cross-border services continued, noticeable in particular in the area of investment services.

Table 4. Providers of cross-border services in Estonia

| | Number of providers as at 31.12.2006 | Number of providers as at 31.12.2007 |
|-----------------------------|---|---|
| Insurance agent services | 974 | 1082 |
| Insurance broker services | 495 | 615 |
| Investment services | 62 | 367 |
| Non-life insurance services | 215 | 272 |
| Banking services | 128 | 183 |
| Life insurance services | 58 | 64 |
| Investment funds | 46 | 58 |
| Fund management services | 7 | 9 |
| E-money services | 4 | 7 |

Table 5. Providers on cross-border services in the European Union (added in 2007)

| Field of activity | Supervised entity | Provides services (country) |
|-------------------------|-------------------------------------|--|
| Fund management company | AS Avaron Asset Management | Latvia |
| Investment firm | AS Evli Securities | Latvia |
| Investment firm | AS GILD Financial Advisory Services | Latvia, Lithuania, Finland, United Kingdom |
| Credit institution | AS Hansapank | Poland |
| Credit institution | AS SEB Eesti Ühispank | Poland |
| Insurer | AS IF Eesti Kindlustus | Sweden, Romania and Bulgaria |
| Insurer | Ergo Kindlustuse AS | Latvia and Lithuania |



Inclusion into the list of insurance intermediaries

In Estonia, insurance intermediaries include insurance brokers and insurance agents. Insurance brokers represent the interests of policyholders. An insurance agent mediating services of a specific insurer represents the interest of that insurer.

As at 31 December 2007, there were 20 insurance brokers and 1131 insurance agents operating in Estonia.

In 2007, three insurance brokers were included into the list of insurance brokers and three insurance brokers were erased from that list. The Financial Supervision Authority refused to include one insurance broker into the list of insurance brokers.

2007 inclusions into the list of insurance intermediaries:

Table 6. Insurance brokers included into the list in 2007

| | |
|------------------|--|
| Insurance broker | CHB Kindlustusmaakler OÜ <i>(named ECE Kindlustusmaakler when the application was submitted)</i> |
| Insurance broker | Lõuna Kindlustusmaakler OÜ <i>(named E.W.R. Kindlustusmaakler when the application was submitted)</i> |
| Insurance broker | Krooni Kindlustusmaaklerid OÜ |

Insurance agents are included into the list of insurance agents by the insurance company represented by the agent. The list of insurance agents is available on the website of the Financial Supervision Authority: www.fi.ee.

Registration of prospectuses for public offers

In 2007, the Financial Supervision Authority registered 10 prospectuses for public offers:

Arco Vara AS, Balti Investeeringute Grupi Pank AS, AS Ekspress Grupp, OÜ Manutent, OÜ Manutent Bond Program, AS Otepää Golf, PTA Grupp AS (new name – AS Silvano Fashion Group), Saaremaa Golfi AS, UAB E-Energia, AS Viisnurk.

3.3.2. Risk analysis and monitoring the activities of market participants

Banks

A effective supervision of credit institutions has a major role to play in guaranteeing the stability of the Estonian financial system. In 2007, the risk analysis of credit institutions was based on usual monthly and quarterly cycles and it covered all credit institutions authorized in Estonian and partly also branches of foreign credit institutions.

Besides monitoring the environment and market developments, major risk areas of credit institutions – credit risk, operational risk, liquidity risk, market risk, etc. – are evaluated during such an analysis, based both on quantitative and qualitative information. Furthermore, also the profitability of banks and adherence to the requirements are examined. Results of this analysis have always been an important input when planning supervisory activities.

In the light of developments in economic environment and real estate market, the Financial Supervision Authority has continuously focused its attention on monitoring mortgage loans. This monitoring includes the volume of mortgage loans and changes in conditions for granting loans, financing of commercial real estate and development projects, as well as the quality of mortgage loans. The Financial Supervision Authority performed an additional analysis in 2007, in order to evaluate better the risks related to loans that are granted in exchange of a mortgage.

Insurance companies

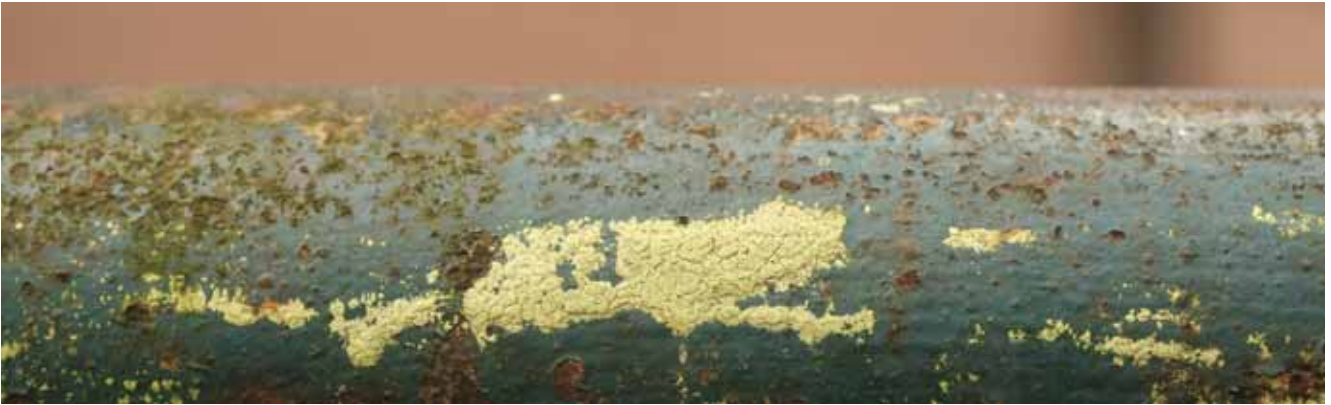
The supervision of insurance sector was continuously focused on analyzing the insurance risk and market risk and on developing respective methods within the internal process of prudential supervision analysis.

The supervision of life insurance sector was continuously focused on the evaluation of asset/liability structure due to the rapid growth in the life insurance sector and to the concurrent increase in technical provisions and investments necessary for covering the financial burden as well as to the diversification of investment portfolios. A special methodology – stress testing – was developed to this end already in 2006. Market fluctuations necessitated regular stress testing – tests were performed both on a half-year and yearly basis. Stress testing was aimed at evaluating the effects that the decline of financial markets has on the insurer.

Due to the reporting obligation imposed on branches in 2007, the Financial Supervision Authority had a better overview of the Estonian non-life insurance market which allowed the Authority to evaluate better the competition-driven risks in the insurance sector.

Insurance intermediaries

The supervision of insurance intermediaries was primarily focused on developing professional standards for insurance brokers in order to ensure that brokers adequately identify the policyholder's insurable interest and give independent advice for the conclusion of insurance contracts.



Investment funds

The Financial Supervision Authority focused in the supervision of investment funds on verifying the compliance with investment restrictions set for investment and pension funds. On the basis of monthly reports presented by fund management companies, the conformity of investments to investment restrictions provided in legislation and fund' terms and conditions are regularly checked. Investment and pension funds registered in Estonia have made approximately 3229 investments in total. The Financial Supervision Authority revealed no violations of legislation and funds' terms and conditions in 2007.

As before, the Financial Supervision Authority paid special attention to the information presented on investment and pension funds, including the information presented in advertisements for funds and on Internet sites belonging to fund management companies.

In 2007, the Financial Supervision Authority registered terms and conditions for 17 new investment funds and amendments to terms and conditions of 37 investment funds, of which 20 were amendments to the terms and conditions of pension funds. When amending the terms and conditions, the Financial Supervision Authority verified their completeness and clearness as well as their conformity to legislation.

Investment firms

In 2007, the supervision of investment firms was focused mainly on verifying the adherence to prudential standards and analyzing changes in the portfolio of investment firms. The supervision of investment firms is primarily based on quarterly supervisory reports. In case of larger and more active market participants an additional monthly risk monitoring is conducted; this monitoring allows the timely discovery of risks or violations of legislation.

Securities market

3 new stock issuers were listed on the Tallinn Stock Exchange in 2007. For the first time, the Financial Supervision Authority forwarded under the Securities Market Act the prospectuses for open offers and trading of 2 stock issuers – Olympic Entertainment Group AS and Arco Vara – to the Republic of Poland where the securities of these issuers were admitted to trading on the Warsaw Stock Exchange.

In 2007, the supervision of securities market was mainly characterized by the entry into force of the new wording of the Securities Market Act on 19 November 2007, whereas its main amendments were related to transposing the requirements of Financial Instruments Directive (2004/39/EC), Takeover Bids Directive (2004/25/EC) and Transparency Directive (2004/109/EC). Transposition of directives necessitated the development of new IT applications and specifications. The biggest project was the development of practical and technical solution for the transaction reporting notification system and the accompanying training of market participants. Transaction reporting notification system enables the participation in trans-European system for exchanging transaction reports and forms in future a part of an automatic supervisory system for the identification of market abuse developed by the Financial Supervision Authority.

3.3.3. On-site inspection of market participants

In 2007, the Financial Supervision Authority focused on monitoring the adherence to Corporate Governance requirements by evaluating the information that was presented in Corporate Governance reports submitted by issuers for the first time together with 2006 Annual Report. Monitoring the adherence to Corporate Governance requirements is one of the priorities also in following years due to inconsistent level of Corporate Governance reports.

As to the financial reporting, the Financial Supervision Authority focused mainly on verifying the segment reporting. There were no significant changes in the quality of reports as compared with 2006 reports. In general, issuers had taken into account the observations made formerly by the Financial Supervision Authority. The Financial Supervision Authority aims continuously at raising the quality of data submitted at reports; achievement of this aim will eventually contribute to the improvement of credibility and transparency .

Banks

In 2007, the Financial Supervision Authority conducted on-site inspections in AS Hansapank and AS Sampo Pank.

The following issues were examined during on-site inspections conducted in 2007:

- Implementation of anti-money laundering procedures;
- Procedures for creating relations with non-resident customers;
- Handling of personal data;
- Management of problems and incidents;
- Ensuring functional consistency.

Special attention was paid to IT, including areas related to the processing of personal data. The Financial Supervision Authority focused also on the compliance with anti-money laundering procedures, evaluating the adequacy of relevant internal rules of procedure and examining relations with high-risk customers. The latter includes in particular non-resident companies registered in low tax regions. The Financial Supervision Authority evaluated mainly the effectiveness of measures implemented in order to ascertain the origin of actual economic activity of such customers, final beneficiaries and funds involved in transactions.

3.3.4. Basel II and internal risk assessment methods

Insurance companies

In 2007, on-site inspections of the following insurance companies were conducted: AS Salva Kindlustus, Inges Kindlustus AS and AS Hansa Varakindlustus

The following issues were examined during on-site inspections conducted in 2007:

- Handling of insurance losses;
- Processing of personal data;
- Organization of IT area;
- Internal control environment and the operation of internal audit function.

Furthermore, on-site inspections covered also calculation principles and adequacy of insurer's outstanding claims provision.

Insurance intermediaries

In 2007, the Financial Supervision Authority conducted on-site inspections at Balti Kindlustusmaakleri OÜ and SEB Ühisliisingu Kindlustusmaakler AS.

The following issues were examined during on-site inspections conducted in 2007:

- Performance of an obligation to identify the customer's insurable interest;
- Processing of personal data.

Fund management companies, investment funds and investment firms

The Financial Supervision Authority conducted no on-site inspections with regard to fund management companies, investment funds and investment firms. The Authority organized meetings with the management of investment firms for supervisory purposes and continued also with regular monitoring of financial data.

In 2007, the Financial Supervision Authority continued active preparations for passing over to the new capital adequacy framework that is based on international capital adequacy standard developed by the Committee of European Banking Supervisors in Basel (also known as Basel II). Basel II is aimed at improving the conformity of capital requirements of financial institutions to their actual risk level, in order to maximize the stability and credibility of the financial system. Besides, Basel II emphasizes the promotion of good practices in risk management, as it is the risk management that is the so-called first protection line to safeguard customers' assets.

In Estonia, credit institutions and investment firms switch over to the principles of Basel II during the year 2008. Similar, more risk-sensitive framework (also known as Solvency II) is being currently developed for insurers. Implementation of Basel II leads to significant changes, e.g. an obligation to calculate the capital requirement for covering operational risk and enabling more precise internal risk assessment methods when calculating capital.

As the implementation of internal risk assessment methods is allowed only when approved by the Financial Supervision Authority, the Authority commenced with examining applications that were submitted by credit institutions in 2007 in order to switch over to internal assessment systems for credit risk and operational risk. Several on-site inspections were conducted where also supervisory agencies of Sweden and other Baltic countries participated. Inspections were aimed at evaluating the credibility of the design of internal risk assessment methods (models) intended for use by credit institutions, the adequacy of underlying time-series and forecasting abilities of such models.

3.3.5. Anti-money laundering

The year 2007 was characterized by the implementation of the Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (so-called the third anti-money laundering directive) in the Estonian legal system. Representatives of the Financial Supervision Authority participated actively in the working group established for drafting a new act on the prevention of money laundering and terrorist financing pursuant to this directive. Draft act was presented to *Riigikogu* at the end of 2007. *Riigikogu* adopted the new Money Laundering and Terrorist Financing Prevention Act on 19 December 2007.

Once again, the legality of activities of institutions distributing e-money and other similar instruments was evaluated. In 2007, the Public Prosecutor's Office opened a proceeding based on the petition of the Financial Supervision Authority, in order to decide whether companies, whose core activity as an e-money institution includes the provision of e-money services, are engaged in illegal economic activities, as the Financial Supervision Authority has not authorized them. The proceeding was closed in 2007 due to the lack of component factors.

A member of the Management Board of the Financial Supervision Authority and the head of anti-money laundering unit participated periodically in the Government Commission established for coordinating the issues related to the prevention of money laundering and terrorist financing. Members of the Commission were introduced to anti-money laundering measures and characteristic problems discovered during on-site inspections. Furthermore, the Authority held regular meetings with officials from the Prosecutor's Office, Central Criminal Police and Financial Intelligence Unit. These meetings were aimed at the clarification of positions and mapping of common priorities. Officials of the Financial Supervision Authority participate also in the anti-money laundering task force of the Estonian Banking Association.

3.4. Transparency of financial services and consumer policy

3.4.1. Priorities of the Financial Supervision Authority and measures for educating consumers

One of the strategic goals of the Financial Supervision Authority is to raise the awareness of consumers. The need to raise consumers' educational level stems from the developed financial services market witnessing constant emergence of new products and services which are intertwined with each other and the consumption of which is inevitable nowadays. A consumer being acquainted with financial services enters into a contract with higher level of awareness, limiting thus the possibility of subsequent disputes with the providers of financial services. The competence of a consumer in concluding a contract adds significant value to ensuring the effective functioning of the market.

In 2007, the Financial Supervision Authority developed further the on-line environment www.minuraha.ee by improving its practicality. It opened also the Russian version of www.minuraha.ee. The number of consultations in www.minuraha.ee increased in 2007 approximately threefold in comparison with the beginning of the year, whereas users of the portal were mostly interested in credit, investment and travel insurance services. In order to increase the number of consultations, the Financial Supervision Authority has started to cooperate with market participants who provide information about the existence of the portal via their distribution channels. Furthermore, a broadcast serial educating consumers of financial services and introducing the portal www.minuraha.ee was played in cooperation with the radio channel *Vikerraadio*. Besides providing basic knowledge of the consumption of financial services, the objective of this consumer information website is to create an active communication environment and provide constantly updated and timely information.

In 2008, the Financial Supervision Authority increases the funding of www.minuraha.ee and other actions related to consumer education, creating two new positions for this purpose.

Transparency of financial services

The Financial Supervision Authority started to publish consolidated reports of financial services in 2007, in order to provide an overview of the volumes and market shares of financial services provided in Estonia. These reports cover primarily banking, fund-related, investment and insurance retail services. They provide, *inter alia*, the shares of Estonian resident consumers by various financial services. Financial services reports increase significantly the transparency of the Estonian financial services market, providing thus market participants and customers with a better footing for decision-making. Consolidated semi-annual reports of financial services are published on the website of the Financial Supervision Authority.

Requirements for insurance mediation

One of the goals of the Financial Supervision Authority in the insurance sector is to safeguard the clearness of insurance services. In 2007, the Financial Supervision Authority approved the Advisory Guidelines on General Requirements to Insurance Mediation, specifying requirements to insurance brokers and insurance agents pursuant to the Insurance Activities Act. The main goal of instructions provided in these Guidelines is to direct service providers to identify the insurable interest of policyholders, so that the customer could choose and the insurance intermediary offer the most suitable insurance contract. These Guidelines came into force on 1 February 2008.

3.4.2. Consumer applications to the Financial Supervision Authority

The principles and competencies of the Financial Supervision Authority are regulated by the Financial Supervision Authority Act as well as by legislation regulating the conduct of insurance companies, credit institutions, fund management companies and investment firms. The Financial Supervision Authority is not competent to settle complaints by customers of financial services, i.e. to issue mandatory precepts to the parties. The Financial Supervision Authority can provide an independent opinion on a situation at hand and, where necessary, can commence supervisory proceedings according to the respective legislation with regard to a bank, an insurance company or any other provider of financial services, in order to ensure the transparency and credibility of the financial services market as well as the adequacy of internal procedures of the service provider. The Financial Supervision Authority is glad to note that market participants are generally taking into account the opinions of the Financial Supervision Authority when they solve consumer disputes.

On the basis of registration and systematization of applications, the Financial Supervision Authority gets an overview of main disputes on the financial services market and of their frequency.

When comparing 2007 data with data from 2006, one can notice the increased proportion of insurance-related disputes. Applications related to insurance services have roughly doubled in comparison with 2006. The Financial Supervision Authority received in total 82 applications in 2007, whereof 56 were related to insurance services. In 2006, the Financial Supervision Authority received 72 applications.

Most of the applications submitted with the Financial Supervision Authority in 2007 were related to voluntary land vehicles insurance and property insurance (mostly home insurance). The share of applications related to banking and investment services was considerably smaller. Activities of investment and pension funds caused no applications.

Main reasons for disputes in the insurance sector: parties' interpretation of terms and conditions did not match; customers had a shallow understanding of the rights and obligations of parties before entering into the insurance contract. Besides, disputes between customers and insurance companies concerned also adherence to the indemnification deadlines by insurers and their refusal to pay the indemnity.

The most common problems in the banking area were primarily related to different interpretation of loan contract conditions or to the fact that customers had a shallow understanding of the rights and obligations of parties before entering into the loan or credit contract. Problems with payment services were related to transactions made with cash machines, everyday payment transactions and the issue of guaranteeing the transparency of bank service fees.

¹ Market shares of life insurance companies do not include branch data.

² Note: market shares as at 31.12.2007. Market share numbers are approximate; market shares in insurance are based on insurance premium payments, those in banking are based on the volume of assets.

Number of applications to the Financial Supervision Authority in 2007 by areas of service and service providers¹:

Table 7

| Area of service | No of applications |
|-------------------------------|--------------------|
| Land vehicles insurance | 17 |
| Property insurance | 13 |
| Motor TPL insurance | 10 |
| Loans/credits | 9 |
| Travel insurance | 8 |
| Investment services | 8 |
| Settlements | 6 |
| Life insurance | 6 |
| Leasing | 2 |
| Deposits | 1 |
| Pension insurance (annuities) | 1 |
| Civil liability insurance | 1 |
| Total | 82 |

Number of applications to the Financial Supervision Authority in 2007 by service providers:

Table 8

| Service provider | No of applications | Market share in its sector ² |
|-------------------------------------|--------------------|---|
| AERGO Kindlustuse AS | 13 | 23.0% |
| Seesam Rahvusvaheline Kindlustus AS | 11 | 14.0% |
| AS Hansapank | 9 | 52.0% |
| AS IF Eesti Kindlustus | 8 | 31.0% |
| AS SEB Eesti Ühispank | 8 | 22.6% |
| Parex Kindlustus Eesti filiaal | 6 | 3.0% |
| AS Hansa Elukindlustus | 4 | 45.0% |
| Balti Investeeringute Grupi Pank AS | 4 | 0.8% |
| Salva Kindlustuse AS | 3 | 9.0% |
| QBE Kindlustuse Eesti AS | 3 | 3.0% |
| AS SEB Ühispanga Elukindlustus | 2 | 30.0% |
| AS Inges Kindlustus | 2 | 4.0% |
| AS E-Kindlustus Kindlustusmaakler | 2 | 23.0% |
| AS SEB Ühisliising | 1 | N/A |
| AS Eesti Krediidipank | 1 | 1.4% |
| AS Sampo Pank | 1 | 11.4% |
| AS Hansa Varakindlustus | 1 | 10.0% |
| BTA Kindlustuse AS | 1 | 2.0% |
| Tallinna Äripanga AS | 1 | 0.5% |
| AS Sampo Liising | 1 | N/A |
| Total | 82 | |

Application dynamics:

Table 9

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|--------------|------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Banks | - | - | 26 | 12 | 16 | 28 | 36 | 24 |
| Insurance | 232 | 86 | 49 | 29 | 41 | 42 | 30 | 56 |
| Other | - | - | - | 5 | 1 | 4 | 6 | 2 |
| Total | 232 | 86 | 78 | 46 | 58 | 74 | 72 | 82 |

3.5. Development of regulative environment

3.5.1. Overview of the development of the regulative environment

The task of the Financial Supervision Authority in the development of legal environment is first of all to make proposals for adopting and changing legal acts and other legislation related to the financial sector and its supervision and to participate in the preparation of relevant draft legislation. Furthermore, the Financial Supervision Authority must provide evaluations of the amendments to legislation in force as well as to new regulations that are being drafted. Pursuant to the Financial Supervision Authority Act, draft legislation regulating a supervised entity or the activities of the Financial Supervision Authority or having in some other way an effect on the achievement of supervisory objectives must be approved by the Financial Supervision Authority.

Credit institutions and Savings and Loan Associations

In 2007, the Financial Supervision Authority and the Ministry of Finance continued their cooperation in preparing the Savings and Loan Associations Draft Act and the Draft Act to Amend the Credit Institutions Act, in order to update the provisions of the Savings and Loan Association Act and to upgrade the Credit Institutions Act in respect of the provisions on the establishment of an association bank and the rules applicable to the members of an association. Main problem areas were: conformity of amendments to the Savings and Loan Associations Act to the Commercial Associations Act; number of members of a savings and loan association; and providing services to third persons.

The Savings and Loan Associations Act and the Draft Act to Amend the Credit Institutions Act were duly approved and presented to the Government for approval.

The following Eesti Pank Governor's Decrees that entered into force in 2007 and at the beginning of 2008 were prepared in cooperation of the Bank of Estonia:

- Eesti Pank Governor's Decree No 4, Reports on prudential ratios of credit institutions and consolidation groups of credit institutions;
- Eesti Pank Governor's Decree No 9, Establishment of supplementary reports on credit institutions' balance sheet;
- Eesti Pank Governor's Decree No 16, Establishment of off-balance-sheet reporting of credit institutions;
- Eesti Pank Governor's Decree No 20, Disclosure of information on credit institutions' risk management, solvency margin and capital adequacy and establishment of supplementary reporting.

Besides, several previously enacted regulations were also elaborated and updated.

The Financial Supervision Authority provided its opinion on the inquiry of the Estonian Banking Association of 12 January 2007 to the Constitutional Committee of *Riigikogu* regarding the draft act to amend the Personal Data Protection Act. The Financial Supervision Authority considered that financial service agreement must clearly and exhaustively specify persons to whom the customer or contract data is forwarded or is made available, in order to allow the customer to decide the extent to which he wishes to make his data available to other persons.

Insurance business

The Act Amending the Insurance Activities Act, the Financial Supervision Authority Act and the Personal Data Protection Act came into force on 1 January 2008. The Insurance Activities Act was renewed due to the transposition of the Directive 2005/68/EC of the European Parliament and of the Council. Amendments concerned the activities of a reinsurer and prudential norms, but the underlying principle formerly in force remained generally unchanged, i.e. provisions on insurers specified in the Insurance Activities Act are applied also to reinsurers, unless otherwise provided in the law. The Insurance Activities Act was also amended due to the transposition of the Directive 2004/113/EC implementing the principle of equal treatment between men and women in the access to and supply of goods and services. Besides the amendments made pursuant to these directives, the Insurance Activities Act was also amended in other aspects: the definition of "customer" was changed; the objective of processing personal data was specified; and the amount of personal data processed in insurance was specified.

The Act Amending the Motor Third Party Liability Insurance Act, the Insurance Activities Act and the Traffic Act entered into force on 2 November 2007. Amendments were made due to the new Directive 2005/14/EC of the European Parliament and of the Council amending Council Directives 72/166/EEC, 84/5/EEC, 88/357/EEC and 90/232/EEC and Directive 2000/26/EC of the European Parliament and of the Council relating to insurance against civil liability in respect of the use of motor vehicles (so-called the Fifth Motor Insurance Directive). Besides implementing this directive, the agenda includes adjustments to provisions related to the conclusion of third party motor liability insurance contracts and compensations for damage, bringing the terminology up to date and adjusting the regulations governing the Motor Third Party Liability Insurance Guarantee Fund.

The Financial Supervision Authority has an important role in issuing regulations on insurers' activities. In 2007, the following regulations were amended in cooperation with the Ministry of Finance: Minister of Finance Regulation No 33 of 13.04.2005, Establishment of insurer's supervisory reporting and requirements to preparation and disclosure of interim reports; and Minister of Finance Regulation No 34 of 13.04.2005, Establishment of insurers' reporting forms, their content and submission deadlines. Also the following regulation was drafted: Minister of Finance Regulation No 20, Preparation and submission of reports by Estonian branches of insurers from contracting countries.

These regulations govern the content, form and preparation of reports of insurers and branches of foreign insurers, as well as procedures for their submission and disclosure and also deadlines

Securities market

The Act Amending the Securities Market Act, the Financial Supervision Authority Act, the Authorized Public Accountants Act, the Investment Funds Act, the Credit Institutions Act and the Commercial Code entered into force on 19 November 2007. Preparation of the Draft Act to amend these acts commenced in 2006 in order to harmonize the Directive 2004/39/EC of the European Parliament and of the Council (Markets in Financial Instruments Directive – MiFID), its implementing Directives 2006/73/EC and 2004/109/EC (Transparency Directive – TD), its implementing Directive 2007/14/EC and to transpose European Parliament and Council Directives 2006/48/EC and 2006/49/EC (new Capital Requirements Directive) and Directive 2004/25/EC of the European Parliament and of the council on takeover bids (Takeover Bids Directive).

In connection with the enforcement of amendments to the Securities Market Act, the following regulations were adopted on 14 November 2007: Minister of Finance Regulation No 52, Procedures for notifying the Financial Supervision Authority of transactions in securities; and Minister of Finance Regulation No 51, Requirements for presenting information and reports to customers in connection with the provision of investment services. Regulation No 52 provides in accordance with Article 91 (8) of the Securities Market Act more detailed methods and technical rules for notifying the Financial Supervision Authority of transactions in securities, authorized data medium and ways of transfer, as well as correction of data provided on transactions. Regulation No 51 enacted pursuant to Article 92 of the Securities Market Act provides specific requirements to information and reports presented to customers in connection with the provision or offering of services related to investment services or investment-related services.

Prevention of money laundering and terrorist financing

Money Laundering and Terrorist Financing Prevention Act that became effective in 1999 and was substantially amended in 2004 was applied in Estonia until 28 January 2008. The new Money Laundering and Terrorist Financing Prevention Act was drafted in 2007, in order to transpose into Estonian law the Directive 2005/60/EC of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing and the Commission Directive 2006/70/EC laying down implementing measures for Directive 2005/60/EC as regards the definition of "politically exposed person" and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis.

The new Act enforced as of the end of January 2008 (adopted on 19 December 2007) maintains generally the principles and solutions as well as the framework of money laundering and terrorist financing provided in the previous act, still substantially upgrading them on the basis of directives mentioned above. E.g. the definitions of money laundering and financial institution were amended and extended and the beneficial owner defined and the term "due diligence" was taken into use. More precise requirements were provided governing obligated persons who must identify and verify the identity, as well as situations where it is necessary to identify and verify the identity. The range of persons who are obliged to implement the requirements of the Money Laundering and Terrorist Financing Prevention Act was extended. The Act specifies the activities of obligated persons in identifying and verifying the identity of their customers.

Besides these directives, the development of the new Money Laundering and Terrorist Financing Prevention Act was also based on the 40 Recommendations and 9 Special Recommendations of FATF³. The implementation of these recommendations is ensured by on-site evaluations of FATF, IMF⁴ and regional representations of FATF, including the MONEYVAL⁵ (Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism of the Council of Europe's Committee of Ministers). The MONEYVAL evaluation visit to Estonia took place in February 2008.

Amendments to the Commercial Code

The Act amending the Commercial Code and related legislation entered into force on 15 December 2007. The amendment of the Commercial Code, the Commercial Pledges Act, the Credit Institutions Act, the Securities Market Act, the Investment Funds Act, the Insurance Activities Act, the Electronic Money Institutions Act and the Community-Scale Involvement of Employees Act stemmed from the need to introduce the regulation of cross-border undertakings into the Estonian legislation, based on the Directive 2005/56/EC of the European Parliament and of the Council on cross-border mergers of limited liability companies. Pursuant to these amendments, a public or private limited company registered in Estonia may merge with another limited liability company established under the law of a member country of the EEA, which registered office, central administration or principal place of business is in the contracting country and which meets the requirements provided in Article 2 (1) of this Directive.

Regulation related to the activities of the Financial Supervision Authority

In 2007, the Article 54 of the Financial Supervision Authority Act governing the confidentiality of information received during supervision was upgraded. The motion to amend was included to the draft Act on a proposal from the Financial Supervision Authority, taking into account also public interests and the interests of market participants. Derogation from the general rule of confidentiality of information received during supervision was established, providing that the Authority has the right to disclose statistical data received from the supervised entity.

In 2007, the process led by Ministry of Justice of amending the draft of the Maintenance of Law and Order Act was continued, where it was envisaged to depict the Financial Supervision Authority as an authority responsible for maintaining public order.

³ Financial Action Task Force

⁴ International Monetary Fund

⁵ The Select Committee of Experts on the Evaluation of Anti Money Laundering Measures

3.5.2. Harmonization and optimization of reporting

In 2007, the process of preparing new reporting principles and new formats was continued. New balance sheet and income statement formats were established for banks in the summer of 2007 and they were implemented as of the beginning of 2008. The establishment of new balance sheet and income statement formats for investment firms is envisaged to take place in 2009.

The introduction of new balance sheet and income statement formats will change the reporting burden of financial undertakings in at least two aspects. Firstly, these new balance sheet and income statement formats meet the requirements of International Financial Reporting Standards (hereinafter: the IFRS⁶). As the use of IFRS in preparing financial statements is compulsory for financial institutions pursuant to the Accounting Act, the supervised entities are relieved of the obligation to submit same data to different institutions in different formats. Secondly, these new formats are based on financial statement formats proposed by the CEBS⁷ and used in many EU Member States. This allows international banking groups to use similar formats all over the Europe, facilitating thus the information exchange between companies themselves and between supervisory agencies.

In connection with preparations made for the final transition to the new capital adequacy framework Basel II in the banking sector, the Authority commenced with testing new reporting forms on prudential norms in 2008. Reports on prudential norms are based on common reporting forms proposed by the CEBS, and should thus significantly facilitate the drawing up and submission of reports, in particular in banks belonging into international groups. These new reporting forms on prudential norms for banks came into effect at the beginning of 2008; investment firms implement new reporting forms during 2008. Besides reporting forms designed for investment firms, it is envisaged to update the reporting forms of fund management companies in 2008 and implement at the beginning of 2009.

The fact that since 2008 the banks are allowed to disclose interim reports and annual accounts in freely chosen format meeting the requirements of IFRS is also an important step in reducing the reporting burden. Formerly, they had to disclose reports and accounts in a prescribed format, which in many cases lead to the need for so-called double reporting as the same data had to be submitted to various target groups in different format. Due to the elimination of these restrictions to the choice of the format of disclosed data, there is no need for double reporting any more.

3.5.3. Advisory Guidelines issued by the Financial Supervision Authority

The aim of the advisory guidelines issued by the Financial Supervision Authority is to explain the legislative provisions that apply to activities in the financial sector and to ensure that supervised entities behave in accordance with legislative requirements. Besides explaining legislative provisions and guiding the activities of supervised entities, the advisory guidelines are aimed at reducing regulative competitive advantages and legal risks of market participants in designing their behavior, as well as promoting good practice in the financial sector.

In 2007, the Financial Supervision Authority approved the following Advisory Guidelines:

Table 10

| Guidelines | Enforcement |
|--|-----------------|
| Requirements to the Internal Capital Adequacy Assessment Process | 1 January 2008 |
| General Requirements to Insurance Contracts (amendments) | 1 February 2008 |
| General Requirements to Insurance Mediation | 1 February 2008 |

⁶ IFRS – International Financial Reporting Standards

⁷ Committee of European Banking Supervisors

• **Advisory Guidelines: Requirements to the Internal Capital Adequacy Assessment Process**

In 2007, the Financial Supervision Authority drafted the Advisory Guidelines "Requirements to the Internal Capital Adequacy Assessment Process" for credit institutions and investment firms, which entered into force on 1 January 2008. These Guidelines were approved within the framework of Basel II, in order to raise the risk sensitiveness of prudential regulation basing to significantly larger extent on the internal assessment of credit institutions or investment firms on their risks and capital requirement. These Guidelines give meaning to Article 631 of the Credit Institutions Act and Article § 822 of the Securities Market Act and provide guidance to credit institutions and investment firms in developing and implementing the Internal Capital Adequacy Assessment Process. The Financial Supervision Authority considers that the Internal Capital Adequacy Assessment Process should be promoted by following the Principles of Good Corporate Governance, by ensuring the existence of adequate internal control mechanisms and in particular by implementing good practice in risk management.

• **Advisory Guidelines: General Requirements to Insurance Contracts**

The Advisory Guidelines of the Financial Supervision Authority "General Requirements to Insurance Contracts" entered into force on 1 February 2008. The initial Guidelines were approved on 1 November 2006. Amendments introduced in 2007 covered the identification of policyholder's insurable interest and the adequate disclosure of information to a policyholder when the contract is concluded. With these Guidelines, the Financial Insurance Authority aims at protecting policyholders' interests through providing advisory instructions to insurers for the development and disclosure of insurance contracts.

• **Advisory Guidelines: General Requirements to Insurance Mediation**

One of the aims of the Financial Supervision Authority in the insurance sector is to promote the clearness of insurance services. In 2007, the Financial Supervision Authority approved the Advisory Guidelines "General Requirements to Insurance Mediation", specifying the requirements to insurance brokers and insurance agents pursuant to the Insurance Activities Act.

The principal goal of these Guidelines is to ensure that service providers identify policyholders' insurable interest, allowing thus the customers to choose and the insurance intermediaries to offer the most suitable insurance contracts for the customer. Clarification of insurance mediator's obligations provides premises for enhanced transparency of the service and helps the consumers to gain better understanding of the nature of insurance mediation. These Guidelines also ensure that persons engaged in insurance mediation have a uniform understanding of requirements provided in the Insurance Activities Act and the Law of Obligations Act. The Guidelines were enforced on 1 February 2008.

In 2007, the following Advisory Guidelines approved by the Financial Supervision Authority in 2006 were enforced:

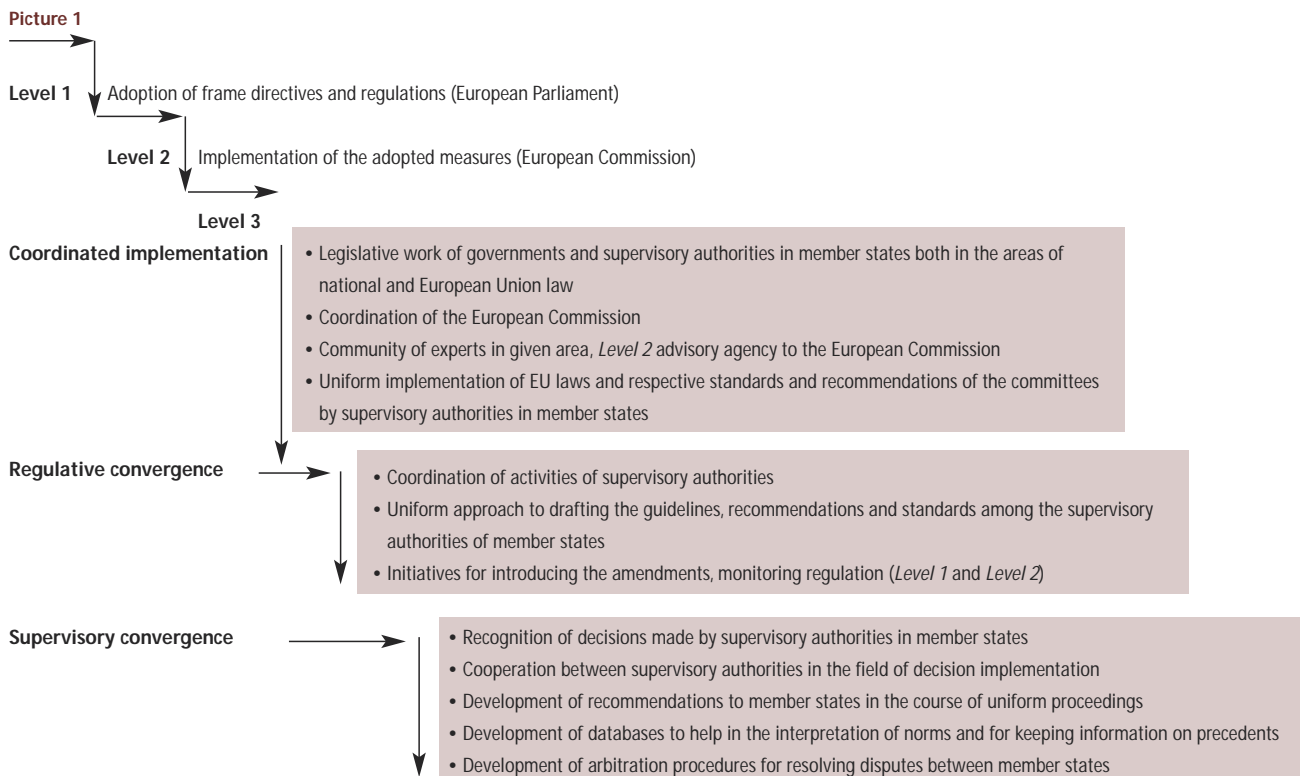
- Requirements for Organizing Business Continuity Process of Supervised Entities
- General Requirements to Insurance Contracts
- Outsourcing Requirements for Supervised Entities

3.6. International cooperation

Estonia is a member state of the European Union and its financial sector is a part of the European financial services market. This means that significant attention should be paid to developing international partnership in the area of supervision. The financial stability of Estonia directly depends on the unification of supervision methods and stable information exchange between EU member states. As the banks operating in Estonia are mostly branches of Scandinavian banking groups, developing cooperation and ensuring information exchange with Swedish and Finnish supervisory authorities is a question of critical importance. Models used by banks to evaluate current risks and the amount of capital required to cover such risks are also subject to approval within the framework of such cooperation.

The Financial Supervision Authority is able to influence the shaping of international supervision customs and policies that have an impact on the Estonian financial market by participating in the work of the EU financial sector supervisory committees. Thus, the main emphasis is on participation on Level 3 committees: The Committee of European Securities Regulators (CESR), The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and The Committee of European Banking Supervisors (CEBS). A large share of decision-making was and is being transferred to the level of these committees in accordance with the European Commission initiative.

The development of the so-called Lamfalussy framework (see Picture 1) in 2001 resulted in deeper cooperation between supervisory institutions in the European Union with the aim of improving legislative activities. Level 3 of the Lamfalussy process involves the representative committees of supervisory institutions in various financial areas; the main goal of such committees being the unification of supervised entities.



3.6.I. International cooperation within the European Union financial supervision committees

In 2007, the Financial Supervision Authority participated in 20 CEBS, CEIOPS⁸ and CESR⁹ working groups. The Financial Supervision Authority participated in the work of only those groups through which we can actually affect the issues that are of great importance for the Estonian financial market. Compared to 2006, the level of activity of participation in different working groups remained the same.

Committee of European Banking Supervisors (CEBS) continued its work in three main areas in 2007. Together with the European Commission it contributed to the harmonized interpretation and implementation of the Capital Requirements Directive (2006/48/EC and 2006/49/EC). Secondly, it was engaged in developing the framework of supervisory disclosures; thirdly, it was active in issues related to the group supervision and supported the respective cooperation network. In 2007, the Financial Supervision Authority participated most actively in the work of three CEBS working groups: the Expert Group on Capital Requirements (EGCR), the Expert Group on Financial Information (EGFI), and the Groupe de Contact (GdC) dealing with the harmonization of prudential supervisory practices.

The Expert Group on Capital Requirements dealing with the implementation of the Capital Adequacy Directive continued to solve technical issues related to the implementation of the new capital adequacy framework (Basel II) for banks. This framework is aimed at ensuring the existence of a more risk-sensitive methodology for calculating capital requirements and harmonizing national prudential supervisory practices. The work is mainly focused on the uniform implementation of capital regulation in different member states.

Expert Group on Financial Information is a working group focused on the issues of auditing and accounting, and its task is to analyze the influence that the developments taking place in the areas of accounting and auditing have on the banking sector. Furthermore, it participates in the development of such processes. At the same time, the working group engaged in accounting and auditing issues plays a leading role in harmonizing supervisory reporting.

In 2007, the most important issues were as before the harmonization of reporting and issues relates to supervisory disclosure. Based on respective questionnaires, the working group managed to map the current status of national reporting.

Groupe de Contact which is the main working group of the CEBS is focused on the harmonization of prudential supervisory practices and information exchange between national supervisory agencies. In 2007, the Financial Supervision Authority took a more active part in the work of the GdC – representatives of the Authority participate in all three subgroups dealing with the convergence of supervisory practices, supervisory delegation and cooperation network for group supervision. The Financial Supervision Authority organized the two-day plenary meeting of the Groupe de Contact in Tallinn from 12 July to 13 July 2007. The Financial Supervision Authority participates also in the Delegation Drafting Task Force which is focused on the issues related to the delegation of banking supervisory actions and responsibilities between home and host supervisors.

The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) – its main task both in life and non-life insurance has been the development of the new capital adequacy framework – the Solvency II directive. The initial draft of the Solvency II frame directive was passed over to the Council of Europe in July 2007. The development and implementation of the new capital adequacy framework Solvency II that will cause substantial changes in the insurance sector appears to be the most demanding process within the activities of CEIOPS so far. The Directive should be enforced in 2009 and the final deadline for national transposition is 18 months after the adoption of the Directive.

The Financial Supervision Authority participated in the work of four expert groups engaged in the development of Solvency II framework: the Financial Requirements Expert Group; the Internal Governance, Supervisory Review and Reporting Expert Group; the Internal Models Expert Group; and the Insurance Groups Supervision Committee. The main task of these working groups is to advise the Council of Europe in respect of the implementation of supervisory technical measures of the Solvency II frame directive. The main objective of the Financial Supervision Authority is to ensure that the new regulation considers also the specific character of Estonia as a small market.

In order to develop necessary technical actions, market participant have participant in four Quantitative Impact Studies (QIS). The report of the third study (QIS 3) was published in November 2007. Solvency working groups prepared the initial task of the fourth study (QIS 4). An important place in the initial task is given to the testing of simplification criteria for the minimum technical provisions and solvency capital requirements.

The Financial Requirements Expert Group is mostly dealing with issues relates to standard capital requirements of Solvency II, e.g. the development of standard requirements for the assessment of technical provisions both in non-life and life insurance. This working group has contributed to the third Quantitative Impact Study and to the preparation of specification for the fourth Quantitative Impact Study.

The Internal Governance, Supervisory Review and Reporting Expert Group is mostly dealing with the development of qualitative requirements for the management of insurers, requirements for supervisory reporting and disclosure, as well as the development of uniform supervisory practices. In 2007, the working group set principles for the harmonization of the content and format of supervisory reporting and disclosure.

The Internal Models Expert Group was founded in 2007 and its task is to set general and specific requirements under the Solvency II framework for the development of internal models for the purpose of calculating solvency requirements.

The Insurance Groups Supervision Committee is a working group dealing with the supervision of insurance groups. It is focused on supervisory issues of consolidation groups under the existing legal framework and makes respective motions to amend current directives. The main goal of the working group is to improve the cooperation between home and host supervisors of insurance groups and to harmonize supervisory practices.

The Committee of European Securities Regulators (CESR) dealt with issues related to the implementation of five directives in 2007 – the Markets in Financial Instruments Directive 2004/39/EC, the Transparency Directive 2004/109/EC, the Prospectus Directive 2003/71/EC, the Market Abuse Directive 2003/6/EC, and the so-called eurofunds (Undertakings for Collective Investment in Transferable Securities) Directive 85/611/EC. Implementation and interpretation issues of these directives are dealt with in permanent and temporary working groups of the CESR. The Financial Supervision Authority took a more active part in the work of seven working groups in 2007.

In 2007, the issues related to the implementation of the Markets in Financial Instruments Directive (MiFID) were most important for the CESR. The final deadline of national transposition of this directive was 1 November 2007. The aim of the MiFID is to establish a uniform integral system for performing orders and making transactions associated with securities, in order to improve the competition in trading environments and transaction methods. It is also aimed at improving the transparency of securities markets in the European Union and the knowledge of investors through the enforcement of uniform minimum standards for the disclosure of regular and other data. The directive forms the basis for the establishment of new securities trading systems.

The main issues discussed in 2007 in the MiFID working group of the CESR were the legal and application problems related to the obligation to register investment firms and store the data. An indicative minimum list of data to be stored was specified. The working group was also active in preparing the launch of a common Transactions Reporting Exchange Mechanism (TREM) in order to step up the detection of market abuse.

The Prospectus Contact Group of the CESR deals with issues related to the interpretation and implementation of legislation governing the prospectus procedure. The activities of the working group are aimed at developing common positions of member states and relevant instructions for disclosure requirements in case of a public offer of securities or an admission of securities to the regulated market.

The Investment Management Expert Group (IM) of the CESR provides advice in issues related to the UCITS Directive of the European Commission, i.e. the directive on unit trusts or euro-funds. In May 2007 it approved the Inducement under MiFID on the way how to ensure that the fees related to investment activities are transparent for the investors. This inducement is aimed at defining fees (in particular those between funds and intermediaries) that add no value to the product (for the investor) and are thus not in the interests of consumers, and ensuring the transparency of fees and costs. At the end of 2007, the IM Expert Group had drafted its proposals to the European Commission in respect of the harmonization of requirements established for a simplified prospectus in different member states.

CESR-POL and its subgroups coordinate the cooperation of CESR members in the implementation of regulations. CESR-POL is also focused on the effective implementation of the Market Abuse Directive and on the creation of a common database on market abuse. The Transparency Working Group has been established for drafting implementing provisions of the Market Abuse Directive. The trans-European electronic information network for issuers – Officially Appointed Mechanism (OAM) – is being established. The information that an issuer of securities trading on national markets must disclose shall be comparable and easily accessible by investors of all member states. The OAM working group develops relevant common standards and harmonizes the understanding of the role of the financial supervision in conducting supervision over the system.

The role of CESR-FIN is to coordinate supervisory policies and to ensure the uniform implementation of European reporting standards on securities (IAS/IFRS) in member states. One of its tasks is to ensure the uniform implementation of financial reporting standards for issuers of securities traded on regulated securities markets also in third countries.

3.6.2. International cooperation within the committees of the system of European central banks

Together with the Bank of Estonia, the Financial Supervision Authority participates in the work of the Banking Supervision Committee (BSC) under the auspices of the European Central Bank. Participation in the process of analyzing the levels of EU financial stability and information exchange is important for the Financial Supervision Authority's own analyses and to facilitate cooperation in the area of supervision and crisis management among central banks. The Financial Supervision Authority takes part in the work of two out of the five expert groups within the framework of the BCS: the Working Group on Developments in Banking (WGDB) and the Working Group on Macroprudential Analysis (WGMA).

The WGMA evaluates the stability of European Union financial and banking systems by conducting macroprudential analysis based on information regarding each member state's macroeconomics and banking sector. In 2007, the Expert Group dealt mainly with the issues of financial stability and liquidity of the European Union.

The goal of the WGMB is first of all to analyze and evaluate structural changes within the EU banking sector. In 2007, it discussed mostly the issues related to changes in the general economic environment.

3.6.3. International cooperation within global organizations

In 2007, the Financial Supervision Authority took part in the work of the International Association of Insurance Supervisors (IAIS), the Bank of International Settlements (BIS), including the BIS Group of Banking Supervisors from Central and Eastern Europe (BSCEE) and the International Organization of Securities Commissions (IOSCO). Representatives of the Financial Supervision Authority participated also in the annual IAIS conference in the USA and in the annual BSCEE conference in Budapest.

3.6.4. International cooperation on the issues of anti-money laundering and prevention of terrorist financing

In November 2007, the Secretariat of the expert committee on anti-money laundering – MONEYVAL¹⁰ – established by the Council of Europe's Committee of Ministers send to Estonia a questionnaire for evaluating measures designed for the prevention of money laundering and terrorist financing. MONEYVAL's evaluation methods are partly based on answers to these questions together with relevant references to legislation and statistical data.

MONEYVAL evaluates the implementation of anti-money laundering procedures, using the FATF¹¹ method, in those Council of Europe's member states that are not members of FATF. The Financial Supervision Authority participates in the activities of MONEYVAL and in the plenary meeting in Strasbourg in December 2007 its representative was chosen as a member of the bureau directing the activities of the MONEYVAL committee.

In 2007, the discussions between various European financial supervisory agencies on issues related to anti-money laundering were assembled to the banking supervision committee at CEBS¹², and the representative of the Financial Supervision Authority participates in the work of this committee since 2007. CEBS' agenda included many important issues, e.g. the development of uniform practices in connection with the implementation of Regulation No 1781/2006 of the European Parliament and of the Council of 15 November 2006 on information on the payer accompanying transfers of funds. Furthermore, its agenda included the analysis of due diligence applied for the identification and verification of natural persons¹³ and in case of cross-border services¹⁴.

3.6.5. Cooperation with foreign supervisory agencies

The Financial Supervision Authority holds regular meetings and exchanges information with Scandinavian and Baltic financial supervisory agencies. In the insurance sector, the Financial Supervision Authority considers that the most important cooperation takes place with Latvian and Lithuanian financial supervisory agencies, in order to agree on home-host supervision principles in a situation where Estonia has become the home country of insurers.

In 2007, the priorities included cooperation with the Swedish Financial Supervisory Authority. Besides the cooperation with the Swedish supervisory agency, the Financial Supervision Authority cooperated actively also with Latvian and Lithuanian supervisory agencies when examining applications submitted by credit institutions for the implementation of internal evaluation systems for credit and operational risks.

When exchanging information with the Swedish supervisory agency, the Financial Supervision Authority *inter alia* sought to get an overview of the effects that the events on global financial markets had on parent banks of Estonian credit institutions. One of the most important issues discussed was the framework for international cooperation in the supervision of banking groups. The Financial Supervision Authority participated in the risk assessment of several cross-border insurance groups for mapping insurance risks.

¹⁰ *The Select Committee of Experts on the Evaluation of Anti Money Laundering Measures*

¹¹ *Financial Action Task Force*

¹² *Committee of European Banking Supervisors*

¹³ *Questionnaire on identification and verification of customers (natural persons)*

¹⁴ *Questionnaire on Customer Due Diligence cross border issues*

2007 witnessed joint seminars, meetings and information exchanges with representatives of the Russian Central Bank, Finnish financial supervisory agency, Finnish insurance supervisory authority, Danish financial supervisory agency, Latvian financial supervisory agency, Lithuanian Central Bank, Central Bank of the Netherlands, Austrian financial supervisory agency, German financial supervisory agency, Romanian securities supervisory agency, and U.S. supervisory agency, discussing various issues related to the cooperation framework, developments and risks in the financial sector, coordination of risk assessment agendas, authorization, merger processes related to the establishment of European companies, development of automatic systems for market monitoring, and possible doubt of market manipulation.

Cooperation memoranda

In 2007, the Financial Supervision Authority signed cooperation memoranda on banking supervision with the Central Bank of the Netherlands and with the Central Bank of Cyprus.

A protocol on cooperation framework was prepared together with the Swedish financial supervisory agency, covering the application submitted by the SEB Group for the implementation of the Advanced Measurement Approach for the calculation of capital requirements for operational risk. A further cooperation framework on the supervision of AS Sampo Pank (subsidiary bank of Danske Bank) was agreed with the Danish supervisor both in regard to the Internal Ratings Based Approach (IRB Approach) for credit risk and regular supervision.

The Management Board of the Financial Supervision Authority approved the amendments to cooperation memoranda on the supervision of payment systems and on the crisis management signed between central banks and supervisory agencies of EU member states.

Foreign missions

In 2007, the Financial Supervision Authority made preparations for several important missions. Estonia was visited by the delegation of IMF¹⁵ and World Bank in February 2008 in order to analyze the status of Estonian financial sector under the Financial Sector Assessment Program (FSAP). The preliminary mission was organized in October 2007. Participants were interested in different scenarios of stress-tests and made proposals in the light of the mission of 2008. In connection with the mission, a comprehensive questionnaire was fulfilled at the end of 2007 and answers to the questions form a material part of the FSAP assessment program of IMF.

In 2007, preparations were made for the Estonian evaluation mission of MONEYVAL¹⁶ that took place in February 2008. This meant that several employees of the Financial Supervision Authority were engaged in the fulfillment of the preceding comprehensive questionnaire.

Officials of the Financial Supervision Authority participated also in meetings under the IMF mission pursuant to Article IV, providing an overview of most significant developments in the Estonian financial sector and of regulative measures. Furthermore, the representatives of the Financial Supervision Authority participated in meetings organized under the mission of the rating agency Fitch Ratings, which was mostly engaged in evaluating the financial sector, monitoring the supervisory actions in the situation of rapid growth in lending business, and examining potential scenarios of stress-tests.

¹⁵ *International Monetary Fund*

¹⁶ *The Select Committee of Experts on the Evaluation of Anti Money Laundering Measures*



4 • Financial Supervision Authority's 2007 Annual Report of Revenues and Expenditures

Accounting principles

The annual report of revenues and expenses has been compiled according to the Financial Supervision Authority Act and accounting principles generally accepted in Estonia, to the extent that they can be implemented and applied to the Financial Supervision Authority. Accounting principles generally accepted in Estonia are based on internationally accepted principles of accounting and reporting, the basic requirements of which are established by the Accounting Act of the Republic of Estonia, which is supplemented by instructions issued by the Accounting Standards Board. According to the Bank of Estonia Act, the Financial Supervision Authority does not pay income tax or other taxes related to business activities, except for taxes related to natural persons. Based on § 21 of the Value Added Tax Act entered into force on 1 May 2004, the Financial Supervision Authority is registered as a taxable person with limited liability and calculates VAT on the turnover of goods and services imported or acquired within the European Community. The revenues and expenses of the Financial Supervision Authority are recorded during the accounting period on an accrual basis, regardless of when cash was received or paid. Financial transactions are recorded according to their acquisition cost and at the moment of their completion. The report on revenues and expenses is compiled in thousands of kroons, unless another currency is specified.

| Revenue and expenditure account (in thousands of kroons) | | | |
|---|--------------|---------------|---------------|
| | Annex | 2007 | 2006 |
| REVENUE | | | |
| Supervisory fees | 1 | 46 184 | 43 184 |
| Other revenue | 2 | 510 | 479 |
| Total operational revenue | | 46 694 | 43 663 |
| EXPENDITURE | | | |
| Personnel expenditure | 3 | 29 036 | 24 768 |
| Misc. operational expenditure | 4 | 16 854 | 15 029 |
| Other expenditure | 5 | 773 | 503 |
| Total operational expenditure | | 46 663 | 40 300 |
| Profit for core activities | | 31 | 3 363 |
| Financial income and expenditure | 6 | 3 029 | 645 |
| Profit for the accounting year | | 3 060 | 4 008 |

Annexes to the annual report of revenues and expenditures

ANNEX 1

The financing principles of the Financial Supervision Authority are provided in the Financial Supervision Authority Act. Supervisory fees consist of two components: firstly, the capital component, which is the amount that equals one percent of the total of the minimum (net) own funds, equity or share capital of the supervised entity; secondly, the volume component, which is the amount that equals the percentage of the supervised entity's assets, total amount of insurance payments, calculated assets or commission fees established by the Minister of Finance at the proposal of the Supervisory Board of the Financial Supervision Authority.

Supervisory fee (in thousands of kroons)

| | Paid supervisory fees 2007 | Share % | Paid supervisory fees 2006 | Share % |
|---------------------------|----------------------------|-------------|----------------------------|-------------|
| Credit institutions | 29,828 | 64.6% | 27,850 | 64.4% |
| Non-life insurers | 5500 | 11.9% | 5421 | 12.5% |
| Fund management companies | 4793 | 10.4% | 4115 | 9.5% |
| Life insurers | 2642 | 5.7% | 1990 | 4.6% |
| Investment firms | 1519 | 3.3% | 1712 | 4.0% |
| Insurance brokers | 1902 | 4.1% | 2096 | 5.0% |
| Total | 46,184 | 100% | 43,184 | 100% |

When establishing the rates for the volume component of the supervisory fees for different groups of supervised entities, the Authority considers the volume and profitability of their activities, evaluates the resources spent on their supervision, and the final decision is based on the assumption that the supervisory fee should not be excessively burdensome for the entity.

Pre-payments of the capital and volume components of the supervisory fee are made to the Financial Supervision Authority by 31 December of the year preceding the financial year. The final payment of the volume part is made by 30 September.

Supervised entities entering the market during the financial year must pay only the capital component of the supervisory fee in 30 days of acquiring the right to operate.

ANNEX 2**Other revenue** (in thousands of kroons)

| | 2007 | 2006 |
|-----------------|------------|------------|
| Processing fees | 458 | 261 |
| Other revenue | 52 | 218 |
| Total | 510 | 479 |

According to the amendments to the Financial Supervision Authority Act, any natural person, legal person or branch of a foreign company that applies to the Financial Supervision Authority to have an application reviewed or an operation completed pays a processing fee to the Financial Supervision Authority.

The item *Other revenues* shows income received from the compensation of training expenses.

ANNEX 3**Personnel expenditure** (in thousands of kroons)

| | 2007 | 2006 |
|---------------------------------|---------------|---------------|
| Salaries | 21,433 | 18,246 |
| Taxes | 7171 | 6162 |
| Supervisory Board compensations | 432 | 360 |
| Total | 29,036 | 24,768 |

Salary expenditures primarily include salary expenditures together with bonuses, compensations for members of the Management Board and the increase in the estimated vacation liability for the unused vacation of Financial Supervision Authority employees, including social taxes totaling 241,445 kroons.

At the end of 2007, the average salary of a specialist of the Financial Supervision Authority amounted to 22,556 kroons per month; in 2006, the average salary of a specialist totaled 21,597 kroons. The average salary of a divisional manager amounted to 41,667 kroons at the end of 2007; in 2006, it totaled 39,400 kroons per month. In 2007, the total sum of compensation to the Supervisory Board and Management Board members amounted to 3,280 thousand kroons. Total bonuses paid to employees comprised 13.3% of salary expenditures.

ANNEX 4

Misc. operational expenditure (in thousands of kroons)

| | 2007 | 2006 |
|-----------------------------------|---------------|---------------|
| Real estate lease | 4466 | 4466 |
| IT systems and development | 2233 | 2472 |
| Business trips | 2471 | 1923 |
| Office expenses | 2639 | 1587 |
| Training expenses | 1378 | 1079 |
| Membership fees | 1465 | 1053 |
| Accounting expenses | 780 | 780 |
| Lease for fixed assets | 401 | 518 |
| Consumer information, advertising | 418 | 373 |
| News agencies | 168 | 295 |
| Personnel search | 237 | 205 |
| Legal assistance and consultation | 95 | 195 |
| Auditing expenses | 94 | 83 |
| Total | 16,854 | 15,029 |

The item *Real estate lease* includes the office space leased from The Bank of Estonia with a total area of 1399 m² at a price of 266 kroons per m² each month, which includes all costs related to the administration of the office space.

The item *IT systems and development* includes IT services bought from The Bank of Estonia at an estimated value of 30 000 kroons per user and the cost of IT development projects of the Financial Supervision Authority.

The item *Business trips* includes all trips related to representing the Financial Supervision Authority and supervisory cooperation. Business trips were primarily related to CESR, CEIOPS and CEBS committee and sub-committee meetings and the development of cooperation with supervisory agencies of the European Union and third countries. Business trip expenses also include the expenses related to the supervision of foreign subsidiaries of supervised entities registered in Estonia. In total, there were 192 business trips.

The item *Office expenses* includes expenses for periodicals and books, translation, office supplies, meetings and representation, phone and transport.

The item *Training expenses* includes the expenses for training locally and abroad, including travel expenses. In 2007, the average cost for training abroad was 12,871 kroons and the expenditure

for local training – 5192 kroons on average. Training was mostly provided in the development of capital regulation in the banking and insurance sectors (Basel II, Solvency II), supervision of the securities market and development of legal competence. Language training for employees has also been substantially encouraged.

The item *Membership fees* reflects the annual fees for membership in CESR, IAIS, BSCEE, CEIOPS, CEBS and IOSCO.

The item *Accounting expenses* includes cost accounting, partial management accounting, payroll accounting, loan accounting, performance of payments and settlements, purchased from the Bank of Estonia.

The item *Lease for fixed assets* includes the lease paid by the Financial Supervision Authority to the Bank of Estonia. The lease for fixed assets used by the Financial Supervision Authority, including IT hardware and software as well as inventory, is paid per year, and the amount of the lease is equal to the depreciation rate at the Bank of Estonia for the specific fixed assets. The cost of the acquisition of fixed assets is limited to 50,000 kroons.

The item *Consumer information and advertising* includes the expenses for development and the launch of the Financial Supervision Authority consumer website www.minuraha.ee, the publication of information materials directed at consumers, and costs associated with the Financial Supervision Authority Yearbook.

Expenses for *news agencies* include expenditures for usage fees to news agencies and for the Financial Supervision Authority website.

The item *Personnel search* includes recruitment costs for the employees of the Financial Supervision Authority.

The item *Legal assistance and consultation* shows expenditures incurred due to the involvement of experts, special audits, legal opinions and legal assistance related to the supervisory activities of the Financial Supervision Authority.

The item *Auditing expenses* includes the expenses of auditing the report on revenues and expenses of the Financial Supervision Authority; according to Article 51(3) of the Financial Supervision Authority Act, the report is audited by an auditor from The Bank of Estonia.

ANNEX 5

Other expenditure (in thousands of kroons)

| | 2007 | 2006 |
|----------------------------|------------|------------|
| Compensation and benefits | 389 | 307 |
| Cultural events and sports | 384 | 196 |
| Total | 773 | 503 |

The item *Compensation and benefits* includes maternity support, special support, expenses involved in guaranteeing the health care of employees and expenses related to sporting activities. This item also reflects the compensation of 1/3 of the contributory pension payments to the employees of the Financial Supervision Authority, but not more than 10% of the gross annual salary of the employee.

The item *Culture and sports* reflects the expenditures for events organized for the employees of the Financial Supervision Authority.

ANNEX 6

The Bank of Estonia pays interests based on the average balance of the Financial Supervision Authority's bank account, and the interest rate equals The Bank of Estonia's rate of return on foreign exchange reserves for the previous quarter.

BALANCE SHEET (in thousands of kroons)

| ASSETS | 31.12.2007 | 31.12.2006 |
|--|---------------|---------------|
| Cash and bank accounts | 92,098 | 79,731 |
| Supervisory fees receivables | 1519 | 2073 |
| Total assets | 93,617 | 81,804 |
| LIABILITIES AND RESERVE | | |
| Payables to employees | 3027 | 2603 |
| Tax arrears | 1146 | 828 |
| Misc. payables | 7870 | 6805 |
| Deferred income | 53,844 | 42,890 |
| Total liabilities | 65,887 | 53,126 |
| Reserve | 24,670 | 24,670 |
| Profit for the accounting year | 3060 | 4008 |
| Total reserve and profit for the accounting year | 27,730 | 28,678 |
| Total liabilities, reserve and profit for the accounting year | 93,617 | 81,804 |

EXPLANATORY NOTES FOR THE 2007 BALANCE SHEET

The item *Cash and bank accounts* shows the balance of current accounts in the Bank of Estonia.

The item *Supervisory fees receivable* shows prepayments of supervisory fees for 2008 not yet received by the Financial Supervision Authority in the amount of 1006 thousand kroons.

The item *Payables to employees* includes unpaid wages and vacation liabilities.

Unpaid wages not yet paid to the employees of the Financial Supervision Authority amount to 1807 thousand kroons. Vacation liabilities include the estimated vacation liability for vacation not taken by Financial Supervision Authority employees in the amount of 1220 thousand kroons.

The item *Tax arrears* shows the tax liability of the Financial Supervision Authority.

The item *Misc. payables* includes expenditures by the Financial Supervision Authority covered by The Bank of Estonia in 2007, which the Financial Supervision Authority will compensate to The Bank of Estonia in 2008. The expenses of the Financial Supervision Authority are recorded in the report according to the accrual method.

The item *Deferred income* includes the prepayments of 2008 supervisory fees.

Reserve – pursuant to the Resolution of March 2006 of the Supervisory Board of the Financial Supervision Authority it was decided that the 2006 net gain totaling to 4008 thousand kroons will be refunded and the reserve will thus remain unchanged.

The *profit for the accounting year 2007* was 2547 thousand kroons.

5 • Independent Auditor's Report

To the Supervisory Board of the Financial Supervision Authority

We have audited the Annual Report of Revenues and Expenditures of the Financial Supervision Authority, consisting of the revenue and expenditure account of the accounting year that ended on 31 December 2007, relevant accounting principles and other explanatory notes.

Responsibility of the Management Board for the Annual Report of Revenues and Expenditures

The Management Board is responsible for the compilation and true and fair presentation of the Annual Report of Revenues and Expenditures, in accordance with the Financial Supervision Authority Act and the accounting principles described in the attached Annual Report of Revenues and Expenditures. Among other things, it is responsible for the development and administration of the relevant internal control system that guarantees the accurate compilation and presentation of the Annual Report of Revenues and Expenditures without material errors caused by fraud or error; for choosing and implementing appropriate accounting principles; and for making accounting assessments that are justified in the given situation.

Liability of the Auditor

Our assignment is to provide an assessment of the Annual Report of Revenues and Expenditures based on the results of our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we follow the rules of ethics, and plan and perform the audit to obtain reasonable assurance that the Annual Report of Revenues and Expenditures is free of material errors.

Our audit includes carrying out procedures to gather evidence about the figures presented and the information disclosed in the Annual Report of Revenues and Expenditures. The auditing procedures depend on the Auditor's assessments, including the assessment of the risk that the Annual Report of Revenues and Expenditures might include material errors caused by fraud or error. In evaluating this risk, the Auditor, with a view to plan appropriate auditing procedures, takes into consideration the internal control system that has been adopted for compiling and presenting the true and fair Annual Report of Revenues and Expenditures, but does not give an assessment of the operation of the system. The audit also includes an assessment of the appropriateness of the accounting principles, of the reasonableness of the accounting assessments of the Management Board and of the general way of presenting the Annual Report of Revenues and Expenditures.

We believe that the audit evidence gathered is sufficient and appropriate for presenting our opinion.

Opinion

In our opinion, the Annual Report of Revenues and Expenditures presents fairly, in all material respects, the financial performance of the Financial Supervision Authority in the accounting year that ended on 31 December 2007, in accordance with the Financial Supervision Authority Act and the accounting principles described in the attached Annual Report of Revenues and Expenditures.



Urmas Kaarlep
AS PricewaterhouseCoopers
14. märts 2008



Stan Nahkor
Certified auditor



6 • Overview of the Estonian Financial Market

6.1. Economic environment

In 2007, risks related to the general economic environment increased. Economic growth in Estonia slowed down, though it was still one of the fastest in the European Union: 7.1%. Economic growth in Estonia was exceeded by Latvia, Slovakia and Lithuania. According to the Ministry of Finance economic growth in the European Union reached 2.6% in 2007.

Economic growth slowed down due to the respective slowdown of the growth in domestic demand and in the export and import of goods and services, especially in the second half of the year. Growth of domestic demand slowed down to 9.3%, in comparison with 16.1% in 2006. Export grew only by 1.5% and import by 2.8% in comparison with the previous year. Pursuant to the opinion of the Ministry of Finance, the slowdown of the economic growth in 2008 will probably be 3.7%. Deterioration in business conditions of various industries and loss of consumer confidence will probably continue.

In 2007, the rate of inflation increased: the average increase in consumer prices was 6.6% (4.4% in 2006). The growth in consumer prices was mainly affected by increasing housing expenditure and increased prices for food. The number of employed persons increased by 9 000 in comparison with the previous year. At the end of 2007, the unemployment rate decreased to 4.7%; this is the lowest level reached during these past 15 years. The growth in wages continued in 2007: the average growth in wages was 20.4%. In 2008, the growth in wages will probably slow down, the growth in employment rate will come to standstill and the unemployment rate will somewhat increase due to the slowdown of economic growth.

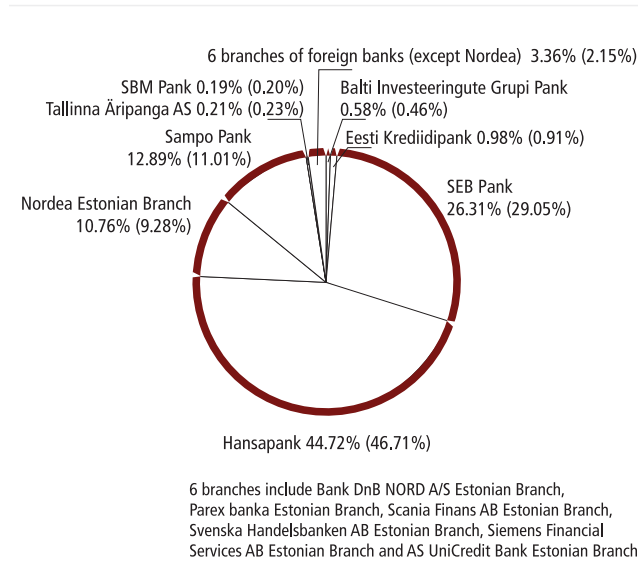
6.2. Credit institutions

As at 31 December 2007, there were seven locally authorized credit institutions and eight branches of foreign credit institutions operating in Estonia. The eight branch – Allied Irish Banks PLC (AIB) Estonian Branch – was registered at the end of 2007. AIB acquired AmCredit Eesti AS, i.e. the provider of housing loans operating in Estonia and reorganized it as the branch of credit institution. Due to the establishment of the branch, the activities of AmCredit extended from previous housing loans to deposits and the branch started to offer banking services also to business customers.

Competition in the loan market still very intense

Competition in the loan market¹⁷ was still very intense in 2007. Compared to the previous year, AS Sampo Bank, Nordea Bank Finland PLC Estonian Branch and smaller branches of foreign credit institutions that recently took up business in Estonia increased their market shares on the account of major banks – AS Hansapank and AS SEB Pank (see Figure 1). At the end of 2007, the share of these two major banks of Estonia totaled 71% of the loan market and their market share had decreased by 5% in comparison with the previous year. Lending policy of major banks has become more conservative, in particular when financing the real estate sector. In the light of presumably increasing competition, branches of foreign banks will continue to expand and act aggressively in grabbing the market share.

Figure 1. Market shares of banks based on loans issued to the non-financial sector as at 31.12.2007, in brackets 31.12.2006

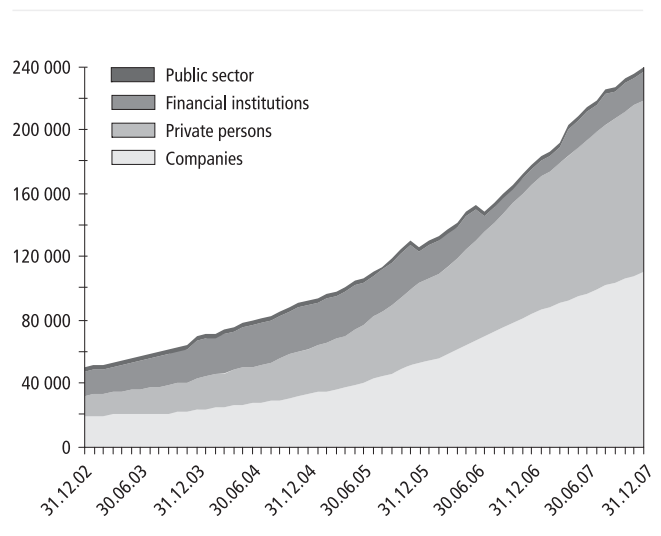


Slowdown of the growth in financing private persons and companies

Total assets of banks increased by 34% and their volume totaled 320.6 billion kroons as at 31 December 2007. This increase in assets was primarily caused by the growth in the client loan portfolio by a total of 35% (42% in 2006). At the end of 2007, the gross loan portfolio for banks was 239.2 billion kroons, i.e. 75% of total assets.

At the end of 2007, the combined loan portfolio of banks was structured as following: loans to companies 46%, loans to private persons 45%, loans to financial institutions 7% and loans to the public sector 1% (see Figure 2). In 2007, companies received loans in the amount of 110.2 billion kroons and private persons in the amount of 108.6 billion kroons. Loans to financial institutions amounted to 17.2 billion kroons and loans to the public sector 3.2 billion kroons.

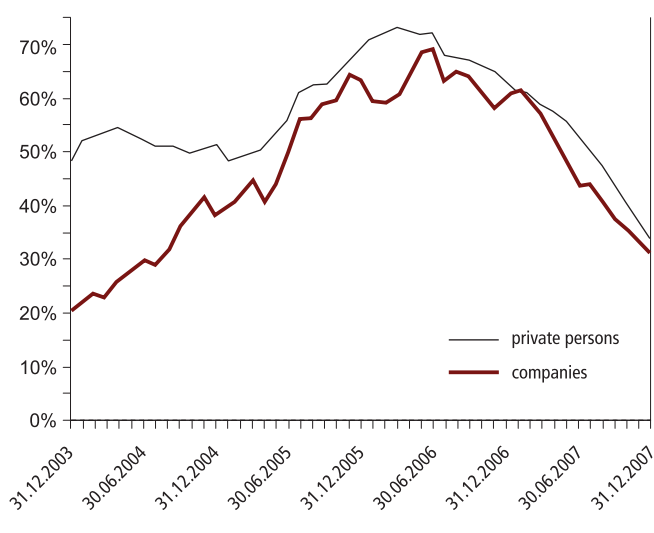
Figure 2. Loan portfolio structure of banks by most important customer groups (in millions of kroons)



¹⁷ This does not include loans to credit institutions and other financial institutions.

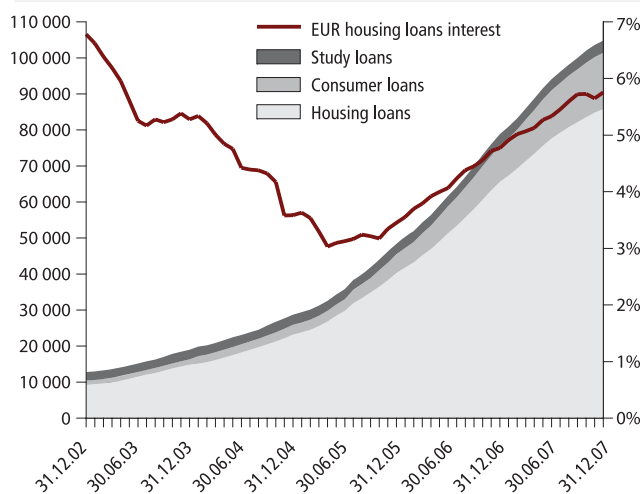
In 2007, the growth in financing both private persons and companies as well as housing loans and business premises slowed down. Whereas loans to private persons increased 69% in 2005 and 63% in 2006, the growth in financing private persons slowed down to 33% by the end of 2007 (see Figure 3). This is true also for the growth in financing companies, which was 63% in 2005 and 60% in 2006, and which slowed down to 31% by the end of 2007. The growth slowed down mostly due to the slowdown in the growth of financing housing loans and business premises.

Figure 3. Annual growth in loans to private persons and companies (%)



The growth in both housing and consumer loans slowed down in 2007. As in previous years, the volume of loans to private persons increased in particular due to the growth (slowing down though) in housing loans. Whereas the growth was 74% in 2005 and 63% in 2006, it slowed down to 31% by the end of 2007. The growth in consumer loans has also somewhat slowed down in comparison with 2006: 94% in 2006 and 56% in 2007. One of the reasons behind the slowdown of growth in housing and consumer loans is the loss of consumer confidence that affects the personal lending behavior. The average interest for Euro-denominated housing loans which is applied to most housing loans taken by Estonian people continued to grow in 2007. It had reached to 5.76% by the end of December (4.77% in 2006).

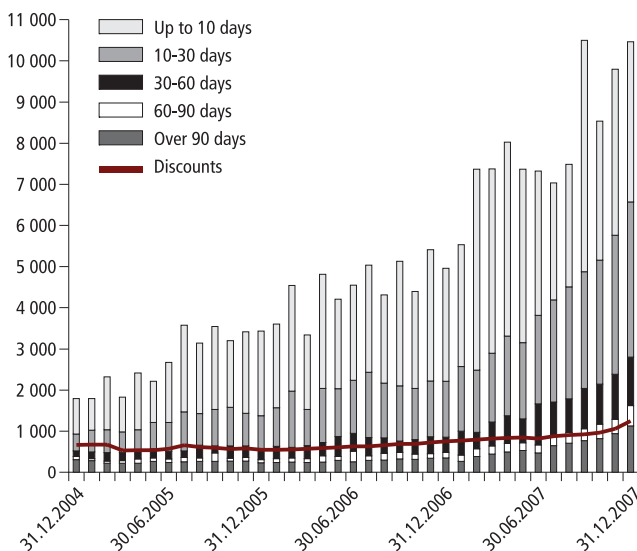
Figure 4. Loans to private persons (in millions of kroons) and Euro-denominated housingloans' interest (%)



Loan portfolio still sound

The quality of combined loan portfolio of the banking sector remained sound. Still, due to the changing economic environment also loans overdue have started to grow both in absolute values and as a share of loan portfolio. At the end of 2007, the percentage of loans overdue more than 60 days was 0.7% of loans given to the non-financial sector (0.3% in 2006). As a result of the strong growth in the number of loans overdue also their coverage with discounts has significantly declined. Whereas the coverage of loans overdue more than 60 days was 152% at the end of 2006, it had declined to 77% by the end of December 2007. 87% of combined loan portfolio was classified as non-problem¹⁸ loans. Loans described as doubtful, risky or unlikely formed 3% of the entire loan portfolio (2% in 2006). In 2008, the number of loans overdue will probably grow further and discounts will probably increase.

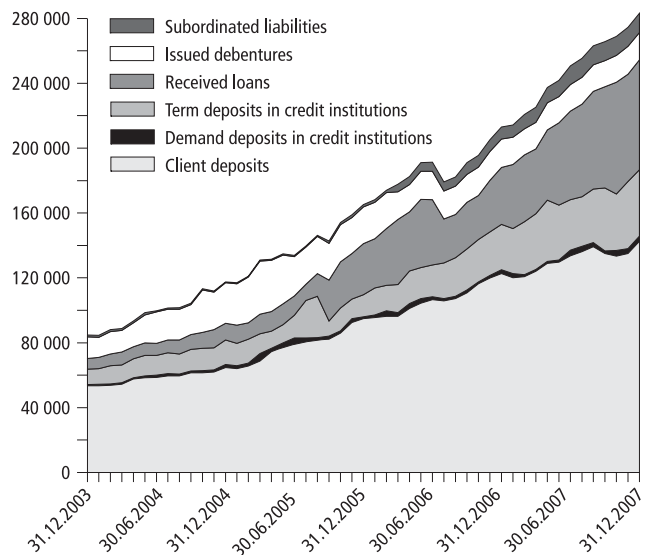
Figure 5. Loans overdue and discounts of banks (in millions of kroons)



Funds from parent banks increasing in the resource base

By the end of 2007, the total volume of resources in the banking sector had reached 233 billion kroons, growing by 29% in 2007. Client deposits accounted still for slightly more than a half of resources of the banking sector, though their share has significantly decreased in 2007. Funds provided by parent banks also picked up, primarily in the form of loans, term deposits and subordinated liabilities (see Figure 6). The growth in deposits was still considerably smaller than the growth in loans. The loan-deposit ratio had significantly increased in favor of loans by the end of 2007, reaching the level of 168% (145% in 2006). As the liquidity risk of Estonian banks is managed on the level of parent bank group, the realization of risk is directly depending on the ability of the parent bank to refinance its liabilities on money markets and to involve additional funds.

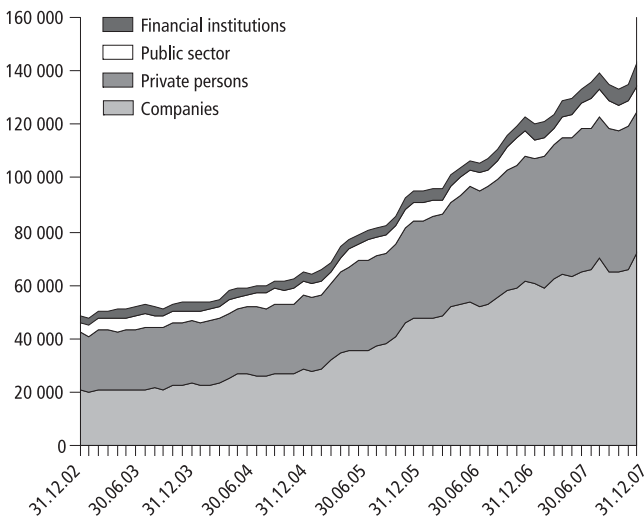
Figure 6. Resources in the banking sector (in millions of kroons)



¹⁸ Classification pursuant to Decree No 9 of the Governor of the Bank of Estonia of 27 June 2000

Client deposits in banks totaled 143 billion kroons at the end of 2007, growing by approximately 20 billion kroons (16%) in 2007. Deposits of companies accounted for the biggest share of deposits, amounting to 72 billion kroons or 50% (see Figure 7). 38% of deposits belonged to private persons, amounting to 54 billion kroons. Deposits of the public sector totaled 9 billion kroons, forming 6% of all deposits. The share of deposits of financial institutions was approximately the same and their total volume was 8 billion kroons at the end of 2007.

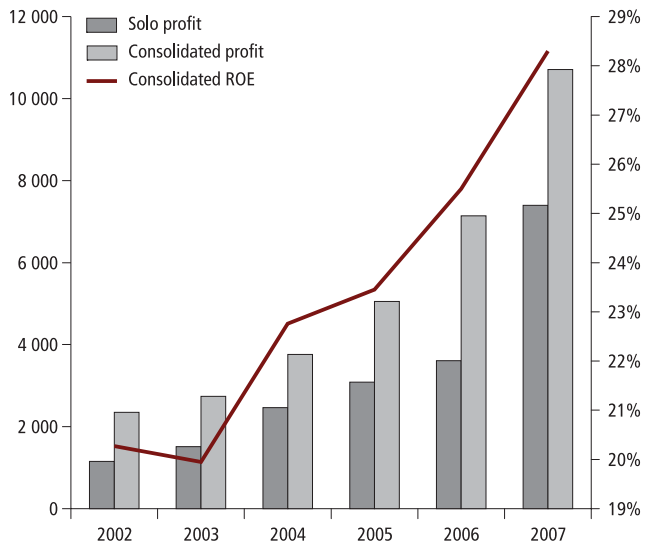
Figure 7. Structure of deposits in banks by most important client groups (in millions of kroons)



Profitability of banks increased about two times

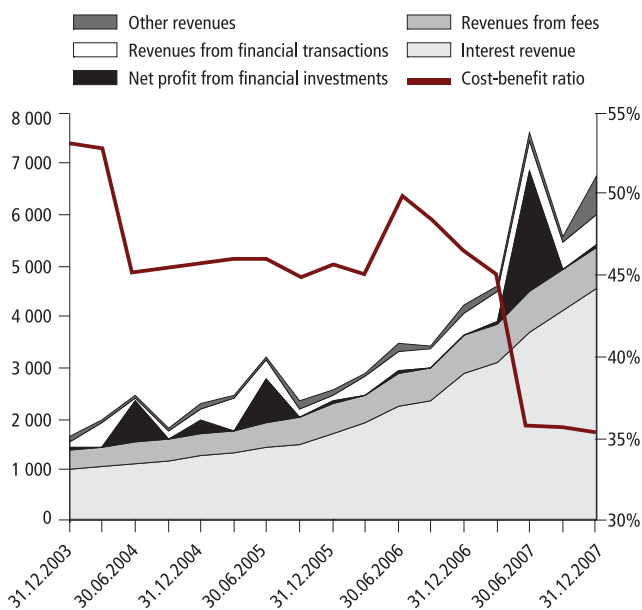
Profitability in the banking sector remained at the high level in 2007 both on solo and consolidated bases. In 2007, banks earned 7.4 billion kroons in net profit on a solo basis, which is twice as high as in the previous year. Net profits in 2006 totaled almost 3.6 billion kroons on a solo basis. The most important efficiency ratios remained also high. E.g. the composite ROE reached 28.3% by the end of 2007 (25.5% in 2006).

Figure 8. Profits of the banking sector (in millions of kroons) and ROE (%)



As was the case in the previous year, revenues came primarily from traditional banking activities – lending. At the end of 2007, interest rate revenues constituted 60% of the total revenue, but the share had decreased during the year. Income structure was affected by high net profits from financial investments received by AS Hansapank as dividends from its subsidiary undertakings in the II quarter of 2007. This affected also the most important ratios and improved them on a solo basis. E.g. the cost-benefit ratio had a considerable drop, reaching the level of 35.1% by the end of 2007. In 2008, the growth in profitability will probably slow down, provided that the slowdown of the growth in loans will continue and discount costs will increase and resources will be more expensive.

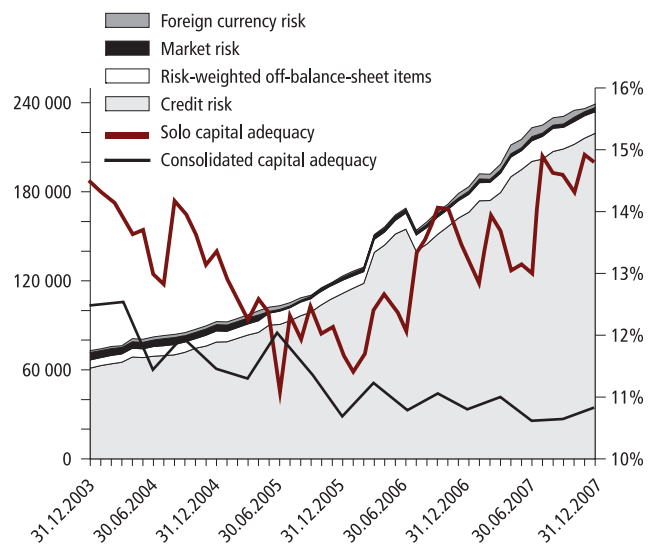
Figure 9. Quarterly bank revenues (in millions of kroons) and the cost-benefit ratio (%)



Strong capitalization of banks

On 31 December 2007, the composite capital adequacy of banks on a solo basis was 14.78% (13.14% in 2006). Banks increased their share capital and included profits and subordinated liability in their own funds in order to keep capital adequacy at a good level. Consolidated capital adequacy of banking groups was 10.84% at the end of 2007 (10.79% in 2006). Credit risk weighted assets still formed more than 90% of total risk weighted assets (see Figure 10).

Figure 10. Risk-weighted assets (in millions of kroons) and capital adequacy of banks (%)



6.3. Insurers

In 2007, eight non-life insurance companies, five life insurance companies and the Estonian Traffic Insurance Fund providing cross-border insurance and reinsurance were operating on the Estonian insurance market. Furthermore, five foreign insurers offered non-life insurance services through their local branches. A total of 272 providers of non-life insurance services and 64 providers of life insurance services have been entered in the register of providers of cross-border services in Estonia.

In 2007, the insurance market growth was higher than in the previous year. The insurance market increased 37.8%, compared to growth of 19.6% in 2006. Insurers collected a total of 6.5 billion kroons in gross premiums, of which 56.9% were non-life insurance and 43.1% life insurance premiums. 2.4 billion kroons worth of claims (including surrenders of life insurance contracts) were paid to policyholders.

Two European companies established

Since 2007, two life insurance companies write business on the Estonian insurance market as European companies (*Societas Europaea*, SE). In 2006, SE Sampo Life Insurance Baltic was established by merging life insurance companies of the Sampo Group. The head office of this European company is situated in Estonia and its branches are situated in Latvia and Lithuania. In 2007, Seesam Elukindlustuse AS bought the shares of Latvian and Lithuanian subsidiaries from its parent undertaking and merged these companies into the European company. The head office of Seesam Life Insurance SE is also situated in Estonia and its branches are situated in Latvia and Lithuania.

Supplementary license issued to AS Hansa Varakindlustus

Supplementary license for accident insurance, sickness insurance, financial loss insurance and motor third party liability insurance was issued to AS Hansa Varakindlustus that took up business in 2006.

Holdings of non-residents in share capital unchanged

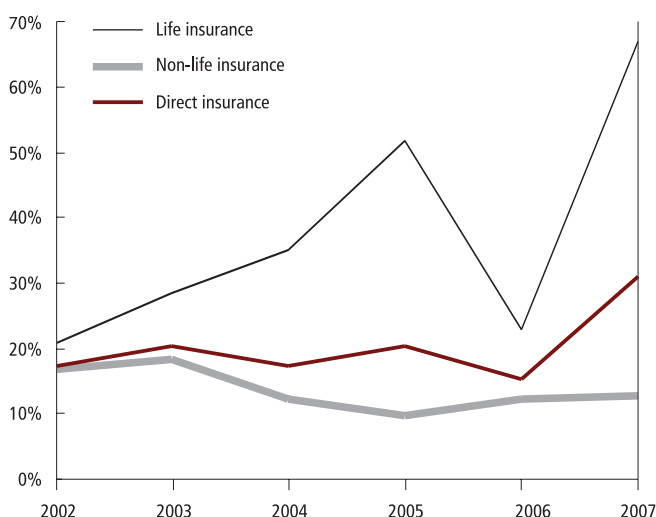
In 2007, the share capital was increased due to the establishment of three non-life insurance companies; in addition, the share capital of SE Sampo Life Insurance Baltic was increased. The ownership structure of AS Inges Kindlustus was changed and the share of residents having the qualifying holding in the share capital increased due to the sale of non-resident holdings. In general, the effect of these changes was small and the direct holding of non-residents in share capital remained unchanged, i.e. 72%.

By gross premiums, the market share directly controlled by non-residents was 82% of non-life insurance and 44% of life insurance. 69% of the life insurance market belongs to Estonian insurance companies, whose owners are two of the major Estonian banks directly controlled by Swedish investors.

Share of life insurance in direct insurance increased

In 2007, the volume of gross life insurance premiums increased 73.9% and the volume of non-life insurance premiums increased 19.0%. During the year, the market distribution of direct insurance – life and non-life insurance – shifted by 9% in favor of life insurance; the share of the latter increased to 43.1%. Considering the 6.6% increase in the consumer price index in 2007, the real growth of direct insurance was 31.2%, compared to 15.2% in 2005 (see Figure 11).

Figure 11. Real growth in annual gross premiums, 2002–2007



6.3.1. Life insurers

In 2007, life insurers collected 2.8 billion kroons in insurance premiums, indicating a growth of 74%. Contractual claims (including surrenders) of 633.1 million kroons were paid out.

Growth in life insurance market backed by the establishment of European companies

Swing growth in life insurance market was primarily caused by the establishment of European companies where the contracts of Latvian and Lithuanian branches were included to insurance portfolio of two insurers. Insurance market witnessed the continuous success of unit-linked life insurance. In 2007, the volume of premiums from unit-linked life insurance grew more than two times (by 1.1 billion kroons) and the volume of investments in unit-linked life insurance increased from 2.2 billion kroons to 4.5 billion kroons. The premium volume of traditional life insurance contracts¹⁹ increased by 16.1% (by 102 million kroons), in comparison to 9.1% in 2006.

Estonian life insurance companies had 267,393 main contracts and 175,607 supplementary contracts²⁰ in force at the end of 2007; the total sum insured was 64.1 billion kroons and annuities per annum totaled approximately 0.5 billion kroons. The increase compared to the previous year was respectively 27.6% for main contracts and 43.2% for supplementary contracts.

Based on the number of insurance contracts, endowment insurance forming 46.8% of all main contracts in force at the end of the year was still a strong market leader. The share of endowment contracts in force has decreased by 13.7% compared to 2006. The share of unit-linked life insurance contracts has concurrently increased from 17.1% to 29.2%. In 2007, 47.9% of all signed main contracts were unit-linked life insurance contracts.

Share of unit-linked life insurance still increased

In 2007, the volume of insurance premiums increased in all insurance classes, except birth and marriage insurance. Based on the volume of premiums, the most popular class of insurance was unit-linked life insurance. Unit-linked life insurance policies are generally characterized by larger than average premium payments per contract, and insurance premiums formed thus 71.4% of all collected payments in spite of the relatively small number of contracts (as at 31 December 2007).

Figure 12. Life insurance portfolio structure in 2007, in brackets 2006

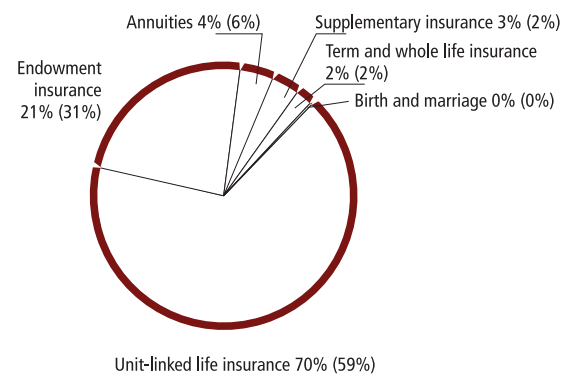
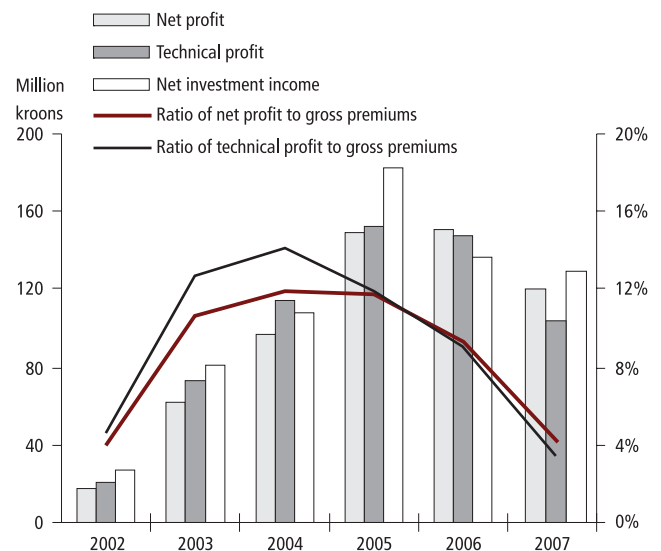


Figure 13. Profit (technical profit) and profit margin (technical profit margin) in life insurance sector, 2002–2007



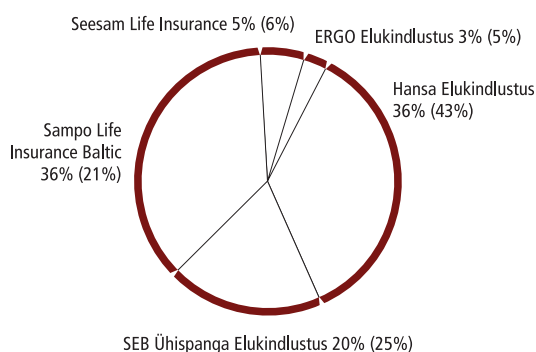
¹⁹ Term and whole life insurance, endowment insurance, birth and marriage insurance, and annuities.

²⁰ The maximum amount of the sum insured paid out during the year (does not include amounts paid out as annuity payments).

Three major life insurers collected 92% of insurance premiums. Due to the establishment of European companies also market shares were changed. AS Hansa Elukindlustus who was the market leader in 2006 is currently sharing its leading position with SE Sampo Life Insurance Baltic (by gross premiums). The market share of both of these companies was 36%. Market shares of AS SEB Ühispaniga Elukindlustus, Seesam Life Insurance SE and Ergo Elukindlustuse AS decreased respectively to 20%, 5% and 3%.

Insurance premiums collected by AS Hansa Elukindlustus, AS SEB Ühispaniga Elukindlustus and AS Sampo Elukindlustus formed 92% of all insurance premiums.

Figure 14. Market shares of life insurers by insurance premiums in 2007, in brackets 2006



Net profit in life insurance sector decreased

According to unaudited data, four companies out of five completed the year 2007 with a profit. In 2007, the total unaudited technical profit of life insurers was 101.9 million kroons and the net profit was 118.2 million kroons. The profit decreased by 21.5% in comparison with 2006.

Annual increase of 60% in the assets of life insurers

Total assets of life insurance companies increased by 60.1% and reached 8.4 billion kroons during the year. Commitments of insurers to policyholders, i.e. technical provisions and guaranteed financial commitments increased 27.8% during the year and reached 2.9 billion kroons by the end of the year. The total volume of investments, as well as cash and cash equivalents was 3.9 billion kroons. All insurance companies complied with the requirements for committed assets provided by the Insurance Activities Act.

6.3.2. Non-life insurers

In 2007, the volume of gross premiums in non-life insurance amounted to 3.7 billion kroons, increasing 19% during the year (in 2006, the increase was 16.1%). Claims paid amounted to 2.1 billion kroons – 25.5% more than in 2006.

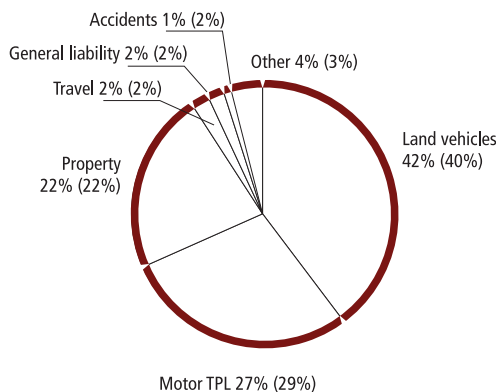
Increased competition

AS Hansa Varakindlustus that is owned by the Hansapank Group and that took up business in 2006 had gained a significant market share of 10% by the end of 2007. In addition to companies authorized in Estonia, the competition is backed also by branches of foreign non-life insurance companies, in particular by Estonian branches of AAS Gjensidige Baltic and BTA as well as by the Estonian branch of Codan Forsikring A/S that took up business at the end of 2007.

Land vehicle insurance continued to be the most popular class of insurance

The non-life insurance market remained dominated by insurance classes related to motor vehicles. The volume of land vehicle insurance and motor TPL insurance formed 2/3 of the total market volume. Property insurance was the third largest insurance class. Shares of other classes of insurance remained between 1% and 3%. In 2007, the share of land vehicle insurance still increased. The growth of the insurance market is primarily based on the obligation imposed by the banks to their clients to insure vehicles or dwelling purchased by a loan or lease.

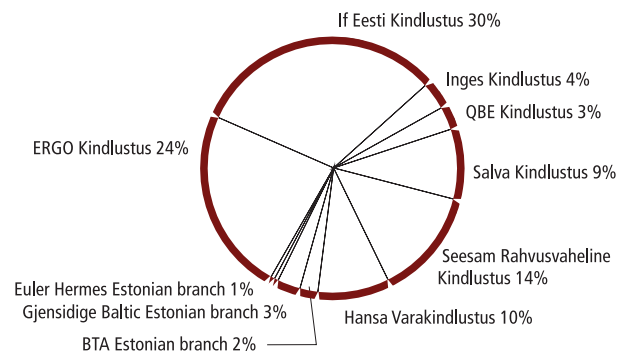
Figure 15. Non-life insurance portfolio structure by direct insurance premiums in 2007, in brackets 2006



Three major non-life insurers captured 81% of the non-life insurance market

In 2007, significant changes took place in the market distribution. AS If Eesti Kindlustus maintained its leading position in the market, though its market share decreased in 2007. Other important players were ERGO Kindlustuse AS, Seesam Rahvusvaheline Kindlustuse AS and AS Hansa Varakindlustus. Main reason behind the changing market distribution was the competition increased by new entrants and *inter alia* the increasing importance of branches of foreign insurers. Branches of foreign insurers formed 6% of the total market volume in 2007.

Figure 16. Market shares of non-life insurers in 2007



Ceded reinsurance share in gross premiums decreased

According to data of 2007, the share of ceded reinsurance in premium volume varied from 2.7% to 77.2%, depending on the company. In 2007, the share of ceded reinsurance in premium volumes decreased by 14% in the market as a whole, compared to 14.6% in 2006.

Loss ratio, expense ratio and combined ratio for non-life insurance

Increasing competition is also reflected in ratios that characterize the insurance activities of companies. The gross loss ratio²¹ was 63.8% in 2007 (57.8% in 2006). Also, the net loss ratio increased. In 2007, the net loss ratio was 66%; the respective figure in 2006 was 60.2%. There is no doubt that adverse results in motor TPL insurance had a significant effect on the loss ratio.

Increasing competition has forced non-life insurers to be more effective. In 2007, gross and net expense ratios²² of non-life insurers were respectively 22.7% and 23.6%.

The gross combined ratio²³ for non-life insurance companies was 86.5% in 2007 and the net combined ratio characterizing the profitability of insurers themselves was 85.6%, being higher than the respective figures for 2006.

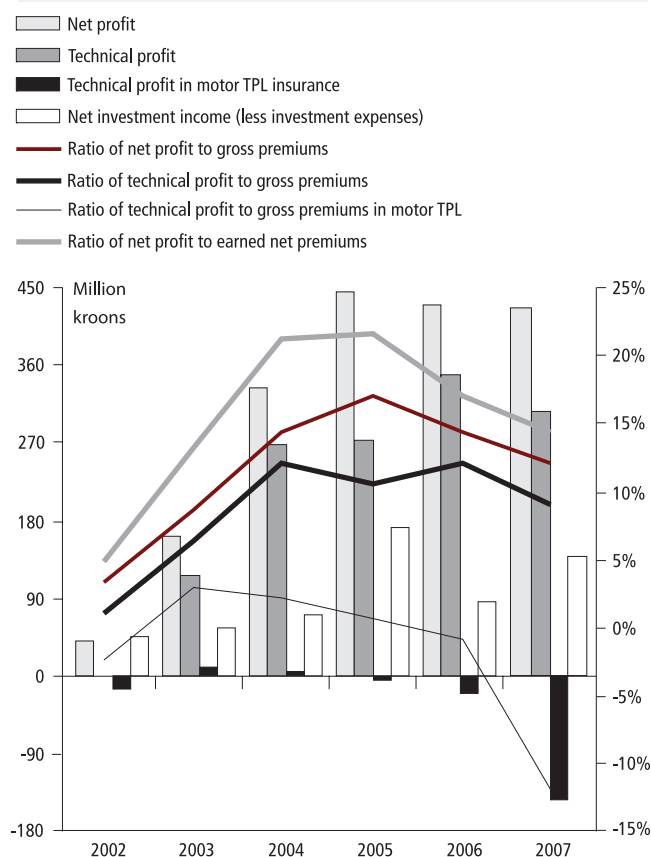
Net profit of non-life insurers remained stable

Non-life insurance companies managed to earn 140.4 million kroons of profit from investments in 2007. In 2007, the technical profit amounted to 304 million kroons, which was a little weaker result than in the previous year. Five non-life insurers had a positive technical profit. The total unaudited net profit for non-life insurance companies was 422.5 million kroons in 2007.

Competition in prices was the highest in motor TPL insurance where the unaudited technical loss for insurance companies totaled 137.6 million kroons in 2007.

Figure 17. Profit (technical profit) and profit margin

(technical profit margin) for non-life insurers, 2002–2007



Growth of 20% in the assets of non-life insurance companies

The asset volume of non-life insurance companies reached to 4.9 billion kroons at the end of 2007. At the end of 2007, technical provisions for non-life insurance companies (net of reinsurance) totaled 2.1 billion kroons, forming 42.5% of the balance sheet volume. The total volume of investments and cash and cash equivalents exceeded the volume of net technical provisions 2.1 times at the end of 2007.

²¹ Loss ratio = ratio of claims incurred to earned premiums (gross figure includes reinsurance).

²² Ratio of administrative expenses and deferred acquisition costs to earned premiums.

²³ Combined ratio = loss ratio + expense ratio (gross figure includes reinsurance).

6.4. Insurance intermediaries

As at 31 December 2007, the list of insurance intermediaries included 22 Estonian insurance brokers, about 600 cross-border insurance brokers, and about 1100 cross-border insurance agents who are entitled to provide insurance brokerage services in the Estonian market.

Pursuant to the information that insurance brokers submitted to the Financial Supervision Authority, both the turnover and profits of brokers increased in 2007.

In 2007, the growth in the brokers' turnover was approximately 20–35%. The increase in brokerage fees (commissions) was between 20% and 40% and in certain cases even higher, depending on the broker. Insurance brokers that entered the market in last couple of years have found their place on the insurance mediation market and both their turnover and the volume of brokerage fees have gradually increased.

In 2007, the volume of brokerage fees (incl. contracts sold in previous years) that non-life insurance companies paid was about 203.5 million kroons. About 2.1 million kroons was paid to insurance brokers from other countries.

Insurance brokers are rarely used in life insurance. In 2007, the volume of brokerage fees that life insurance companies paid to Estonian insurance brokers was about 750 thousand kroons. About 3.2 million kroons was paid to insurance brokers from other countries.

The number of notices received from EU member countries in respect of the mediation of cross-border insurance services is constantly increasing; still, the activities of cross-border insurance intermediaries have currently no significant effect on the Estonian insurance mediation market. The number of insurance contracts mediated from foreign countries will probably increase in areas where it is complicated to find the respective insurance product from the local insurance market..

6.5. Fund management companies and funds

6.5.1. Fund management companies

At 31 December 2007, there were eleven fund management companies operating in Estonia.

In 2007, three new fund management companies were included to the list of fund management companies operating in Estonia. Respective licenses were issued to AS Trigon Alternative Funds, AS GILD Property Asset Management and AS GILD Fund Management. AS Trigon Alternative Funds acquired also the right to provide the securities portfolio management service. AS GILD Property Asset Management is a company established for administrating real estate funds and AS GILD Fund Management is designed for administrating venture capital funds.

Increasing income of fund management companies raised profits

The volume of the aggregated balance sheets of fund management companies grew by 43% during the year, reaching 1.2 billion kroons by the end of 2007. The increase in balance sheet volume was caused by an increase in the equity of fund management companies, which took place due to an increase in the profitability of fund management companies as well as the adherence to the share capital requirements by new market participants. At the end of the year, equity of fund management companies constituted 92% or 1.1 billion kroons of the consolidated balance sheet.

In 2007, the net profit of fund management companies totaled 364 million kroons, in comparison to a net profit of 213 million kroons in 2006. The growth in profit relates mostly to the growth in revenues from management fees.

The operating income for fund management companies increased 53% in 2007, reaching to 948 million (611 million kroons in 2006) kroons due to rapid expansion of the volume of investment funds. The structure of operating income remained stable: the majority of the operating income (79%) originates from the management of investment funds, 13% from unit sales charges and redemption fees, 7% from the management of clients' securities portfolios and 1% from other services (mainly consulting about investing in securities).

The operating expenses of fund management companies increased 49% in 2007, reaching to 623 million kroons (418 million kroons in 2006). The growth in operating expenses was caused by an increase in the volume of services provided.

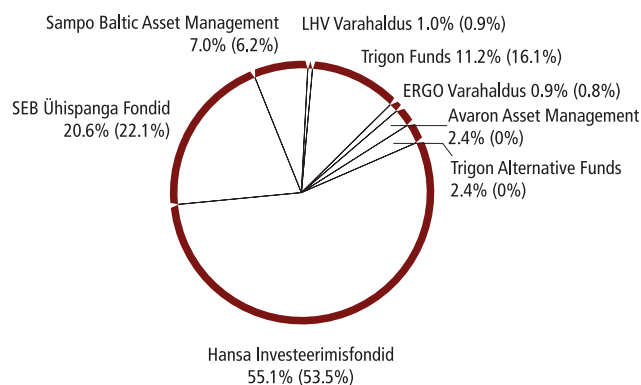
The largest increase was in revenues from fees and commissions related to fund management activities, in particular from brokerage for fund units and management of securities portfolios. Fees and commissions formed 75% of all operating expenses. Personnel expenses constituted 13%, other administrative expenses 10% (incl. advertising expenses) and other operating expenses 2%.

High market concentration

Estonian fund market is characterized by high concentration. At the end of 2007, the three largest fund management companies controlled 87% of the market²⁴ (92% in 2006).

More than a half of the market was captured by AS Hansa Investeerimisfondid – 55.1%. AS SEB Varahaldus captured 20.6% of the market and AS Trigon Funds captured 11.2% of the market. New fund management companies – both Avaron Asset Management and AS Trigon Alternative Funds – captured 2.4% of the market on 31 December 2007.

Figure 18. Market shares of fund management companies, based on volume of investment funds as at 31.12.2007 (in brackets 31.12.2006)



Total volume of managed assets increased significantly

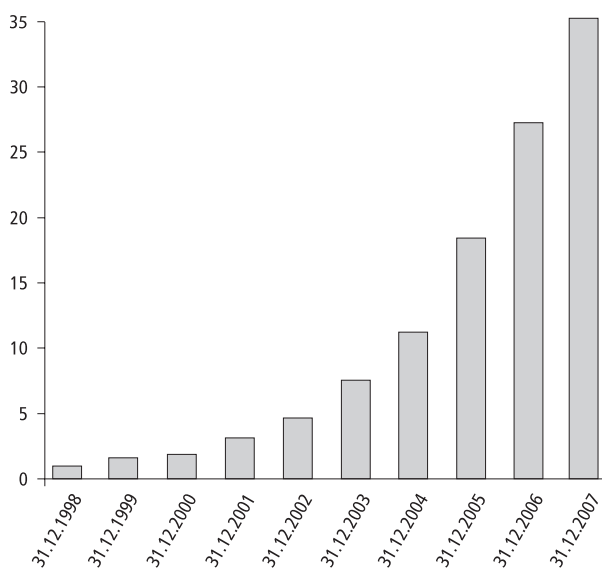
Total assets managed by fund management companies increased rapidly in 2007, reaching 41.6 billion kroons by the end of 2007 (31.6 billion kroons in 2006), of which 35 billion kroons originated from managed investment funds and 6.6 billion kroons from clients' securities portfolios. Portfolio management services were offered by five fund management companies.

²⁴ AS GILD Property Asset Management and AS GILD Fund Management that received the fund management license in the second half of 2007 had not yet started to offer fund units on 31 December 2007.

6.5.2. Investment and pension funds

The net asset value of investment funds (including pension funds) increased by 29% in 2007, reaching 34.6 billion kroons by the end of the year.

Figure 19. Dynamics of the net asset value of investment funds (incl. pension funds) for 1998–2007 (in billions of kroons)



2007 witnessed an uneven development of funds. The first half of 2007 was characterized by continuing rapid growth in the volume of funds, but in the second half of the year the growth in funds' assets slowed down due to stock market corrections. The volume of funds' assets hit the roof at the end of October reaching to 36.4 billion kroons, and decreased thereafter to 34.6 billion kroons by the end of December.

In 2007, ten new equity funds (incl. fund of funds with equity strategy) and two new debt funds were registered in Estonia as investment funds. The number of investment funds registered in Estonia reached to 57 by the end of 2007, whereof 27 funds were equity funds (18 in 2006), 8 were debt funds (6), 15 were mandatory pension funds (15) and 7 were voluntary pension funds (7).

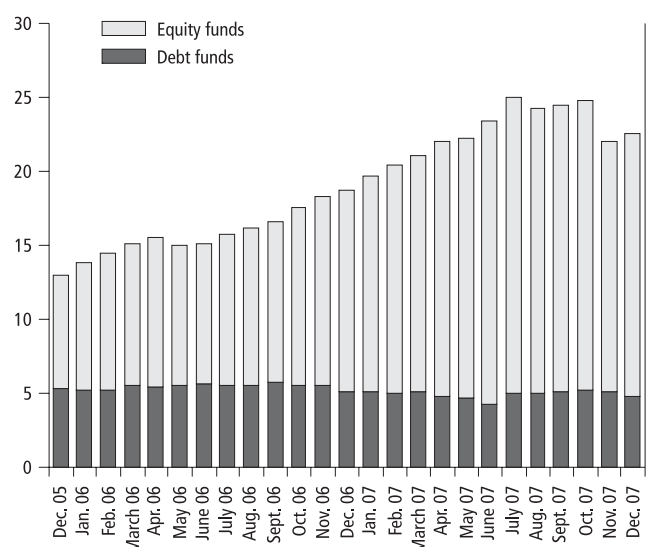
Growth of equity funds slowed down

Real estate loan crises in the USA lead to the confidence crises in the financial sector as a whole, causing significant corrections in global stock markets. Events on global stock markets influenced also the development of Estonian investment and pension funds.

The growth in equity funds' assets that had driven the growth in the whole Estonian fund sector stopped in the second half of 2007 and turned to a fall during the last months of the year. Due to rapid growth in the first half of the year, the volume of equity funds' assets increased 30% in 2007, growing from 13.6 billion kroons at the beginning of the year to 17.7 billion kroons at the end of the year. The growth in equity funds' volume was supported by the entry to the market of new equity funds with the total volume of 2.3 billion kroons (31.12.2007).

The volume of debt funds (money market and fixed income funds) decreased 5% in 2007, amounting to 4.8 billion kroons at the end of the year. This drop was hedged by new debt funds with total assets of 0.6 billion kroons (31.12.2007)..

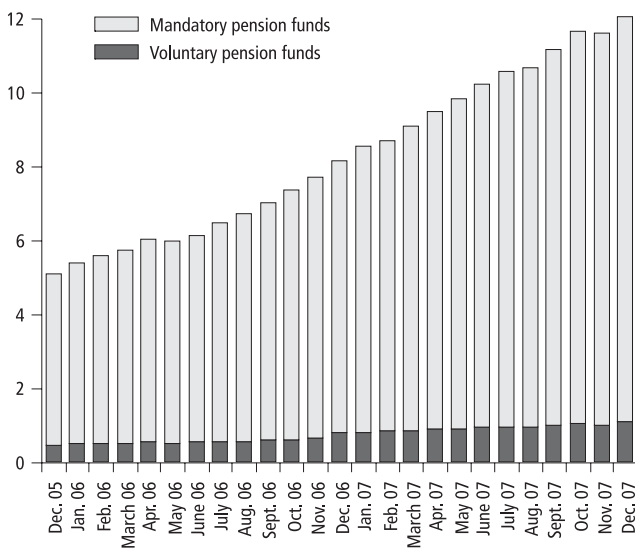
Figure 20. Asset volume of investment funds (in billions of kroons)



Still rapid growth of pension funds

Due to continuing rapid growth, the total asset volume of pension funds registered in Estonia crossed the margin of 12 billion kroons at the end of 2007. The volume of mandatory pension funds increased 48% within the year, increasing from 7.4 billion kroons to 11 billion kroons. The volume of voluntary pension funds increased 45% within the year, increasing from 0.8 billion kroons to 1.1 billion kroons.

Figure 21. Asset volume of pension funds (in billions of kroons)

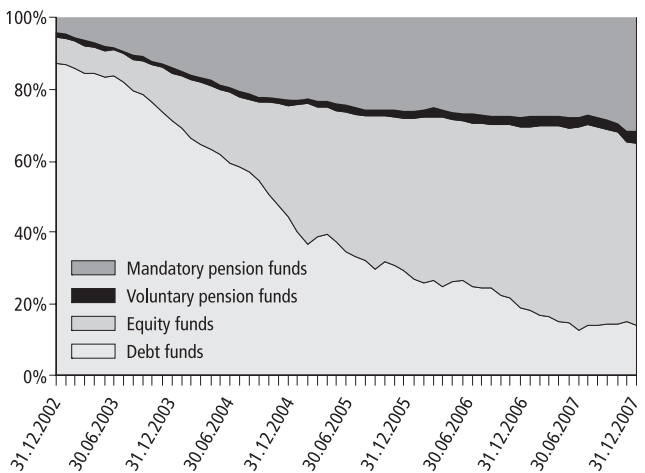


Equity funds still dominate

The share of equity funds in the aggregated portfolio of investment funds remained unchanged due to the stop of growth of equity funds in the second half of 2007, remaining to the level of 51% of the total market volume. Nevertheless, equity funds are still the biggest class of funds in the Estonian funds market. The share of debt funds continually declined, constituting only 14% of total market volume by the end of the year (19% in 2006).

The share of mandatory pension funds increased during the year, capturing 32% of total market volume by the end of the year (28% in 2006). The share of voluntary pension funds remained stable with 3% of the total market volume.

Figure 22. Division of market according to different fund types 31.12.2002–31.12.2007



Share of direct investments decreased

The decrease of direct investments and the increase of indirect investments (investments made through other investment funds) can be considered as the biggest change in the consolidated portfolio structure of investment and pension funds in 2007.

This applies primarily to mandatory pension funds, where the share of units of other investment funds grew from 37% to 51% in 2007 due to the decrease of direct equity and bond investments.

The growth in the share of instruments with equity risk from 82% to 88% can be considered as the main change in the consolidated portfolio structure of equity funds in 2007. Investments into instruments with fixed interest decreased from 7% to 2%.

The share of instruments with equity risk in the investment structure of mandatory pension funds remained unchanged, i.e. 40%. Concurrently, the share of instruments with fixed interest decreased from 56% to 52% and the share of term deposits increased from 1% to 7%.

Figure 23. Asset structure of equity funds as at 31.12.2007
(in brackets 31.12.2006)

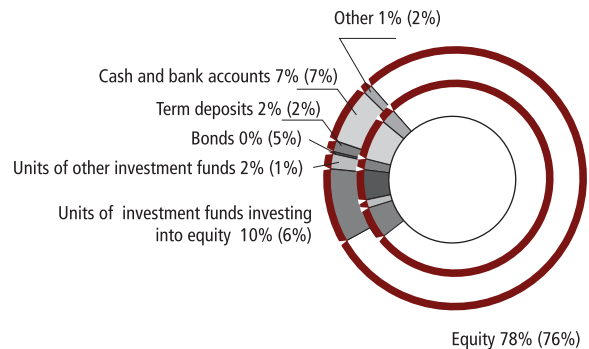
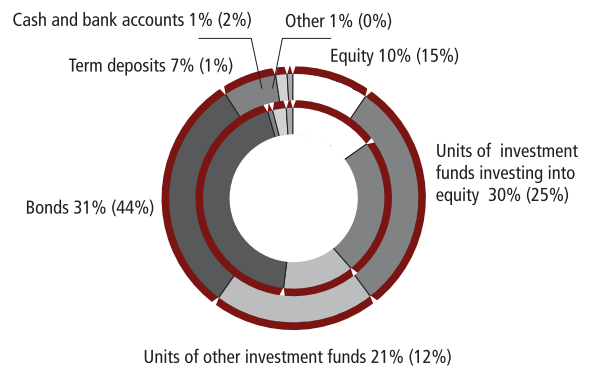


Figure 24. Asset structure of mandatory pension funds as at 31.12.2007
(in brackets 31.12.2006)

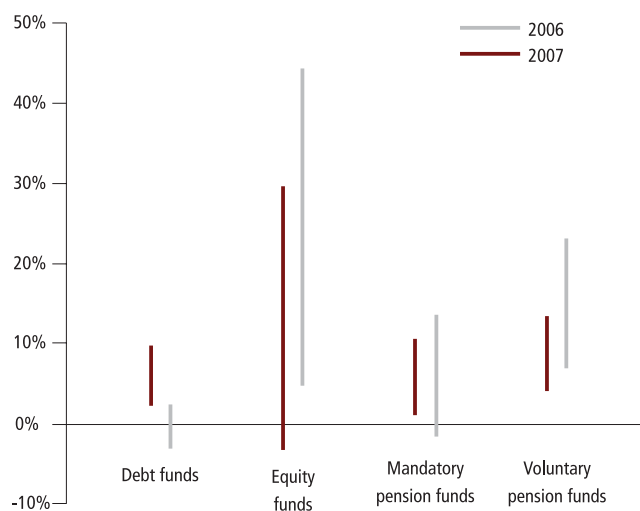


Performance of debt funds improved

Developments on global financial markets were reflected also in the performance of investment and pension funds registered in Estonia. In 2007, the performance of funds investing into equity instruments got worse and the performance of debt funds improved.

Equity funds guaranteed the return between 3% and 30%, mandatory pension funds between 1% and 11%, voluntary pension funds between 4% and 13%, and debt funds between 2% and 10%.

Figure 25. Annual performance range of various fund types



Investments into European countries increased

The most important investment region for Estonian fund investors was Western Europe where 30% of the assets of investment and pension funds were invested as at the end of 2007 (24% in 2006). The change in the volume of investments into Central and East Europe was insignificant, but their share decreased to 22% (29% in 2006). Investments into Estonia remained at the level of 22%.

Interest in pension funds increased

The number of people joining mandatory pension funds (mandatory funded pension) increased in 2007 from 519,726 to 554,353.

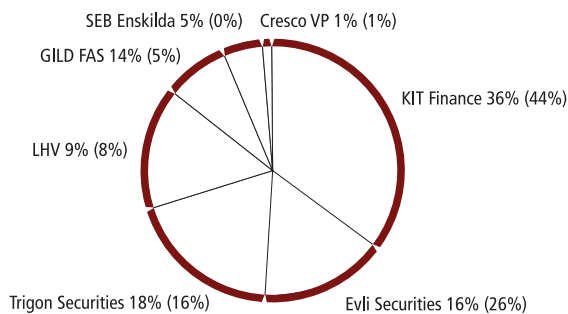
The number of people joining voluntary pension funds increased also considerably – from 25,107 at the end of 2006 to 42,000 at the end of 2007.

6.6. Investment firms

In 2007, a new investment firm AS SEB Enskilda, the subsidiary of AS SEB Bank, was authorized. AS SEB Enskilda was successful in capturing the advisory services market during the first two quarters of the year and its share increased to 54% by the end of the year.

AS KIT Finance Europe, the subsidiary of a Russian investment bank, was as before the largest investment firm by asset volume. In 2007, AS GILD Financial Advisory Services managed to increase its share, in particular due to its extraordinarily big profit. At the end of the year, there were three investment firms owned by banking groups operating in Estonia: Evli Securities AS, AS KIT Finance Europe and AS SEB Enskilda, capturing more than half of the asset volume of the market. The provision of investment services is generally not a capital intensive activity, and thus also investments firms that do not depend from banking groups and have a relatively small asset volume have obtained a significant market share in various market segments (Figures 27–29).

Figure 26. Market shares by asset volume 31.12.07 (31.12.06)



Market shares of investment firms by service charges 2007

Figure 27. Advisory services (183 mln)

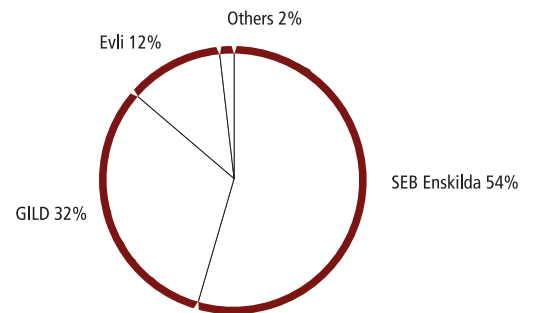


Figure 28. Securities brokerage (91 mln)

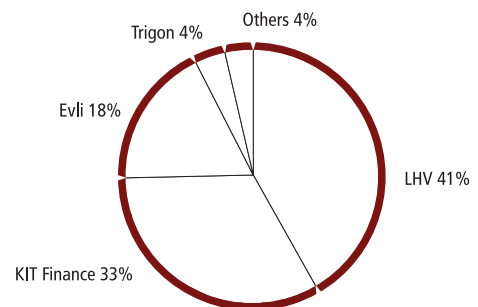
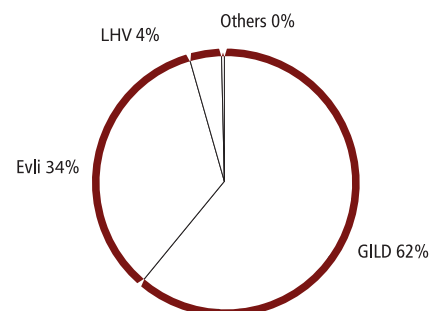


Figure 29. Portfolio management (107 mln)



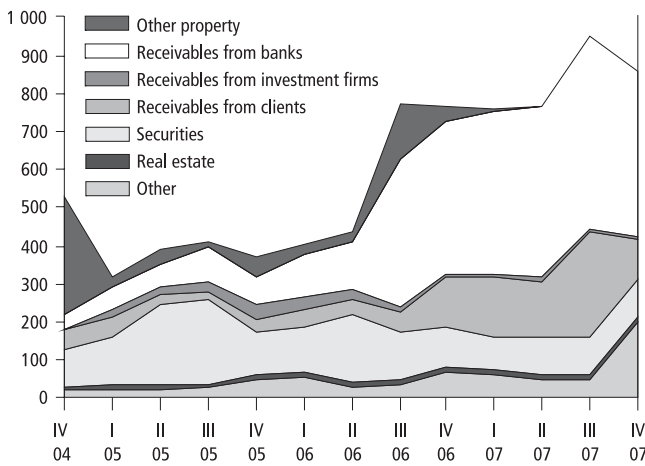
Deposits form the majority of assets

The growth in the asset volume of investment firms is a long-term process supported primarily by the increase in equity capital. The volume of assets decreased at the end of 2007 due to the decreased lending. As investment firms grant short-term loans backed by securities, we can anticipate that their volume fluctuates in correlation with developments on the securities market.

Bank deposits form the majority of investment firms' assets. The Financial Supervision Authority considers that balance sheet risks of investment firms are moderate.

Most of the risks originate from off-balance-sheet activities, in particular from the mediation of securities transactions of clients and keeping of clients' assets.

Figure 30. Aggregated assets of investment firms (in millions of kroons)



Profitability continues to be high

Profits earned by investment firms in 2007 from service charges were 1.5 times higher than in the previous year. Profits increased especially in the areas of advisory services and management of securities portfolios.

The majority of profits from portfolio management came from the management of fund-like investment products or assets of institutional clients and not from the classic sale of private banking services designed for wealthier private persons.

Main advisory services were: arrangement of securities emissions and consultation on take-over of companies, i.e. services designed for larger companies.

Although the relative ROE of investment firms decreased, the profitability of equity capital achieved (31%) can be considered very good.

Figure 31. Profit and profitability of equity capital of investment firms (in millions of kroons)

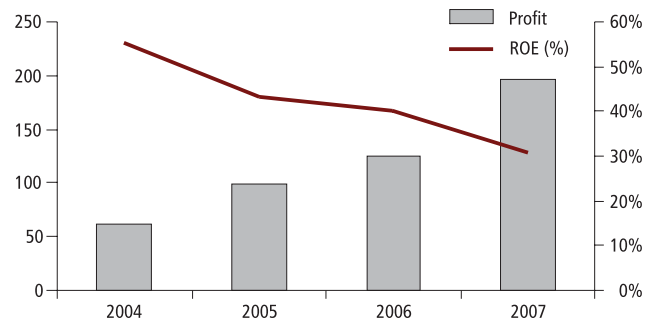
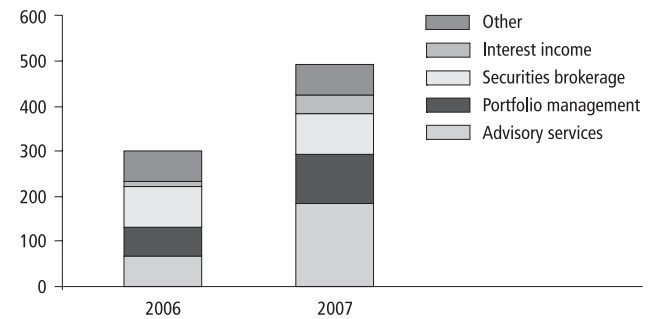


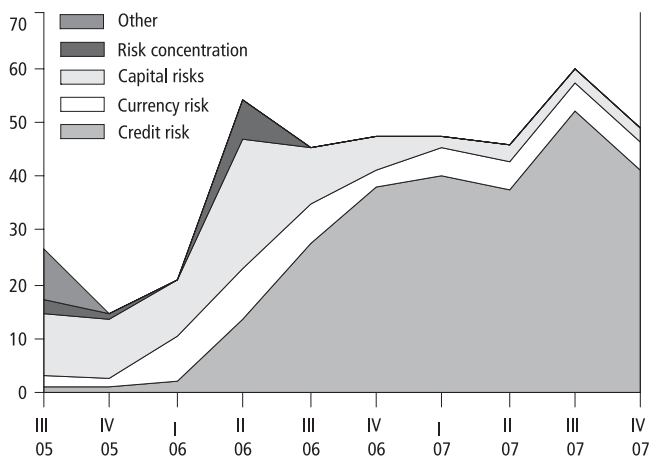
Figure 32. Revenues of investment firms by areas of activity (in millions of kroons)



Prudential requirements

All investment firms managed to meet sufficiently the capital adequacy requirement and the absolute minimum requirement of own funds. Besides the minimum requirement of own funds (0.8, 2.0 or 11.4 million kroons, depending on the type of offered services), investment firms are also subject to the risk-based capital adequacy requirements similar to the requirements applied to banks. Only two investment firms out of seven had a smaller risk-based capital requirement than the minimum requirement of own funds. On the one hand, this indicates that investment firms operating in Estonia are relatively small. On the other hand, this means that investment firms do not take substantial risks on their own account and prefer the intermediation of investments to clients.

Figure 33. Capital requirement of investment firms by risks
(in millions of kroons)

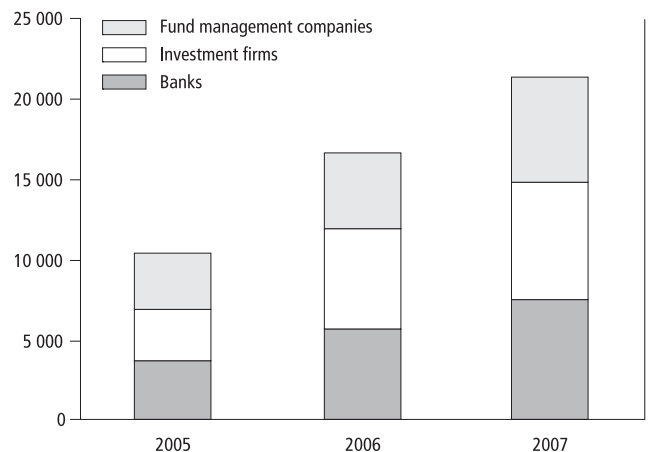


6.7. Investment services

6.7.I. Management of securities portfolios

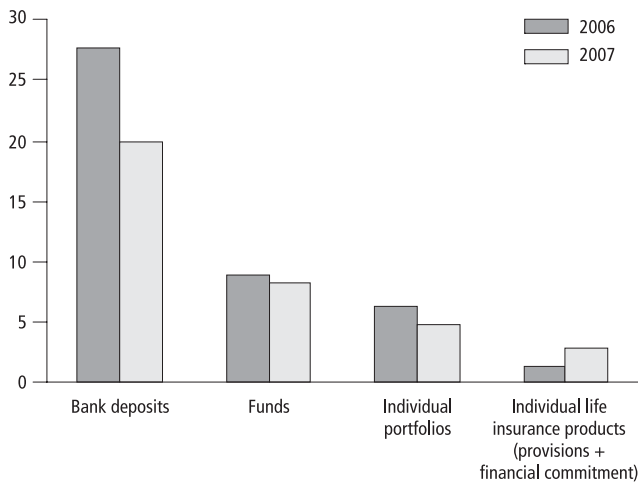
Management of securities portfolios is the management of portfolios made up of securities offered to each individual client separately according to general directions given by the client. Securities portfolio management service can be provided by fund management companies, investment firms and credit institutions. The service is used by private as well as professional investors who buy in the portfolio management service – e.g. fund management companies and insurers.

Figure 34. Volume of managed individual portfolios by sectors
(in millions of kroons)



The volume of individually managed portfolios reached to 21 billion kroons at the end of 2007 (16 billion kroons in 2006). Individual securities portfolios were the third investment product by their volume as well as by annual growth after bank deposits and funds. Customers of securities portfolio management service were wealthier private persons and institutional clients. Still, the number of clients was significantly smaller than in the funds sector, though their asset volume is similar.

Figure 35. Comparison of individual portfolios with other savings and investment products (in billions of kroons)



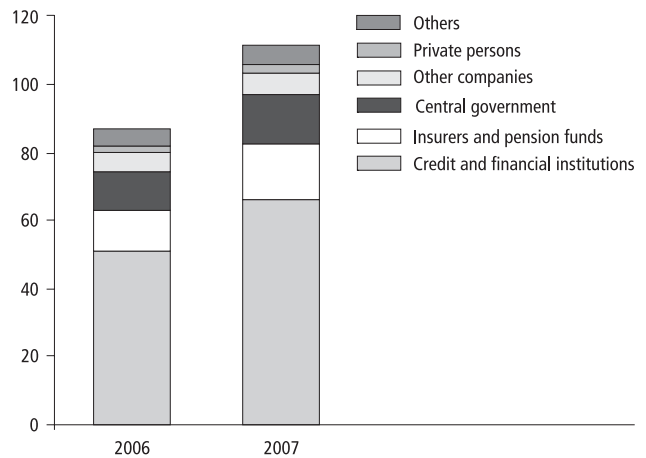
Official statistics for the market of portfolio management service is somewhat distorted in Estonia as several market participants offer similar services under investment advisory contracts. These contracts are not included in the statistics of the Financial Supervision Authority, although the service is very similar to the portfolio management. Thus, it is highly probable that the market volume of securities portfolio management is considerably bigger than shown in the statistics.

6.7.2. Safekeeping of securities

Safekeeping of securities means the safekeeping of securities on securities account opened in the name of a credit institution or an investment firm by third parties or in the Central Register of Securities in a way that third parties can not identify the ultimate owner of securities. Pursuant to legislation in force in Estonia and in many EU countries, securities kept for clients are separated from the bankruptcy estate of service provider. Still, there are jurisdictions where there is no separation of assets.

Clients are safekeeping the securities on accounts opened in the Central Register of Securities of the respective country in their own name, if it is not possible or practicable to keep these securities by themselves. Most of the owners of securities are professional investors: credit institutions, financial institutions, government, etc. Private persons own a relatively small share of the total value of securities.

Figure 36. Securities of clients kept in credit institutions (in billions of kroons)



The securities' safekeeping market is still mostly driven by banks in Estonia. Credit institutions kept in total 109 billion kroons of clients' securities and most of these securities belonged to institutional clients: foreign credit institutions and financial institutions, investment and pension funds, etc.

Only three investment firms out of seven used the business model which requires that clients' securities are kept on the account of investment firm; the volume of assets kept by these investment firms amounted to 2.9 billion kroons (1.6 billion kroons in 2006).

6.8. Issuers of securities

As at 31 December 2007, there were the shares of 18 companies listed on the main list of the Tallinn Stock Exchange; in addition, it was possible to trade with the securities of 6 issuers of debt instruments. In 2006, the main list included 12 issuers, the investor list included 4 issuers, and 6 issuers traded with debt instruments.

In 2007, two new equity issuers – Arco Vara AS and AS Ekspress Grupp – were included to the main list of AS Tallinn Stock Exchange (hereinafter: Tallinn Stock Exchange). The emission of Arco Vara AS amounting to 1.5 billion kroons was oversubscribed by 2.1 times, and the emission of Express Grupp amounting to 565 million kroons was oversubscribed by 6 times.

In 2007, an issuer was divided. AS Viisnurk was established as a result of dividing AS Trigon Property Development that was listed on the Tallinn Stock Exchange. The division was aimed at transferring the production of construction materials and furniture and the retail sale of furniture into the new publicly traded company and ensuring that AS Trigon Property Development continues its activities as a development company.

PTA Grupp AS acquired Silvano Fashion Group in 2007 and the new name of the company is AS Silvano Fashion Group. The mandatory takeover bid of Baltic Moontech Investments Holding AS to the shares of AS Starman came to an end and slightly more than 65% of the company belongs thus to the Baltic Moontech Investments Holding AS.

The shares of AS Tallinna Farmaatsiatehas were removed from the list of Tallinn Stock Exchange at the beginning of 2007.

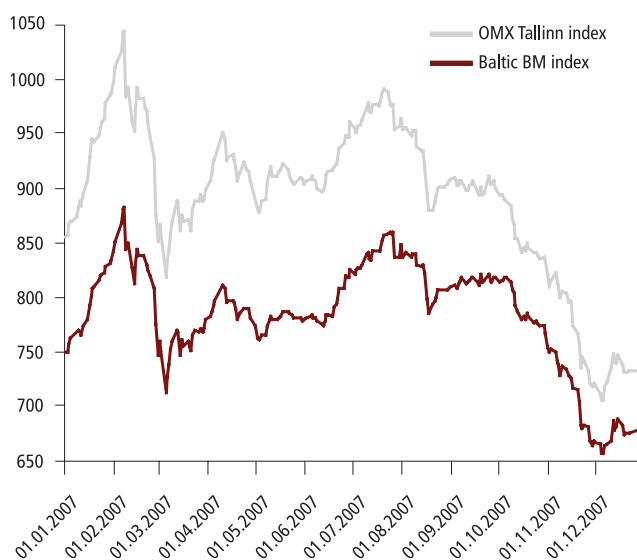
6.9. Securities market operators

6.9.I. Tallinn Stock Exchange

The Tallinn Stock Exchange is the only regulated secondary market for securities in Estonia, providing the administration of the environment necessary for trading with securities, settlement of transactions with securities and listing of companies. AS Tallinn Stock Exchange belongs to the international OMX Group.

The general change in the direction of the shares listed on the Tallinn Stock Exchange is reflected by the OMX Tallinn index. Whereas in 2006 the OMX Tallinn index rose 29% (656 points as at 31 December 2006), then in 2007 the OMX Tallinn index dropped more than 13% (742 points as at 31 December 2007). Still, the highest level of 1043 points during eleven years of activity of Tallinn Stock Exchange was achieved on 6 February 2007. The decrease in the Baltic Benchmark for the year was 8.6% (685 points as of 31 December 2007).

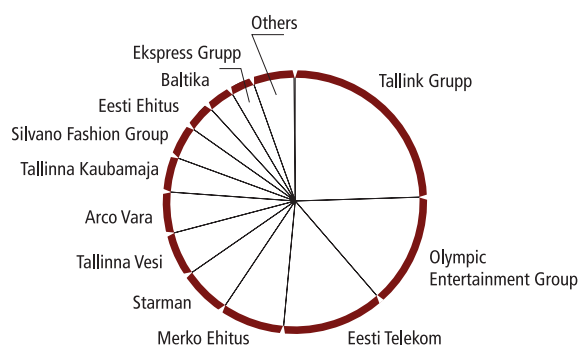
Figure 37. OMX Tallinn and Baltic Benchmark indices in 2007



Nordic and Baltic electronic trading system SAXESS is used by stock exchanges of Tallinn and Riga since 2004 and by Vilnius Stock Exchange since 2005; besides stock exchanges mentioned it unites the stock exchanges of Stockholm, Helsinki, Oslo, Copenhagen and Reykjavik. The strategic goal of OMX Group is to minimize the differences between the three Baltic markets by implementing a common trading platform and harmonized market rules, in order to facilitate cross-border trading, decrease related costs and attract more investments to the region.

Market liquidity, transaction statistics and market value of shares In 2007, AS Tallink Grupp shares had the highest trading volume, followed by the shares of AS Olympic Entertainment Group and AS Eesti Telekom (see Figure 38). The turnover of the Tallinn Stock Exchange was twice as high as in 2006, approaching to 24 billion kroons.

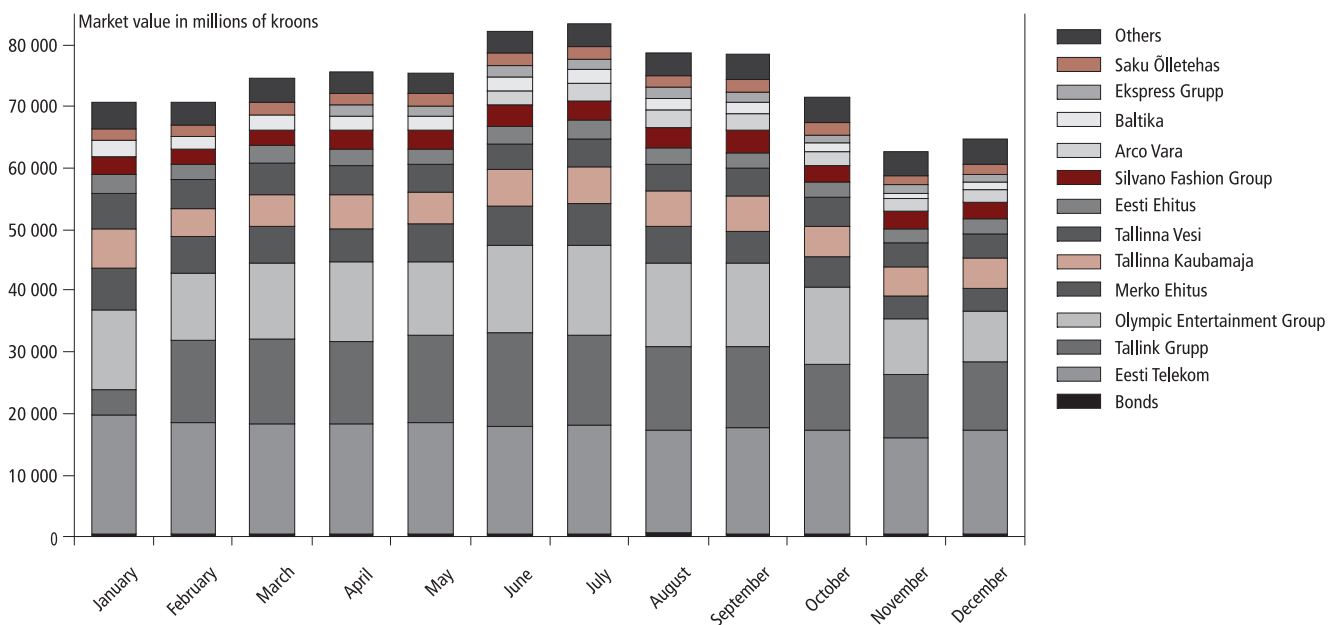
Figure 38. Distribution of securities turnover in 2007



One of the primary indicators of market liquidity – the ratio of turnover and average market share value – on the Tallinn Stock Exchange was 35.4% in 2007 (20.3% in 2006). There were 142,291 transactions with shares and bonds made on the Tallinn Stock Exchange (an increase of 127% compared to 2006), and the turnover of these transactions was almost 24 billion kroons (decrease of 100%), while the average size of exchange transactions was approximately 169 thousand kroons (decrease of 13%).

The market value of the shares of publicly traded companies was 70.8 billion kroons at the beginning of 2007 and 64.2 billion kroons at the end of the year.

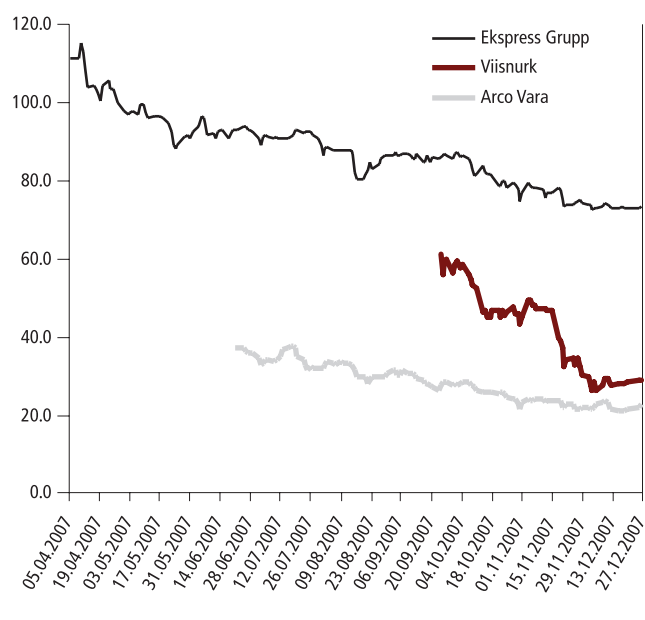
Figure 39. Market value of securities listed on the Tallinn Stock Exchange in 2007



Changes in share prices of new issuers

In 2007, the shares of three new issuers – Arco Vara AS, AS Ekspress Grupp and AS Viisnurk – were listed on the Tallinn Stock Exchange, and the closing price of these shares are illustrated by Figure 40.

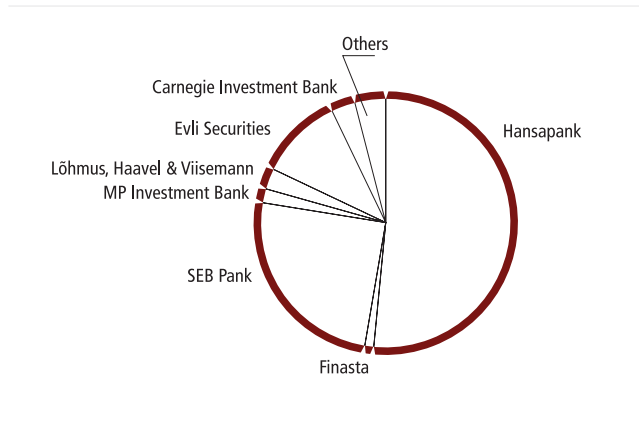
Figure 40. Closing prices for new shares (from the first day of trading)



Activeness of members of the Stock Exchange

The most active trader on the Tallinn Stock Exchange was AS Hansapank in 2007 and the trade with its shares accounted for more than 51% of the total turnover of the stock exchange and almost 40% of the total number of transactions. AS Hansapank was followed by AS SEB Pank with 25% and 20%, respectively, and the third place was taken by Evli Securities AS with 10% and 6%, respectively.

Figure 41. Participation of the Stock Exchange members in total turnover in 2007



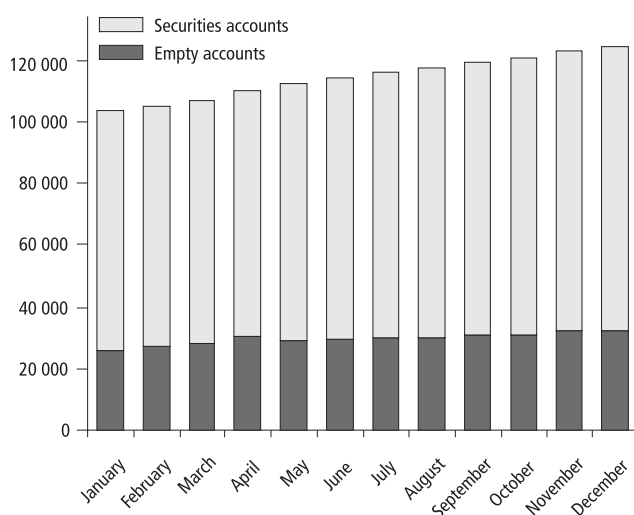
6.9.2. Estonian Central Register of Securities

The Estonian Central Register of Securities (initially called the Estonian Central Securities Depository), founded in 1994, is the central electronic register of Estonian securities and the administrator of the register for funded pensions in Estonia, and it keeps accounts on all the securities accounts and pension accounts opened in Estonia and the share registers of all public limited companies operating in Estonia. It also administers the acceptance of applications for the funded pension or II pillar of the pension system, and the issuance of fund units. The Tallinn Stock Exchange owns 100% of the shares of the Estonian Central Register of Securities.

Changes in the number of securities accounts

There were 124,532 valid securities accounts registered with the Estonian Central Register of Securities at the end of 2007; of these 111,167 belonged to private persons (an increase of 21% compared to 2006). In 2007, there were about 25,000 active investors who had made at least five transactions (stock exchange transactions + over-the-counter transactions). The number of empty accounts remained quite stable, witnessing a minor leap upwards after the stock exchange correction performed in March.

Figure 42. Number of securities accounts in 2007



Annex I

List of Supervised Entities as of
December 31 2007

| Supervised entities | Address | Contact | | Executive Director |
|--|---------------------------------|----------------------|-----------|----------------------|
| Credit institutions and branches | | | | |
| Balti Investeeringute Grupi Pank AS | Rüütli 23, 51006 Tartu | www.big.ee | 7 377 570 | Targo Raus |
| AS Eesti Krediidipank | Narva mnt 4, 15014 Tallinn | www.krediidipank.ee | 6 690 900 | Andrus Kluge |
| AS Hansapank | Liivalaia 8, 15040 Tallinn | www.hansa.ee | 6 310 310 | Erkki Raasuke |
| AS Sampo Pank | Narva mnt 11, 15015 Tallinn | www.sampopank.ee | 6 302 100 | Aivar Rehe |
| AS SBM Pank | Pärnu mnt 12, 10148 Tallinn | www.smbbank.ee | 6 110 500 | Riho Rasmann |
| AS SEB Eesti Ühispank | Tornimäe 2, 15010 Tallinn | www.seb.ee | 6 655 100 | Ahti Asmann |
| Tallinna Äripanga AS | Vana-Viru 7, 10111 Tallinn | www.tbb.ee | 6 688 000 | Valeri Haritonov |
| Allied Irish Banks plc Estonian Branch | Roosikrantsi 11, 10119 Tallinn | www.amcredit.ee | 6 277 180 | Aidan Clarke |
| Bayerische Hypo- und Vereinsbank AG Tallinn Branch | Liivalaia 13/15, 10118 Tallinn | www.hvb.ee | 6 688 300 | Frank Roland Marcus |
| AS DnB NORD Banka Estonian Branch | Tartu mnt 10, 10145 Tallinn | www.dnbnord.ee | 6 868 500 | Hans Pajoma |
| Nordea Bank Finland Plc Estonian Branch | Hobujaama 4, 15068 Tallinn | www.nordea.ee | 6 283 300 | Vahur Kraft |
| AS Parex banka Estonian Branch | Roosikrantsi 2, 10119 Tallinn | www.parex.ee | 7 700 000 | Eizens Slava |
| Scania Finans AB Estonian Branch | Peterburi tee 72, 11415 Tallinn | www.scania.ee | 6 651 263 | Veljo Barbo |
| Siemens Financial Services AB Estonian Branch | Pärnu mnt 139C, 11317 Tallinn | www.siemens.ee | 6 305 705 | Jarl Anders Stenbock |
| Svenska Handelsbanken AB Estonian Branch | Harju 6, Tallinn 10130 | www.handelsbanken.se | 6 808 300 | Harri Tapio Tuohimaa |
| AS UniCredit Bank Estonian Branch | Liivalaia 13/15, 10118 Tallinn | www.unicreditbank.ee | 6 688 305 | Taavi Laur |
| Fund management companies and funds | | | | |
| AS Avaron Assets Management Avaron Areneva Euroopa Väikeettevõtete Fond Avaron Balkani Fond | Narva mnt 5-58, 10117 Tallinn | www.avaron.ee | 6 644 200 | Peter Priisalm |

| Supervised entities | Address | Contact | | Executive Director |
|---|-----------------------------|---------------------|-----------|--------------------|
| Ergo Varahalduse AS ERGO Rahulik Pensionifond ERGO Tuleviku Pensionifond | A. Lauteri 5, 10114 Tallinn | www.ergofondid.ee | 6 106 703 | Aadu Oja |
| AS GILD Fund Management | Tartu mnt 2, Tallinn 10145 | www.gildbankers.com | 6 800 401 | Tõnno Vähk |
| AS GILD Property Asset Management | Rävala pst 6, Tallinn 10143 | www.eereit.ee | 6 272 600 | Urmas Laur |
| AS Hansa Investeerimisfondid Hansa Intressifond Hansa Ida-Euroopa Aktsiafond Hansa Ida-Euroopa Võlakirjafond Hansa Rahaturufond Hansa Venemaa Aktsiafond Hansa Kesk-Aasia Aktsiafond Hansa Ida-Euroopa Kinnisvara Aktsiafond Hansa Private Debt Võlakirjafond Hansa Fondifond 30 Hansa Fondifond 60 Hansa Fondifond 100 Hansa Pensionifond K1 Hansa Pensionifond K2 Hansa Pensionifond K3 Hansa Pensionifond V1 Hansa Pensionifond V2 Hansa Pensionifond V3 | Liivalaia 8, 15038 Tallinn | www.hansa.ee | 6 131 336 | Mihkel Õim |
| AS Kawe Kapital Kawe Investeerimisfond | Pärnu mnt 15, 10141 Tallinn | www.kawe.ee | 6 314 178 | Ago Lauri |
| AS LHV Varahaldus LHV Täiendav Pensionifond LHV Uued Turud LHV Maailma Aktsiad LHV Tasakaalustatud Strateegia LHV Dünaamilised Võlakirjad LHV Kvaliteetsed Võlakirjad LHV Tõusva Euroopa Alfa Fond LHV Maailma Aktsiad Fond | Tartu mnt 2, 10145 Tallinn | www.lhv.ee | 6 800 470 | Rain Lõhmus |
| Sampo Baltic Asset Management AS | Narva mnt 9A, 10117 Tallinn | www.sampo.ee | 6 302 215 | Silja Saar |

| Supervised entities | Address | Contact | | Executive Director |
|---|-----------------------------|-------------------|-----------|--------------------|
| Sampo Uus Euroopa Fond | | | | |
| Sampo Likviidsusfond | | | | |
| Sampo Globaalne Kasvufond | | | | |
| Kohustuslik Pensionifond | | | | |
| Sampo Pension 25 | | | | |
| Kohustuslik Pensionifond | | | | |
| Sampo Pension 50 | | | | |
| Kohustuslik Pensionifond | | | | |
| Sampo Pension Intress | | | | |
| Sampo Pensionifond | | | | |
| PP Intressistrateegia Fond | | | | |
| PP Arenenud Turgude | | | | |
| Aktsiastrateegia Fond | | | | |
| PP Arenevate Turgude | | | | |
| Aktsiastrateegia Fond | | | | |
| AS SEB Ühispanga Fondid | Tornimäe 2, 15089 Tallinn | www.eyf.ee/fondid | 6 655 100 | Sven Kuning |
| SEB Kasvufond | | | | |
| SEB Geneerilise Farmaatsia Fond | | | | |
| SEB Tasakaalukas Fondifond | | | | |
| SEB Aktiivne Fondifond | | | | |
| SEB Dünaamiline Fondifond | | | | |
| SEB Ühispanga Likviidsusfond | | | | |
| SEB Ühispanga Võlakirjafond | | | | |
| SEB Ühispanga Konservatiivne Pensionifond | | | | |
| SEB Ühispanga Progressiivne Pensionifond | | | | |
| SEB Ühispanga Aktiivne Pensionifond | | | | |
| SEB Ühispanga Tasakaalukas Pensionifond | | | | |
| Trigon Funds AS | Pärnu mnt 15, 10141 Tallinn | www.trigon.ee | 6 679 200 | Mehis Raud |
| Trigon Teise Laine Fond | | | | |
| Trigon Kesk- ja Ida-Euroopa Fond | | | | |
| Trigon Uus Euroopa Väikeettevõtete Fond | | | | |
| Trigon Uus Euroopa Top 10 Fond | | | | |

| Supervised entities | Address | Contact | | Executive Director |
|--|--------------------------------|--|-----------|--------------------|
| Trigon Areneva Finantssektori Fond | | | | |
| AS Trigon Alternative Funds Trigon Active Alpha Fund | Pärnu mnt 15, 10141 Tallinn | www.trigon.ee | 6 679 200 | Ülo Adamson |
| Investment companies | | | | |
| Cresco Väärtpaberite AS | Tartu mnt 2, 10145 Tallinn | www.cresco.ee | 6 405 860 | Olev Schults |
| Evli Securities AS | Tartu mnt 2, 10145 Tallinn | www.suprema.ee | 6 405 700 | Aidas Galubickas |
| AS GILD Financial Advisory Services | Tartu mnt 2, 10145 Tallinn | www.gildbankers.ee | 6 800 401 | Rain Tamm |
| AS KIT Finance Europe | Roosikrantsi 11, 10119 Tallinn | www.aas.ee | 6 676 270 | Kaido Kaljulaid |
| AS Lõhmus, Haavel & Viisemann | Tartu mnt 2, 10145 Tallinn | www.lhv.ee | 6 800 400 | Liisi Ruus |
| AS SEB Enskilda | Tornimäe 2, 15010 Tallinn | www.enskilda.ee | 6 655 390 | Henrik Igasta |
| AS Trigon Securities | Pärnu mnt 15, 10141 Tallinn | www.trigoncapital.com | 6 679 220 | Ülo Adamson |
| Privanet Pankkiiriliike Oy Estonian Branch | Videviku 1, 93815 Kuressaare | | | Jaanika Merilo |
| Non-life insurers | | | | |
| D.A.S. Õigusabikulude Kindlustuse AS | Veerenni 58A, 11314 Tallinn | www.das.ee | 6 799 450 | Ilona Kuber |
| ERGO Kindlustuse AS | A. Lauteri 5, 10114 Tallinn | www.ergo-kindlustus.ee | 6 106 500 | Sergei Vahnitski |
| AS Hansa Varakindlustus | Liivalaia 12, 15039 Tallinn | http://w.hansa.ee/ est/kindlustus_ varakindlustus.html | 6 133 111 | Jan Andresoo |
| AS If Eesti Kindlustus | Pronksi tn 19, 10124 Tallinn | www.if.ee | 6 671 100 | Andres Sooniste |
| AS Inges Kindlustus | Raua 35, 10124 Tallinn | www.inges.ee | 6 410 436 | Voldemar Vaino |
| Salva Kindlustuse AS | Pärnu mnt 16, 10141 Tallinn | www.salva.ee | 6 800 500 | Tiit Pahapill |
| Seesam Rahvusvaheline Kindlustuse AS | Vambola 6, 10114 Tallinn | www.seesam.ee | 6 281 801 | Ivo Kuldmäe |
| QBE Kindlustuse Eesti AS | Sõpruse pst 145, 13417 Tallinn | www.qbe-estonia.com | 6 671 400 | Aivar Vähi |
| QBE Insurance (Europe) Limited Estonian Branch | Sõpruse pst 145, 13417 Tallinn | | | Aivar Vähi |
| MTÜ Eesti Liikluskindlustuse Fond | Mustamäe tee 44, 10621 Tallinn | www.lkf.ee | 6 671 800 | Kristjan Niinemaa |
| Fennia Mutual Insurance Company Eesti filiaal | Harju 6, 10130 Tallinn | www.fennia.fi | 6 310 691 | Kalmet Kala |
| Euler Hermes Kreditversicherungs- Aktiengesellschaft Estonian Branch | Tina 9, 10126 Tallinn | | 6 679 350 | Frank Wille |

| Supervised entities | Address | Contact | | Executive Director |
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| BTA Apdrošināšanas akciju sabiedrība Estonian Branch | Lootsi 3a, 10151 Tallinn | www.bta-kindlustus.ee | 6 868 060 | Lauris Boss |
| Codan Forsikring AS Estonian Branch | Peterburi tee 2f, 11415 Tallinn | www.royalsunalliance.ee | 6 224 557 | Kaido Kepp |
| AAS Gjensidige Baltic Estonian Branch | Pärnu mnt 238, 11624 Tallinn | www.gjensidige.ee | 6 728 955 | Marko Privoi |
| Life insurers | | | | |
| ERGO Elukindlustuse AS | A. Lauteri 5, 10114 Tallinn | www.ergo-kindlustus.ee | 6 106 677 | Marek Zacek |
| AS Hansa Elukindlustus | Liivalaia 12, 15036 Tallinn | www.hansa.ee/est/ kindlustus.html | 6 131 120 | Mihkel Mandre |
| SE Sampo Life Insurance Baltic | Jõe tn 3, 10151 Tallinn | www.sampolife.ee | 6 302 300 | Imre Madison |
| Seesam Life Insurance SE | Roosikrantsi 11, 10119 Tallinn | www.seesamlife.ee | 6 103 000 | Erki Kilu |
| AS SEB Ühispaniga Elukindlustus | Tornimäe 2, 15010 Tallinn | www.seb.ee | 6 658 020 | Indrek Holst |
| Insurance brokers | | | | |
| Aadel Kindlustusmaaklerid OÜ | Laki 11 12915 Tallinn | www.aadel.ee | 6 816 910 | Tõnis Laks |
| OÜ ABC Kindlustusmaaklerid | Endla 69/Keemia 4, 10615 Tallinn | www.kindlustuseabc.ee | 6 679 650 | Harri Kahl |
| OÜ ADVICE S.E. Kindlustusmaakler | Mustamäe tee 6B, 10621 Tallinn | www.advice.se | 6 115 230 | Ain Niineste |
| AS AON Eesti Kindlustusmaakler | Liivalaia 13/15, 10118 Tallinn | www.aon.com | 6 996 227 | Lauri Tõnise |
| Balti Kindlustusmaakleri OÜ | Liivalaia 12, 15039 Tallinn | | 6 131 525 | Kaido Tõnisson |
| Colemont BKM Kindlustusmaakler OÜ | Peterburi tee 2f, 11415 Tallinn | www.colemont.ee | 6 679 130 | Heiki Nurmeots |
| CHB Kindlustusmaakler OÜ | Toom-Kooli 7-18, 10130 Tallinn | www.chb.ee | 6 650 160 | Andry Saarm |
| AS E-Kindlustus Kindlustusmaakler | Tornimäe 2, 10145 Tallinn | www.e-kindlustus.ee | 6 660300 | Risto Rossar |
| AS In Bro & Partners Kindlustusmaakler | Tartu mnt 87d, 10112 Tallinn | www.inbro.ee | 6 115 240 | Markus Haiba |
| KindlustusEst Kindlustusmaakler OÜ | Mustamäe tee 55, 10621 Tallinn | www.kindlustusest.ee | 6 776 751 | Maldon Ots |
| OÜ Kindlustusmaakler Järva ja Partnerid | Tartu mnt 16-6, 10117 Tallinn | www.kindlusmaaklerid.ee | 6 616 844 | Janek Järva |
| K. Kindlustusmaakler OÜ | Narva mnt 90 Tallinn 10127 | www.kindlustusjuht.ee | 6 022 025 | Reet Lahesalu |
| Kominsur Kindlustusmaakler OÜ | Mooni 18 Tallinn 10613 | www.kominsur.ee | 6 616 970 | Dmitri Soljanik |
| Lõuna Kindlustusmaakler OÜ | Raatuse 20, 51009 Tallinn | | 7 407 134 | Andro Ross |
| OÜ Marks ja Partnerid Kindlustusmaaklerid | Endla 69/Keemia 4, 10616 Tallinn | www.marks.ee | 6 680 266 | Jaan Marks |
| Marsh Kindlustusmaakler AS | Tartu mnt 18, 10115 Tallinn | www.marsh.ee | 6 811 000 | Mart Mere |
| Optimal Kindlustusmaakler OÜ | Nõmme tee 59/2, 11311 Tallinn | www.optimal.ee | 6 562 828 | Tarmo Hillep |

| Supervised entities | Address | Contact | | Executive Director |
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| OÜ RA Kindlustusmaakler | Rävala pst 19-99 , 10143 Tallinn | | 6 312 627 | Roman Illarionov |
| SEB Kindlustusmaakler AS | Tornimäe 2, 10145, Tallinn | www.seb.ee | 6 549 677 | Raivo Piibor |
| Vagner Kindlustusmaakler AS | Villardi 23-2, 10136 Tallinn | www.vagner.ee | 6 312 627 | Roman Illarionov |
| AS Vandeni Kindlustusmaaklerid | Tornimäe 7, 10145 Tallinn | www.vanden.ee | 6 271 765 | Raul Källo |
| Securities market operators | | | | |
| AS Eesti Väärtpaperikeskus | Tartu mnt. 2, 10145 Tallinn | www.e-register.ee | 6 408 800 | Kristel Johanson |
| AS Tallinna Börs | Tartu mnt. 2, 10145 Tallinn | www.ee.omxgroup.com | 6 408 800 | Andrus Alber |
| Issuers | | | | |
| Share issuers | | | | |
| AS Arco Vara | Jõe 2B, 10151 Tallinn | www.arcorealestate.com | 6 144 600 | Ahto Altjõe |
| AS Baltika | Veerenni 24, 10135 Tallinn | www.baltika.ee | 6 302 700 | Meelis Milder |
| AS Eesti Ehitus | Akadeemia tee 15B, 12618 Tallinn | www.eestiehitus.ee | 6 400 450 | Jaano Vink |
| AS Eesti Telekom | Valge 16, 19095 Tallinn | www.telekom.ee | 6 311 212 | Valdo Kalm |
| AS Ekspress Grupp | Narva mnt 11e, 10151 Tallinn | www.egrupp.ee | 6 698 181 | Priit Leito |
| AS Harju Elekter | Paldiski mnt. 31, 76606 Keila | www.harjuelekter.ee | 6 747 400 | Andres Allikmäe |
| AS Kalev | Tornimäe 5, 10145 Tallinn | www.kalev.ee | 6 161 900 | Oliver Kruuda |
| AS Merko Ehitus | Järvevana tee 9G, 11314 Tallinn | www.merko.ee | 6 805 105 | Tõnu Toomik |
| AS Norma | Laki 14, 10621 Tallinn | www.norma.ee | 6 500 444 | Peep Siimon |
| AS Silvano Fashion Group | Akadeemia tee 33, 12618 Tallinn | www.silvanofashion.com | 6 710 700 | Sergei Kusonski |
| AS Starman | Akadeemia tee 28, 12618 Tallinn | www.starman.ee | 6 779 977 | Peeter Kern |
| AS Tallink Grupp | Tartu mnt 13, 10145 Tallinn | www.tallink.com | 6 409 800 | Enn Pant |
| AS Tallinna Vesi | Ädala 10, 10614 Tallinn | www.tallinnavesi.ee | 6 262 225 | Roch Cheroux |
| AS Trigon Property Development | Pärnu mnt 15, 10141 Tallinn | www.trigonproperty.com | 6 679 200 | Ülo Adamson |
| AS Viisnurk | Suur-Jõe 48, 80042 Pärnu | www.viisnurk.ee | 4 478 323 | Andres Kivistik |
| Olympic Entertainment Group AS | Pronksi 19, 10124 Tallinn | www.olympic-casino.com | 6 671 250 | Armin Karu |
| Saku Õlletehase AS | Saku alevik, Saku vald, 75501 Harjumaa | www.saku.ee | 6 508 400 | Ireneusz Smaga |
| Tallinna Kaubamaja AS | Gonsiori 2, 10143 Tallinn | www.kaubamaja.ee | 6 673 100 | Raul Puusepp |
| Bond issuers | | | | |
| Balti Investeeringute Grupi Pank AS | Rüütli 23, 51006 Tartu | www.big.ee | 7 377 580 | Targo Raus |
| LHV Ilmarise Kinnisvaraportfelli OÜ | Tartu mnt 2, 10145 Tallinn | www.lhv.ee | 6 800 401 | Tarmo Jüristo |
| Q Vara AS | Tartu mnt 2, 10145 Tallinn | www.qvara.ee | 6 681 600 | Meelis Šokman |
| AS Tallinna Sadam | Sadama 25, 15051 Tallinn | www.portoftallinn.com | 6 318 555 | Ain Kaljurand |





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