

Banking - Estonia

Overview (December 2008)

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Introduction

According to the Central Bank of Estonia,⁽¹⁾ the Financial Supervision Authority (FSA)⁽²⁾ and the Banking Association,⁽³⁾ in October 2008 the total asset value of all Estonian banks stood at approximately €22 billion.⁽⁴⁾ In Estonia, six banks have been established as locally registered credit institutions, 10 banks act as branches of a foreign credit institution and approximately 200 foreign banks are licensed to offer banking services as cross-border service providers. The two leading banks in the Estonian market are Swedbank and SEB, followed by Danske Bank (acting through branches) (formerly Sampo Bank) and Nordea Bank (acting through branches).⁽⁵⁾ The Estonian banking market is controlled by these major Scandinavian banks, which together hold a total market share of approximately 95%.

As Estonia is a member of the European Union, Estonian banking law and its respective regulations are generally in line with EU directives and regulations. In order to create competitive financial and banking markets, Estonia has adopted and implemented most of the required EU banking and finance law regulations, including:

- the Capital Requirements Directives (Basel II) (2006/48/EC and 2006/49/EC);
- the Markets in Financial Instruments Directive (2004/39/EC);
- the Reorganization and Winding-Up of Credit Institutions Directive (2001/24/EC);
- the Deposit Guarantee Schemes Directive (1994/19/EC);
- the Money Laundering Directives (2005/60/EC and 2006/70/EC);
- the Financial Collateral Directive (2002/47/EC); and
- the E-money Directive (2000/46/EC).

The most important legal act for the establishment and regulation of credit institutions and their activities in Estonia is the Credit Institutions Act, which came into force in July 1999. Since 1999, due to the continuing development of EU banking law, the Credit Institutions Act has been amended approximately 30 times.

The following laws and regulations also apply to banking activities in Estonia:

- the Commercial Code;
- the Money Laundering and Terrorism Financing Prevention Act;
- the International Sanctions Act;
- the Securities Market Act;
- the Financial Supervision Authority Act;
- the Deposit Guarantee Act;
- the Bank of Estonia Act;
- the Law of Obligations Act;
- the specific regulations of the Ministry of Finance and the Bank of Estonia; and
- the FSA official guidelines.

Legal Form and Licensing

When wishing to offer banking services in Estonia, a market participant can choose to establish itself as:

- a locally established credit institution;

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- a branch of a foreign credit institution; or
- a cross-border banking services provider.

Estonian law also permits the establishment of a representative office of a foreign bank, a savings and loan association or an association bank. However, due to legal restrictions and an underdeveloped regulatory framework in that area, and taking into consideration the current market situation, such forms of activity are not widely used in Estonia. Estonia has only a few representative offices, approximately 15 savings and loan associations and no association banks.

Credit institution

The most restrictive regulations apply to the activities of locally established credit institutions. Such credit institutions can be founded only in the form of a public limited company and with a minimum paid-in share capital of €5 million. The credit institution's share capital must be paid-in in cash only and it cannot be established through a public share issue. According to the Commercial Code, a public limited company's shares and shareholders' register must be maintained by the public Central Register of Securities and it is the obligation of the management board to ensure the timely submission of correct shareholder information to this register. The share register may be examined in accordance with the provisions of the Central Register of Securities Act by:

- shareholders;
- members of the management or supervisory board;
- competent state institutions; and
- any other person with a justified interest.

According to the Credit Institutions Act, only a licensed credit institution (ie, holding an activity licence from the FSA) may collect deposits and receive other repayable funds from the public. In order to obtain an activity licence, the credit institution must, alongside its application, present the FSA with the following information and documentation:

- its articles of association;
- its foundation resolution or decision;
- its business plan;
- evidence of its paid-in share capital;
- a balance sheet and profit-loss statement;
- information about the bank's IT support/software data, security and other control systems;
- a description of internal procedures and bank manuals;
- information about the managers, supervisory board members, head of the internal audit unit and head of the control committee;
- information concerning the bank's independent auditor;
- information about the shareholders and more specific information about those shareholders that own more than 2% of the total share capital; and
- detailed information about shareholders with a qualified shareholding (more than 10%).

All information and supplementary documents must be presented to the FSA in Estonian or with an Estonian translation.

The FSA must decide within six months of receiving all the required documents and information whether it will grant the activity licence. This must be no later than 12 months after the credit institution delivered its first application to the FSA.

In addition to establishment costs, the credit institution must pay expenses of €1,500 for the FSA's management of the licensing procedure.

According to the Credit Institutions Act, every credit institution which is established as a public limited liability company must include the Estonian word for 'bank' (*pank*) in its official business name. Companies that do not hold a banking activity licence are not permitted to use this word in their official name.

Branch of foreign credit institution

If a foreign credit institution plans to offer banking services in Estonia on a permanent basis, under the Commercial Code it can establish a branch. A branch is not a separate legal entity and the foreign credit institution is still liable for obligations arising from the branch's activities. On registration of the branch, the credit institution must include the Estonian word for 'branch' (*Eesti filiaal*) in its official business name.

Before a branch of a credit institution can be registered in the Commercial Register, the bank must apply for an activity licence from the FSA in accordance with the regulations established in the Credit Institutions Act. For this purpose the Credit Institutions Act

provides two different licence procedures, depending on the applicant credit institution's country of origin.

Any credit institution registered in one of the contracting states of the European Economic Area (EEA) has the right to apply for an activity licence under the European passport regulation by informing the FSA of its intention to register a branch in Estonia through the financial supervision authority of its home country. In addition to the application, the credit institution must present the FSA with:

- a business plan or activity programme (including information about its planned services and a description of its organizational structure);
- its branch address; and
- information about its branch directors.

According to this authorization procedure, the credit institution can register its branch and begin offering banking services provided that: (i) it has received approval from the FSA through the financial supervision authority of its country of origin; or (ii) at least two months have passed since it presented its documents to the FSA and the FSA has not replied or informed it of any additional requirements.

A bank registered in non-EEA countries must apply directly to the FSA for an activity licence. In addition to the information and documents mentioned above, the bank must present information about its qualified shareholders and other branch establishment documents and information required by the Commercial Code, including:

- an official certificate (eg, an extract from the Company Register of its country of origin) concerning its existence in its home country;
- a document certifying the authority of its branch director(s) or a copy of a resolution appointing the director(s);
- a copy of its articles of association;
- information on the branch's planned principal activities; and
- the branch's contact details.

In addition to the above, in order to establish an Estonian branch of a bank registered in a non-EEA country, the bank must present:

- consent from its state of origin's financial supervision authority;
- confirmation that it holds a valid activity licence;
- data relating to its net assets amount and its capital adequacy; and
- data relating to its state of origin's deposit guarantee system.

Contrary to the European passport system and subject to other provisions of the Credit Institutions Act, the FSA may refuse to grant authorization if:

- in the FSA's opinion, the financial situation of the foreign credit institution is not sufficiently sound;
- the corporate structure of the branch of the foreign credit institution in Estonia is not suitable for the intended activities;
- the legislation of the credit institution's state of origin does not require it or the financial supervision authority of the home state does not exercise sufficient supervision, including supervision on a consolidated basis; or
- the financial supervision authority of the foreign state has no legal basis or possibilities for cooperation with the FSA.

In such cases the FSA must issue a reasoned decision for its refusal to grant authorization within two months of receiving the application and the specified data and documents.

The branch licensing procedure requires no additional processing fee to be paid to the FSA and the establishment costs and expenses are generally lower than those of a credit institution.

Cross-border banking services

According to the Credit Institutions Act, cross-border banking services in Estonia can be offered only by credit institutions registered in an EEA contracting state.⁽⁶⁾ If a credit institution plans to provide cross-border services in Estonia, it must inform the FSA through the financial supervision authority of the contracting state and indicate which transactions and acts it intends to conclude and perform in Estonia. The credit institution may commence the provision of cross-border services once notice has been forwarded to the FSA. However, the FSA may also formulate a decision in which it determines conditions for the credit institution's provision of services in Estonia.

Representative office

Pursuant to the Credit Institutions Act, a foreign credit institution may open a

representative office in Estonia. A representative office can be established for representative purposes and for the protection of a credit institution's interests in Estonian territory. It is not considered to be a legal entity and cannot offer any banking services or conduct any other business activity in Estonia.

In order to open a representative office, a foreign credit institution must submit the following data and documents to the FSA:

- confirmation from the financial supervision authority of its country of origin that the credit institution holds valid authorization;
- the representative office's activities programme;
- a document certifying authorization of the representative;
- a document concerning the registration of the credit institution in its country of origin (eg, an extract from the Company Register or a transcript of the registration certificate);
- the credit institution's articles of association; and
- the seat, address and contact details of the representative office.

These documents must be submitted to the FSA together with a notarized translation into Estonian.

Association bank and savings and loan association

Under the Credit Institutions Act and the Savings and Loan Association Act, it is possible to establish association banks or savings and loan associations. No association banks are currently operating in Estonia and only 15 savings and loan associations have been established, which have only a regional and limited impact on the Estonian financial market.⁽⁷⁾ The Credit Institutions Act sets out a minimum capital requirement of €5 million for association banks. Savings and loan associations are not licensed or supervised by the FSA.

An amendment to the Credit Institutions Act and the Savings and Loan Association Act is being pushed through Parliament. The aim of the amendment is to clarify and review the respective requirements for association banks and savings and loan associations.

⁽⁸⁾ The amended law will provide:

- more restrictive requirements for savings and loan associations concerning their establishment, members, minimum capital and financial requirements;
- specifications about their internal procedures, manuals and risk management; and
- capital requirements for and restrictions on assets and business activity.

The amendment should also exempt association banks from the obligatory requirement to be established, operate and be targeted at limited groups of people on a regional level.

Financial Supervision

State financial supervision in Estonia is conducted by the FSA, acting under the Financial Supervision Authority Act and operating through the Bank of Estonia. The FSA carries out financial supervision on behalf of the state, but in its actions it is independent of the Bank of Estonia and the government and has its own standalone budget and supervisory and management board. The FSA was established and began its activities as a unified financial supervision authority on January 1 2002 when three autonomous supervision authorities were merged into one supervision entity.

According to the Financial Supervision Authority Act, the main functions and rights of the FSA are to:

- analyze and monitor constantly the compliance of subjects of financial supervision with the requirements for financial soundness and own funds;
- guide and direct subjects of financial supervision in order to ensure sound and prudent management;
- apply measures prescribed by legislation to protect the interests of clients and investors;
- apply administrative coercion on the basis of, to the extent of and pursuant to the procedure prescribed by the Financial Supervision Authority Act;
- make proposals for the establishment and amendment of legal acts and other legislation concerning the financial sector and related supervision, and participate in the drafting of such laws and legislation;
- cooperate with international financial supervision organizations, foreign financial supervision authorities and other competent foreign authorities and persons;
- perform functions arising from the Guarantee Fund Act, the Money Laundering and Terrorist Financing Prevention Act, the International Sanctions Act and legislation issued on the basis thereof; and
- perform other functions arising from law which are necessary to fulfil the objectives

of financial supervision.

In addition to market participants acting under the Credit Institutions Act, the FSA supervises:

- insurance companies;
- insurance brokers;
- investment service providers and other financial market participants;
- investment management companies;
- investment funds;
- pension funds;
- e-money institutions; and
- any other subjects or activities regulated by the applicable financial market laws.

Locally established credit institutions are directly supervised by the FSA. Although the FSA's direct supervisory rights and powers are related to banking activities in Estonia in the form of branch or cross-border services, supervision in these cases is mainly conducted by the financial supervision authority of the respective credit institution's country of origin. According to the Financial Supervision Authority Act, the Credit Institutions Act and concluded bilateral cooperation agreements, the FSA is obliged to:

- support such foreign country supervision;
- provide information; and
- assist foreign financial supervision through local inspections or other supervisory activities.

The FSA is directly funded by market participants, which means that credit institutions and their branches incur additional costs.

In general, the supervision fee consists of two parts. The first part is the capital share, which for a locally established credit institution is an annual amount equal to 1% of the required minimum amount of net own funds (currently €5 million). The second part is the share calculated on the basis of assets. In the case of a credit institution or branch of a foreign credit institution, this is an annual share of the supervision fee, which is calculated on the basis of assets and equals an amount between 0.005% and 0.05% of the assets of the credit institution or the corresponding Estonian branch. Depending on the FSA's estimated costs and financial budget, the exact rate will be approved by the FSA supervisory board on an annual basis. For 2008 the rate was fixed at 0.0112% of the credit institution's or branch's assets.

The supervisory fee payable by branches of foreign credit institutions is calculated on the basis of the branch's assets.

Other Requirements

When founding a bank in the form of a credit institution, a branch or an entity offering cross-border services, it is important to clarify whether applicable requirements set by other Estonian laws or regulations apply to the bank's activities and business. Institutions embarking on offering banking services in Estonia should consider the following issues:

- Credit institutions and branches are obliged to open a current account with the Central Bank of Estonia and conclude agreements for becoming a member of the Estonian settlement system.
- Credit institutions and branches must fulfil reporting requirements to the Bank of Estonia, the FSA and the Department of Statistics.
- Credit institutions, branches and cross-border service providers must ensure that their banking activities comply with laws and regulations regarding money laundering and terrorism financing prevention. These issues are mainly regulated by the Money Laundering and Terrorism Financing Prevention Act.
- Credit institutions and branches must ensure that their activities are in accordance with the Deposit Guarantee Act and, if required, must become a full member of the Deposit Guarantee Fund.
- If a credit institution, branch or cross-border service provider offers investment services in addition to its banking services, it must ensure that these services are provided in accordance with the Securities Market Act and any legislation established on the basis thereof.
- If concluding customer service agreements or other business agreements, the bank must ensure that these agreements are in accordance with the provisions of Estonian contract law (the Law of Obligations Act) and other applicable laws.
- Credit institutions and branches must comply with Estonian taxation laws and regulations. Most banking services, except for leasing and factoring, are free from value added tax in Estonia. Depending on the capacity of the leasing or factoring activity, it may be recommended to establish a separate legal entity or at least

analyze the taxation issues more specifically if such services are to be provided by the credit institution or branch directly.

- After establishing its activities and depending on the services provided, a bank might consider becoming a member or partner of the Estonian Banking Association, the Credit and Export Guarantee Fund⁽⁹⁾ or the Rural Development Foundation.⁽¹⁰⁾

For further information on this topic please contact [Priit Pahapill](#) at [Luiga Mody Hää](#) Borenus by telephone (+372 665 1888) or by fax (+372 665 1899) or by email (priit.pahapill@lmh.ee)

Endnotes

(1) www.eestipank.info/frontpage/en/.

(2) www.fi.ee/?lang=en&PHPSESSID=b7081cb349633ef91097b4744f888084.

(3) www.pangaliit.ee./eng/.

(4) http://www.eestipank.info/dynamic/itp/itp_report.jsp?reference=132&className=EPSTAT&lang=et.

(5) www.pangaliit.ee/pangandusinfo/.

(6) The freedom to offer cross-border banking services in EEA countries is regulated by Article 28 of the EU Capital Requirements Directive (2006/48/EU).

(7) According to the Union of Estonian Savings and Loan Associations, approximately 15 savings and loan associations are registered in Estonia. For more information see www.hoiu-laenu.ee/index.php?lang=eng.

(8) www.riigikogu.ee/?page=en_vaade&op=ems&eid=280030&u=20081201122839.

(9) www.kredex.ee/.

(10) www.mes.ee/index_eng.php.

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