

2008

ANNUAL REPORT



RAHOITUSTARKASTUS
FINANSINSPEKTIONEN
FINANCIAL SUPERVISION

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Director General's Review

The year under review has been a dramatic one for the financial market. Disturbances emanating from the sub-prime loan crisis, which had emerged in the United States the previous August, only became worse and by the autumn of 2008 were threatening the stability of the entire global financial system.

The Financial Supervision Authority's aim was to minimise the crisis's effect in Finland. In practice, this meant intensifying the FIN-FSA's supervisory activities, continuous analysis of both the global and domestic situation as well as close cooperation and flow of information, as much with the central bank and the respective ministries as with overseas supervisory authorities. Analysis of the crisis situation was enhanced by the administrative connection the FIN-FSA has with the Bank of Finland.

International financial market crisis

The crisis led to a loss of confidence in the markets. Risk premia in the interbank markets rose to record levels and liquidity conditions in the money market dried up. As a result, the governments of many countries ended up either taking control of or pouring capital into systemically significant banks. When, in September, the investment bank Lehman Brothers was not rescued, confidence in

the markets collapsed completely. This led to even greater difficulties in the availability of financing, asset meltdown and grave consequences for the real economy. By the end of the year insurance companies and banks were reporting write-downs from investments of more than a thousand billion dollars. Almost as much capital has already been poured into them, with governments being the most important provider of that capital.

The reasons behind the crisis, and the lessons that can be learnt, have already been closely analysed. Inadequate supervision and regulation, loose monetary policy and, above all, the insatiable greed of market participants combined with deficient internal monitoring systems, have all been blamed for the situation we now face. In any case, I see that as collective an approach to regulation and supervision as possible is essential, not only within the European Union, but also globally. The crisis has concretely demonstrated that disturbances in the global financial market are not hindered by national borders, rather, that they spread beyond national and sectoral borders at a significant pace. The crisis has also concretely demonstrated that it is absolutely essential to cooperate when supervising multinational houses. Supervisors do not wish to be taken unawares when risks are transferred from parent company to subsidiaries and branch operations.

Based on the lessons learnt, changes in financial sector regulations are needed. However, when making such changes we should bear in mind their overall workability. It shouldn't merely be a matter of piling new upon old. At the top of my list of priorities are improved transparency, particularly in the provision of financial information, sound internal control of banks and other market participants and regulation of liquidity risk management as well as a reduction in the procyclicality of the capital adequacy and financial reporting regulations.

The effects of the crisis in Finland

Up until now, banks operating in Finland have survived the crisis relatively unscathed. Counterparty risk, incurred from institutions that have gone under, have been comparatively low. The liquidity position has been eased by the fact that deposits as a proportion of refinancing is notably high and there has been a strong growth in deposits throughout the year. Banks have also prepared for the liquidity crisis by boosting their reserves and by adding, one way or another, to their stock of central bank-eligible assets. In fact the availability of money market funding has been very good throughout almost the entire year. While, since the fall of the Lehman Brothers, long term funding has again been hard to come by.

From the Finnish perspective, the most critical situation was when the Icelandic government took over control of its three largest banks, which led to Kaupthing Bank's ceasing to repay deposits to depositors in its overseas offices. There were three banks under Icelandic ownership in Finland, which received deposits; of these Kaupthing was one that operated as a branch office. Without delay, as the news from Iceland became direr, FIN-FSA began to implement supervisory measures in order to minimise depositors' losses. These measures were both successful and effective.

FIN-FSA contributed to achieving the arrangement whereby three Finnish banks provided the financing that enabled the Finnish branch of Kaupthing Bank to repay its Finnish depositors. The arrangements were an excellent example of an effective private sector solution. Despite its success,

the arrangements were criticised by the public. Critics believed that the depositors should have been made to bear the brunt of the risk, at least as far as the high rates of interest that Kaupthing had offered were concerned. Admittedly, under normal conditions, they would have had to bear the brunt of it. Where a depositor or investor takes a risk in order to receive a higher rate of return, they should also normally bear the consequences, should the risks materialise. The prevailing situation in the financial markets during that October period was, however, far from normal. For this very reason FIN-FSA took the attitude that the depositors should not suffer economic losses in the rescue operation, as it would have had a detrimental effect on confidence levels in the entire Finnish banking system, with a particularly injurious effect on deposit security.

Naturally, the Finnish financial market has not been left unscathed by the effects of the crisis. The effect of the situation has been twofold. The banks' performance was improved by the increase in net interest income, which was made possible by a strong growth in lending and the interest rates that remained higher until the autumn. On the other hand, the crisis was seen in the rise in funding costs and a fall in the value of securities investment along with a decline in the sale of investment services. In particular, investments by life and non-life insurance companies belonging to banking groups have increased losses booked to fair value reserve on their balance sheets and reduced the groups' overall capital adequacy. Investment firms' profitability has in some cases notably weakened due to the unfavourable market conditions.

By the end of the year, the financial crisis began to have a rapidly deteriorating effect on the economy. Although the quality of the banks' credit portfolios had declined, the weakening situation was not yet visible in the number of non-performing loans or credit losses, which remain low particularly in comparison to the start of the 1990s. By December, non-performing loans were 0.4% of the stock of lending, whereas in 1992 they had accounted for 9.3%. While loan losses were 0.14% of the stock of lending, while in 1992 they had accounted for 3.7%. If the economic situation weakens considerably further or if the outlook for economic growth remains bleak for an extended period, the state of affairs could change significantly. The first

signs can already be seen in the increasing number of bankruptcies that are being declared. FIN-FSA continues to monitor the situation. It is most essential that banks' risk management operates impeccably, that banks assess the position of their credit portfolios continuously and that they embark early on any necessary measures to strengthen their capital base, in good time.

In particular, corporate lending by banks grew rapidly last year. There are many reasons for this. Companies had to resort to domestic bank financing, as market financing availability dwindled and foreign banks – embroiled in their problems – no longer had any interest in participating in lending syndicates to finance Finnish companies. With the weakening in the quality of credit portfolios, banks' capital adequacy requirements intensified. Banks have tightened their lending criteria, new customers are related to more critically and they have become wary of financing certain sectors under special scrutiny. Although, in the wake of a period of robust growth, the balance sheet of the corporate sector are in relatively sound shape, in the autumn corporate financing clearly started to become more difficult to obtain. In this period of flux, it is essential that various measures are in place that make it possible for large, small and medium-sized companies alike to meet their funding needs, in order to maintain economic activity. In spite of Finnish banks' solvency position remaining satisfactory, the banking sector's resources alone are insufficient to cover the overall financing requirements. For this reason, we must be prepared for a credit crunch in Finland, too. Currently, work is underway to develop new funding channels for companies and, in line with EU guidelines, the Government is supporting banks by guaranteeing funding as well as being prepared to grant banks capital loans eligible as Tier 1 capital. The aim is keep the wheels of the national economy turning, with everybody pulling together.

Over-indebtedness

For years, in its consumer information work, FIN-FSA has endeavoured to advise households against taking on loans that exceed their repayment capabilities. I wrote on this same subject in last year's review. However, in the credit survey

undertaken by FIN-FSA in early autumn, some households have an alarmingly high burden of debt. According to our recent survey, in the case of 20% of new loans the borrower's loan servicing costs exceed 50% of the borrower's net income. With the drop in housing prices and unemployment figures looking progressively bleaker, there is an increasing risk of more households having difficulties servicing their loans. While on the one hand the drop in interest rates eases a borrower's position, the margins on new loans have doubled in only a short period of time. The importance of managing one's own finances soundly is more pronounced in times of economic difficulties.

When thinking of one's future, personal financial management skills ought to be firmly placed in the secondary school curriculum of every child, in order that everybody would have an improved chance of evaluating and planning their own finances.

The effects of the crisis on investors

The value of stocks was subject to sharp decline last year. This reflected a considerable weakening in the expectations in the real economy. The OMX Helsinki All Share Index lost close on half its value and individual listed companies' value dropped by as much as 80%. FIN-FSA had the essential task of ensuring that even when undergoing extremely hard times, listed companies continue to provide information on their performance and financial position, in line with their reporting obligations.

Globally, it was shares of financial sector companies that suffered the greatest. In the United States and Europe alike, supervisory authorities investigated suspected short selling manipulative activities in financial sector shares. According to FIN-FSA's findings, short selling does not appear to have been used to manipulate the market in Finland.

Money market funds have been most vulnerable to the effects of the crisis. This came as a surprise. Money market funds have accounted for approximately 30% of all fund assets. Investors – whether corporate or household – have been disappointed with their performance and have sold their units. In comparison with July 2007, the capital held in money market funds has halved.

The problem also lies with the funds themselves. Money market funds have not been very successful in describing their investment policies as they have had difficulties in distinguishing funds that take credit risk through investing in long term, floating rate corporate bonds from funds that invest in short term money market instruments. European supervisors are in the process of discussing whether there ought to be a more standard and clear definition of various types of money market funds. Investors in Finland have been confounded by money market funds taking such long credit exposure – albeit within the margins allowed. As corporate bond risk premia spread, the value of the funds invested in them dropped. Sudden valuation changes in money market funds have previously not happened, to this extent. In its investigations, FIN-FSA has observed that the valuation principles of illiquid securities were not well defined by all fund management companies. More specific rules regarding the role of external auditors in the operation of funds are also called for.

Supervisory cooperation

The foreign-owned banks' share of the Finnish credit and deposit stock is over 60%. As the situation in the markets calms down, it is likely that a few significant institutions will change their operations from their current format of subsidiary into branch arrangements. As I already stated in last year's annual report, in its EU supervisory committee work, FIN-FSA has appropriately had an influence on such as issues as the role of host state supervisor being properly acknowledged as having legal and practical powers when supervising subsidiaries and branches, within EU Directives and EU practices. With the Capital Requirements Directive we are finally moving in this very direction. According to the provisions of the Directive, supranational banking groups are to be supervised in cooperation by a so-called college of supervisors – in other words a forum for cooperation between banking supervisors – in which representatives of the supervisors of subsidiaries and branch offices alike can participate. Significant decisions concerning the capitalisation of groups would still lie with home country supervisors, in other words with the authority responsible for the parent company. The formalisation of this so-called college model is a sound step forward and should

be extended to cover the supervision of all cross-border financial conglomerates and application of the model represents a highly practical enhancement of supervisory cooperation.

The durability of this model will be put to the test in the crisis situation we now face. As the current crisis shows, supervisors and governments easily come up with solutions from their own perspectives, in their own national interests and bearing domestic depositors and tax payers in mind. The division between home and host countries' responsibilities does not correspond to present business operation models. Generally risk management in large groups is centralised. Nor do business models follow the juridical company structure, but rather risk-prone operations can be concentrated in one country, for example. In times of crisis the home supervisory authority cannot necessarily manage the problems faced by subsidiaries or branch offices. As the ongoing crisis indicates, the supervisors of branches may be left with the administrative responsibilities despite not possessing the powers to make decisions that would limit the risks beforehand. In drawing up the Act on the new Financial Supervisory Authority, FIN-FSA specifically placed emphasis on supervisors having adequate access to information – and on supervisory rights regarding branch operations, albeit within the limits outlined in the Directive. Good supervisory cooperation during times of normal conditions is a prerequisite for effective cooperation during times of crisis.

To quote myself, last spring: "I do not believe that the current EU model for supervisory cooperation and memorandum of understanding would be adequate in a time of crisis. A crisis situation requires readiness to make rapid decisions – including unpleasant ones. It requires an ESCB-type of supranational supervisory framework, to supervise the most significant financial conglomerates and banking groups' capital adequacy. However, we don't yet have sufficient political will to bring this about. The decision making process would be speeded up only if market disturbances requiring a massive, cross-border rescue operation were to occur." At the time I was not intending my statement to be prophetic, but a working group established only half a year or so later – the de Larosière Group – was given the task of formulating a solution to this framework and in a fast timeframe.

Financial Supervisory Authority

The reporting year was the last in FIN-FSA's 15 year stretch. Since it was established, there have been radical changes in the Authority's operating environment. The domestically-owned financial sector has become foreign-owned. The role of supervisory cooperation has become more pronounced, especially as regards Nordic banking and insurance groups and more recently also the supervision of stock exchange and clearing and settlement operations. The establishment of the new Financial Supervisory Authority was marked by the emergence of the worst financial crisis could also be taken as having fortuitous timing. Although cooperation between the Insurance Supervisory Authority (ISA) and the Financial Supervision Authority had worked extremely well, only a united supervisory authority can ensure that the monitoring of banking, insurance and investment operations is undertaken sufficiently broadly and that there are no blind spots.

Convergence of the two authorities was prepared for in many different ways. Special thanks go to the Bank of Finland, which took care of the administrative aspects of the convergence with efficiency and professionalism. The largest projects included integration of IT systems with the Bank's systems, various personnel administrative arrangements and the amalgamation of the office arrangements of ISA with those of the old FIN-FSA. Both supervisory authorities put a lot of effort into creating as trouble-free a start-up of operations as possible. Several joint meetings were arranged at which the different operating practices were compared and the core distinctions in the authorities' supervisory approaches were examined. One of the key tasks was the work of preparing the new organisational model.

Cooperation and the preparatory work have gone on in the most positive of spirits. I firmly believe that the new Supervisory authority that has been born out of the convergence of the two former authorities will be more dynamic, effective and proficient. In the economic conditions we currently find ourselves, it is essential that the newly converged authority hits the ground running. Our stakeholders are expecting the highest quality supervision from the new Financial Supervisory Authority.

Finally, I should like to thank all the FIN-FSA staff for their untiring work in this time of market uncertainty, for their commitment and the brisk manner in which they take matters on as well as the positive working atmosphere they generate. It has been a pleasure working with you.

Helsinki, 16 January 2009

Anneli Tuominen

The FIN-FSA in brief

FIN-FSA tasks and organisation

The Finnish Financial Supervision Authority (FIN-FSA) was engaged in the supervision of financial markets and financial market participants. The activities of FIN-FSA ceased on 31 December 2008.* Supervised entities included banks and other credit institutions, investment firms, fund management companies and the stock exchange. FIN-FSA also monitored listed companies' compliance with disclosure obligations, the quality of financial reporting and the code of conduct in securities markets.

The objective of FIN-FSA operations was to ensure financial stability and maintain public confidence in financial markets, as stated in the Act on the Financial Supervision Authority. Operations followed the strategy adopted by FIN-FSA Board.

Objectives of FIN-FSA operations

FIN-FSA's core operations comprised supervision and regulation, performed both as prudential and market supervision. The focus of prudential supervision was particularly on the most important and risk-sensitive institutions and activities, assessing supervised entities' financial position, risks, risk-bearing capacity and risk management systems. Market supervision was also risk oriented.

FIN-FSA emphasized owners' and management's responsibility for internal control and risk management as to ensure that supervised entities had sufficient financial and other prerequisites to carry out operations and that they did not assume so much risk as to endanger their capital adequacy. FIN-FSA sought to be proactive in identifying risks and pressures for change threatening financial market stability. However, supervision was not regarded as a means of preventing financial market corporations' bankruptcies at all times, nor could it be so. The objective was to ensure that the related consequences affecting customers and financial stability were contained.

Market supervision focused on codes of conduct applied by supervised entities and on securities issuers' compliance with disclosure requirements and International Financial Reporting Standards (IFRSs). FIN-FSA also monitored compliance with insider regulations and other provisions of the Securities Markets Act. In addition, FIN-FSA sought to promote smooth and reliable functioning of securities trading, clearing and settlement.

FIN-FSA granted authorisation to credit institutions, investment firms, fund management companies, custodians and pawnshops. It had also the right to revoke the authorisation of these supervised entities either on their application or on conditions fulfilling revocation requirements. Authorisation

decisions made in the year can be found in Table 'Journal 2008' on page 12.

In addition to supervisory measures, FIN-FSA had the right to impose administrative sanctions if it found that the law or its own regulations had been breached. The main sanctions were public reprimand, public warning and administrative fine as well as penalty payments proposed by FIN-FSA and imposed by the Market Court.

Regulation activities covered both the issuance of standards and participation in the drafting of financial markets legislation at national as well as at EU level. FIN-FSA monitored market conditions closely and, where necessary, submitted proposals to other authorities for legislative action or other measures.

Besides supervision and regulation, FIN-FSA was also vested with the task of promoting public knowledge and awareness of the financial markets as to give members of the public a better opportunity to take and bear responsibility for their own finances.

GOVERNANCE AND MANAGEMENT

FIN-FSA was connected administratively with the *Bank of Finland*, but was autonomous in its decision-making.

The governance and management system of the FIN-FSA was prescribed by the Act on the Financial Supervision Authority (the FSA Act). It was complemented through an audit performed by the auditors of the Bank of Finland, independent internal audit, as well as internal guidance and control systems.

The FSA Act required that FIN-FSA demonstrate transparency in its operations and decision-making procedures and have a sound governance and management system. As for the establishment and organisation of governance and management, FIN-FSA observed, where applicable, the same principles as its supervised entities.

Parliamentary Supervisory Council

The Parliamentary Supervisory Council, elected by the Finnish Parliament, bore responsibility for supervising the overall expediency and efficiency of the FIN-FSA's activities and decided on certain administrative issues.

The Board of the FIN-FSA

FIN-FSA Board was responsible for the steering and supervision of the FIN-FSA's activities, decided the long-term strategic decisions and objectives and monitored their achievement.

The Board consisted of six members. Four members were nominated by the Parliamentary Supervisory Council, one on the basis of a proposal of the Bank of Finland, two based on the *Ministry of Finance proposal* and one based on the proposal of the *Ministry of Social Affairs and Health*. The Directors General of FIN-FSA and the Insurance Supervisory Authority were ex officio members of the Board.

Director General

FIN-FSA was headed by a Director General whose appointment and dismissal rested with the President of the Republic of Finland. The Director General was responsible for ensuring that FIN-FSA performed all its duties efficiently and expediently in accordance with guidelines laid down by the Board in order to achieve its statutory objectives.

The Director General took decisions on important issues in consultation with the Management Group, consisting of the Director General, Deputy Director Generals and the Chief Legal Counsel.

ORGANISATION

The organisation of the FIN-FSA consisted of three departments: the Market Supervision and the Prudential Supervision departments as well as the Regulatory Governance unit. In addition, the Communications unit operated directly under the Director General. FIN-FSA's organisation chart is shown in Annex 1.

The supervisory and regulatory functions were assigned to Market Supervision and Prudential Supervision. Market Supervision was responsible for the supervision of markets, code of conduct and securities markets infrastructure as well as related regulation and its development. It was also responsible for the supervision of compliance with International Financial Reporting Standards (IFRSs) as well as with disclosure requirements by securities issuers.

Prudential Supervision focused on the prudential supervision of all supervised entities, information systems as well as related regulation and its development. The department monitored the risks, capital adequacy and profitability of credit institutions, investment firms and fund management companies. It was also responsible for analysing the overall situation of the financial markets and assessing the risks relating to changes in the economic environment. Furthermore, the department supervised compliance with Basel II capital adequacy reform.

The Regulatory Governance unit was in charge of steering the issuance of FIN-FSA regulations and the preparation of the strategic objectives for regulation. It was also responsible for the authorisation and sanction processes, the legality of FIN-FSA activities, uniform interpretation of the law and the supervision of staff compliance with insider regulations. In addition, the Regulatory Governance unit was responsible for organisational development, financial issues and document management.

The Communication unit was responsible for consumer information, as well as regular communication.

STAFF

FIN-FSA was an expert organisation; 73% of the staff held expert positions, 10% served as managers and 17% held other positions.

FIN-FSA's approved headcount was 142 employees, but at the end of 2008 the actual numbers stood at 137.5. A total of 50 worked in the Market

Supervision, 65 in Prudential Supervision, 16.5 in the Regulatory Governance unit, 3 in Communications and 3 in senior management. The number of man-years worked totalled 140.7. The average turnover rate was 8.5% for those entering FIN-FSA's service¹ and 9.5% for those leaving FIN-FSA².

FIN-FSA's role as the authority supervising financial markets set specific ethical requirements on its employees and their activities, these being loyalty and independence. The employees were to bear in mind FIN-FSA's objectives and work towards their achievement. Their relationships or economic ties to supervised entities were not to become too close or otherwise such that their independence could be compromised.

FIN-FSA staff members had captured their values jointly as follows:

We are financial market professionals who

- ❖ earn trust, every day
- ❖ communicate actively and are service-minded
- ❖ work efficiently and effectively
- ❖ pull together.

FUNDING AND OPERATING COSTS

FIN-FSA financed its operations by levying supervision and processing fees from supervised entities and securities issuers. In the year under review, the combined supervision and processing fees charged by FIN-FSA totalled EUR 18.9 million. In addition, a deficit of EUR 0.6 million was transferred from 2007.

FIN-FSA's operating costs totalled EUR 16.2 million. The majority of this consisted of staff expenses (EUR 11.2 million). Other major expense items were administrative services from the Bank of Finland (EUR 2.2 million) and rental of premises

¹ Turnover rate for those entering the FIN-FSA's service = Number of recruited employees/average headcount* 100.

² Turnover rate for those leaving the FIN-FSA's service = Number of persons who left the FIN-FSA's service/average headcount* 100.

(EUR 1.3 million). In addition, FIN-FSA will pay its contribution to the Bank of Finland pension fund, amounting to EUR 1.4 million.

Staff-related expenses include statutory and voluntary social security expenses as well as occupational health service expenses.

Other expenses were due to official travel, training, security, catering and personnel services as well as services purchased from external parties. Official travel comprised mainly working group meetings of the Committee of European Banking Supervisors (CEBS) and the Committee of European Securities Regulators (CESR) as well as joint meetings of Nordic supervisors.

Financial and insurance supervision was integrated under a new Authority from the beginning of 2009

The Financial Supervision Authority and the Insurance Supervisory Authority merged to become a new Authority called the Financial Supervisory Authority* from 1 January 2009.

The new Authority took over most of the responsibilities of the former Financial Supervision Authority and Insurance Supervisory Authority. The entities supervised by the Financial Supervisory Authority include banks, insurance and pension companies, investment firms, fund management companies and the stock exchange. Pawnshops are no longer supervised entities.

The Financial Supervisory Authority operates in connection with the Bank of Finland. The Parliamentary Supervisory Council supervises the efficiency of the Financial Supervisory Authority's activities.

The Parliamentary Supervisory Council appoints the board members of the Financial Supervisory Authority. The Board consists of five members. In addition to the representatives of the Bank of Finland, the Ministry of Finance and the Ministry of Social Affairs and Health, the board has two independent members with no affiliation to these authorities. The Director General is not a member of the board. Any member of the board may be elected Chairman of the board.

Pentti Hakkarainen, Deputy Governor of the Bank of Finland, was elected the first Chairman of the board of the Financial Supervisory Authority. The board members are

Martti Hetemäki, Under-Secretary of State, Ministry of Finance (Deputy *Tuija Vuorinen*)

Antero Kiviniemi, Director, Ministry of Social Affairs and Health (Deputy *Leena Väänänen*, Senior Actuary)

Pirkko Juntti, LLM

Paavo Pitkänen, MA

Martti Hetemäki was elected Vice Chairman. The deputy to Pentti Hakkarainen is *Kimmo Virolainen*, Head of Department.

The Parliamentary Supervisory Council appointed *Anneli Tuominen* acting Director General of the Financial Supervisory Authority.

Of the Financial Supervisory Authority's activities, 95% will be funded by supervised entities and securities issuers, with the remainder of 5% being provided by the Bank of Finland.

The objective of the Financial Supervisory Authority's activities is to enable balanced operations of credit institutions, insurance and pension companies and other supervised entities in stable financial markets, to protect the rights of the insured and foster public confidence in financial market operations.

*The new supervisory authority, the Financial Supervisory Authority will continue to use the same abbreviation, FIN-FSA. In English, the only name change has been from Supervision to Supervisory Authority.

The year's events

23 January FIN-FSA issues a public reprimand to Kari Haavisto, board member of Aspo plc, for abuse of inside information

23–24 January FIN-FSA participates in *Vero 2008* (Taxation 2008) event, arranged by the Taxpayers Association of Finland

24 January FIN-FSA detects shortcomings upon inspection of insider registers; 14 administrative fines imposed

8 February Parliamentary Supervisory Council designates Pentti Hakkarainen, Deputy Governor of the Bank of Finland as Chairman of the FIN-FSA Board

12 February Working group headed by Minister Antti Tanskanen publishes memorandum on *consolidation of the Financial and Insurance supervisory authorities*

1 March Revised standard 5.2b *Disclosure requirements applicable to listed companies and shareholders* comes into effect

3 March FIN-FSA issues a public warning to *CenCorp Corporation* for neglect of disclosure obligation

7 March FIN-FSA Board hands in its Annual Report for the previous year to the Parliamentary Supervisory Council

31 March FIN-FSA issues its opinion on the memorandum on the consolidation of the Financial and Insurance supervisory authorities

31 March FIN-FSA posts an online register of interpretations on its website (available in Finnish)

2–16 April FIN-FSA organises four information meetings on disclosure requirements for listed companies

21 April FIN-FSA and the Danish supervisory authority Finanstilsynet sign a Memorandum of Understanding on the supervision of the Danske Bank Group

1 May Standard 5.1 *Regular reporting requirements* comes into effect

1 May Revised standard 5.3 *Declaration of insider holdings and insider registers* comes into effect

1 June The broad-based Memorandum of Understanding between EU authorities on the management of cross-border financial crises comes into effect; FIN-FSA is one of the signatories

22 May FIN-FSA invites consumer journalists to an information meeting on mutual funds and the authorisation requirement of investment services

23 May Government submits a proposal to Parliament for the Act on the Financial Supervisory Authority

16 September FIN-FSA issues a press release on the immediate effects of the insolvency of *Lehman Brothers* on the entities supervised by FIN-FSA

18 September FIN-FSA releases information on banks' right to raise interest rates under the new standard loan terms, which replace the previous term entitling banks to require advance loan repayment

25 September FIN-FSA holds a press conference on the current state of financial markets

29 September FIN-FSA issues a press release stating that the Icelandic government ownership of *Glitnir Bank hf.* does not have a direct impact on the customers of *Glitnir Bank Ltd* in Finland

6 October FIN-FSA issues a prohibition on asset transfers from Icelandic-owned banks out of Finland

6 October FIN-FSA announces that it has stepped up supervision of shares in financial corporations with regard to potential short-selling

6 October FIN-FSA issues a press release stating that the Finnish banking system remains stable

7 October FIN-FSA invites listed companies to an information meeting on insider regulations

8 October Finland raises deposit protection to EUR 50,000 in

line with the recommendation of the EU Ecofin Council.

8 October The Icelandic supervisory authority FME takes control of *Glitnir Bank hf.*, FIN-FSA announces that the Finnish operations of *Glitnir Bank Ltd* will continue

9 October The Icelandic supervisory authority FME takes control of *Landsbanki hf.*

9 October FIN-FSA suspends the operations of *Kaupthing Bank hf., Finnish Branch* and announces that a prohibition against asset transfers from Icelandic-owned banks out of Finland was issued three days earlier

9 October FIN-FSA announces that it is exploring the possibilities for repaying depositors of Kaupthing Bank, Finnish Branch

10 October FIN-FSA publishes information on Finnish banks' Iceland-related risks

13–15 October FIN-FSA arranges information meetings for supervised entities on anti-money laundering

16 October FIN-FSA specifies the information on Finnish banks' Iceland-related risks; risks are small, amounting to EUR 20 million according to revised figures

16 October FIN-FSA removes the ban on asset transfers from Glitnir Bank as the bank ceased to be a member of the Glitnir Group

20 October FIN-FSA allows the provision of investment services to existing customers of Kaupthing Bank, Finnish Branch

20 October FIN-FSA releases information on the arrangements for repayment of deposits with Kaupthing Bank, Finnish Branch

24 October FIN-FSA arranges a press conference jointly with the *Finnish Association of Mutual Funds* on current issues in the mutual funds business

27 October Finnish Parliament approves a state guarantee related to repayment of deposits with Kaupthing Bank, Finnish Branch

29 October FIN-FSA participates in the *IMF* country inspection of Finland

30 October FIN-FSA releases information on repayment of depositors in Kaupthing Bank, Finnish Branch

12–13 November FIN-FSA participates in *Sijoitus-Invest 2008* (an investment fair), arranged by Helsinki Fair Ltd

13 November FIN-FSA publishes a report on IFRS, stressing the particular importance of financial information in times of market disruptions

19 November FIN-FSA invites supervised entities to an information meeting on transaction reporting

3 December At a meeting with journalists, FIN-FSA renders an account of the state of the banking sector and on the higher debt burden on households resulting from new housing loans

3 December Parliament passes the acts on the Financial Supervisory Authority

19 December The President of the Republic adopts the acts on the Financial Supervisory Authority

19 December The Parliamentary Supervisory Council appoints the Board of the Financial Supervisory Authority and designates Pentti Hakkarainen, Deputy Governor of the Bank of Finland, Chairman of the Board

19 December The Parliamentary Supervisory Council appoints Anneli Tuominen acting Director General of the Financial Supervisory Authority

19 December Office of Director General is declared open

The list of year's events is primarily based on the press releases published in the year but also includes some other events.

Journal 2008

Main items of the Journal	2008	2007
Governance	50	86
Regulation	124	164
Market supervision	545	554
Prudential supervision	80	82
Other supervisory activity	967	927
Other	188	130
<i>Total</i>	<i>1954</i>	<i>1943</i>

Major categories of Journal entries

Notifications	521	380
Prospectuses	237	282
Regulations related matters	122	151
Requests for further investigation	117	100
Fit and Proper reports; senior management	91	88
International cooperation	67	49
Contractual terms	59	52
Authorisation decisions, incl. new authorisations granted, changed authorisations and revocations	55	20
Inspections and supervisory visits	53	53
Publications; communication releases	48	43

In 2008, 1,954 entries were made in the FIN-FSA Journal, broken down by department, as follows:
Market Supervision 1,448; Prudential Supervision 429; Regulatory Governance 77.

Source: Financial Supervision Authority.

The year in brief

The financial crisis put supervisory cooperation to the test and stepped up supervision

Developments in Finnish financial markets, in conjunction with the global financial crisis, have highlighted the significant role and distinct powers of host supervisors and emphasised effective supervisory cooperation. In response to the crisis, the supervisory authority increased the reporting frequency for data on liquidity position and counterparty risks and stepped up regular contacts with supervised entities, especially in the areas of risk and prudential supervision. In-house analyses and cooperation with other financial market authorities were also increased. For closer details on the financial crisis, see the section on the economic operating environment, pages 17-22.

The year under review was marked by the drafting of legislation on the new Financial Supervisory Authority and preparations for the start of the new authority, as well as the financial crisis.

Finnish depositors' interests protected in the Icelandic banks' crisis

The crisis that overcame Icelandic banks and the takeover of the three largest banks by the Icelandic regulator were also reflected in the Finnish units of

these banks. *Glitnir* and *eQ* operated subsidiaries engaged in deposit banking in Finland, whereas *Kaupthing Bank* had a Finnish branch. On 6 October 2008, FIN-FSA issued a prohibition on asset transfers from the banks' Finnish units out of the country. On 9 October, operations in *Kaupthing Bank* Finnish Branch were suspended and an authorised representative was appointed for the branch. Suspension of operations was necessary to protect depositors' assets. The situation was resolved regarding the depositors with the negotiation of an arrangement with three major Finnish banks, *Nordea Bank Finland*, *OP-Pohjola Group* and *Sampo Bank*, providing for full repayment of all the deposits with the bank at the end of October. The banks contributed to the financing of the repayment.

The banks undertook to bear the financial risk arising from the fact that the proceeds of the realisation of the assets pledged as collateral would not be enough to cover the loan. The banks, however, set as a condition that government provide a state guarantee against the legal risks, which, although highly unlikely, might be sizeable if realised. The legal risks may materialise if the other creditors of *Kaupthing Bank* require recovery of the deposits to the estate should the bank enter into liquidation. Government provided a guarantee against these legal risks and thus undertook to pay

to the estate on behalf of Finnish depositors an amount in excess of the approved compensation to the bank's Finnish depositors.

The Finnish private-sector financial arrangement for repayment of the depositors of Kaupthing Bank Finnish Branch differed from the approaches chosen by other European countries. The other EU member states, with the exception of Sweden, mainly resorted to the deposit guarantee schemes. Recovery of deposits via the deposit guarantee scheme takes much longer and payments are subject to a legal maximum.

With the takeover of Glitnir Bank by the Finnish management group on 14 October and the restructuring of the bank back to Finnish ownership and resumption of its former name, FIM, the ban on asset transfers from the bank was lifted. Repayment of the depositors of Kaupthing Bank Finnish Branch also paved the way for the controlled closedown of the bank's other operations. The prohibition on asset transfers from eQ Bank remains in effect.

In addition to exercising practical crisis management, representatives of FIN-FSA were, on several occasions, summoned as experts to parliamentary committee hearings on government relief measures to ensure financial stability and avert a credit crunch. State guarantees to Finnish banks and revision of the Deposit Guarantee Schemes Directive were among the issues on the agenda.

Preparations for the Financial Supervisory Authority

The drafting of legislation on the new supervisory authority started in effect in the early part of the year with the submission of a proposal for the acts and key principles relative to the establishment of the new consolidated financial and insurance supervisory authority, by the working group headed by Minister *Antti Tanskanen*. This working group had been set up by the Ministry of Finance and the Ministry of Social Affairs and Health in June 2007 to explore the best way of achieving the objective of consolidation of the financial and insurance supervisory authorities, as set out in the government programme.

Consultations on the working group's proposal ended at the end of March 2008. In its opinion, FIN-FSA emphasised the new authority's responsibility for ensuring the stability of the EEA branches operating in Finland. FIN-FSA also endeavoured to achieve adjustments for example to the provisions on the authority's right to obtain information on branches. This would create better prerequisites for promotion of stability across the Finnish financial sector in conditions where major banks operate via branches in Finland, and make the Finnish authorities better equipped to handle potential crises in branches.

In May 2008, Government submitted a bill to Parliament with a proposal for the Act on the Financial Supervisory Authority and other related acts. FIN-FSA and the Insurance Supervisory Authority launched practical preparations by mapping their functions and identifying interfaces. The practical preparations were coordinated at joint management group meetings.

Legislative preparations were stepped up towards the end of the year. The final decision on the new Financial Supervisory Authority was taken at the presidential session on 19 December 2008.

The Parliamentary Supervisory Council appointed the Board of the Financial Supervisory Authority on 19 December 2008 and designated Pentti Hakkarainen, Deputy Governor of the Bank of Finland, Chairman of the Board. Upon proposal by the Board, the Parliamentary Supervisory Council appointed Anneli Tuominen acting Director General until such time as the appointed Director General took up office. The office of Director General was declared vacant, with the deadline for applications set at 14 January 2009.

PRUDENTIAL SUPERVISION

The sustained financial crisis weakened the performance of banks and investment firms. The capital adequacy of Finnish market participants, nevertheless, remained sound overall.

Prudential Supervision stepped up inspections and contacts with supervised entities, with special focus on market and liquidity risks and rising credit risks.

Cross-border supervisory cooperation turned out to be a very important element in the restructuring of the Nordic financial groups and in the organisation of crisis-hit banks. The Committee of European Banking Supervisors (CEBS) further developed the services of the mandatory colleges of supervisors and closely monitored the state of the EU financial sector. FIN-FSA took an active part in these activities.

MARKET SUPERVISION

The financial crisis, the *Directive on Markets in Financial Instruments (MiFID)* that took effect at the end of 2007 and the changes in securities marketplaces and the securities clearing and settlement systems were in many ways reflected in the FIN-FSA's activities during the year. The valuation of financial instruments was closely monitored, as was the description of inherent risks in financial reports. The rapid deterioration of the overall economic situation increased the need for evaluation of the consequences of the slowdown for the information on the effects of the situation made available to investors by listed companies.

Because of MiFID, FIN-FSA received both new applications for authorisation as well as applications for amendments to existing authorisations were subject to review. Inspections of supervised entities' compliance with the requirements under MiFID were also initiated. Because of the changes in ownership and competitive conditions, FIN-FSA focused on the stock exchange and the clearing and settlement services. Supervision of market participants' compliance with insider regulations continued. Efforts were devoted to risk-based supervision, and the number of inspections was increased. International cooperation concentrated on practical supervision.

REGULATION

The financial crisis highlighted a need for regulatory amendment for example with regard to market transparency, risk management of market participants and internal control. Measures for

regulatory and supervisory convergence at EU level were continued. The provisions of home and host country supervision in the Capital Requirements Directive (CRD) were revised to ensure better correspondence with the current structures and supervisory requirements of international banking.

In the spring, FIN-FSA posted a register of interpretations on its Finnish website including interpretations of individual supervision cases and technical details issued by FIN-FSA. The register was made available to a broad circle of financial market participants. The register of interpretations is not part of FIN-FSA's official set of regulations but supplements it by addressing frequently asked practical questions. Currently, the register includes interpretations concerning the obligation to disclose share holdings, capital adequacy calculations, risk management and prospectuses prepared in line with the Securities Markets Act.

CUSTOMER INFORMATION

The need for customer information is constantly growing as the economic operating environment is becoming increasingly complex.

The public's responsibility for their own economy was supported by a special website (in Finnish and Swedish) designed and maintained for savers and investors to help them make assessments of financial services and products. Recent issues in the online publication *FSA Newslines* include the authorisation requirement for providers of investment advice, mutual funds and their supervision, the criteria of investment fraud and capital-guaranteed structured notes. Several articles on the deposit guarantee scheme have previously been posted on FIN-FSA's website.

In May, FIN-FSA released a Finnish-language version of the CESR publication *A customer's guide to MiFID*. In September, the Bank of Finland and FIN-FSA released new exercises for the task package on the *Euro.fi online study site* intended for comprehensive and high-school students. FIN-FSA's contribution *Can you stay in the saddle?* discusses saving, conventional loans and instant loans. The online study site also includes the *Financial Wizard*

quiz, which has been played by more than 40,000 visitors, so far. Over the year, FIN-FSA held four press conferences, which promoted media coverage of banking, investment and savings issues.

During the peak of the crisis of the Icelandic banks, FIN-FSA posted a FAQ section on the crisis and issued press releases and other material on developments. In October 2008, FIN-FSA introduced a free consumer helpline for bank customers and extended opening hours according to need.

At the investment fair *Sijoitus-Invest 2008* held in November, members of staff gave brief presentations on issues such as management of interest rate risk on loans, mutual fund risks, protection of depositors and investors, and the identifying features of investment fraud.

For supervision of securities trading, a program was designed for searching the database of the *Population Register Centre* for persons with close links to insiders, and the database of the Finnish business and credit information company *Asiakastieto* for insiders' corporate contacts.

For the analysis of the financial standing and risks of supervised entities, an *XBRL-based* system for reporting capital adequacy data by fund management companies was designed in line with the CEBS recommendation. The software for analysing financial standing and risk was modified to allow for the analysis of both financial and other data reported in the old format and capital adequacy ratios (under the common reporting framework, COREP) using the XBRL taxonomy.

SUPERVISORY INFORMATION SYSTEMS

Preparations of the information systems for the Financial Supervisory Authority were launched in the spring in cooperation with the Insurance Supervisory Authority. Systems development was divided into initial phase systems and merging of existing systems. The initial phase systems, which enable or greatly facilitate the daily operations of the new authority, were accessed right from the start of operations.

Although there are systems already available for undertaking the processes of the Financial Supervisory Authority, system overlaps between the two previous authorities, such as registers of supervised entities and reporting systems, must be consolidated or rebuilt. Consolidation is expected to take several years.

Economic operating environment

The financial crisis deepened

The financial crisis that began in the US housing loan markets spread during the year not just regionally but also across almost all sectors of the financial market. The impacts of the crisis were shown extensively in interbank money markets, securities markets and companies' market funding. According to data collected by *Bloomberg*, crisis-related losses and impairments on housing loans and structured products suffered by the financial sector until the end of December totalled EUR 719 billion. Out of this amount, banks and investment banks accounted for EUR 614 bn and investment companies EUR 104 bn. Geographically, the losses were distributed as follows: the Americas (primarily United States) EUR 485 bn and Europe (particularly Switzerland and Great Britain) EUR 211 bn. In addition to that, equity markets nosedived, causing large losses.

The earnings of EU area banks deteriorated in the first three quarters of the year. Deterioration was caused by impairments and losses emerging in the weak market conditions. Earnings were also affected by increasing credit loss provisions, tightened lending procedures and decelerating loan stock growth. However, the majority of banks nevertheless showed a profit. As measured by total capital adequacy, capital adequacy on average remained fairly solid as banks raised more capital

and sold risky assets. However, a weakening of the quality of the loan stock, as predicted by the credit markets, may be a significant threat to capital adequacy in future.

Due to the crisis, a few international banks were forced to take off-balance-sheet special purpose vehicles used in the construction of structured products back into their balance sheets. The securitisation of loans became more difficult. Constant news of write-offs and the consequent

Yield spread between secured and unsecured deposit

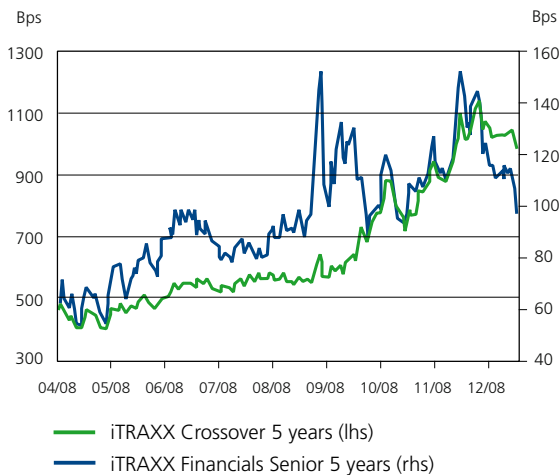


Source: *Bloomberg*.

liquidity problems in a few banks made other banks and market participants, such as investors, avoid counterparty risk. Banks' unwillingness to lend money to each other resulted in a disappearance of liquidity from interbank markets. This was shown in increased interest rate volatility, high spreads between bid and ask quotations, steep increase of spreads between interest rates on collateralised and non-collateralised loans and also a decrease of prices of mortgage-backed and structured products.

The situation escalated in September in the wake of the bankruptcy of the US investment bank Lehman Brothers. Central banks tried to alleviate the situation for example by extending the list of eligible collateral, increasing the size of money market operation and their maturity. Central banks have indeed become a substitute for the money markets as a source of lending.

Price of hedging against bank credit risk



Source: Bloomberg.

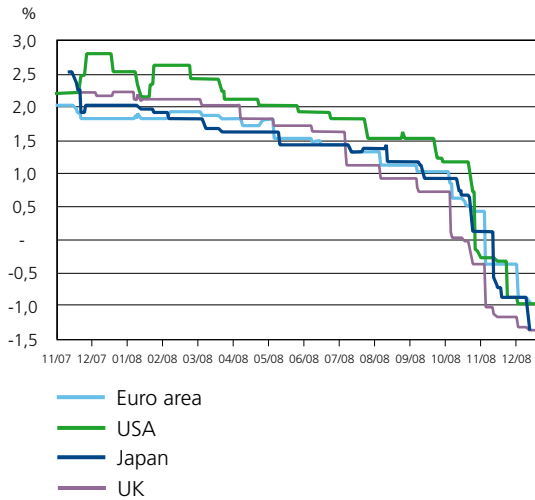
Uncertainty relating to banks and the resulting weakness of market liquidity hampered funding of even solvent banks and increased their costs. The iTraxx Europe Senior Financial index indicating the price of credit risk related to banks with high credit ratings rose to a new high. Many governments wanted to ensure banks' funding eg by providing guarantees against compensation. However, for an increasing number of banks, the issue is also a capital adequacy problem due to large losses. Instead of guarantees, many governments have followed the UK's example and bolstered banks' capital adequacy by direct capital injections. In Europe, capital support

has been provided by the following countries: Belgium, Denmark, France, Germany, Great Britain, Luxembourg and the Netherlands. The total capital support provided by these countries amounts to EUR 67 billion. Many other European countries have also prepared to support banks by capital injections if necessary. The abovementioned support measures did indeed re-establish confidence and liquidity in the markets in late autumn.

Nervous markets reflecting grim expectations

Funding difficulties and large losses that eroded the own funds of large international banks weakened banks' ability and willingness to lend money to customers; together with the reduced confidence and the steep decline in asset values this slowed down economic growth all over the world. Now banks' difficulties are overshadowing the prospects of the real economy, which deepens the banks' plight further. The euro area wound up in recession in autumn, and economists cut estimates of GDP growth in many countries for 2009.

Consensus forecasts of GDP growth for 2009

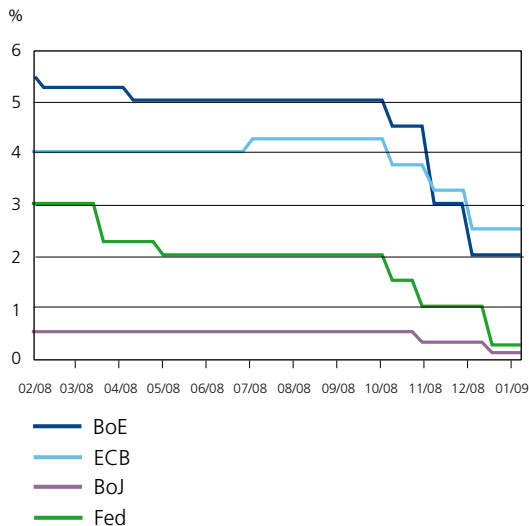


Source: Bloomberg.

More traditional monetary and fiscal policy measures were also adopted to ward off the recession. For example, the EU summit in December approved a coordinated EUR 299 billion stimulus package. As economic growth, commodities prices and inflationary expectations decreased, the central banks of

developed countries cut their policy rates heavily. The effectiveness of monetary policy was undermined by the abovementioned problems related to the transmission mechanism. However, for example the yield curve for the euro area steepened markedly from the beginning of the review year.

Central banks' policy rates

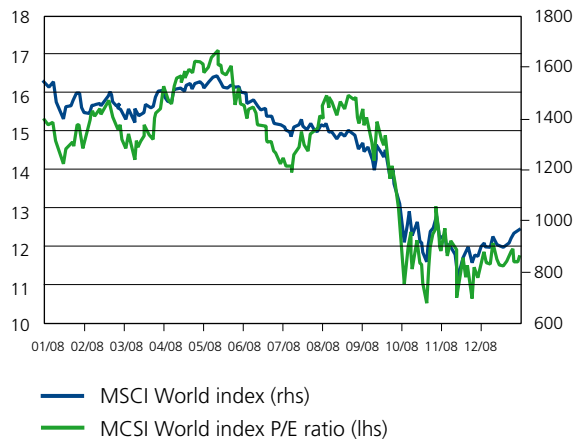


Source: Bloomberg.

Government bonds were seen as a safe haven, that is, a trustworthy investment. Risk premia on bonds issued by companies rose to exceptionally high levels. This predicts a significant increase of payment difficulties over the next few years. Partly due to the banking support packages, yield spreads between different countries' government bonds grew materially. For instance, Hungary, Ukraine, Iceland and Pakistan wound up in a balance-of-payments crisis and sought help from the *International Monetary Fund (IMF)*.

Globally waning economic growth and difficulties in the financial sector lifted the risk premia on equity markets to a high level. The major indices slumped to the levels of 2003 and historical P/E-ratios indicating the price of a share relative to earnings were at the lowest levels in decades, reflecting expectations of dramatic reductions in earnings performance. Equity market volatility rose to levels not seen since the great depression in the 1930s. In the United States, nominal house prices decreased over 20%. In some euro area countries, such as Ireland and Portugal, house prices also declined materially.

MCSI World Index and its P/E ratio

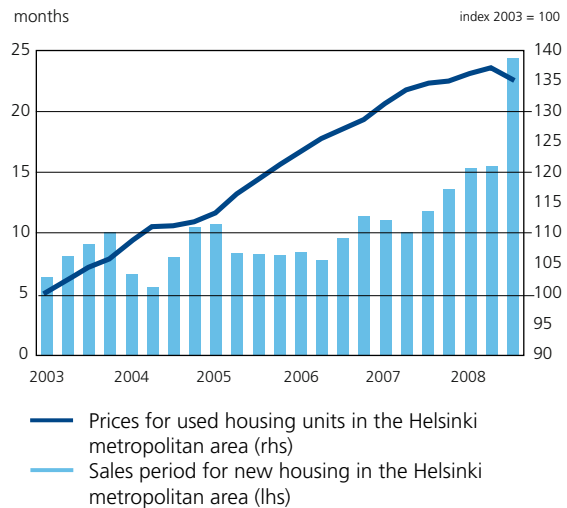


Source: Bloomberg.

Impacts of the financial crisis in Finland

The impact of the financial crisis in Finland can be seen in many ways eg through weakened prospects for the real economy, decreasing asset prices, increased costs of banks' fund raising as well as changes in households' and companies willingness to borrow and saving behaviour.

Stock of new houses for sale and housing prices



Sources: STH-Group Ky and Statistics Finland.

Deterioration of global economic growth prospects also rapidly weakened the outlook for the Finnish real economy in the autumn. Decreasing asset prices pushed both companies' and consumers' confidence to the lowest level in the 21st century. This is shown above all as weakening investment

Market liquidity at historical low

Market liquidity reflects the depth of markets and their vulnerability to price disturbances. In liquid markets, there are always a large numbers of willing buyers and sellers, and therefore individual transactions do not have a great impact on price formation. Poor liquidity due to thin and disrupted markets will materialise as liquidity risk, if banks are unable to dispose of assets quickly without extra cost or if, as a result, it becomes significantly more difficult or expensive to acquire and maintain funding.

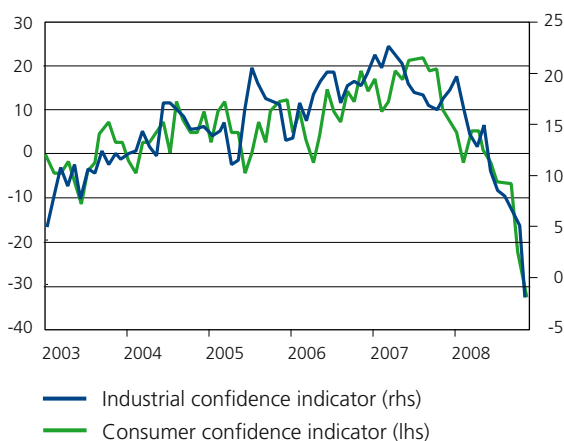
A couple of years ago, an abundance of liquidity was still available in the financial markets. The credit risk premiums charged in financial markets were then at record-low levels and banks' costs of market-based funding was only slightly higher than the risk-free government lending rate, since the risk of banks becoming bankrupt was considered negligible. Abundant liquidity gave rise to rapid lending growth and ran up share prices. At the same time, investors sought income from complex investment products that had a complex risk profile and were less liquid and transparent than traditional investments. Securitised subprime housing loans belonged to this category. As loan losses on subprime mortgages grew, the risks started to emerge, but their size or exact location remained obscured. This caused a major

loss of confidence between banks and the other market participants resulting in serious disruptions in many markets. Hence, market liquidity tightened significantly, share prices plummeted and banks' lending criteria became stricter.

Confidence in international financial markets has not yet normalised. Banks have been unwilling to extend loans to one another and, as a result, the interbank market has become illiquid. This has been reflected in growing interest rate volatility, wide purchase and sale bid margins and sharp increases in lending rate differentials between secured and unsecured loans.

In September, the financial market crisis deepened when big financial and insurance corporations had to face major restructuring, the direct and indirect impact of which on market participants remained unclear. At this stage, not only structured investments but also the more traditional investment outlets were hit. Central banks have tried to restore the situation by expanding the list of eligible collateral, increasing the volumes of money market operations and extending the maturities of money market operations. In October, the EU countries agreed on joint measures aimed at stabilising the financial markets. The Finnish

Confidence indicators



Sources: Research Institute of the Finnish Economy and Statistics Finland.

activity and reduced order books. In particular, construction production and the housing markets cooled off markedly. The amount of unsold houses rose to record levels and the real house prices decreased. Export prospects weakened as many key export markets have wound up in difficulties. This is likely to affect employment prospects further and to increase precautionary saving. Gross domestic product is indeed expected to decline in 2009, and growth in 2010 is expected to remain modest.

The stock of housing loans has increased already for years fairly rapidly on the back of low interest rates and extended loan periods.³ Part of households has assumed a worrisomely high burden of debt. In connection with a long loan period, there is not much

³ FIN-FSA's household loan survey, August 2008.

Parliament consented to the granting of temporary government guarantees to Finnish deposit banks. The guarantees can be utilised as soon as their detailed terms and conditions have been set. The different central bank and government measures have had a stimulating effect especially on the short-term money markets, but the situation is still highly uncertain and market liquidity unusually weak.

Banks' funding costs rise as a result of the financial market crisis

The price of a bank's funding consists of a risk-free interest rate and the bank's risk premia. The loss in confidence increased banks' risk premia on funding, particularly those that were due to credit risk. These risk premia have remained high because of weak market liquidity, the ongoing uncertainty and the losses and write-downs of banks. The higher risk premia raise the price of banks' market-based funding. Banks have had to refinance their maturing loans at higher costs than before. The credit risk premia are particularly high for long-term funding (with a maturity of over a year) and in relation to short-term financing the price of long-term financing has risen sharply while supply has become short.

New recommendations on the management of liquidity risk

Risk management refers to the recognition,

measurement assessment, mitigation and monitoring of all risks that affect a bank's liquidity situation and ability to pay. A bank's management of its liquidity risk involves management of funding risk in the balance sheet and risks relating to market liquidity. The protracted financial market crisis has spotlighted the importance of good risk management and a strong risk management culture. At the same time, risk management regulation and supervision have increased in importance. The international organisations for supervisory cooperation have analysed the consequences of market turbulence and possible shortcomings in the work procedures of supervised entities, and in regulation and supervision. In the autumn, the Committee of European Banking Supervisors (CEBS) issued recommendations on the management of liquidity risk. These recommendations will be taken into account when revising the Credit Institutions Directive (2006/48/EG). FIN-FSA will incorporate the recommendations in its standard on the management of liquidity.

Regulations will be reviewed particularly as regards liquid reserves, stress testing and continuity planning. More detailed guidance will also be required for taking account of market liquidity and recognising and measuring risks in a more comprehensive manner.

room to manoeuvre, since the proportion of interest rate in the instalment is high. The amount of non-performing housing loans and their proportion of the loan stock has increased, but proportionately still remains fairly low. However, a turn for the worse has taken place, which predicts an increase in payment difficulties and a reduction in the quality of the housing loan stock. From the banks' perspective, however, credit losses still remain low.

The situation in the housing loan markets changed abruptly in the autumn. In the wake of grim economic news, households lost their confidence in the future, and credit demand contracted markedly in October. At the same time, banks also reduced lending by tightening their lending criteria. Due to increased funding costs, banks also increased margins. Towards the end of the year, housing markets became

sluggish as house prices took a downturn and selling periods lengthened.

Hence, growth of the households' loan stock decelerated further, but at the same time, growth of the corporate loans stock accelerated. Companies prepared for tightening availability of finance by drawing loans that exceeded their immediate financing needs. Companies that had previously raised their funding in the markets now turned to banks.

Banks' long-term fund raising became clearly more difficult as the financial crisis deepened during the autumn. In contrast, funding maturing in less than a year was ample after the Lehman Brothers disruption ended. The liquidity of Finnish banks was improved throughout the autumn by continuing strong deposit growth. In less than a year, increasing

interest rates and collapse of equity prices led to a redistribution of the savings market. Saving in one's bank account became the most popular means of saving by far. Deposit interest rates were increased at the beginning of the year by increased level of interest rates and tightened competition. In addition, weaker performance of alternative forms of saving contributed to the shift into deposits.

In addition to redemptions, mutual fund assets were reduced by market fluctuations. Equity funds suffered in particular from declining share prices. Fixed-income fund assets on the other hand were reduced more on account of redemptions, but on the other hand redemptions were increased by the fairly high peak seen in interest rates. Funds were shifted into deposits also from insurance savings. In particular, the unit-linked insurance policies in the largest product group, savings life insurance, declined in terms of both new sales and insurance savings.

The impact of the international crisis on Finnish banks has so far materialised primarily as reduced fair values of investments. Finnish banks must record losses and impairments in their fair value reserve, so the impact is reflected in their results and capital adequacy. Although the figures were significant in comparison to the banks' profits, relative to own funds they were not as worrisome. On the whole, the capital adequacy of the Finnish banking sector may still be considered strong, although the risks increase steeply as economic growth slows down.

Decreased asset prices had the most significant impact on the capital adequacy of employment pension and life insurance companies. The operating capital of both employment pension and life insurance companies was reduced almost to a half from the beginning of the year. The average solvency of these companies can be considered satisfactory.

Stabilisation of the financial markets is the most important goal for the near term. In Finland, too, decisions have been made to take measures in line with the EU countries' common stance particularly to safeguard the lending ability of the banking sector. The government bill on government guarantees to new debt instruments issued by banks was adopted at the end of the year. In addition, the Ministry of Finance was in the process of preparing a proposal for a capital support package.

Guarantees would be granted on a discretionary basis to certificates of deposit and bonds issued without other collateral. Capital support would be given so that the government would subscribe for a non-secured capital loan belonging to the bank's original own funds. Compensation would be charged for both the guarantee and the capital loan. Pricing will reflect the risk profile of the bank concerned. Guarantees and capital loans could only be granted to banks capable of operating and meeting the capital adequacy criteria. The purpose of this is to ensure banks' liquidity and lending capacity. In Finland, too, it is important to provide banks with instruments agreed at the EU level, in order that the competitive position of Finnish banks remains neutral.

Structural changes in the financial sector

Operation of the *Sampo Bank* group continued as a subsidiary of the Danish *Danske Bank*. A step towards the integration of the bank as a part of the Danske Bank Group was taken in spring when the information systems of Sampo Bank were combined with parent's IT systems. This caused disruptions in customer banking that lasted for several months.

After the Pohjola transaction, restructurings and mergers within the OP-Pohjola group were completed as the name of *OKO Bank* was changed into *Pohjola Bank* in March. Within the group, combinations of member banks continued. Mergers were announced by the following co-operative banks (new bank in parentheses): Lieksa, Nurmes and Valtimo (*Pielisen Osuuspankki*) as well as Kiikalan Rekijoki, Kisko, Kuusjoki, Perniö and Salon Seutu (*Salon Osuuspankki*).

Within the Finnish Savings Banks Group, mergers were decided by Hauho and Renko savings banks (*Kantasäästöpankki Oy*) and Töysä and Kuortane savings banks (*Töysän Säästöpankki Oy*).

Payment and clearing centre ACH Finland Oyj was established

A licence was granted in December to *ACH Finland Oyj*, the joint payment and clearing centre of *Paikallisosuuspankkiliitto Oy*, *Säästöpankkien Holding Oy* and *Aktia*. The objective of the company is to ensure cost-competitive payment traffic services to participating banks and their customers in the SEPA operating environment that was introduced in January.

Operating year 2008

Prudential Supervision

Prudential supervision is aimed at identifying risks to financial stability and addressing them through pre-emptive action. However, although supervision cannot prevent all crises and bankruptcies from befalling supervised entities, efforts will be made to keep any adverse effects of a crisis under control. The main supervisory focus was on supervised entities and systems that are the most significant ones from the financial stability perspective. During the reporting year, regular analyses were undertaken of supervised entities' corporate governance, financial performance, risks and capital adequacy. Supervision was increased and intensified in respect of those supervised entities that faced liquidity problems.

International cooperation between supervisors continued to expand. Cooperation was necessary especially in the supervision of Nordic financial conglomerates, as their operations have a major impact on the functioning and stability of the Finnish financial markets. CEBS provided assessments of the situation in the EU financial sector as a whole, and supervisors exchanged information among themselves.

Key events in 2008

- ❖ *The effects of the financial crisis on bank profitability and capital adequacy were under heightened scrutiny. Despite weaker earnings performance, in general banks' capital levels remained adequate.*
- ❖ *Inspections and contacts with supervised entities were stepped up. The focus was specifically on market and liquidity risks and increased credit risks.*
- ❖ *Cross-border supervisory cooperation gained increasing importance in connection with the restructuring of Nordic financial conglomerates and the organisation of operations of banks that had drifted into a crisis.*
- ❖ *CEBS developed the activities of colleges of supervisors and devoted greater efforts to monitoring the EU financial sector during the financial crisis. Within CEBS, FIN-FSA participated in supervisors' immediate and ongoing exchange of information on the situation in the financial sector.*

Outlook for 2009

- ❖ *The close monitoring of supervised entities' risk exposures will continue, with intensified supervision, if necessary, of banks and investment firms where problems surface. Supervised entities' risk-bearing capacity will be assessed on a regular basis with a view to identifying various risks.*
- ❖ *Supervisory cooperation concerning cross-border conglomerates will be upgraded further in inspections and assessments of conglomerates' capital adequacy.*
- ❖ *Influence will be exercised within CEBS for the improvement of supervisory practices applied to financial conglomerates and for the enhancement of the colleges of supervisors' activities in crisis situations. Emphasis will be laid on issues imperative for the stability of the Finnish financial markets, such as the role of the host country supervisor in the supervision of conglomerates.*
- ❖ *The changes required by the revised Capital Requirements Directive will be incorporated into the corresponding FIN-FSA standards.*
- ❖ *Evaluation of supervised entities' own Internal Capital Adequacy Assessment Processes (ICAAPs) will be deepened by using more precisely specified criteria in risk assessments.*
- ❖ *Operational procedures for crisis management will be improved together with other authorities.*
- ❖ *Key supervisory processes for financial and insurance supervision will be harmonised.*

Financial crisis weakened banks' earnings developments

Finnish banks' investments in subprime-linked securities were negligible. Banks avoided incurring immediate subprime losses, but their earnings growth weakened, as securities prices generally dropped to record lows. Securities-related fee income fell, and income from trading and investment decreased. The situation was alleviated by favourable developments in banks' net interest income. Despite weaker capital adequacy ratios, banks' capital positions still remained at comfortable levels by international standards. The own funds buffer required to cover risks contracted mainly because lending growth also increased the need of own funds.

Inspections and meetings with supervised entities were more frequent

Inspection activity concerning credit, market and operational risks was increased according to supervisory objectives. Owing to the financial crisis, a proportion of supervisory resources were directly reallocated to assessment of crisis situations; an area in which the workload grew considerably towards the end of the year. Close contacts with banks were necessary, as the financial market situation changed very rapidly. The methods and procedures applied in the Supervisory Review and Evaluation Process (SREP), an overall assessment of supervised entities' capital adequacy conducted at least once a year, were updated and improved.

Although the price for banks' funding continued to be high due to the loss of confidence in the markets, Finnish banks did not experience problems in accessing funding. Finnish banks' liquidity situation remained broadly stable. Even so, the Icelandic banking crisis was reflected in the Finnish market, and FIN-FSA launched special measures in order to intervene in the operations of Icelandic banks' Finnish units. At the end of the year, the EU's common financial market stabilisation package restored some confidence to the interbank market. Nevertheless, the markets continued to be volatile, and the final impact of the EU's common efforts could not yet be estimated.

Importance of cross-border supervisory cooperation increased in practical work

FIN-FSA takes part in the supervision of the Nordea Group and the Danske Bank Group at the level of colleges of supervisors, formed by the relevant supervisors. The activities of these colleges have been confirmed through agreements between supervisors. Supervision of the Nordea Group was coordinated by the Swedish supervisor *Finansinspektionen* and that of the Danske Bank Group by the Danish *Finanstilsynet*. In addition to group-level supervision, FIN-FSA was also responsible for supervising the banking groups' subsidiaries operating in Finland.

During the course of the spring, Sampo Bank changed over to using the information systems of its parent company Danske Bank. The information systems, combined over the Easter period, started to show signs of problems that substantially hampered banking services provided to Finnish customers. The Danish supervisory authority *Finanstilsynet* and the Danske Bank management were also involved in settling the matter. The handling of this disturbance showed that the supervisor of the country of location of a subsidiary should have adequate potential to obtain information and exert influence on the supervision of conglomerates that have an important share of the financial market of the subsidiary's country of location.

SUPERVISED ENTITIES' PROFITABILITY AND RISKS

Bank profitability weakened from last year's peak performance

The Finnish banking sector's profitability weakened from the record levels observed in the previous year. Although the combined net operating profit for the banking sector that had grown steadily in 2007 started to decline in the year under review, there was no dramatic fall in the sector's financial results. So far, Finnish banks have been able to avoid massive writedowns on risky investments, as opposed to many European banks in the year under review.

Nevertheless, the global financial crisis was also reflected in Finnish banks' financial performance, which took a more tangible form in clearly lower profits from trading and investment. Compared to 2007, net interest income continued to develop on a positive trend, whereas net fee income assumed a downward tendency. Overall, banks' core business, made up of net interest income and fee income, remained profitable. Even so, economic growth that slowed sharply in the last quarter had inevitably a negative impact on sales of banking services, too, thereby causing banks' earnings developments to deteriorate towards the end of the year.

Net interest income growth maintained bank profitability

Ongoing strong credit demand growth since 2007 and the high level of reference rates until the autumn contributed to banks' net interest income growth. The pace of growth in credits extended to households decelerated in the year under review.

In contrast, there was higher demand for corporate credits extended by banks. This corporate credit demand was significantly boosted by the exceptional financial market situation, which elevated the price for corporate market funding and made access to funding directly in the market more difficult.

Higher net interest income compensated for the clear decline in banks' income from trading and investment. This decline was caused by impairment in the fair values of investments. Financial conglomerates, too, recorded lower income from insurance business, as investments fell in value.

In an environment of lower income from business operations and higher expenses against the previous year, bank profitability mainly weakened. The cost-to-income ratio depicting cost efficiency rose and the return on equity declined. Some banks, though, registered higher expenses owing to one-off costs related to changes in business operations.

Banks' liquidity situation tightened towards year end

Finnish banks were able to acquire short-term market funding without much difficulty, but

problems occurred in the autumn in the acquisition of funding at longer, over one year maturities. The average maturity of market-based funding shortened during the year, but the funding structure remained diversified.

Deposits from the public grew strongly throughout the year, which eased the banks' liquidity situation. However, bank balance sheets expanded faster than deposits, and the difference was mainly covered by issuance of certificates of deposits. Although the protracted growth in market-priced funding waned, the relative share of deposits in funding remained slightly lower than in the previous year.

Bank balance sheets also grew more rapidly than lending to the public. Banks invested increasingly in money and capital markets, particularly in short-term debt securities. Due to the weaker market situation, however, return on investment remained low compared to the previous years' peak performance. After all, investment liquidity was considered more important than return.

During the year under review, banks increased their reserves of liquid, low-risk assets, which they can quickly convert into cash or against which they can obtain central bank financing or other collateralised funding. In their liquidity risk management, banks have prepared for an extended period of market uncertainty.

Banks' problem loans grew, loan losses on the increase

Banks' overdue loans continued to grow. They also increased relative to the lending stock, which suggests deterioration in the quality of banks' credit portfolios. Despite growth in non-performing loans, their ratio to the lending stock continues to be low. Banks' net impairment losses eroded their profits towards the end of the year. The ratio of gross impairment losses to the lending stock remains, despite growth in losses, substantially below its long-term average.

The impact of the deteriorating economic situation on banks' credit portfolios will be lagging, but the lower quality of the lending stock was already visible in the latter part of the year. In the longer term, the stock of unserviced loans threatens to

continue growing amid the economic slowdown. According to the household credit survey conducted by FIN-FSA in August, less than a fifth of new mortgage borrowers are now in a situation where more than half of net income goes into payment of interests and amortisations on housing loans. Higher unemployment may hamper the situation of households with housing loans further still. The number of corporate bankruptcies went up by 14% in January-October compared with the previous year. Difficulties encountered by firms are also anticipative of an increase in problem loans.

Continued growth in household debt, higher risk of indebtedness

According to *Statistics Finland's* November consumer survey, households' intentions to apply for credit diminished clearly in the latter part of the year, although households still considered their own finances and savings opportunities as being fairly good. The strongest phase of growth in household credit demand appeared to be over in the year under review. Even so, households' debt ratio continued to expand rapidly during the year. Average household debt in the year under review is estimated to exceed for the first time disposable annual income. In Finland, however, household debt is lower than the international average.

Households' housing loan problems concentrate on young families with children, many of whom are forced to renegotiate their housing loans. Households with housing loans have less leeway than earlier, as not only loan servicing expenses but also other costs of living rose rapidly in the course of the year. The fall in reference rates that started in the latter part of the year began to be reflected in housing loan servicing expenses, too. Simultaneously, though, banks started to raise the margins they charged on new housing loans. Debtors' payment difficulties began to be reflected in the growth of payment defaults on consumer credit, in particular. Unserviced housing loans and their share of the housing lending stock also increased, even though the share of unserviced loans continued to remain limited. A turn for the worse in the economy and employment may increase problem loans and the number of debtors heading for payment difficulties.

Overdue credits (credits overdue 30 to 90 days) accounted for 0.6% of the housing lending stock and non-performing credits (credits overdue more than 90 days) for 0.5%.⁴

Interest rate risks remained low

Income risk in the banking book, measuring sensitivity of Finnish banks' net interest income to interest rate changes, has remained moderate and close to the 2007 level. Despite financial market uncertainty, developments in the banking sector's net interest income were more favourable than in the previous year, causing the ratio of income risk to net interest income to decline.

During the year under review, FIN-FSA introduced a new method that enables it to assess and monitor the effects of interest rate changes on economic value calculated for banks. This indicator, too, confirms the very low level of interest rate risk for the banking sector.

Challenging market situation reduced investment firms' income

Investment firms' fee income started to decline. The unfavourable market situation had a negative impact on income from asset management and securities intermediation, in particular. Meanwhile, income from other investment services (such as corporate restructuring and investment advice) remained unchanged, which lifted their relative share of fee income. Fee income reported by investment firms was also undermined by corporate restructuring arrangements in which large investment firms merged with parent banks.

Fee income in the investment services sector is predicted to continue on a downward trend. On the other hand, in the latter part of the year, new firms commenced operations in the sector (such as investment advisors and actors in commodity derivatives markets).

⁴ Situation according to the FIN-FSA August survey.

Fund management companies' fee income on the decrease

Income developments of fund management companies reflect a contraction of mutual funds' net assets. Lower management fee income weakened fund management companies' profitability, as fixed expenses could not be similarly reduced. Especially fund management companies engaged in asset management experienced a downturn in profitability.

Redemptions from mutual funds continued throughout the year. Owing to redemptions and changes in fair value, mutual funds' net assets contracted by about EUR 20 billion during the year under review, returning to the levels observed at the end of 2005. Large redemptions in the latter half of the year and changes in market values of shares point to a further fall in fee income.

Cross-border contagion risks for banks diminished

As a consequence of a confidence gap between banks and more difficult access to funding, banks' mutual interdependencies were under close scrutiny. FIN-FSA monitored and analysed both direct interbank channels of contagion and implications of possible risk propagation from sources beyond the banking sector for Finnish banks' capital adequacy.

The level of systemic risk can still be considered moderate in Finland. The underlying reasons are increasingly wider contacts between banks and resultant risk dispersion. In becoming more international, banking has increased the variety of contagion sources for risks, but the simultaneous spreading of risks has mitigated the effects of potential contagion on the Finnish banking sector. In the autumn, Finnish banks sought to reduce their claims on foreign banks.

SUPERVISED ENTITIES' CAPITAL ADEQUACY

Capital adequacy is assessed on the basis of Basel II regulations

From the beginning of the year under review, all supervised entities have complied with the Basel framework.⁵ It was possible to start complying with this framework from the beginning of 2007 already, and a significant number of supervised entities also did so. The Basel II regulations enable supervised entities to introduce more advanced methods for the measurement of credit, market and operational risks in their capital adequacy calculations. The introduction of more sophisticated methods has reduced capital levels required to cover these risks. On the other hand, the Basel II framework highlights the importance of overall risk assessment. As well as meeting the minimum own funds requirement (Pillar 1 requirement), the supervised entity needs to provide its own reasoned opinion of capital required to cover all material risks and planned risk-taking. The capital requirement for credit risk can be calculated using the standardised method or more advanced approaches, based on the bank's own internal risk ratings. More advanced methods enable to align capital requirements more closely with default probabilities in the bank's credit portfolio than in the case of the standardised method. Internal ratings based methods are the *Internal Ratings Based Approach (IRBA)* and the more sophisticated *Advanced Internal Ratings Based Approach (AIRB)*. Application of more advanced methods always requires permission from the supervisory authority. Most supervised entities calculate their capital requirements for credit risk using the standardised method. Only the largest banks, Nordea Bank Finland and OP-Pohjola Group, Sampo Bank as part of the Danske Group and Diners Club belonging to the Swedish *SEB group* and *Handelsbanken Finance*, have received IRBA permission. The method is introduced in stages.

⁵ The Basel II capital adequacy framework for capital adequacy regulation is applicable to credit institutions, investment firms and fund management companies engaged in asset management.

Subject to supervisory permission, the capital requirement for market risk and operational risk may also be calculated using more advanced approaches. Nordea Bank Finland was also allowed to use the *Value at Risk (VAR)* method for the calculation of the capital requirement for market risk. The Swedish SEB group's subsidiaries operating in Finland are allowed to apply a more sophisticated method, the *Advanced Measurement Approach (AMA)*, for the calculation of the capital requirement for operational risk.

FIN-FSA conducted annual overall assessments of individual supervised entities' capital adequacy in line with Pillar 2 of the Basel II framework (known as *Supervisory Review and Evaluation Process, SREP*). The purpose of this process was to ensure that supervised entities have adequate levels of own funds available for covering material risks and that they have in place such internal governance, internal control and risk management systems as are capable of safeguarding the stability of their operations. FIN-FSA considered it important that capital adequacy calculation be linked with strategic planning and operative business management. Capital adequacy calculation can also provide a useful pricing tool if it functions well.

Pillar 2 assessments were elaborated by comparing supervised entities' procedures in cooperation with European and Nordic supervisors. Prudential regulation and supervision were aimed at obliging supervised entities to maintain adequate levels of own funds in order to ascertain their operational ability even under exceptional circumstances. The current crisis highlighted the importance of stress test calculations. Another aim was to foster supervised entities' risk management and to support the development of related methods. FIN-FSA monitored the development of the methods of supervised entities and of the sector in general, permitting use of justified and reliable methods for the calculation of risk-based capital requirements. The annual supervisory reviews were based on supervised entities' reports on capital management (ICAAP)⁶, inspections and supervisory information. These reviews could not be undertaken using the same method for all supervised entities. The scope of an individual assessment was determined by the

importance of the role assumed by the supervised entity in the financial markets. Parts of the reviews of supervised entities were conducted jointly with Nordic supervisors, whereas evaluations of domestic local banks were performed collectively with their umbrella organisations.

The Basel II framework also requires wider disclosure of information on capital adequacy from supervised entities, which was monitored for the first time in the year under review. Comparisons of required information disclosures will be possible in respect of all supervised entities for the first time in 2009, when Pillar 3 requirements are observed in all financial statements issued for 2008.

Banking sector's capital adequacy and risk-bearing capacity also assessed through stress tests

The FIN-FSA and the Bank of Finland conducted two stress tests in the banking sector in the year under review. The stress test carried out in the summer also involved the insurance sector and the sector's supervisor, the Insurance Supervisory Authority. Another test was performed in November, as the outlook for the financial markets and the economy in general had significantly deteriorated within the period of a few months.

The first stress test was based on a scenario established for 2008–2010 in which the financial market turbulence strengthens, with its ramifications also reflecting in the Finnish real economy. The scenario of weaker-than-expected macroeconomic performance included considerably lower-than-baseline GDP development and an increase in unemployment. Real estate and share prices were expected to decline, interest rates were assumed to rise and risk premia to expand.

In November, an update of the scenario with timely information was seen as warranted, given that both the prospects and actual developments had changed; for example, the previous scenario had foreseen a drop of 35% in share prices since the beginning of the year, whereas the actual outcome in November was about 50%. Accordingly, more dramatic scenario elements were incorporated into the second stress test calculation.

⁶ ICAAP = Internal Capital Adequacy Assessment Process

Financial crisis triggered discussion in EU on review of Deposit Guarantee Schemes Directive

The financial crisis has triggered discussions on deposit protection both in Finland and in other EU member states. The financial problems of the British bank Northern Rock launched the discussion on the efficiency of the British deposit guarantee scheme. The real challenge is rapid payouts to depositors. Also when the Icelandic Kaupthing Bank and Landsbanki ran into problems, the question was raised in several EU countries on how to protect depositors in a situation where the deposit protection in the bank's home state is inadequate.

First the financial turmoil led to a significant increase in the deposit guarantee in several EU member states. In certain member states the upper limit was abolished altogether as the Government fully guaranteed the claims of depositors and other creditors. The EU Council convening in the composition of Economic and Finance Ministers unanimously recommended an increase in the minimum level of compensation for private persons' deposits to EUR 50,000, for one year from 8 October 2008. In Finland there had not been any compelling need to increase the guarantee due to the high level of solvency and profitability of the Finnish banks. However, to ensure fair competition, the amount of our deposit guarantee was also raised to EUR 50,000, from EUR 25,000.

At the same time the European Union initiated a discussion on the long expected review of the Directive on Deposit Guarantee Schemes (94/19/EEC). A proposal was presented to guarantee the deposits of private persons up to EUR 100,000, significantly reduce the payout period, abolish

deductibles and clarify the funding mechanisms in the various member states. An alternative with a maximum level of compensation for deposits of private persons was also debated. These propositions will be considered and agreements made in the near future.

The Financial Supervision Authority (FIN-FSA) has been in favour of having shorter payout periods, abolishing deductibles and in other ways streamlining the directive in order to harmonise the schemes as much as possible. In addition, FIN-FSA has supported both an upper and a lower limit being set for the deposit guarantee and that deposits are compensated according to the gross method. This would ensure equal competitive terms for banks throughout Europe.

Why is it important to protect depositors? The opportunities for individual small depositors to assess the financial risks in a bank's operations are minimal. Therefore there should be a deposit guarantee scheme to support banking system stability so that the problems of an individual bank or the entire banking system do not lead to an extensive run on deposits. Depositors improve the stability of banking operations.

A guarantee scheme is also necessary to the funding of banks. According to September statistics, Finnish banks' total lending amounted to EUR 155 billion, of which more than EUR 100 billion was funded by deposits. Proportionately, 70% of this was from households' deposits, or EUR 70 billion. Less than half of the total amount is covered by the guarantee scheme.

In the first stress test, it had not been necessary for banks to resort to loss buffers in excess of the 8% capital requirement. Nor did the November stress test calculation significantly alter the picture of banks' capital adequacy and risk-bearing capacity. The scenario affected strongly the banks' financial results and profits and also meant loss-making years for part of the banks. The November stress test pointed to a clearly sharper deterioration in the profitability of the banking sector than the previous test, and the weakening was expressly caused by the

more dramatic scenario. The November assessment, however, still suggested adequate levels of loss buffers in the banking sector.

Finnish banks' capital adequacy continues to be high by international standards

While the ratio illustrating Finnish banks' overall capital adequacy has declined in the longer term, capital adequacy was still at a high level by

international standards. However, the own funds surplus diminished significantly. The reduction was particularly due to an increase in the own funds minimum requirement, but also to an actual contraction in own funds. The requirement becomes higher, for instance, because of growth in bank balance sheets.

The quality of own funds remained good. Well over 90% of own funds are Tier I capital, and this ratio remained almost unchanged. The share accounted for by subordinated loans of Tier I capital is at reasonable levels. Tier II capital mainly consisted of debenture loans. The stock of both debenture loans and subordinated loans remained stable. Credit risk accounts for almost 90% of total capital requirements. The rest is composed of the shares of operational risk and market risk as well as of the transitional requirements for the adoption of more advanced methods for capital calculation. These shares remained almost unchanged.

Investment firms in general also had adequate levels of capital. However, there were significant differences between capital positions of firms, and the uncertain market situation widened them still further. The own funds requirement allocated for operational risk reduced markedly the loss buffers and capital adequacy ratios of some firms.

Fund management companies are subject to capital requirements under the Mutual Funds Act and fund management companies engaged in asset management also need to comply with capital requirements under the Credit Institutions Act. The composition of companies' own funds was favourable, as the funds were almost entirely Tier I capital assets. The own funds surplus did not materially change.

SUPERVISION AND INSPECTIONS

Number of inspections increased

The number of prudential supervision inspections was increased and more time was used for them than in the previous year. Inspections of small banks were stepped up, although the majority of

the inspections focused on large supervised entities. Ongoing supervision also identified increased risks at smaller supervised entities, and the entities were under closer scrutiny where needed. Inspections of subsidiaries and branches operating in Finland were carried out in cooperation with other Nordic supervisors.

The emphasis of the inspections was on credit, market, liquidity and operational risks. Supervised entities' information systems, payment systems and contingency planning for exceptional circumstances under the Emergency Powers Act were also subject to inspection. Fair value measurement of investments was monitored via surveys and supervisory visits. In the year under review, there were also two larger inspections concerning banks' trading in interest rate derivatives and related systems.

Household credit risks and bank procedures were reviewed

As lending growth remained strong in the early part of the year, credit risks continued to take centre stage in supervision. A survey was conducted in the latter half of the year in order to gain an insight into bank lending to households and bank procedures (for more information, see page 26).

Banks were required to provide for protracted liquidity problems

With the deepening of the financial crisis, supervision was particularly targeted at monitoring supervised entities' financial and liquidity positions, market risks and capital adequacy. There were more frequent contacts with supervised entities, and discussions on their preparations for a prolonged crisis were continued. FIN-FSA required a specification of the contingency plans. Accuracy of financial instrument valuations and verification of accuracy at supervised entities were assessed and no significant shortcomings were detected.

Supervised entities were required to provide more frequent than regular reports on counterparty risks. In addition, analyses were undertaken of exposures that banks have vis-à-vis risky counterparties.

Improvements to Sampo Bank's information systems were required

At Easter, Sampo Bank integrated its information systems into those of its parent company, Danske Bank. The migration consisted of a sizeable information system project, on the planning and progress of which the bank was requested to report to FIN-FSA during the spring. The merger of the information systems did not go without problems, however, and immediately after Easter significant malfunctions started to emerge. At this stage, FIN-FSA required that Sampo Bank report daily on disruptions and provide clarifications for their remedy. The Danish supervisor Finanstilsynet and the Danske Bank management were also involved in handling the situation. While the disruptions did not jeopardise Sampo Bank's capital adequacy, they caused significant problems in customers' daily banking services. FIN-FSA requested that the bank provide an explanation for the reasons that led to the problems and required corrective action in order to prevent recurrence of similar situations in the future. In its supervisory letters, FIN-FSA also paid attention to the bank's communication to customers and adequate reporting to FIN-FSA on information system changes and malfunctions.

Compliance with Basel II capital requirements monitored

Supervised entities that made use of the transitional period permitted for the introduction of the revised Basel II capital adequacy framework changed over to capital calculation under the new rules at the beginning of the year. Accordingly, all supervised entities now fall within the COREP capital adequacy reporting system. Accuracy of reporting was also inspected via on-site visits, and supervised entities were urged to remedy detected errors. Specifications were made to the guidelines concerning reporting of mortgage-backed credits.

Use of internal ratings based, more advanced methods for the calculation of capital requirements is subject to permission from the supervisor. OP Central Cooperative and member credit institutions of the amalgamation of cooperative banks OP-yhteenliittymä were granted permission to use the IRBA approach, the application of which in capital calculation will be introduced in stages.

Nordea Bank Finland, in turn, was allowed to start using the Internal Ratings Based Approach (IRBA) in the calculation of capital requirements for credit risk, also in respect of retail claims. The bank had previously applied the IRBA method only for corporate credit.

Payment systems and contingency planning under perusal

In the spring, FIN-FSA continued mapping banks' contingency planning by means of supervisory visits, started in autumn 2007. Inspections of payment systems were also continued. The transitional period for migration towards the Single Euro Payments Area (SEPA) began in January with the introduction of SEPA credit transfers. FIN-FSA continued monitoring the SEPA migration of banks operating in Finland by means of a survey conducted in the spring and in connection with payment systems inspections. Towards the end of the year, FIN-FSA commenced inspections of online banking services provided to companies.

NATIONAL AND INTERNATIONAL SUPERVISORY COOPERATION

Supervision of risks of financial and insurance conglomerates

FIN-FSA worked together with the Insurance Supervisory Authority in the supervision of the OP-Pohjola Group, *Aktia-Veritas Group* and the *Tapiola Group*. The aim was to particularly supervise group-level financial performance, risks and stability. The supervision also covered intra-group business operations. In addition to group-level supervision, the financial sector was supervised by FIN-FSA and the insurance sector by the Insurance Supervisory Authority.

Higher risk premia and lower share valuations led to writedowns on investments by financial and insurance conglomerates. Nevertheless, the situation of the conglomerates remained stable.

Close cooperation in supervision of Nordic banking groups

Supervision of the Nordea Group continued as a cooperative effort between the Nordic supervisors, coordinated by the Swedish supervisor Finansinspektionen. Apart from FIN-FSA, the group of supervisors included the Norwegian Kredittilsynet and the Danish Finanstilsynet. The supervisory group monitored the Nordea Group's overall situation on an ongoing basis, planned supervisors' joint inspections and was responsible for preparing the supervisory review and evaluation process under the Basel II framework concerning the Nordea Group. During the autumn, the supervisory group also proved a useful channel for information exchange in the assessment of the implications and risks of the global financial market turbulence for the Nordic financial sector. On top of this, FIN-FSA worked together with the Baltic supervisors in the supervision of the Nordea Group, the OP-Pohjola Group and Evli Bank, all of which have units in the Baltic region.

Agreement over the supervision of the Danske Bank Group was finalised with the signing of a memorandum of understanding (MoU) in April between FIN-FSA and the Danish Finanstilsynet, but joint action had already started in the previous year. In the year under review, cooperation in the supervision of the Danske Bank Group deepened, with a particular emphasis on the integration of Sampo Bank's information systems into those of the Group. Credit risks were also monitored in collaboration with the Danish supervisor.

The Nordea Group and the Danske Bank Group hold material stakes of the Finnish market through their subsidiaries. For this reason, Group oversight required a considerable input of FIN-FSA resources, and FIN-FSA was additionally responsible for supervising the Groups' Finnish units.

FIN-FSA also participated in the supervision of the Svenska Handelsbanken Group, coordinated by the Swedish Finansinspektionen. The supervisors conducted joint inspections, exchanging information on the Supervisory Review and Evaluation Process (SREP) concerning the Svenska Handelsbanken Group. The market shares of the Group's Finland-based units have grown to a level that, in the light of preparations for a new directive relating to the taking

up and pursuit of the business of credit institutions, requires closer contacts and coordination of supervisory measures.

CEBS active in financial crisis monitoring

CEBS increased information exchange between supervisors, and many meetings dealt with the situation in the EU banking sector and measures taken by supervisors. The reinforced role of EU supervisory committees in creating supervisory convergence requires allocation of fairly considerable preparatory resources from national supervisors, especially when the global crisis led to the initiation of a number of projects aimed at enhancing regulation.

Within CEBS, FIN-FSA focused on issues important for the Finnish financial sector. Particular efforts were devoted to influence development of the activities of colleges of supervisors in the supervision of cross-border financial conglomerates. Areas that FIN-FSA also considered important included regulatory development concerning liquidity risk management and enhancement of methods needed for Pillar 2 supervision under the Basel II capital adequacy framework. CEBS seeks to improve supervisors' crisis management capabilities, which is also in line with FIN-FSA's objectives.

FIN-FSA participated in the work of the CEBS Bureau and key permanent CEBS working groups and task forces, which enables influence to be exerted at the preparatory stage on the contents of guidelines directed at national supervisors and supervised entities.

CEBS worked towards upgrading supervisory guidance and operational principles for liquidity risk management, activities of colleges of supervisors and for Basel II/Pillar 2 monitoring. Progress was also made in drafting operational guidelines for financial market crisis management. The procyclicality of the Basel II capital requirements was examined in cooperation with the ESCB Banking Supervision Committee.

Financial sector situation was assessed with the Bank of Finland

In the year under review, information exchange and coordination of actions between supervisors and central banks proved important for the stability and smooth operation of the financial markets. The Bank of Finland promotes financial stability within the Eurosystem and is responsible for oversight of payment and settlement systems. Through its supervisory work, FIN-FSA, in turn, seeks to exert influence with a view to ensuring that supervised entities' operations do not jeopardise their liquidity or capital adequacy and thereby threaten the stability of the financial system.

FIN-FSA's supervisory measures made use of the Bank of Finland's macroprudential analysis and information collected from financial market monitoring. FIN-FSA and the Bank of Finland issued regular forecasts for the financial performance of the banking sector and, working together with the Insurance Supervisory Authority, conducted stress tests to analyse the financial sector's resilience to various economic and financial threats.

In Finland, cooperation in crisis management between ministries, the central bank and supervisors is confirmed by a memorandum of understanding (MoU). The arrangement is in conformity with documents and recommendations concerning crisis management in the EU financial markets. In the year under review, efficient information exchange and collaboration between FIN-FSA and the Bank of Finland facilitated the monitoring of the financial crisis and the assessment of its implications.

Together with the Bank of Finland, FIN-FSA participated in the work of the *Banking Supervision Committee (BSC)* of the European System of Central Banks (ESCB). The Committee monitors developments in the EU financial sector, evaluating their repercussions for the sector from the perspective of stability. FIN-FSA, in conjunction with the Bank of Finland, was responsible for providing the BSC with information and assessments concerning the Finnish financial sector. The BSC annually publishes a stability report on the EU banking sector, the *Banking Stability Report*,

and bears responsibility for the production of those parts of the ESCB *Financial Stability Report* that concern the banking sector. In assessing risks to the operating environment of supervised entities, FIN-FSA made use of the BSC's analyses and comparative information concerning the EU banking sector.

The BSC prepared a uniform assessment framework for the evaluation of the systemic effects of the financial market crisis, for use by supervisors and central banks, aimed at bringing greater convergence and efficiency to the management of cross-border financial crises.

Market Supervision

Market supervision contributed to the reliability of securities market trading venues as well as clearing and settlement operations, a high level of investor and customer protection and sound market practices. Market supervision activities supported growth and a level playing field in the Finnish financial markets.

Key events in 2008

- ❖ *Listed companies' readiness and existing practices to comply with the disclosure obligation were assessed*
- ❖ *Management of insider information in connection with takeover bids was inspected*
- ❖ *Attention was paid to valuation of financial instruments and information on risks in financial reporting*
- ❖ *Mutual funds were found to have defects in bond valuation*
- ❖ *About 60 authorisation-related issues were dealt under the Directive on Markets in Financial Instruments (MiFID)*
- ❖ *Supervision of stock exchange and clearing and settlement operations focused on assessment of ownership arrangements and competitive conditions*
- ❖ *A new FIN-FSA standard on disclosure of periodic information came into force*
- ❖ *Repayment of depositor claims on Kaupthing Bank, Finnish Branch, and reorganisation of customer relationships were monitored*

Outlook for 2009

- ❖ *Repercussions of the financial crisis on mutual fund business will be monitored, with particular emphasis on the liquidity of funds' investments, compliance with statutory investment limits and valuation issues*
- ❖ *Investment services providers' obligation to clarify customers' investment knowledge and experience will be scrutinised in the light of suitability and appropriateness testing*
- ❖ *A follow-up inspection will be carried out concerning fund management companies' disclosure requirements: descriptions of mutual fund risks and descriptions of calculations concerning fees based on return on investment and computation of financial ratios will be inspected*
- ❖ *Use of derivative contracts will be particularly emphasised in the supervision of the obligation to disclose major holdings and the obligation to make a takeover bid*
- ❖ *As regards listed companies' disclosure obligation, the focus will be on timely and consistent disclosure*
- ❖ *In IFRS enforcement, particular attention will be given to the transparency and clarity of information provided*

The financial crisis, the MiFID Directive (on Markets in Financial Instruments) implemented at the end of 2007 and changes in securities markets trading venues and in clearing and settlement were characteristic of the year under review. Owing to the financial crisis, market supervision work was closely linked with monitoring valuation of financial instruments and how related risks are described in financial reporting. The rapid weakening of the

overall economic situation increased the need to assess the effects of the downturn on the financial position and results of both listed companies and supervised entities and on how financial market participants inform investors of the impact of the situation.

As a consequence of the coming into force of the MiFID, there were about 40 confirmations

of existing authorisations and some 20 new applications for authorisation. Inspections concerning compliance with MiFID obligations commenced in the autumn. The supervisory focus was on stock exchange and clearing and settlement operations because of both implemented ownership arrangements and a dramatic change in the competitive situation. Market participants' insider information management has already been supervised for a longer period of time given the pre-emptive impact of such supervision.

Continued effort was put into risk-based supervision, and the number of inspections was increased. The extent of international cooperation remained significant. The emphasis was on practical supervisory work rather than on regulatory preparation.

SUPERVISION OF PRACTICES

Mutual funds reported too briefly on risks and fees based on return on investment

Inspection of mutual funds concerned the presentation of investment policy, risks, fees and financial ratios in statutory brochures and marketing material. The aim was to clarify how information published on mutual funds corresponds to regulation and whether additional guidance was needed. At the same time, the clarity and appropriateness of published information were evaluated.

The main finding of the inspection was that too little information had often been provided on mutual funds' risks and fees based on return on investment and that most fund management companies complied only partly with the recommendations concerning financial ratios. FIN-FSA required closer compliance with disclosure regulation from fund management companies and improvement of the clarity of published information.

Mutual funds had defects in bond valuation

In the year under review, FIN-FSA inspected the valuation of bonds in mutual funds. The inspection

also included bond valuation processes at fund management companies. The inspection covered 24 fund management companies.

The aim was to clarify whether mutual funds' holdings of corporate bonds had been valued correctly, ie in accordance with rules and guidelines, as of 31 January. Additionally, the functioning and independence of the valuation process, including related controls, were examined, and an assessment was undertaken of fund management companies' internal guidance.

Application of objective measurement principles, enabled by the fund rules, had led to major price differentials between mutual funds managed by various fund management companies.

It was found that mutual funds' rules and fund management companies' internal guidelines required specification and improvement. Imperfections were also identified in the application of decision-making powers related to valuation and in the documentation of the valuation process.

Most securities intermediaries classified their clients properly

FIN-FSA sought to clarify compliance with the customer classification criteria under the Securities Markets Act, in addition to coverage of such classification and the appropriateness of information provided to customers on the classification and its meaning. There were also assessments of the coverage of internal guidance concerning customer classification. The inspection was targeted at 23 securities intermediaries, who were requested to submit material concerning customer classification. On the basis of the material received, inspection visits were paid to seven securities intermediaries.

The majority of securities intermediaries subject to inspection had systematically gone through their customer base as a whole, reclassifying their customers in accordance with the current Securities Markets Act as either non-professional customers, professional customers or eligible counterparties. Four securities intermediaries had not reclassified their customers in the manner required by the transitional provisions of the Act.

Securities intermediaries must have internal guidelines in place concerning customer classification, but there were seven securities intermediaries who had failed to do so. In their internal guidelines for customer classification, only about one half of securities intermediaries had taken account of their own organisational structures, systems and services offered, and issued their own interpretations of the classification criteria.

The law requires that customers be notified of their classifications. However, notifications by securities intermediaries did not always comply with the requirements of the law. In general, securities intermediaries had informed their customers that an amendment to customer classification may be applied for, but only limited information was provided on the implications of a potential change in classification. Often, they also failed to notify that the protection offered by the Investors' Compensation Fund does not cover mutual fund activity.

All securities intermediaries were sent an inspection letter that emphasised the fulfilment of the above obligations.

Customer reporting by asset managers inspected

In the latter part of the year, FIN-FSA conducted an inspection of customer reporting by asset managers. The inspection concerned six asset managers, who had a central position on the basis of the number of their non-professional customers or the value of assets managed by them or whose inspection was considered necessary on account of observations made in ongoing supervision.

The aim was to ensure that asset managers issue reports for non-professional customers in accordance with the FIN-FSA standard (2.1) on code of conduct for the provision of financial services. Another aim was to assess how the reporting requirements laid down in the standard were incorporated into customer contracts and how the contractual terms concerning reporting were complied with. On top of this, a survey was made of how the assets presented in the reports had been valued.

As regards the requirements under the FIN-FSA standard on code of conduct, deficiencies were mainly identified in the reporting of fair value, cash holdings and certain detailed information on transactions. At the time of inspection, one company's reports failed to include performance calculations and information on fees. In some cases, a benchmark index had been defined for portfolios, but the reports failed to indicate the performance of the index, nor were there comparisons with customer portfolios' performance. Customer contracts fairly often failed to specify the type of reports customers should expect to receive. Many contracts did not clearly indicate whether the contract allowed for the use of credit and derivatives and how this would affect the reporting frequency. Some companies failed to meet the requirements laid down in customer contracts concerning reporting frequency or did not submit the required reports in practice. Very little information was provided on the valuation of assets.

MiFID led to a number of applications for authorisation

MiFID was implemented in Finland in November 2007 by the adoption of a new Investment Firms Act, which is wider than the old act in terms of scope of application. Authorisation is now required, for instance, for investment advice and multilateral trading. Specifications were also made to the concept of a financial instrument and derogations to the application of the legislation. The legislative amendment concerned, for example, the provision of investment services by means of commodity derivatives.

Issuance of individual recommendations to a customer for a business transaction concerning a certain financial instrument constitutes provision of an investment service. Prior to the coming into force of the Act, there were many market actors who provided investment advice, while simultaneously acting as insurance brokers or agents. Advisers whose business met the requirements for authorised business had to apply for investment firm authorisation or close down their business that required such authorisation, by 30 April.

FIN-FSA received 18 applications in which authorisation was sought for investment advice and

intermediation of orders. Some of the applications were cancelled, as the related discussions revealed that the advice provided by the company was not subject to authorisation, but rather was general counselling in nature.

As well as applications for investment advice authorisation, FIN-FSA received over ten other applications concerning investment firm authorisation or fund management company authorisation. Authorisation was applied for the provision of asset management, in particular. The business idea was to provide such services by means of a very small organisation, consisting of three or four persons, although the offering of these services is subject to detailed regulation. In such small organisations, it is highly challenging to arrange internal governance (compliance with the code of conduct, segregation of operations) and internal control in a reliable and acceptable manner.

Commodity derivatives are financial instruments as referred to in the Investment Firms Act (section 4). Investment services linked with commodities often constitute part of risk management related to wider (eg electricity production) business activity.

There were six energy and environmental companies specialising in commodities that applied for authorisation. Key underlying assets for derivatives were electricity and emission allowances and reductions. Use of electricity derivatives is a key instrument in managing electricity price risks.

Availability of basic banking services improved

A survey of the availability and pricing of basic banking services is conducted once a year among deposit banks. Basic banking services are considered to include at least a current account used for payment transmission, an online facility for using the account (an ATM or bank card) and processing of payment orders. In the year under review, the survey was carried out on the basis of the situation prevailing at the beginning of March.

Compared with the previous survey, prices had gone up within the range of EUR 0.10–1.00. Withdrawal of funds from one's own account, as well as deposit

of funds in one's own account at one's own branch and payment of an invoice as a direct debit service continued to be free of charge. The cheapest way of paying invoices was the online service, in which the most common price was EUR 2.50 per month. The most expensive basic banking service was payment of an invoice in cash at a bank branch, and the highest price was EUR 8.00 per invoice.

No problems have occurred in the availability of basic banking services, and these services continue to be accessible at a reasonable price. Although an individual charge may be sometimes considered high, there are alternative, more advantageous methods of payment on offer. Direct debit, which is suitable for recurrent payments, continued to be provided as a free service. A payment service concept is suitable for individual payments.

Access to banking services improved markedly. *S-Bank Ltd* commenced operations in October 2007, and in March 2008 the bank had 129 customer service outlets and 815 banking service points. There was also a new market entrant for cash dispenser business, *Eurocash Finland Ltd*, whose ATMs are installed at R-kiosks. The business of Eurocash does not require authorisation from the supervisor.

The Sampo Bank information system migration caused a lot of service outages for bank customers in the spring and the summer. FIN-FSA required from Sampo Bank daily problem reporting, prioritisation in problem solving and remedy of problems without delay.

SUPERVISION OF THE DISCLOSURE OBLIGATION

Disclosure of periodic information was supervised by means of theme inspections

FIN-FSA examined how listed companies reported on their near-term risks and sources of uncertainty and provided justifications for their business prospects in management reports of their annual reports, financial statement releases and interim reports. The obligation to incorporate this information into interim reports became effective in 2007.

Mutual funds must determine their value every banking day

In the midst of the financial crisis, the valuation of investments in mutual funds has become increasingly challenging, but at the same time, also more important, since in uncertain conditions, there are a greater number of subscriptions and redemptions than normal.

When an investor redeems his mutual fund units, the proceeds received are based on a net asset value (NAV) calculation of the fund. If an error occurs in the NAV calculation, it may hurt either the redeemer or the remaining unitholders.

If the NAV of the mutual fund unit is determined to be higher than the value of the securities held by the fund, the proceeds received would be higher than the sum that the redeemer would be entitled to, at the cost of the remaining unitholders of the mutual fund.

In contrast, if the NAV of the mutual fund is calculated to be lower than the value of the securities held by the fund, the redeemer would receive lower than entitled proceeds, and the remaining unitholders of the mutual fund would gain this unjustified benefit.

A similar situation also arises in the context of subscriptions. Hence, the requirement of correctness of NAV calculation and marking-to-market of investments are all about fair and equitable treatment of unitholders.

Finnish mutual funds are primarily open-ended. As a rule, anyone can make a subscription in a mutual fund on any given day and redeem his units on any day he chooses. Therefore, the mutual fund must be able to determine its value on every banking day.

In some special investment funds, one cannot make subscriptions and redemption on every banking day, but this does not eliminate the need for correct valuation, one must be able to monitor the development of value on a continuous basis.

What if no market prices can be found for investments?

In order that mutual funds could be reliably valued, they may, as a rule, only invest in securities subject

to public trading. The amount of securities that are not traded publicly has been limited in legislation, with respect to ordinary mutual funds, to 10% of the assets of the mutual funds. With respect to special investment funds, the limit is slightly higher, 15%.

The market value may be either the last trading price or bid or ask quotation. What market value refers to, with respect to each security, is defined in the rules of the mutual fund. If such a market price does not exist or is unavailable due to the circumstances, the value is determined on the basis of so-called objective criteria.

These objective criteria include, for example:

1. the market price of an essentially similar instrument or instruments on the review date is used instead (benchmark price)
2. the value is derived on the basis of transactions executed outside public trading
3. the value of fixed-income instruments is determined on the basis of the yield curve for government benchmark bonds or interest rate swaps or other applicable instruments, adding the spread applicable to the loan and issuer on top of this
4. the value is asked from a previously selected market maker or market makers

The objective criteria have been defined in a multi-step manner. The goal is that they could be used to determine a value in any circumstances. Exceptions have been seen in extreme situations when marketplaces have been unpredictably closed: in the context of the World Trade Centre terrorist attacks in 2001 and temporary shutdowns of the Russian Stock Exchange during the review year. In these cases, subscriptions and redemptions for units in mutual funds investing in the markets concerned are suspended, since a reliable value cannot be determined.

Deficiencies were detected in both reporting areas. Listed companies provided risk descriptions of varying scope, but these were often at a rather general level. The same was true for the rationale behind the business outlook: the prospects were frequently justified by mere overall demand and market factors, rather than viewed from the perspective of the company's own business. In the same context, it was pointed out that the profit forecasts issued were not always unambiguous.

The results of the survey were taken into account in the application guidelines and examples included in FIN-FSA standards on regular disclosure obligation and in other guidance to listed companies.

Supervisory visits to listed companies started

Listed companies' readiness and existing practices to comply with the disclosure obligation were among the priorities of FIN-FSA supervision of listed companies. In the year under review, 17 listed companies were visited to establish how they had organised compliance of the disclosure obligation in practice, how they were prepared to meet the requirements and what procedures they had put in place. The companies were selected according to a risk-based approach. The criteria included a listed company's earlier supervisory history, its line of business and exposure to cyclical and structural changes, concentration of ownership, company size, important corporate restructuring and how long the company had been a listed company. Of the companies visited, 13 were small-cap and four mid-cap companies. The visits composed in particular of discussions on presenting the business outlook, how companies monitored their earnings performance and the criteria for issuance of a profit warning.

On the basis of the understanding obtained during the supervisory visits, the companies appeared mainly to have adequate readiness for meeting the disclosure obligation. FIN-FSA also emphasised the statutory requirement for timely and consistent communication, recommending an evaluation of the operation and adequacy of communication principles and practices, and documentation of these principles in the form of a disclosure policy.

Public warning for neglect of disclosure obligation

In March, FIN-FSA issued a public warning to *Cencorp Corporation* for failures to observe the disclosure obligation. FIN-FSA considered that, during the year 2006, the company had repeatedly acted in violation of financial markets provisions, since it had provided unjustified estimates of the company's prospects and delayed provision of justified information and because, due to the recognition of a deferred tax asset, had failed to give a true and fair view of the result of the company's operations and financial position in its financial statements for 2005 and 2006. The company rectified the error in its financial statements for 2007 by retrospectively adjusting the benchmark figures for those years. As the company's action had been continuous and recurrent, FIN-FSA took the view that it fulfilled the criteria for issuance of a public warning.

Inspection of marketing material revealed defects

FIN-FSA inspected the overall quality and appropriateness of marketing material for indexed loans issued in Finland. An estimation was made as to whether the key characteristics of a loan and factors having an impact on its yield were presented clearly and consistently in relation to the loan terms and whether the product features were illustrated unbiased so that, as well as benefits, also the risks and potential costs incurred by the investor were indicated.

On average, the design of marketing brochures was fairly well in line with the FIN-FSA standard 2.2 concerning marketing, whereas there were often defects in advertisements, direct marketing material and website information. Issuers and marketers should take particular care to ensure that their internal procedures, guidance and allocation of responsibilities are organised so as to enable compliance with current regulation and guidelines, and good practice in marketing.

No outright deficiencies were detected in yield calculations for index-linked notes

Key Finnish issuers of index-linked notes were selected for an inspection focusing on the reliability of yield calculations. The purpose of the inspection was to find out how yield calculations for index-linked notes had been arranged in practice and whether the arrangement enabled a reliable determination of the yield for each loan.

No clearly insufficient processes were discovered in the inspection. Issuers had control procedures in place for ensuring correct calculation. There were differences among issuers in respect of calculation systems, internal guidance and manuals. On the basis of replies submitted, errors in yield calculation had occurred fully as single occurrences, with a majority of issuers having no errors at all. Also, market disruptions had very seldom occurred at the same time as yield calculation.

As a consequence of the inspection, FIN-FSA emphasised the importance of transparency in the determination of yields for investors. By improving reporting, issuers could better signal to investors the rationale for determining yields in respect of more complex products, in particular.

Use of derivative contracts increased in the securities market

Use of derivative contracts has increased in the securities market. Forward contracts, for instance, are increasingly used as a means of financing interest in shares. In connection with the amendment of its standard 5.2b, FIN-FSA clarified its interpretations related to derivative contracts as regards the disclosure of major holdings. In the autumn, FIN-FSA requested market participants submit opinions on whether shares controlled through derivatives could or should be taken into account in the assessment of the obligation to make a takeover bid. FIN-FSA also paid attention to derivative contracts in its opinion on the overall revision of the Securities Markets Act. FIN-FSA proposed that particularly issues related to the obligation to disclose major holdings and the obligation to make a takeover bid should be evaluated in connection with the upcoming Securities Markets Act revision.

ENFORCEMENT OF FINANCIAL REPORTING

IFRS enforcement focused on risk-based, company-specific enforcement

In its financial information enforcement work, FIN-FSA applies the methods defined in the standards issued by the Committee of European Securities Regulators (CESR). A company's financial statements may be selected for enforcement purposes in the aggregate or in respect of a pre-defined focal area. Selection of companies for financial reporting enforcement is based on risks. Following this risk-based selection process, the financial statements for 2007 of 16 companies were thoroughly gone through by means of a disclosure checklist developed jointly by European financial information enforcers.

Owing to the financial crisis, the risk-based enforcement also focused on information that financial statements must disclose on financial instruments (IFRS 7) and on goodwill impairment testing (IAS 36). As regards IFRS 7, the notes to financial statements concerning financial instruments, as presented by the above-mentioned (16) companies selected for risk-based enforcement, were reviewed. The perspective for impairment testing of assets was extended.

As part of financial reporting enforcement, FIN-FSA also examined listed companies' IFRS reporting on an interim basis by going through all listed companies' 2008 first-quarter reports. The most frequent deficiencies in information required by IFRS standards were found in reporting under IFRS 3 *Business combinations*. Analyses were also undertaken of the introduction of the new standard, IFRS 8 *Operating segments*, concerning segment reporting and listed companies' assessments of the implications of the standard. FIN-FSA considered it important that the principles of the standard be carefully reviewed in respect of all companies even in the event of no material change in the segments reported.

Report on IFRS enforcement: Information disclosed in financial statements becomes increasingly important in market turbulence

In October, FIN-FSA published its annual report on its IFRS enforcement, which describes FIN-FSA's financial reporting enforcement from the end of 2007 to October 2008. The report addresses key perceptions of listed companies' and supervised entities' financial statements, providing an overview of the methods applied in enforcement.

According to FIN-FSA's observations, the notes to financial statements, prepared in compliance with IFRS 7, concerning financial instruments require a considerable amount of development. As regards impairment testing in accordance with IAS 36, attention needs to be devoted to the definition of the correct level of cash generating units and the rationality of assumptions behind impairment testing. In respect of business combinations, it was found that separation of intangible assets from goodwill continues to pose one of the most challenging elements in the preparation of a purchase price allocation. It is challenging, for instance, to separate and value trademarks and to identify intangible assets related to customer relationships.

The financial crisis increasingly underlines the importance of clarity and transparency of financial statement information. Transparent financial statement information, particularly on financial instruments, their fair values and the risks involved are factors that contribute to the build-up of confidence in financial market activity.

The financial crisis is causing downward revisions to growth expectations for the immediate years ahead. Impairment tests of goodwill and of other assets conducted in this sort of operational environment require particular carefulness from companies in the evaluation and reporting of both the level of future cash flows and assumptions related to impairment testing.

Stronger emphasis on transparency of information on financial instruments needed

One of the key priorities of financial reporting enforcement was to review compliance with IFRS

7, the application of which was mandatory for the first time in financial statements issued for 2007. In applying IFRS 7 requirements, the company must ensure that financial statements disclose such information on financial instruments as enables investors to estimate the impact of these instruments on the company's financial position and results. The company must also provide information on its exposure to risks arising from the financial instruments.

Monitoring of the operational environment and definition of cash generating units are key to impairment testing

In rapidly changing market conditions, monitoring and assessment of impairment indications take centre stage. The importance of sensitivity analysis for impairment testing also increases, as investors evaluate a company's financial profitability and equity levels.

According to IAS 36, assessment of impairment must be made at the level of an asset or cash generating unit or groups of units. Accordingly, determining the level of the cash generating unit and the level of cash flows has a key impact on detecting impairment. Market uncertainty highlights the importance of definitions and assumptions underlying impairment testing.

Imperfections in financial statements of investment firms and fund management companies

In the year under review, enforcement covered financial statements of some 20 investment firms and almost 20 fund management companies. Some of the financial statements were defective in terms of both presentation and valuation. About half of the companies had failed to provide cash flow statements. Less than a fifth of the companies had not measured on-balance sheet available-for-sale financial assets according to requirements at fair value, but at cost. Consequently, the total amount of equity of these companies was incorrect in this respect.

TRADING SUPERVISION

Inspection of insider information management related to takeover bids

FIN-FSA inspected management of insider information in takeover bids implemented in 2007. The inspection was directed at parties to bids and their advisers. The objective of the inspection included taking stock of practical procedures related to the establishment of project-specific insider registers, their information content and administration, provision of insider information, and regulatory compliance.

No material delays were identified in the establishment of project-specific insider registers by listed companies. In general, however, there were deficiencies in the information content of project-specific insider registers, especially as regards the rationale for making an entry into the register and the exact point in time concerning provision of insider information. Nor had the obligations emanating from a register entry always been announced to project-specific insiders in adequate detail. Moreover, the prohibition on providing insider information should be taken much better into account. Several registrars had failed to define entirely whom insider information may be provided or who decides on provision of insider information.

Deficiencies were detected in the keeping of registers by advisers used by listed companies. Not all advisers, for instance, had written guidelines for project-specific registers and management of insider information. Some advisers were also uncertain whether they were under a separate obligation to establish a project-specific insider register.

FIN-FSA inspected public insider registers and compliance with declarations on insider holdings

FIN-FSA inspected reliable maintenance of insider registers by those obliged to keep such registers and timely compliance with the declaration requirement, by virtue of amendments, entered into force on 1 January 2006, to the Securities Markets

Act. The survey covered all issuers, investment firms, credit institutions providing investment services and fund management companies. The aim of the inspection was to pay attention to the upkeep of insider registers in a reliable manner and the updating of information entered in insider registers.

In connection with this scrutiny, FIN-FSA reviewed 830 declarations on insider holdings, examining whether they had been submitted on time. On 17 January, following a hearing procedure, FIN-FSA imposed a total of 14 administrative fines for non-compliance with the declaration requirement concerning failures that were the most significant ones for investor information and extended over a longer period of time.

Those subject to the declaration requirement are personally responsible for the timely submission of declarations on insider holdings. Registrars, in turn, are responsible for a reliable upkeep of insider registers, ensuring that the information provided by insiders is entered into insider registers without undue delay.

Ongoing emphasis was laid on the obligation to report suspicious transactions

As in previous years, FIN-FSA made inspection and supervisory visits among brokers, concentrating on the reporting of suspicious transactions. The purpose of the supervisory visits was to find out how internal guidance concerning reporting had been provided and how, and to which extent, training had been organised.

Brokers mainly had adequate guidelines and procedures in place. In some cases, brokers were reminded that the mere suspicion of the illegality of a transaction triggers the reporting obligation and that the reporting obligation does not require particular examination by the person subject to such obligation of securities trades and other business transactions or their backgrounds.

Further progress in transaction reporting system AKVA

Europe-wide transaction reporting in compliance with MiFID commenced on 1 November 2007.

During the first year of operation of the system, FIN-FSA received transaction reports, exchanging them with other European securities regulators, in the case of cash trading and part of derivatives trading required under MiFID.

FIN-FSA contributed actively to the development of the transaction reporting system in the context of both Nordic-Baltic cooperation and at European level within the CESR. Market supervision concentrated on assessment of the quality of reported information and on measures required for quality improvement both at home and in cooperation between European securities regulators.

2007, one public reprimand for neglect of the disclosure obligation). FIN-FSA also imposed 14 administrative fines for neglect of the disclosure obligation. Cooperation with the police and prosecutors continued.

During the year, 62 supervision cases were investigated (65 cases in 2007). Out of this number 27 (45) concerned suspected abuse of insider information, 11 (5) suspected market manipulation and 12 (12) suspected neglect of the disclosure obligation. There were 12 (3) other cases under investigation, mainly concerning the offering of securities without a brochure, the obligation to disclose major holdings and compliance with the code of conduct.

SUSPECTED ABUSE CASES INSPECTED AND ADMINISTRATIVE SANCTIONS IMPOSED

Suspicious of securities market abuse at previous years' level

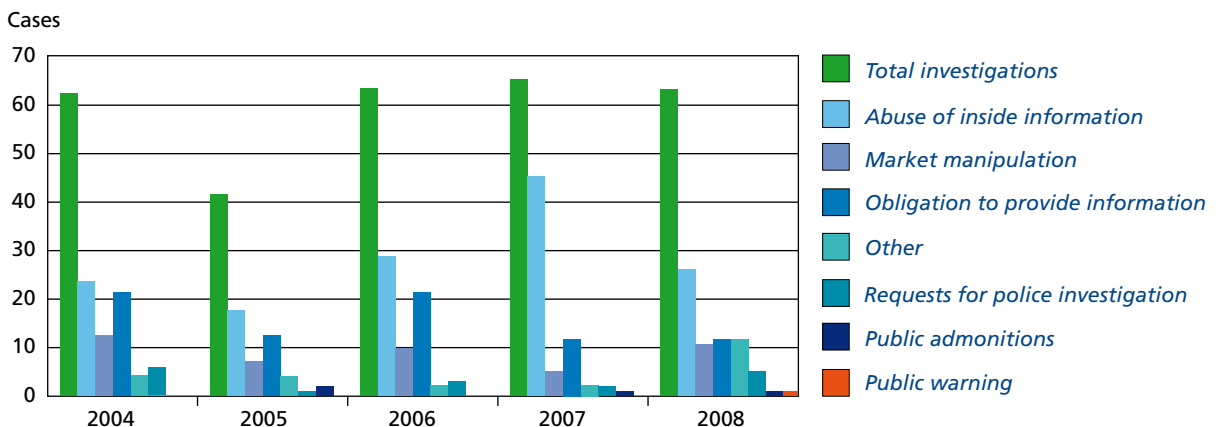
FIN-FSA made 5 (2 in 2007) investigation requests to the police. Additionally, FIN-FSA issued one public warning for neglect of the disclosure obligation and one public reprimand for exploitation of insider information (in

SUPERVISION OF FINANCIAL MARKETS INFRASTRUCTURE

Implications of stock exchange ownership arrangements were reviewed

In Finland, stock exchange activity is conducted by *NASDAQ OMX Helsinki Ltd* (subsequently Helsinki Stock Exchange). It belongs to the *NASDAQ OMX Nordic Ltd group*, owned by *OMX AB*, which – besides the Helsinki Stock Exchange – also includes stock exchanges in Stockholm, Copenhagen,

Securities market inspections conducted by FIN-FSA 2004–2008



Source: Financial Supervision Authority.

Reykjavik and the Baltic countries. FIN-FSA supervises both the Helsinki Stock Exchange and its holding company NASDAQ OMX Nordic.

Ownership of OMX AB was transferred to *NASDAQ OMX Group, Inc.* on 27 February. The legal structure of the OMX AB group did not alter in connection with the ownership change. The ownership change increased the intra-group coordination of business management and owner control of member stock exchanges of NASDAQ OMX Nordic. This meant closer supervisory cooperation between FIN-FSA and other stock exchange supervisors, especially in mutual information exchange and coordination of interpretations and opinions. As a consequence of these structural arrangements, supervision focused particularly on the organisation of stock exchange activity and market supervision. The supervisory aim is to have the memorandum of understanding between the supervisors of stock exchanges belonging to NASDAQ OMX Nordic updated and a supervisory cooperation agreement signed with the NASDAQ supervisor, the *U.S. Securities and Exchange Commission (SEC)*.

Ownership arrangements within the Finnish Central Securities Depository

The *Finnish Central Securities Depository (APK)* has been a fully owned subsidiary of the Swedish Central Securities Depository *VPC AB* since 2004. The companies together form the *NCSD Group (Nordic Central Securities Depository)*. Supervision of the APK is exercised in close cooperation with the Bank of Finland.

On 2 June, *Euroclear*, the NCSD and the largest owners of the NCSD announced having signed a letter of intent on the sale to Euroclear of the entire share stock of the NCSD Group's holding company, *NCSD Holding AB*. The deal was finalised on 31 October. Following the deal, the APK is part of the multinational Euroclear Group, which includes the central securities depositories of Belgium, France, the Netherlands, the UK and Ireland. In connection with the deal, a decision was made to change the name of the APK into *Euroclear Finland Ltd.*

The Financial Supervisory Authority will sign a memorandum of understanding with the

Belgian supervisory authority which has the main responsibility for the supervision of the Euroclear Group and with the other national supervisors participating in the supervision. The Memorandum of Understanding will provide for the division of work between the supervisors, exchange of information and other forms of cooperation. Practical supervisory cooperation will be exercised by a supervisory group, including representatives from each country's supervisory authorities.

Securities market structures changing

Structural changes in the European internal securities market continued. Apart from ownership arrangements concerning the stock exchange and the APK, the EU's efforts to promote market integration and increase competition started to bear fruit. In the year under review, a number of structural changes were under way, the effects of which will become visible in the next few years.

Alternative trading venues, ie MTFs (multilateral trading facilities) commenced trading in Finnish shares, too. In particular, a growing number of MTF trades were done in *Nokia* shares and those of other large companies. No information is published on MTF trading, as opposed to ordinary on-exchange trades. On the basis of information collected from various sources, some percentages of trades in Finnish shares were apparently executed via MTFs outside Finland.

MTFs seek to gain market share through aggressive pricing, for instance. As trade-specific MTF prices fall, clearing and settlement costs will become a more decisive factor in the selection of the execution venue for trades. In October, the Helsinki Stock Exchange announced its intention to partly change over to using a central counterparty (CCP) in the clearing of exposures arising from trades, as from the beginning of 2009. The purpose of this project was to respond to MTF price competition, in particular.

The APK and key market participants, under the leadership of the Bank of Finland, participated in the *Target2 Securities (T2S)* project launched by the ECB. The aim is that participating European central securities depositories outsource their securities

settlement for execution via a technical platform set up by central banks. The technical platform, due for introduction in 2013 at the earliest, is scheduled to facilitate convergence of settlement procedures and cooperation.

Implementation of the *Code of Conduct for Clearing and Settlement* agreement, drawn up on the initiative of the European Commission and signed by stock exchanges, central counterparties and central securities depositories, continued in Europe. This project became tangible, when more than 80 link requests were received from various participants. The challenging nature of this collaboration is illustrated by the possibility of implementing only one link in the year under review.

INFORMATION PROVIDED TO THE MARKETS

Several events on topical issues for listed companies

FIN-FSA seeks to actively inform market participants of topical regulatory and supervisory issues and to maintain an open dialogue. In the spring, FIN-FSA organised four information meetings with similar contents for listed companies, dealing, for example, with the new FIN-FSA standard 5.1 on disclosure of periodic information by listed companies, amendments concerning the dissemination and storage of information to the FIN-FSA standard 5.2b (on disclosure obligation of the issuer and shareholder), as well as events having an impact on financial statement information and future IFRS changes. In the autumn, an information meeting on topical insider issues was organised. Active dialogue with listed companies and other market participants is sought especially in connection with regulatory changes in order to take account, to the extent possible, of the views of the parties concerned in the preparation of standards.

'Markkinat' publication as a channel for information distribution

Information was distributed to market participants in five issues of the *Markkinat* (Markets) publication. The publication dealt with topical regulatory issues, interpretations and supervisory observations in the area of market supervision. Of the publications, two were theme issues, of which one focused on the new standard 5.1 on disclosure of periodic information by listed companies and the other on insider questions.

Regulation

The regulatory activities of the Financial Supervision Authority (FIN-FSA) comprised both issuance of its own regulations (Standards within the Authority's set of regulations and guidelines) and participation in legislative preparation in Finland and at EU level. At EU level, the FIN-FSA participated in the work of the so-called level-three committees of supervisors (CEBS, CESR), while at the national level representatives of the FIN-FSA took part in the law drafting groups set up under the auspices of various ministries.

In this work, the objective of the FIN-FSA was to promote the convergence of regulatory and supervisory practices within the EU, ensure the clarity and key focus of the FIN-FSA's own regulatory issuance and support the development of accountable self-regulation.

Main events in 2008

- ❖ *The financial crisis underscored deficiencies and needs for change in regulation and market practices*
- ❖ *Harmonisation of regulation and supervision practices in the EU continued, the crisis boosted consideration of a reform of supervision structures*
- ❖ *The Capital Requirements Directive (CRD) was revised for example in respect of the provisions on home and host country supervision, to ensure better correspondence with the current structures and supervisory requirements of international banking*

What's coming in 2009

- ❖ *Needs for change in regulation, underscored by the financial crisis, will take concrete form particularly in terms of supervisors' powers, supervisory structures and supervision of branches as well as crisis management powers*
- ❖ *Overall reform of the Securities Markets Act will begin*
- ❖ *The Financial Supervisory Authority will determine its principles for issuing regulations and guidelines*
- ❖ *The Financial Supervisory Authority will determine harmonised procedures for processing licences and sanctions*

Financial crisis expected to result in material regulatory changes

An effective and genuinely integrated single market in financial services is the key aim of the Commission's Financial Services Policy. Within the EU, the focus has been on the implementation of the Financial Services Policy and the guidelines of the *Francq* report adopted by the *Ecofin Council*, as well as the improvement of the *Lamfalussy* model. The EU's Financial Services Action Plan (FSAP) will soon be implemented in its entirety. The new regulation strategy also gave grounds to expect a

less active period in regulation, when room would be given for self regulation. This was shown in the implementation of clearing and settlement systems for securities transactions on a self-regulation basis.

However, aggravation of the financial crisis in the autumn of the review year changed the situation. The measures proposed since then cover an extensive area from supervision to crisis management. It seems clear that self-regulation required and supervised by authorities as well as new regulation by authorities are in the pipeline.

Committees of supervisors to focus on practical work

The focus of the work of committees of supervisors is shifting from regulatory activities to enhancement of supervisory cooperation and harmonisation of supervisory practices.

The consistent application of regulations and convergence of supervisory practices is monitored by comparing the practices of different countries. For this monitoring work, the committees of supervisors, CEBS and CESR, have set up so-called Peer Review Panels. In addition, they have introduced mediation mechanisms.

The status of colleges of supervisors to be established

In cross-border supervision, FINFSA favours the approach of multilateral cooperation entrusted to colleges of supervisors. CEBS has promoted a supervisory model based on the idea that all the relevant supervisors of companies in cross-border conglomerates participate in the overall supervision of the conglomerate. Application of the model to the supervision of banks organised as branches has also been encouraged.

Changes in home and host country supervision have been reviewed in connection with the revision of the Capital Requirements Directive. The proposed amendments are designed to consolidate the status of multilateral colleges of supervisors and the role of host country supervisors in the supervision of cross-border conglomerates, also including major branches.

How the costs arising from supervisory cooperation will be covered, for example delegation of duties, still remains to be resolved. This may require amendment of national legislation. The supervisory powers of individual supervisors are not adequately convergent in all areas to allow for as efficient cooperation as possible. Now these problems have also been identified at the political level within the EU.

Financial crisis revealed deficiencies in regulation and supervision

The crisis revealed considerable weaknesses in financial market regulation, supervisory structures and operation of market participants. Deficiencies were found on the one hand in market participants' operations, including risk management, internal control as well as characteristics and transparency of the products offered. On the other hand, they were related to the regulation and supervision of internationally active groups (branches in particular), for instance in terms of the powers and division of responsibilities of authorities in cross-border operations.

The reasons of the crisis and the necessary measures have been reviewed by many. Some recommendations regarding both regulation and supervision have already been issued, but in some areas the evaluation is still ongoing.

Need for development has been identified at least in the following areas: market transparency, capital adequacy regulation regarding securitisation, risk management and supervision of these market participants, the valuation of financial products and the operation of the markets. With respect to the operation of the markets, in addition to the regulative changes relating to credit rating agencies, it must be assessed whether some market participants outside the scope of present regulation (eg hedge funds) should be covered by regulation.

The focal points of development were included in the recommendations published after the meeting of G20 countries in Washington on 15 November. The concrete implementation of these initiatives in Europe constitutes preparation under the management of the Ecofin. The necessary measures have been assembled in a separate action plan where the tasks are divided into short-term (crisis management and recovery of financial systems) and longer-term (in relation to market structures and supervision) measures. The goal is to implement the short-term measures by the end of March 2009. The initiatives have been grouped into the following subject areas: improvement of transparency and accountability, regulation on financial market participants, reliable operation of the markets and cooperation between supervisors.

As part of the short-term measures, capital adequacy regulation and risk management are evaluated as part of the reform of the Capital Requirements Directive. Valuation issues are considered, in addition to IASB/FASB also in the context of the work of CESR-Fin. A working group under the CESR-Fin has been tasked with reviewing the appropriate and uniform application of the IFRS.

Initiatives relating to the operation of the markets focus on the operation of credit rating agencies. The issue was addressed in the scope of both IOSCO and CESR. Initially, the preparation was based on self-regulation within the field, but as the crisis deepened, the EU settled on legislation instead.

In the EU, regulation changes have advanced furthest in the context of the reform of the Capital Requirements Directive and the Deposit Guarantee Directive (more information on page 29). The changes are related to the review and amendment of the Basel II framework. New regulation is needed particularly with respect to banks' capital adequacy and management of liquidity risk.

As regards credit rating agencies, a regulation proposal by the Commission requires that rating agencies operating in the EU area are registered and placed under supervision by authorities, and that they institute measures to control conflicts of interest and expands their disclosure obligation.

Reform needs in supervision structures are being considered by a high-level working group appointed by the Commission (so-called *de Larosière Group*), whose proposals will constitute the basis for discussion in spring 2009.

In addition to the Ecofin action plan, the crisis also had an impact on authorities' crisis management capabilities. This was reflected in the changes adopted or prepared in the EU and Finland to support crisis-stricken banks. In some countries, banks were taken under government control or ownership. In Finland amendments were made to the Act on Government Guarantee Fund that increased the authorities' scope of manoeuvre. In addition, the FIN-FSA identified needs for crisis capability development concerning branches.

COMMITTEES OF SUPERVISORS

The committees of supervisors are preparing for the implementation of the effectiveness measures. Cooperation in different forms increases in concrete supervision work. Introduction of a voting procedure combined with increasing the actual effectiveness of level-3 guidelines (comply or explain) will likely at least facilitate the approval in committees of those initiatives that are supported by the vast majority.

CEBS

The responsibility of the Committee of European Banking Supervisors (CEBS) is to foster the convergence of banks' supervisory practices, issue advice to the Commission and promote cooperation and exchange of information between supervisors.

In early 2008, the CEBS gave the EU Commission advice on large exposures, liquidity risk management, use of hybrid instruments and use of national discretion. The Commission largely took heed of the advice in its proposal for amendments to the Directive on Credit Institutions and the Capital Requirement Directives. Further information on pages 51-52.

Desire to decrease national discretion

The large amount of national discretion (options) is problematic, particularly to large cross-border groups. The objective of a CEBS working group is to answer to the Commission's request for advice on whether national options can be harmonised. If there are no grounds for harmonisation, can then reciprocal recognition be agreed on?

The CEBS reviewed in a survey published in October the position of national supervisors to potential harmonisation of options and also consulted market participants. In its responses the FIN-FSA has advocated the elimination of

discretion, thus supporting the harmonisation of regulation and supervision procedures.

Progress in supervision development initiatives

The work of CEBS is particularly influenced by the focus areas identified by the Ecofin in its December 2007 meeting:

- ❖ enhancing the efficiency of working processes and decision making
- ❖ extending convergence to daily supervision work and supporting cooperation in colleges of supervisors
- ❖ promoting the uniformity of regulatory reporting
- ❖ stronger efforts to develop a European supervision culture
- ❖ clarifying the differences between the respective powers of supervisors and mapping their impacts

In accordance with a recommendation by Francq's report, CEBS has adopted a mediation mechanism which can be used in reconciling conflicting points of views between supervisors. So far, the procedure has not been used. Similarly, self-assessment by supervisors and the related Review Panel has been adopted. The operation of the Review Panel was tested during the review year by evaluating the application of CEBS's model validation guideline (GL10). Through a training and exchange programme, CEBS concretely promotes uniform operating procedures for supervisors.

To improve uniform reporting at EU level, the development initiatives concerning regulatory reporting on IFRS financial statements (FINREP) and Common Solvency Ratio Reporting (COREP) are still in progress. The changes will begin to have an impact on reporting guidelines and forms in 2009.

CEBS assessed the publication of information on securitisation, structured products and illiquid instruments. On 18 June, CEBS published reports related to challenges posed by uncertainty in the markets. The reports concerned the valuation of complex and illiquid financial instruments and the transparency and clarity of banks' financial

reporting. The report focused on operations and products affected by the market turmoil.

CEBS continued to explore fields of supervision where the delegation of tasks is cost-effective. At the same time, attention was also paid to legal obstacles hindering the delegation of tasks and responsibilities, and principles were drafted that could be used in further efforts.

Uniform methods and criteria for Pillar 2 supervision

Efforts aimed at harmonising Pillar 2 supervision continued. A subgroup under the *Group de Contact* focused on evaluation methods for economic capital models (ECM), treatment of diversification benefits and allocation of capital within a conglomerate. The outcome of the work will be utilised gradually in supervision. According to the schedule, new guidelines will be available in 2009.

Work by colleges of supervisors guided by agreements and instructions

Colleges of supervisors of 17 European conglomerates operate in a working group (*SON, Subgroup on Operational Networks*) under the *Groupe de Contact*. An agreement model (*Multilateral Cooperation and Coordination Agreement*) prepared by the subgroup was tested in the early part of the review year. The operating principles of supervisors of cross-border conglomerates (*Range of Practices on Supervisory Colleges and Home-Host Cooperation*) and the supervision agreement guide the practical work of the colleges. The agreement model is intended for the supervision of multinational conglomerates operating in both a subsidiary and a branch structure. SON's work continues to focus on the harmonisation of supervision practices. ECOFIN requested CEBS to investigate whether guidelines could be provided in an effective manner for the operation of colleges of supervisors. This project (*Good Practices Paper on Supervisory Practices*) will be completed in early 2009. The launch of the operation of the colleges of supervisors also in the supervision of significant branches is an important focus area in the near term.

CEBS reporting on the state of the financial sector to EU committees to increase

CEBS reported to EU committees during the early part of the year on the financial crisis and initiatives launched due to the crisis, with the aim of improving supervision. Going forward, CEBS will report regularly to EU committees on the state of the financial sector. Increasing the exchange of information will improve the possibilities of supervisors and other authorities to prevent and tackle the emergence of crises, already at an early stage.

CESR

Advice given by the Committee of European Securities Regulators (CESR) to the EU Commission included an assessment of the equivalence of the national GAAP in certain countries and the IFRS. In addition, CESR suggested a reform of the simplified prospectuses of mutual funds.

Practical supervision also on CESR agenda

Enhancement of practical supervisory cooperation is also a key objective of the Committee of European Securities Regulators. The mediation mechanism for settlement of conflicts between members is already available. Similarly, peer review of members is undertaken by the Review Panel of CESR. Recent work by the Review Panel covers the national application of the most recent directives. In addition to powers and sanctions, this includes an assessment of eg the members' internal authorisation, inspection and supervision processes. With respect to sanctions, it can already be seen that there are significant differences between countries.

Coordination of decisions made in different areas of supervision is warranted. This is emphasised particularly in IFRS supervision and the supervision of issuers' disclosure obligation. From the EU's viewpoint, functioning of the internal market requires that in interpreting provisions, supervisors end up in similar conclusions in similar situations.

The Prospectus Directive and the Transparency Directive required that the Commission determine during the review year whether the calculation regulations of a third country can be considered equivalent to the IFRSs. CESR assisted in this work. In March 2007, CESR gave the Commission advice on the definition of equivalence and in June 2007 a second piece of advice on the mechanism to be used in the determination of equivalence of the GAAP of a third country. After the second piece of advice, the Commission issued a regulation on the mechanism to be used. Thereafter, the Commission requested advice from CESR on the evaluation of IFRS equivalence of GAAP of certain third countries on the basis of the mechanism described in the regulation. CESR-Fin was responsible for this. Since January 2009, an issuer from a third country that issues securities in EU's regulated markets may present its financial statements and interim reports according to its national GAAP if the Commission has stated that it is equivalent to the IFRSs. In other cases, issuers from third countries must present their financial statement information and interim reports in accordance with the IFRSs. Based on CESR's advice, the Commission named the GAAP of the following countries equivalent with the IFRSs: USA, Japan, China, Canada, South Korea and India.

Operations of the permanent cooperation groups, CESR-Pol and CESR-Fin continued actively. CESR-Pol has concentrated on the consistent application of the Market Abuse Directive. The group has also set up a subgroup for the exchange of information on suspicions of market abuse.

CESR-Fin has been vested with the task of coordinating supervision and other activities in the member states relating to issues concerning to the financial reporting of listed companies. Under CESR-Fin, the European Enforcers Co-ordination Sessions (EECS) convene to discuss application issues related to IFRS financial statements. CESR has published a total of 56 enforcement decisions by European financial statement supervisors. Uniform financial statement treatment and uniformity of enforcement decisions in Europe is ensured so that significant and interpretation-wise difficult financial statement questions are submitted for discussion by the European Enforcers Co-ordination Sessions. The final enforcement decision is, however, always made by the national supervisor.

Furthermore, CESR-Fin was engaged in the evaluation of the correspondence of third country financial reporting standards with IFRSs, as well as the implementation of the CESR-SEC cooperation programme.

During the year, an ad hoc working group on valuation issues related to financial statement regulation operated under CESR-Fin. On 3 October, CESR published its view on the valuation of financial instruments in illiquid markets. At the same time, the statement constituted CESR's contribution to the Financial Market Action Plan published by the Ecofin Council in October 2007.

Management company passport included in the UCITS Directive reform

CESR's working group on *Investment Management (IMEG)* focused in spring to supplement the reform of the UCITS Directive with a management company passport. Management company passport had been removed altogether from the proposal published in spring because many member states doubted its feasibility.

However, the management company passport was reinstated on the agenda under the direction of the new EU Presidency country. In August, IMEG began to draft CESR advice on the subject. The advice was presented to the CESR Plenary Session at the beginning of October and submitted to the Commission at the beginning of November.

The management company passport requires very extensive and close cooperation between authorities. The point of departure is that a management company established in one member state may manage a fund established in another member state without setting up a subsidiary or branch in the host country. The management company passport will test the functionality of supervision mechanisms and issuance of sanctions targeted outside the home country of the competent authority.

Due to the very unstable market conditions, the working group assessed mutual funds' redemption situations and potential liquidity problems in the member states.

IMEG submitted a guideline on risk management principles for management companies and mutual funds to be approved by CESR Plenary Session.

Development of European-wide transaction reporting poses challenges

A crucial area of work from the supervision point of view is the development of a common transaction reporting system. MiFID changed the reporting of transactions made by investment firms so that each firm now reports its transactions to the supervisor of its home country. In order for supervisors to have a sufficient overall picture of trading, CESR's common transaction reporting system (TREM) ensures that the necessary information is available to all supervisors.

This type of initiative changes the nature of CESR's operations significantly. The conduct of operative tasks, such as development of common IT systems, is a challenging endeavour for a cooperation association like CESR. Obtaining sufficient resources for the development of the transaction reporting system has been problematic.

Although the system is operational, it still has many deficiencies from the supervisory point of view. Not all countries can yet submit data to the system. Further, not all instruments are yet covered by the exchange of information. From the Finnish point of view, the most significant deficiency is the lack of *Eurex* and *Liffe* derivatives.

If the initiative of mutual recognition of the EU's and US securities markets proceeds as planned, CESR will be vested with the task of equivalence assessment of regulations on broking and securities exchange operations in the member states vis-à-vis the United States. At the moment, however, progress with respect to the initiative has come to a halt.

REGULATION REFORMS

Directive on Credit Institutions and Capital Requirements Directive to change

Reform work is in progress in the EU with respect to directives concerning taking up and pursuit of

the business of credit institutions as well as that on the capital adequacy of investment firms and credit institutions. The Commission's proposal was issued in October. The amendments will be addressed by the European Parliament and the intention is to have them adopted during spring 2009.

The reform covers eg the following issues:

- ❖ Regulation of credit institutions' large exposures
- ❖ Regulation relating to own funds and especially to so-called hybrids
- ❖ Supervision arrangements, eg issues relating to the supervision of branches
- ❖ Certain technical questions concerning capital adequacy calculation
- ❖ Principles of liquidity risk management
- ❖ Common capital adequacy assessment by a college of supervisors
- ❖ Strengthening of the role of CEBS

The provisions of the directives will be implemented in Finland by amendments to the Credit Institutions Act and FIN-FSA standards, mostly concerned with capital adequacy calculation. The intention is that the directives are in force in Finland by the end of 2010 at the latest.

Supervision arrangements

The issues included in the proposal related to the supervision of branches are quite important for Finland due to the structural changes planned by credit institutions. The Owner of Sampo Bank, Danske Bank, has announced that it would change Sampo Bank into a branch after some time. For the time being, however, the plan has been postponed. Danske Bank's Finnish branch could be considered a systemically important for the Finnish financial markets.

A systemically important branch refers to a branch which, in the host country, has either a sufficient market share, significant influence on the payment and clearing systems of the host country or other grounds for significance, such as the number of customers.

The purpose of the directive amendments is not to change the respective responsibilities of the

home and host country supervisors. The main supervision responsibility for branches would continue to belong to the home country authority, but the directive will include the concepts of systemically important branch and articles on supervision cooperation between the home and host country authorities and the right of the host country authorities to receive information. The change would make cross-border supervisory colleges mandatory. In addition to the exchange of information, the task of the colleges would include assessment of the capital adequacy of the entire supervised conglomerate. The directive amendments also aim to give the host country the right to receive information in the context of supervision of important branches. The point of departure is that the supervisor of the host country could also participate in the common supervisory college. However, the ultimate power of decision on the composition of the college belongs to the home country supervisor.

Large exposures

Provisions on large exposures limit the risk related to a single customer or group of connected customers. The basic requirement continues to be that the amount of liabilities may not exceed 25% of the own funds of the credit institution. Changes will be made eg to the treatment of interbank and intra-group liabilities. As regards interbank liabilities, a significant change from the present would be that they would be included in the scope of the customer risk limitations. The treatment includes certain alleviations for liabilities under EUR 150 million. Also intra-group liabilities would be covered by the limits, however, national exceptions to this requirement are allowed.

Own funds and hybrid instruments

Regulation on own funds is in the process of being reformed. The purpose is to define the content of hybrid instruments counted as own funds, to set uniform quantitative limits to so-called innovative and non-innovative hybrids and propose a transitional provision to restrict the impact of the new regulations on the financial markets. The conditions set for hybrid instruments will

tighten and the maximum amount allowed will be linked to the conditions. Instruments that can be converted into equity could in the future only amount to 50% of own funds, and other hybrids to 35%. In addition, the amount of innovative hybrids will be limited to a maximum of 15% of Tier 1 capital.

Hybrid instruments refer to capital instruments including characteristics of both equity and liability at the same time. Non-innovative hybrids refer to instruments whose conditions include an early repayment option and innovative hybrids to instruments whose conditions also include a possibility to increase interest before maturity or another incentive to early repayment.

Proposals concerning large exposures and own funds are based on CEBS's advice.

UCITS Directive changing

In July, the Commission put forward a proposal on amending the UCITS Directive. The amendment would include both reforms in the content that are significant in principle, and revisions that are more technical in nature and clarify the structure of the Directive.

The major content revisions are

- ❖ enabling of cross-border mutual fund mergers
- ❖ combination of mutual fund assets by allowing Master-feed structures (pooling) also for UCITS funds
- ❖ reform of the simplified prospectus
- ❖ acceleration of the notification process
- ❖ intensification of supervision cooperation

Further material revisions were made to the directive proposal during the autumn when the management company passport was added to the draft directive.

A level 2 Commission directive (2007/16/EC) on the implementation of the UCITS Directive to clarify certain definitions was implemented in the summer in Finland by a Regulation of the Ministry of Finance that entered into force on 23 July. The Regulation clarifies the definition of eligible assets

but is not expected to result in any significant changes to present interpretations in the markets in Finland.

Proposed amendment to the Real Estate Funds Act

Amendments to the Real Estate Funds Act and the Mutual Funds Act entered into force on 1 May 2007. Despite advance market interest, no real estate funds have been set up under the new rules; the main reason being issues related to the transparency of the fund and valuation of assets.

On 15 May, the Ministry of Finance circulated a proposal for amendment of the Real Estate Fund Act for comment. It is proposed that the Real Estate Fund Act be supplemented for example by provisions concerning real estate funds investing solely or primarily in rental apartments. The new regulation would create a new regime on real-estate investment firms subject to special tax treatment (cf REIT, Real Estate Investment Trust).

New Act on preventing and investigating money laundering and financing of terrorism

A new Act on the prevention and investigation of money laundering and financing of terrorism (503/2007) entered into force on 1 August. The Act enacted the EU's third Money Laundering Directive in Finland. It replaced the Act on preventing and clearing money laundering, reformed in 2003.

The objective of the Act is to prevent money laundering and financing of terrorism by developing the procedures related to knowing your customer and risk management of companies operating in finance or otherwise falling within the scope of the Act. The Act also contains more detailed provisions on customer due diligence. The primary point of departure is a risk-based approach. It means that parties subject to the notification obligation may adapt their procedures concerning customer due diligence to their operations based on the risks related to money laundering and financing of terrorism. A risk-based assessment requires that the supervised entity has sufficient procedures concerning the nature and extent of its

operations to assess the risks of money laundering and financing of terrorism related to its industry, products, customers and services. According to the transitional provision of the Act, supervised entities must develop their own risk-management procedures by 1 August 2009.

Supervised entities must develop both their processes related to customer due diligence and their risk management. Knowing the customer base in a risk-based manner also means that existing customer relationships are assessed critically and customer relationships are categorised according to risks. Information obtained on the customers must also be updated. Additional information may also have to be obtained, since the new Act requires, among other things, identification of the actual beneficiary, such as the owners of a legal person. The Act on credit information was also amended in this context so that those bound by the notification obligation may obtain information on the customer both at the outset of a customer relationship and in context of suspecting money laundering or financing of terrorism may also obtain information on the customer from the credit information register.

Reform of Consumer Credit Directive specifies consumer credit contracts

The European Parliament and the Council have adopted the amended Consumer Credit Directive. A working group has been established for the implementation of the directive. Its term ends in October 2009. In connection with the implementation, chapter 7 of the Consumer Protection Act is renewed completely and it will include provisions on eg principles of accountable lending and accountable procedures in credit relationships.

Amendment of the Consumer Credit Directive will likely increase the amount of detailed conduct of business regulation of credit institutions. Standard information on loans will facilitate the comparison of loans by the consumer.

Preparation of overall reform of Securities Markets Act began

The Ministry of Finance began preparations for an overall reform of the Securities Markets Act (SMA). An evaluation memorandum was made on the reform of the SMA, in which the Ministry presents preliminary views of the need for reform. The Ministry intends to appoint a working group in early 2009 to prepare the reform. The goal is that the reformed SMA and other related acts could enter into force in 2011.

In reforming the SMA, the functionality of the act and its effectiveness in the changed operating environment are evaluated, the objectives and general principles of the act are clarified and the act is evaluated in terms of structure, content and technical details.

Preparation of the act is guided by the desire to ensure the international competitiveness of the Finnish securities markets and market participants. Another objective is an as diverse offering of financial services as possible, which is balanced by supervision promoting the functioning of the markets and sufficiency of investor protection. The preparation also seeks Nordic uniformity where appropriate and accounts for the principles of better regulation including eg the evaluation of opportunities to use self-regulation.

European IFRS and US GAAP to converge

Efforts to reform IFRS regulation continued with the aim of converging IFRS and US GAAP regulation. A document to that effect was updated in the autumn. During the year, numerous minor revisions were made to a number of standards, and many discussion papers were published covering eg the simplification of regulation regarding financial instruments, categorisation of capital, pensions and presentation. Progress was also made during the year with respect to the reform of the theoretical framework. The Standard on Company and business acquisitions was adopted in final form. It enters into force on 1 July 2009.

IASB eased regulation due to financial crisis

IASB made an easing of the reclassification of financial instruments as the financial crisis deepened in the autumn. Partially the reason for which was also the harmonisation of IFRS and US GAAP. In addition, IASB has clarified regulation on fair value accounting. According to the revised regulation, for example such instruments that no longer have a trading nature may be transferred from the trading portfolio to other asset categories. The changes could be applied retroactively from 1 July. Reclassification could thus be made at the fair values at the end of June when risk premia in the financial markets were at lower levels than in autumn. IASB has also published an amendment proposal concerning information provided on fair values of financial instruments and related liquidity risk. In October, European supervision committees (CESR, CEBS and CEIOPS) made a common statement on recent development efforts concerning financial reporting regulation.

Payment Service Directive to bring new supervised entities

The European Parliament and the Council adopted the Payment Service Directive on 13 November 2007. Member states are to transpose the Directive into national law by 1 November 2009.

In Finland, responsibility for the national implementation of the Directive is shared by the Ministry of Justice and the Ministry of Finance. Proposal by the Ministry of Justice was published on 18 December. The term of the Ministry of Finance working group ends on 31 December 2009.

The Directive is designed to provide a common EU framework for the provision of payment services. With the implementation of the Directive, provision of payment services will become subject to authorisation. The Directive will also include provisions on the information requirements and codes of conduct applicable to payment service providers. The changes will be reflected in FIN-FSA's standards in the future.

The Directive has significant impacts also on the operation of entities already under supervision with

respect to new conduct of business obligations. As such, the provision of payment services does not require that credit institutions apply for a separate new authorisation or changes in presently valid authorisations.

New supervised entities will include almost all companies providing payment services that are required to have authorisation after the entry into force of the Act. The concept of payment services subject to authorisation is extensive and covers eg traditional credit transfers and direct debits but also money remittance and different payment services through technical tools (eg payment via mobile phone).

New Standard on Issuers' regular disclosure obligation

The Transparency Directive was implemented in Finland with an amendment of the Securities Markets Act (SMA) and the Regulation of the Ministry of Finance on regular disclosure obligation of issuers of securities issued in the same context. In connection with the SMA amendments FIN-FSA received the power to issue provisions concerning the information referred in the abovementioned Regulation. Hence, the FIN-FSA issued a new Standard on 18 March on the regular disclosure obligation, which entered into force on 1 May. The Standard belongs to the section on *Disclosure of information* in the FIN-FSA's set of regulations. Previously, instructions related to this information had been given by the Accounting Board. With respect to issuers, the Standard replaces the guideline on annual report given by the Accounting Board on 12 September 2006.

The Standard applies to issuers' of securities and their financial statement, management report, financial statement bulletin, interim report, interim management report and annual summary. The Standard addresses the content and date of publication of the above documents and the publication procedure of the annual summary. In addition to FIN-FSA regulation and guidelines, the Standard contains a compilation of regulation on the disclosure obligation from accounting, securities market and limited companies legislation.

In special sectors, such as banking and insurance, there is sector-specific regulation in addition to or instead of the Standard. The Standard determines, in which respects entities supervised by the FIN-FSA are to follow the FIN-FSA Standard on *Financial statements and management* report in addition to or instead of the abovementioned Standard. In this context, the scope of application of the Standard and its subchapters on the management report and interim report has been updated accordingly.

Changes to issuers' and shareholders' disclosure obligation

Amendments to FIN-FSA Standard on *Disclosure obligation* of the issuer and shareholder entered into force on 1 March. The Standard was reformed to match the amendments of the Securities Markets Act that entered into force on 15 February 2007 due to the Transparency Directive. With respect to the Standard, the amendments concern the dissemination and availability of information to be published as well as the duty to disclose major holdings. At the same time, some other sections of the Standard were also amended to the effect that the Standard was supplemented by application guidelines published in the FIN-FSA's *Markkinat* bulletin.

The Standard now also includes the FIN-FSA regulation on the notification procedure related to the purchase of own shares. Upon its entry into force, the amendment repealed the FIN-FSA regulation on disclosure of transactions made with publicly traded shares by the limited company itself.

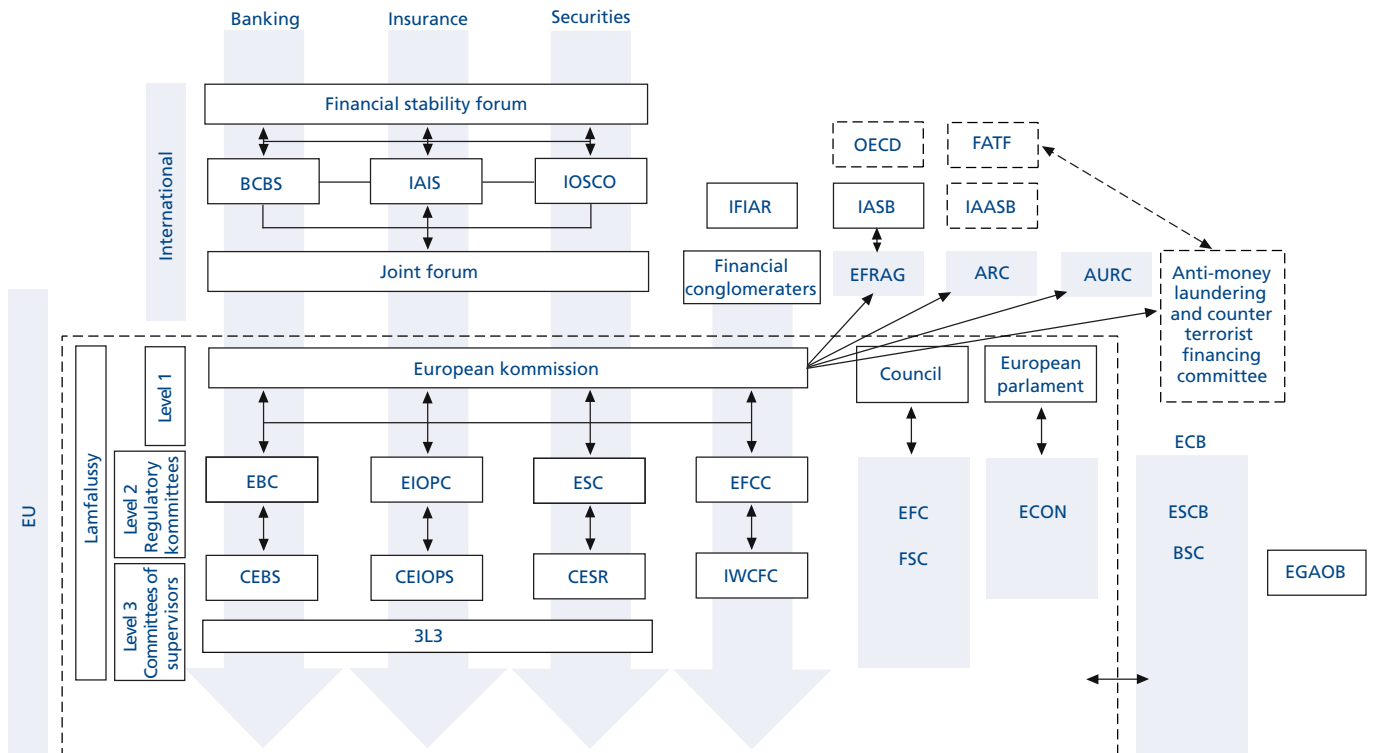
Other amendments to Standards

Amendments to FIN-FSA Standard on *Authorisations and notifications* entered into force on 1 July. The Standard belongs to the section *Corporate governance and business activity*. The Standard was supplemented by an application guideline related to the Investment Firms Act. The application guideline addresses the question what kind of combination of equity and liability insurance may be considered sufficient with respect to the liability level referred to in the relevant provision.

Amendments to FIN-FSA Standard on *Declarations of insider holdings and insider registers* entered into force on 1 May. The Standard was reformed to match the amendments of the Securities Markets Act and Mutual Funds Act that entered into force on 1 November 2007. These amendments concern the extent and content of the insider disclosure requirement of persons subject to the disclosure obligation at securities intermediaries and management companies. Also this Standard was supplemented by application guidelines based on statements and interpretations published in the FIN-FSA's *Markkinat* bulletin. At the same time, the structure of the Standard was revised to the effect that regulation on issuers, market participants and management companies has been assembled in separate chapters.

The Standard on Internal governance and risk management was updated. Its new name is now "Standard on Internal governance and organisation of activities". In updating the Standard, changes in international and domestic legislation were taken into account. Now its scope of application also includes management companies, holding companies of financial and insurance companies focusing on finance as well as securities exchanges and entities exercising control over stock exchanges within the meaning of chapter 1 section 5 of the Securities Markets Act. The Standard gave up the previous concepts of "board of directors" and "senior management" and adopted the concept "other senior management" used in the reformed legislation. Other senior management is considered to include the persons, in addition to the board of directors and managing director, in effect run the operation of the supervised entity. The amendments took effect on 1 January 2009.

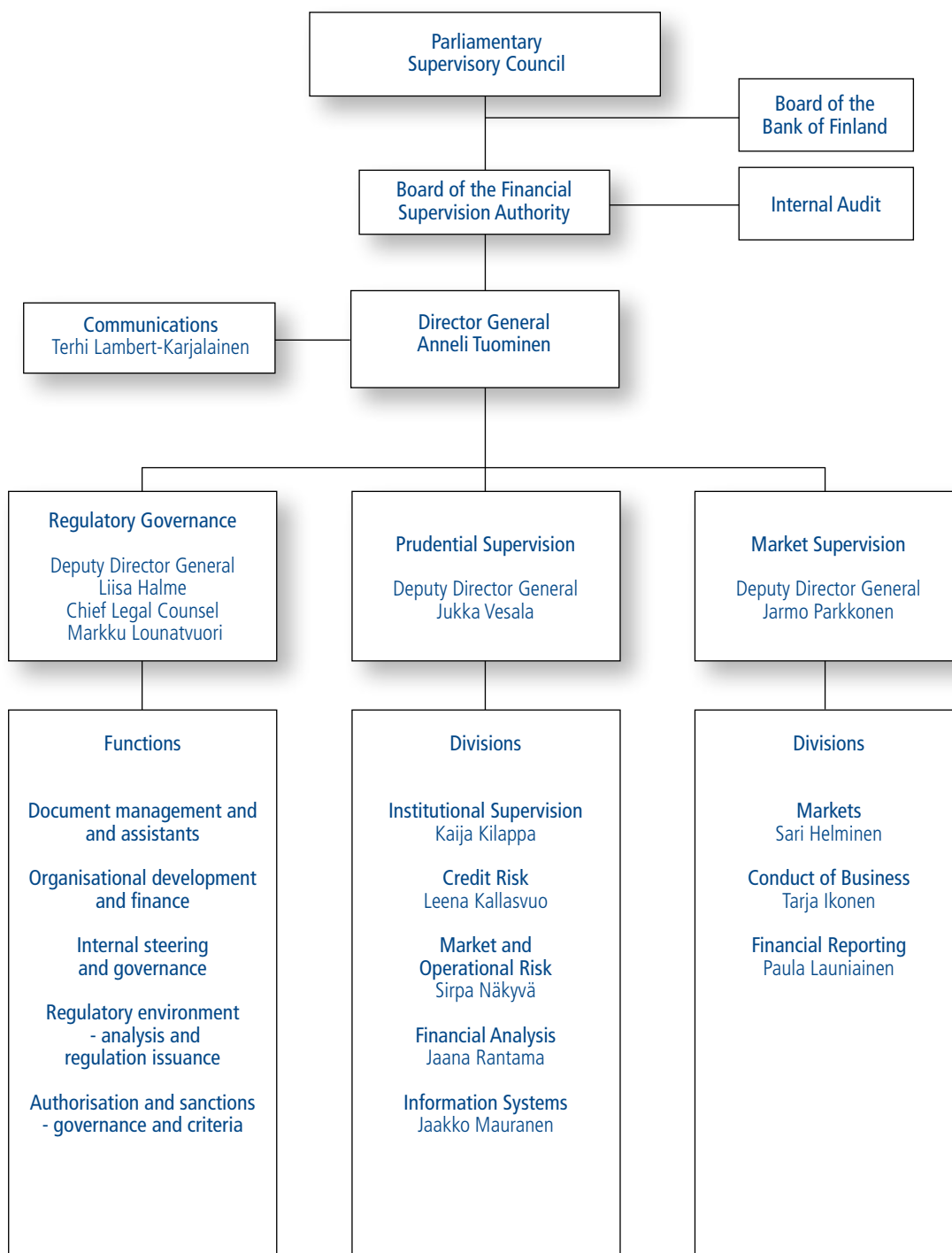
EU and international committees



- ARC Accounting Regulatory Committee
- AURC Audit Regulatory Committee
- BCBS Basel Committee on Banking Supervision
- BSC Banking Supervision Committee
- CEBS Committee of European Banking Supervisors
- CEIOPS Committee of European Insurance and Occupational Pension Supervisors
- CESR Committee of European Securities Regulators
- EBC European Banking Committee
- ECB European Central Bank
- ECON Committee on Economic and Monetary Affairs
- EFC Economic and Financial Committee
- EFCC European Financial Conglomerates Committee
- EFRAG European Financial Reporting Advisory Group
- EGAOB European Group of Auditors' Oversight Bodies
- EIOPC European Insurance and Occupational Pension Committee
- ESC European Securities Committee
- ESCB European System of Central Banks
- FATF Financial Action Task Force of Money Laundering
- FSC Financial Services Committee
- IAASB International Auditing Assurance Standards Board
- IAIS International Association of Insurance Supervisors
- IASB International Accounting Standards Board
- IFIAR International Forum of Independent Audit Regulators
- IOSCO International Organization of Securities Commission
- IWCFI Interim Working Committee on Financial Conglomerates
- OECD Organisation for Economic Co-operation and Development

Source: Financial Supervision Authority.

The Finnish Financial Supervision Authority 31.12.2008



The Management Group members for the Finnish Financial Supervision Authority are Director General Anneli Tuominen, Deputy Directors General Jukka Vesala, Liisa Halme and Jarmo Parkkonen as well as Markku Lounatvuori (Chief Legal Counsel).

The FIN-FSA staffing by task, 2008

	2008	
	Number of persons	Number relative to total staff, %
Licensing and authorisation function	7	5
Regulation issuance and process management	7,1	5
Sanctions and investigation	2	1
Internal control and governance	2	1
Monitoring and financial reporting	9,5	7
Financial reporting and analysis	14	10
Market supervision	12,5	9
• Public offer and listing prospectuses	4	3
• Reporting and disclosure obligations	3,5	3
• Stock exchange trading supervision and market abuse investigation	4,5	3
• Insider register	0,5	0
Inspection and supervision function	46,3	34
• Prudential supervision	28,5	21
• Monitoring codes of practice	11,4	8
• Financial market infrastructure (payment and IT systems, trading, clearing, payment and deposit systems, operators and counterparties)	5,5	4
International activities	4,8	1
Communications	2,8	3
Consumer information	0,9	2
Document management and assistants	6	4
Information systems	8	6
Organisational development and finance	2,5	2
Senior management, secretaries	13	9
Total	137,5	100

Source: Financial Supervision Authority..

Supervision and specific fees, 2004–2008

Table 1. Supervision fees, EUR thousands

The figures for 2004 are not comparable with other years, due to the changes in the structure of fees payable to FIN-FSA brought about through the implementation of the Act on Supervision Fees, from the beginning of 2005.

Fee-paying entities	2008	2007	2006	2005	2004
Credit institutions	11 902	9 991	11 016	11 482	
Investment firms	785	730	1 015	1 262	
Fund management companies	2 869	2 470	2 216	1 792	
Stock exchange	676	549	536	591	
Finnish Central Securities					
Depository (APK)	197	182	215	252	
Issuers	1 578	1 475	1 773	1 845	
Others	75	108	130	211	
<i>TOTAL</i>	<i>18 081</i>	<i>15 504</i>	<i>16 901</i>	<i>17 435</i>	<i>14 857</i>

Table 2. Specific fees, EUR thousands

Fee-paying entities	2008	2007	2006	2005	2004
Credit institutions	161	288	88	15	45
Issuers	100	187	207	374	422
Fund management companies	151	166	216	220	283
Investment firms	163	88	39	57	12
Others	256	182	42	3	1
<i>TOTAL</i>	<i>830</i>	<i>910</i>	<i>592</i>	<i>669</i>	<i>763</i>

Table 3. Total fees, EUR thousands

Fees	2008	2007	2006	2005	2004
Supervision fees	18 081	15 504	16 901	17 435	14 857
Specific fees	830	910	592	669	763
<i>TOTAL</i>	<i>18 911</i>	<i>16 414</i>	<i>17 493</i>	<i>18 104</i>	<i>15 620</i>

Source: Financial Supervision Authority.

The FIN-FSA expenses and income 2007–2008, EUR thousands

	Actual 2007	Actual 2008
Expenses		
Staff expenses		
Wages	8 521	8 722
Other staff expenses	2 444	2 447
Contribution to the Bank of Finland pension fund ¹		1 444
<i>Total staff expenses</i>	<i>14 309</i>	<i>12 614</i>
Other expenses		
Training	177	171
Travel	418	390
IT expenses	1 333	1 095
Language services	274	307
Real estate rents and maintenance costs	1 286	1 348
Security	376	376
Other expenses	1 339	1 650
<i>Total other expenses</i>	<i>5 203</i>	<i>4 986</i>
Depreciation		
Equipment and furniture	27	25
Software	17	17
<i>Total depreciation</i>	<i>44</i>	<i>42</i>
TOTAL EXPENSES	19 556	17 642
Income		
Supervision fees	15 504	18 081
Processing fees	910	830
Other income	5	7
<i>Surplus of the previous year²</i>	<i>2 559</i>	<i>-577</i>
TOTAL INCOME	18 978	18 341

¹ The Bank of Finland's pension fund was created with the purpose to prepare for covering pension liability and finance employees' pensions. The aim is to cover pension liabilities to a level of 110% by 2012 through regular accruals to the fund. To attain the targeted level the Bank of Finland has to pay a contribution to the pension fund for 2007. The amount and FIN-FSA's respective share will be confirmed later in spring.

² The Act on Supervision Fees (1249/2004) outlines the practice in such cases where the income from the combined supervision fees and processing fees exceed expenses in the FIN-FSA's annual budget. In the case that there is a surplus for the previous year greater than 5% of the annual budget total, the fees charged to the supervised entities are reduced accordingly, taking the previous calendar year's surplus/deficit into account. Equal treatment of the supervised entities requires that an equivalent relative reduction is made to all of the supervision fees payable.

Abbreviations and definitions index for 2008 annual report

AKVA, Monitoring system for securities transactions
AIRBA, Advanced Internal Ratings Based Approach
AMA, Advanced Measurement Approach
APK, Finnish Central Securities Depository (Arvopaperikeskus Oy)
BSC, Banking Supervision Committee, a committee of the ESCB
CEBS, The Committee of European Banking Supervisors
CESR, The Committee of European Securities Regulators
CEIOPS, The Committee of European Insurance and Occupational Pensions Supervisors
CESR-Fin, Operational group on Financial Reporting
CESR-Pol, Operational group for enforcement of Market Abuse
CCP, Central Counter Party
COREP, Common Reporting Framework
ECOFIN, The Economic and Financial Affairs Council
ECM, Economic Capital Model
EECS, European Enforcers Coordination Sessions
EGFI, Expert Group on Financial Information
ECB, European Central Bank
ESCB European System of Central Banks
FASB, Financial Accounting Standards Board
FATF, Financial Action Task Force on Money Laundering
FINREP, Standardised framework for consolidated financial reporting for credit institutions Financial Reporting)
FSAP, Financial Services Action Plan
IASB, International Accounting Standards Board
ICAAP, Internal Capital Adequacy Assessment Process
IFRS, International Financial Reporting Standards
IMEG, Investment Management Expert Group
IMF, International Monetary Fund
IRBA, Internal Ratings Based Approach
MiFID, Markets in Financial Instrument Directive
MTF, Multilateral Trading Facility
NCSD, Nordic Central Securities Depository
REIT, Real Estate Investment Trust
SEC, Securities and Exchange Commission
SEPA, Single Euro Payments Area
SMA, Securities Markets Act
SREP, Supervisory Review and Evaluation Process
SON, Subgroup on Operational Networking
UCITS, Undertaking for collective investments in transferable securities
US GAAP, United States Generally Accepted Accounting Principles
VAR, Value at Risk, risk-assessment method based on statistical probability distributions
XBRL, Extensible Business Reporting Language

EU Directives referred to in the Annual Report

Markets in Financial Instruments Directive (MiFID): Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (32004L0039); OJ L 145, 30.4.2004, p. 1.

UCITS Directive Reform: Proposal for a new codified UCITS Directive.
COM(2008) 458, 2008/0153 (COD) Proposal for a Directive of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

3rd Money Laundering Directive: 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 (32005L0060); OJ L 309, 25.11.2005, p. 15.

Prospectus Directive: Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (32003L0071); OJ L 345, 31.12.2003, p. 64.

Transparency Directive: Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (32004L0109); OJ L 390, 31.12.2004, p. 38.

Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast)

Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast)

Nordic supervisory authorities

Finansinspektionen, Sweden

Kredittilsynet, Norway

Finanstilsynet, Denmark

Fjármálaeftirlitið, Iceland

*The Annual Report is based on data available
from 16 January 2009.*

*The texts refer to the reporting year 2008,
unless otherwise mentioned.*

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