Financial Market Report

4 • 2009

- Bank deposit growth turned modestly negative
- Banks' financial results remained healthy and solvency improved
- E-invoicing saves euros and nature
- Financial crisis changes accounting rules

Bank of Finland

Financial Markets and Statistics

12.1.2010

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1 Financial intermediation

1.1 Households' financial assets grew in the second quarter 2009

Hanna Häkkinen

As a result of the rise in prices of high-risk financial assets, households' financial assets started to increase again, after 18 months of decreases. The positive price developments also affected the financial assets of the other sectors of the national economy in the second quarter of 2009.

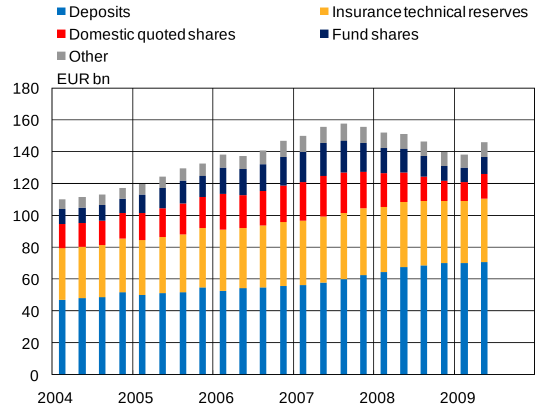
Households' financial assets started to increase in the second quarter of 2009. In April–June, households' financial assets increased by EUR 7.7 billion on the previous quarter. This was due to mainly rising prices of high-risk financial assets. Households' net investments in financial assets totalled EUR 1.9 billion. The price increases also boosted financial assets by EUR 5.8 billion, ie by 4.2% of the stock of financial assets at the end of the first quarter 2009. In June 2009, households' financial assets totalled EUR 146.1 billion, which was however EUR 5.5 billion (3.7%) less than in the second quarter of 2008.

During the financial market crisis, households have shifted a considerable amount of assets from fund shares to deposits. As a result of the increase in prices, the trend had reversed already in the first quarter of 2009. In April–June 2009, households' net subscriptions of fund shares totalled EUR 0.7 billion. At the end of June, the stock totalled EUR 10.8 billion. This was accompanied by a EUR 0.4 billion growth in deposits.

The rise in prices was also reflected in households' insurance-related saving in the second quarter of 2009. Households' stock of savings in life and pension insurance increased by 2.9%, totalling EUR 33.2 billion at the end of June. The increase was due to the rise in value of mutual fund shares, which underlie the savings in unit-linked life insurance. The stock of savings in guaranteed-return insurance remained virtually unchanged.[1]

The increase in financial assets halted the shrinking of households' net financial assets, which had started in summer 2007. In June 2009, households' net financial assets totalled EUR 50.2 billion, which was still EUR 10.3 billion (17.0%) less than a year earlier.

Chart 1. Households' financial asset holdings at end of quarter



Source: Bank of Finland.

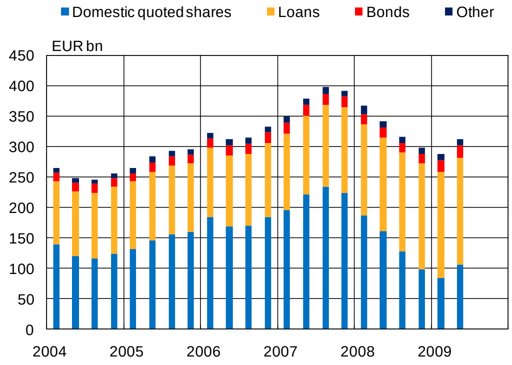
During the financial market crisis, the financing of non-financial corporations was characterised by decreasing stocks of debt securities, particularly

[S] Source: Federation of Finnish Financial Services.

commercial paper, which was compensated by an increase in loan financing. The stock of debt securities nevertheless started to increase at the start of 2009, totalling EUR 25,6 billion at the end of June, an increase of EUR 2.7 billion on the year-earlier period. At the same time, the stock of corporate lending by banks has decreased slightly. Lending by employment pension funds and debt financing from abroad however sustained the growth of the stock of corporate loans in the second quarter. In June 2009, outstanding loans to non-financial corporations (excl. loans between Finnish corporations) amounted to EUR 99.1 billion. Non-financial corporations' total debt financing (loans and debt securities) grew by 15.7% compared to June 2008.

The rise in share prices boosted the market value of non-financial corporations' quoted shares (in financial accounting: quoted shares outstanding) to EUR 105.5 billion – an increase of EUR 21.8 billion on the previous quarter. The market value of quoted shares is still 34.7% lower than in June 2008.

Chart 2. Selected liabilities of non-financial corporations at end of quarter



Source: Bank of Finland.

1.2 Fixed-term deposits no longer attract households

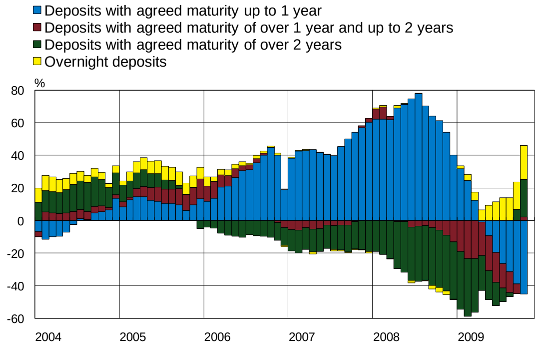
Elina Salminen

In 2009, there was a considerable shift in households' deposits, from fixed-term to transaction accounts. The decline in deposit interest rates has eroded the popularity of fixed-term deposits. Investment funds have since spring 2009 attracted a considerable amount of new capital.

In 2008, households'[2] deposits grew rapidly, due to attractive interest rates and general economic uncertainty, as households shifted funds from higher-risk investment instruments to safe bank deposits. In 2009, deposit rates declined in parallel with market interest rates, and fixed-term deposits in particular became less attractive. Reduced economic uncertainty has increased the popularity of fund investments.

Deposits are households' biggest financial asset item. In addition, the household sector has the largest holdings of bank deposits. Total deposits grew at a record rate in 2008, boosted by attractive interest rate offerings. The annual growth rate of deposits with an agreed maturity of less than one year peaked at nearly 80%. Households' deposits reached a historical peak in April 2009 when households' bank deposits totalled EUR 74.4 billion. After April, total deposits started to decline, and at the end of October, households' deposits in banks operating in Finland totalled EUR 73.0 billion. The annual growth rate of total deposits slowed in October to 0.7%.

Chart 3. Annual growth of households' deposits, by type and maturity



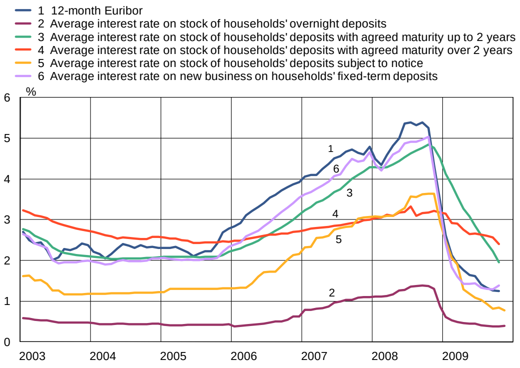
Source: Bank of Finland.

In 2009, a considerable shift took place in the structure of households' deposit holdings (Chart 3), between various types of account: households' fixed-term deposits shrank in January–October 2009 by EUR 9.7 billion, the majority of which was shifted to overnight deposits and deposits subject to notice. The stock of these deposits grew in 2009 by EUR 9.0 billion. Their proportion of total household deposits increased from 54% at the start of the year, to 77% at the end of October. The interest rate on these accounts is significantly lower than that on fixed-term accounts, but customers can withdraw money without notable costs or restrictions. Households seem to have favoured better liquidity over yield in the period up to end-October 2009.

The majority of fixed-term deposits (76%) have agreed maturities of up to one year. These deposits have shrunk the most – by EUR 10.2 billion in 2009. By contrast, the stock of households' fixed-term deposits with longer maturities (1–2 yrs and over 2 yrs) have increased over the same period by a total of EUR 0.5 billion. Deposits with longer maturities are however modest (they totalled EUR 4.1 billion at the end of October).

[2] Including non-profit institutions serving households.

Chart 4. Average interest rates on households' deposits



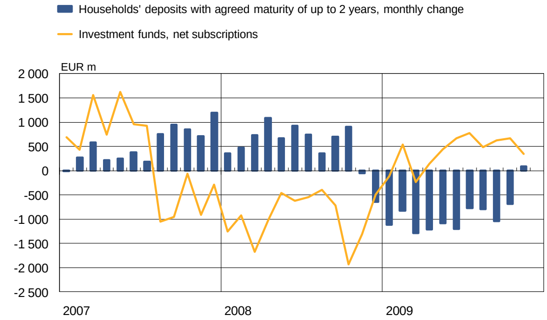
Source: Bank of Finland.

In 2008, the financial market crisis was reflected also in deposit interest rates, which moved in parallel with market interest rates (Chart 4). Deposit rates on new business in particular move in line with market interest rates.

The average interest rate on total deposits decreased for the year and was 0.86% at the end of October. The average interest rate on the stock of overnight deposits fell to 0.38% at the end of October. Nevertheless, total overnight deposits increased to EUR 39.6 billion. The sharpest fall in interest rates was recorded for deposits with agreed maturity up to one year. In October 2008, the average interest rate on these deposits was 5.04%, and in October 2009 it was 1.25%. These deposits have suffered the biggest loss in popularity.

The most attractive interest rates are currently paid on deposits with agreed maturity of over one year; the interest rate on new business on these deposits was 1.93% at the end of October. In October 2008, the average interest rate on deposits with agreed maturity of over one year was 4.84%.

Chart 5. Subscriptions in investment funds and monthly change in fixed-term deposits



Sources: Bank of Finland and Association of Mutual Funds.

The global financial crisis and the ensuring economic uncertainty led investors to flee from the investment fund market in 2008. In 2009, net subscriptions in investment funds however turned positive again (Chart 5). In 2009, the value of investment funds registered in Finland grew by EUR 11.7 billion,[3] reaching EUR 52.9 billion in November. Of this growth, EUR 4.4 billion was accounted for by net subscriptions and EUR 7.3 billion by changes in valuation. Most of the increase in the stock of investment funds was due to favourable developments in share prices.

The household sector is one of the biggest sectors investing in investment funds.[4] Households invest mainly in equity and fixed income funds[5]. Of households' holdings of fund shares, 20% are direct holdings. Households also hold fund shares via insurance saving, which is reflected in households' holdings in the insurance sector.

[3] Finnish Association of Mutual Funds.

[4] For information on the distribution of fund shares, see http://www.bof.fi/en/tilastot/sijoitusrahastot/index.htm

[5] Including money market funds.

2 Banks

2.1 Domestic banks' results have remained good

Eero Savolainen

The pre-tax profits of Finnish banking improved in the third quarter of 2009 by 16% on the previous quarter, as a result of a decrease in loan losses. By contrast, results for January–September were 44% weaker than a year earlier, due to increased loan losses and a decline in net interest income.

The pre-tax profits of domestic banking totalled EUR 744 million in January–September 2009 (Table 1). Banks' performance is characterised by a decline in net interest income – due to low market interest rates – and an improvement in net income from securities transactions, which is included in other income (Chart 6).

Chart 6. Income and profits of Finnish banking, quarterly data*

* Nordea's banking operations in Finland, Danske Bank's banking operations in Finland,OP-Pohjola Group's banking and investment services, Aktia's banking business, savings banks, local cooperative banks, Bank of Åland, Evli Bank, and eQ.
Sources: Banks' interim reports and financial statements, and Bank of Finland.

Banks' operating profit, ie results before loan losses, has remained good. But loan losses increased sharply on the previous year and caused a weakening of banking sector profitability.

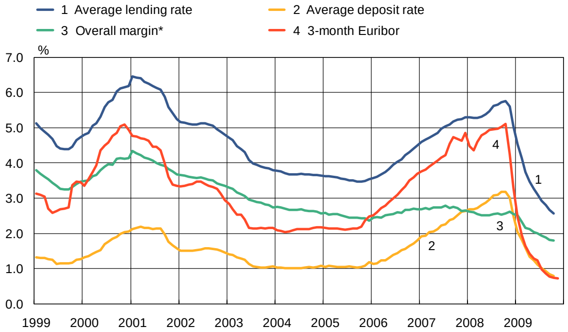
It should be noted that net interest income is affected not only by interest payments on lending and deposits but also the interest payments on debt securities and derivatives. Developments in the components of net interest income have been mixed: net interest income from lending and deposit activities has decreased, whereas net interest income from debt securities, in particular, has improved. Moreover, in banks' segment reporting, a part of the net interest income is allocated to group functions and so it is not included in the results of banking operations. For example, the net interest income from OP-Pohjola group's banking and investment activities in January–September 2009 decreased by 9% on the previous year, whereas net interest income for the whole group decreased by only 5%, due to the improvement in net interest income from group functions.

Developments in the expenses of domestic banking have been moderate. Total expenses increased in January–September by only 1% on the previous year. Differences between banks in the development of expenses are partly due to corporate acquisitions and other one-off events.

The widening of banks' lending margins, which started in the second half of 2008, has moderated since summer. The margin on new household credit has narrowed for three consecutive months. In October, the margin was 1.06%, ie same as in April. The margin on corporate credit increased in October by 16 basis points; far-reaching conclusions should however not be drawn based on this, as the margin on corporate credit typically fluctuates more widely than that on household credit. The average lending rate has decreased faster than the average deposit rate, so that banks' overall margin has continued to shrink (Chart 7).

Growth in the volume of banking operations has slowed. The annual rate of growth in loans and deposits was in October only ca 2%. Developments in both volumes and margins are thus weighing on net interest income.

Chart 7. Finnish MFIs interest rates and 3-month Euribor



* Average interest rate on the lending stock minus average interest rate on the stock of deposits.
Source: Bank of Finland.

Banks' profitability in the coming years depends largely on macroeconomic developments and movements in market interest rates. A protracted recession would be reflected in higher loan losses, due to the growing number of bankruptcies and higher employment. On the other hand, an increase in market rates from the current extremely low levels would improve the banking sector's net interest income.

The banking sector's capital adequacy has improved despite the weak economic performance, as banks continue to post a profit, and some banks have acquired new capital via share issues. Moreover, the capital requirements for credit and market risk have been reduced. In September 2009, the banking sector's capital adequacy ratio was 14.4% (13.7% at end-2008). The banking sector's regulatory capital was in September ca EUR 9 billion larger than the minimum capital requirement. Another positive sign is that Finnish banks' capital consists mainly of Tier 1 capital.

Table 1. Key items from income statements of banks operating in Finland, January–September 2009, and changes on the year-earlier period.

	Net interest income		Other income, net		Total expenses		Loan losses, net		Profit before tax	
	EUR m	Change	EUR m	Change	EUR m	Change	EUR m	Change	EUR m	Change
Nordea Group	3 982	7 %	2 933	31 %	3 293	3 %	1 139	..	2 483	-5 %
Nordic banking	2 964	-6 %	1 544	-7 %	2 286	-2 %	884	..	1 338	-44 %
Banking in Finland	602	-30 %	451	2 %	590	2 %	144	..	319	-55 %
Danske Bank Group	2 787	6 %	3 374	121 %	2 917	16 %	2 779	..	466	-63 %
Banking	2 750	5 %	1 037	-5 %	2 455	15 %	2 457	..	-1 125	..
Banking in Finland	321	-1 %	155	20 %	336	-17 %	246	..	-106	..
OP-Pohjola Group	825	-5 %	737	39 %	1 040	2 %	127	..	393	10 %
Banking and investment services	762	-9 %	526	34 %	792	6 %	116	..	379	-17 %
*Pohjola Bank	177	48 %	494	46 %	366	9 %	95	..	211	85 %
Savings banks	114.2	-6 %	44.1	60 %	99.9	5 %	3.3	..	55.1	0 %
Aktia Group	112.4	51 %	70.0	34 %	111.7	26 %	26.3	..	44.4	19 %
Banking	108.1	55 %	38.9	44 %	77.6	9 %	25.9	..	43.6	73 %
Local cooperative banks	67.7	-18 %	23.2	45 %	57.8	6 %	1.0	..	32.2	-27 %
Bank of Åland Group	29.4	-6 %	58.0	191 %	54.2	45 %	2.4	..	30.9	90 %
Evli Bank Group	2.8	.	37.1	-15 %	34.7	-19 %	0.0	..	5.1	920 %
eQ Group	2.6	-42 %	19.3	9 %	35.6	49 %	0.5	..	-14.2	..
1. Finnish banking	2 009	-14 %	1 353	21 %	2 077	1 %	539	..	744	-44 %
2. Financial groups operating in Finland	7 923	5 %	7 295	63 %	7 644	8 %	4 078	..	3 495	-20 %

Other income includes eg net fee income, capital gains/losses from sales of tangible and intangible assets, capital gains from sales of wound-up operations, and shares in profit/losses of associated companies. Expenses include depreciations and write-downs on tangible and intangible assets, refunds to shareholders and profit distributions to staff.

.. = change not meaningful.

1. Savings banks, Aktia Group's banking, local cooperative banks, Bank of Åland Group, Evli Bank Group, eQ Group, OP-Pohjola Group's banking and investment services, Nordea Group's banking operations in Finland, and Danske Bank Group's banking operations in Finland.
2. Nordea Group, Danske Bank Group and the Finnish banking groups listed in this table.

Sources: Banks' interim reports and Bank of Finland.

3 Infrastructure

3.1 Spring sees the arrival of new central counterparties

Marko Myller and Pertti Pylkkönen

The interoperating links between central counterparties (CCP) are only taking their first steps in Europe. In spring, many actors will launch CCP services for the Helsinki Exchange. The transfer of OTC derivatives to CCP clearing took all of 2009.

CCP clearing was launched at the Helsinki Exchange on 16 November 2009. The services will be provided by the Dutch company European Multilateral Clearing Facility N.V (EMCF). Two other service providers, the Swiss company SIX X-clear and EuroCCP, a UK-incorporated clearing house, will launch operations in the spring, subject to approval by the authorities. It is still too early to assess the impact of CCP clearing on the Helsinki Exchange, but the aim is to increase the liquidity of the market. The launch of CCP clearing should help the Helsinki Exchange in its competition for market shares.

The interoperability of several CCPs as equal players is challenging, due to the problem of mutual risk management. Nearly all the models launched thus far are based on subordination, ie one CCP is a member of the other. When CCPs operate on an equal basis they have to be able to jointly manage the risks, to prevent the creation of uncontrolled risks. LCH.Clearnet, which clears trades at the London Stock Exchange, was planning to cooperate with eg EMCF from the beginning of November on clearing trades at multilateral trading facilities. Authorities supervising the operations of the CCPs in both the countries however have postponed the initiative until their concerns about risk management are resolved[6]. Finding a solution will pave the way for other European CCP initiatives on increasing interoperability.

Tighter regulation of OTC derivatives

OTC derivatives have been used as a scapegoat in the financial crisis that shook the world. As a result of the crisis, the EU has taken measures to tighten the regulation of derivatives markets. The EU Commission will issue new legislation in 2010, with the aim of reducing the risks derivatives bring to the financial markets. The new regulations are part of measures aimed at strengthening financial supervision in the EU. Standardised OTC derivatives should be traded on exchanges or electronic trading venues. These derivatives trades should be cleared by CCPs by the end of 2010. The use of tailored OTC derivatives is still possible, but these derivatives contracts would involve eg higher capital requirements for banks than do standardised OTC derivatives trades. The aim is also to increase the transparency of OTC derivatives and their use[7].

[6] Financial Times, 29 October 2009.

[7] ECOFIN press release, 2 December 2009.

3.2 Finnish companies trust credit transfers

Charlotta Grönqvist and Maija Salmela

The majority of companies' payments were executed in 2008 as credit transfers, based on the conventional paper invoice. These credit transfers however accounted for only a small portion of total payments in Finland.

The business financing survey 2009[8] focused on companies' payment habits. The aim was to examine how often companies used cash, payment cards, credit transfers and direct debits for purchasing raw materials, services and labour (payment of wages) in 2008.

The use of cash is minor – the majority of companies used less than EUR 1,000 in cash in 2008. On average, companies used ca EUR 1,300 in cash, which is less than 0.1% of cash usage at country level. There are hardly any company-specific or geographical differences in the use of cash. But cash usage differs between sectors. In the accommodation and catering services and other civic and personal service sectors, companies use more cash for paying invoices than do companies on average.

Card payments are more frequent than cash payments. Companies' card payments for goods and services total EUR 41,000 per year on average – less than 1% of total card payments in Finland.

Card payment differs from cash payment in that the number of card payments increases with the size of the company. Results of the survey show that a surprisingly large proportion of micro and small companies did not make any card payments in 2008. For micro and small companies that make card payments, bank and debit cards are used more frequently, whereas for medium-sized and large companies, credit and charge cards are used more frequently.

Card payments also differ geographically. In East Finland and Lapland, card payments were in 2008 less frequent on average than in other parts of the country. As with cash payments, card payments also differ between sectors. Card payments are most frequent in transportation, storage and communications companies, and in wholesale and retail companies.

As with card payments, the number of invoices paid increases with the size of the company. Of the respondents in micro companies, nearly 80% pay less than a thousand invoices per year. The majority of small and medium-sized companies pay 1,000–10,000 invoices per year. Of large companies, as many as 80% paid over 10,000 invoices.

The majority of invoices paid by companies are purchase invoices. In 2008, most of these invoices were paid by credit transfer. Companies' credit transfers nevertheless accounted for only 5–10% of all the credit transfers executed in Finland in 2008.

Credit transfers based on e-invoices currently account for only a minor share of total credit transfers, ie companies continued to prefer paying conventional paper invoices. Large companies paid

[8] Bank of Finland, Confederation of Finnish Industries EK and the Ministry of Employment and the Economy conduct a joint annual survey on business financing (http://www.suomenpankki.fi/fi/julkaisut/selvitykset_ja_raportit/rahoituskyselyt/index.htm, in Finnish only). 959 non-financial corporations, employing ca 460,000 staff, participated in the 16th survey conducted in autumn 2009.

a bigger portion of credit transfers based on e-invoices than smaller companies[9].

Only a few companies accept payment of invoices by direct debit. The majority of companies that responded to the survey pay less than 10% of their purchase invoices by direct debit. The average number of direct debits per company is ca 500, ie direct debits from companies account for only ca 3–5% of all the direct debits in Finland in 2008.

[9] For more information on the e-invoice, see section 4.3.

Table 2. Cash payments, card payments, credit transfers and direct debits by companies in 2008

	Average use per company	***Payments in Finland, total***	***Of which payments by companies****
Amount of cash	*ca EUR 1,300*	*ca EUR 20,000 mill.*	*under 0.1%*
Number of card payments	*ca 690*	*760 mill.*	*under 1%*
Number of credit transfers	*ca 7,860*	*699 mill.**	*~5–10%*
Number of direct debits	*ca 510*	*82 mill.*	*~3–5%*

* Credit transfers to a bank.

** Share of companies' payments in total payments in Finland, per payment method.

Sources: Statistics Finland, Federation of Finnish Financial Services, and Business financing survey.

3.3 Electronic invoice a step closer to breakthrough – Government leads the way

Kirsi Ripatti

As of 1 January 2010, government agencies will no longer accept paper invoices. The introduction of the e-invoice will bring considerable savings – in both euro and environmental terms.

The State Treasury has informed its invoicers (over 16,000) that as of 1 January 2010, invoices to government agencies and institutions must be sent as e-invoices. Of the 2.7 million invoices received yearly by government, ca 60% are still in paper form. Because conventional invoices are processed manually, the cost of processing an e-invoice is estimated at just one-third of that for a paper invoice. Introduction of the e-invoice will generate EUR 1 million of savings for the government.

Electronic invoicing is also less costly and more efficient for the invoicer. The government sector justifies its decision also on environmental grounds. The environmental load of a paper invoice is up to 20 times bigger than that of an e-invoice.

The public sector can, by setting an example, lead the way in the widespread introduction of electronic invoicing. All the prerequisites for an electronic invoicing breakthrough are now in place. Technology is no longer an obstacle to the widespread introduction of electronic invoicing. The standardisation of invoices and practices and procedures however need to be improved. What is now required is the will on all sides to actually send and receive invoices electronically. In the EU, the issue has been promoted in eg the Expert Group on European Electronic Invoicing, which published its final report in November[10].

Electronic invoicing improves efficiency. Even small changes can allow participants to gain some benefits. The final outcome will be that electronic invoicing will facilitate a higher standard of service at a lower cost.[11]

[10] Expert Group on European Electronic Invoicing, EEI. (http://ec.europa.eu/internal_market/consultations/docs/2009/e-invoicing/report_en.pdf).

[11] For more information, see Bank of Finland Bulletin (2/2008) Electronic invoicing means more efficient and greener payments (http://www.bof.fi/en/julkaisut/bulletin/index.htm?year=2008), Finnish Information Society Development Centre (http://www.tieke.fi).

4 Key regulatory and supervisory initiatives

4.1 Financial crisis forces major reform of accounting regulations

Jukka Vauhkonen

Regulations on the recognition of impairments are being thoroughly revamped. The reform will enhance the transparency of financial statement information and reduce the procyclicality of banks' reported results.

Regulatory shortcomings contributed to the onset and intensification of the recent financial crisis. It is evident that current accounting regulations and their implementation produced an overly positive picture of the banks' situation and risks before and during the financial crisis.[12] The problems concern, for example, the current regulations on recognition of the impairment of banks' financial assets.

Currently, banks' loans are generally reported at amortised cost in the financial statements. The value of loans can be reduced only if there is *objective* evidence of impairment. Debtor bankruptcy, other significant financial difficulty and default or delinquency in interest or principal payment are examples of such observable evidence.[13]

As a result of current regulations, impairments of loans can cause unexpected and major fluctuations in banks' results. Initial recognition of loans is based on the assumption that the borrower is able to repay the loan with interest at the agreed timetable. Subsequent impairments may suddenly reduce a bank's reported results. Even if the lender estimated – eg based on previous experience – that credit it has granted will lead to a certain amount of loan losses in the years ahead, current regulations do not allow the recognition of loan losses in advance.

Current regulations are problematic from the macroeconomic perspective, as impairment losses recorded on loans are typically small compared to realistically expected future loan losses. In an upswing, a small amount of impairments improves banks' profits, capital, lending capacity and possibilities of bolstering its balance sheet. Large reported profits may also boost a bank's share prices and the performance-related bonuses of its personnel and thus further encourage banks to increase lending. Correspondingly, the loans provided in an upturn may generate sudden and large loan losses in a downturn,

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[12] See eg. Huizinga and Laeven (2009) Accounting discretion of banks during a financial crisis. CEPR Discussion Paper No. 7381.

[13] Impairments can be allocated also to a specific group of financial assets (eg mortgages) although the impairment cannot yet be identified with the individual loan. This requires evidence of such changes in economic conditions (eg an increase in the unemployment rate in the geographical area of the borrowers) that point to increasing repayment difficulties for debtors in the group.

which weakens banks´ profitability, capital adequacy and lending capacity.

To amend the shortcoming in accounting regulations, the leaders of the G20, in their statement in London in April 2009, called on accounting standard bodies to make several improvements in standards by the end of 2009. The International Accounting Standards Board (IASB) has been preparing a total reform of the standard on financial instruments (IAS 39) in which the old standard will be replaced by a new standard IFRS 9.[14]

The IASB's project to replace IAS 39 consists of three phases. In the first phase, finalised in November 2009, the IASB simplified the rather complex principles for measuring financial instruments. Adoption of the change has however met resistance in the EU, as it is suspected that the reform would eg increase the fair value measurement of financial instruments, contrary to the expectations of several parties. The second phase involves regulations on the impairment of financial assets (which are examined in this article). The IASB published its proposals for public comments on 5 November. Proposals on the third phase (hedge accounting) are expected to be published in the first quarter of 2010.

The IASB proposes a reform of impairment regulations which is significant in principle and practice. The current method, based on objective evidence (incurred loss impairment method), would be replaced by a method based on expected credit losses (expected loss impairment method).

Under the IASB proposal, expected credit losses on financial assets measured at amortised cost, such as ordinary bank loans, would be estimated already when the lending decision is made. Entities would build up a provision against these expected credit losses over the life of the financial asset, so that interest revenue (based on the real lending rate) on the credit would not be recognised in full in the bank's income statements. The higher the expected credit losses on a specific credit (or credit portfolio), the wider the difference between the effective interest rate used in the calculation of interest revenue and the contractual interest rate. Expected credit losses on loans would be reassessed each accounting period and adjustments are recognised in profit or loss.

As a result of the reform, credit losses would be recognised in a bank's income statement and balance sheet at an earlier stage and would reduce the current procyclicality of the recognition of impairments. The reform would also better reflect the actual pricing of loans. Expected credit losses are also currently priced in interest rates on loans: interest rates on high-risk loans are higher than those on low-risk loans. With the reform, the disclosure of banks' results would better reflect the quality of banks' loan portfolios as reported interest revenue would be based on effective interest rates that take into account credit risk, instead of on contractual interest rates.

The proposal is open for comment until June 2010, and the new regulations are expected to become mandatory at the beginning of 2013.

[14] The Financial Accounting Standards Board (FASB) is responsible for preparing US accounting standards.

4.2 Public bank support in Finland in 2009

Jarmo Pesola

As a result of the global financial crisis, the Finnish government took measures in 2009 to support banks, if necessary. The measures include capital investments in deposit banks, extending the authorisations of the Government Guarantee Fund, and government guarantees for banks' refinancing. Finnish banks have so far not resorted to such support.

Of the government support measures, capital investments are available only to fundamentally sound and solvent banks, to strengthen their capital adequacy. The support of a bank in a crisis is based on the act on the Government Guarantee Fund. Government guarantees are aimed at improving banks' possibilities of acquiring refinancing from the market – the crisis has particularly hampered the acquisition of long-term funding. The contingency measures are in line with the measures applied in the EU in general, which are approved by the EU Commission and accord with ECB recommendations. Finnish banks have not utilised the support measures available.

Government capital investments

In December, Parliament adopted an act on Government capital investments in deposit banks, which is based on a Government proposal submitted to Parliament in February 2009. The act, which took effect at the beginning of 2010, allows the subscription of capital loans only up to 30 April 2010.

The act adopted by Parliament allows the government to subscribe a capital loan issued by a fundamentally sound and solvent Finnish deposit bank. A capital investment can also be made in a Finnish holding company of a Finnish deposit bank or in a central body of an amalgamation of cooperative banks. Government can subscribe capital loans for a maximum amount of EUR 4 billion or within the level of appropriations or authorisations granted in the Government budget.

A capital loan can be considered part of a bank's Tier 1 capital. A capital loan subscribed by government may amount to a maximum of 25% of a bank's regulatory capital or consolidated own funds. The annual interest rate on the loan is a reference rate based on the interest rate on government bonds with 5-year maturity plus a premium of six percentage points. More specific provisions on the reference rate are set out in a Government decree.

The issuer of a capital loan may call the loan capital back after a period of three years, at the earliest. Even after redemption of the loan the bank must fulfil the requirements on the minimum amount of own funds laid down in the Credit Institutions Act. The capital loan agreement will include a provision restricting profit distribution as well as a provision restricting the acquisition of own shares or savings banks' basic fund shares. The refunding of cooperative banks' supplementary share capital or investment share capital will also be restricted.

A bank taking a capital loan must commit eg to paying the interest on the loan before distribution of dividends and to execute major business restructuring only with government approval. Banks also must commit to maintaining lending to households and small and medium-sized companies.

A capital loan will include restrictions on the remuneration schemes of banks' senior management. Banks must adhere to the general principles on remuneration in state-owned companies adopted by the Cabinet Committee on Economic Policy.

Act on Government Guarantee Fund revised

The revised act on the Government Guarantee Fund took effect in August 2009. Under the new act, a deposit bank that has solvency problems may be required to apply for support from the Government Guarantee Fund. The Council of State can order a bank to submit a support application when the requirements on support are fulfilled. Prior to its decision, the Council of State must request opinions on the matter from the Bank of Finland and the Financial Supervisory Authority.

The precondition for such a decision by the Council of State is that the bank's capital adequacy has weakened to the extent that the bank is unable to continue operating without financial support and that the bank's liquidation or bankruptcy could lead to severe disruption of the financial markets. If the bank does not submit a support application by the date set by the Council of State, its shares and capital loans could, by Council of State decision, be transferred for full compensation to the Government Guarantee Fund, which would amount to government takeover of the bank. In respect of cooperative banks and savings banks, the business operations would be transferred, not their shares.

The new act on Government Guarantee Fund allows the Council of State to restrict, for up to six months, the operations of credit institutions or other companies operating in the financial markets or take decisions on restrictions and prohibitions regarding securities trading. A restriction may be imposed only if it is necessary in order to ensure the smooth and sound operation of the Finnish financial markets or entities in the markets in the event of serious global disruptions in financial markets or actions by authorities of another country.

Government guarantee on banks' refinancing

Parliament consented in December 2008 to the granting of temporary government guarantees to Finnish deposit banks and mortgage institutions. In accordance with the decision by Parliament, the Government may grant guarantees worth a maximum of EUR 50 billion up to the end of 2009. Parliament had initially granted the Government authorisation to guarantee banks' financing that becomes due before 30 April 2009. But at the end of April, Parliament decided to extend the period for granting government guarantees to the end of 2009. At the same time, the guarantees were extended to cover debt instruments with maturities of up to five years (previously debt instruments with maturities of up to three years). The maximum maturity of 5 years already applied to mortgage-backed debt securities.

In February 2009, the European Commission approved the terms and conditions of government guarantees, required by EU rules on government support. The State Treasury will grant the guarantees upon the banks' applications.

In February 2009, the Council of State issued a decree on fees to be levied on government guarantees. The annual fee on a guarantee of a 12-month credit is 0.50% of the guarantee. The annual fee on a bond with a maturity 1 to 5 years is the reference price used in the market plus a premium of 0.5 percentage points; the premium on mortgage-back debt securities would be 0.25%. The reference price used in the market is 0.375% of the guarantee, if the bank receiving the guarantee has the second highest credit rating of an international credit rating agency, and otherwise 0.43% of the guarantee.

In December 2009, Parliament decided to extend the authorisation to grant state guarantees to the end of 2010, provided the Council of State assess by 30 June 2010 the need to grant new guarantees. Under the decision by Parliament, the guarantees may cover euro-denominated debts with a total maximum nominal value of EUR 17 billion.

5 Key corporate arrangements and events in the financial sector

Date	*Event and description*
April 2009	*Moody's confirms Nokia's ratings P-1 and A1, changes the rating outlook on long-term senior debt from stable to negative.*
	Moody's confirms Metso Corporation's ratings A-3 and BBB, outlook negative.
	Moody's confirms Aktia Bank plc's ratings P-1, A1 and C, outlook stable.
	Moody's confirms Aktia Bank plc's ratings P-1, A1 and C, outlook stable.
	S&P lowers UPM Kymmene's ratings: short-term from A-3 to B and long-term from BBB- to BB+.
	Moody's confirms Stora Enso's long-term rating Ba2, outlook negative.
	S&P confirms Stora Enso's ratings B and BB+, outlook negative.
	Fitch confirms Fingrid Oyj's ratings F1+ and AA-, changes outlook from stable to negative. Fingrid's long-term senior unsecured debt rating is AA.
	Moody's changes the outlook on Pohjola Bank's long-term rating (Aa1) from stable to negative. The outlook on short-term rating (P-1) remains stable.
	Aktia Bank announces it will sell Aktia Life Insurance Ltd to Aktia plc.
	Cooperative banks Lieksan Osuuspankki, Nurmeksen Osuuspankki and Valtimon Osuuspankki merge via combination merger. The name of the new bank is Pielisen Osuuspankki.
	Cooperative banks Kiikalan Rekijoen Osuuspankki, Kiskon Osuuspankki, Kuusjoen Osuuspankki, Perniön Osuuspankki and Salon Seudun Osuuspankki merge. The name of the new bank is Salon Osuuspankki.

Date	***Event and description***
May 2009	*Talvivaara Mining Company Plc's shares listed on the Helsinki Stock Exchange.*
	Dresdner Bank is merged into Commerzbank.
	Nordnet Bank AB announces it will purchase eQ Bank from Straumur Burdaras Investment Bank for ca EUR 37 million. The deal was completed on 1 July 2009.
	Moody's downgrades Aktia Real Estate Mortgage Bank plc's long-term covered bonds from Aaa to Aa1.
	S&P lowers Stora Enso's long-term rating from BB+ to BB-. Short-term rating (B) remains unchanged.
	Trading in shares of six Finnish companies commences at the Swedish multilateral trading facility Burgundy, launched in April.
	The Japan Securities Clearing Corporation plans to establish a clearing house for interest rate swaps and credit default swaps.
June 2009	*Department of Finance of the Irish government announces reform of the institutional structures for regulation of financial services in Ireland.*
	Savings banks Hauhon Säästöpankki and Rengon Säästöpankki merge to form Kantasäästöpankki Oy.
July 2009	*eQ Bank, a subsidiary of Nordnet Bank, sells the Advium corporate finance operations to its senior management.*
August 2009	*Fitch lowers UPM Kymmene's long-term rating from BB+ to BB-. Rating outlook negative.*
	Fitch changes the outlook on Pohjola Bank's rating from stable to negative. The ratings are short-term: F1+ and long-term AA-.
	Moody's confirms Stora Enso's long-term rating (Ba2), following restructuring announcement.
	Moody's places Metso's long-term rating (Baa2) on watch for possible downgrading.
	Sampo plc announces it will submit an application to the Swedish Financial Supervisory Authority for a license to increase the holding in Nordea Bank AB above 20%.
	Nordea announces it will acquire the Danish bank Fionia Bank.

Date	***Event and description***
September 2009	*Moody's downgrades Pohjola Bank's long-term rating from Aa1 to Aa2. Nordea's long-term rating was downgraded from Aa1 to Aa2.* *S&P upgrades Fortum's long-term rating from A- to A. Rating outlook stable.* *The Finnish Association of Mutual Funds was merged with the Federation of Finnish Financial Services.* *Savings banks Kuortaneen Säästöpankki and Töysän Säästöpankki merge to form Oma Säästöpankki Oy.* *Remote broker Van Der Moolen Effecten B.V's operations at the Helsinki stock exchange cease as its parent company in the Netherlands is declared bankrupt.* *Aktia's shares listed on the Helsinki Stock Exchange.*
October 2009	*Evli Bank Plc acquires Carnegie's asset management operations in Finland and Erik Penser Fonder AB in Sweden.* *Moody's lowers Fingrid Oyj's long-term rating from Aa3* to *A1. Rating outlook negative.* *Moody's lowers Nokia Plc's long-term rating from A1* to *A2. Rating outlook stable.* *Dutch bank DSB Bank NV is declared bankrupt.* *Government of Iceland reaches agreement with the U.K. and the Netherlands on repaying depositors at Icesave. The agreement was also approved by the Parliament of Iceland.* *Swedish Financial Supervisory Authority grants Sampo plc a license to increase its holding in Nordea Bank AB beyond 20%. Sampo plc's ownership of shares in Nordea exceeded 20% in December.*
November 2009	*Ministry of Justice working group proposes reform of regulations on the provision of consumer credit. The objective is to transpose the new EU directive on consumer credit and to amend national legislation in line with the development of markets.* *Standard & Poor's affirms the sovereign credit ratings for the Republic of Finland. Short-term A-1+ and long-term AAA. Rating outlook remains stable.* *Moody's confirms Metso Corporation's long-term rating Ba1. Rating outlook remains negative.*

Date	*Event and description*
November 2009	*Metso Corporation and Tamfelt Corporation sign a combination agreement.* *Moody's lowers Iceland's foreign and local currency bond ratings from Baa1* to *Baa3. Rating outlook stable.* *Estonian bank BIGBANK opens a branch in Helsinki.* *Finnish State Treasury accepts Eurex Bonds as trading platform for Finnish government bonds.*
December 2009	*EU finance ministers reach an agreement at the Ecofin Council meeting to create new financial supervisory authorities (for securities markets, banking and insurance) by the end of 2010. The three authorities will cooperate with the European Systemic Risk Board to be established under the auspices of the European Central Bank.* *Société Générale takes full control of Credit Du Nord by paying EUR 676 million for Dexia's 20% stake in Credit Du Nord.* *Austrian government nationalises Hypo Group Alpe Adria.* *eQ Bank, a subsidiary of Nordnet Bank, announces it will sell its asset and fund management business to the current managers of the business and Fennogens Investments S.A.* *Fitch downgrades Greece's short-term foreign currency and local currency Issuer Default Ratings (IDR) from F1 to F2 and the long-term rating from A- to 'BBB+. Rating outlooks negative.* *Standard & Poor's downgrades Greece's long-term credit rating from A- to BBB+. Rating outlooks negative. Short-term credit rating is A-3, rating outlook negative.* *Moody's downgrades Greece's government bond ratings from A1 to A2. Rating outlook remains negative.* *Standard & Poor's revises the outlook for the Kingdom of Spain from stable to negative, and affirms Spain's sovereign credit rating: short-term A1+ and long-term AA+.* *Standard & Poor's downgrades Danske Bank's long-term rating from A+* to *A. Sampo Bank's long-term rating was also lowered. Rating outlooks negative.* *Fitch lowers Nokia's credit rating: short-term from F1 to F2 and long-term from A* to *A-. Rating outlooks stable.* *Citibank sells its consumer credit business in Finland to S-Bank. The ca EUR 200 million lending stock will be transferred to S-Bank in February.*

Date	*Event and description*
December 2009	*Finnish Parliament adopts act on long-term saving.*
	Finnish Parliament adopts act on government capital investments in deposit banks. Capital loans may be subscribed until 30 April 2010. Parliament also decides to extend the temporary guarantee for deposit banks and mortgage banks in December 2009 to the end of 2010, provided the Council of State, by30 June 2010, establishes a need to grant new guarantees.