

Suomen Pankin kirjasto



0000091043

IVA5a

Kirjasto: alaholvi

SUOMEN PANKKI D

The index clause system in the Finnish money and capital markets
Suomen pankin taloustieteellisen tutkimuslaitoksen julkaisu
2 1969

THE INDEX CLAUSE SYSTEM IN THE
FINNISH MONEY AND CAPITAL MARKETS

(A REVISION)

Institute for Economic Research
Bank of Finland
Series D:2 Mimeographed studies
January 1969

Bank of Finland Institute for Economic Research Publications

Series: D Mimeographed Studies

1. PERTTI KUKKONEN On the Measurement of Seasonal Variations. 1963. 11 p.
2. The Index Clause System in the Finnish Money and Capital Markets. 1964. Revision in January 1969. 18 p.
3. J.J. PAUNIO Adjustment of Prices to Wages. 1964. 15 p.
4. HEIKKI VALVANNE and JAAKKO LASSILA The Taxation of Business Enterprises and the Development of Financial Markets in Finland. 1965. 26 p.
5. MARKKU PUNTILA Likvidien varojen kysyntä ja yleisön likviditeetin kehitys Suomessa vuosina 1948 - 1962. 1965. 110 p.
6. J.J. PAUNIO Taloudellinen kasvu ja suhdannevaihtelut dynaamisen makrotarkastelun valossa. 1965. 117 p.
7. AHTI MOLANDER Kokonaistaloudelliseen hinta- ja palkkatasoon vaikuttavat tekijät Suomessa vuosina 1949 - 1962. 1965. 159 p.
8. ERKKI PIHKALA Keskinäisen taloudellisen avun neuvoston pysyvät komissiot työnjaon toteuttajina. 1965. 35 p.
9. KARI NARS Statens prispolitiska parametrar. 1965. 118 p.
10. HEIKKI VALVANNE The Framework of the Bank of Finland's Monetary Policy. 1965. 34 p.
11. JOUKO SIVANDER Ulkomaankaupan substituutiojoustojen teoriasta ja mittaamisesta. 1965. 91 p.
12. TIMO HELELÄ - PAAVO GRÖNLUND - AHTI MOLANDER Muistio palkanvauotteluja varten. 1965. 56 p.
13. ERKKI LAATTO Suomen ulkomaisen tavarakaupan volyyymi-indeksit neljännesvuosittain vuosina 1949 - 1964 eräistä lyhytaikaisista vaihteluista puhdistettuna. (English Summary). 1965. 24 p.
14. DOLAT PATEL The Share of the Developing Countries in Finnish Foreign Trade. 1966. 31 p.
15. PEKKA LAHIKAINEN Tuotoksen ja työpanoksen välisen suhteen vaihteluista. 1966. 25 p.
16. HEIKKI U. ELONEN Yrityksen rahoituspääomien kysynnästä ja tarjonnasta. 1966. 88 p.

I	THE BACKGROUND	1
II	MEASURES OUTSIDE THE MONEY AND CAPITAL MARKETS	2
a)	Indemnity operations	2
b)	National pensions	4
c)	Compulsory employment pensions.....	4
III	THE INDEX CLAUSE ON THE DOMESTIC BOND MARKET	4
a)	Government Securities	4
b)	Issues made by financial institutions	5
c)	Local authority issues	6
d)	Bonds issued by non-financial companies	7
e)	General terms of the bond issues	8
IV	THE INDEX CLAUSE IN PRIVATE INSURANCE	9
V	PUBLIC'S DEPOSITS IN BANKING INSTITUTIONS	10
VI	INDEX-TIED LENDING	12
a)	Financial institutions	12
1.	Insurance companies	12
2.	National Pensions Institution	12
3.	Mortgage institutions	13
4.	Banking institutions	13
-	Post Office Savings Bank	13
-	Commercial banks	13
-	Central Bank of the Co-operative Credit Societies	13
-	Co-operative Credit Societies	13
-	Savings banks	14
b)	Government	16
c)	Other lenders	16
VII	THE ABOLITION OF INDEX LINKAGES IN 1968	17

THE INDEX CLAUSE SYSTEM IN THE FINNISH
MONEY AND CAPITAL MARKETS^x

I. The background

Since the second world war, Finland has passed through periods of considerable inflation. Nevertheless, the propensity to save has remained fairly high when compared with those of other countries. This has been mainly due to large public saving in the form of real investment and lending, and to the fact that numerous households have been able to save for acquiring capital goods. Their investments in real capital have been comparatively little affected by inflation, but inflation may well have caused them to reduce their saving in the form of bank deposits and insurance. Undoubtedly, inflation has also retarded the development of the bond market.

The use of the index clause was initially occasioned by the Government's desire to observe social justice in certain transactions. Thus it was applied to the promissory notes and bonds which were given as partial compensation for the losses of property sustained by private persons during the war. National pensions and wages were tied to an index for the same reason. The index clause also came into use when various financial institutions, borrowers, and the Government, competing for the public's monetary savings, began to attach index clauses to deposits, life assurance policies and bonds.

Figures showing the increase of the price level are given in Table 1.

x

This article describes the index mechanisms applied in the Finnish money and capital markets from 1945 to 1968. It was originally based on an unpublished paper written by JUSSI LINNAMO in 1960. The original paper was revised and brought up-to-date by SIRKKA HÄMÄLÄINEN in 1964, and it appeared as Number 2 in Series D of the Institute for Economic Research, Mimeographed studies, October 1964; in November 1965 it was revised again. A new revision was undertaken in December 1968 by SEPPO KOSTIAINEN.

In 1968 certain stabilization and incomes policy measures were taken, which involved the abolition of the greater part of the existing index linkages. Chapters I-VI have not been re-edited to take account of these subsequent developments, but Chapter VII is added to summarize the relevant points and a timetable of these measures.

Table 1. The development of prices in Finland

	Wholesale price index		Cost of living index	
	1945=100	change %	1945=100	change %
1945	100		100	
1946	156	56.0	160	60.0
1947	188	20.5	207	29.4
1948	249	32.4	279	34.8
1949	251	0.8	284	1.8
1950	289	15.1	323	13.7
1951	413	42.9	377	16.7
1952	409	-1.0	392	4.0
1953	394	-3.7	399	1.8
1954	394	0.0	397	-0.5
1955	390	-1.0	385	-3.0
1956	408	4.6	429	11.4
1957	446	9.3	478	11.4
1958	482	8.1	509	6.5
1959	479	-0.6	517	1.6
1960	497	3.8	534	3.3
1961	501	0.8	544	1.9
1962	509	1.6	568	4.4
1963	527	3.5	595	4.8
1964	567	7.6	657	10.4
1965	592	4.4	689	4.9
1966	604	2.0	716	3.9
1967	622	3.0	754	5.3

II. Measures outside the money and capital markets

a. Indemnity operations. After the war, Finland ceded certain territories to the USSR. Those private persons and firms that had been domiciled on the ceded areas received compensation for their property losses on a degressive scale. A small proportion of the compensation was paid in cash, the greater part being given in the form of share certificates in the Holding Company¹ or index-tied indemnity bonds.

The holders of Holding Company share certificates obtained redemption and interest, the rise in the value of shares acting

1. A Capital Levy was made after the war to provide funds for the indemnity due, and joint stock companies were allowed to pay it by handing over shares of their own to the Holding Company founded for that purpose.

as a kind of index compensation.

The first issue of index-tied indemnity bonds, the Indemnity Loan 1945, was not a capital market transaction. Bonds equivalent to the estimated value of the property ceded were given to those entitled to indemnity. They represented promises to pay indemnity to displaced persons over a period of ten years. The index clause attached to them provided for a 100 per cent compensation for rises in the wholesale price index. The indemnity was given in marketable bonds in order to enable the receivers to dispose of their property freely at once. The bonds were sold, for instance, on the Helsinki Stock Exchange, where at times they formed the bulk of the turnover. (In addition, non-index-tied indemnity bonds and additional-indemnity bonds had been given to cover the losses incurred during the war of 1939/40.)

Table 2. Government Indemnity bonds

	Outstanding at end of year			Sold during year		
	Total	Index-tied		Total	Index-tied	
	Mill.mk	Mill.mk	%	Mill.mk	Mill.mk	%
1945	49.93	0.78	1.6	3.62	0.78	21.5
1946	119.84	81.83	68.3	91.25	90.88	99.6
1947	145.33	115.74	79.6	57.41	54.51	94.9
1948	130.00	109.30	84.1	12.65	12.11	95.7
1949	113.66	93.97	82.7	7.83	7.75	99.0
1950	98.50	79.77	81.0	5.69	5.66	99.5
1951	81.75	64.00	78.3	3.15	3.15	100.0
1952	65.34	48.56	74.3	3.46	3.46	100.0
1953	48.54	32.73	67.4	0.53	0.53	100.0
1954	30.77	16.54	53.8	0.78	0.78	100.0
1955	14.23	0.21	1.5	1.33	0.56	42.1
1956	22.68	0.11	0.5	9.53	-	-
1957	29.47	0.06	0.2	12.18	-	-
1958	30.09	0.02	0.1	10.14	-	-
1959	23.23	-	-	1.49	-	-
1960	15.53	-	-	0.22	-	-
1961	7.70	-	-	0.03	-	-
1962	6.52	-	-	-	-	-
1963	4.53	-	-	-	-	-
1964	2.54	-	-	-	-	-
1965	0.57	-	-	-	-	-
1966	0.56	-	-	-	-	-
1967	0.56	-	-	-	-	-

b. National pensions. Since the beginning of 1957, national pensions - both the basic pensions and the additional assistance pensions - have been tied to the cost of living index to the extent of 100 per cent.

c. Compulsory employment pensions. The employment pensions insurance system, which took effect on July 1, 1962, is operated through private insurance companies, pension foundations and pension funds. All employment pensions are linked to the general wage level, and the Ministry for Social Affairs specifies for each year the value of the wage index on the basis of which pensions are to be recomputed.

III. The index clause on the domestic bond market

a. Government securities. The first index-tied bond issue intended for the capital market was made in 1953 for the conversion of the Indemnity Loan 1945, and was offered exclusively to holders of such bonds. This issue was also tied to the wholesale price index to the extent of 100 per cent. In 1953-1955, the majority of Government bond issues had either a 50 per cent or a 100 per cent index clause tying the capital, and very often also the interest, to the wholesale price index or the cost of living index. Since 1956 only the 50 per cent clause has been applied. Government securities held by private persons have been tax-exempt with the exception of some index-tied issues, i.a. in 1961 and 1962. Most of the 1967 issues are liable to taxation for a half of the yield and capital.

Table 3. Domestic Government bonds denominated in Finnish marks excluding indemnity bonds

	Outstanding at end of year			Sold during year		
	Total Mill.mk	Index-tied Mill.mk	%	Total Mill.mk	Index-tied Mill.mk	%
1953	502.64	18.56	3.7	235.98	18.56	7.9
1954	552.73	92.83	16.8	112.61	77.91	69.2
1955	588.36	154.00	26.2	72.01	68.97	95.8
1956	638.90	232.01	36.3	114.09	98.44	86.3
1957	621.87	270.79	43.5	84.50	71.64	84.8
1958	555.32	239.62	43.1	99.92	12.56	12.6
1959	596.83	200.37	33.6	114.63	1.88	1.6
1960	653.08	301.41	46.2	166.58	142.20	85.4
1961	672.99	333.36	49.5	166.09	77.42	46.6
1962	848.49	520.35	61.3	323.61	237.40	73.4
1963	1 133.43	554.21	48.9	431.54	88.21	20.4
1964	1 246.17	607.78	48.8	339.46	117.20	34.5
1965	1 460.09	780.47	53.5	619.64	361.97	58.4
1966	1 604.99	1 042.50	65.0	627.65	365.80	58.3
1967	1 409.78	1 076.91	76.4	203.43	151.57	74.5

b. Issues made by financial institutions. In 1953, the Industrial Mortgage Bank of Finland was the first credit institution to make an index-tied bond issue. It was sold in Finland, and both capital and interest were tied to the official rate of exchange for sterling to the extent of 50 per cent. Since then, the majority of the mortgage banks and some other financial institutions have tied their bonds either to sterling, or to the export price index, the wholesale price index or the cost of living index. With the exception of one issue which is tied to the sterling rate to the extent of 100 per cent, all have a 50 per cent index clause. The index-tied bonds issued by the financial institutions are subject to taxation, as all non-Government bonds generally are. The only exceptions are the 50 per cent index-tied bonds issued in 1957 and 1958, which were exempted from income and property tax until the end of 1960. The greater part, over 80 per cent, of the bonds of the financial institutions have been sold to other banking institutions.

Table 4. Domestic bonds denominated in Finnish marks issued by financial institutions

	Outstanding at end of year			Sold during year ¹		
	Total Mill.mk	Index-tied ¹ Mill.mk	%	Total Mill.mk	Index-tied ¹ Mill.mk	%
1953	73.20	28.58	39.0	43.58	28.58	65.6
1954	98.29	48.21	49.0	28.74	19.64	68.3
1955	109.11	46.67	42.8	18.80	1.79	9.5
1956	105.07	48.17	45.8	4.83	4.83	100.0
1957	95.68	44.84	46.9	-	-	-
1958	170.56	118.69	69.6	84.62	77.50	91.6
1959	210.39	148.74	70.7	52.58	33.70	64.1
1960	221.74	151.89	68.5	24.36	12.80	52.5
1961	212.35	134.69	63.4	17.23	-	-
1962	240.27	169.97	70.7	54.22	52.62	97.0
1963	243.47	182.92	75.1	32.17	32.17	100.0
1964	316.16	216.36	68.4	102.51	102.51	100.0
1965	382.96	294.58	76.9	111.43	103.66	93.0
1966	393.46	350.33	89.0	60.22	59.67	99.1
1967	384.86	333.61	86.7	36.68	36.68	100.0

1. Index-tied and sterling-tied bonds.

c. Local authority issues have been made on a comparatively small scale since the war. In 1952, the city of Helsinki made one issue, the capital and interest of which were index-tied. During the period 1958-1961 several towns issued similar loans, all linked to the cost of living index to the extent of 50 per cent. From 1962 to 1965 no bonds were issued by local authorities. In 1966-1967 cities made four bond issues, which were all 50 per cent tied to the cost of living index. - About 80 per cent of local authority bonds were subscribed by banking institutions.

Table 5. Domestic local authority bonds denominated in Finnish marks

	Outstanding at end of year			Sold during year		
	Total Mill.mk	Index-tied Mill.mk	%	Total Mill.mk	Index-tied Mill.mk	%
1952	26.59	6.00	22.6	7.77	6.00	77.2
1953	25.39	5.60	22.1	1.22	-	-
1954	25.82	5.20	20.1	2.94	-	-
1955	27.38	4.80	17.5	4.12	-	-
1956	27.07	4.40	16.3	2.51	-	-
1957	24.76	4.00	16.2	0.62	-	-
1958	35.26	16.20	45.9	13.55	12.70	93.7
1959	36.12	20.98	58.1	7.10	6.56	92.4
1960	47.43	33.18	70.0	16.08	14.51	90.2
1961	48.59	36.81	75.8	5.99	5.99	100.0
1962	47.71	37.98	79.6	3.83	3.83	100.0
1963	45.56	37.93	83.3	3.46	3.46	100.0
1964	40.67	34.65	85.2	0.12	0.12	100.0
1965	35.97	31.50	87.6	0.30	0.30	100.0
1966	32.03	28.72	89.7	0.67	0.67	100.0
1967	33.91	31.28	92.2	6.33	6.33	100.0

d. Bonds issued by non-financial companies. Private non-financial companies were first authorized to issue index-tied bonds in 1957 (in Finland all bond issues have to be authorized by the Government). In 1957-1959 almost all bond issues were provided with an index clause, but in 1960-1963 only a small proportion was index-tied. One of the two issues made in 1964 and one of the three issues in 1965 were index-tied. In 1966 non-financial companies did not launch any domestic bonds. The five issues made in 1967 were all 50 per cent index-tied. The majority of index-tied bonds were tied to the cost of living index to the extent of 50 per cent, and some of them to the extent of 25 per cent. A few were tied to the wholesale price index and one to sterling. These issues have been made by companies and co-operative firms in the fields of manufacturing, foreign and internal trade, transport and communications. About 80 per cent of these bonds also are held by banking institutions.

Table 6. Domestic bonds denominated in Finnish marks, issued by non-financial companies

	Outstanding at end of year			Sold during year		
	Total Mill.mk	Index-tied ¹ Mill.mk	%	Total Mill.mk	Index-tied ¹ Mill.mk	%
1956	131.35	-	-	1.82	-	-
1957	159.98	30.97	19.4	38.12	30.97	81.2
1958	164.97	39.81	24.1	14.26	10.31	72.3
1959	157.62	54.71	34.7	17.58	16.38	93.2
1960	156.27	59.28	37.9	10.76	5.77	53.6
1961	157.77	86.00	54.5	32.72	30.84	94.3
1962	160.12	81.33	50.8	26.60	7.57	28.5
1963	190.33	71.43	37.5	52.69	2.53	4.8
1964	201.57	62.56	31.0	37.49	5.48	14.6
1965	196.86	58.04	29.5	38.63	8.63	22.3
1966	192.57	48.28	25.1	17.14	3.38	19.7
1967	196.05	62.89	32.1	31.26	23.92	76.5

1. Index-tied and sterling-tied bonds.

e. General terms of the bond issues. Apart from differences relating to the choice of index and the compensation percentage, the terms of the index-tied bond issues have differed with regard to a) the nominal rate of interest, b) the degree of exactness in calculating the compensation (the percentual changes in the index which occasion index compensation range from 1 to 5 per cent), and c) the direction in which the index clause operates (in some cases only rises in the index produce adjustments, while in other cases both rises and drops in the index produce corresponding adjustments upwards or downwards). The weighted average interest rates of index-tied issues and non-index-tied issues are compared in Table 7.

Table 7. Percentage rates of interest per annum

	Government bonds		Issues by local authorities and private sector		Six months' deposit rate of the commercial banks at end of year
	Index-tied bonds	Other bonds	Index-tied bonds	Other bonds	
1952	-	7.18	7.50	7.39	5.50
1953	5.25	6.58	8.00	7.88	5.50
1954	7.02	7.02	8.00	7.82	5.50
1955	7.28	8.45	8.50	8.26	6.00
1956	7.72	8.49	5.75	7.63 ¹	5.75
1957	6.33	8.25	7.25	6.54 ¹	5.75
1958	6.64	6.89	7.19	7.58 ¹	5.00
1959	6.00	6.85	6.98	6.94 ¹	4.50
1960	6.45	6.50	6.90	6.84 ¹	4.50
1961	6.55	6.65	7.00	6.77 ¹	4.50
1962	7.77	7.46	7.17	7.65	4.50
1963	6.63	8.36	7.09	7.73	4.50
1964	6.78	8.45	6.94	7.75	4.50
1965	6.90	8.78	6.98	7.25	4.50
1966	7.15 ^v	8.17	7.20	~7.70	4.50
1967	6.93	7.06 ⁻	7.08	7.76	4.50

1. The "perverse" behaviour of the rate of interest is partly due to the issue of non-index-tied bonds by the Central Bank of the Co-operative Credit-Societies (OKO) and the Land and Industry Real Estate Bank Ltd which is affiliated to it. These bonds are primarily intended for subscription by the co-operative credit societies.

IV. The index clause in private insurance

Since 1948, life assurance companies have offered special pure risk policies, so-termed "great policies" which are decreasing term policies based on a constant premium and decreasing assurance. These involve no fund saving and they are payable if the policy holder dies before the age of 65 years. Under this clause both the sums assured and the premiums are 100 per cent linked to the cost of living index. During 1948-1956, the life assurance companies offered policies with a clause, by which the sums assured were 100 per cent tied to the cost of living index, but the clause was valid only for the first three years, i.e., the period, during which the policy made no appreciable contribution to funds. At the beginning of 1957, the system was changed for new policies, in that the sums assured were index-tied to the

extent of 100 per cent during the first three years, after which both the sums assured and the premiums were 50 per cent index-tied. At present practically all new assurance policies have an index clause, and old policies have been index-tied for the rest of their duration. - Similar index clauses have been attached to permanent fire insurance policies sold in January 1958 - April 1967. - The terms of the index clauses are the same in all assurance companies.

V. Public's deposits in banking institutions

The banking institutions introduced accounts for index-tied deposits in 1955. These deposits were tied to the cost of living index to the extent of 100 per cent. The minimum amount of deposit was fixed at 300 marks (= 30 000 old marks), and the period of deposit at 12 months. The rate of interest was 1 - 1 1/2 percentage units below that on non-index-tied deposits. During 1956, neither the commercial banks throughout the country, nor those banking institutions operating in Greater Helsinki accepted index-tied deposits. During 1957 and 1958, all banking institutions accepted such deposits in two kinds of accounts, one with a 100 per cent and another with a 50 per cent cost of living index clause. In these cases also, the minimum deposit was 300 marks (30 000 old marks) and the period of deposit 12 months. From the beginning of 1959 to the end of May 1963, new index-tied deposits were only accepted in the 50 per cent accounts. Interest on both kinds of index-tied deposits was paid at a rate 1 percentage unit below that for ordinary deposits until the end of 1960. During 1961, 1962 and the first five months of 1963 the difference between the rates on index-tied and ordinary deposits was 1/2 percentage unit. At the beginning of June 1963, 100 per cent deposit accounts were re-introduced by all the banking institutions, and at the same time the rates of interest were differentiated so that the rate on 50 per cent deposits was 1 percentage unit, and that on 100 per cent deposits 1 1/2 percentage units lower than that on ordinary deposit. Until the end of April 1964 the deposits on the 100 per cent accounts were subject to State income and property tax in respect of capital,

interest and index compensation, and to income tax payable to the local authority and the church, whereas deposits on 50 per cent accounts held by private persons were exempted from taxation. On May 1, 1964, the 100 per cent accounts likewise became tax-free. Since that date the rate of interest on 100 per cent deposits has been 2 percentage units and that on 50 per cent deposits 1/2 percentage unit lower than that on ordinary deposits. On June 1, 1966 the rate of interest on the 100 per cent deposits was raised by half per cent. The 50 per cent deposits were discontinued from the same date. - The terms applied are the same in all banking institutions.

Table 8. a) Proportion of index-tied deposits in all banking institutions

End of	All term deposits Mill.mk	Index-tied deposits		Total Mill.mk	%
		50 % clause Mill.mk	100 % clause Mill.mk		
1955	3 158.43	-	3.41	3.41	0.1
1956	3 229.53	-	224.62	224.62	7.0
1957	3 390.09	362.06	462.38	824.44	24.3
1958	3 851.75	598.41	234.48	832.89	21.6
1959	4 541.89	279.03	1.49	280.52	6.2
1960	5 404.53	151.41	-	151.41	2.8
1961	6 270.31	37.88	-	37.88	0.6
1962	6 706.68	68.06	-	68.06	1.0
1963	7 185.01	229.16	52.05	281.21	3.9
1964	8 158.20	118.93	1 167.92	1 286.85	15.8
1965	9 198.55	75.89	1 594.48	1 670.37	18.2
1966	10 437.30	31.29	2 185.53	2 216.82	21.2
1967	11 537.86	-	3 997.17	3 997.17	34.6
1968 VI	11 881.03	-	3 612.11	3 612.11	30.4

b) Percentage of index-tied deposits of the total term deposits in each kind of banking institution

End of	Commercial banks	Savings banks	Co-operative societies and OKO	Post Office Savings Bank	Savings accounts of co-op. stores
1955	0.2	0.1	0.1	0.1	0.0
1956	0.1	10.1	14.7	4.2	1.7
1957	22.6	27.2	29.9	14.1	13.8
1958	20.3	24.3	26.5	12.2	12.2
1959	6.7	6.6	5.7	5.2	3.7
1960	3.1	3.0	2.4	2.4	1.7
1961	0.4	0.7	0.7	1.0	0.4
1962	0.7	1.0	1.7	0.8	0.4
1963	4.1	3.7	5.3	2.3	1.3
1964	17.1	16.6	18.3	6.1	6.3
1965	20.3	18.3	20.3	8.0	7.7
1966	24.6	21.1	23.0	8.8	8.1
1967	39.2	35.3	36.7	16.7	14.4

c) Interest rates on different accounts

	Ordinary term deposits	Index-tied deposits 50 % clause	100 % clause
1960	4 1/2	3 1/2	-
1961	4 1/2	4	-
1962	4 1/2	4	-
1.1.-31.5. 1963	4 1/2	4	-
1.6.-31.12. 1963	4 1/2	3 1/2	3
1.1.-31.3. 1964	4 1/2	3 1/2	3
1.4.-30.4. 1964	4 1/2	4	3
1.5.-31.12. 1964	4 1/2	4	2 1/2
1965	4 1/2	4	2 1/2
1.1.-31.5. 1966	4 1/2	4	2 1/2
1.6.-31.12. 1966	4 1/2	-	3
1967	4 1/2	-	3

VI. Index-tied lending

a. Financial institutions. Index charges on lending have, in general, only been collected to the extent necessary for covering the index compensation due to depositors. The methods of collection vary between different financial institutions.

1. Insurance companies. The private insurance companies introduced the index clause in their lending in 1948. Initially, the cost of living index or the wholesale price index was employed, but since 1957 the cost of living index has usually been applied in new loans. In most cases the index charge is collected in connection with amortizations and interest. Practically all index clauses are on a 50 per cent basis.

2. National Pensions Institution. At the end of 1946, the National Pensions Institution began to attach an index clause to some of its loans. Since the beginning of 1948, almost all loans have been 50 per cent tied to the wholesale price index. As the assistance parts of the pensions are financed by the State and local authorities, and the State contributes to the financing of the basic pensions, the National Pensions Institu-

tion has been able to keep its lending 50 per cent index-tied, in spite of pensions being 100 per cent tied to cost of living index.

3. Mortgage institutions. Loans granted from the proceeds of bonds issued by the mortgage institutions have index clauses similar to those attached to the respective bonds.

4. Banking institutions. The Post Office Savings Bank has tied those loans exceeding a certain limit to the cost of living index, generally on a 25 per cent basis.

Other banking institutions, primarily the commercial banks, have attached direct index clauses (usually cost-of-living clauses) to some of their loans to the public and the Government. In the main, however, the compensation due to depositors has been covered by means of an additional rate of interest on loans. These loans are said to be indirectly index-tied. The following description relates to such indirectly index-tied loans.

Commercial banks. From April 1957 to September 1958, these banks debited index charges of 1 per cent on the greater part of their lending, and during the last three months of 1958 the charge was 1/2 per cent. The encashed charges were accumulated on special accounts from which the compensations paid to depositors were drawn. From the beginning of 1959 to the end of May 1963, the collection of index charges was suspended. Since June 1, 1963, to the second half of 1966 the commercial banks have been allowed to collect index charges of 1/2 per cent per annum. Subsequently, the charge was raised to 3/4 per cent since December 1, 1966, to 1 per cent since July 1, 1967, and to 2 per cent since January 1, 1968. The index charges have been deposited in special blocked accounts held by the Bank of Finland in each bank; the balances on these accounts carry no interest and may only be used for index compensation to depositors.

Co-operative credit societies and the Central Bank of the Co-operative Credit Societies (OKO). During the

first half of 1956 the individual societies and their central bank debited index charges to their borrowers of the same amount as that paid in compensation to depositors. As the size of the charges was dependent not only on the rise in the cost of living index, but also on the ratio of index-tied deposits to lending, and the relative shares of 100 per cent and 50 per cent deposits, the percentage index charges were different in the various credit societies. From mid-1956 to mid-1958, an amount equivalent to the estimated total of index compensation due to depositors in all-co-operative credit societies was collected semi-annually from the borrowers of all societies, calculated on outstanding loan balances. By means of this pooling system (administered by the OKO) the percentage index charges were equalized in all credit societies. At the beginning of July 1958 the collection of index charges was suspended. It was resumed in 1963 and has since operated on the lines of the pooling system applied from 1956 to 1958.

S a v i n g s b a n k s . From 1956 to 1963 each of the savings banks made a calculation of the percentage index charge on the basis of the rise in the cost of living index, the proportion of its index-tied deposits to its lending, and the relative shares of 100 per cent and 50 per cent deposits. The charges, which are collected at the same time as that for interest and amortization, were calculated according to the index charge percentage for the month of payment. In 1964 a pooling system, very similar to that of the co-operative credit societies, was built up, and all savings banks belonging to this organization debit the same index charge to their borrowers. Membership of the pool is voluntary. It began operations in July 1964, with about 75 per cent of all savings banks as members, accounting for about 55 per cent of total savings bank lending. The pool is administered by the League of Finnish Savings Banks and the Central Bank of the Savings Banks.

Table 9. Index charges debited on indirectly index-tied loans, percentage per annum

	Commercial banks	Savings banks (average)	Co-operative credit societies and OKO
1956 2nd half	-	1.0	1.2
1957 1st "	0 and 1.0	1.6	2.0
2nd "	1.0	2.2	2.0
1958 1st "	1.0	1.4	1.0
2nd "	1.0 and 0.5	0.2	-
1959 1st "	-	} 0.1	-
2nd "	-		-
1960 1st "	-	} 0.1	-
2nd "	-		-
1961 1st "	-	} ..	-
2nd "	-		-
1962 1st "	-	} -	-
2nd "	-		-
1963 1st "	-	} 0.1	0.2
2nd "	0.5		0.2
1964 1st "	0.5	0.5 ¹	0.8/0.5 ²
2nd "	0.5	1.0	1.2/0.5
1965 1st "	0.5	1.0	0.8/0.5
2nd "	0.5	0.5	0.4/0.5
1966 1st "	0.5	0.5	0.6/0.5
2nd "	0.5 and 0.75	0.5 and 1.0	1.4/0.5
1967 1st "	0.75	1.0 and 1.75	1.6/0.5
2nd "	1.0	1.75	1.5 and 2.5/0.8-1.5 and 2.5

1. Since July 1, 1964, the data comprise only the savings banks included in the pooling system.

1. From the beginning of 1964 to the end of June, 1967, OKO collected index charges in the same way and at the same rate as the commercial banks. In the latter half of 1967 the index charges collected by OKO were as follows:

	Loans	Bills
1.7. -31.7.	0.8	1.0
1.8. -30.11.	1.5	1.0
1.12.-31.12.	2.5	2.5

Table 10. Loans¹ granted by all financial institutions to the private sector and the Government

End of	Total lending Mill.mk	Index-tied lending			
		Indirectly index-tied loans		Loans with an index clause	
		Mill.mk	%	Mill.mk	%
1958	5 892.8	3 225.1	54.7	1 477.6	25.1
1959	6 593.2	2 061.8	29.2	1 663.8	25.2
1960	8 102.3	2 384.8	29.4	1 898.0	23.4
1961	9 390.0	3 520.6	37.5	2 107.1	22.4
1962	10 252.0	3 635.9	35.5	2 585.5	25.2
1963	11 082.1	4 779.9	43.1	2 651.2	23.9
1964	12 712.3	6 678.8	52.5	3 152.1	24.8
1965	14 352.0	6 434.8	44.8	3 683.3	25.7
1966	16 034.5	8 583.7	53.5	4 082.2	25.5
1967	17 678.9	8 633.0	48.8	5 059.3	28.6

1. Excluding bonds, including hire purchase credits.

b. Government. A 50 per cent clause based on the wholesale price index has been attached to some employment loans. Big concerns, primarily power companies have obtained budgeted loans, which have been tied to the cost of living index to the extent of 50 per cent. Some large loans granted to power companies since this period have also been linked to the wholesale price index to the extent of 25 or 50 per cent. In 1958-1959, the loans granted to large-scale industry from the proceeds of the export levy were tied to the rate of exchange for sterling to the extent of 1/3. The 1963-1966 export levy loans to large-scale industry are 50 per cent tied to the wholesale price index. Export levy loans to small-scale industry have always been exempted from an index-charge.

c. Other lenders have, in general, applied an index clause in recent years, but detailed information is not available. Trade credits seem not to have been index-tied.

VII Abolition of index linkages in 1968

The devaluation of the mark in October 1967 together with the index linkages included in collective agreements and applied in the Finnish financial markets, as illustrated above, seemed likely to lead into a strong inflationary spiral, which would have quickly endangered the competitive advantage gained in the world market by the devaluation. To curb this cost pressure, negotiations were initiated by the Government aimed at the achievement of an overall solution in the form of an incomes policy. The result was a comprehensive Stabilization Agreement, signed by various interested organizations on March 27, 1968. Following this, an Economic Special Powers Act to safeguard economic development in 1968-1969 was passed by Parliament on April 9, 1968.

The abolition of various index linkages was an integral part of the Stabilization Agreement and the Economic Special Powers Act. From the enforcement of the Act onwards index clauses, based on changes in the cost of living, wholesale price, building cost or similar indices, were abolished from all contracts with few exceptions.

On the money and capital markets index linkages were abolished with the exception of some special cases. From March 20, 1968, the banks ceased to accept index-tied deposits. The index clauses of existing accounts were, however, applied until November 30, 1968; i.e. the index figure of November 1968 was to be used as the last adjustment index. In their lending the banks are entitled to charge an additional 1 per cent of interest until the index compensations payable on these deposits are covered. This arrangement replaced the various direct and indirect index schemes which were described in the preceding chapter.

According to the Economic Special Powers Act the index clause will continue in force for Treasury bonds that were launched before the enforcement of the Act, as well as for insurance policies. A decision of the Cabinet provides that the index clause may remain valid in international agreements, contracts and other arrangements made before the enforcement

of this Act.

In connection with the passing of the Economic Special Powers Act it was agreed that arrangements for abolishing index linkages on private securities and mortgage bank loans, issued or granted before the enforcement of the Act, should be made by the end of November 1968. Consequently the Cabinet decided on November 14 that such linkages should be frozen at the figures current for November 1968. In order to observe the interests of both creditors and debtors and thus to maintain stable conditions in the market for these securities, another cabinet decision provides that the issuers of the bonds in question may pay a higher rate of interest on them from January 1, 1969. If the additional annual rate of interest does not exceed 1 1/4 per cent on the nominal loan capital the debtor does not require special cabinet permission for this measure.

Mortgage banks having index-tied bonds or debentures in circulation agreed to pay annually an additional 1 1/4 per cent interest on the nominal loan capital. The mortgage banks are accordingly charging an extra 1 1/4 per cent interest rate on the nominal amount of index-tied loans granted by them.

Detailed information on these measures and on the interpretation of the Economic Special Powers Act is to be found in the 1968 issues Nos. 4, 5, 6, 7 and 12 of the Bank of Finland Monthly Bulletin.

IVA5a 1969 74176.4
Suomen

Suomen pankin taloustieteellisen
tutkimuslaitoksen julkaisuja ; D
Hämäläinen, Sirkka & Linnamo, Jus
The index clause system in the
finnish money and capital
1996-02-28

17. TIMO HELELÄ and J.J. PAUNIO
1967. 10 p.

18. KARI NARS Undersökning av ef

19. KARI PUUMANEN Indeksivaateet

20. RICHARD ALAND Sijoituspankki

**SUOMEN PANKIN
KIRJASTO**

Investment Banking Function in the United States.
1968. 31 p.