

Annual Report 2009



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The Annual Report is based on data available on 17 February 2010. The texts refer to the review year 2009, unless otherwise indicated.

Director General's review

Despite the international financial crisis, Finland's financial sector is in a stable condition. The most visible effect of the crisis was its weakening impact on banks' and firms' funding conditions. The situation eased somewhat during the review year, but the operating environment for the financial sector remains challenging.

The crisis highlighted inadequacies in financial supervision and regulation, leading to worldwide moves to reform the supervision and regulation of financial markets. The aim is to prevent a repeat in the future of the sort of crisis experienced recently. Well-founded proposals have been put forward for reforming supervisory structures in the EU.

The financial crisis also highlighted problems in the marketing and selling of investment products and services. The conduct of supervised entities has not always been appropriate, and the Financial Supervisory Authority has required them to institute the necessary corrective measures.

There is also room for improvement in financial supervision in Finland. Supervision should continue to focus on the marketing of investment products and services. It should also be both effective and of high quality, and the speed of reaction to observed problems brisk. Experience from the first year of the newly integrated supervisor – the Financial Supervisory Authority (FIN-FSA) – suggests this is an achievable objective.

Financial sector supervision has just come through a year of reform. Changes to financial market supervision and regulation were prepared intensively at both global and EU level with the aim of preventing a repeat in the future of the type of financial crisis experienced recently. In Finland, it was also the Financial Supervisory Authority's first year of operation.

Finland's financial sector remains in a stable condition

Stress tests conducted in early autumn by FIN-FSA together with supervised entities and the Bank of Finland indicated that the Finnish financial sector could withstand even a prolonged economic downturn. The direct effects of the financial crisis on the Finnish banking sector have been modest. Capital adequacy remains good and the sector continues to be profitable. Also, the liquidity situation has returned to normal. In contrast to many other EU countries, in Finland there has been no need to resort to government capital

injections or guarantees to bolster banks' capital adequacy or supplement their liquidity position. During the crisis, no depositors made losses on their deposits, nor were any shareholders' financial sector holdings nationalised. Depositors, investors and customers have all benefited from the sustained health of the financial sector.

In the Finnish insurance sector, the global crisis was felt as a decline in the value of investments. During the acute phase, owners were forced to bolster the capital of private life insurance companies, while the solvency regulations for pension insurance providers were amended through temporary legislation. The recovery in investment markets during the review year improved conditions in the insurance and pension sectors.

In the present economic environment, the profitability of core banking business is under pressure. Profitability is weakened by both impairments and low net interest income. Earnings development will be essentially

affected by the length of the recession and future interest rates.

Competition has recently become stiffer, especially in the deposit and housing loans markets. However, this must not be allowed to lead to unhealthy pricing or risk-taking, or to inappropriate conduct towards customers.

From financial crisis to deep problems in the real economy

The acute financial crisis in autumn 2008 inflicted serious damage on the real economy in various countries and plunged many countries into a difficult recession the following spring. The first positive data on the economic cycle came towards the end of the review year. The growth outlook for 2010 in the euro area remains, however, moderate. The ability of indebted governments to support growth constitutes a new problem. The operating environment for the financial sector remains challenging and the outlook is still marked by considerable uncertainty.

Central banks and governments have supported the financial sector in Europe with a range of measures that prevented the total collapse of the financial system. In the present situation the key question is when the support measures can be safely withdrawn. Premature withdrawal could undermine the still fragile economic recovery and destroy international confidence in the banking sector, while delaying too long could feed inflation and a financial market bubble.

The rapid increase in government debt has caused unrest on the financial markets, and at the time of writing the situation shows no signs of easing. Finland's financial sector is in good health, but the international problems could grow and spread in a way that could also affect Finnish financial sector firms.

Economic significance of financial sector increased

The relative importance of the financial sector has grown in recent years in almost all developed economies. Very fast growth does, however, inevitably mean growing risks: banking and financial crises have become more frequent since the 1970s, and their costs have been enormous. According to the most recent assessment by the IMF, the cumulative losses over the years 2007–2010 for banks and other financial sector companies from the present financial crisis will reach approximately USD 2,800 billion.

The use of public funds to rescue banks or insurance companies could lead to reckless risk-taking, which could sow the seeds of a new crisis in the future. Looking forward, it will be essential to achieve better

recognition of the early signs of a crisis and limit their effects; it will also be vital to ensure that financial sector companies have strong incentives for effective risk management. The risk of overly rapid growth will also need to be controlled. This can best be achieved by companies practising effective internal controls coupled with vigilant supervision.

Towards more comprehensive supervision

One of the lessons from the financial crisis is the need to ensure that important activities are not obscured from the oversight of supervisors. Supervision has suffered from inadequate coordination between central banks and financial supervisors. There was not enough dialogue between micro and macro supervision, and micro-supervisors' knowledge of the risks exposures of individual institutions was not available to macro-supervisors. In this respect, one of the most important reforms is the establishment of a European Systemic Risk Board (ESRB) with input from both central banks and supervisors.

The ESRB's task will be macroprudential supervision of the EU's financial system to prevent and alleviate systemic risks. Besides analysing the stability of the financial system and threats thereto, it will also be expected to warn about these threats and, if necessary, recommend appropriate policies to Member States, national supervisors or the Commission. High expectations are placed on the ESRB.

The system of financial supervisors within the EU is also being developed by increasing the importance of the supervisory committees for the banking, insurance and securities markets and changing their status to that of EU authorities. The objective is to achieve more convergence in regulatory and supervisory practices within the European Union. Time will tell how successful the new system will be in practice. Whatever the outcome, the chosen model of three authorities is administratively rather heavy.

These steps to develop the EU's supervisory system represent a step in the right direction, as they will reinforce cooperation between supervisory authorities. They will not, however, resolve the basic issues relating to supervision of large cross-border financial conglomerates and their crisis management. The problems of the present dispersed system, and the related potential conflicts of interest, will persist. The financial crisis showed yet again that, in crisis situations, solutions are often taken from national perspectives with insufficient attention to the impacts on other countries. This points up the need for an EU-level supervisory authority concentrating on the supervision of large multinational financial groups. Having supervision at EU

level would be particularly in the interests of those Member States in which foreign banks or branches command a large share of the market.

One consequence of the financial crisis has been an increase in the scope of supervision and the powers of supervisors in many countries. One way in which powers should be further developed is to allow supervisors to make early interventions to forestall risks. The problems of home country supervision have not yet been satisfactorily resolved in EU legislation. Host country supervisors should be given clear powers to intervene in branch activities in order to ensure the stability of their financial markets.

In Finland, financial market supervision is strengthened by FIN-FSA's operating in conjunction with the Bank of Finland. This allows close cooperation between the central bank and the supervisory authority. FIN-FSA can benefit from Bank of Finland research and economic analysis, while the latter's analysis of macro stability benefits from close cooperation with FIN-FSA.

Tighter regulation proposals soundly based

International proposals for regulatory reform envisage the tightening of capital requirements by, for example, requiring banks to put in place special cyclical buffers. The requirements for management of liquidity risk are also to be tightened. In addition, in order to restore confidence it has been seen as expedient to bring both credit rating agencies and hedge funds within the sphere of supervision. Risk management requirements pertaining to the financial sector as a whole will be tightened, and steps will be taken to reduce the incentives to take excessive risks by, for example, regulating remuneration practices. The proposed changes are all in the right direction.

The significance of the pro-cyclical impact of regulation was underestimated until the present crisis. Capital adequacy regulations are likely in future to require banks to establish cyclical buffers. In other words, they will be expected in good times to accumulate equity capital in excess of the minimum requirement. During weak economic conditions this capital can be released to sustain the lending capacity of the banking system.

Proposals for the reform of capital adequacy regulation also envisage changes to banks' practices in respect of loan loss provisions so as to enable banks to build reserves to absorb expected losses. In addition, an expected loss model for reporting the impairment of financial assets is likely to be adopted in international financial reporting regulations. These are both worthwhile changes. In contrast, it would be a step

backward if a simple, non-risk-based minimum leverage ratio were taken as the decisive measure of capital adequacy. How the reforms will be implemented in practice, and what their impact will be on the financial sector, is currently the subject of quantitative impact studies.

The EU's Solvency II Directive adopted last year marked a thoroughgoing reform of the solvency framework for life and non-life insurance companies. The aims of more effective risk management and an enhanced risk basis for capital requirements are very welcome.

Supplementary provisions currently being prepared by the Commission based on the work of the Committee of European Insurance and Occupational Pensions Supervisors will define the detailed solvency requirements. These will be based on a requirement in the Directive for a solvency level to protect the insured whereby insurance companies' probability of insolvency must be at most 0.5%. The financial crisis demonstrated that earlier trial calculations had been unable to take account of all the factors that can influence asset value fluctuations. The chosen confidence level would certainly appear to be producing higher-than-expected solvency requirements. The appropriateness of this level of requirement will be evaluated following the quantitative impact assessments to be carried out in autumn 2010.

As with banking regulation, the working group currently considering the reform of solvency regulations for Finland's employee pension providers should seek, in addition to the existing means, new ways to reduce the pro-cyclical features of the solvency requirements. It is also important to bolster the risk basis of solvency requirements and sound management of risk and solvency within these institutions. In this regard, it would be appropriate to apply the key elements of Solvency II.

With regard to deposit guarantees, it is important to harmonise practices across Europe. The guarantee should, on one hand, give sufficient security for depositors, while, on the other hand, not giving banks an incentive for unhealthy pricing of deposits.

Housing loan borrowers face a substantial interest rate risk

Interest rates on housing loans in Finland are low and margins on the loans have been very narrow in recent years relative to other EU countries. Banks have in the past been very keen to use price as a competitive tool. In the first half of the review year, there was a rapid broadening of margins relative to 2008. However, the most recent data indicates the margins on new housing loans have narrowed again from the level of just under one percentage point prevailing last summer.

Banks are not expected to suffer significant loan losses from their housing loan business. Despite some increase in payment defaults, the debt servicing ability of the household sector is, overall, still fairly good. In the review year, there was scarcely any increase in household debt relative to income. If, however, unemployment were to deteriorate further and interest rates rise from their present very low level, the problems of over-indebtedness could affect a growing number of households.

One cause for concern is households' insufficient preparedness for a rise in interest rates. At present, households are not taking a sufficiently long-term view of interest-rate risk.

Customer protection needs reinforcing

During the financial crisis, supervision was focused on monitoring and analysing the stability of the financial sector. Securing the health of the financial sector was FIN-FSA's main priority. However, the crisis also highlighted problems in supervised entities' market conduct. With hindsight, FIN-FSA could have responded to these problems even more forcefully than it did.

The service provider must give the customer accurate and adequate information on the characteristics and risks of investment products. The crisis highlighted cases in which the customer was of the opinion that the service provider did not sufficiently explain the risks, gave misleading information on them or understated the risks. In this area, the law and FIN-FSA's guidance are unambiguous: non-professional investors must have the risks explained to them, and a product's suitability for the customer must be assessed. In a customer service situation, it is unacceptable for the customer to be given false product information in order to speed up the sales process.

Over the past couple of years the Financial Supervisory Authority and its predecessor have conducted extensive inspections of compliance with disclosure requirements in respect of various products (especially money market funds and structured loans), the appropriateness of service providers' suitability assessments and the accuracy of fund managers' NAV calculations. Based on the inspections, FIN-FSA has required supervised entities to carry out corrective actions. Implementation of these has been closely monitored.

Customer protection issues carry considerable weight within FIN-FSA. One important area of supervision is inspecting the appropriateness of savings and investment product development and sales processes. The importance of customer protection is also reflected in FIN-FSA's organisational structure: both customer protection issues and savings instruments and services

issues have their own divisions. FIN-FSA is developing its procedures so as to be able to intervene in irregularities promptly.

Regulation on sales of investment products to be harmonised at EU level

The European Commission considers it important that the information given to retail customers on different savings and investment products and the sales and marketing of such products be regulated as consistently as possible, whether the products in question are securities, bank deposits or insurance products. This spring I will be chairing a working group established by EU financial supervisors, in which insurance, banking and securities supervisors will be seeking a common line on this issue.

Increased concern over competitiveness of Finland's financial markets is well founded

For the healthy development of the Finnish economy it is important to ensure the competitiveness of the country's financial markets. Both Finnish households and businesses benefit from the presence in Finland of a diverse range of quality financial services at a competitive price. The Finnish Foundation for Share Promotion has commissioned a report on the development needs of Finland's capital markets, while the Ministry of Finance has also commissioned a study on the issue. It is important that both the private and the public sector are involved in this project.

On the securities markets, the pace at which shares are being traded is quicker and the costs of trading have declined. These are both positive trends. From the point of view of stock market operations, however, it is important to reassess the success of the regulation of trading facilities under MiFID. It is important to analyse whether the operating requirements for organising trading are sufficiently neutral towards different parties and whether regulatory obligations apply equally to different trading facilities. It is also important to assess the challenges posed to supervision by the current fragmented trading environment, and what the appropriate response to these challenges would be.

Newly founded FIN-FSA successfully up and running

The organisational overhaul of FIN-FSA was successfully concluded at the beginning of August. When drawing up the model, a lot of weight was given to the best way to achieve synergies and supervise similar types of risk in different sectors using common resources.

Insurance, banking and securities supervision were not organised into separate departments in order to avoid the compartmentalisation of activities. To facilitate learning and the adoption of new procedures, the inevitable choice was for a functional model in which supervision is structured according to function rather than sector.

Based on our experiences so far, I can say the model works well. Fine-tuning common procedures and processes will nevertheless take some time, and synergies in the form of lower operating expenses will only become apparent over a longer period. The Financial Supervisory Authority's first year of operations got off to a good start and the organisational changes that had to be implemented did not disrupt the ongoing supervisory work.

FIN-FSA's strategy covers the next three-year period. Key areas in the strategy include an increased supervisory focus on risk, fostering customer and investor protection and bolstering international cooperation. The Financial Supervisory Authority and its predecessors have been very active in developing cooperation between supervisors at both EU and Nordic

level. Although good progress has been made in developing cooperation, it is still essential to ensure it is sufficiently comprehensive and cost-effective.

According to the job satisfaction survey addressed to our entire personnel shortly after completion of the organisational overhaul, FIN-FSA's working atmosphere is satisfactory. The survey was conducted at a time when many issues pertaining to personal tasks, responsibilities and goals were still unresolved. FIN-FSA has taken brisk steps towards our vision of being a dynamic and highly respected supervisor. Our strategy also stresses the importance of a common operating culture. In practice, this means efficient, high-quality working methods in pursuit of our objectives and a positive and productive working atmosphere.

I would like to thank all FIN-FSA staff for the commitment and stamina they have displayed in building the new supervisory authority, and for their valuable input during the organisation's first year of operation.

Helsinki, 17 February 2010

Anneli Tuominen

Financial Supervisory Authority

The Financial Supervisory Authority (FIN-FSA) commenced operations on 1 January 2009. The new Authority took over most of the responsibilities of the former Financial Supervision Authority and Insurance Supervisory Authority. Administratively, FIN-FSA operates in connection with the Bank of Finland, but it takes independent decisions in its supervisory work.

The FIN-FSA's activities are aimed at ensuring the stable operation of credit, insurance and pension institutions and other supervised entities whose stability is essential to the stability of the financial markets. Another objective is to safeguard the interests of the insured and maintain confidence in the financial markets. At year end, there were 1,111 supervised entities and other entities liable to pay supervision fees.

Mission

FIN-FSA is responsible for supervising the operations of financial market participants, as specified in law. Its responsibilities also include fostering compliance with good practice on the financial markets and public awareness of the markets. FIN-FSA's mission and objectives are spelt out in the Act on the Financial Supervisory Authority.

Section 3 of the Act on the Financial Supervisory Authority, Mission (extract):

...the Financial Supervisory Authority shall

1. grant authorisation to financial market participants, register financial market participants and confirm rules concerning their operations;
2. monitor that financial market participants comply with the provisions applicable to them governing financial markets and the regulations issued thereunder, the terms of their authorisation and the rules concerning their operations;
3. monitor the issuance of, and trading in, financial instruments and compliance with the provisions and regulations governing clearing and custodial services;
4. supervise compliance with International Financial Reporting Standards, as provided below;
5. monitor that financial market participants comply with the provisions and regulations applicable to them concerning prevention and detection of money laundering and the financing of terrorism;
6. issue regulations necessary for application of the Act as separately provided in law;
7. direct and supervise the activities of the savings bank inspectorate;
8. perform its other statutory responsibilities.

In addition, FIN-FSA is to (extract continues):

1. monitor and evaluate developments in financial markets and the rest of the operating environment for financial market participants, and the evolution of other general operating conditions;
2. introduce initiatives for the development of financial market legislation and other requisite measures, and participate in the preparation of legislation;
3. monitor and analyse the availability and pricing of basic banking services;
4. foster reliable corporate governance systems in those financial market participants whose financial position it monitors;
5. collect and regularly publish comparable data on financial market participants' financial position and otherwise contribute to access to information on financial services and financial market activity;
6. participate in national cooperation between authorities;
7. take part in the work of the Committee of European Banking Supervisors, the Committee of European Securities Regulators and the Committee of European Insurance and Occupational Pensions Supervisors in developing the supervisory framework and enhancing the smooth operation of financial market participants within the European Union, and in other international cooperation between authorities;
8. participate in combating criminal misuse of the financial system;
9. promote scientific research and education for the financial sector in cooperation with institutions of higher education.

Supervised entities

- credit institutions
- non-life, life and reinsurance companies
- employee pension insurance companies
- company pension funds
- industry-wide pension funds, sickness funds and other insurance funds
- local mutual insurance associations
- unemployment benefit funds
- insurance brokers
- other actors in the insurance sector
- investment firms
- fund management companies
- the Finnish Deposit Guarantee Fund
- the Finnish Investor Compensation Fund
- the central securities depository
- the stock exchange

FIN-FSA also supervises

- listed companies' compliance with disclosure obligation and IFRS regulations on financial statements
- securities trading
- compliance with the obligation to disclose major holdings
- securities offerings and public tender offers

Strategy 2010–2012

Mission

Our primary objectives are the maintenance of financial stability and confidence in the well-functioning of financial markets. We also work for enhanced customer and investor protection.

To promote these objectives we focus our supervisory activities on

- the risk management of financial institutions, and their financial viability;
- the appropriateness of business practices observed in customer relationships and
- in financial markets, as well as the quality of investor and customer information.

Strategic choices

Strengthening of risk-based supervision

- We conduct timely analysis of the main sources of risk and consequently focus supervisory activities on the business areas and specific financial market participants that entail the greatest vulnerability.
- We improve our financial market risk assessments and enhance our crisis management capabilities.
- We regularly inform the public of our supervisory priorities and supervisory findings.

Intensification of international supervisory and regulatory cooperation

- We support the creation of the EU's new supervisory framework.
- We strengthen cooperation especially amongst especially Nordic supervisory authorities in order to cover all relevant risk areas. We foster division of labour between supervisors and specialisation within international colleges of supervisors.
- We seek to influence those regulatory developments that are key to Finnish financial market stability, competitiveness and customer protection by actively participating in the preparatory work at an early stage.

Vision

The Financial Supervisory Authority is a dynamic and highly respected supervisor and promoter of a common European supervisory culture of high quality.

Our aim is to ensure

- sound development of Finnish financial markets and equal competitive opportunities for all market participants;
- regulation and supervision which is proportionate to the risks taken by supervised entities; and
- better understanding by customers of financial markets.

Promotion of customer and investor protection

- We promote public awareness of the costs and risks of financial products and services.
- We react quickly and vigorously to inappropriate market practices.
- We focus on the supervision of product development and selling practises of savings and investment products.

Moving to a common culture

- We deepen our expertise on risk management regarding all supervised institutions and our knowledge of specific financial products and business activities.
- We increase the use of IT-tools and maintain a comprehensive, timely and reliable supervisory data warehouse.
- We ensure synergies from the integration of supervisory activities and utilise enhanced cooperation with the Bank of Finland. We enhance the efficiency and consistency of work flows and working processes.
- We are committed to maintaining a positive and productive working environment and good management.

Governance

Parliamentary Supervisory Council

The Parliamentary Supervisory Council bears responsibility for supervising the overall expediency and efficiency of FIN-FSA's activities.

In 2009, **Timo Kalli** was Chairman and **Antti Kalliomäki** Vice Chairman of the Parliamentary Supervisory Council. The Council's other members were **Tanja Karpela, Martti Korhonen, Mika Lintilä, Pekka Ravi, Marja Tiura, Jutta Urpilainen (Liisa Jaakonsaari until 9 September) and Ben Zyskowicz.**

Board

The FIN-FSA Board oversees supervisory activities by deciding overall strategy, setting specific operational objectives and directing and supervising compliance with the strategy and achievement of the objectives. The Board also draws up the annual budget of FIN-FSA and submits it to the Board of the Bank of Finland for confirmation. In addition, at least once a year, it supplies the Parliamentary Supervisory Council with a report on the operational objectives of FIN-FSA and their achievement. The Board also annually consults representatives of financial market participants on the objectives set for supervision and their achievement; the FIN-FSA budget and expected changes in supervision, and their potential effect on the accumulation of supervision fees; and measures required by the aforementioned expected changes.

The Board has five members appointed for a three-year term. Board members and deputy members are appointed by the Parliamentary Supervisory Council.

In the review year, **Pentti Hakkarainen**, Deputy Governor of the Bank of Finland, acted as Chairman of the Board, while **Martti Hetemäki**, Permanent Under-

Secretary at the Ministry of Finance, was Vice Chairman. The other Board members were **Pirkko Juntti**, LL.M.; Director **Antero Kiviniemi** of the Ministry of Social Affairs and Health; and **Paavo Pitkänen**, MSc.

The deputy to Pentti Hakkarainen was **Kimmo Virolainen**, Head of Financial Markets and Statistics at the Bank of Finland. The deputy to Martti Hetemäki was Director **Tuija Taos**, while the deputy to Antero Kiviniemi was **Leena Väänänen**, Senior Actuary.

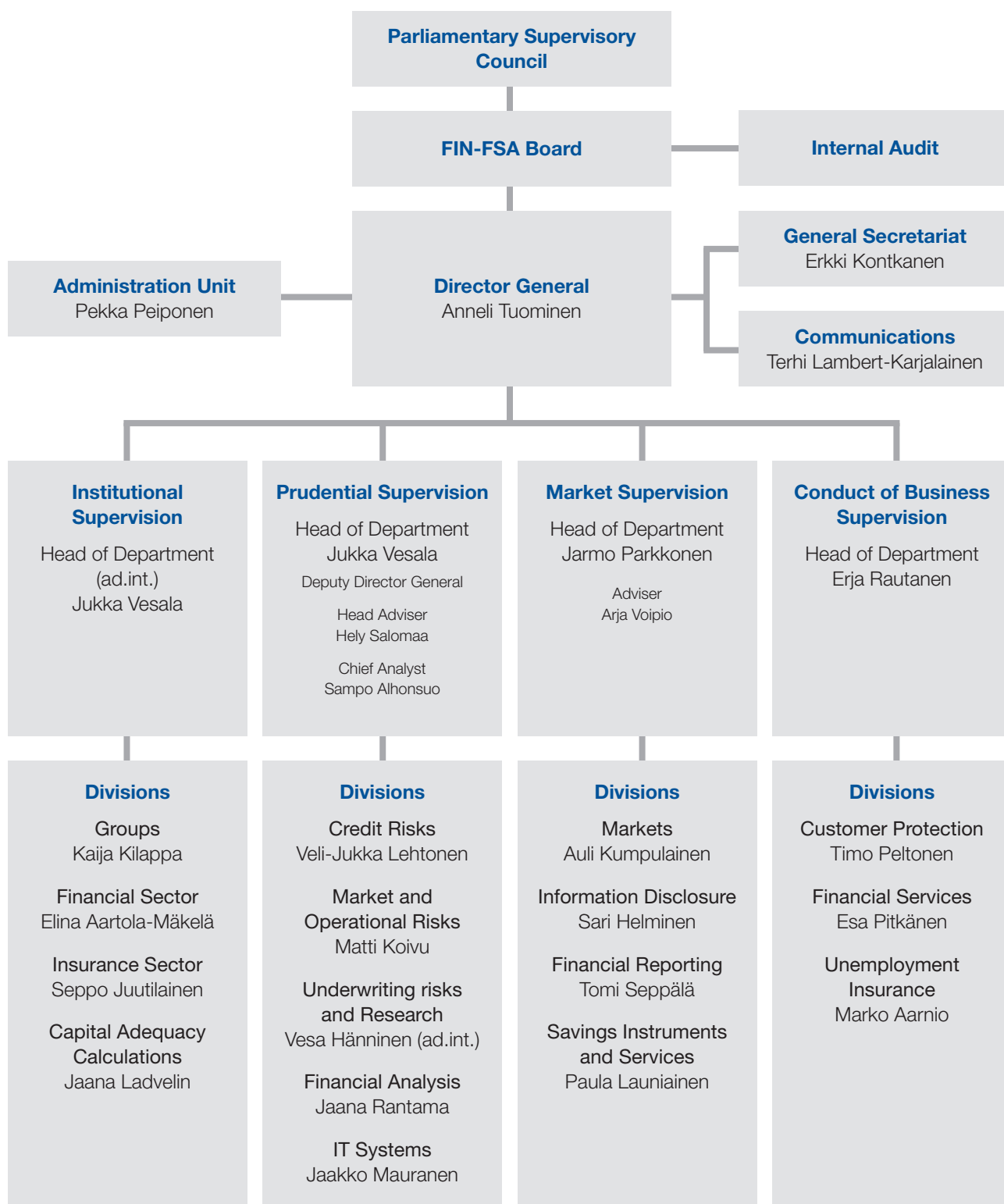
During the year, a total of 17 Board meetings were held.

Director General, management group and departments

The responsibilities of the Director General include managing the activities of FIN-FSA and taking decisions other than those falling within the competence of the Board. The Director General in 2009 was **Anneli Tuominen**, LL.M., MSc (Econ.). She was assisted by a consultative management group (see presentation on page 13) consisting of the heads of department and other FIN-FSA employees appointed by the Director General.

FIN-FSA has four departments: Institutional Supervision, Prudential Supervision, Market Supervision and Conduct of Business Supervision. The departments are subdivided into divisions. Besides the departments, the Administration Unit, the General Secretariat and Communications are directly accountable to the Director General.

Financial Supervisory Authority Organisation chart 1 February 2010



The members of the FIN-FSA management group are Anneli Tuominen, Director General; Jukka Vesala, Deputy Director General; Jarmo Parkkonen, Head of Market Supervision; Erja Rautanen, Head of Conduct of Business Supervision; Erkki Kontkanen, Chief Advisor; and Hely Salomaa, Chief Advisor.

Institutional Supervision is responsible for building an overall picture of the business, capital adequacy and risks of supervised entities and for coordinating contacts with supervised entities and supervisory measures at FIN-FSA (through the work of senior banking supervisors). The department's responsibilities include producing an annual assessment of the capital adequacy of all insurance and financial market participants commensurate with their business operations and risks. It also reviews applications for authorisation from banks and insurance companies, in cooperation with the other departments. In addition, Institutional Supervision assesses the internal governance and financial statements of supervised entities and the legality of their operations. The department is responsible for coordinating cooperation within colleges of supervisors.

Prudential Supervision is responsible for supervising the risks and risk management of supervised entities. Supervision takes the form of inspections and analysis of regular reporting (on credit, market, liquidity, operational and insurance risks, anti money laundering measures, payment systems and IT infrastructure reliability). The aim of prudential supervision is to identify and prevent risks to capital adequacy and liquidity. It is designed to ensure that risk exposures do not exceed risk-bearing capacity, that risk management and internal control processes are appropriate and that supervised entities have in place sound processes for capital and liquidity management. The department is also responsible for analyses and reports on the financial situation and risks of supervised entities and the financial sector as a whole, and for research and systems development at FIN-FSA. Its responsibilities further include development of best practices for EU supervisory authorities and coordination of inspection activity.

Viewed as a whole, the common objective of institutional and prudential supervision is efficient crisis management, with a view to keeping the consequences of crises and disruptions for customers and system operability and for the costs to the national economy to a minimum.

The objective of **Market Supervision** is to foster confidence in investor information and the functioning of securities markets. Confidence is built by the provision of clear and timely investor information of high quality, the availability of appropriately functioning securities market infrastructure and sound market conduct.

The department supervises the investor information provided by listed companies on performance, securities offerings, IFRS financial statements and various savings products and services. It also supervises the functioning of market infrastructure, securities market trading and trading practices and investigates potential market abuse. As a member of the Auditing Board of the Central Chamber of Commerce, FIN-FSA takes part in the supervisory work of auditors and its further development.

Conduct of Business Supervision is responsible for supervising the relationship between financial service providers and their customers. The department supervises the marketing of financial sector services and products and the provision of customer information, as well as service providers' conduct towards customers. It approves banks' account terms and supervises the insurance terms of insurance providers.

The department's responsibilities also include review of the applications for authorisation and registration filed by investment firms, fund management companies and insurance brokers and of notifications for cross-border service provision. It also supervises the activities of unemployment benefit funds. The department further supervises compliance of the internal processes and organisation of supervised entities with the rules of market conduct. Supervision of customer information to the general public also falls within its responsibilities, especially in regard to product risks. In the field of customer protection and customer information, FIN-FSA cooperates with the National Consumer Administration and the Finnish Financial Ombudsman Bureau (FINE).

All departments are responsible for regulatory development within their respective fields of competence.

Management group



The management group of FIN-FSA, from left to right: Hely Salomaa, Jarmo Parkkonen, Erja Rautanen, Anneli Tuominen, Jukka Vesala, Leena Kallasvuori and Pirjo Kyyrönen.

Anneli Tuominen

Director General; Chairman
LLM, MSc (Econ.)

Jukka Vesala

Deputy Director General, Prudential Supervision;
Vice Chairman
DSc (Econ.)

Leena Kallasvuori

Head of Institutional Supervision, member of the
management group until 10 December
MSc (Econ.)

Jarmo Parkkonen

Head of Market Supervision
LLM, MSc (Econ.)

Erja Rautanen

Head of Conduct of Business Supervision
LLM

Hely Salomaa

Chief Advisor, Prudential Supervision
DSocSc

Pirjo Kyyrönen

Senior Legal Advisor, Secretary to
the management group
LLM

*Missing from the picture is Erkki Kontkanen, LLD,
who assumed his position as Chief of the General
Secretariat and Chief Advisor on 1 January 2010.*

Organisation

The Act on the Financial Supervisory Authority and other related acts were adopted at the presidential session of the Government on 19 December 2008 and entered into force on 1 January 2009.

Immediately upon adoption of the Act, the Parliamentary Supervisory Council appointed the members and deputy members of the FIN-FSA Board, also designating the Chairman and Vice Chairman of the Board, which appointed Anneli Tuominen acting Director General.

The office of Director General was declared vacant in December 2008. In January, eight applicants handed in their applications for the post. In February, the Parliamentary Supervisory Council appointed Anneli Tuominen as Director General for a five-year term.

The posts of head of department were declared vacant in February. Altogether 47 applications were received by the deadline. The Board appointed the heads of department in March.

Public recruitment of the heads of division, heads of unit and chief analyst took place in April. There were 161 applicants for the posts. Appointments were made in May, generally to take effect at the beginning of June. All management appointments were made for a fixed term of 3 to 5 years. Internal recruitment of experts and support staff took place in May, with appointments made in June.

The new organisation started its work on 1 August 2009. At the beginning of September, the staff was relocated between two offices (at Snellmaninkatu 6 and Mikonkatu 8), with the main functions of Prudential Supervision and Institutional Supervision located in Snellmaninkatu and those of Market Supervision and Conduct of Business Supervision in Mikonkatu. The Snellmaninkatu offices also house the Administration Unit, the General Secretariat and Communications.

Staff

FIN-FSA is an expert organisation, with 73% of staff holding expert positions, 11% management positions and 16% serving as support staff. The approved headcount is 218 persons, with the headcount standing at 211 at the end of the year. The breakdown of staff at the end of the year was:

Prudential Supervision	70
Institutional Supervision	43
Market Supervision	41
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Because of FIN-FSA's role as the authority responsible for financial market supervision, its staff must fulfil specific ethical requirements. In their conduct, they must bear in mind the objectives of FIN-FSA and work to achieve them. They must not develop too close links or economic ties with supervised entities, or otherwise have such links or ties with supervised entities as would compromise their independence. Staff are subject to a wide-ranging requirement to disclose close links (securities holdings, loans, guarantees, other commitments, secondary positions and other links). In addition, detailed provisions apply to investments in securities and insurance by members of the FIN-FSA staff.

Funds and operating costs

FIN-FSA finances its operations mainly by levying supervision and processing fees on supervised entities and other entities liable to pay supervision fees. The amount of supervision fees, which are similar in nature to a tax, is laid down by law and based on the scope of a supervised entity's business as measured by a number of factors, including its balance sheet total. All securities issuers pay a fixed fee prescribed by law. The Bank of Finland contributes 5% of funding costs. Any excess is repaid to supervised entities and other liable entities.

In 2009, operating expenses amounted to EUR 24.5 million, most of which were staff costs (EUR 17.6 million). Other major expense items were services from the Bank of Finland (EUR 2.4 million) and real estate expenses (EUR 2.3 million).

IT systems

Integration of the IT systems of the two merging authorities was a key task in the new FIN-FSA's first year. The first phase of system integration facilitated the operative activities of the new authority. This phase was completed in June.

Consolidation of overlapping systems will continue during the second phase until 2012, at which time the regulatory reporting systems and registers of supervised entities will be merged or rebuilt.

Communications

FIN-FSA published 18 press releases in the course of the year. In connection with publication of the press release in September on supervised entities' financial standing and risks, FIN-FSA held a press conference at

which the findings of the stress tests conducted during the summer were also reported.

During the year, 31 news releases were published on the front page of the FIN-FSA website, and 39 supervisory releases were issued for supervised entities. The statistics pages were regularly updated with data on securities and credit markets, key financial data for supervised entities and comprehensive insurance statistics.

In the autumn, FIN-FSA adopted a new visual identity.

The year in brief

Key events in 2009

- Intensified supervision of risks and capital adequacy was continued, with supervised entities required to report more frequently.
- Inspection focused particularly on banks' increased credit risks as well as insurance and pension companies' investment risks and risk management processes. Inspections revealed no risk management negligence that would jeopardise capital adequacy.
- Banks' new payment system initiative (SEPA) was noted to be progressing appropriately.
- Stress tests were conducted twice in cooperation with supervised entities and domestic authorities; the tests showed that supervised entities' capital adequacy would cope with a considerably deeper and longer recession than forecast.
- Monitoring of employment pension providers' investment risks was intensified due to lower capital adequacy requirements introduced under a temporary Act.
- Mutual funds were requested to remedy deficiencies in their compliance with the disclosure obligation.
- Sellers and issuers of index-linked bonds were requested to describe risks in more detail in their marketing material.
- The appropriateness of information on structured products was inspected.
- A need for guidance in respect of listed companies' reporting of their prospects was noted; FIN-FSA revised its instructions.
- More specific instructions were issued on the transparent reporting of financial instruments and goodwill impairment testing by listed companies and other entities subject to IFRS financial statement disclosure.
- Lengthened processing times for applications for unemployment fund benefits were addressed.
- Close supervisory cooperation regarding large Nordic banking and insurance conglomerates continued; systematic collegial cooperation was commenced concerning Svenska Handelsbanken and Skandinaviska Enskildabanken, headed by home-country supervisors.
- A cooperation agreement was signed with foreign supervisors on the transition to central counterparty clearing.
- A review showed that the remuneration principles of large financial-sector companies were generally in accord with international recommendations. FIN-FSA issued a statement on remuneration principles on 17 February 2010.
- FIN-FSA issued a statement on the right to change housing loan reference rates and conditions for grace periods.
- Work began on the renewal of FIN-FSA's set of regulations.

In the review year, the international financial crisis began to ease. The value of equities and debt securities began to recover and there was increased liquidity on the financial markets. However, the problems simply changed shape, with the difficulties in the real economy caused by the financial crisis deepening into a global economic recession. In Finland, too, there was a substantial contraction in the economy and an increase in unemployment. The economies of the Baltic States drifted into serious difficulties.

Although the operating environment for supervised entities continued to be demanding and the outlook remained very uncertain, FIN-FSA was able to note that the capital adequacy of supervised entities remained strong. Stress tests conducted together with supervised entities and the Bank of Finland indicated that Finnish banks, insurance companies and pension providers would be able to withstand a serious recession. The stability of the Finnish financial system would not be threatened even if the economy were to develop in 2010 and 2011 much more weakly than forecast.

Banks found it easier to arrange long-term financing, but credit risks began to materialise. Declining business volumes and low interest rates eroded the profitability of banks' core business activities.



FIN-FSA continued the more frequent reporting and concentrated supervision begun in response to the financial crisis. In view of the altered risk profile, the focus was directed particularly towards banks' credit risks, insurance and pension companies' investment risks and all entities' risks from derivatives activities.

Inspections of banks' credit risks were directed especially towards corporate financing risks and business in the Baltic States plus management of credit risks and problem credits. In respect of insurance and pension companies, inspections were focused on management of investment risks and internal control. The inspections revealed inadequacies in risk management and internal control. There was, however, no indication of risks threatening entities' stability or business continuity. There was also no sign of substantial risks relating to bonuses for management and other key personnel.

FIN-FSA monitored the position of bank customers and possible problems with access to credit for corporate customers. According to FIN-FSA's assessment, banks' capital adequacy and liquidity situation did not pose an obstacle for access to credit for viable businesses. There had admittedly been some problems with access to business credit, but the situation had eased towards the end of the year.

The financial crisis underlined in a concrete fashion the importance of effective crisis management. The objective of supervision is to ensure that the impacts of problems on customers and the financial markets are kept under control as much as possible. The administrative measures instituted in Finland in response to the crisis at Icelandic banks were brought to a successful conclusion early in the year. In the autumn FIN-FSA took part in an extensive crisis exercise for the Finnish financial sector.



For investors, the financial crisis was reflected in risks not being communicated clearly enough in investor information or not being updated quickly enough to match new situations as the crisis unfolded.

FIN-FSA urged mutual funds to be more precise in the information they provide on risks and investment policies and urged sellers and issuers of index-linked loans to describe the risks more precisely than before in their marketing material. FIN-FSA also examined the appropriateness of information provided on structured products. Implementation of corrective actions has been closely monitored.



Meanwhile, changing market structures, above all the emergence of new marketplaces, has dispersed trading, particularly in liquid shares, into the international arena and the new marketplaces. Getting accurate data on trades therefore requires extensive cooperation between supervisors, on at least a European scale.

FIN-FSA investigated suspected violations of the disclosure obligation with regard to trading and securities. If a breach of the regulations is discovered and the evidence gives cause to suspect criminal activity as defined in the penal code, the matter is referred to the police for investigation. In some cases, FIN-FSA can nowadays issue its own administrative sanctions, such as a public reprimand or public warning. Such cases are less severe than those defined as criminal activity, but are nevertheless clearly in breach of financial market regulations. During the year, 74 cases were investigated.

Based on its investigations, FIN-FSA issued five public reprimands: two for failure to disclose major holdings, one for failure to comply with the prohibition on disclosure of insider information, one for share price manipulation and one for failure to issue a prospectus.

The year's events

15 January 8 applications are received for the position of Director General of the Financial Supervisory Authority.

2 February FIN-FSA announces that the operations of the Finnish branch of Kaupthing Bank have been terminated and that the branch has repaid the loan arranged by Finnish banks.

4 February Anneli Tuominen is appointed Director General of the Financial Supervisory Authority for a 5-year term.

10 February FIN-FSA increases the frequency of banking sector reporting.

13 February FIN-FSA announces the granting of temporary government guarantees to Finnish banks and the related application procedure.

4 March FIN-FSA announces changes in employee pension providers' financial reporting regulations.

9 March FIN-FSA announces that the Finnish operations of eQ Bank and its subsidiaries will continue.

20 March FIN-FSA increases the frequency of reporting by company pension funds and industry-wide pension funds.

24 March FIN-FSA heads of department are appointed.

1 April The standard Management of market risk comes into effect.

8 April FIN-FSA issues a public reprimand to Swedish Fundior AB for failure to comply with prospectus requirements.

8 April FIN-FSA publishes key annual financial statement figures for financial sector supervised entities' with comparative data.

8 April Changes in the provisions on corporate governance of supervised entities are published.

19 May FIN-FSA unit and division heads are appointed.

26 May FIN-FSA issues a public reprimand to Erik von Ehrenheim for breach of the disclosure ban on insider information.

26 May FIN-FSA issues a public reprimand to Ahti Vilppula for failure to disclose holdings.

26 May FIN-FSA issues a public reprimand to the Helsinki branch of Danske Bank A/S for failure to disclose holdings.

29 May FIN-FSA announces that insurance institution solvency is at least satisfactory in spite of financial market developments.

4 June FIN-FSA estimates that banking sector capital adequacy will withstand a stress scenario.

9 June FIN-FSA announces that the prices and availability of basic banking services are unchanged.

10 June FIN-FSA announces that inspection findings show that marketing material on index-linked bonds falls short of requirements.

15 June FIN-FSA launches a new website: Fin-fsa.fi.

7 July FIN-FSA publishes a survey on the Local Government Pensions Institution's investment activities.

13 July FIN-FSA issues a public reprimand to Jan Michael Streng for market manipulation.

1 August FIN-FSA's new organisation is up and running.

25 September FIN-FSA estimates that, according to stress tests, the Finnish financial sector would cope with a severe recession.

1 October The revised standard Declaration of insider holdings and insider registers comes into effect.

1 October FIN-FSA announces that inspection findings show shortcomings in the contents and up-to-dateness of the prospectuses of some mutual funds.

29 October FIN-FSA publishes a report on IFRS enforcement indicating deficiencies in listed companies' goodwill impairment testing.

6 November FIN-FSA clarifies its competence in disputes regarding the marketing of securities.

11–12 November FIN-FSA participates in Sijoitus-Invest 2009 (an investment fair), arranged by Helsinki Fair Ltd.

12 November The Board of FIN-FSA approves the new strategy.

18 November FIN-FSA announces that the remuneration principles of large financial-sector companies are generally in accord with recommendations, but some changes are required.

19 November FIN-FSA makes an announcement about the reporting obligation prior to the launch of service provision as laid down in the Act on long-term savings.

3 December FIN-FSA announces it has commenced reform of the insurance sector reporting system.

10 December FIN-FSA announces that the capital adequacy of the banking and insurance sectors has become stronger.

11 December FIN-FSA publishes for comment its statement on remuneration policies.

16 December Reporting frequency in the banking sector's reporting of financial risk and capital adequacy is restored to normal.

Operating environment

Economy in deep recession

The international crisis on the financial markets became more pronounced in 2008 and then spread early in the review year to the real economy. Many economic regions – including the European Union – drifted simultaneously into a deep recession.

Finland's export volume declined almost a third from 2008, with a rapid deterioration in the employment situation during the review year. The recession will continue on the labour market through 2010, with the unemployment rate on the rise.

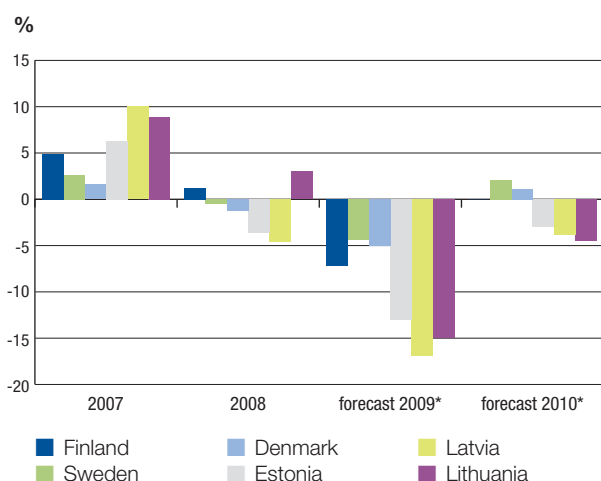
The developments in the international economy have had a particularly negative impact on the Baltic States, with preliminary data indicating a contraction of 13–18% in the Estonian, Latvian and Lithuanian economies in the

review year. In Sweden, too, the international recession caused a contraction in the economy.

The work of governments, central banks and international organisations was characterised by one objective above all others: to prevent the financial crisis from deepening further and at the same time pursue policies to minimise the impacts of the severe recession and sustain economic activity.

In the second half of the year, many large economies showed the first signs of a return to growth. The moderate recovery was due to the exceptionally expansionary economic policies pursued by governments and central banks, which enabled them to get a grip on the recessionary trend and the threat of a deepening downward spiral in the economy.

GDP change in Finland, Sweden, Denmark, Estonia, Latvia and Lithuania



* The forecasts for 2009 and 2010 are based in respect of Finland on the Bank of Finland forecast, and for other countries on The Economist Poll, an average of several published forecasts.

Source: National Accounts data.

The Finnish economy will recover from recession once growth takes off properly in the country's most important trading partners. The structure of Finland's export industry, in which capital goods predominate, means that new demand will emerge for Finnish exports only once investments begin to grow again in the major economies.

The exceptional nature of the financial crisis and the present economic juncture is also affecting the general level of prices. Consumer prices declined in many countries during spring and summer. The greatest downward impact came from cheaper prices for energy products and foodstuffs. In Finland, too, the review year was marked by very low inflation.

In Finland, household and corporate debt peaked and the household debt-to-income ratio, for example, grew scarcely at all in the review year. Households currently have debt equal to just slightly more than their annual disposable income.

Financial markets recovered from crisis due to pursuit of non-standard policies; increased uncertainty on the markets once more

During the review year, the global financial markets were dominated by the process of recovery from the crisis of autumn 2008. The condition of markets and banks improved, while investors' willingness to take risks grew over the course of the year.

Governments took on considerably more debt to help reflate their economies. The willingness to take on debt and the pace at which this process was pursued substantially boosted the supply of government bonds.

In the early part of the year, central banks lowered their policy interest rates very rapidly to historically low levels. This relaxation in monetary policy was made possible by the disappearance of inflationary pressures in the economy. Short-term market rates declined rapidly, to a record low. There was also a rapid decline in retail banks' loan and deposit rates.

Central banks guaranteed the liquidity of the interbank markets with exceptionally large refinancing operations. In the euro area, the ECB decided to offer banks the full allotment of liquidity they required through longer-term refinancing operations with a maturity of one year, provided the banks concerned could supply sufficient assets as collateral.

The Eurosystem began the purchase of covered bonds from the markets. The non-standard measures taken by the central banks were referred to as 'quantitative easing' or 'credit easing', because, once short-term interest rates had fallen to or close to zero, many central

banks sought to stabilise the markets by taking long-term financial claims onto their balance sheets. This succeeded in considerably boosting the money supply, which was reflected in exceptionally rapid and substantial growth in central bank balance sheets.

The steps taken by governments and central banks secured banks' funding and bolstered the lending capacity of the banking system. For example, the governments of the United Kingdom and Denmark were forced to augment banks' equity and provide guarantees for their funding. In Finland, there has been no need for such measures.

Emissions of both government and corporate bonds found willing buyers, and long-term interest rates were stable from spring onwards. The stability of long-term rates reflected, among other factors, the stability of medium-term inflation expectations.

Risk premia on the markets declined from spring onwards. Market interest rates on both secured and unsecured short-term credit approached the pre-crisis levels of August 2007. Risk premia on bonds issued by major banks and on government bonds also declined during the course of the year.

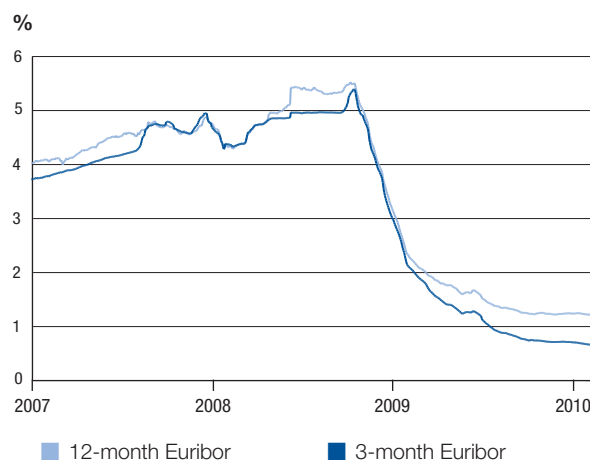
On the stock markets, it was a year of contrasting developments. The decline at the start of the year bottomed out in March, after which prices rose on all markets by as much as several tens of percents. This was partly because the yields on other investment instruments were low at a time when the supply of funds for investment and liquidity on the markets was growing. Expectations for the economy and corporate earnings

Yield differentials between secured and unsecured deposits in the euro area



Source: Bloomberg.

3 and 12-month Euribor rates



Source: Bloomberg.

development also became more positive during the course of the year.

Stock market volatility, ie fluctuations in share prices, was more moderate than in 2008. Many other markets were more volatile: there were substantial fluctuations on the foreign exchange markets, where the decline in the value of the dollar was a characteristic feature. The prices of many metals, gold and oil all increased. This was due to growing international demand and economic activity, particularly in the second half of the year. The rise in gold prices reflected the decline in the dollar and the risk aversion of some investors.

Developments on the international financial markets were reflected in similar trends in Finland. There were substantial gains in share prices, and interest rates were exceptionally low. These factors contributed to a rise in house prices during the second half of the year, despite the deep recession.

Since January 2010 there has been growing uncertainty on the markets: share prices have fallen, volatility increased and the risk premia on government bonds grown again. This has been due to rapidly growing concern on the markets over the growth in government debt and governments' ability to service this debt. The attention of the markets, as also the demands for an end to the deepening spiral of debt, has focused on Greece, although the problem itself is a broader one. There is no easy way out. The most important thing is get control of the debt process by pursuing credible policies.

Financial performance of supervised entities

Bank earnings declined while insurance sector investments did well

In the review year, aggregate bank earnings declined relative to the previous year, while insurance operations were characterised by a good yield on investment activities.

The steep decline in interest rates combined with fading growth in the stocks of loans and deposits to cause a decline in banks' largest source of income, net interest income. The interest rate margin calculated from the stocks of loans and deposits narrowed substantially during the course of the review year, while the stocks themselves showed scarcely any growth. Banks assessed credit risks more thoroughly than before. MFIs' stock of loans to the corporate sector declined by 5% during the year, with the figures for the reference period reflecting the exceptional growth in bank lending to the corporate sector caused by the scarcity of other sources of credit during the financial crisis. In contrast, MFIs' stock of housing loans grew by 6%. At the same time, the low interest rates encouraged customers to transfer their deposits, for example into mutual fund investments.

The importance of banks' interest rate risk is illustrated by the fact that a change of one percentage point in interest rates translates as approximately EUR 600 million in aggregate net interest income. Thus, a one percentage point rise (fall) in market interest rates would increase (decrease) deposit banks' net interest income by approximately EUR 600 million. This corresponds to around 15% of net interest income.

From an earnings perspective, one positive feature was the substantial recovery in banks' capital market yields. This was, however, insufficient to compensate for the decline in net interest income and growth in loan losses.

In the review year, credit impairments, ie loan losses, increased many-fold from the previous year. Cumulative credit impairments amounted to EUR 840 million, which,

annually adjusted, corresponded to 0.5% of the stock of loans and guarantees. Loan losses wiped out almost a third of bank earnings. Historically, loan losses in Finland peaked at the height of the banking crisis in 1992, when they equalled 3.7% of the stock of loans and guarantees.

Nonperforming assets are loans on which interest payments or capital instalments have been overdue for more than 90 days. The volume of nonperforming assets grew in the review year to stand at EUR 1.2 billion by the end of December, equal to 0.7% of the stock of loans and guarantees. The volume of nonperforming assets at the end of the year had, however, not risen as high as previously expected. Historically, nonperforming assets in Finland peaked at the end of 1993, when they accounted for 9.6% of the stock of loans and guarantees.

Banking liquidity improved as the financial crisis eased and it became easier to procure funding. The risk premia included in the price of finance declined during the course of the year. As the year progressed, banks augmented their liquidity reserves, which means they retained on their balance sheets a greater amount of liquid, low-risk securities eligible for collateral purposes.

During the year, the price of long-term funding declined, although it remained higher than the pre-crisis level. Deposits retained their key position in banks' funding acquisition, although the volume of deposits did not grow. At the turn of the year, deposits from the public covered 67 % of the credit granted in Finland.

Insurance institutions' investment activities developed positively as a result of rising share prices and the general recovery on the financial markets. The upward trend in the value of key investment instruments began in the spring. This substantially boosted insurance

company earnings and the return from investment activities was decidedly positive.

There were major differences in the return on investments between different sectors of the insurance business due to the use of different investment allocations and derivative instruments. Similarly, even within the same sector the structure of different companies' allocations differed more than in previous years. As a result, returns on investment were also more differentiated than previously.

Employee pension insurance companies reduced the weighting of equities in their investments at the height of the financial crisis, but increased it again during the review year. The volume of equity and interest rate derivatives grew, but their overall effect was to lower the level of equity risk. In life insurance companies, equities' share of investments remained almost unchanged. Bond investments expanded their share, while the share of money market investments declined. Non-life insurance companies' investments were predominantly in bonds, and changes in investment allocations were slight.

Supervised entities' capital adequacy and capital buffers strengthened

Capital adequacy in the banking sector and solvency in the insurance sector both developed positively during the review year.

The capital adequacy of Finnish banks improved during the year, and the capital structure was healthy. Core capital accounted for approximately 95% of total assets. Preliminary data indicates that, at the turn of the year, the aggregate capital adequacy ratio for the banking sector as a whole was 14.5%, which is high in international comparison. Capital buffers, ie own funds in excess of the minimum capital adequacy reserves, grew to approximately EUR 9 billion.

Although sector earnings were down, most individual banks still returned a profit. Together with their large capital buffers and high levels of capital adequacy, this has meant that banks have been well placed to cover all their risks (credit risks, market risks, operational risks and other possible risks) as well as the effects of the weaker operating environment.

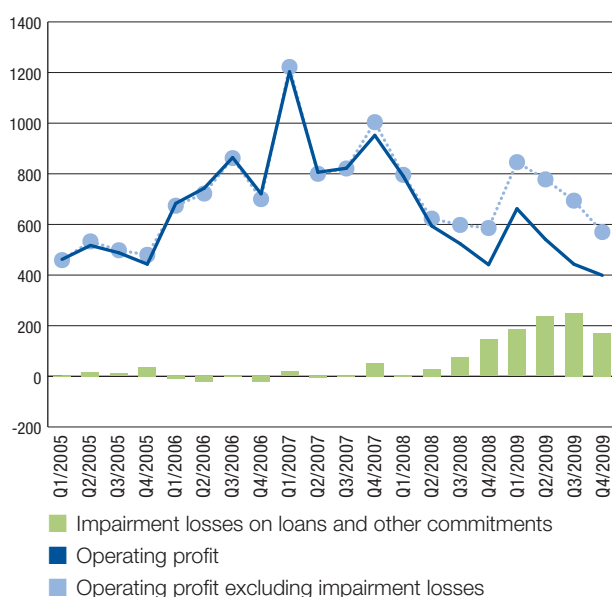
Since the beginning of 2008, banks have been implementing the Basel II capital adequacy regulations. Basel II did not bring any essential or substantial changes to banks' capital adequacy ratios, although these did rise slightly due to the new regulations.

Insurance companies' solvency was improved during the review year by the recovery on the investment markets.

Employee pension insurance companies' aggregated solvency margin grew from EUR 9 billion in 2008 to over EUR 14.7 billion.

Finnish banking sector's operating profit and impairment losses

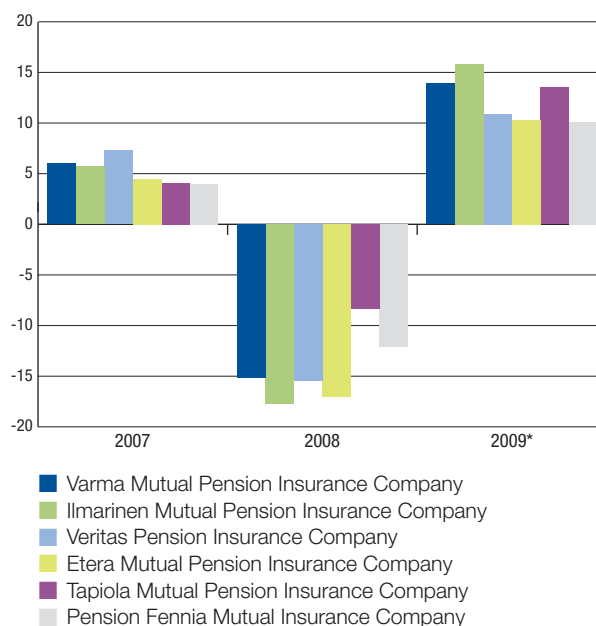
EUR million



Source: Financial Supervisory Authority.

Employee pension insurance companies' net investment income at fair value

%



* Data for 2009 are preliminary.

Source: Data published by the featured companies.

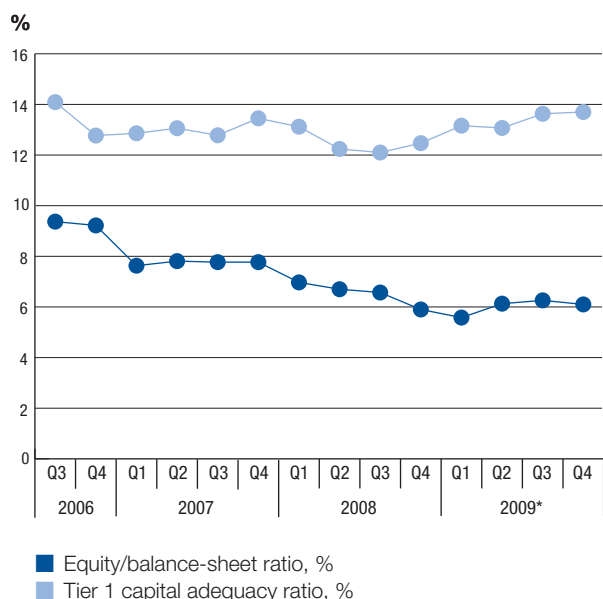
Solvency among both life and non-life insurance companies also improved due to the positive trend in investment activities. For both life and non-life insurance companies, the level of the solvency margin grew in the review year.

The capital adequacy of financial and insurance conglomerates improved. These conglomerates engage

in both banking and insurance activities. In addition to calculating capital adequacy and solvency ratios for their banking and insurance activities, they also calculate an overall capital adequacy ratio at conglomerate level.

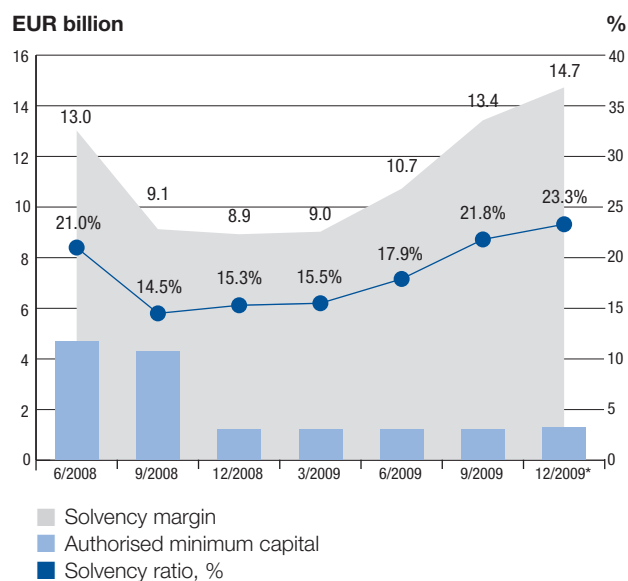
Banking activities account for a decisive share of claims under own funds at conglomerate level (over 85%). The remainder are spread between life and non-life

Finnish banks' Tier 1 capital adequacy ratio and equity/balance-sheet ratio



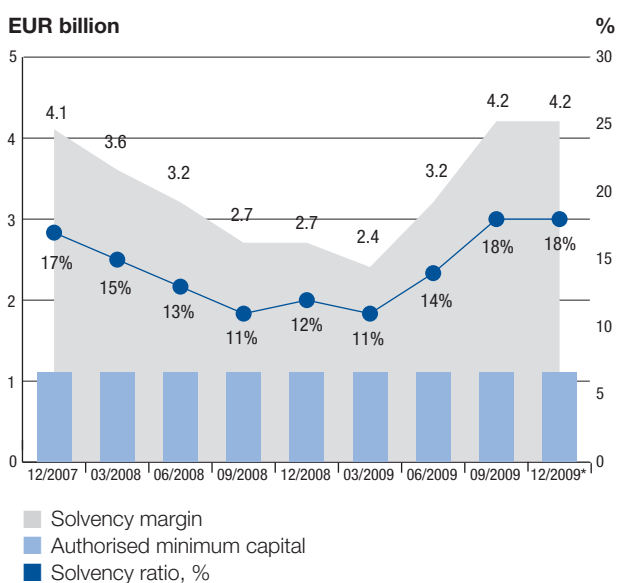
* Data for the end of 2009 are preliminary.
Source: Financial Supervisory Authority.

Solvency of employee pension companies



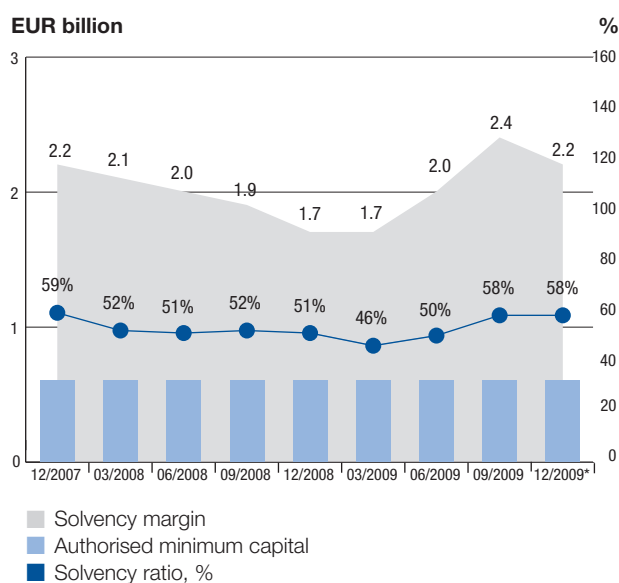
* Data for the end of 2009 are preliminary.
Source: Financial Supervisory Authority.

Solvency of life insurance companies



* Data for the end of 2009 are preliminary.
Source: Financial Supervisory Authority.

Solvency of non-life insurance companies



* Data for the end of 2009 are preliminary.
Source: Financial Supervisory Authority.

insurance. The minimum capital adequacy requirement for these conglomerates is 1.0, which means they must have sufficient own funds to cover at least the minimum requirement for own funds based on their risks. During the course of the year the ratio grew, and at the end of the year, according to preliminary data, the aggregate ratio for all conglomerates stood at 1.7.

The solvency margins of most employee pension funds also grew during the year.

Stress tests conducted during the year reinforced the view that the capital adequacy of the financial and insurance sector would withstand a serious and prolonged recession in Finland.

Temporary amendment of solvency legislation for employee pension providers to prevent forced sales of shares

The solvency provisions for pension providers engaging in employee pension insurance activity in the private sector were temporarily amended at the end of 2008 in response to the strong fall in asset values in the wake of the financial crisis. The amendment enhanced the risk-taking capacity of employee pension providers and considerably reduced their need to sell high-risk investments in order to maintain solvency.

The aggregate solvency margin for employee pension companies and funds at the end of 2007 totalled EUR 19.8 billion. The situation changed radically in 2008: at the end of June, the solvency margin stood at EUR 14.6 billion, and at the end of September at EUR 10.4 billion. Because of the decline in asset values, primarily share prices, about EUR 9.5 billion, or close to half, of the solvency margin had vanished over the period January–September 2008.

Market developments were also reflected in a shift towards a lower-risk asset allocation in employee pension providers. During January–September 2008, the proportion of equity holdings fell on average from 38% to 26%.

After September 2008, share prices continued to decline, falling by close to one third more in October–November. This was reflected in a further decline in the solvency margins of pension providers, which contracted, on average, close to the solvency limit.

In a time of falling asset prices, employee pension providers can raise their solvency ratio only by replacing high-risk assets with lower-risk investments that tie up a smaller amount of the solvency margin. It was becoming evident that employee pension providers would have to strengthen their solvency position by disposing of their holdings in Finnish shares.

At the end of June 2008, employee pension providers' holdings in Finnish listed companies amounted to more than EUR 8 billion, which accounted for one fifth of their total equity portfolio. At the time, this accounted for 4.4% of the total market value of the Helsinki Stock Exchange. The shares would thus have been sold in a market with exceptionally low share prices. A massive disposal of shares would also have caused a deeper dive in the stock market and economy in Finland, possibly resulting in a weaker contribution base and impairing employers' scope for collecting contributions.

In October 2008, the Finnish Government submitted a bill to Parliament with a proposal for temporary amendment of the provisions on the funding of old-age pensions and the solvency margin applicable to pension providers engaging in statutory pension insurance activity. The proposed legislation applied to employee pension companies and funds under the Employee Pensions Act (TyEL), and the Seamen's Pensions Fund. The resulting Act entered into force on 22 December 2008 and will remain in force until the end of 2010. Some of the amendments took effect on the very day the Government bill was issued, ie 17 October 2008.

The purpose of the Act is to lower the solvency requirements for employee pension providers so as to ensure they will not have to dispose of their holdings in, for example, Finnish shares under unfavourable market conditions. In order to strengthen solvency, the provisions on the funding of old-age pensions and the determination of additional technical provisions related to the return on stock were amended, while equivalent treatment with the solvency margin was introduced for part of the provision for pooled claims.

In 2008, the provision for old-age pensions was augmented only by an amount equalling the discount rate, ie 3%. The return based on the applicable ►

► coefficient for 2008 was not transferred to the provision for old-age pensions, but remained in the provision for future bonuses within the solvency margin. As a result of this amendment, the technical provisions of employee pension providers declined and solvency margins increased by around EUR 1.3 billion.

The transitional provision concerning the additional technical provisions related to the return on stock was repealed, and, as a result, the proportion of technical provisions related to the return on stock increased from 4% to 10% already in 2008. In response to losses on shares, the additional technical provision related to the return on stock was around EUR 1.6 billion smaller than if it had been calculated according to the previous 4% rule. Solvency margins increased correspondingly.

The provision for pooled claims is the item of technical provisions set aside as a short-term buffer against fluctuations in joint pension liability and contribution rates. Since Finland's entry into European Monetary Union, the level of the provision for future claims has been higher than the buffer requirement for joint pension liability (EMU buffer). Some of this excess amount will be treated as equivalent to the solvency margin until the end of 2010. The equivalent amount represents 4% of the technical provisions (before deduction of the equivalent amount) used in calculating the solvency limit, ie about EUR 2.6 billion.

The temporary amendment also applies to the minimum amount of the solvency margin. Under normal conditions, the minimum solvency margin must amount to at least two thirds of the solvency limit for employee pension companies, and one third of the solvency limit for funds. Under the amendment, the minimum amount for employee pension companies is 2% (and for funds 1%) of the technical provisions on which the solvency limit is calculated. Hence, during the validity of the Act, the minimum amount is not dependent on investment risks.

Overall, the solvency margins of employee pension providers were strengthened by around EUR 5.5 billion, while the minimum amount of the solvency

margin was reduced by around EUR 1.9 billion. In other words, solvency capital in excess of the minimum amount rose by approximately EUR 7.4 billion. Of the addition to the solvency margin, around EUR 2.6 billion was accounted for by the amount of the provision for pooled claims treated as equivalent to the solvency margin. As the risk-taking capacity of employee pension providers was increased, their need to sell high-risk investments in order to maintain solvency was considerably reduced.

The Act also has some bearing on the rules for refunds and contributions. Neither the amount calculated on the applicable annual coefficient for transferral to the solvency margin nor the amount of the provision for pooled claims treated as equivalent to the solvency margin can be distributed to policyholders as rebates on contributions.

Employee pension providers will report and disclose solvency data both with and without the temporary relaxation allowed by the Act. In reports prepared without the relaxation, the amount of the provision for future claims treated as equivalent to the solvency margin does not count towards the solvency margin, the minimum amount of the solvency margin instead being calculated according to risk criteria under the permanent legislation.

In May 2009, the Ministry of Social Affairs and Health set up two working groups to explore the need for reform of the solvency regulations for the private-sector earnings-related pension scheme, with due recognition of the financial and economic crisis. The working groups proposed extension of the validity of the temporary amendment by two years until the end of 2012.

The temporary regulatory amendment has contributed to lowering the pressure on employee pension providers to reduce their holdings in, for example, Finnish shares under unfavourable market conditions. Hence, the temporary amendment promotes the long-term financing objectives of the earnings-related pension scheme by reducing pressure for raising contribution levels.

Analyses and inspections

Reporting frequency increased

The international financial crisis and the ensuing economic downswing placed pressures on banks' profitability and capital adequacy. The spread of the financial crisis into the real economy increased the need for closer supervision of the operating conditions of supervised entities, in Finland as elsewhere. Due to the rapid changes in the operating environment, FIN-FSA increased the frequency of official reporting in respect of the balance sheet and financial statement, capital adequacy and liquidity risk from quarterly to monthly. So as to assess risks proactively, supervised entities' risk-bearing capacity was subject to intensified monitoring through monthly analyses and meetings with supervised entities' representatives.

Stress tests revealed Finnish financial sector's capacity to bear risk

Forecasts of banks' financial performance were prepared on the basis of macroeconomic forecasts for the Finnish economy. Banks' and insurance companies' profitability was also assessed in financial sector stress tests twice during the year. In spring 2009, FIN-FSA conducted, together with the Bank of Finland, a stress test based on a more negative scenario than the macroeconomic baseline scenario current at the time. The aim was to assess the implications for deposit banks' results and capital adequacy. In July–September, FIN-FSA conducted another stress test, this time together with banks and insurance companies. This time, supervised entities applied a scenario created by FIN-FSA in order to calculate the implications for their own earnings and capital adequacy. The stress tests showed that supervised entities' capital adequacy could withstand a much deeper and more prolonged recession than forecast.

Risk-oriented selection of inspection targets

Prudential supervision – as other FIN-FSA supervision – is risk-oriented. The deepening of the financial crisis into a recession that affected the whole economy led to heightened credit risks. The liquidity situation on the international money markets improved during the review year, but the supervision of liquidity risks was improved on the basis of experiences from the crisis.

In inspections and other risk monitoring, priority was given to credit risk management, capital adequacy, liquidity risk management and management of market and investment risks. No risk management negligence was detected that could have jeopardised supervised entities' capital adequacy. Entities were, however, made aware of several aspects of risk management that could benefit from further development. Inspections were also conducted into banks' derivatives business. Operational risks were addressed in connection with inspections of a variety of risk areas and functions. In addition, the internal operational risk management systems of the largest supervised entities were subjected to specific inspection. When inspecting market and investment risks and operational risks, FIN-FSA sought to integrate the risk management competences of the previously separate financial and insurance supervisors. Group-level inspections of Nordic conglomerates, such as Danske Bank and Nordea, were conducted in cooperation with home country supervisors.

Besides being risk-oriented, FIN-FSA inspections also follow the principle of regularity. Beginning in the latter part of 2009, inspection targets were chosen in a uniform manner in both financial and insurance sectors. Significant supervised entities were determined for each area of risk and a minimum frequency set for the conducting of inspections. The precise focus of

inspections is based on ongoing entity-specific monitoring and assessment of the effects of changes in the operating environment.

Quantitative discriminant analysis is employed to focus inspections in the case of smaller supervised entities. Looking further ahead, supervised entities will be informed in advance of planned inspections.

Supervision of credit risk

Quality of credit portfolios deteriorated, but capital adequacy was not jeopardised

Credit risk inspections focused on the management of credit risks, estimations of Internal Ratings Based Approaches (IRBA) for the calculation of capital requirements for credit risk, and the quality of supervised entities' credit portfolios. The credit risks of the largest banks were assessed comprehensively in several inspection visits. The credit risk for the Finnish banking system from the Baltic States was monitored and analysed closely during the review year. The area was also included in FIN-FSA's inspection programme for the year.

Inspections of credit risk management focused on examining credit risk management arrangements as a whole, and several methods were employed in evaluating the quality of the credit portfolio. Areas covered included the credit-granting process, credit ratings, pricing and credit margins, risk concentrations, collateral management and the use of various credit risk instruments. The quality of the banking sector's credit stock, sector- and company-specific concentrations and related risks were assessed on the basis of information reported by the supervised entities and separate FIN-FSA surveys.

Banks can choose between the Standardised Approach (SA) and an Internal Ratings Based Approach (IRBA) when calculating their capital requirements for credit risk. The use of IRBA requires the permission of the supervisor. In the review year, evaluation of banks' IRBA applications was continued and the quality of the procedures of banks already using IRBA was monitored. Due to the economic situation, special supervisory focus was placed on changes in counterparty classifications and their analysis. The up-to-dateness of banks' counterparty classifications and their updating as required was also subject to close monitoring.

Inspections revealed that credit-granting criteria began to tighten as the economy drifted into recession. Based on reporting and inspections, the quality of banks' credit portfolios was observed to deteriorate in 2009, but these risks did not jeopardise supervised entities' capital adequacy. Credit ratings applied by small deposit banks

could benefit from further development. The ratings of banks using IRBA methods were more advanced in this respect, as in others.

The comprehensive application of IRBA has required banks to improve their internal rating systems, and for this reason it has been a challenge for banks and supervisor alike. Banks' activities in the Baltic States were also inspected.

Besides inspections of the most significant banks, FIN-FSA also inspected the credit risks of several local banks. The inspections indicated that, in general, the management of credit risk was good in the banks inspected.

More detailed reporting on problem assets

In spring 2009, a reporting system that enables entity-specific analysis of reported data by the supervisor was introduced to support credit risk inspection. In autumn, the submission of supervised entities' internal credit risk reports that supplement official reporting to the supervisor was systematised. In response to the unfavourable economic developments, reporting of problem assets was further developed and extended to individual deposit banks.

Supervision of market and operational risks

Employee pension providers' investment activity under special scrutiny

In December 2008, Parliament approved a temporary Act amending the solvency provisions for pension providers. The purpose of the temporary amendment was to avoid employee pension providers being forced to sell their security holdings at a time of falling prices in order to keep within the solvency requirements. Owing to the temporary easing in solvency provisions, FIN-FSA intensified supervision of the insurance sector in regard to pension providers' risk management in their investment activities and their solvency. Inspections focused on questions such as solvency classifications and risk management in respect of hedge fund and real estate investments. Inspections of employee pension providers' and insurance companies' investment risks will be continued and expanded in 2010.

Monthly reporting of liquidity risks

The financial crisis put the management of banks' liquidity risks in a whole new light from the perspective of the availability and pricing of funding. In respect of liquidity risks, inspections and contacts with supervised entities were already increased substantially in 2008, and the heightened level of monitoring was sustained in 2009. The frequency of banks' funding risk monitoring was increased to monthly. In addition, information on

banks' financial situation was supplemented by separate surveys. Nordic cooperation in the supervision and regulation of liquidity risks was increased in respect of both joint inspections and exchange of information.

CEBS published its guidelines on adequate liquidity buffers, which FIN-FSA will incorporate in its standard on the management of liquidity risk to be issued in 2010. These guidelines build partly on CEBS's earlier recommendations on liquidity risk management, stress tests and contingency plans. CEBS is also preparing guidance on the allocation of banks' internal financing costs. Work on drafting quantitative limits for liquidity risk was begun in a working group of the European Commission at the end of the year.

Security of corporate web banking services appropriate

Inspection of operational risks was continued as planned in significant supervised entities. Thematic inspections relating to banks' derivatives trading were also continued, focusing on assessing market risks and business-related operational and information system risks.

Supervision of payment systems and SEPA projects was continued in the largest supervised entities. In the latter half of the year, inspection of settlement risk management in foreign exchange trading was begun, and this will be continued in 2010.

Inspection of corporate web banking services offered by banks was continued. The purpose was to assess web banking services – especially those related to payment transfers – provided by banks to companies, the organisations managing these services and their strategic guidelines, security and technical solutions. The inspections also evaluated services through which companies send and receive payment traffic data in electronic form. Supervisory findings indicated that the organisation, security and management of technical solutions concerning corporate web banking services provided by banks are, as a rule, appropriate.

Money laundering prevented through domestic supervision and international cooperation

Early in the year, FIN-FSA began to monitor the development of risk management procedures and systems relating to money laundering and terrorist financing required by the Act on Preventing and Clearing of Money Laundering and Terrorist Financing, which entered into force on 1 August 2008.

In summer 2009, the Financial Action Task Force on Money Laundering (FATF) reviewed observations of its members and the private sector on the effects of the financial crisis on money laundering and terrorist financing. Some member countries reported that money laundering had increased, but no unusual growth was

detected in Finland. In 2007, the FATF conducted an evaluation on Finland, and in October 2009 Finland issued a statement to the FATF on action taken to correct the shortcomings observed in the evaluation, for instance regulatory deficiencies.

The Act on Strong Electronic Authentication and Electronic Signatures came into force on 1 September 2009. For banks to ensure the 'Tupas' identifiers they have issued continue to be recognised as strong authentication methods, they will have to provide written notification to the Finnish Communications Regulatory Authority, which monitors compliance with the Act. The Act provides for a six-month transitional period for this notification. The creation of a strong electronic authentication requires specifically defined initial identification. Besides banks, other institutions are also developing strong electronic authentication methods. These include teleoperators' mobile certificates.

Supervision of underwriting risks

No major deficiencies detected in underwriting risk management and methods

The supervision of underwriting risks was aimed particularly at ensuring that risk management is adequate and appropriate. In the review year, the economic recession had only a moderate impact on the underwriting risk of supervised entities operating in the non-life insurance sector. In the life sector, however, underwriting risks followed general developments in market risks.

FIN-FSA operations were notably affected by various national and international regulatory projects, including the forthcoming Solvency II Directive relating to life and non-life insurance companies, solvency regulations in respect of employee pension providers and regulation of premiums for statutory accident insurance.

In the review year, various stochastic financial and mortality models were studied, particularly Solvency II internal models. The financial crisis showed there was a need to develop better models for forecasting the solvency of insurance companies and estimating how different economic factors affect insurance company operations. In the review year, FIN-FSA continued to monitor official reporting and develop analytical tools.

Revision of reporting by insurance companies

The reporting processes of insurance companies and banks will be integrated by combining databases and transferring insurance company reporting to the Virati data collection system of FIN-FSA, the Bank of Finland and Statistics Finland. The number of reports required from insurance companies will also be reduced. At the same time, report contents will be clarified, deadlines

updated and reporting configured technically to match the Virati concept. The revision will expand the possible uses of the information collected.

Remuneration principles of large financial sector companies generally in accord with international recommendations; some changes nevertheless required

According to a survey by FIN-FSA in autumn 2009, the remuneration policies of the largest financial sector companies are mainly in accord with current recommendations. Directors' remuneration at key financial sector companies does not include features that would encourage risk-taking in excess of the company's risk tolerance. Recently published international recommendations and regulatory developments relating to remuneration (see page 47) mean, however, that Finnish financial sector companies will need to review their remuneration principles thoroughly.

In general, the largest financial sector companies surveyed have set clear upper limits on performance-related bonuses for directors. The companies had already taken account of risks arising from executive and other staff remuneration prior to the financial crisis.

Nor did remuneration of other staff members indicate the existence of incentives for risk-taking that would be unjustified from the viewpoint of the supervised entity. Even so, some cases pointed to a need to restrict the maximum amount of staff bonuses, to align remuneration more broadly with a company's overall performance and to spread bonus payments over a longer time horizon.

Some companies have linked part of directors' remuneration to the company's share price performance, or agreed on bonus payments in the form of shares after a certain fixed period. In such cases, share price performance may lead to a substantial increase in remuneration. Generally, persons remunerated in this way have had to invest their own funds in company shares.

A company's board is responsible for the content of remuneration principles. The board must confirm the remuneration policy, constantly update it and ensure compliance with it. The board is ultimately responsible for ensuring the confirmed remuneration policy is consistent with sound and effective risk management and does not induce excessive risk-taking on the part of directors or other staff members.

Nordic supervisory cooperation

International supervisory cooperation concerning Nordic conglomerates is already established practice. CEBS has begun work to establish colleges of supervisors for all major credit institution groups operating in Europe and prepare guidelines for the operational functioning of the colleges in line with the Directive. The guidelines should be finalised by summer 2010.

The financial position and risks of large Nordic banking and insurance conglomerates were evaluated at conglomerate level in cooperation with Swedish, Danish and Norwegian supervisory authorities. FIN-FSA was also responsible for supervising profitability and capital adequacy for all units operating in Finland.

In the review year, collegial cooperation was commenced with the Danish supervisor Finanstilsynet regarding the Danske Bank group. A Memorandum of Understanding (MoU) on this cooperation was signed in the summer. FIN-FSA also began collegial cooperation regarding Svenska Handelsbanken and Skandinaviska Enskilda Banken (SEB). The MoU on Handelsbanken was signed with the Swedish supervisor Finansinspektionen, while the MoU on SEB is still under preparation.

FIN-FSA acted as coordinating supervisor of the supervisory group for Sampo Group, bringing together Finnish, Swedish, Norwegian and Estonian supervisors. FIN-FSA's role as coordinating supervisor will become considerably more important when the new financial and insurance conglomerate is established.

Changes in supervised entities

Changes in financial conglomerates

Sampo Group

Sampo Group's ownership of shares in Nordea Bank AB (publ) exceeded the threshold of 20% on 10 December 2009. Consequently, a new financial and insurance conglomerate was born. In addition to the holding company Sampo plc, the new conglomerate comprises the non-life insurance group If and one of Finland's largest life insurance companies, Mandatum Life, whose subsidiary Sampo Life Insurance Baltic SE operates as a life insurer in the Baltic States. Nordea is, in turn, one of the largest banks in the Nordic countries. The group has also significant life insurance activity in the Nordic countries, Poland and the Baltic States.

The new conglomerate is primarily engaged in financial activities and is headed by Sampo plc. The coordinating supervisor is FIN-FSA. Supervision of the conglomerate is based on the Act on the Supervision of Financial and Insurance Conglomerates. Besides capital adequacy

supervision based on this Act, the conglomerate is also subject to supplementary supervision in accordance with standards and instructions. This supplementary supervision requires international reporting by the conglomerate primarily on internal governance, organisation of activities, financial statements and the management report as well as intra-group transactions. The supplementary supervision is based on the Financial Conglomerates Directive, which requires the establishment of a college of supervisors. Looking ahead, supervision of the conglomerate will involve the supervisory authorities of Poland, Luxembourg and the Baltic States as well as the Nordic financial supervisors.

OP-Pohjola Group

Two cooperative bank mergers took place in the review year, leading to the establishment of Salon Osuuspankki and Joensuu Seudun Osuuspankki. In addition, Pohjola Finance Ltd merged with its parent company, Pohjola Bank plc on 30 September.

Tapiola Group

Tapiola Corporate Life Insurance Ltd, specialised in life insurance for its corporate customers, merged with Tapiola Mutual Life Assurance Company on 31 December.

Aktia Group

Veritas Mutual Non-Life Insurance Company merged with Aktia plc on 1 January, changing its name to Aktia Non-Life Insurance Company Ltd. On 8 April, Aktia Bank plc sold Aktia Life Insurance Ltd to Aktia plc. Aktia listed on NASDAQ OMX Helsinki on 29 September.

Restructurings in local banks and insurance associations

Restructurings in savings banks continued. During the year under review, three savings banks were converted into limited liability savings banks owned by local savings bank foundations. The change in corporate structure increased the banks' size, as three other savings banks handed their activities over to the limited liability banks. The savings banks of Hauho and Renko merged to form Kantasäästöpankki Oy, while those of Töysä and Kuortane merged to form Oma Savings Bank Ltd. The merger between the savings banks of Ikaalinen and Luopioinen will be finalised in 2010.

Several insurance associations merged in 2009. There were in all 88 insurance associations at the beginning of the year and 70 at the end of the year.

Payment Services Directive brings new supervised entities

The Payment Services Directive will be transposed into Finnish law in spring 2010 with the Payment Services Act and the Payment Institutions Act. These Acts will form the legislative framework governing issues such as

the provision of payment services, authorisation and own funds. The Payment Institutions Act will extend the scope of regulation to companies that provide payment services. These include companies issuing payment and credit cards or teleoperators that provide certain payment services. Payment companies within the meaning of the new Acts are not previously known in Finland, which means that, for FIN-FSA, they represent completely new supervised entities.

The Payment Institutions Act stipulates transition periods during which companies providing investment services should apply for authorisation from FIN-FSA, register their activities or discontinue trading. Due to the transition periods, FIN-FSA supervision is likely to focus at first on assessing the operating requirements for entities providing payment services.

New companies accepting deposits

The refinancing of operations via deposits has provided a cheap source of funding compared with, for example, bonds. FIN-FSA received several enquiries regarding the requirements for deposit banking activities, and two new participants submitted an application for authorisation. Companies providing instant loans and consumer credit to private individuals have shown particular interest in deposit banking activities.

One credit institution authorised in an EEA state that has accepted deposits from Finland on a cross-border basis established a branch in Finland at the end of the year.

More new participants in the markets for investment services and fund investing

Interest in the establishment of management companies persisted, even though fund assets continued to decline in value in the early part of the year. FIN-FSA also received new applications for authorisation to trade as an investment firm, and there were also a lot of applications during the year for updates of existing applications. The turn in the market situation has not, at least yet, led to substantial market exits or mergers. The first notable merger was seen in early autumn when Evli Bank Plc acquired the asset management companies Carnegie Kapitalförvaltning AB and its wholly owned subsidiary Carnegie Fund Management Company Ltd. In the autumn the Swedish Nordnet Bank AB, since the summer the new owner of eQ Bank Ltd, began the process of integrating the online trading business of eQ Bank with its own operations and discontinued some activities not included in its core business.

Increase in wind-ups of company and industry-wide pension funds

In the review year, a total of 7 industry-wide pension funds or company pension funds pursuing activities specified in employee pensions legislation were dissolved and their operations transferred to employee pension

insurance companies. The transfer of pension fund insurance activities to an insurance company is subject to supervisory approval. The number of wind-ups was greater than in previous years, signifying a reduction of 18% in the total pension liability or technical provisions of pension funds. At the end of the year, the number of company and industry-wide pension funds operating under the Employees' Pensions Act totalled 26.

Supervision of information for investors and customers

Listed companies' prospects in the weakened state of the economy

Due to the deterioration in the economic environment, FIN-FSA carried out early in the year a follow-up survey of how companies have reported and justified their prospects, based on their 2008 financial statement releases. The survey showed that three out of four companies had published a profit forecast, compared

with 96% in an earlier survey. The uncertain economic situation was also reflected in the fact that some companies ceased publishing prospects for their individual segments. On the other hand, instead of just providing a general outlook for the future, some companies extended their disclosure of information by providing a profit forecast or group prospects with additional information on individual segments.

Most companies published a profit forecast for the whole reporting year; thus, the uncertainty did not seem to influence the length of forecast period. FIN-FSA has proposed that in exceptional circumstances the profit forecast could be shortened to cover, for example, only the current quarter, even if the general rule is that the outlook should be published for the whole reporting year.

In the rationale behind their prospects, many companies referred to the uncertain market. In its comments, FIN-FSA emphasised that companies should clearly disclose

Solvency II: Harmonised and comprehensive prudential supervision of non-life insurance, life insurance and reinsurance undertakings

In 2003, the EU's Insurance Committee endorsed the Commission's proposal for a comprehensive reform of the solvency rules for insurance companies. The objectives of Solvency II include protecting the interests of policyholders and beneficiaries, fostering companies' own risk management, increasing intra-EU competition and enhancing efficient capital management.

Under Solvency II, assets and liabilities will be valued largely on the basis of their market value. Another innovation will be the assessment of risks in order to calculate the capital requirement. The risks to an undertaking's business and to its assets and liabilities include underwriting risk, market risk, credit risk and operational risk. The combined effect of the various types of risk will also be assessed. Current solvency requirements laid down in Directives are based on the volume of business and do not take account of the actual risks involved in a business. In addition to the minimum requirements laid down in the Directive, EU countries have introduced nationally their own additional requirements. These differing requirements will now be replaced by uniform solvency requirements.

In addition to quantitative solvency requirements, Solvency II emphasises the importance of good

governance and its various sub-areas such as risk management. In future, companies will be required to prepare annually a total assessment of their own risks, risk management procedures and available capital (own-risk and solvency assessment). Solvency II also enhances the transparency of supervision and the disclosure of information by insurance undertakings on their business and related risks.

The financial crisis showed that the objectives of the reform remain valid during a crisis and that there is a growing need for new, harmonised, risk-based regulation that emphasises risk management.

The behaviour of various investment instruments in market disruptions does, however, require further examination, as do the liquidity risks of insurance operations. The effectiveness of group supervision must also be ensured, and the possible pro-cyclical effects of regulation examined. The requirements of good governance ought to be strengthened further. Good governance also covers remuneration policies and related issues.

For more information on Solvency II, see page 48.

all factors of uncertainty. On the whole, the rationale behind the prospects varied greatly, which corresponds with FIN-FSA's earlier observations. More than half the companies referred to cost-cutting in the justifications for their prospects.

FIN-FSA looked at listed companies' interim financial reports and also monitored their disclosure of prospects in other ways, and changes made therein. This revealed that companies use a terminology for describing their prospects that cannot be considered particularly informative (such as 'well below' or 'falls below the 2008 level'). Due to the economic situation, it can be hard for investors to form an opinion about the significance of the changes. Therefore, FIN-FSA has emphasised that, despite the economic uncertainty, the information disclosed on the outlook should be reliable and clear enough to enable investors to make an informed assessment of the company's financial position and performance.

Special focus on the use of derivatives in supervising the obligations to disclose major holdings and make takeover bids

In recent years, there has been an increase in the use of derivatives on the securities market. In autumn 2008, FIN-FSA requested opinions on whether shares controlled through derivatives should be considered in assessing the obligation to make takeover bids. In its spring 2009 response to comments received, FIN-FSA stated that it is possible for the holders of derivatives to exercise control over underlying shares and that the method of settling the derivatives (cash or physical settlement) is, as such, insignificant. However, the situation must be assessed case by case. In its Markkinat ('Markets') newsletter, FIN-FSA stated its views on the use of derivatives in connection with the obligations to disclose major holdings and make takeover bids, and pointed out the regulatory requirements to market participants.

In its supervisory work, too, FIN-FSA focused on the use of derivatives and addressed neglect of the obligation to disclose major holdings by issuing a public reprimand to two market participants that had neglected to disclose changes in their share holdings stemming from share lending. The share lending pertained to a situation where a market participant borrowed the underlying shares in a forward contract to be able to participate in a company's Annual General Meeting.

Supervision also focused on appropriateness of marketing material on index-linked bonds

In 2007 and 2008, the former FIN-FSA inspected the marketing material on index-linked bonds and reported shortcomings to the inspected entities. In its ongoing supervision during the review year, FIN-FSA focused on the appropriateness of marketing material, and

particularly on the online services of marketers. FIN-FSA published its observations in June, informing marketers with a supervision release and the public with a press release.

The marketing material still had shortcomings, particularly in its description of product risks. If reference to the safety of the securities is made in marketing, the risks should also be clearly presented in the same context, to avoid misleading the investor. For example, FIN-FSA finds it misleading if marketing material emphasises that the principal is guaranteed without in the same connection explaining the repayment risk.

Disputes regarding marketing of securities are primarily handled by the Securities Complaint Board

One of the tasks of FIN-FSA is to review prospectuses relating to securities offerings. Securities offerors are responsible for ensuring that these prospectuses are made available to investors. It is with the help of this information that investors are able to evaluate the properties and related risks of the securities on offer. Following the entry into force on 1 November 2007 of new legislation (MiFID), service providers have a discrete responsibility to evaluate the appropriateness for their client of complex investment products.

The present FIN-FSA's predecessor reviewed and approved the publicly discussed Mermaid bond prospectuses in 2006, as well as the four-page marketing brochure related to the bonds. The characteristics and risks relating to the bonds were brought out in both publications. The publications also clearly underlined a potential loss of capital. The product was not capital-guaranteed.

FIN-FSA monitors compliance with regulations governing the financial markets. If, in the course of its supervisory work or as the result of a complaint received, FIN-FSA has reason to suspect conduct in contravention of the regulations, it investigates the case. Where a breach of the regulations is discovered, FIN-FSA can, for example, issue the offender with a public reprimand or warning.

It is not, however, possible for FIN-FSA to supervise sales discussions, nor does it have powers to solve disputes between service providers and their clients. Any contact made with FIN-FSA regarding a dispute is redirected to the Finnish Financial Ombudsman ►

► Bureau (FINE), in connection with which the Securities Complaint Board operates.

The Securities Complaint Board is able to issue recommendations for resolution regarding disputes between service providers and non-professional investors. These recommendations are non-binding in nature. Proceedings at the Securities Complaint Board are provided free of charge to customers. The customer may also bring the case to the competent judicial authorities. Only the courts are empowered to issue decisions on disputes that are binding upon all parties. Cases are evaluated by the Complaint Board on the basis of written evidence alone. In cases handled by the judicial authorities, witnesses can also be heard.

FIN-FSA has, in accordance with the regulations, required that the characteristics of investment products be described in as balanced a manner as possible and that the risks involved be brought out clearly. Similarly, information given at sales discussions should be consistent with the information provided in the prospectus. This is essential in order to enable the investor, who ultimately bears the investment risk, to make an informed investment decision.

Disclosure obligation of mutual funds inspected

FIN-FSA inspected mutual funds' compliance with their disclosure obligation by going through the statutory material and marketing material published on mutual funds. Either one or several mutual funds from each fund management company were selected as targets of the inspection. The inspection was a follow-up to one carried out in spring 2008. In the 2008 inspection letter, emphasis had been placed on the importance of describing risks, and particularly on the need to clearly describe the special characteristics of mutual funds when describing the investment policy and risks of the funds. The follow-up inspection concentrated on mutual funds' disclosure of investment policy, risks and key performance indicators, as the greatest shortcomings had previously been observed in these areas.

In some simplified prospectuses, the investment policy has been described in very general terms, which has complicated investors' assessment of the particular risks related to the mutual funds in question. FIN-FSA also found that the terminology used in the simplified prospectuses on short-term fixed income funds has not always been accurate and unambiguous when, for example, describing the mutual fund as a money market fund, or when defining duration and maturity.

Several fund management companies illustrated their risk descriptions with risk tables or risk categories, as officially recommended. Some short-term fixed income funds had been compared with and presented as alternatives to deposits, even though their risk profile differs from the risk profile of deposits.

Mutual funds' simplified prospectuses and other marketing material have not always been updated to match changes in the market and in mutual funds' investment activities. The simplified prospectus is a key instrument for providing information on an individual mutual fund, and it must be kept up to date. Simplified prospectuses should be updated to correspond with changes both in the market situation and in the investment activities of the mutual fund.

FIN-FSA required the fund management companies to regularly go through all the investor information on an individual mutual fund and update it as necessary. In 2010, FIN-FSA will go through material subject to the mutual funds' disclosure obligation on the basis of the observations made in the 2009 inspection.

Information in the written material on savings and investment policies

In spring 2009, FIN-FSA asked the life insurance companies operating in Finland to submit their product material on all savings policies and unit-linked investment policies currently available on the market. The material to be submitted comprised product descriptions and/or brochures, policy terms, price lists, written information for customers on the investment instruments, detailed lists of attachable investment components of the products and calculation bases for the products. In addition, FIN-FSA asked the companies to account for products under development. The survey included the products of 11 life insurance companies, a total of 54 products.

The purpose of the inspection was to comprehensively survey the insurance products currently available on the market and their characteristics, to establish the nature of the written information provided to the customer at the time of sale and to further establish what other written material on the product is available. An additional purpose was to analyse how information considered significant by FIN-FSA has been provided in the written material: if, for example, the product descriptions of unit-linked investment policies disclose the risk of loss of principal, if yield expectations on savings policies are provided and what information on expenses, fees and commissions is provided to the customer.

Most of the respondents offered both unit-linked investment policies and guaranteed-return savings policies or combinations of the two. On the whole, the policy terms and product descriptions were considered

appropriate. Information on issues subjected to special inspection was provided either in the product description or the policy terms. However, companies should pay particular attention to ensuring customers are clearly informed about the risk of loss of principal, and the information provided on pension insurance expenses should indicate what expenses will be debited during the investment period versus the pension period. At the same time as companies inform about the tax benefits from long-term insurance contracts, it is also important to remind customers about possible changes in tax legislation and their potential effects on contracts in force.

IFRS enforcement in listed companies

As regards 2008 financial statements, enforcement focused particularly on the information on goodwill impairment testing and financial instruments. In addition, an assessment was made of the reporting of covenants in companies' loan agreements and the reporting of companies' ability to continue as a going concern. In connection with the supervision of prospectuses, important financial reporting issues arose concerning, primarily, the treatment of business combinations in the financial statements.

Information on goodwill impairment testing should be more transparent

The uncertain market situation has made it increasingly important to disclose the values of the assumptions used in goodwill testing, as the test results are significantly affected by the values of the assumptions applied, such as the level of projected cash flows arising from operating activities and the discount rate. The notes to companies' financial statements did not exhaustively and comprehensively disclose how the values of the assumptions and changes therein affected the value-in-use calculations and hence the test results. In addition, very few companies had described the changes made in their discount rates and related measurement techniques compared with the previous year, and companies had not always updated the discount rate to reflect the market assessment at the time of testing. The global recession increases business risks, and this should also be reflected in the discount rate used in the testing, in terms of both the risk-free interest rate and other market-based components of the interest rate. The published information on sensitivity analyses of the test results have improved over the years, but in the 2008 financial statements the information was still not sufficiently informative.

Information on sensitivity analyses of financial risks and disclosure of covenants

In their financial statements, companies must disclose information to enable investors to assess the nature and extent of the risks arising from financial instruments.

Sensitivity analysis information disclosed on market risks must reveal the impact on equity and profit or loss of changes that have occurred in various market risks, such as interest rate, exchange rate, credit and price risks. Reporting of credit risk was still modest, although the information on liquidity risk had substantially improved.

The risk information to be disclosed also covers covenants, because a possible breach of covenants in loan agreements may provide information on a company's liquidity or interest rate risks. FIN-FSA's view is that more detailed information on covenant terms must be disclosed in situations where a breach of covenant limits is close.

During the year under review, special attention was paid to listed banks' accounting policies and their practical application in respect of investments in financial instruments. FIN-FSA's enforcement efforts were primarily focused on equity, mutual fund and interest rate investments categorised as available-for-sale financial assets, as the uncertainty on the financial markets significantly affected the fair values of these investments.

Goodwill impairment testing and business combinations will remain in focus in financial reporting enforcement in 2010. Enforcement results will be reported already in the course of the year.

Banking services

Prices and availability of basic banking services unchanged

According to FIN-FSA's assessment, the availability of basic banking services was still good and no significant changes had occurred in prices. At present, basic banking services are supplied in a variety of regular customer and other service packages, which may affect the pricing of services and the transparency and comparability of pricing.

There had also been no major changes in pricing from the previous survey in 2008. Mostly, rises have occurred in, for example, monthly fees for additional Visa cards and some individual fees. All banks still provided free payment of invoices through direct debit. Apart from that, online payment was the most favourable invoice payment alternative, and the monthly fee was usually EUR 2.50. Payment of invoices in cash over the counter was still the most expensive alternative. The highest price for cash payment was EUR 6.60–7.00 per invoice.

Customer policies

Conditions placed on grace periods

Some banks had made an increase in the loan margin a condition for granting a grace period for capital instalments on their housing loans. In some cases, this condition had taken borrowers by surprise. In a letter to the Federation of Finnish Financial Services in August, FIN-FSA took the view that, in the following cases, it is unreasonable to set a rise in the loan margin as a condition for granting borrowers a grace period on their housing loan:

- A grace period was agreed in principle in the loan agreement and the agreement does not state that other loan terms and conditions can be reviewed in connection with or after the granting of a grace period.
- A grace period was not agreed in the loan agreement but, when the agreement was made, a grace period was marketed in such a way that it is justifiable to assume that the borrower understood that other loan terms and conditions would not be changed in connection with the granting of a grace period.
- A grace period was not agreed in the loan agreement but, when the agreement was made, the borrower was otherwise given to understand that other loan terms and conditions would not be changed in connection with the granting of a grace period.

Change of reference rate

The commonly used reference rate for housing loans is the 12-month Euribor. The decrease in the level of shorter Euribor rates made customers interested in changing their reference rate to shorter interest rates. Banks were generally agreeable to such a change, but there were also some refusals. Customers often considered that they had the right to change the reference rate without changes in other loan terms and conditions or extra costs. A reference rate change always requires the bank's approval, and it can charge a fee in accordance with its list of charges. If the right to a reference rate change has not been specifically agreed, the bank has no obligation to agree to a change. However, the customer can always pay off the loan, on certain conditions.

Marked differences in suitability assessments of asset management and investment advice customers

A securities intermediary providing asset management or investment advice must, before providing investment services, obtain sufficient information relating to the customer's financial situation, knowledge and experience in investing and his investment objectives to be able to recommend to the customer a suitable

security or service. Assessment of the information obtained from the customer should be reflected in the products and services offered. The securities intermediary is responsible for the suitability of the product or service provided to the customer.

FIN-FSA conducted an inspection of suitability assessments in spring 2009. The purpose of the inspection was to ensure that securities intermediaries carry out suitability assessments as referred to in the Securities Markets Act before offering asset management or investment advice services to their customers. One aim was to determine how securities intermediaries collect information on their customers, what information is collected and how it is documented. The inspection also evaluated how securities intermediaries' suitability assessments were reflected in the services or products provided to customers.

For new customers, most of the inspected securities intermediaries collected the information needed for the suitability assessments as required by law. However, for existing customers, most securities intermediaries were still in the process of collecting the required information.

Some securities intermediaries providing investment advice collect information and conduct suitability assessments on all new customers. However, some intermediaries did not collect information and conduct suitability assessments on all investment advice customers, since the advice provided for the customer had been defined as allocation advice, which does not require a suitability assessment. In reality, however, the advice was, for example, a recommendation to invest in a specific investment fund.

A general inspection letter was sent to all supervised entities providing asset management and investment services.

Training of insurance companies' sales personnel and agents

Inspection visits concerning sales and marketing, commenced in 2006 by the former Insurance Supervisory Authority (now part of FIN-FSA), continued in the year under review. In spring, FIN-FSA made inspection visits to two non-life insurance companies, one life insurance company and one Finnish branch of a foreign EEA non-life insurance company. The purpose was to ensure that the companies have adequate training, steering and control systems so that marketing and sales material as well as customer policy is in line with legislation and proper practice.

The inspection visits revealed no major deficiencies or issues requiring comment. The companies were observed to have improved the training of sales

personnel and agents. Attention was paid to operating models relating to the comparison of competitors' products and to ensuring customers have access to all the information necessary for choosing an insurance product. In respect of agents, deficiencies were detected regarding the provision of information on the agents themselves, as required by the Insurance Mediation Act.

Unemployment funds' processing times lengthened

In 2008, the average time for processing unemployment fund decisions on earnings-related daily allowances was 15.5 days. In the third quarter of 2009, the average processing time was 36.5 days. Processing times were longer especially in the case of industrial sector unemployment funds. The longer processing times were mainly due to the sharp rise in applications resulting from layoffs and redundancies.

Unemployment funds sought to solve the problems with processing times. Steps taken included hiring more staff, getting existing staff to do additional work and overtime, and arranging more effective organisation of fund activities. They also enhanced training and guidance for both staff and applicants. As a result of these measures, the number of unemployment fund decisions doubled or, in some cases, even tripled. By the latter part of the year, it was already clearly visible that the lengthening in processing times had come to a halt or even gone into reverse.

FIN-FSA monitored processing times and was of the opinion that the longest times were much too long, given that the decision concerned applicants' income protection. On the other hand, FIN-FSA also recognised that the unemployment funds themselves had not caused the rise in applications and had taken significant steps to remedy the situation.

Inspection of unemployment funds' processing policies, internal control and information security

Inspection of unemployment funds' processing policies, commenced in 2008 by the former Insurance Supervisory Authority (now part of FIN-FSA), continued. In the review year, evaluations focused on fund policies concerning the processing of earnings-related daily allowance applications, internal control procedures relating to the processing of applications and administrative information security. FIN-FSA made inspection visits to 29 of the total of 36 unemployment funds. An inspection report was sent to each fund inspected. The inspections revealed that investment funds generally processed allowance applications appropriately. The most common observation regarding internal audit was that the funds had several practices relating to internal audit but had not yet dealt with the issue as a separate entity of its own. In respect of

administrative information security, the most common observation was that investment funds should pay attention to the documentation of their information security.

Trading supervision

Inspection of transaction reporting by securities intermediaries

The primary objective of the inspection was to assess the comprehensiveness of transaction reporting, the reporting process and related controls as specified in the FIN-FSA standard on transaction reporting. The purpose of transaction reporting is to collect and make available to FIN-FSA all such information on trading as is necessary for supervisory purposes. Efficient supervision requires reporting to be comprehensive, accurate, up to date and reliable.

Some securities intermediaries only report a portion of trades subject to reporting. On the other hand, some intermediaries report trades that are not subject to reporting requirements. The reports also include errors of content. There were also deficiencies in the systematic follow-up of reporting and internal control.

Company-specific inspection letters sent to the inspected securities intermediaries required remedial action regarding the extent and accuracy of reporting. Implementation of the remedial action is subject to ongoing supervision. In addition, a general letter was sent to all reporting parties on the inspection and supervisory visit findings in order to prevent and correct erroneous practices.

Investigated cases of suspected abuse and administrative sanctions imposed

FIN-FSA investigated 74 supervision cases during the year. (Its predecessor, the Financial Supervision Authority, investigated 62 cases in 2008.) Out of this number, 37 (27) concerned suspected abuse of insider information, 17 (11) suspected market manipulation and 16 (12) suspected neglect of the disclosure obligation. There were 4 (12) other cases under investigation, mainly concerning the code of conduct.

FIN-FSA issued five public reprimands, of which two concerned failure to disclose holdings, one concerned a breach of the disclosure ban on insider information, one concerned market manipulation and one concerned failure to comply with prospectus requirements (in 2008, one public reprimand for abuse of insider information and one public warning for neglect of the disclosure obligation).

Supervision of infrastructure

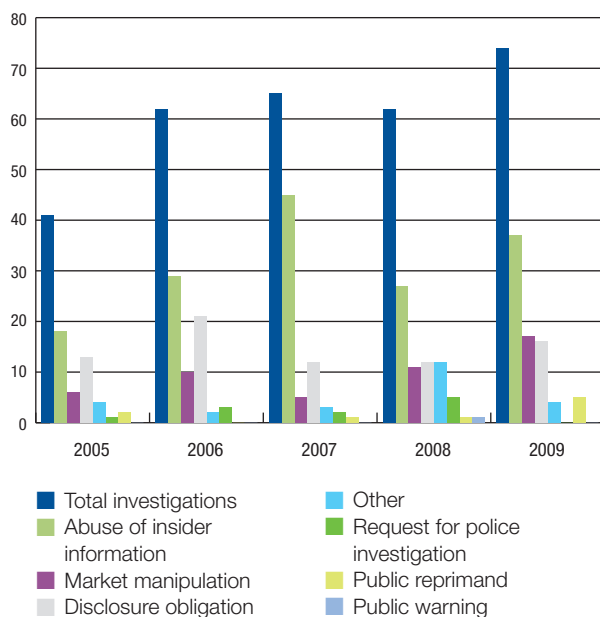
Introduction of central counterparty clearing in Helsinki

Together with the stock exchanges of Stockholm and Copenhagen, NASDAQ OMX introduced central counterparty clearing (CCP clearing) at the Helsinki Stock Exchange for clearing of obligations arising from share trades. CCP clearing commenced in February on a voluntary basis between willing market participants, and it became mandatory for all participants in November. Mandatory CCP clearing was conducted on a trial basis with three shares beginning in October. The CCP clearing service is provided by the Dutch company European Multilateral Clearing Facility (EMCF).

In central counterparty clearing, EMCF becomes the counterparty to both buyer and seller, nets the trades by calculating the sum of sales and purchases by each counterparty and transmits the net obligations to be processed in Euroclear Finland's (EFI) systems. EFI participants distribute the net sums to the investors' accounts. Traditional clearing and settlement in one place is thus divided into clearing by a central counterparty and settlement in the central securities depository. FIN-FSA supervised the transition to CCP clearing and entities' readiness for the transition. FIN-FSA also signed the necessary cooperation agreements with other supervisory authorities in this field.

Securities market investigations conducted by FIN-FSA 2005–2009

Cases



Cases for 2005–2008 were investigated by the Financial Supervision Authority.
Source: Financial Supervisory Authority.

Authorisations and registrations

During the review year, FIN-FSA granted new authorisations to eight investment firms and three fund management companies. Three authorisations were extended, and one was cancelled on the company's own request. Based on the enquiries about authorisations for investment firms and fund management companies, the supply of investment and fund services would appear to be increasing. As many as 670 new insurance brokers were registered during the year.

Authorisations are often applied for by small companies with multi-task employees. This may jeopardise good corporate governance and therefore poses a challenge for both applicants and supervision. Applicants also seek to outsource as many activities as possible and achieve geographical coverage of their services through a large network of tied agents.

One hundred companies were entered on the warning list at www.fin-fsa.fi. Most of these had been brought to FIN-FSA's attention by a foreign supervisory authority.

Customer information and customer complaints

At the investment fair Sijoitus-Invest 2009, FIN-FSA gave brief presentations on issues such as insurance investment, fraud, investor protection and comparative study of index-linked bonds, mutual funds and unit-linked insurances. A new version of the Financial Wizard quiz, supplemented with questions about insurance, was published at the fair. The quiz has now been played by more than 45,000 visitors.

FIN-FSA still cooperates with the Bank of Finland in providing the task package on the www.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 number of visitors at www.euro.fi increased by 40% from the previous year, with nearly 8,000 visitors a month during autumn 2009.

FIN-FSA's telephone advice service answers questions from bank, insurance and investment customers about, for example, financial companies' code of conduct. During the reporting year, about 300 phone calls were made to this free service number. Written complaints and enquiries totalled 200.

Customer enquiries were also directed to the Finnish Financial Ombudsman Bureau (FINE), which is an advisory office established by the Consumer Agency, FIN-FSA and the Federation of Finnish Financial

Successful choice of investment products requires skilled sellers and enlightened buyers

The favourable investment market developments during several years prior to the financial crisis created a good foundation for the development of new types of investment product that were also often more complex or more risky. Yield was also sought aggressively on established investment products, thus testing the limits of the picture created for investors of investment products and risks.

The financial crisis, with its repricing of risks, drew attention to product risks that have clearly been difficult to communicate or have been poorly communicated. With index-linked bonds, the risk of loss of principal has perhaps not been quite clear to investors, because the principal has been described as guaranteed at the same time as the risk of issuer insolvency has been inappropriately described. Correspondingly, the investment policy or risk disclosure of mutual funds has not necessarily been updated in line with changes in investment activities or risk level.

The realisation of risks has in turn underlined the fact that both skilled sellers and enlightened buyers are necessary to ensure a successful end result in the choice of investment products.

Skilled sellers have well-functioning internal processes

The service provider should have a good idea of its own customers and the type of products suited for different customer groups. Not all products are suited for everyone, and neither should all products be sold to everyone. These factors should be considered at an early stage of product development.

The service provider's disclosure obligation mandates disclosure of accurate and adequate information on investment objects. In addition to statutory material, investors also often get information that would be classified as marketing material. As regards material within the scope of the actual disclosure obligation, there are detailed provisions on the product information to be disclosed to the investor. In contrast, the provisions on marketing material are less detailed. They emphasise that the information on different product characteristics should be balanced and that it may not be untrue or misleading.

The provisions on life insurance investment policies are different. Here, the insurer should provide potential customers with the information necessary

for assessing their insurance need and the appropriate choice of insurance product, but there are no detailed legal provisions on the information to be disclosed.

In addition to adequate written information to fulfil the disclosure obligation, guidance and education of sales personnel is vital. Customers often attach great importance to verbal information provided personally at the time of sale. All sales personnel involved with customers must be equipped to follow market events, so their customers can be provided with adequate and timely information to support their investment decisions. Exceptional market conditions underline the need for timely information.

Enlightened buyers study the information and compare alternatives

There are many different types of investment product, and the needs of investors are individual. Investment horizon, willingness to take risk, know-how and investable capital are all factors that affect the number of available alternatives and the investor's final decision.

Responsibility for studying the material provided on the investment object always lies with the investor, who should have a clear and realistic picture of his investment goals and the questions that need to be clarified to enable a reliable assessment of the risks in the investment. No investment decisions should be made solely on the basis of marketing material.

The investor can always decide not to make the investment, if, for example, the product terms and conditions are too complicated, the investment decision must be made very quickly or the product risks are unclear.

Not all sales can be supervised

Not all products or sales can be supervised. Based on the level of risk, FIN-FSA focuses its supervision on, for example, new and complex products and areas of the information provided for investors where shortcomings have previously been observed.

FIN-FSA approves the rules of mutual funds but does not in advance confirm their prospectuses, reports or marketing material. In contrast, domestic issuers' prospectuses on index-linked bonds are approved by FIN-FSA. Furthermore, FIN-FSA approves base prospectuses, but loan terms and conditions for ►

► individual products are not examined in advance. FIN-FSA does not give advance approval for terms and conditions, product brochures or marketing material for insurance products. Prospectuses and reports on mutual funds, the terms and conditions of index-linked bonds, marketing of investment products, and the terms and conditions, brochures

and marketing of insurance products are supervised retrospectively through separate inspections or in response to customer complaints. However, FIN-FSA cannot supervise all individual sales and does not have the judicial power to resolve conflicts between customers and service providers.

Services. In cases of conflict, customers of financial companies can turn to the banking, insurance and securities boards operating in conjunction with FINE.

Information to interested parties

FIN-FSA actively informs market participants about current regulatory and supervisory issues and maintains an open dialogue. During the year, FIN-FSA arranged courses where its own experts lectured on Solvency II, temporary government guarantees and IFRS enforcement, among other topics. In addition, FIN-FSA employees spoke at more than one hundred events for interested parties.

In 2009, four issues were published of the Markkinat ('Markets') newsletter directed at listed companies. These dealt with supervisory observations as well as current market supervision issues related to interpretations, standards and legislation on listed companies' disclosure obligation and financial reporting enforcement.

Cooperation between EU supervisors

Committees of supervisors regularly assess the condition of the financial sector

The Committee of European Banking Supervisors (CEBS) monitored and assessed the condition of the EU banking sector and reported to the Economic and Financial Committee (EFC) of the EU. CEBS assessed in particular the risks and capital adequacy of the largest cross-border banking groups and supervisory measures. FIN-FSA prepared an assessment on the Finnish banking sector, which was used in the EU-level assessment, and participated actively in preparing an overall assessment in the *Groupe de Contact*, an expert group of CEBS. In the *Groupe de Contact*, national supervisors regularly exchanged information on the condition of national banking sectors and individual banks.

CEBS reformed guidelines on risk management and the colleges of supervisors

CEBS launched several initiatives aimed at addressing

deficiencies identified in banks' risk management. It published revised general principles on risk management. These focus on the responsibility of banks' senior management in defining risk-taking propensity and underline the importance of comprehensive risk management. The financial crisis has demonstrated that the risks involved in various business models also need to be assessed. CEBS also published principles for sound remuneration schemes and recommendations on liquidity risk management. In the autumn, it clarified its guidelines on liquidity risk management by publishing for public consultation proposals on the quantitative restriction of liquidity risks. Detailed guidelines for the operational functioning of the colleges of supervisors and implementation guidelines on stress testing by supervised entities were presented for approval at the CEBS meeting in December. In addition, CEBS assessed the countercyclicality of regulatory changes regarding financial instruments relative to current regulation.

CEIOPS' crisis working group assessed impacts

The global financial crisis was also reflected in the work of the Committee of European Insurance and Occupational Pension Supervisors (CEIOPS). At the turn of the year 2008–2009, CEIOPS prepared a document entitled 'The lessons to be learnt from the current crisis'. This discusses issues raised by the crisis, and particularly how these observations should be utilized in drafting Solvency II and in the work of CEIOPS in general. Under CEIOPS' auspices there is also a crisis working group. Its task is to compile information rapidly and assess the impact of individual events on the insurance sector and pension funds.

FIN-FSA representatives participate in nearly all CEIOPS working groups: Solvency II (all four working groups), the Review Panel (for peer review), the Committee on Consumer Protection and the Financial Stability Committee.

A significant proportion of CEIOPS' work in the review year involved drafting advice for the European Commission on Solvency II and Level 2 implementation measures.

FIN-FSA seeks to ensure that CEIOPS' advice accords with the principles set forth in the Directive so that it takes into consideration functionality and appropriateness for the various types of entity. The key objective was to ensure sufficiently precise regulations and their implementation in national supervision and by supervised entities. Attention was also paid to the characteristics of national markets so that they can be taken into consideration in implementation without endangering convergence.

CESR assessed the impacts of the financial crisis and drafted a reform of supervision and regulation

CESR analysed the impact of MiFID (which entered into force in 2007) on the structures of securities trading. As part of this work, CESR also studied the disclosure of trading data. The results of such studies and possible proposals for development are presented to the Commission as part of the regular review of the Directive. Regarding the transparency of trading, CESR members started coordinating the granting of transparency waivers to trading facilities.

In relation to packaged investment products marketed to retail investors, CESR responded to the Commission's request for comments. The Commission's aim is to identify the need for developing regulation of packaged products so that investor protection does not vary depending on the form of investment. CESR will continue this work in 2010, in cooperation with CEBS and CEIOPS.

In connection with the financial crisis, attention was paid to differences in regulations on the short selling of securities. To remedy the situation, CESR published a consultation paper on its proposals for a disclosure obligation on the activity. The consultation paper proposes a pan-European short selling disclosure regime on significant net positions.

In relation to UCITS, CESR provided advice on the following key areas:

- the management company passport and guidelines on organizational procedures (MiFID level regulation)
- risk management principles and the development of risk indicators
- KID (Key Investor Information Document, particularly the synthetic risk indicator and disclosure of charges)
- cross-border mergers
- master-feeder structures
- speeding up the notification process.

In the review year, CESR launched the Instrument Reference Data System (IRDS). This collects reference data for all instruments admitted to trading in regulated markets in the EEA. The IRDS is used by CESR members. The system includes data on over a million instruments admitted to trading.

CESR is preparing to extend transaction reporting and the exchange of transaction reports to OTC derivative instruments. Extension of the Transaction Reporting Exchange Mechanism (TREM), the system that will facilitate the exchange of transaction reports on OTC derivative instruments, is scheduled for 2010.

The European Enforcers' Coordination Session (EECS) is a forum for the discussion of questions concerning IFRS application, both in terms of technical solutions and enforcement actions. FIN-FSA brought up 9 financial reporting issues concerning business combinations, strategic equity investments and impairment testing for EECS discussion in 2009.

CESR-Fin's 'Fair value' working group was established in 2008 as a result of the market disruption. The group has participated in global discussions on the impact of the market crisis on financial reporting and on problems concerning fair value measurement in illiquid markets. The working group also organised a review of financial companies' financial statements as a joint European-level exercise, together with national enforcers. In November 2009, CESR published a report on compliance with standard IFRS 7.

Outlook for 2010

- Inspections of risks and risk management will be stepped up; stress tests will continue amid a persistently weak operating environment for supervised entities.
- Inspections of insurance and pension companies' investment risks and banks' credit risks will continue; inspections of insurance companies' operational and underwriting risks will begin.
- Product development and sales processes in respect of investment services and products will be inspected.
- Listed companies' compliance with the disclosure obligation regarding regular disclosure will be inspected.

- Service providers' capacity for reliable provision of long-term savings products will be examined.
- Official reporting by insurance and pension companies on their financial position and risks will be reformed.
- Transaction reporting will be extended to cover financial derivatives.
- Customer information will be enhanced to increase customers' risk and cost awareness.
- Financial conglomerate supervision of Sampo Group will begin together with foreign supervisors.
- Information will be provided regularly on changes in European capital adequacy regulation of insurance companies and banks.
- Preparatory work will be carried out on the launch of the EU's new supervisory bodies and several major regulatory changes.

Regulation

FIN-FSA's regulatory activities covered both issuance of its own regulations and participation in legislative preparation both in Finland and at EU level. At EU level, FIN-FSA was mainly involved in the work of the committees of supervisors (CEBS, CESR and CEIOPS), while at national level representatives of FIN-FSA took part in law drafting groups set up under the auspices of various ministries.

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

Regulatory changes brought about by the financial crisis

In November 2008, the European Commission appointed a high-level group that subsequently published its report (the de Larosière report) on development of a European regulatory and supervisory framework on 25 February. In its communication released in the spring, the Commission took a preliminary stand on the recommendations made in the report for reforming regulation and supervision of the financial sector. This preparatory work provided the basis for the Commission's submission of several proposals for the development of EU legislation.

Main features of Commission proposals

The proposed changes will reform the structures of EU financial market supervision and fill the gaps and deficiencies detected in financial market regulation.

Supervision will be developed in the area of macroprudential supervision by establishing an EU body (the European Systemic Risk Board) to oversee the stability of the financial system as a whole. At micro level, in line with the Commission proposals, reform will include the establishment of a European System of Financial Supervisors composed of a cooperation network of representatives from national supervisory authorities, the Commission and three new European Supervisory Authorities (ESAs) for each sector of

finance, ie banking, securities markets and insurance. In addition, a joint committee, shared by the three ESAs, will be set up for dealing with issues common to all three sectors.

As regards the functioning of the financial markets, proposals cover regulation and supervision of hedge funds, private equity and other systemically relevant market players, reform of the capital adequacy framework for banks, regulatory revisions concerning derivatives markets regulation, regulation of risk management and remuneration and regulation regarding market abuse. A closer description of the proposals is provided below.

Development of EU financial supervision

At the Ecofin Council, Member States reached understanding towards the end of the year on supervisory development initiatives based on the Commission proposals. The proposals will be considered by the European Parliament during spring 2010. The aim is to have organs compliant with the new structures up and running from the beginning of 2011.

European Systemic Risk Board

Macroprudential supervision will be developed by setting up, in connection with the European System of Central Banks, a separate body responsible for macroprudential oversight of financial markets, the European Systemic Risk Board (ESRB). The ESRB will be responsible for macroprudential oversight of the financial system within the EU. Its job will be to prevent and mitigate the spread of systemic risks in order to foster the smooth functioning of the internal market and ensure the financial sector's contribution to stable economic growth. When necessary, it will be able to issue recommendations or warnings to Member States or supervisors regarding major identified risks. It will not be a separate legal person nor have legally binding powers of decision, but in practice it will exercise considerable influence on parties to whom it addresses its warnings or recommendations. The ESRB will be assisted by a permanent secretariat operating in connection with the European Central Bank.

As no organisation similar to the ESRB has previously existed, its establishment represents essential improvement to the EU's macroprudential analysis.

European Supervisory Authorities

The reform foresees the establishment of three new European supervisory authorities to replace the current committees of supervisors (CEBS, CEIOPS and CESR): supervisory authorities for banking, for insurance and occupational pensions and for securities. Each European Supervisory Authority (ESA) will have its own legal personality. They will be responsible for the missions of the current supervisory committees, such as technical advice to the Commission. They will also receive additional tasks and powers, such as preparation of technical standards complementing EU legislation and mediation in disputes between national supervisory authorities, including decision-making powers in emergency situations. Moreover, the Commission proposals would provide these authorities with exclusive supervisory powers in respect of special cases separately defined in Community law (for the present, credit rating agencies). To this end, the new authorities will need to be given the necessary investigatory and executive powers, defined separately, and powers to collect supervisory fees.

As proposed, the ESAs will be able to submit proposals for binding technical standards in areas specifically defined in Community law. The standards would be adopted in the form of Commission regulations or decisions. The areas for which standards may be issued will be defined separately in each Directive concerning the financial markets.

In the case of diverging opinions between national authorities on a matter in respect of which Community legislation requires cooperation, the ESAs could assist them in reaching agreement. Conciliation should take place within a fixed period of time. If no agreement is reached, the ESAs may settle the matter. This procedure is possible in situations separately defined in the relevant Directives. Currently, it seems that the scope of application will remain limited.

The application of emergency powers will require a situation that could seriously jeopardize the orderly functioning and integrity of the financial markets or the stability of the whole or part of the financial system in the Community. Decisions on the existence of an emergency situation and the use of emergency powers will be taken by the Ecofin Council. In emergencies, the ESAs would have the competence to take individual decisions where national authorities are required to act in accordance with Community legislation for the prevention of risks. The decisions taken by the ESAs would prevail over any previous decisions adopted by national supervisory authorities on the same matter.

The proposals also include a safeguard clause under which the ESAs must ensure that their decisions adopted in response to the Commission's determination of the existence of an emergency or for the settlement of disagreements between national authorities will not in any way impinge on the fiscal responsibilities of Member States.

The ESAs will contribute to the functioning of colleges of supervisors defined in Community legislation, facilitate the delegation of tasks and responsibilities between competent national authorities and foster the development of a common supervisory culture. In addition, they will periodically conduct peer review analyses to further enhance consistency in supervisory outcomes, fulfil a general coordinating role between competent authorities, assess market developments and develop contacts with supervisory authorities from third countries. They will also provide opinions to the European Parliament, the Council and the Commission on all issues within their remit.

The ESAs will be expected to cooperate with the new European Systemic Risk Board (ESRB), which is currently in the process of being established. On receipt of a warning or recommendation from the ESRB, the ESAs will assess the implications of such a warning or recommendation for the fulfilment of their tasks and decide on the appropriate actions in response. Where necessary, they will be expected to use the powers conferred upon them to ensure timely follow-up. Pursuant to the proposals, each ESA will establish a stakeholder group for the purpose of consultation with interested parties in areas relevant to its tasks.

Some of the tasks proposed for the ESAs have so far been taken care of by the European supervisory committees. The role of the new authorities will, however, be much broader. In the first place, their powers will be directly based on EU legislation, which will serve to increase their authority. Secondly, they will have more extensive powers than the former supervisory committees, particularly the possibility of issuing binding technical standards and, under certain circumstances, settling, with binding effect, disagreements between national supervisors. They will also be equipped with better resources for performing their tasks, as some of the expenses involved will be covered from the EU budget. On the other hand, the costs incurred by national supervisors will also grow appreciably.

Regulation of the European Parliament and of the Council on credit rating agencies

In November 2008, the European Commission put forward a proposal for a Regulation of the European Parliament and of the Council on credit rating agencies. The Regulation was adopted last autumn and entered into force on 7 December 2009.

Credit rating agencies issue independent ratings on the probability of default or expected losses in respect of non-financial corporations, governments and issuers of various financial instruments. These ratings are used by, for example, institutional investors as a basis for their investment operations. Credit ratings are also widely employed in banks' capital adequacy calculations. Previously, credit rating agencies were primarily subject to the voluntary application of rules (Code of Conduct Fundamentals) issued by the International Organisation of Securities Commissions (IOSCO). Moreover, the CESR evaluated rating agencies annually. There is scarcely any national-level regulation in place in Member States that would expressly concern credit rating agencies.

Credit rating agencies significantly contributed to the emergence of the financial crisis, since they had underestimated the risks inherent in structured credit instruments and assigned high credit ratings to most subprime products. The ratings initially had an over-reliance on mathematical models. Then, when market conditions deteriorated, the ratings were not adequately adjusted.

The aim behind regulation of credit rating agencies is to improve the management of conflicts of interest, the methods applied by rating agencies and the quality of their ratings and to increase their disclosure requirements. Credit rating agencies operating in the EU need to apply for registration and will henceforth be subject to official supervision. Although there are currently no credit rating agencies as referred to in the Directive operating in Finland, the Regulation will be of particular relevance for banks' capital adequacy calculations, as credit ratings have an impact on banks' own funds requirements.

Revision of IFRS regulation on financial instruments

As a result of regulatory reviews following the financial crisis, the IASB¹ decided to reform the entire standard on financial instruments. The aim is to simplify regulation concerning the classification, measurement and hedge accounting applied to financial instruments. In the spring, a separate proposal was made for the derecognition of financial instruments.

In November, a new standard (IFRS 9 '*Financial Instruments*') was issued. At this stage, the standard only includes amendments to the classification and measurement of financial assets. November also saw the submission of proposals for amending measurement and impairment for financial assets to be measured at amortised cost. According to the IASB, a proposal for amending hedge accounting will be submitted in the first quarter of 2010. The aim is to have one single method

for hedge accounting in place. European listed companies could not apply the changes regarding classification and measurement in their financial statements for 2009, as they had not been adopted in the EU before the end of the year. Application of the standard in its entirety will become mandatory from the beginning of 2013.

The IASB is also clarifying its regulation concerning fair value measurement by making it consistent with the US GAAP. There will be a separate standard on fair value measurement (Fair Value Measurement Guidance), which will replace equivalent regulation in separate standards. The final standard is due for release in the third quarter of 2010.

Changes due to UCITS IV Directive

The UCITS Directive amendments endorsed in July will be reflected in simplified fund prospectuses, which are to be replaced in terms of their contents by harmonised EU-wide prospectuses. This 'Key Investor Document' will include the key information on risks and expenses that must be provided to investors.

The Directive provides fund management companies with the opportunity to manage investment funds from another Member State. As a counterbalance to this expansion of the sphere of action, fund management companies will be governed by rules on the organisation of activities similar to the MiFID rules currently applicable to investment firms.

The provisions of the new Directive must be put into force by 30 June 2011. FIN-FSA will provide guidance necessitated by the Directive insofar as the relevant regulation is not incorporated in the Finnish Act on Common Funds or the related decree.

Directive on alternative investment fund managers

In April, the European Commission put forward a proposal for a Directive on alternative investment fund managers. This will introduce a harmonised set of regulatory standards applicable to entities managing and operating alternative investment funds. Alternative investment funds are considered to include all funds that do not fall within the scope of application of the UCITS Directive. The funds referred to in the draft Directive are hedge funds, private equity funds, real estate funds, commodity funds, infrastructure funds and other types of institutional funds.

The aim of the proposed Directive is to ensure that alternative investment fund managers deliver due transparency as required within the European Union and that they are supervised as provided for in law. The draft Directive is surrounded by political tensions and disagreements among Member States as regards its

¹ International Accounting Standards Board.

contents. Many key market players perceive regulation according to the Directive proposal as going too far.

Regulation of derivatives markets

The Commission proposes development of regulation concerning the derivatives markets. The key objective is to improve the management of counterparty and operational risks related to derivatives and to enhance the supervision and transparency of these markets. The Commission published two communications and intends to submit the relevant legislative proposals in 2010 on the basis of comments received in response to the communications.

Basel II – Regulatory changes adopted and planned for Capital Requirements Directives

Capital requirements regulation concerning banks and investment firms entered into force in March 2007. However, prior to the entry into force of this regulatory framework, it had already been found necessary to reform and specify regulation, for example concerning large exposures. The European Commission initiated work in the latter part of 2007 with a view to revising the Capital Requirements Directives regarding credit institutions. The financial crisis that began in autumn 2008 created a further need to update this regulation.

The amendments to the Capital Requirements Directives will be implemented in several phases. The first amendments (CRD II) were adopted on 6 May. These changes need to be transposed into national legislation by 31 October 2010, to enter into force on 31 December 2010. As regards the second amendments (CRD III), the handling of the draft Directive issued by the Commission in July is still pending within the EU organs, but political understanding has been reached on their contents. The proposals are scheduled to enter into force early in 2011. With regard to the third amendments (CRD IV), the Commission is expected to launch public consultation early in 2010. Subsequently, possibly in the autumn, the contents of the Directive proposal due in 2010 will also be affected by the impact assessment on the proposals, commissioned by the Commission. The amendments will enter into force in 2012.

The new provisions in the Capital Requirements Directives will be implemented in Finland via a combination of new legislation and FIN-FSA regulation. The changes to the Capital Requirements Directives will significantly affect the operations of supervised entities and, for instance, the standards on capital adequacy calculation.

First adopted amendments (CRD II)

The first, already adopted, amendments mainly concern

cooperation in the supervision of cross-border banks and banking groups and issues relating to the supervision of branches, regulation of supervised entities' large exposures, regulation of own funds and (primarily) hybrids, as well as certain technical questions in connection with capital adequacy calculation. Owing to the turmoil that began in the financial markets in autumn 2008, qualitative criteria related to liquidity risk management and more rigorous capital rules for securitised assets were also incorporated in the Directives.

Important supervisory issues are **the new principles established for cooperation in the supervision of cross-border banking groups and supervision of branches**. Although the Directive amendments do not change the areas of supervisory responsibility between home and host country supervisors,² the Directive has been supplemented, as regards subsidiaries and branches, with the concept of a systemically relevant branch and articles on supervisory cooperation between home and host country supervisors.

The main responsibility for supervising branches continues to lie with the home country supervisor, but the host country supervisor has been assigned more extensive rights to access information in the supervision of systemically relevant branches.³ In considering the Directive proposals, several countries, Finland included, emphasised host country supervisors' right to participate in actual supervisory work and in the meetings of supervisory groups prior to the onset of an emergency.

The establishment of colleges of supervisors for cross-border banking groups will be mandatory in the future. Supervisors from various countries will be able to take part in joint supervisory work within the colleges of supervisors, under the leadership of the parent company's home country supervisor, the 'consolidating supervisor'. The consolidating supervisor will have the right to decide who may participate in meetings of the colleges, but is also under an obligation to notify the members of a college ex ante of the issues on the meeting agenda and ex post of the outcomes of the meeting.

Consolidating supervisors will play an important role in the supervision of cross-border banking groups. For

2 'Home country supervisor' refers to the competent authority of the country where a credit institution group operating in several countries has its registered place of business. Correspondingly, 'host country supervisor' refers to the authority supervising a subsidiary or branch belonging to a cross-border credit institution group.

3 By definition, 'systemically relevant branch' means a branch which in the host country either has sufficient market share (more than 2% in terms of deposits), significant impact on the host country's payment and settlement systems or otherwise occupies an important position in the host country in terms of the size of the latter's population.

example, they will coordinate all supervisory cooperation, set up and chair colleges of supervisors, decide on the participants in college meetings and supervise the overall capital adequacy of banking groups together with the supervisors of group subsidiaries. The allocation of responsibilities for 'solo supervision' of subsidiaries has not been changed, nor has the supervisory responsibility for recapitalisation of subsidiaries been transferred to the consolidating supervisors. However, the relevant consolidating supervisor will coordinate the supervisory review process for determining a group's capital requirements (Pillar 2), with a view to reaching agreement between all supervisors on the adequate level of regulatory capital for the supervised group as a whole, and on the determination of any additional capital charges.

The **provisions regarding large exposures** limit the risk arising from a credit institution's exposure to a single client or group of connected clients. The main rule will continue to be that the amount of exposures may not exceed 25% of the credit institution's own funds. The other quantitative limits (20% and 800%) will be abolished.

Exposures to other credit institutions and investment firms will fall within the scope of application of provisions governing large exposures, irrespective of exposure maturity. Accordingly, these should be treated and reported mainly in accordance with the same rules as other exposures. The Directive allows Member States and national supervisory authorities to grant certain derogations from the main rules. The definition of a group of connected clients has been more precisely defined. The treatment of large exposures may also take better account of assets accepted as collateral in capital adequacy calculation.

The Directive defines, for example, the necessary features of **hybrid instruments included in Tier 1 capital**, incorporates uniform quantitative limits on innovative and non-innovative hybrids⁴ and takes account of a transitional provision which makes it possible to restrict the new provisions' impact on the financial markets. The maximum amounts of various hybrid instruments permitted under the Capital Requirements Directives were implemented via a statement issued by FIN-FSA on 16 January. Following issuance of the statement, the maximum amount of hybrid instruments that may be included in original own funds is set at 50% of the original own funds.

4 'Hybrid instrument' refers to capital instruments reflecting simultaneously the features of equity and debt. 'Non-innovative hybrid' refers to instruments whose terms and conditions include an early redemption option, while 'innovative hybrid' refers to instruments whose terms and conditions additionally include a possibility of step-ups in interest rate during the term to maturity or other incentive for early redemption.

As regards liquidity risk, the Directive at this stage includes qualitative criteria for liquidity risk management. These reflect the new international recommendations on, for example, liquidity strategy, risk identification and measurement, monitoring and supervision, risk mitigation, reserves of freely disposable liquid assets, potential barriers to free transfer of assets, stress tests, reporting to management and business continuity planning. Discussions on quantitative limits for liquidity risk are also under way within various international working groups and the European Commission.

Amendments under consideration (CRD III)

On 13 July, the European Commission published its new proposal for planned amendments to the Capital Requirements Directives. This Directive proposal includes regulation on remuneration policies and related supervisory review, changes concerning capital requirements for the trading book and securitisation, and increased disclosure requirements for securitisation exposures.

These proposals were dealt with by EU organs during the autumn, and the revisions are expected to enter into force in 2011.

The aim of the proposed Directive is to **tighten capital requirements for the trading book** and to align capital charges for securitisation positions in the trading book with those in the banking book. The financial crisis revealed the flaws of internal models in the calculation of capital requirements for the trading book, as the assessments based on these models of the scale of potential losses proved inadequate in stressed conditions. Moreover, the capital requirements under the standardised approach for trading book equity investments have proved inadequate in relation to the actual risks inherent in these investments. The proposed disclosure requirements for securitised exposures will improve the position of investors and enable a more thorough picture of supervised entities' risk profiles.

Remuneration policies of banks and other financial sector companies that focus on encouraging risk-taking and achieving short-term objectives contributed to the build-up of problems in many large global market players and to the emergence of the international financial crisis. The Commission's Directive proposal would impose on banks and investment firms an obligation to have remuneration policies in place that are consistent with and support sound and effective risk management. These principles apply not only to the remuneration of directors, but to remuneration of the bank staff as a whole. The main emphasis is on the long-term objectives of remuneration policies, their transparency and clarity, allocation of responsibilities in decision-making and follow-up, performance measurement and forms of remuneration.

The entry into force of the draft Directive will mean that entities supervised by FIN-FSA will need to carefully review their principles relating to remuneration and compare them with the provisions in the Directive. Many supervised entities will need to specify their remuneration policies and pay closer attention to the long-term nature of their remuneration, ensuring that risk-taking incentives emanating from remuneration practices will be systematically identified, analysed and controlled and that the remuneration principles will be disclosed with adequate transparency.

Already prior to the Directive amendment, the European Commission, CEBS and CEIOPS had issued new rules and recommendations for remuneration in financial sector companies. These seek to remove remuneration scheme features that increase risk-taking in companies and contribute to eroding the stability of companies or even the markets as a whole.

The new recommendations mean that entities supervised by FIN-FSA will also need to carefully review their remuneration policies.

Going forward, many supervised entities will need to pay increasing attention to the systematic identification, analysis and control of risks related to remuneration and to adequate transparency in their remuneration policies. On the basis of these measures, FIN-FSA issued a recommendation on remuneration principles in February 2010.

According to the recommendation, the key remuneration principles require that

- Supervised entities must have in place a remuneration policy adopted by the board of directors that is consistent with sound and effective risk management and does not induce excessive risk-taking. It should be in line with the business strategy.
- The remuneration policy should cover the entire staff. The recommendations should be applied especially to payment of bonuses to the managing director and other persons whose actions have a material impact on the risk exposure of the supervised entity.
- Payment of any substantial, variable pay elements should be deferred for at least three years.
- Performance-related bonuses should be based on an overall assessment and reflect the performance of both the relevant business unit and the entire company as well as individual performance.

- Performance should be assessed against a multi-year framework and remuneration should recognise the relevant business cycle of the supervised entity.
- The remuneration criteria should take into account the costs of the capital employed and the required level of liquidity.
- Significant supervised entities are advised to set up their own remuneration committees.
- Independent control of the effectiveness and implementation of the remuneration policy should be in place.
- Relevant details of the remuneration policy should be disclosed in a transparent way.

More revisions in the pipeline (including CRD IV)

In July, the European Commission put forward for consultation a new working document on planned further changes to the Capital Requirements Directives. This mainly included proposals for dynamic provisioning related to capital buffers, incremental capital requirements for residential mortgages denominated in foreign currency and plans for the removal of national options.

However, the Commission's working document did not yet include proposals for restraining excessive and unsustainable balance sheet growth (leverage ratio and core funding ratio), which were lively debated in the spring and summer in various working groups and with supervised entities.

The Commission has postponed the submission of its proposal for further changes until 2010. At the global level, the Basel Committee on Banking Supervision has examined the corresponding need to revise capital requirements regulation and published its own proposal for comment in December. Both proposals will be dealt with further in 2010.

The aim is to continue the reform work even after these changes. During the autumn, under the leadership of the Commission and in other international working groups, there were preliminary discussions on issues relating to the definition of capital and its quality, the imposition of quantitative limits on liquidity risk, the mitigation of excessive procyclicality and associated capital buffers and the treatment of systemically important financial institutions.

Preparation for implementation of Solvency II

The European Parliament adopted the Solvency II Directive in April. This updates regulation concerning the solvency of life insurance, non-life insurance and

reinsurance companies, while merging numerous existing Directives on the insurance business into one single Directive. The objective is to have a harmonised, comprehensive and risk-based solvency framework in place that fosters internal competition within the EU, efficient allocation of capital and companies' own risk management, thereby better safeguarding the interests of the insured. The Directive is scheduled to enter into force in October 2012.

In connection with the revision of the Finnish Insurance Companies Act in 2008, the proactive supervision of life insurance business was largely provided for in accordance with the Solvency II Directive. The new regulatory framework does not change actual solvency requirements based on EU Directives; rather, proactive supervision seeks to bring greater efficiency and transparency to supervision and to enable sufficiently early intervention by the supervisor when a supervised entity's financial standing deteriorates.

In the latter part of the year, FIN-FSA conducted a survey of preparations by the insurance sector for the new solvency legislation. According to the survey, companies had begun to prepare and were making fairly good progress in all areas on average. There were, however, differences between companies and areas of business.

The Ministry of Social Affairs and Health has set up a working group for national transposition of the Solvency II Directive. FIN-FSA is represented on the management group and on each of the four working sub-groups. The mandate of the working group will expire on 31 December 2011.

Other regulatory reforms

Revision of solvency regulation concerning private earnings-related pension schemes

In May, the Ministry of Social Affairs and Health set up a working group to examine the need for reform of solvency regulation concerning private sector earnings-related pension schemes. The mandate of the working group will expire on 31 March 2010.

The working group seeks to have regulation in place for pension providers' investment operations that will enable increases in employment pension contributions to be kept as low as possible. The regulation should prevent excessive risk-taking by pension providers, but should not unnecessarily restrict risk-taking even in adverse conditions.

Work begun on comprehensive reform of securities markets legislation

In February, the Ministry of Finance set up a working group to prepare a comprehensive reform of securities

markets legislation. The working group's mandate extends until the end of 2010. Underlying the reform are the numerous partial revisions made to securities markets legislation in recent years in connection with the implementation of EU Directives, which has blurred the clarity of legislation.

The aim of the reform is to ensure that securities markets legislation is clear, effective and understandable. The legislation should also promote the competitiveness of Finnish markets and should therefore avoid any competitiveness-hampering deviations from the regulation applied in EU countries of key importance to the operation of the markets. Another objective is that the legislation should ensure the availability and feasibility of investment services in circumstances where such services are being offered increasingly by non-Finnish providers. The legislation should also ensure the efficiency of securities markets supervision and the effectiveness of sanctions for procedures contrary to law.

The working group has been assigned the task of drafting a proposal for a new Securities Markets Act and proposals for amending securities clearing, settlement and custody legislation. The working group is also commissioned to prepare proposals for legislative changes concerning the indirect holding of securities (multi-tiered custody of securities), provided, however, that the current direct holding system continues to remain in place as an alternative to the multi-tiered structure.

Direct holding vs multi-tiered model

- Direct holding model = Finnish securities held by Finnish investors are entered in the investors' book-entry accounts with the Central Securities Depository (centralised register).
- Multi-tiered model = A custodian (often a bank) keeps record of securities held by Finnish investors with the custodian's own systems rather than the Central Securities Depository.
- As regards Finnish securities, multi-tiered custody is currently only accessible by foreign investors (nominee registration). For Finnish investors, multi-tiered custody is available for holdings in foreign securities.

The working group is also mandated to assess the feasibility of the current regulatory hierarchy (Acts, Ministry of Finance decrees, FIN-FSA standards) and to explore the possibilities of increasing self-regulation on the securities markets. In addition, the working group is to

examine the feasibility and effectiveness of the sanctions regime concerning non-compliance with securities markets legislation and defects in investor protection.

The working group's further work and timetables face a particular challenge arising from the ongoing numerous projects for regulatory change within the European Union as a consequence of the financial crisis. These are expected to lead to major amendments and updates to EU regulation in the near future.

The working group dealt separately with proposals for amending securities settlement legislation that related to the launch of central counterparty clearing services for trades done on NASDAQ OMX Helsinki Ltd (Helsinki Stock Exchange). The related Government bill was submitted to Parliament in October. The bill was passed on 10 December, and the Act entered into force in early February 2010. Under the new legislation, foreign clearing houses used by a Finnish marketplace need to obtain permission from the Ministry of Finance before they can start to clear trades done on said marketplace. FIN-FSA supervises the operations of foreign clearing houses in cooperation with their home-country supervisory authorities.

Long-term saving services may be provided by domestic and foreign deposit banks, investment firms and fund management companies

On 4 December, Parliament passed a bill that expands the options for saving for retirement. The resulting Act on long-term saving provides an opportunity for people to supplement their pension cover with a voluntary scheme as an alternative to pension insurance, starting from 2010. Savings contracts may be offered by deposit banks, investment firms and fund management companies and by comparable foreign service providers operating in Finland. Deposits on long-term savings accounts are tax deductible on the same conditions as contributions made under voluntary, individual pension insurance schemes.

Service providers must notify FIN-FSA of their decision to start providing long-term saving services at least one month prior to the commencement of the service provision. The Act provides for a three-month transitional period. Although the Act entered into force on 1 January 2010, the relevant service provision may commence in April 2010 at the earliest. The Act authorises FIN-FSA to issue regulations for fulfilment of the obligation to notify FIN-FSA in advance of the commencement of service provision. FIN-FSA participated in drafting this legislation and made preparations for accepting advance notifications of business start-ups for provision of long-term saving services. FIN-FSA also established the relevant needs related to this service provision, such as systems, disclosure requirements and the need to enhance customer awareness.

Payment Services Directive to bring new supervised entities

The European Parliament and the Council adopted the Payment Services Directive on 13 November 2007. It is proposed that the Directive be transposed into Finnish law by two separate Acts: one on payment institutions and one on payment services. These are likely to enter into force in spring 2010.

The Directive is designed to provide a common framework for the provision of payment services within the EU. Provision of payment services will become subject to authorisation. The Directive also includes provisions on disclosure requirements and codes of conduct applicable to payment service providers. The changes will be reflected in FIN-FSA's future regulation.

The new code of conduct obligations in the Directive have significant implications for the operations of entities already under supervision. As such, the provision of payment services does not require that credit institutions apply for a separate new authorisation or for changes to presently valid authorisations.

New supervised entities will include almost all companies providing payment services that are required to have payment institution authorisation after the entry into force of the relevant Act. The concept of payment services subject to authorisation is extensive, covering not only such traditional services as credit transfers and direct debits, but also money remittance and various payment services using technical devices (e.g. payment via mobile phone).

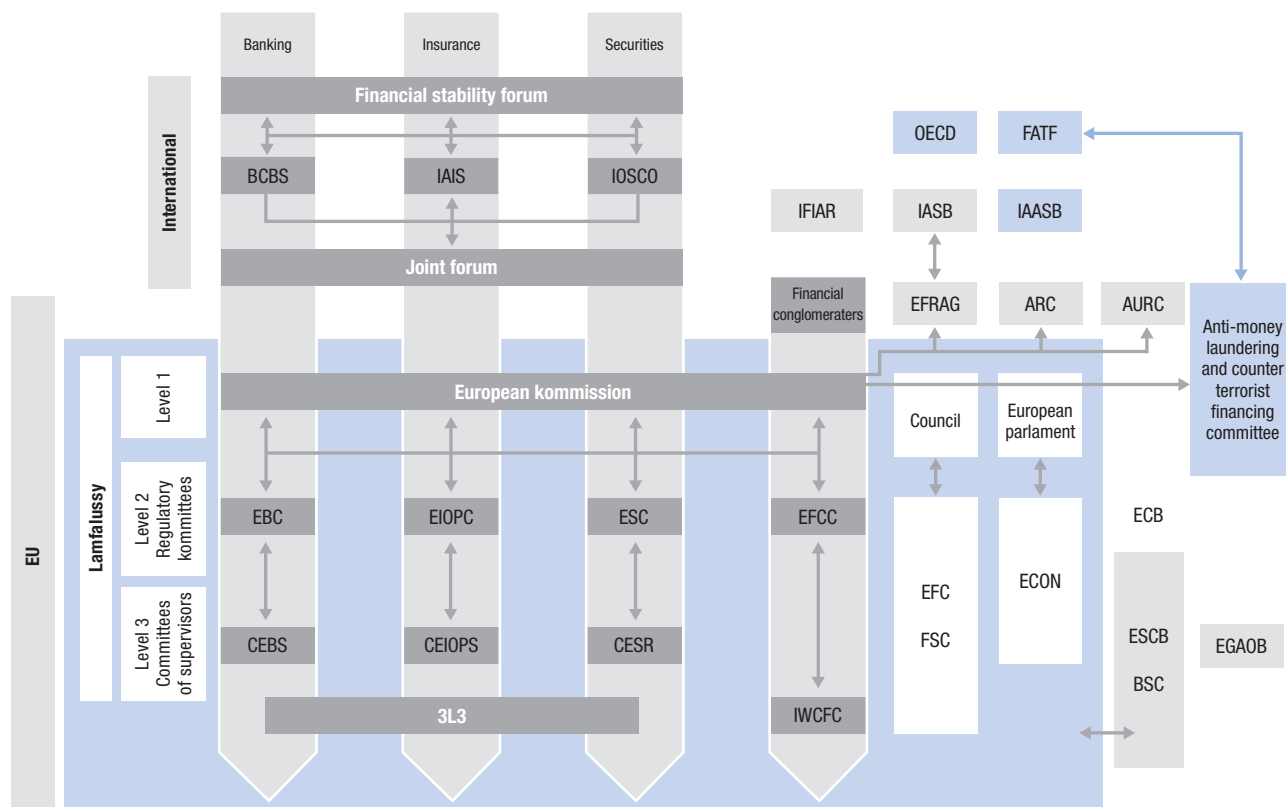
Planning begun on new set of regulations and guidelines

FIN-FSA's current regulation is based on that of the former authorities: standards issued by the Financial Supervision Authority and regulations and guidelines issued by the Insurance Supervisory Authority. These remain in force by virtue of transitional provisions contained in the FIN-FSA Act. These will be combined to constitute FIN-FSA's new set of regulations and guidelines.

FIN-FSA began the reform process by publishing a call for comments on the key aspects of the structure of its new set of regulations and guidelines. The round of comments ended in October, with 18 responses. Based on the feedback received, FIN-FSA will prepare a concrete proposal for the structure of the new set of regulations and guidelines. This will be separately distributed for comment in spring 2010. The final structure of the set of regulations and guidelines will be determined, on the basis of this round of comments, before summer 2010. Thereafter, work will begin on amending individual regulations and guidelines.

Appendices

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

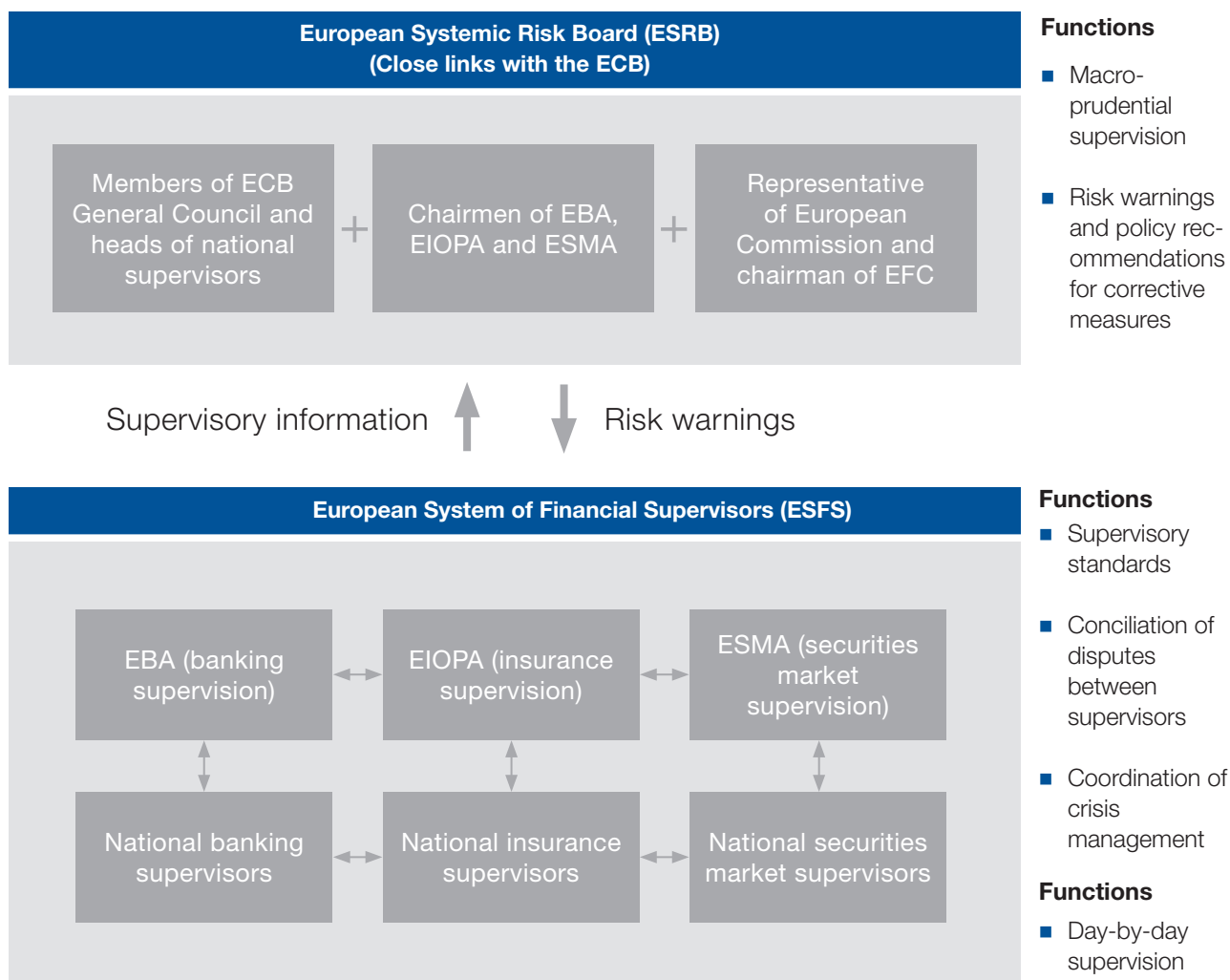
IOSCO International Organization of Securities Commission

IWCFC Interim Working Committee on Financial Conglomerates

OECD Organisation for Economic Co-operation and Development

Source: Financial Supervisory Authority.

New structure of European financial supervision



EBA European Banking Authority
ECB European Central Bank
EIOPA European Insurance and Occupational Pensions Authority
ESFS European System of Financial Supervisors

ESMA European Securities Market Authority
ESRB European Systemic Risk Board

Source: Financial Supervisory Authority.

Total number of supervised and other fee-paying entities¹

Fee-paying entities	31 December 2009
Credit institutions	352
Investment firms	59
Fund management companies	33
Securities issuers	142
Stock exchange, clearing corporation	1
Finnish Central Securities Depository (APK)	1
Other fee-paying entities in the financial sector	22
FINANCIAL SECTOR, TOTAL	610

Fee-paying entities	31 December 2009
Life insurance companies	13
Non-life insurance companies	21
Employee pension companies	7
Unemployment funds	36
Company and industry-wide pension funds	77
Sickness funds and other insurance funds	149
Insurance associations	88
Insurance brokers	62
Public sector pension funds	3
Other fee-paying entities in the insurance sector	45
INSURANCE SECTOR, TOTAL	501

ALL SUPERVISED AND OTHER FEE-PAYING ENTITIES, TOTAL	1 111
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¹ FIN-FSA also supervise e.g. insurance agents and persons subject to the obligation to declare insider holdings.

Expenses and funding 2009

Figures unaudited and unconfirmed.

Expenses and funding 2009, EUR thousands

	Actual 2009		Funding of operations
Staff expenses	17 620	Supervision fees	24 092
Staff-related expenses	824	Specific fees	989
Other expenses	3 541	Other income	34
■ Services	707	Bank of Finland's contribution:	
■ Real estate expenses	2 301	5% of expenses	1 226
■ Other expenses	533	Surplus carried over from previous year	1 097
Depreciation	124	Surplus carried over to next year	-2 909
Bank of Finland services	2 420		
TOTAL EXPENSES	24 529	TOTAL FUNDING	24 529

Set supervision fees, EUR thousands

Fee-paying entities	2009
Credit institutions	11 834
Investment firms	1 074
Fund management companies	1 076
Securities issuers	2 367
Stock exchange, clearing corporation	664
Finnish Central Securities Depository (APK)	260
Other fee-paying entities in the financial sector	103
FINANCIAL SECTOR, TOTAL	17 378
Life insurance companies	983
Non-life insurance companies	1 401
Employee pension companies	1 920
Unemployment funds	1 078
Company and industry-wide pension funds	393
Sickness funds and other insurance funds	130
Insurance associations	127
Insurance brokers	97
Public sector pension funds	423
Other fee-paying entities in the insurance sector	162
INSURANCE SECTOR, TOTAL	6 714
Fee-paying entities, total	24 092

Specific fees, EUR thousands

Fee-paying entities	2009
Credit institutions	124
Investment firms	84
Fund management companies	202
Securities issuers	195
Other fee-paying entities in the financial sector	8
FINANCIAL SECTOR, TOTAL	613
Insurance companies ¹	55
Unemployment funds	15
Company and industry-wide pension funds	26
Sickness funds and other insurance funds	29
Insurance associations	24
Insurance representatives ²	220
Other fee-paying entities in the insurance sector	7
INSURANCE SECTOR, TOTAL	376
Fee-paying entities, total	989

1 Life, non-life and employee pension companies.

2 Insurance brokers and agents.

Abbreviations

CCP, central counterparty

CEBS, Committee of European Banking Supervisors

CEIOPS, Committee of European Insurance and Occupational Pensions Supervisors

CESR, Committee of European Securities Regulators

CESR-Fin, Operational group on Financial Reporting

ECB, European Central Bank

ECOFIN, Economic and Financial Affairs Council

EECS, European Enforcers Coordination Sessions

EFC, Economic and Financial Committee

EMU, Economic and Monetary Union

FATF, Financial Action Task Force on Money Laundering

IASB, International Accounting Standards Board

IFRS, International Financial Reporting Standards

IMF, International Monetary Fund

IOSCO, International Organisation of Securities Commissions

IRBA, internal ratings based approach

IRDS, **CESR**'s centralised Instrument Reference Database System

MiFID, Markets in Financial Instruments Directive

OTC, over-the-counter (instruments traded outside regulated exchanges)

SEPA, Single Euro Payments Area

Tier 1 capital adequacy ratio, ratio of core capital (original own funds) to risk-weighted assets

TREM, **CESR**'s transaction reporting exchange mechanism

TyEL, Employee Pensions Act (Finnish legislation)

UCITS, undertaking for collective investments in transferable securities

US GAAP, Generally Accepted Accounting Principles in the United States

EU Directives and Directive proposals 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

Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)

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) and amendments thereto

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) and amendments thereto

Directive 2002/87/EC of the European Parliament and of the Council of 16 December 2002 on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate

Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast)

Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market

Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)

Commission proposal for a Directive of the European Parliament and of the Council amending Directives 1998/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109 EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of

the powers of the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (Directive on the powers of supervisory authorities in the EU)

Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers, COM(2009) 207 final

Nordic supervisory authorities

- Finansinspektionen, Sweden, www.fi.se
- Finanstilsynet, Norway, www.finanstilsynet.no
- Finanstilsynet, Denmark, www.finanstilsynet.dk
- Fjármálaeftirlitið, Iceland, www.fme.is

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