

Annual Report





The Financial Supervisory Authority (FIN-FSA) is the authority for supervision of Finland's financial and insurance sectors

FIN-FSA seeks to ensure that

- the operations of its supervised entities are on a sound footing, meaning that they hold capital resources to cover the risks and losses arising from their operations and are able to meet their commitments
- supervised entities do not take excessive risks in their operations
- the information provided to customers and investors on products, services, service providers and issuers is of high quality
- financial market practices are appropriate
- payment systems are secure.

Objectives

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.

In addition, FIN-FSA has a statutory duty to foster public awareness of financial matters.

FIN-FSA's work is aimed at ensuring that customers in Finland can be confident in conducting their business with banks, insurance companies and other financial-sector enterprises and can make decisions on their own finances on the basis of reliable information.

During the year under review, a total of 1,094 supervised entities (1,100 in 2010) and other entities were liable to pay supervision fees.

Administratively, FIN-FSA operates in connection with the Bank of Finland, but in its supervisory work it takes its decisions independently (for more information, see p. 16). FIN-FSA is part of the European system of financial supervision.

Supervised entities

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

The FIN-FSA also supervises

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

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Unless otherwise indicated, all texts refer to the review year 2011.



Anneli Tuominen

Debt crisis led to a marked increase in financial sector risks

Financial market turmoil increased in late summer against the backdrop of the prolonged European debt crisis. Banks had difficulties in accessing funding, share prices collapsed and the economic outlook deteriorated. The negative feedback loop between the financial sector and the real economy added to the threat of systemic risk. The European Central Bank had an important role to play in safeguarding stability and covering temporary liquidity needs. Despite the markets' partial recovery in the current year from their steepest falls, economic prospects continue to be gloomy in the European Economic Area. It is therefore essential that the various policymakers are able to break this vicious circle in a credible manner. In particular, the crisis countries need to demonstrate discipline in restraining spending and adhering to the decisions that have been taken.

Significant action taken by European financial supervisors to restore confidence

European financial supervisors have made their own contribution to resolving the crisis and restoring confidence. The European Banking Authority (EBA) sought to enhance confidence in the banking sector by organising a stress test in the summer. This exercise led to the publication of more detailed information on participating banks' sovereign exposures, among other issues. Later in the summer, after the situation on the markets had escalated into a full-blown crisis, the EBA was forced to assess the situation once again. The only possibility was to require that the EU banking sector maintain adequate capital buffers to cover the fallen market values and the higher risks of sovereign debt instruments. FIN-FSA was closely involved in the EBA's decision-making.

There are practical problems relating to implementation of the aforementioned decision: how can distressed banks raise capital in the markets, and how can we ensure that banks do not strengthen their capital positions by reducing their balance sheets, thereby contributing to a possible credit crunch? According to a preliminary estimate, the plans of banks that need to bolster their capital adequacy emphasise measures aimed at increasing capital. Lending to the real economy is projected to decline only marginally. This is good news for economic growth in Europe – provided the planned measures can be implemented in practice.

By issuing a public statement, the European Securities and Markets Authority (ESMA) sought to influence banks and insurance companies to be as consistent as possible in applying IFRS requirements in the recognition and measurement of sovereign debt in their 2011 financial statements. This was an important contribution to ensuring the comparability of financial statements.

The Finnish financial sector has so far come through the crisis at least satisfactorily

The capital adequacy of the Finnish banking sector is at a good level. Although liquidity risks have increased, banks have encountered no problems in their short-term funding. Last year, long-term funding could be obtained mainly in the covered bonds market, albeit at higher prices. Currently, issues of unsecured bonds have again become widespread. The banking sector's loan losses remain moderate and have not yet been affected by the weakened economic conditions. Finnish banks' position has been eased by their better-than-average cost-effectiveness compared with their European competitors.

In Finland, the effects of the debt crisis have so far been hardest felt by the insurance sector, where investment returns and solvency vary according to the trends in securities markets. The impact has been strongest in the life insurance and employee pension insurance sectors; however, these sectors' risk-based solvency positions continue to be at least reasonable.

In response to the deepening crisis, FIN-FSA stepped up its analysis of supervised entities' financial position and risks, requiring higher-frequency reporting. For banks, this meant more frequent reporting on their liquidity situation, while insurance companies were asked to report frequently on their solvency and investment returns. The FIN-FSA emphasised to its supervised entities the importance of strong liquidity and robust capital buffers.

A difficult market situation puts the spotlight on how supervised entities' own risk management and internal control operate in practice. The FIN-FSA therefore focused inspections on these areas. The inspections led to requirements or recommendations for corrective action in the case of almost all supervised entities. However, no shortcomings severe enough to jeopardise the continu-

ance of business were detected. The good levels of risk management and internal control have contributed to the ongoing ability of Finnish financial-sector participants to cope well with the difficult operating environment.

Need for stricter, but consistent regulation

The FIN-FSA considers it important to tighten capital adequacy and liquidity regulation and to adopt more risk-based approaches. Strengthening the loss-absorbing ability of supervised entities by imposing higher capital requirements is essential to safeguarding the stable operation of the financial sector, as is the imposition of higher liquidity requirements in order to improve resilience in the face of market crises.

However, with a view to ensuring comparability and competitive neutrality, regulation should be as consistent as possible across the EU as a whole. Practices applied by the banking sectors of various countries have been too uneven in respect of both capital adequacy calculations and the preparation of financial statements. The insurance sector still operates largely on the basis of national regulation, and this will continue until the introduction of the Solvency II reform.

Some countries have recently taken decisions on tightening the Basel III capital framework at national level. The FIN-FSA considers that different regulatory bases and different interpretations not only hamper supervision but also make it difficult for investors to compare different entities. Moreover, they are an impediment to the entities' cross-border business, eg mergers and acquisitions. There must, however, be scope for national tightening of the requirements as a temporary solution if the local market situation so requires; nevertheless, the basic requirements should be the same and sufficiently strict in order to safeguard financial stability in the Single Market area as a whole.

Both the financial and insurance sectors are currently uncertain about the precise content of upcoming regulation, which naturally makes it difficult to prepare for the new regulatory frameworks and acts as a constraint on the issuance of capital and debt instruments. On the other hand, regulation includes areas that should be reassessed in terms of their fitness for purpose, such as the still preferential treatment of sovereign debt in capital and liquidity Regulations.

As consistent regulation as possible for different sectors...

In its own regulation and supervision, the FIN-FSA seeks to rely on the same solutions in different sectors as often as possible – within the limits of the relevant legislation. If

similar structures, risks or behavioural models were regulated and supervised differently, it would lead to risks migrating into sectors with looser requirements. However, the FIN-FSA seeks at the same time to carefully consider different sectors' business conditions and specific risk features. Risk management is an example of an area where the basic principles should be identical, irrespective of the sector. The EU sectoral supervisory authorities should also seek to achieve, as far as possible, the same solutions in the regulation and supervision of similar risks.

The securities, banking and insurance sectors all compete for the same savings assets. Financial sector companies are tempted to sell products on which they receive the highest income. It is therefore of key concern that customers receive as consistent information as possible on the risks and costs related to the products offered. This is also the objective of EU legislation that is currently under preparation.

...not forgetting the principle of proportionality

The principle of proportionality should, however, be borne in mind in all regulation, meaning that regulation should be adapted to the scope, quality, complexity and risks of the business conducted. The FIN-FSA has highlighted this issue, but it will pose a major challenge to supervisory effectiveness at European level in the future. In our own regulation and supervision, we have not yet fully managed to take account of the principle of proportionality. We can improve our action in this area, within the limits permitted by EU regulation.

Compliance with the principle of proportionality also applies to regulation in general. If banking regulation, for example, is too strict, there is a danger that business will move beyond the reach of such regulation. 'Shadow banking' has, in fact, snowballed internationally. It is also crucial to find a balance between new, tighter regulation that pushes up costs and the promotion of economic growth.

Even so, it is worthwhile keeping in mind that no amount of regulation is adequate if supervised entities' own internal control and governance processes, their own ethical base for their operations and corporate culture are not in order. Good corporate governance also includes the management's solid understanding of the business logic of the company and of the risks it takes on.

Responsibilities and instruments for macroprudential supervision need to be defined in Finland, too...

One of the problem areas raised by the financial crisis was that micro- and macroprudential supervisors failed to co-operate to the degree needed. From the perspective of

the macroeconomy, risks arising from individual institutions were not analysed with adequate coverage. Property market bubbles caused by overheated lending in different countries could be cited here as an example. The establishment of the European Systemic Risk Board (ESRB) has bridged gaps in cooperation between central banks and supervisors.

According to the programme of Finland's current government, FIN-FSA must be equipped with the requisite powers to deploy macroprudential policy instruments. The Government Programme particularly underscores the objective of preventing further accumulation of corporate and household debt. The Ministry of Finance set up a working group with responsibility for presenting the necessary action for the creation of an effective national framework for macroprudential supervision. The aim of the FIN-FSA is to define with adequate clarity the circumstances in which macroprudential instruments can be deployed. It is also important to clearly specify the supervisory powers and tools and to clarify the areas of responsibility of the different parties. Effective deployment of existing resources in the area of macroprudential supervision should also not be forgotten.

The FIN-FSA has already for some time been seeking to ensure that households' risks are kept under control by recommending compliance with sound lending criteria and careful assessment of customer risks. The information we have received confirms that banks have moved in the right direction. In Finland, people are still strongly committed to repaying their debts. Very long-term housing loans that are not amortised, with only the interest being paid, have not become widespread, as in other Nordic countries. Nevertheless, some customers are heavily indebted and competition for loan margins between banks remains keen. Margins in Finland are among the lowest in the euro area. Although the risks of individual households are of particular concern, banks' margins should also cover the risks they incur over the long term.

...while it is necessary to assess at EU level whether there are structural risks related to the European banking system

In order to minimise future costs to society from financial crises, the European Commission has decided to clarify whether structural issues concerning the banking sector should be regulated separately. Should, for example, low-risk retail banking be ring-fenced? Which structural measures could improve the resilience of the banking sector? Erkki Liikanen, Governor of the Bank of Finland, was appointed in January to chair a High-level Expert Group on structural aspects of the EU banking sector

with responsibility for considering during the current year whether there is a need for additional European regulation in this area.

European supervisory authorities should put more emphasis on supervisory convergence...

Last year, the new supervisory authorities – the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) – commenced operations as part of the European system of financial supervision. These authorities have extensive powers compared with their predecessors. They are more independent in their activities and have in practice also proved to be more assertive and target-oriented than the preceding committees. The more efficient and faster decision-making process can be cited as an example: no consensus is sought, with decisions taken by vote if necessary. This speeds up decision-making, rendering it more focused and forceful, and actually provides small countries with better opportunities to exert influence.

One matter of concern is that an overly large part of authorities' work programmes is devoted to drafting new regulation required by the Commission. This means that less time remains for developing good European supervisory practices, such as best and coherent approaches in inspections as well as risk analysis and capital adequacy assessment. One of the contributory causes of the crisis was supervisory failure in many separate areas. Accordingly, the FIN-FSA has sought to influence the work programmes so that they would better prioritise supervisory practices and the development of cooperation between supervisors. FIN-FSA is also actively involved in ESA workstreams fostering customer protection, because they facilitate improvements in this area, especially in cross-border service provision.

...as is already partly the case at Nordic level

Nordic supervisory cooperation continued to function well within the established framework. Nordic supervisors have, for example, agreed on the assessment of capital adequacy of multinational banking groups and the size of capital buffers required from groups and subsidiaries. This work takes place in supervisory colleges.

With regard to liquidity management, the FIN-FSA has underlined the need for subsidiaries and branches based in Finland collecting deposits to have adequate levels of liquidity. The assets should also be located in Finland in order to ensure better safeguards for depositors' claims in the event of a crisis.

Adequate information exchange between supervisors has posed a challenge in the context of rapidly and strongly changing market situations. A lot still remains to be improved in this area among Nordic supervisors, too. We also need to continue work on supervisory convergence amongst the Nordic countries.

Availability of cash is part of a well-functioning financial system

In the year under review, some banks began restricting the availability of cash in their branches. Banks see this as a matter of cost-effectiveness. With card payments becoming increasingly widespread, the role of cash has diminished. The use of ATMs does not always compensate for the costs incurred. On the other hand, from the bank customer's point of view, it is essential to ensure adequate availability of cash. This is a service that can be considered a basic banking service that constitutes an essential element of a smoothly functioning banking system. Consequently, the FIN-FSA considers it important that banks honour their social responsibility and cater for an adequate level of service provision in this area. This is especially important for senior customers.

Finland's capital markets need a boost

The financial crisis highlighted the importance of well-functioning capital markets. If the crisis and new regulation weaken banks' lending capacity, the importance of financing from the capital markets will increase. Finland's capital markets have suffered from a 'periphery' phenomenon: investors avoid illiquid and remote markets during bad times. The Helsinki Stock Exchange has witnessed a record low number of new listings in recent years at the same time as already listed companies have withdrawn from exchange trading. It is vital to develop Finland's capital markets and ensure that cost-increasing features specific to Finland are eliminated.

Both the Commission's various proposals and the comprehensive overhaul of Finnish securities markets legislation are aimed at improving small and medium-sized enterprises' access to the capital markets. Positive news for market development is that a multilateral trading facility directed particularly at small and medium-sized enterprises, First North, was finally launched in Finland in April 2011. It enables listing with lower requirements than those normally imposed on companies listed on regulated markets. To date, however, there have been no listings.

Finland's corporate bond markets have traditionally been highly illiquid and opaque. Through its amendments to the Markets in Financial Instruments Directive (MiFID), the Commission seeks to increase the transpar-

ency of price information on bond trades. This would help increase confidence in the bond markets. From the viewpoint of developing the capital markets, it is crucial to increase retail investors' market activity. In this context, it would be worth assessing whether the legislation on long-term savings that has been in force for a couple of years has achieved the objectives set, or whether it requires further development.

On the other hand, proposals have also been put forward that could impair the functioning of Finland's capital markets. The most important of these is the proposed financial transaction tax. FIN-FSA takes the view that a comprehensive study of the impact of the tax should be undertaken before its imposition. Another precondition for the introduction of the tax should be that it would have at least an EU-wide application. Otherwise, there would be a danger that the tax would weaken the international competitive position of small and remote financial markets such as Finland's.

Consultations and stakeholder surveys assisting in development of activities

The FIN-FSA Board invites views from financial market participants at least once a year. The aim is to afford market participants an opportunity to express their opinions on, for example, the objectives set for supervision and their achievement. In addition, a stakeholder survey is commissioned every three years to chart the views of stakeholders on the activities of FIN-FSA. The survey carried out last year awarded FIN-FSA a better grade (8 out of 10) than our predecessors had obtained.

Both official consultations and stakeholder surveys provide FIN-FSA with valuable information for the development of our activities. Areas requiring development include our working methods, provision of information and communications, cooperation channels, cost-effectiveness and appropriate allocation of professional skills. The feedback also revealed imperfect knowledge of FIN-FSA's international activities. In order to improve awareness of our activities, FIN-FSA organised in January 2012 a seminar where the chairpersons of all three European supervisory authorities and a European Commission representative gave presentations. We have also arranged several information sessions on EU regulatory changes.

Demands on supervision continue to increase

A challenging operating environment and a variety of regulatory reforms demand from FIN-FSA professional rigour and the ability to prioritise. The supervisor is expected to operate as proactively as possible, because ex-post reaction – such as withdrawal of authorisation – is often seen

as a sign of supervisory failure. Stakeholders are looking for deeper, and also broader, professional competence from FIN-FSA staff in an increasingly complex regulatory environment. At the same time, they rightly expect FIN-FSA's actions to be effective. Meeting these challenges is a demanding task, especially when the new European supervisory system, contrary to what was anticipated earlier, requires considerable additional input from national supervisors. Even so, I believe that, when we set clear objectives for our work, take care of a good working atmosphere and cherish our values, we will be able to meet these demands.

In conclusion, once again, I would like to thank all FIN-FSA staff members. You have demonstrated excellent strength and determination in working towards the achievement of FIN-FSA's objectives. The operating environment has been difficult, but you have not let this discourage you. Thank you!

Helsinki, 23 February 2012

Anneli Tuominen

Strategy updated

In 2009, the FIN-FSA Board confirmed the strategy for 2010–2012. The strategic choices proved to be appropriate, but the strategy was updated in 2011 to make it better meet the requirements of a changed operating environment. The core pillar of the strategy concerns the effectiveness of FIN-FSA's work and risk-based supervision. The objectives defined under this pillar include timely and high-quality analysis of risks to the operating environment and the financial sector plus the ability, in pursuing the work of financial supervision, to take full benefit from its close connection with the central bank.

The new strategy for 2012–2014 is published here on page 7; however, this Annual Report reviews the activities of FIN-FSA against the strategy set for 2010–2012.

Mission

Our primary objectives are to maintain financial stability and confidence in the financial markets and to foster customer and investor protection and the protection of the insured.

To promote these objectives we focus our supervisory activities on

- the risk management and financial viability of entities operating on the financial markets;
- the appropriateness of business practices observed in customer relationships and market activities and the quality of information provided to customers and investors.

Vision

The Financial Supervisory Authority is a dynamic and highly respected supervisor and contributes to the development of a high-quality European supervisory culture.

Our aim is to ensure

- healthy development and a level competitive playing field on Finland's financial markets;
- appropriately sized regulation and supervision; and
- customers' improved awareness of the financial markets.

Strategic objectives and choices

Operational efficiency and risk-focused supervision

- Up-to-date, quality analysis of operating-environment and financial-sector risks
- Regulation of the different supervisory sectors that is as uniform and integrated as possible
- Readiness for rapid, focused decision-making in a crisis
- Top-ranking quality and efficiency among European supervisors
- Derive full benefit from close relationship with the central bank
- Fluent and positive cooperation with other authorities
- A supportive and motivating climate at work, and activity in accordance with our values

Supervised entities' strong risk-bearing capacity and high-quality administration

- Our inspections will focus on assessing the reliability of risk management and internal control.
- We will sharpen the focus of our risk assessments, emphasising the adequacy of capital and liquidity buffers.
- We will assess entities' operational risks and require adequate financial provision for said risks.
- We will contribute to organising macroprudential supervision and foster readiness for crisis management.

High-quality customer and investor protection

- We will require the internal procedures of service providers to take account of the demands of customer and investor protection.
- We will require financial sector participants to provide quality information on their financial position, products and services plus the related risks.
- We will enhance the scope and visibility of educational information provided to customers.
- We will intervene vigorously in the event of inappropriate activities on the financial markets.

Productive cooperation between supervisors

- We will focus resources at a sufficiently early stage on international projects of key relevance to the stability and smooth functioning of Finland's financial markets.
- We will foster the adoption within the EU of the best European supervisory practices.
- In our own work, we will draw on the work of other European supervisors.
- We will enhance real-time exchange of information between supervisors.

Mission

Our primary objectives are the maintenance of financial stability and confidence in the wellfunctioning 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.

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.

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 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.

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.

Strengthening of risk-based supervision

- FIN-FSA focused its supervisory work on those areas of risk where the deepening debt crisis led to higher risks, and on the functioning of supervised entities' own risk management and internal control processes.
- In the banking sector, the monitoring of market and liquidity risk was increased. In the insurance and pensions sector, the emphasis was on monitoring investment-related market risks and operational risks.
- National stress tests were conducted to analyse the risk-bearing capacity of the Finnish financial sector if the sector were to be hit by a deeper debt crisis and macroeconomic recession. In addition, the largest supervised entities in the banking and insurance sector participated in EU-wide stress tests.
- In April and September, FIN-FSA published its assessments of the situation in the Finnish financial sector.
- Supervised entities' reporting frequency was stepped up. The tools employed for analysing supervised entities' risks and capital positions were updated.
- Owing to the increased vulnerability of banks' payment transmission to system failures, FIN-FSA mandated improvements in system reliability.

Promotion of customer and investor protection

- Inspections revealed no major defects in market practices for financial products and services. In three cases, however, a public reprimand was issued. Five administrative fines were imposed for failure to declare insider holdings.
- In the housing finance survey, FIN-FSA addressed banks' maximum loan-to-value (LTV) ratios and compliance with housing affordability calculations.
- On the basis of the survey of basic banking services, FIN-FSA urged some banks to reassess the fairness of their service fees.
- With respect to product development processes applied to savings and investment products, FIN-FSA emphasised the need for supervised entities to ensure the clarity of processes and the testing of products in different economic and market situations from the perspective of the customer.
- Guidance was prepared for the provision of information on costs related to unit-linked insurance policies.
- Supervision of financial information and communication was directed at, for example, goodwill impairment tests and reports on business prospects and risks.

Intensification of international supervisory and regulatory cooperation

- FIN-FSA focused on projects of particularly high importance to the Finnish financial sector's capital adequacy and structural features.
- FIN-FSA was closely involved in the work of the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Securities and Markets Authority (ESMA) and the Joint Committee, supporting their efforts to mitigate the crisis and stabilise the financial markets (eg stress tests, recapitalisation of banks, consistent treatment of sovereign debt).



- Within the EBA, FIN-FSA was active in revising regulation on banks' own funds.
- As regards the EIOPA, the emphasis was on the preparation of provisions for the insurance sector's Solvency II reform.
- Within ESMA, FIN-FSA made an active contribution to enhancing EU-level cooperation in securities markets supervision and improving supervision of new financial products.
- The liquidity positions of Nordic financial conglomerates were under particularly strict scrutiny.

Moving to a common culture

- Coordination of various supervisory tasks was improved. Internal processes were updated.
- Work continued on the new uniform set of regulations and guidelines, with the first regulations and guidelines included in the new framework being published.
- According to FIN-FSA's first interest group survey, two of three respondents estimated that FIN-FSA had succeeded well in promoting confidence in the operation of the financial markets, customer and investor protection and financial market stability.
- FIN-FSA's public disclosure policy specified the information to be published.

European system of financial supervision

European Supervisory Authorities (ESA)

- European Banking Authority (EBA), eba.europa.eu
- European Insurance and Occupational Pensions Authority (EIOPA), eiopa.europa.eu
- European Securities and Markets Authority (ESMA), esma.europa.eu

European Systemic Risk Board (ESRB), www.esrb.europa.eu

For more information, see page 40.

Parliamentary Supervisory Council

The Parliamentary Supervisory Council is responsible for supervising the overall expediency and efficiency of FIN-FSA's activities. In supervising expediency, the Parliamentary Supervisory Council assesses how the objective provided in law has been achieved. As regards the supervision of efficiency, the Parliamentary Supervisory Council focuses particularly on how changes in tasks, legislation or markets affect developments in FIN-FSA's staff size and budget. Each spring, the Parliamentary Supervisory Council issues an annual report to assess the activities of FIN-FSA in addition to those of the Bank of Finland.

Timo Kalli was Chairman and **Antti Kalliomäki** Vice Chairman of the Parliamentary Supervisory Council until 29 June. In the first half of the year, the other members were **Tanja Karpela**, **Martti Korhonen**, **Mika Lintilä**, **Pekka Ravi**, **Marja Tiura**, **Jutta Urpilainen** and **Ben Zyskowitz**.

As from 30 June, the Parliamentary Supervisory Council was chaired by Ben Zyskowitz, with **Pirkko Ruohonen-Lerner** as Vice Chairman. The other members were **Jouni Backman**, **Timo Kalli**, **Mari Kiviniemi**, **Marjo Matikainen-Kallström**, **Lea Mäkipää**, **Jan Vapaavuori** and **Pia Viitanen**.

The secretary to the Parliamentary Supervisory Council was **Anton Mäkelä**, LLM (trained on the bench), of the Bank of Finland.

Board

The FIN-FSA Board oversees supervisory activities by deciding overall strategy, setting operational objectives and directing and supervising achievement of the objectives and compliance with the strategy. The Board discusses the budget of FIN-FSA and submits it to the Board of the Bank of Finland for confirmation. Once a year, the Board supplies the Parliamentary Supervisory Council with a report on the operational objectives of FIN-FSA and their achievement.

 The reports are published (in Finnish and Swedish) on the FIN-FSA website at **Finanssivalvonta.fi > Julkaisut ja tiedotteet > Johtokunnan kertomus pankkivaltuustolle**.

The Board has five members appointed for a three-year term. Board members and deputy members are appointed by the Parliamentary Supervisory Council. Members appointed on the basis of a proposal by the Ministry of Finance, the Ministry of Social Affairs and Health and the Bank of Finland each have a designated deputy member.

Members and deputy members of the Board

Pentti Hakkarainen, Chairman

Deputy Governor, Bank of Finland

Martti Hetemäki, Vice Chairman

Under-Secretary of State, Ministry of Finance

Outi Antila

Director-General, Ministry of Social Affairs and Health

Pirkko Juntti

LLM (trained on the bench)

Paavo Pitkänen

MA

Deputy to Pentti Hakkarainen:

Kimmo Virolainen, Head of Department, Bank of Finland

Deputy to Martti Hetemäki:

Tuija Taos, Director, Legislative Counsellor, Ministry of Finance

Deputy to Outi Antila:

Erkki Rajaniemi, Director, Ministry of Social Affairs and Health

The Secretary to the Board was Senior Legal Advisor **Pirjo Kyyrönen**.

On 18 November, the Parliamentary Supervisory Council appointed the Board for the next three-year term, commencing on 1 January 2012. The Board continues its functions unchanged with one exception. **Jaakko Tuomikoski**, MA, SHV¹ was appointed as a new member of the Board to replace Paavo Pitkänen, MA.

During the year the Board convened 14 times. All members or deputy members were present at all meetings except one. All meetings were quorate.

The Parliamentary Supervisory Council has determined a monthly fee for Board members and deputies. No separate attendance allowance is paid. Monthly fees to the members and deputies totalled EUR 59,550.

Valuable information from financial market participants at Board consultations

The Board consults financial market participants annually. Consultations provide the Board with an opportunity to hear the views of the representatives of financial market participants on FIN-FSA's budget and on supervisory

¹ Actuary accredited by the Ministry of Social Affairs and Health.

Management group



The FIN-FSA management group, from left to right: Erkki Kontkanen, Marja Nykänen, Erja Rautanen, Anneli Tuominen, Hely Salomaa and Jukka Vesala. Jarmo Parkkonen is not in the photograph.

Anneli Tuominen

LLM (trained on the bench), MSc (Econ.)
Director General; Chairman

Jukka Vesala

DSc (Econ.)
Deputy Director General, Head of Prudential Supervision

Marja Nykänen

LLM (trained on the bench)
Head of Institutional Supervision

Erja Rautanen

LLM
Head of Conduct of Business Supervision

Erkki Kontkanen

LLD
Chief Advisor, Chief of the General Secretariat (since 15 December, also acting Head of Market Supervision)

Hely Salomaa

DSocSc
Chief Advisor

Jarmo Parkkonen

LLM, MSc (Econ.)
Head of Market Supervision (on sick leave since 15 December)

 See the CVs of the management group members at:
Fin-fsa.fi > About us > Organisation > Management group CVs

objectives and their achievement. In addition, expected changes in supervisory work and their impact on supervision fees are also discussed.

The 2011 consultation was held in April. The representatives noted the importance of information access related to regulatory changes and the need to allow adequate time for preparation, as well as the consideration of competitive neutrality and the avoidance of over-regulation on the part of both EU authorities and FIN-FSA.

Director General and management group

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 2011 was **Anneli Tuominen**, appointed by the Parliamentary Supervisory Council for a five-year term in 2009. The Parliamentary Supervisory Council appointed **Jukka Vesala**, Head of Department, in 2009 as Deputy Director General to stand in for the Director General.

The Director General was assisted by a consultative management group consisting of the heads of department **Marja Nykänen**, **Jarmo Parkkonen**, **Erja Rautanen** and Jukka Vesala and other FIN-FSA employees appointed by the Director General, namely **Erkki Kontkanen**, Chief Advisor and Chief of the General Secretariat, and **Hely Salomaa**, Chief Advisor. The Secretary to the management group was Senior Legal Advisor Pirjo Kyyrönen.

The Board appointed the heads of department for five-year terms (Jarmo Parkkonen, Erja Rautanen and Jukka Vesala in 2009, Marja Nykänen in 2010) and Erkki Kontkanen, Chief Advisor and Chief of the General Secretariat (2010) also for a five-year term.

The management group convened 63 times during the year.

The Director General's salaries and fees totalled EUR 207,513.00. Salaries and fees paid to the other management group members totalled EUR 738,591.77

Departments and units

FIN-FSA has four departments

- Institutional Supervision
- Prudential Supervision
- Market Supervision
- Conduct of Business Supervision

The departments are subdivided into divisions. For more details, see the organisation chart on page 17. Besides the departments, there were three units directly accountable to the Director General

- Administration
- General Secretariat
- Communications

Institutional Supervision is responsible for the work of senior financial supervisors. This includes

- processing applications for authorisation
- building an overall picture of the business, capital adequacy and risks of supervised entities
- assessing the internal governance, financial statements and capital adequacy calculations of supervised entities and the legal compliance of their operations
- coordinating actions regarding supervised entities
- exercising cooperation within collegial bodies of Nordic supervisors

The department has responsibility for insurance and financial sector participants, excepting non-group investment firms and fund management companies. Their authorisations and registration applications are dealt with, and their supervision is ensured, by the Conduct of Business Supervision department.

Prudential Supervision aims to identify and prevent risks to supervised entities' capital adequacy and liquidity. Supervision is designed to ensure that

- supervised entities' risk exposures do not exceed their risk-bearing capacity
- their risk management and internal control procedures are appropriate
- they have in place sound processes for capital and liquidity management

Supervision takes the form of inspections and analysis of regular reporting. Furthermore, the department

- is responsible for analysis and research on the financial situation and risks of supervised entities and the operating environment
- ensures FIN-FSA's IT systems development and coordination of inspection activity
- has responsibility for the development of best practices for EU supervisory cooperation and coordination of work within the EBA, EIOPA and ESRB.

Viewed as a whole, one of the common objectives of Institutional and Prudential Supervision is efficient crisis management, with a view to minimising the consequences of crises and disruptions for customers and system operability and for the national economy.

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 an appropriately functioning securities market infrastructure
- sound market conduct

The department supervises investor information related to

- communications by listed companies on performance
- securities offerings
- IFRS financial statements
- various investment products

It also supervises the operations of the stock exchange and the central securities depository as well as securities trading. As a member of the Auditing Board of the Central Chamber of Commerce, FIN-FSA takes part in the supervision of auditors and its further development. The department is responsible for coordinating ESMA-related work.

Conduct of Business Supervision is responsible for supervising service providers' code of conduct towards their customers and the related internal processes and organisation of activities. The areas of supervision and inspection include

- the marketing of services and products
- the information provided to customers

- the code of conduct towards customers and
- service providers' sound internal governance processes

The department's responsibilities also include review of the applications for authorisation and registration filed by fund management companies, investment firms and insurance brokers. It supervises the financial position of fund management companies and investment firms not belonging to conglomerates and the management and code of conduct of unemployment benefit funds. Moreover, the department deals with notifications for cross-border service provision.

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.

Staff

The FIN-FSA is an expert organisation, with 75% of staff holding expert positions, 14% serving as support staff and 11% holding management positions. The approved headcount in 2011 was 217 persons, with the headcount at the end of the year standing at 208. The staff turnover rate was 11% (9% in 2010).


The administrative connection between FIN-FSA and the Bank of Finland means that, among other things, the FIN-FSA staff is part of the staff of the Bank of Finland, staff members come under the same collective civil service agreement and FIN-FSA observes the same personnel policy as the Bank of Finland.

The breakdown of staff at the end of the year was:

Prudential Supervision	71
Institutional Supervision	40
Market Supervision.....	37
Conduct of Business Supervision	31
Administration unit.....	14
General Secretariat.....	8
Communications	6
Director General	1

Gender division by function (%)

	Men	Women
All FIN-FSA staff	39	61
Management	55	45
Experts	43	57
Support staff	7	93


 FIN-FSA publishes a Personnel Audit every year. The latest Personnel Audit is available (in Finnish only) at **Finanssivalvonta.fi > Tietoa Finanssivalvonnasta > Avoimet työpaikat**

An employee survey is conducted every other year to monitor, among other things, the organisation's internal functioning and improvements in working conditions. According to the survey undertaken in the autumn, the job satisfaction index (3.36 in a scale of 1–5) had slightly improved since the 2009 measurement (3.23) and matched the benchmark of other Finnish expert organisations in the research institute's database (3.40). Leadership performance was also measured for the first time by the relevant index (3.49). The result matched the benchmark (3.52).

In its verdict issued in December on a civil action, the Helsinki District Court considered that, in extending on 28 May 2009 the period of application for a position as an expert due to a case of transsexuality, FIN-FSA had placed the complainant in a different position to other employees

Rules governing trading by and commitments of FIN-FSA staff

Trading rules restrict securities trading by FIN-FSA staff in order to prevent abuse of insider information. Disclosure of the staff's links with or ties to supervised entities ensures that their independence is not compromised. FIN-FSA staff members must not have such links or ties that could give rise to doubts about their ability to discharge their duties in an impartial and proper manner. The members and deputy members of the Board are also under a legal obligation to disclose their securities holdings and close links. More information is available at:

 **Fin-fsa.fi > About us > Organisation > Rules governing securities trading of FIN-FSA staff and obligation of disclosure**

in the manner referred to in section 7, subsection 1, paragraph 1 of the Equality Act. According to the verdict, FIN-FSA must pay the complainant compensation of EUR 15,000 under the Equality Act, including interest, and also pay her legal costs. In other respects, the District Court dismissed the claim. Neither party registered dissatisfaction with the verdict, which is therefore final.

Cooperation between FIN-FSA and the Bank of Finland

FIN-FSA is administratively connected to the Bank of Finland but is autonomous in its decision-making. Supervision in connection with the central bank has brought distinct synergy benefits. Both FIN-FSA and the Bank of Finland play a pivotal role in safeguarding the stability of the financial markets and both organisations benefit from their close cooperation. In directing its own supervisory work, FIN-FSA can make use of the Bank of Finland's broad-based data collection and analysis of the macroeconomy and the financial markets, while the Bank of Finland has the opportunity of utilising FIN-FSA's analysis based on supervisory information. Overlap in analytical work and data collection can be avoided, and different staff competence profiles complement each other.

During the year under review, cooperation was further intensified. For example, Bank of Finland experts participated in FIN-FSA's analysis group for the banking sector tasked with performing higher-frequency assessments of the position of the banking sector against the backdrop of the debt crisis. In addition to the analysis of risks to the operating environment and the financial sector and the conduct of stress tests, cooperation is intense with regard to the supervision of securities markets infrastructure and payment systems. For example, joint supervisory visits were conducted in this area. Close cooperation also continued in the development of data collection systems. As in previous years, international regulatory developments were analysed together. Similarly, participation in the operations of the new European supervisory framework, particularly in the work of the European Systemic Risk Board (ESRB) and the European Banking Authority (EBA), was carried out in concert.

Owing to the administrative connection with the Bank of Finland, FIN-FSA can make use of many administrative services offered by the central bank (financial administration, security and IT services), for which it pays in accordance with transfer pricing.

Establishment of a framework for macroprudential supervision

In future, each EU country will need to establish clear procedures for the use of macroprudential instruments. One of these instruments is a countercyclical capital buffer for banks, which can be introduced at national level in order to limit risks to the banking sector as a whole. Taking account of risks to the entire financial sector (ie the macroprudential perspective) is nothing new; rather, it has already been key to the activities of the Bank of Finland and FIN-FSA, of which FIN-FSA's action to limit risks to lending for house purchase can be cited as an example. Macroprudential supervision is, however, subject to intense development, which means still closer cooperation between the Bank of Finland and FIN-FSA in their future analysis of threats to stability and the necessary tools to combat these. According to Finland's Government Programme, it is necessary to ensure that FIN-FSA has the requisite powers to deploy macroprudential policy instruments. In early 2012, the Ministry of Finance set up a working group responsible for submitting a proposal for the creation of an effective national macroprudential framework during the year.

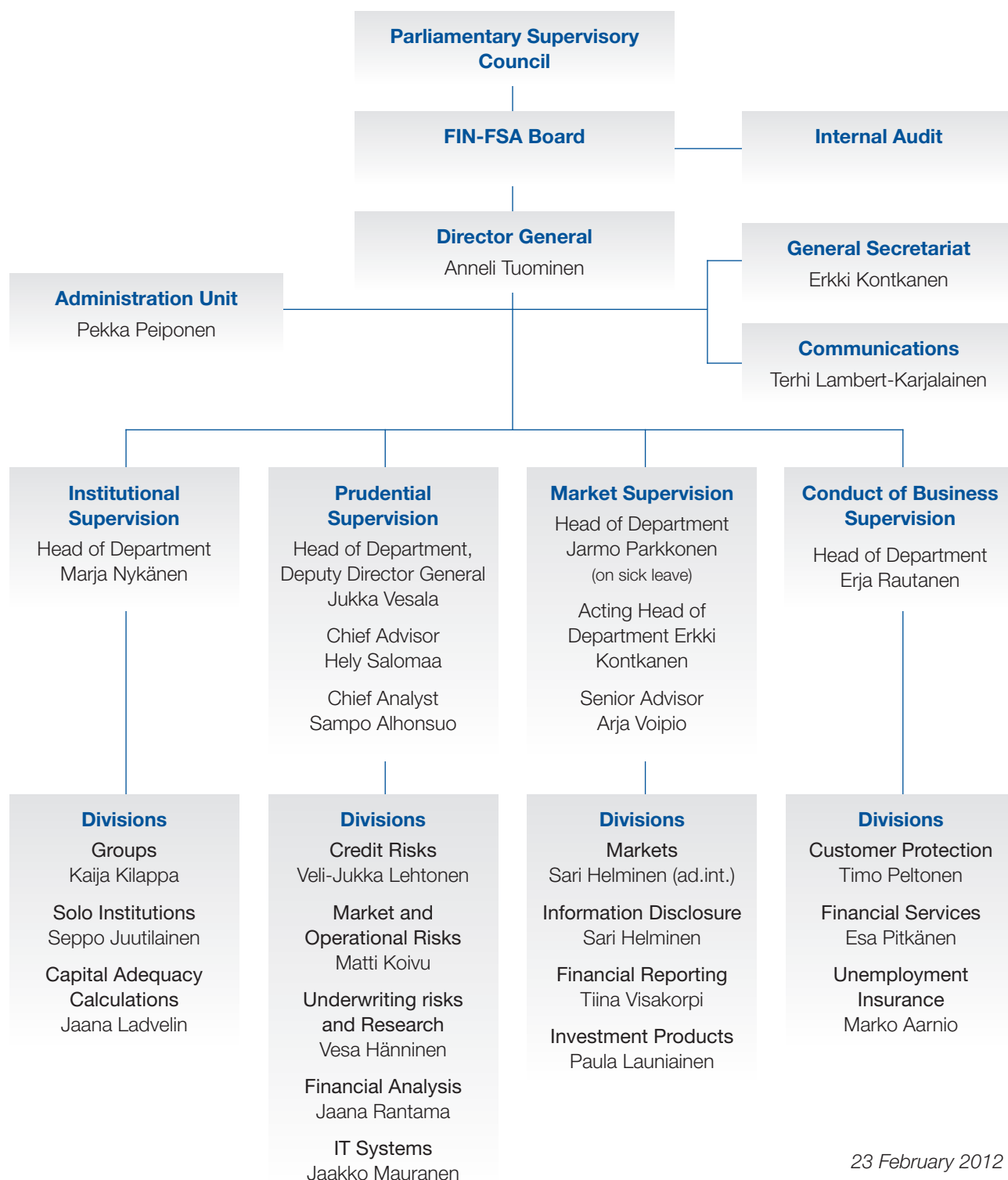
Funds and operating costs

FIN-FSA finances its operations mainly (95%) by levying supervision and processing fees on supervised entities and other entities liable to pay supervision fees. The Bank of Finland contributes 5% of operating costs.

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.

Any excess is taken into account in determining the supervision fees for the following year.

In the year under review, operating expenses amounted to EUR 26.1 million (EUR 25.3 million in 2010), of which most were staff costs (EUR 18.5 million). Other major expense items were services from the Bank of Finland (EUR 2.7 million) and real estate expenses (EUR 2.4 million).



23 February 2012

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

Operating environment risks increased

In the year under review, the international operating environment of the Finnish financial sector was surrounded by a high degree of instability caused by the sovereign debt crisis and the liquidity and recapitalisation problems of the European banking sector. Waning economic growth added to the instability towards the end of the year.

Sovereign debt crisis led to market instability

Problems related to sovereign debt worsened in many European countries. Governments took steps to bring their public debt levels onto a sustainable footing and to improve the operating conditions for the economy as a whole, but failed to convince market participants, resulting in continued nervousness on the markets.

Interest rate spreads widened, with a simultaneous increase in instability in many market segments. A pronounced turn for the worse occurred in late July and early August, when released economic data deteriorated over a short time period in both the United States and Europe. In tandem, credit rating agencies downgraded their ratings for the United States and a number of European countries. This was followed by a widening of many euro area governments' bond spreads vis-à-vis Germany and by an increase in credit risk premia. Greece's problems also escalated.

European banking sector highly exposed to crisis countries

Government bonds are often held by a country's own banking sector. Greek banks, for example, have large holdings of Greek government bonds. Cross-border investments in different government bonds are also substantial. As doubts about governments' creditworthiness and ability to meet their obligations increase, banks' chances of obtaining funding directly from the market are also impaired. Access to market funding has posed and continues to pose the biggest single risk to banks.

The situation was aggravated in the year under review, bringing a significant threat to banking liquidity. Market participants had doubts about banks' capital adequacy in a situation where they would need to recognise large losses. This particularly weakened the availability of long-term refinancing. The dearth of refinancing and the inadequate availability of capital threatened the stability and lending capacity of the European banking sector.

Supervisory authorities staved off problems

In an uncertain market situation, the new European supervisory authorities, acting in concert with national supervisors, implemented measures to bolster confidence. Both the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) coordinated a stress test, conducted by national supervisors, for large European banks and insurance companies. The aim of the tests was to conduct a comprehensive assessment of banks' and insurance companies' resilience to risks and to collect information for the markets. As regards banks, the stress test sought to identify common criteria for the necessary recapitalisation.

Bank-by-bank publication in July of the results of the EBA-coordinated stress test indicated that of the 90 banks tested, eight fell below the agreed 5% core Tier 1 threshold. Although the stress test did not assume a default by an EU member state, the scenario included an increase in government bond yields and a risk of impairment on sovereign exposures as a consequence of government rating downgrades.

Detailed publication of the EBA stress test results and banks' credit risks provided the markets with an abundance of new information on banks' sovereign exposures. In the autumn, owing to the prompt deterioration of the market situation, national supervisory authorities and the EBA made new calculations of the capital needs of large European banks, related in particular to sovereign exposures. Data as at the end of September point to an aggregate capital shortfall of approximately EUR 115 billion for 31 European banks, with the 9% Core Tier 1 ratio set as a threshold.

The minimum capital adequacy level should be reached by 30 June 2012. The immediate priority is to increase the level of regulatory capital by, for example, refraining from dividend distribution, raising new capital or converting existing capital instruments into higher-quality assets.

European Central Bank secured money market functioning

In August, the European Central Bank (ECB) reactivated its securities markets programme for the purchase of private and public assets, the purpose of which was to help safeguard the smooth functioning of the markets. With inflationary pressures abating and euro area economic growth slowing, the ECB lowered its policy rate twice in the autumn.

During the financial and sovereign debt crises, the ECB has ensured the operation of European money markets over several years. This line of action continued in the year under review. In the latter half of the year, in an exceptionally large refinancing operation, the ECB provided banks with unlimited amounts of three-year liquidity against eligible collateral. At the same time, the ECB reduced the reserve ratio for the calculation of banks' reserve requirements and expanded the range of assets eligible for collateral. These measures significantly eased the banking sector's liquidity situation.

Interest rates and share prices declined

Developments in long-term government bond yields diverged strongly across the euro area and the EU as a whole in the year under review. This reflected sovereign risks of different size. German government bonds are considered the safest investments, which has lowered German bond yields. Bond yields have risen for many euro area countries, as markets have interpreted the debt situation as being difficult.

Euro area short-term interest rates rose initially, but began to fall in the autumn. Interest rate declines pointed to a high volume of liquidity in the market and to market expectations of further policy rate cuts by the ECB.

Share prices both in Finland and across Europe as a whole began to decline in the spring. The sharpest falls were experienced in late July and early August. Meanwhile, stock market volatility, ie fluctuations in share prices, rose to a level previously observed in autumn 2008 and May 2010. Later in the autumn, share price developments levelled off and prices began to rise as the year drew to a close.

Finland's economic growth slowed in the latter half of the year

For the Finnish economy, it was very much a year of two halves. The first part of the year witnessed exceptionally rapid progress in the economy, which was largely due to recovery from the deep recession in 2009. In the second half of the year, growth decelerated appreciably, as the international and particularly the euro area economy ran into worsening problems.

Economic activity in Finland has been partly underpinned by the fact that many countries important to Finland's exports, such as Sweden, Germany and Russia, have experienced faster economic growth than the euro area and EU as a whole. Even so, the most recent data releases on Finnish exports indicate subdued developments. One positive observation from the year under review was a steady decline in unemployment. In Decem-

ber, according to Statistics Finland, there were 192,000 unemployed job applicants, slightly less than a year earlier, and the unemployment rate was 7.4% (7.9% in December 2010).

The pace of increase in consumer prices was 2.9% at the end of the year, with an average of 3.4% for the year as a whole. Interest rates on new lending (excl. consumer credit) are lower than the rate of inflation, as are deposit rates. Real interest rates were thus negative in the year under review.

Housing price trend reverses amid weakening household and business sentiment

The European debt crisis continued to dampen Finnish firms' business prospects. Households' estimates of the country's economy and particularly the evolution of their own economy became considerably gloomier in the year under review. Households' depressed sentiment regarding their own economy leads to lower private consumption, which means private demand is unlikely to drive growth in the Finnish economy. Survey results point to modest credit demand in the near term.

In the year under review, the household debt ratio (debt relative to disposable income) was about 108%, excluding households' share of housing corporation debt. The debt burden is unevenly distributed among households, as, for example, only about a third of households have housing loans. Households' financial position and debt servicing were in general eased by a mild improvement in the unemployment situation and the low level of interest rates.

Housing prices began to decline in terms of monthly data for the country as a whole. In the Greater Helsinki area, price developments bottomed out in the latter part of the year. In addition, the number of housing transactions decreased. Data on the housing market suggests a rapid calming down and levelling off compared with, for example, developments in 2009 and 2010, when housing prices climbed apace. At the same time, the data also confirm that the latter half of the year was more challenging for the financial sector.

Changes in supervised entities

In the year under review, two applicants were granted authorisation to conduct deposit banking and two other applicants authorisation to engage in mortgage banking. Two new actors also entered the insurance sector. Mergers between savings and cooperative banks continued.

There were also changes among providers of investment services. Five new investment firms commenced operations, three amended their authorisations and four firms applied for withdrawal of authorisation. The group of new investment firms includes a number of very small enterprises that have outsourced a significant part of their administration and production, meaning that the enterprise only retains operations subject to authorisation.

Four payment institutions began operations. No new starts were recorded for fund management companies. There were 16 registrations of new insurance brokers and 19 business closures. A total of 606 new insurance agents were registered and 621 agents were removed from the register owing to termination of business.

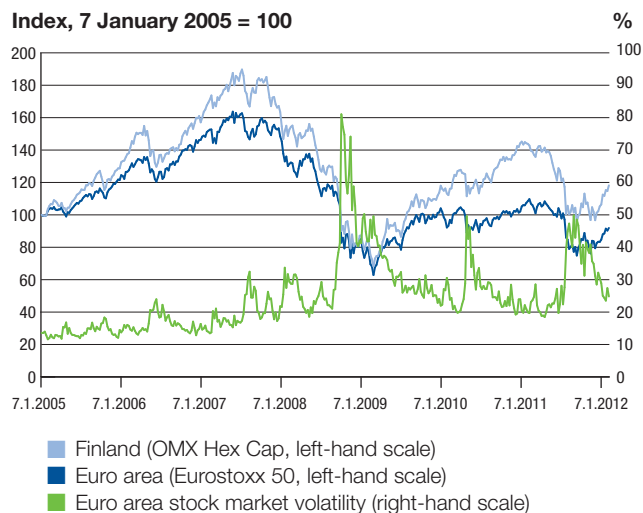
Sofia Bank plc's winding-up procedures commenced in March 2010 are still pending. Almost all depositors have recovered their assets in full. The bank and the Deposit Guarantee Fund reimbursed individual depositor assets up to the amount of

EUR 340,000. Depositors still waiting for compensation are only those whose deposits exceeded the already reimbursed amounts and money market investors not covered by deposit insurance. Moreover, the Deposit Guarantee Fund is demanding payment from Sofia Bank up to EUR 3.8 million, the amount the Fund paid out to depositors.

An administrator is supervising realisation of the bank's assets. The remaining assets are illiquid and the conclusion of the winding-up procedures may drag on. The bank is also involved in legal proceedings that need to be closed before the winding-up procedures can be terminated.

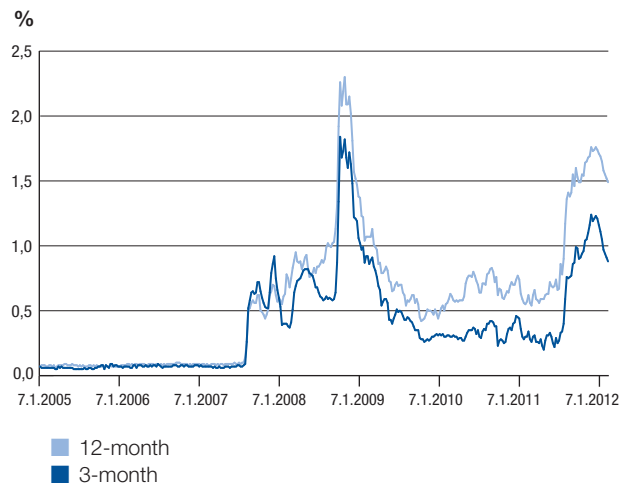
During the year under review, one pension fund engaged in statutory employee pension insurance was wound up and its insurance business was assigned to an employee pension insurance company. In addition, Viabek, a pension fund for the traffic services sector, decided at its extraordinary fund meeting on 15 December to make the fund subject to winding-up procedures under the Employee Benefit Funds Act. This was due to a marked weakening in the financial position of the pension fund during the autumn. Based on the decision of the fund meeting, an administrator was appointed for the fund. In December, FIN-FSA appointed an attorney to supervise matters related to the fund's winding-up procedures.

Share prices in Finland and the euro area, stock market volatility



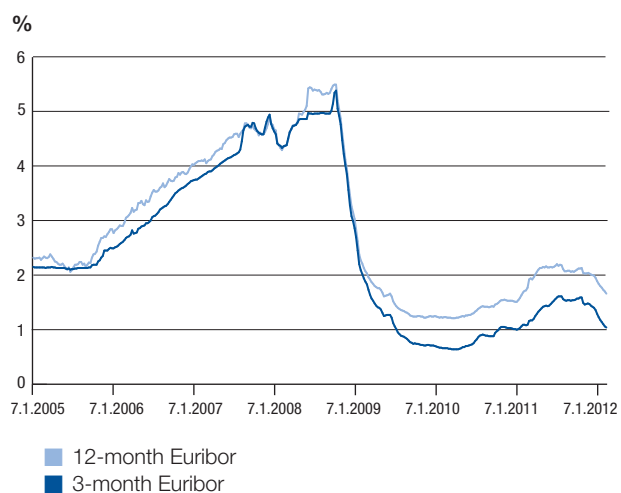
Weekly data, last observation 17 February 2012.
Source: Bloomberg.

Interest rate spread between banks' secured and unsecured funding in the euro area



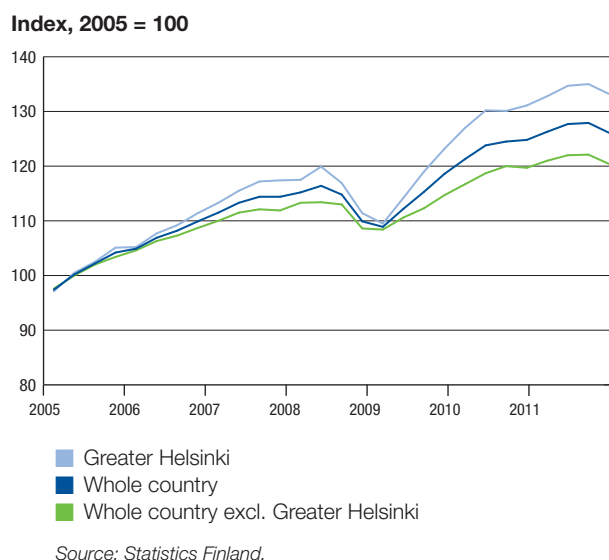
Weekly data, last observation 17 February 2012.
Source: Bloomberg.

3 and 12-month Euribor rates



Weekly data, last observation 17 February 2012.
Source: Bloomberg.

Housing price developments



Source: Statistics Finland.

Banking sector liquidity and capital adequacy remained good, financial results slightly improved

Finnish banks' liquidity position remained good throughout the year. Deposits accepted by Finnish monetary financial institutions (MFIs) from the euro area grew by 6.9%, while loans granted by MFIs to the euro area private sector increased by 8.6%. In the second half of the year, however, the deteriorating economic situation in the euro area had an impact on the pricing and availability of Finnish banks' market-based funding. Even so, short-term funding by issuing certificates of deposit was easily available, at favourable prices. By contrast, funding through bond issues became significantly more difficult, with a higher cost of funds on international markets. Nevertheless, Finnish banks could benefit from 'safe-haven' demand, as investors rated Finnish banks safer for investment than European banks on average. This enhanced the liquidity situation of Finnish banks.

Net impairments on bank lending declined during the three first quarters of the year but began to grow again later in the year in response to weaker economic developments. Overall, however, impairments during the year remained well below the two preceding years. The bulk of impairments were recognised on corporate loans, as in previous years. Non-performing assets also registered a slight increase during the year, which points to banks' higher credit risks due to the downturn in the economic cycle.

The banking sector's operating profits, EUR 2.3 billion, were up 12% on the previous year. Even so, the sec-

tor's profits were still almost a third down on their pre-crisis peak. In the year under review, income increased by a total of 2%, expenses grew by 4% and credit impairment losses decreased by 49%. The most important single factors underlying the sector's improved results were higher net interest income and lower credit impairments.

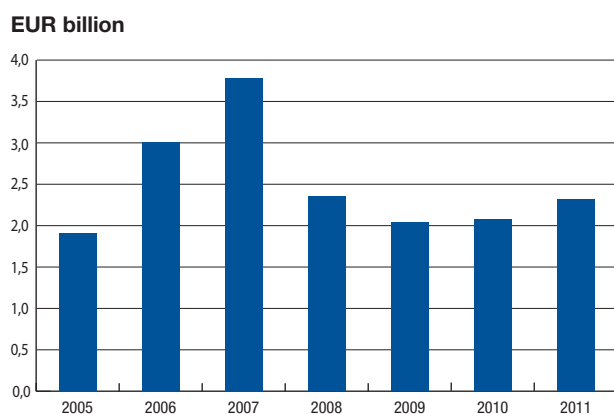
Higher net interest income on the previous year was underpinned by a rise in short-term interest rates, which helps widen banks' interest rate margins. The volume of bank lending also grew moderately during the year, thereby supporting developments in net interest income. Towards the end of the year, however, short-term interest rates resumed a downward trend, which is likely to narrow banks' interest rate margins in the period ahead.

The banking sector's capital adequacy continued to remain strong during the year, although capital adequacy ratios declined slightly in the autumn following redemptions of debentures and impairments on securities investments as well as the resulting negative developments in fair value reserves. At the end of the year, capital adequacy ratios were boosted by retained earnings and a wider application of internal ratings based approaches (IRBA) in the calculation of the capital requirement for credit risk.

The capital adequacy ratio was 14.2% at the end of the year, against 14.4% one year earlier. The Tier 1 capital ratio was 13.6%, ie at the same level as at the end of the previous year (13.6%). The Core Tier 1 capital ratio also remained almost unchanged at 13.1% (13.2%).

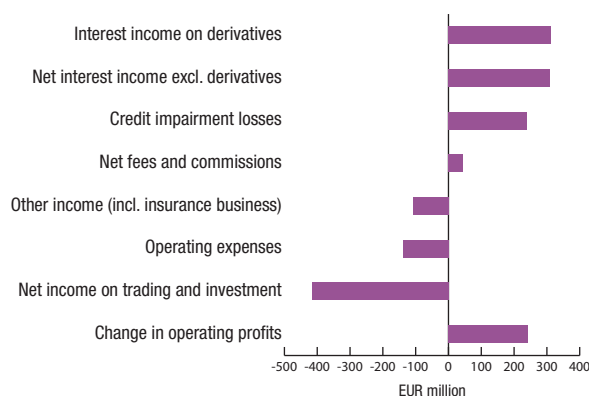
The banking sector's capital buffer beyond statutory minimum requirements amounted to EUR 9.1 billion at the end of the year (EUR 9.6 billion at the end of 2010). The sector's ongoing ability to generate profits had a favourable impact on equity capital. This did not grow, however,

Banking sector's operating profits, year-on-year



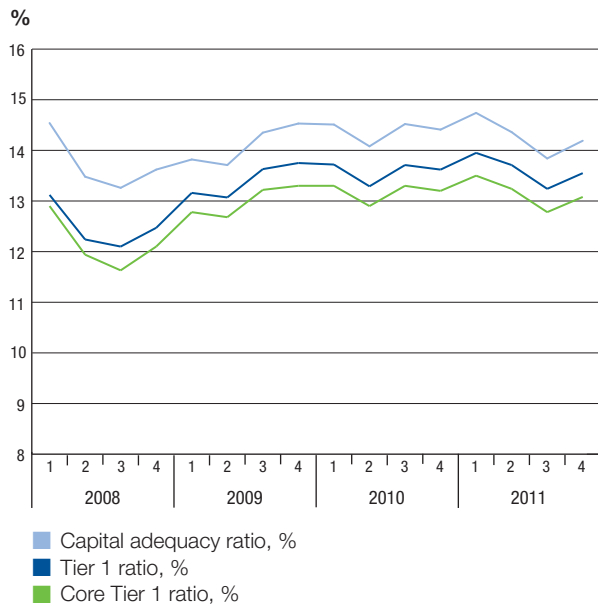
Source: Financial Supervisory Authority.

Effect on banks' operating profits of changes in individual income items, 2010–2011



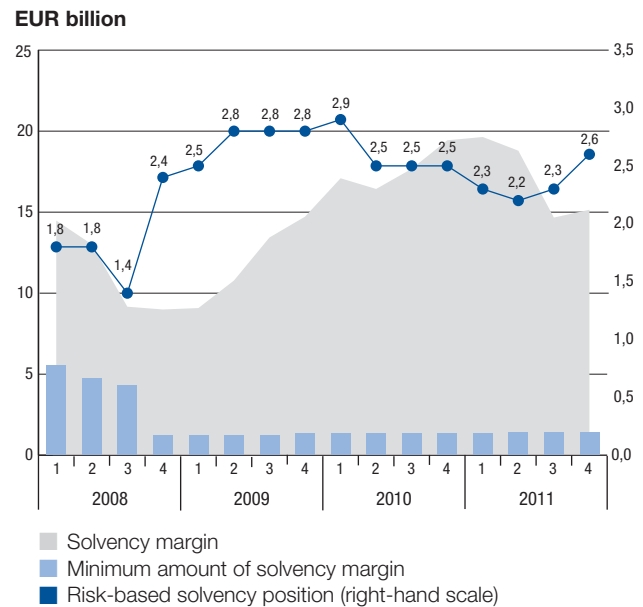
Source: Financial Supervisory Authority.

Banking sector's capital adequacy, quarter-on-quarter



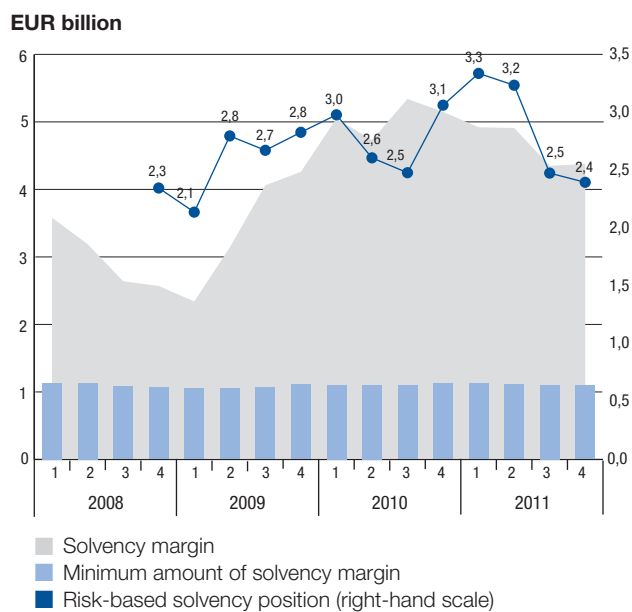
Source: Financial Supervisory Authority.

Solvency of employee pension insurance companies



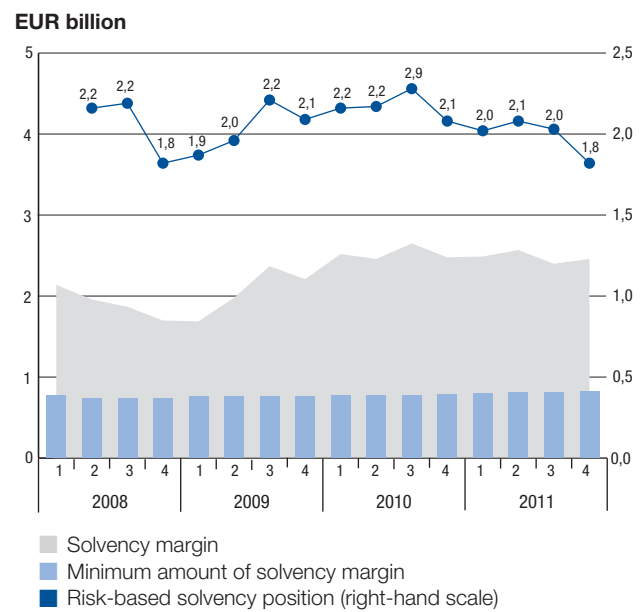
Source: Financial Supervisory Authority.

Solvency of life insurance companies



Source: Financial Supervisory Authority.

Solvency of non-life insurance companies



Source: Financial Supervisory Authority.

as profits were outpaced by redemptions of debentures, increased acquisitions of holdings in the case of banks belonging to groups and negative developments in fair value reserves.

Market uncertainty reflected in solvency of employee pension insurance companies

As a consequence of a very difficult and erratic year on the investment markets, employee pension insurance companies' income from investment operations were negative in the year under review (-2.9% on average). Earnings did, however, improve slightly towards the end of the year as key investment markets recovered.

The combined solvency margins of employee pension insurance companies and company and industry-wide pension funds declined markedly both in euro terms and relative to technical provisions. The risk positions of investment assets were reduced. This led to solvency margins relative to risks taken in investment operations remaining, on average, twice as high as the solvency limit, ie at a good level. There were major differences between companies in both investment income and solvency.

Life insurance companies' solvency level reasonable

Low investment income weighed on the profitability of the life insurance sector, turning the sector's aggregate result negative. Even so, there were major inter-company differences in earnings, due to variations in risks related to investment assets. Risks were lowered during the year by reducing in investment portfolios, on one hand, the proportion of shares, and, on the other hand, the proportion of sovereign debt instruments of problem countries. Life insurance companies' return on investment in the year under review was on average 0.65%, ie much better than that of employee pension insurance companies. The positive result can be explained by life insurance companies having a higher proportion of bonds in their investments than employee pension insurance companies.

Life insurance companies' solvency margin declined on account of both impairments on investments and negative results. Nevertheless, the sector's solvency position remained at a good level, with the solvency margin being four-fold relative to the minimum amount laid down by law. Meanwhile, the risk-based solvency position weakened significantly, standing at around 2.4 at the end of the year. The ratio was negatively affected by the sector's lower solvency margin and, on the other hand, by an increase in market-based technical provisions.

The low level of market interest rates and the deteriorating earnings outlook add to pressures for the replenish-

ment of technical provisions, as average rates of guaranteed interest are fairly high relative to market interest rates and the expected return on investments.

In addition, the economic uncertainty is having a negative impact on demand for savings products.

Non-life insurance companies' solvency still adequate

Non-life insurance companies' solvency, gauged by different indicators, was still adequate at the end of the year, despite the sector's negative aggregate results for the year under review and a deteriorating risk-based solvency position. The ratio of the sector's combined solvency margin to the minimum amount was 3.7, compared with 3.9 a year earlier. Non-life insurance companies withstood the capital market instability well compared with life and employee pension insurance companies due to the relatively low risk level of their investments. Investment income at fair value was positive for most non-life insurance companies. The sector's average return on investment was 1.4 during the year.

Non-life insurance companies' balance on technical account was weak due to calculation base changes that increase pension-type technical provisions. The changes were related to the mortality model update and the lowering of the discount rate. The combined expense ratio weakened compared with the previous year, standing at 107%. In the absence of calculation base changes related to technical provisions, the sector's insurance-technical profitability would have remained at a satisfactory level. Premiums written increased by 6% on the previous year, to approximately EUR 3.3 billion, before deduction of the reinsurer's share. Claims incurred, taking account of changes in the outstanding claims provision, increased by 11%, to about EUR 2.8 billion. A significant part of the increase in technical provisions, caused by calculation base changes, was financed by reducing the equalisation provision.

Investment firms' operating profits declined

Investment firms' fee income was lower than one year earlier. Fees from asset management represented more than half of all income from investment services. While these still increased slightly, other income declined. Despite a steady accumulation, operating profits contracted compared with the previous year. The third quarter was the weakest, due to the steep fall in stock prices. Small investment firms' earnings capacity was poor; hence, the number of investment firms that made operating losses grew from a year ago.

Operating profits of fund management companies down slightly

Fund management companies' operating profits declined compared with the previous year. Even so, business operations were mainly steady and profitable. The sector's fee income is tied to capital market developments. The higher degree of uncertainty in the operating environment was reflected in reduced business volumes and lower fee income in the latter half of the year. In the year under review, fund management companies' fund capital assets fell by about EUR 6.5 billion, staying at EUR 55.7 billion at the end of the year. Fee income from business operations contracted year-on-year.

Fostering risk-based supervision

One of the statutory objectives of FIN-FSA is to foster market stability and confidence. Under FIN-FSA's strategy, supervision is focused on the most substantial risks, the most risk-prone participants and the riskiest activities.

Europe's sovereign debt crisis expanded to threaten the entire financial system, which also increased the risks considerably in Finland. Therefore, FIN-FSA concentrated its supervisory efforts on areas of risk exacerbated by the deepening debt crisis and on the functioning of supervised entities' own risk management and internal control. In particular, investments and related risk management proved very challenging to supervised entities due to the difficult market situation. The same pertained to liquidity management. Supervision of market and liquidity risk was increased regarding the banking sector, while supervision of market and operational risk in investments was emphasised concerning the insurance and pension sector.

Supervision was intensified by increasing inspections and supervisory visits related to supervised entities' risk positions and risk management. In addition, continuous analysis of supervised entities' risk positions and capital adequacy was intensified. This was achieved by requesting more frequent reports from supervised entities to FIN-FSA and maintaining an unbroken dialogue. Cooperation with the Bank of Finland was intensified in analysing the operating environment, and communication about risk positions was increased. Finnish stress tests were used for analysing the risk-bearing capacity of the Finnish financial sector in a situation where it could be hit by a deeper debt crisis and macroeconomic recession. This was carried out in cooperation with supervised entities and the Bank of Finland. In addition, the largest supervised entities in the banking and insurance sectors participated in stress tests at EU level.

According to the continuous analysis and the stress tests, the Finnish financial sector remained in a stable condition despite the weakening operating environment, and its risk-bearing capacity was found to be sufficient. As to risk management and internal control, FIN-FSA required several corrective actions by supervised entities. As a general assessment, it may be stated that risk management and internal control had been adequately arranged. Banks' liquidity risks increased and the price of refinancing rose in the review year, but liquidity positions remained steady.

There were still a lot of short-term disruptions in inter-bank payments. These were often related to the transition to the Single Euro Payments Area (SEPA). Due to the growth of disruptions and disruption vulnerability, FIN-FSA required banks to make changes in their internal processes to improve the reliability of payment transfers.

Development of analytical tools and reporting systems was also an important priority in FIN-FSA's operations. The objective was that analysis would identify increased risks as early as possible and enable effective corrective actions to be taken. The analytical ratios indicating supervised entities' risks and capital adequacy were updated and reintroduced in the autumn. A large reform of insurance sector reporting was also completed during the year.

In both the financial and the insurance sectors progress was made during the year regarding EU regulation projects important to risk and solvency supervision. These reforms will boost the efficiency of risk-based supervision and introduce stricter minimum requirements for capital adequacy and liquidity. They also require considerable changes of both supervisors and supervised entities. FIN-FSA actively surveyed supervised entities' preparations for regulatory changes and arranged several information events. Significant variations were observed in the quality of supervised entities' preparations.

Below, FIN-FSA's activities in the review year are described in more detail regarding the supervisory areas of supervised entities' risk analysis, risk management and sound corporate governance (incl. internal control) as well as capital adequacy.

Analysis of risk positions

Progress reports every two weeks

Due to the unstable market situation, FIN-FSA requested more frequent progress reports (every two weeks instead of the normal quarterly reporting) by supervised entities, beginning in early autumn. In supervised banks, liquidity positions were particularly closely monitored. Meetings with supervised entities focused on contingency funding plans, availability of refinancing and the sufficiency of liquidity buffers. As regards employee pension, life and non-life insurance companies, monitoring and meetings with supervised entities were concentrated on investment income and developments in capital adequacy.

An increase in refinancing costs significantly increased the liquidity risks of Finnish banks. However, the liquidity positions of Finnish banks have remained good and short-term financing has performed well. Long-term funding has largely shifted to covered bonds.

Supervised entities in the insurance sector reacted to the change in the market situation by decreasing their investment risks. This was done particularly by lowering the weight of shares in their investment portfolios. Supervised entities sought to wind down their share positions by active selling of shares. The decline in weighting was also partly due to a decline in market values. Supervised enti-

ties decreased their holdings of Finnish shares partly also for reasons of liquidity risk and because they provide less scope for hedging.

To a growing extent, supervised entities switched their interest rate investments from problem government bonds and banking sector loans to money market investments considered to represent a lower risk. Later the interest rate level of low-risk interest rate investments became a problem, as it often falls below inflation. In the review year, FIN-FSA surveyed insurance and pension institutions' exposures to sovereign debt of the GIIPS² countries in the euro area. Between June and October, the insurance sector's investments in GIIPS government bonds decreased from EUR 3.1 billion to EUR 1.3 billion. Thus the sector's exposure to GIIPS risks declined by 60%. Assessed as a whole, the GIIPS risks of insurance institutions are modest. In a statement in November, the European Securities and Markets Authority (ESMA) called for consistent application of the principles provided in IFRS regarding sovereign debt exposures in 2011 financial statements. ESMA stated that it will, if necessary, act to ensure the appropriate treatment of government bonds in financial reporting. Finnish insurance institutions' receivables from GIIPS countries have been measured at fair value in the solvency margin and income calculation. More than 99% of banks' investments in GIIPS government bonds had been measured at market value on 31 December 2011.

Threshold values used in targeting supervisory measures

In order to monitor the capital adequacy and liquidity positions that form part of supervised entities' risk positions, FIN-FSA introduced an updated system of supervisory threshold values based on a range of risk area indicators. The new system makes ongoing supervision more effective and improves FIN-FSA's capacity for proactive response to supervised entities' problems at an early stage by, for example, requiring strengthened capital adequacy. Supervised groups are analysed as a whole, and separate supervised entities at least quarterly. Threshold values help in identifying entities that require more intensive supervision or special supervisory measures. Where necessary, more frequent reporting can be applied to supervised entities and problem areas can be inspected with greater precision.

In the revision of FIN-FSA's crisis management instructions, the impact of the changed market situation was taken into account. The instructions comprise procedures and crisis measures that can ultimately be deployed under the management of FIN-FSA.

Good progress in development of reporting systems

A large and comprehensive reform of reporting of supervisory data by insurance sector entities was completed in the spring. In the reform, most of the reporting by insurance institutions was transferred to the common electronic data collection system of the authorities involved (Virati). The reform clarified the reporting requirements and facilitated the practical work of reporting. In addition, the reporting process became more effective and information security was improved. The supervisor can now utilise the reported information more effectively.

As regards the financial sector, the new capital adequacy reporting (COREP) according to the amendments of the EU capital requirement directive (CRD II and CRD III) began in March. These amendments comprised new provisions on hybrid instruments and securitisation in own funds as well as changes in capital requirements for market risk and securitisation.

At the end of the year, FIN-FSA released for consultation a draft regulation and guideline on revision of mortgage bank reporting, according to which the reporting will be transferred to Virati during 2012. Quarterly reporting will be introduced and monthly reporting dropped.

At the beginning of 2011, FIN-FSA became empowered to impose administrative fines for reporting delays and errors. A fine may be imposed if the liable reporting party fails to fulfil its obligation of a timely submission to FIN-FSA of information on its economic situation or risks or of other supervisory documents. A fine may also be imposed if a report includes essentially incorrect data. In 2011, no fines were imposed for reporting delays or errors.

FIN-FSA published regular reports on the position of supervised entities

FIN-FSA published its biannual analysis reports on the financial position and risks of supervised entities. Among other things, these reports dealt with the financial sector's risk-bearing capacity and preparations for a prolonged debt crisis, employee pension insurance companies' changed risk profile, insurance companies' capital buffers, pricing changes in capital and money markets and developments in problem credits. The April report based on end-2010 figures concluded that the Finnish financial sector's risk-bearing capacity is strong. The September report based on end-June figures still described the Finnish financial sector's capital adequacy as relatively good. When the reports were published, it was emphasised that the banking and insurance sector should prepare for a longer-term debt crisis through risk management and sufficient profitability and capital adequacy. The increased risks in housing loans were also brought up.

2 The abbreviation GIIPS stands for Greece, Ireland, Italy, Portugal and Spain.

Two reports were published on banking and insurance sector solvency, which dealt with the adequacy of own funds in different risk areas in the banking sector and the proportion of original own funds in the capital structure as a whole. As regards the insurance sector, the solvency of supervised groups and investment developments were studied.

Sound risk management and internal governance

Compliance with central principles of internal governance

FIN-FSA performs a fit and proper assessment of the supervised entities' owners and persons responsible for key business operations, inspects the entities' manner of arranging operations in compliance with the provided regulations, and provides recommendations on internal governance on the basis of the inspections performed.

FIN-FSA requested corrective actions by inspected companies and provided recommendations, particularly on

- the work of the Board of Directors,
- the tasks of the Managing Director,
- the Board's obligation to monitor and assess corporate risks,
- the integrity of risk control,
- organisation of the compliance function, internal audit and other internal control in accordance with the standards provided, and the provision of sufficient resources for the aforementioned tasks.

As a general assessment based on inspection observations, FIN-FSA can state that supervised entities have complied with the central principles of internal governance in the organisation of their operations.

Remuneration must not encourage undue risk-taking

A decree by the Ministry of Finance on remuneration schemes entered into force on the last day of 2010. Credit institutions and investment firms have changed their planning and implementation of remuneration schemes in accordance with the new provisions. The largest entities have appointed a remuneration committee to work in connection with the Board and the companies have also identified and grouped risk-taking persons in line with the decree.

Most follow-up work is caused by the remuneration decree requirement of connecting risk management to the determination of variable remuneration. In addition, supervised entities should subsequently assess risks arising from their business and their impact on the payment of variable remuneration.

Development issues observed in credit risk management and housing loans

In inspections focusing on credit risk and sound internal governance, the arrangements for credit risk management, the quality of loan portfolios and processes for assessing impairments were under scrutiny. In inspections of credit risk management, it was observed that banks' internal lending instructions were not always connected to the assessment processes for risk management, internal control and impairment. In some supervised entities, bank lending was based on collateral provided, with the customer's solvency and economic prospects insufficiently analysed.

FIN-FSA observed deficiencies in the risk-based pricing of loans and considered it important that banks tighten their customer monitoring so as to anticipate payment difficulties that could be encountered by their customers.

In the spring, FIN-FSA published the results of a sample study of housing finance performed at the end of 2010. About half the loans to first-time house buyers had been granted at above 90% household indebtedness. In some individual cases, loans had been granted at a high indebtedness rate to customers with poor solvency. Hardly any risk-based criteria were found in the pricing of loans, meaning the credit risk attached to the customer has scarcely affected the loan margins applied.

For more information on housing finance consumer protection, see pages 33.

In the autumn, inspections began of the most important banks for housing finance. The aim was to examine compliance with the housing loan recommendations issued in 2010. These addressed the assessment of customer solvency, the loan-to-value ratio of the purchase and other consumer protection issues. Inspections of local banks also targeted housing loans. The inspections will be continued in 2012.

Supervision of market risk focused on management of risks highlighted by the financial crisis

In inspections of insurance and pension insurance companies' market risks, the risk management adequacy versus risk taking and risk-bearing capacity in investment operations were assessed. Inspections were focused particularly on the use of derivatives in investments and their impact on companies' profitability and risk positions. In the inspections, deficiencies were observed in the organisation of internal risk control functions as well as development issues in measurement of market and derivative risks and the comprehensiveness of internal reporting. Not all supervised entities had begun mitigating their risks to the extent required by their solvency position.

In market risk inspections of banks, the management of interest rate risks was prioritised. The inspections revealed development needs in the measurement of and limits applied to interest rate risks. In addition, the adequacy of capital allocated to business in the supervised entities has not always been adjusted to the entities' current risk position.

Banks' increased liquidity risks required enhanced risk management

Compliance with FIN-FSA's new liquidity standard based on regulation of liquidity at EU-level was supervised through inspections focusing on risk management strategies and organisation as well as the adequacy of liquidity buffers, liquidity contingency plans and stress testing of supervised entities. In the inspections, deficiencies were observed in the systems for mitigation, monitoring and reporting of liquidity risk. On several occasions, FIN-FSA pointed out to supervised entities the importance of performing stress tests, which would enable them to determine the amount of highly liquid assets they need to hold to ensure liquidity. It was also observed that funding contingency plans had not adequately assessed the amount of funding available from different sources.

Broad inspections of operational risk continued

Broad theme inspections of operational risk management were performed on topics such as the general organisation of risk management, reliability of IT systems, contingency planning for important functions, functioning of payment systems as well as customer identification and combating money laundering. The inspections targeted supervised entities in both the financial and the insurance sectors. As regards supervised entities in the insurance sector, it was found that the processes for assessing and reporting operational risks are still at the development phase. This could be due to gaps in the regulatory framework.

As regards actions against criminal utilisation of the financial system, FIN-FSA inspected how the introduction of customer identification and monitoring systems has progressed and how extensively money laundering and terrorist financing risks have been surveyed across different functions. The new money laundering regulations require all supervised entities to regularly assess their procedures for customer identification. Analysis was still found to be inadequate in some supervised entities.

Significant system revisions reflected in functioning of payments

In payment system inspections, the key topic was card payment processes, ie issuing cards and acquiring services for card payments. In addition, the inspections also checked control measures and instructions related to card

processes. FIN-FSA required the banks take measures to improve payment and IT system reliability.

Payment disruptions still caused intraday delays in wage and pension payments. Otherwise the payment systems worked reliably. The disruptions were primarily caused by system errors in SEPA implementation. Banks submitted explanations of errors and their cause as part of their normal reporting. FIN-FSA also asked for additional information on the causes of errors and corrective actions.

Large variations in insurance companies' Solvency II preparations

Inspections of insurance risk management are largely connected to the Solvency II regulatory reform for insurance companies entering into force at the beginning of 2014. Inspections of market-consistent technical provisions were performed in several insurance companies with the aim of surveying the calculation process for technical provisions and particularly the faultlessness of information and level of documentation used in the calculation. In addition, inspections and supervisory visits were used for surveying supervised entities' readiness to comply with the future Solvency II framework.

Large variations were observed in insurance companies' Solvency II preparations. Some supervised entities have already progressed very far, while others are just launching their development projects. The key challenges relate to the tight time schedules of the projects and the required staff resources.

FIN-FSA published instructions on the pre-application phase of approving an internal Solvency II model. The pre-application phase precedes the internal model application process. Pre-application improves the efficiency of the application process, which is useful as the time reserved for application is relatively short and internal models may be comprehensive and require a large amount of research. Pre-application was launched concerning the planned internal models of two insurance companies. FIN-FSA aims to harmonise its internal model application process, reviewing of models and calculation of technical provisions with the other Nordic supervisors.

FIN-FSA prepared instructions on the accounting and financial reporting treatment of guaranteeing insurance companies' technical provisions. The future Solvency II framework changes the valuation of technical provisions in the solvency calculation, which for insurance companies creates a need for active management of interest rate risk. For example, derivatives can be used for hedging against the interest rate risk caused by market-consistent technical provisions.

Capital adequacy

Capital adequacy assessed at least quarterly, more frequently where necessary

Supervised entities' capital position, amount and quality of own funds and liquidity position were monitored through quarterly reports utilising, among other things, the above-mentioned measurements and supervisory threshold values. A supervised entity's solvency and capital management plan forms an important part of solvency assessment. If necessary, FIN-FSA can require revision of the plan or the strengthening of solvency.

Comprehensive annual supervisory reviews of capital adequacy

On the basis of ongoing supervision, continuous analysis and inspection observations, FIN-FSA prepares institutional supervisory reviews assessing capital adequacy in relation to operating risks. As an alternative to an annually prepared supervisory review, an annual report may be drawn up regarding smaller supervised entities, including a more concise assessment of their capital adequacy. In addition to the institutional reviews, summary reviews are prepared on supervised groups in order to identify supervised entities requiring special measures within a group.

Supervisory reviews utilise a four-step scale prepared by the EBA that applies particularly to cross-border banking groups. To ensure uniform reviews, FIN-FSA applies the scale to all its supervised entities, including Finnish participants and insurance companies, although, for example, EIOPA has not yet issued corresponding recommendations to the insurance sector.

The supervisory reviews prepared in 2011 assessed the risk-bearing capacity of the supervised entities as sufficient. Through stress tests the reviews also assessed the size of capital buffers and, where necessary, provided recommendations on risks and risk management issues, such as requesting a supervised entity to prepare models for liquidity risk management. Remuneration systems were included in the review on a case-by-case basis.

FIN-FSA continued the assessment of applications concerning the Internal Ratings Based Approach (IRBA). Internal credit ratings is an approach subject to authorisation that provides an alternative to the standard approach. Three completely new applications were received, in addition to which more extensive use of IRBA models within banking groups by banks already holding a permit was being assessed. After the application and extension phases, work will begin focusing on ongoing model supervision. At the end of 2011, the proportion of banks using IRBA models in their calculation of capital requirements for credit risk formed 80% in balance sheet terms of the bal-

ance sheet total of the whole Finnish banking sector. The others use the 'standard' approach.

In the three largest banking groups, the capital requirement for operational risk is based on the key financial figures for the performance of the different business lines. Other supervised entities still use the Basic Indicator Approach, in which a three-year average of company turnover is used as the basis of calculation. Supervised entities have not yet started using risk-based calculation of the capital requirement for operational risk.

Without enhanced risk-bearing capacity, the expected earnings of employee pension institutions will decline

The first phase of the employee pension institutions' solvency reform based on proposals by the former Koivusalo working group was completed and the changes came into force on 31 March. The investment classification to be used in the calculation of employee pension institutions' solvency requirement was changed so that the new classification better reflects the riskiness of the investments, particularly the credit risk. In the revised classification, the classification of euro-denominated bonds is based on the credit risk of the debt instrument or its issuer in the case of government bonds as well as corporate bonds. The higher a debt instrument's credit rating is, the lower the risk classification.

Preparations for the second phase of the reform have continued in working groups at the Ministry of Social Affairs and Health and a Government bill has been prepared on the basis of the proposals drawn up there. Through the changes in the second phase, employee pension institutions' risk-bearing capacity will be strengthened by making more effective use of solvency buffers, the solvency margin and the equalisation provision and by establishing an agreed procedure for solvency regulation in exceptional conditions. The objective is to maintain employee pension institutions' solvency and risk-bearing capacity at a level that enables sufficiently profitable investments, thereby curbing the upward pressure on employee pension insurance premiums.

The second phase of the reform is due to enter into force when the temporary Act on relaxation of the solvency regulation expires on 1 January 2013. Without the proposed reform, employee pension institutions' risk-bearing capacity in terms of the solvency ratio would decrease by about five percentage points. A significant decrease in risk-bearing capacity would mean a fall in the expected long-term return of the employee pension system and higher pension insurance premiums. Presently two different buffers are used for preparing against insurance and investment risks: the equalisation provision and the solvency margin. The equalisation provision is used for preparing against insurance risks, and the solvency margin against investment risks. By merging the solvency margin and the equalisation provision into a single buffer, solvency capital, and setting a joint capital requirement for both buffers, the capacity of the employee pension system to bear investment risk can be retained almost unchanged after expiry of the temporary Act.

Real risk-bearing capacity decisive

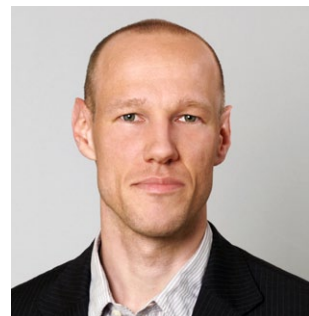
FIN-FSA considers it important that, in providing for a more effective use of existing buffers, care also be taken to ensure that solvency capital as a whole remains of sufficiently high quality. This would grant institutions a sufficient real risk-bearing capacity to cover losses. However, merging the buffers must not hamper the operating conditions of different types of institutions and lead to a centralised system.

The policyholder's exposure to realised risks varies according to the corporate form of the provider of insurance cover. If the insurance cover is provided by a company, the exposure is different from the cover provided by a pension foundation or pension fund. In a company, the policyholder's exposure is limited to payment of the insurance premium, while the members or unit holders of a foundation or fund ultimately carry the investment risks taken by the institution by paying an additional premium, if required. In the reform, the special characteristics of the different types of institution have been taken into account by allowing industry-wide pension funds and company pension funds to include in their solvency capital an item based on the employer's obligation to pay an additional premium.

The third phase of the reform package has been prepared parallel to the second phase. The purpose of the new solvency mechanism is to give more comprehensive consideration to all es-



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sential investment and insurance risks of employee pension institutions. An ancillary aim is to dampen pro-cyclicality in the financial sector. The third phase is due to enter into force in 2014.

FIN-FSA considers it desirable that broadly the same principles be followed in employee pension institutions' risk measurement and management as in the financial sector as a whole, except where another way of operating is justified by the special characteristics of the sector. The solvency level should always be chosen according to the employee pension system's specific needs and objectives. On the other hand, a solvency framework and risk management requirements that are as uniform as possible and applicable to different sectors increase risk comparability and transparency. Hence FIN-FSA considers it important that the solvency mechanism be revised in a way that takes the Solvency II reform into account as broadly as possible. To a large extent the capital requirement in Solvency II is based on stress testing of different risk factors, whereas the present solvency framework requires that each investment be classified into the best suitable risk category. Particularly in the case of complicated investment instruments, the Solvency II approach is better suited for risk assessment than the present mechanism and it also adjusts better to developments in investment instruments.

Promotion of customer and investor protection

One of the statutory responsibilities of FIN-FSA is to foster compliance with good practice on the financial markets and also public awareness of the markets. Its other responsibilities include collecting and regularly publishing comparable data on banks', insurance companies' and other parties' financial positions and otherwise contributing to the availability of information on financial services and financial market activity.

Through its supervisory activities in the year under review, FIN-FSA aimed particularly to improve the quality of customer and investor information. The lessons learnt in the financial crisis were applied in this work: analytical tools and supervisory reporting were developed, the effectiveness of inspections was increased and supervisory practices jointly developed in the EU were applied. In addition, FIN-FSA prepared for future major regulatory changes, such as the Alternative Investment Fund Managers Directive (AIFMD), reassessment of the securities market Directives currently in force and total revision of the securities market legislation.

FIN-FSA inspected the market practices applied to the supply of financial products and services to the public. In connection with a theme inspection on the granting of housing loans, FIN-FSA intervened over the maximum credit portion accepted by individual banks and compliance with regard to calculations of repayment capacity. Based on a survey of basic banking services, FIN-FSA also requested some banks to look into the possible un-

fairness of certain service fees. On the basis of inspection observations concerning product development processes, FIN-FSA requested supervised entities to pay attention to the clarity of these processes and to product testing from the customer's point of view in different financial and market situations.

In the supervision of listed companies' information disclosure, proactive supervision was emphasised and targeted on the basis of risk. Supervisory visits to monitor information disclosure were continued and listed companies were instructed in providing future prospects in the prevailing uncertain market situation. The supervision of financial reporting was focused on correct treatment in financial statements of goodwill impairment testing, segment reporting and business combinations. As regards banks, the enforcement of financial reporting particularly focused, at EU level, on disclosure in the financial statements of government bonds issued by the GIIPS countries.

On the whole, no major deficiencies were found in either market practices or investor and customer information. FIN-FSA required corrective actions where individual deficiencies were found, and in some cases an administrative fine was imposed.

Information on the financial market was published both on the website Fin-fsa.fi (sample research report on private customers' housing loans, in Finnish only; key financial figures of the banking sector; statistical publications on the insurance sector, in Finnish only) and on the website Financialcustomer.fi directed to customers of banks, insurance companies and investment firms. In particular, information was provided on product costs and risks.

Financial sector

Sampling survey provided information on granting of housing loans

In a large sampling survey, FIN-FSA studied practices in the granting of housing loans. The calculation of repayment capacity and levels of indebtedness were analysed for new housing loans granted by all banks with housing loan activity during a period of 1–5 days (about 1,500 loans in all, sample days in November 2010). In addition, the extent of risk-based pricing of these loans was assessed. The survey analysed how the banks complied with the recommendations on housing loans published by FIN-FSA in spring 2010.

In some cases banks granted loans despite the borrower's poor repayment capacity. In the survey, it was observed that up to half of all loans to first-time house buyers were granted without any self-financing. In the financing of moves by non-first-time buyers, too, the purchaser's level of indebtedness was also often high.

In May, FIN-FSA requested the Boards of the banks to report how they aim to correct the observed deficiencies and ensure compliance with FIN-FSA's instructions. Training on the subject and development of processes and reporting continues in the banks. FIN-FSA will continue conducting housing loan inspections and developing the relevant reporting procedures. A description of a loan to collateral value calculation suitable to Finnish conditions has been prepared in cooperation with the sector.

Housing loan conditions must be disclosed to debtors according to responsible lending practices

In response to a change in the legislation on housing loans, FIN-FSA confirmed that the housing loan conditions used by banks are compatible with the new provisions and that, prior to concluding a housing loan contract, the banks provide information to the debtor and guarantor on the new provisions and on good and responsible lending practices. FIN-FSA inspected all banking groups and individual banks, a total of 22 separate inspections. In addition to housing loan contracts, guarantees and pledges related to the loans were also inspected, as was the information provided to the customer before concluding a contract.

As a rule, housing loan and collateral contracts were appropriate. However, some deficiencies were found in the information provided to customers (eg standardised European consumer loan information) before concluding the loan contract. Internal instructions on the disclosure obligation were also missing at several banks, or were not sufficiently detailed.

Transparent pricing also required regarding compensation for early repayment of housing loans

In December, FIN-FSA decided on regulations and guidelines to be provided in order to clarify and harmonise the calculation of a maximum compensation charged for early repayment of a fixed interest rate housing loan. The regulations and guidelines specify the methods to be used in the calculation and the requirements on those methods. From the customer's viewpoint, the objective is to promote transparent and predictable pricing so that the customer already upon acceptance of the loan is informed about the calculation methods applied and can give consideration to the amount of compensation for possible early repayment in different situations.

In addition to the regulations on calculation methods, FIN-FSA also issued guidelines on a code of conduct for parties granting housing loans. With these guidelines, FIN-FSA seeks to foster good lending practices and ensure borrowers are properly informed on the methods used in calculating the compensation payable for early repayment and how much it will cost them. The regulations and guidelines will enter into force on 31 March 2012.

Basic banking services still readily available; payment terminals less common than before

FIN-FSA annually assess the pricing and availability of basic banking services provided to private customers based on both a questionnaire survey and supervisory observations.

On the basis of a survey in March, basic banking services are still readily available. No problems with the availability of these services has come to FIN-FSA's knowledge, nor has FIN-FSA any knowledge of unfounded refusals to provide such services. Basic banking services refer to normal deposit accounts, account facilities (such as online debit cards) and execution of payment orders.

The most important change from the previous year was a decrease in customer terminals, and particularly payment terminals. The number of bank branches did not change significantly from the previous year, but in some banks the supply of cash had been reduced by, for example, offering cash services only on certain weekdays or at a certain hour. On the other hand, new retail banking possibilities and service outlets not in the branches had been introduced. The number of ATMs remained almost unchanged. At the beginning of 2012, FIN-FSA assessed the availability of cash.

The highest service fee for paying invoices in cash over the counter was EUR 8. According to FIN-FSA's assessment, that may in some situations be unreasonable. 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 most common monthly fee for this facility was EUR 2.50.

FIN-FSA published a supervision release on the subject and requested a few banks to reassess the fairness of their service fees.

Insurance sector

No significant deficiencies in claims management pertaining to statutory employment accident and motor liability insurances

With inspections of claims management pertaining to statutory employment accident insurance and statutory motor liability insurance, FIN-FSA wanted to ensure that the insurance company handles the compensation claims within a reasonable time and according to legislation and good insurance practice. The inspections were focused on non-life insurance companies with the largest market shares.

FIN-FSA found no significant deficiencies or problems in claims management pertaining to employment accident and motor liability insurance. However, in the inspected sub-areas several smaller development issues were observed. In individual cases, FIN-FSA requested insurance companies to pay attention to, for example

- sufficient staff resources in claims management,
- the time taken to handle compensation claims,
- the monitoring of handling times,
- justifications and contents of compensation decisions,
- information on the pricing of telephone services,
- and monitoring and handling of customer contacts (such as emails).

Since previous surveys, insurance companies have revamped their organisations in pursuit of greater efficiency and to introduce a higher level of expertise in the handling of difficult cases.

Advice and customer service at unemployment funds the focus of a major inspection for the first time

FIN-FSA inspected the advice and customer service of unemployment funds. Unemployment funds' obligation to provide advice is statutory, and the advice and customer service is very important to fund members. These aspects have not been inspected so thoroughly before. The inspection was conducted in 12 unemployment funds, and the inspection issues included handling of customer feedback, electronic service, advice, information and marketing.

As a rule, advice and customer service was appropriately handled by all unemployment funds. Some development issues were observed, such as shortcomings in Swedish-language information services, documenta-

tion, communication planning, or internal control related to the subject of inspection. Deficiencies were greater in small funds than in large ones, due to limited resources. The inspections also addressed individual deficiencies in marketing.

Investment products

Assessment of product behaviour from the customer's point of view in different market situations introduced into product development processes

FIN-FSA continued the inspections of product development processes for investment products started in 2010 (structured investment products, mutual funds and unit-linked insurance policies). The purpose of the inspections was to ensure that supervised entities providing investment products to the public follow in their chain of producing new products appropriate procedures both in their own risk management and in customer and investor protection.

In 2010 and 2011, FIN-FSA conducted inspections in altogether 20 supervised entities. Both entities of different size and of different operational and organisational model were targeted. The general assessment was that product development was well planned and organised in most of the entities. However, various development needs were observed in different sub-areas. Although most entities had clear process descriptions, there were difference in how the processes were complied with. For example, a significant change in an existing product was not always identified as comparable with development of a new product. Institutional feedback was provided on sub-areas such as clarity of and compliance with processes, identification criteria of new products and consideration of customer and investor needs in product development.

FIN-FSA considers it important that the product development process is thoroughly planned and described and that responsibilities and order of decision-making are clearly indicated in the description. In addition to the assessment from a risk management point of view, it is important that supervised entities assess, from the customer's point of view, how a product will behave in the event of different financial and market changes. Furthermore, FIN-FSA considers it important that criteria are introduced in internal instructions regarding the characteristics of a new product and when the development process should be followed. According to FIN-FSA, it is advisable to make more frequent use of the expertise of product development units in generating customer information.

Seller must disclose costs of long-term savings contracts and insurance policies

The 2010 survey of the cost structures of investment products showed that customers had problems getting a clear picture of overall product costs (of, for example, unit-linked insurance), whether studying the price list or discount offers. In the interests of customer protection, it is important that sellers disclose to customers consistently appropriate and essential information on the costs of and return on both insurance policies and long-term savings contracts.

In October, FIN-FSA published draft regulations and guidelines for consultation on disclosure of the costs of and return on long-term savings contracts and insurance policies. A public hearing on the subject was arranged in November. The aim is to issue the actual regulations and guidelines during the first half of 2012.

Cross-border activities of investment funds becomes easier, key investor information document for effortless fund comparability introduced

The aim of the new Directive on undertakings for collective investments in transferable securities (UCITS IV) is to facilitate cross-border activities of investment funds in the European Economic Area (EEA). It also provides new requirements on information to be disclosed to investors. The amendments required by the Directive in, for example, the Mutual Funds Act entered into force on 31 December 2011.

During 2011, FIN-FSA prepared for the regulatory and supervisory changes required by the Directive, and in April an event for discussions and information on the effects of the Directive was arranged for fund management companies. Consultations on the draft regulation and guideline were arranged in October–November, and the new regulations and guidelines entered into force in connection with the entry into force of the Mutual Funds Act at the end of 2011.

In the supervision of investment fund marketing, an electronic notification procedure between the relevant authorities in the EEA was introduced at the beginning of July. In addition, FIN-FSA discussed the contents and introduction of the new key investor information document (KIID) with fund management companies.

The simplified fund prospectus is replaced by the aforementioned KIID. It summarises an investment fund's key information in a standardised format set out clearly on two pages and is provided to the prospective investor prior to the investment decision. The presentation format and terminology are consistent throughout all EEA states. The purpose of the KIID is to facilitate investment fund comparability.

Supervision of information disclosure and financial reporting of listed companies

Increased uncertainty in the markets reflected in future prospects of listed companies

In supervision of listed companies' information disclosure, FIN-FSA sought to foster good disclosure practices and influence the quality of information provided. FIN-FSA also discussed regulation of presenting future prospects with market participants. Supervisory visits to listed companies were continued and mainly directed to smaller listed companies on risk-based grounds.³ Supervisory visits were used to, for example, assess listed companies' disclosure practices. Companies were given individual feedback, and suggestions for improvement were presented in respect of disclosure obligation issues. In the view of FIN-FSA, companies as a rule complied with their disclosure obligations in an appropriate manner.

The detail and degree of information in listed companies' future prospects were assessed and the appropriateness of profit warnings was monitored particularly in connection with 'loose' profit forecasts and interim reports. Towards the end of the year, FIN-FSA focused on how listed companies recognised the increased market uncertainty in their prospects and description of risks and uncertainty factors. Although many companies kept their future prospects unchanged, they simultaneously disclosed the increased uncertainty regarding realisation of the given prospects. FIN-FSA underlined the importance of careful and up-to-date monitoring of performance and that issuing a 'loose' profit forecast does not eliminate the company's obligation to issue a profit warning in the event of a material change in the company's performance. A profit warning cannot be postponed to the interim report if the information on a material change in prospects has already become known to the company at an earlier stage. In an uncertain market situation, companies must consider whether they can present future prospects as profit forecasts at all, due to their potentially misleading contents. In FIN-FSA's view, future prospects should only be disclosed to the extent and for a period that probable developments can be reliably assessed. The risk factors that create uncertainty should also be disclosed in the future prospects.

New alternative procedure for disclosing financial reports

At the beginning of 2011 an alternative procedure for disclosure of financial reports was introduced. Under the new

3 Companies are selected for monitoring based on certain criteria (such as business sector, size, earlier supervision history, changes in management and changes in corporate structure). Companies with larger relative exposures are followed more closely, others at a more general level.

procedure, interim reports and financial statement releases may be disclosed so that information that is likely to have a material impact on the value of the security is incorporated in a stock market release and the complete financial report as an appendix to the stock market release in question. However, according to FIN-FSA's survey, most companies (about 80%) continued disclose financial reports in line with the earlier procedure.

Careful preparation and sufficient disclosure important to retain confidence in financial statement information

The European Securities and Markets Authority (ESMA) issued specific guidelines on the treatment of GIIPS countries' government bonds in banking sector financial statements. In 2011, the consolidated financial statements of two banks were inspected. Enforcement focused on the impairment recognition process for loans and receivables from the IFRS point of view. According to FIN-FSA, banks' internal instructions on the impairment recognition process were not sufficiently comprehensive and did not appropriately consider the IFRS requirements. FIN-FSA requested these banks to pay attention to careful preparation of their financial statements and sufficient disclosure of information to ensure continued confidence in financial statement information in the uncertain market situation.

Enforcement of financial reporting was focused on assessment of the correct recognition of financial instruments, goodwill impairment testing and segment reporting. In line with the enforcement practice pursued for several years, enforcement of goodwill impairment testing was focused on companies with the largest goodwill in euro terms where the goodwill constitutes a significant proportion of the company's equity. One of the supervised listed companies recognised a significant impairment loss on its goodwill. The purpose of FIN-FSA's individual feedback is to develop listed companies' impairment testing processes and thereby contribute to an improvement in the quality of financial statements.

As regards segment reporting, FIN-FSA observed deficiencies in the determination of the operating segments according to the standard-based two phase approach, which can lead to the segments in the financial statements not being in line with the IFRSs. Other European financial statement enforcers have also observed problems related to this IFRS standard, due to both weaknesses in the standard itself and deficiencies in its application. One objective of financial statement enforcers is a more harmonised pan-European application of the IFRS standard on segment reporting. Segment reporting on, for example, the performance of different corporate business lines or geographical areas provides crucial financial statement information for investors' decision-making.



'Markets' releases and events

In the review year, FIN-FSA published four issues of the Markets release, dealing with observations relating to interpretations of the disclosure obligation and financial statement supervision of listed companies, insider issues, standards and regulation. Among other things, the release also provided information on statements by the new European Securities and Markets Authority (ESMA).

In December, Market Supervision arranged two topical events for listed companies, mainly on supervisory subjects pertaining to financial statements. Most listed companies participated in the events.

Services for listed companies are provided on the website Listedcompanies.fi, which is maintained in Finnish, Swedish and English.

Please visit Listedcompanies.fi

Supervision of financial market infrastructure

International cooperation between authorities is important in supervision of securities trading

FIN-FSA supervised the financial market infrastructure in close cooperation with the Bank of Finland. In the review year, the most important cooperation projects were the comprehensive revision of the Securities Markets Act, EU-level securities settlement projects and Euroclear Finland Ltd's (the central securities depository) and Euroclear Group's cooperative supervision together with other supervisors and central banks as well as the cooperation related to central counterparty (CCP) clearing.

FIN-FSA assessed the smoothness and reliability of Euroclear Finland Ltd's clearing as well as the company's outsourcing and development projects. As regards NASDAQ OMX Helsinki Oy (Helsinki Stock Exchange), supervision focused on changes in market models for trading, internal market surveillance activities of the stock exchange and the organisation of operations to ensure reliability and continuation of trading. One crucial part of the supervision of the Nordic stock exchanges was the cooperation by Nordic supervisors to achieve, among other things, a common policy in significant control issues.

Finnish multilateral trading platform commenced operations

Helsinki Stock Exchange began operating a multilateral trading platform, First North Finland, in April. FIN-FSA supervised the start of operations. First North Finland is the first Finnish multilateral trading platform and a brokers list as referred to in the Securities Markets Act. It offers small and medium-sized enterprises a funding alternative less regulated than the stock exchange, and investors alternatives in the choice of execution venues and investment objects.

Supervision of trading and inspection of market abuse

Development of transaction reporting continued

The fragmentation of securities trading still continued between stock exchanges and multilateral trading platforms, such as Burgundy and Chi-X. Through transaction reporting, FIN-FSA gets information on securities transactions executed in different market places. This information is used in, for example, FIN-FSA's market abuse inspections.

In collecting and maintaining transaction reports, FIN-FSA makes use of a system developed through Nordic cooperation. In September, the transaction reporting obligation of securities intermediaries was extended when FIN-FSA started collection of information on transactions with OTC derivatives and exchange of that information

with ESMA member countries. At the same time, FIN-FSA broadened intermediaries' reporting obligations to cover customer identification and address information, which improved the usability of transaction reporting information in supervisory work. Fragmented trading and the large volume of reported transactions mean there is still a need to continue further development of transaction reporting.

New system for supervision of insider trading enhanced and automated trading supervision

FIN-FSA's new system for supervision of insider trading connects the information on reported transactions with the information of insiders and thus enhances and automates trading supervision. The new system also supports improved quality in customer information included in the transactions reports through validations developed for the system.

Securities intermediaries' best execution principles need development

FIN-FSA inspected compliance with the best execution principle by companies providing securities intermediation and asset management services. As regards customer protection, best execution is a core trading practice obligation whose significance has grown due to the fragmentation of trading and emergence of different market places.

According to the best execution obligation, securities intermediaries must aim for the best result from their customers' point of view. The inspection revealed that the execution principles of securities intermediaries were often kept on a very general level and did not always include special executing characteristics for different financial instruments and order channels. The general nature of the principles made it difficult for customers to assess the execution arrangements of different intermediaries and use execution principles as one of the criteria for selecting an intermediary.

Quality of information disclosed in investment analyses has improved

FIN-FSA surveyed the fair presentation of investment recommendations, or investment analyses, and disclosure of interests and conflicts of interest. The survey focused on six producers of recommendations.

The survey showed that the companies on the whole fulfilled well the requirements in the regulation of investment recommendations, and relative to an inspection conducted in 2009 the level of information disclosed in the investment recommendations had improved. The most serious deficiencies pertained to the disclosure of major shareholdings between the producers of investment recommendations and the issuers.

FIN-FSA reminded the producers of recommendations that investment recommendations must include clear and unambiguous information on major holdings between the producer of the recommendation or a legal person within the same group and the issuer. It must be clearly indicated in the recommendation whether an investment recommendation has been shown to the issuer prior to its disclosure to the public.

80 cases of suspected market abuse inspected

FIN-FSA inspected a total of 80 cases of suspected securities market abuse, making four investigation requests to the police, issuing three public reprimands and imposing five administrative fines.

FIN-FSA issued public reprimands on neglect of the European Commission's Prospectus Regulation and the disclosure obligation in the Securities Markets Act, neglect of the disclosure of periodic information and neglect of the disclosure of major holdings as well as related internal control deficiencies. FIN-FSA imposed five administrative fines for neglect of insider declarations.

FIN-FSA received 16 notifications of suspicious securities transactions or other suspected operations from brokers. The market surveillance of Helsinki Stock Exchange reported 29 cases.

FIN-FSA received three requests for judicial assistance from other authorities. For its part, FIN-FSA requested judicial assistance from three supervisors.

Inspected cases of suspected market abuse, requests for investigation and administrative fines 2002–2011

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total investigations	65	57	61	41	62	65	62	74	70	80
Abuse of inside information	24	28	24	18	29	45	27	37	27	34
Market manipulation	11	11	12	6	10	5	11	17	11	23
Disclosure obligation	30	18	21	13	21	12	12	16	25	16
Other	-	-	4	4	2	3	12	4	7	7
Request for police investigation	6	7	5	1	3	2	5	-	3	4
Public reprimand	-	-	-	2	-	1	1	5	3	3
Public warning	-	-	-	-	-	-	1	-	-	-
Administrative fine	-	-	-	-	-	-	14	-	1	5

Customer education

FIN-FSA also seeks to reach people in need of information in other ways than through its web service. One method is participation at different public events. For over ten years, FIN-FSA has participated in the Sijoitus-Invest event and held short presentations. This time, 13 short presentations were held at the November event. Among the most interesting subjects were once again the characteristics of authorised financial services and frauds and comparisons of different investment product groups.

In April, FIN-FSA participated in the Child Fair in Helsinki. The fair was part of FIN-FSA's customer education program on housing loans, and, in particular, young adults and families with children in the target group for housing loans were approached at the event. With brochures and loan calculators, the effects of interest rate changes on loan servicing costs or repayment times and the management of housing loan risks were described.

In matters dealing with customer protection and customer education, FIN-FSA works in collaboration with the Finnish Financial Ombudsman Bureau (FINE) and the National Consumer Administration. FIN-FSA participates in

the activities of the Advisory Council on Financial Management administrated by the Ministry of Employment and the Economy, and in the National Consumer Research Centre's two-year research project (expiring in 2012) on promoting young people's financial skills.

FIN-FSA's telephone help line handles financial customer enquiries

FIN-FSA's telephone help line handles customer enquiries from the banking, insurance and investment sectors, advising on, for example, the procedures required to be observed by different service providers operating on the financial markets. In 2011, the help line dealt with some 270 enquiries.

During the year, FIN-FSA also handled some 240 written enquiries. Of all enquiries, more than a half were concerned with banking, about a third with insurance and about a tenth with investment. The most frequent banking enquiries concerned loans and the deposit guarantee, while most insurance enquiries concerned compensation procedures and the handling time for compensation claims and most investment enquiries concerned authorisation and operations subject to authorisation.

Unbiased information to bank and insurance customers

One of FIN-FSA's statutory tasks is to provide information on the financial markets to the public. The main channel for this work is the website Financialcustomer.fi. The Finnish part of the web service was published in 2010 and the Swedish and English versions in 2011.

The Financialcustomer.fi website broadly describes expenses and risks associated with financial services and products and, among other things, housing loan

issues. In addition, six customer-oriented articles were published on the website. These addressed payment systems, capitalisation contracts, changes in investment fund regulation, basic banking services, non-regulated investment products and the price risk of shares.

 Please visit **Financialcustomer.fi**



Intensification of international supervisory and regulatory cooperation

The first year of the European System of Financial Supervision was marked by the sovereign debt crisis, the impacts of which spread to the financial sector. The Financial Supervisory Authority (FIN-FSA) strongly supported the measures taken by the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA) to mitigate the crisis and restabilise the financial markets. Restoring confidence in the EU banking sector was important for Finland, as the problems in other EU countries also reflected negatively on the Finnish financial sector.

In the year under review, an extensive reform of financial regulation was prepared in the EU. In international supervisory and regulatory cooperation, FIN-FSA focused on initiatives that are particularly important in terms of the capital adequacy, competitiveness and structural characteristics of the Finnish financial sector. Within the EBA, FIN-FSA worked actively on revising the regulations on banks' regulatory capital. The other key priorities for FIN-FSA were the reform of liquidity regulation and improvements to the monitoring of banks' liquidity positions. Work within EIOPA focused on preparations for revision of the capital adequacy regime for the insurance sector (Solvency II). Within ESMA, FIN-FSA worked actively to enhance

EU-level supervisory cooperation on securities markets and improve the supervision of new financial products.

Nordic supervisory cooperation was stepped up during the crisis. Monitoring of Nordic financial groups and timely exchange of supervisory information were both increased. Supervisors monitored especially closely the liquidity of Nordic financial groups. They also continued their well-established cooperation in the supervision of banks, insurance companies and securities markets.

New European system of financial supervision launched

European financial supervision took on a new shape when the new European Supervisory Authorities (ESAs) commenced operations at the beginning of 2011. The ESAs were granted new powers in EU financial regulation. They were also authorised to steer more intensively the operations of supervisory colleges and coordinate the joint crisis management measures of national supervisors. The role of the ESAs in the assessment of financial sector risks focused increasingly on assessing the systemic impact of crises, which was of vital importance in the management of the financial crisis. In the review year, systems were put in place for the supervision of financial products and customer protection, and authorities began producing the first EU-level assessments on these topics.

The EBA is responsible for banking supervision, EIOPA for insurance supervision (excl. statutory earnings-related pension insurance) and ESMA for supervision of the

EU's framework for supervision



securities market. The main decision-making bodies in the European Supervisory Authorities are the Boards of Supervisors, whose voting members are high-level representatives of the national supervisory authorities. Each Board of Supervisors has a full-time Chairman, who also chairs the meetings of the Management Board. In addition to the Chairman, the Management Board also includes six members chosen from the voting members of the Board of Supervisors. The Management Board is responsible for ensuring that operations are managed in line with the decisions taken by the Board of Supervisors. The Manage-

ment Board also prepares for the Board of Supervisors the work programme and budget of the authority. The EBA Management Board also plays an important role in preparing the topics to be presented at meetings of the Board of Supervisors.

Responsibility for the day-to-day supervision of financial markets still lies with the national supervisors. In addition to this, ESMA is responsible for the supervision of credit rating agencies, and it has been proposed that ESMA should receive supervisory powers over trade repositories.

FIN-FSA's memberships in the key preparatory and decision-making bodies of the European Supervisory Authorities⁴

Preparatory and decision-making body	Member/Chairman
ESMA Board of Supervisors	Anneli Tuominen, Director General, voting member Jarmo Parkkonen, Head of Department, deputy member
ESMA FISC, Financial Innovation Standing Committee (supervision of new financial products)	Anneli Tuominen, Director General, Chairman
ESMA's IT Management and Governance working group	Arja Voipio, Senior Adviser, Chairman
EBA Board of Supervisors	Jukka Vesala, Deputy Director General, voting member Anneli Tuominen, Director General, deputy member
EBA Management Board	Jukka Vesala, Deputy Director General, voting member
EIOPA Board of Supervisors	Anneli Tuominen, Director General, voting member Hely Salomaa, Chief Advisor, deputy member
Consumer Protection Sub-Committee (sub-committee of the Joint Committee of the ESAs)	Anneli Tuominen, Director General, Chairman
Risk Sub-Committee (risk assessment, sub-committee of the Joint Committee of the ESAs)	Jukka Vesala, Deputy Director General, Chairman
Work stream on the Methods of Consolidation for Financial Conglomerates (technical standards on the capital adequacy of financial conglomerates)	Marja Nykänen, Head of Department, Chairman
General Board of the ESRB	Anneli Tuominen, Director General, member (non-voting)

⁴ For a full list, see p. 65–66.

National supervisors participated in preparatory work and decision-making

The tasks of EU-level supervisors increased compared with the previous system of committees, and consequently they began to strengthen their resources. Nevertheless, in preparatory work, they continued to rely heavily on the expertise of national supervisors. All three ESAs have several committees and working groups, the members and chairmen of which are representatives of national supervisors. The committees prepare the topics to be discussed by each Board of Supervisors. The Standing Committees have several sub-committees responsible for eg drafting ESA technical standards, recommendations and guidelines, and preparing risk assessments and stress tests on the financial sector. In addition to EU-level financial regulation, a considerable amount of resources is still devoted to developing monitoring systems and procedures.

Regulatory and supervisory cooperation between the banking, insurance and securities markets is coordinated by the Joint Committee of EBA, EIOPA and ESMA. Their cooperation is important for assessing the interdependencies of the banking, insurance and securities sectors and their impact on the stability of the EU's financial sector. They also seek to increase the convergence of regulation and supervisory practices in the sectors.

FIN-FSA sharpened its international efforts

One objective of FIN-FSA is to exert influence in the EBA, EIOPA and ESMA, particularly in areas of key importance to the Finnish financial sector, in terms of capital adequacy, competitiveness and structural characteristics, as well as customer and investor protection. FIN-FSA participated in discussions through memberships in Standing Committees and working groups.

The European Supervisory Authorities were granted the powers to prepare binding technical standards. This was a major reform in terms of the harmonisation of EU financial regulation. The most efficient way of influencing the contents of technical standards and other regulation is to participate in their preparation in various expert groups. In the review year, FIN-FSA participated in the work of the key expert groups.

In the review year, the European Commission prepared Directives and Regulations on the financial sector. FIN-FSA participated in the preparation of EU regulation in close cooperation with the relevant ministries, and it also presented Finland's views within the European Supervisory Authorities. FIN-FSA and the ministries adopted common positions to influence particularly capital adequacy regulations on banks and insurance companies and the regulation of alternative investment fund managers (AIFM), both in preparations at EU-level and within the European Supervisory Authorities.

FIN-FSA worked in the key preparatory and decision-making bodies of the European Supervisory Authorities. These tasks continue in 2012.

Financial supervisory cooperation dominated by management of the financial crisis and major regulatory projects

In the year under review, European financial supervisors increased real-time monitoring of the financial sector and significantly improved their mutual exchange of information. Risk analyses on the entire financial sector were also performed in sub-committees of the Joint Committee. There was a great need for this, due to the diverse interlinkages within EU financial markets and the fact that individual crises spread rapidly from one sector and country to another.

The crisis management capacity of the new ESAs was put to the test immediately, as the debt crisis deepened during the course of the year and the stability of the financial sector weakened. The EBA, EIOPA and ESMA regularly assessed the situation of the financial sector and tested its risk-bearing capacity by conducting stress tests. They also extended the assessment of risks between the banking, insurance and securities markets, and their impact on macroprudential stability, together with the European Systemic Risk Board (ESRB). The EBA coordinated the joint measures of the national supervisory authorities to increase the capital requirements for large EU banks. It also supported the measures taken by national supervisors to ensure that supervised entities strengthen their capital adequacy and liquidity management in order to restore financial stability.

In respect of EU-level regulation, FIN-FSA supported the granting to national authorities of adequate powers and tools for macroprudential supervision. Towards the end of the year, the European Systemic Risk Board promoted the development of national macroprudential oversight arrangements by issuing recommendations on the macroprudential mandate of national authorities. Anneli Tuominen, Director General of FIN-FSA, participated in the meetings of the ESRB's General Board (as a non-voting member), together with Erkki Liikanen, Governor of the Bank of Finland (voting member).

During the course of the year, the European Commission prepared several extensive proposals for EU regulations aimed at supporting the stability of financial markets in the longer term. The Commission worked on, for example, new capital requirements for the banking sector (CRD⁵ and CRR⁶), a new capital adequacy regime for the insurance sector (Solvency II) and several regulatory initiatives on the securities markets. The ESAs issued

5 Capital Requirements Directive.

6 Capital Requirements Regulation.

opinions on the proposals under preparation and prepared binding technical rules and advice to the Commission concerning delegated acts as well as guidelines and recommendations.

Improving the supervision of customer protection issues is a key objective of the ESAs. This means improving the transparency and clarity of the markets for financial services and products targeted at consumers. Each of the three ESAs has been assigned a specific task of customer protection, and ESMA has also been given the task of enhancing investor protection. In December, EIOPA published a report on initiatives by national supervisors to enhance financial literacy and education. Future reports will be published periodically, in cooperation with the EBA and ESMA.

The financial innovation committees of the new authorities commenced operations. Their role is to enhance customer protection by coordinating the regulation and supervision of new and innovative products and services. They monitor consumer trends and innovations, analyse innovations from the perspective of financial stability and consumer protection and, where necessary, propose regulator or supervisory measures. FIN-FSA has strong representation on the committees.

Monitoring and analysis of financial trends and innovations requires comprehensive data on the supply and volume of products and services in various markets. Data collection plays a key role in the work of the committees, particularly in the early stages.

Focus on regulatory reform, practical supervisory cooperation and thorough risk assessment

Within the EBA, FIN-FSA's key priority was the reform of regulatory capital and liquidity regulations. Maintaining strong capital positions and easy access to funding proved to be particularly important during the autumn for fostering confidence in the financial sector. This gave an additional incentive to improve monitoring and regulation of liquidity positions. FIN-FSA supported the convergence and harmonised application of financial regulation.

Within the EBA and EIOPA, FIN-FSA supported the development of harmonised procedures for the EU's supervisory colleges in order to bolster the commitment of home and host Member States to the supervision of cross-border financial groups and supervisory best practices in continuous supervision. Progress has been made in establishing supervisory colleges for supervision of cross-border financial groups. In the opinion of FIN-FSA, however, supervisory cooperation should be further deepened in, for example, the assessment of risks and capital adequacy as well as in on-site inspections. The supervisory colleges also need to improve their real-time exchange of information.

EIOPA's work focused primarily on the overall reform of the solvency requirements and solvency monitoring of the insurance sector (Solvency II). This reform is also important for the Finnish insurance sector and enhances the assessment of risk-based capital adequacy. Due to the characteristics of the Finnish insurance sector, one of FIN-FSA's focuses in the reform was on equalisation provisions and calculation of technical provisions. FIN-FSA has informed supervised entities regularly on the progress made in Solvency II. For more information on Solvency II, see page 53–54.

On the EU level, the key priority in ESMA's work programme was commencement of the supervision of credit rating agencies. The most important regulatory projects were the preparation of Level 2 advice and technical standards concerning the Directive on Alternative Investment Fund Managers (AIFMD) and the proposal for a Regulation on OTC derivatives markets, and the preparation of Level 2 advice and technical standards concerning the regulation on short selling. Supervisory cooperation on securities markets continued, particularly in the enforcement of IFRS financial statements, inspection of market abuse and the supervision of investment funds and prospectuses. Due to market developments, ESMA's efforts focused on topics including complex investment products, ETF funds, high-frequency trading and algorithmic trading, and it issued guidelines and recommendations in these fields.

FIN-FSA's input in the work of ESMA focused particularly on supervisory cooperation and regulatory initiatives concerning the AIFM Directive. FIN-FSA has also participated in preparations concerning the establishment of a Standing Committee on financial innovations.

Nordic supervisory cooperation intensified during the crisis

The monitoring of Nordic financial groups and the real-time exchange of supervisory information was intensified as the debt crisis continued. The core of supervisory cooperation are the supervisory colleges, consisting of all the key supervisors of the financial group in question. In addition to Nordic supervisors, some Baltic supervisors participated in the work of the supervisory colleges.

The supervisory colleges regularly reviewed the risk positions of financial conglomerates and prepared a joint supervisory assessment on the exposures and capital adequacy of the conglomerates. They monitored especially closely the liquidity of Nordic financial groups. They also assessed other risks in the economic environment and the housing market.

In the supervision of Nordic cross-border banking groups, an agreement was reached between the supervisors on the assessment of capital adequacy the capital requirements at Group and subsidiary level. The subsidi-

aries must have adequate capital to cover local risks and fulfil stress test requirements. Part of the capital buffer can, however, be held at Group level, which fosters the use of uniform Group-level capital management processes.

Audit plans were coordinated in the supervisory colleges, and inspection guidelines were prepared, on the initiative of FIN-FSA. The Nordic supervisory colleges discussed the findings of inspections conducted in financial conglomerates by various supervisors. FIN-FSA participated in conglomerate supervision of Nordea, Handelsbanken and SEB, coordinated by Finansinspektionen, the Swedish supervisor. FIN-FSA also worked in the supervisory college for Danske Bank Group, the work of which is coordinated by the Danish supervisor Finanstilsynet. Conglomerate supervision of Sampo Group was headed by FIN-FSA. The Nordic supervisors carried out a joint inspection of Nordea Group's credit risks.

With the revision of solvency requirements for the insurance sector (Solvency II) it has been considered necessary to increase Nordic supervisory cooperation, particularly to ensure consistent interpretation of regulatory provisions on the calculation of life insurance companies' technical provisions. For this purpose, a separate cooperation group was set up, and the first chair of the group was FIN-FSA. Another objective is to promote, via EIOPA, the introduction of these interpretations in other parts of the EU. Similar work is also being launched in the field of non-life insurance.

The supervision of insurance companies' internal mathematical models used in Solvency II capital adequacy calculation was discussed by a joint working group of Nordic supervisors. This promoted the harmonisation of inspection practices. The group also discussed actual inspection cases and exchanged information on inspection practices. The cooperation enabled the individual supervisors to utilise their scarce resources well in the supervision of internal models.

European financial supervisors worked to stabilise the markets

Juha Savela

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Increase in sovereign exposures threatened banks' liquidity

In the early stages of the sovereign debt crisis, funding costs increased and the availability of funding weakened for banks in the most deeply indebted countries. Banks in the countries experiencing sovereign distress were a source of contagion for other European banks, and consequently the lack of confidence also began to be reflected in the funding costs for banks in other EU countries. EU banking and insurance sector investments in GIIPS sovereign debt securities posed an imminent risk for the investing institutions. At the end of September, European (excl. Greek) banks' claims on and investments in the GIIPS countries totalled EUR 511 billion, and sovereign exposures in EEA countries totalled EUR 1,574 billion.

Lack of confidence in the banking sector was sustained by uncertainty over future losses on sovereign debt. The uncertainty then spread to the stock market. The positive sentiment on the equity markets in the first half of the year was gradually reversed, and the early autumn was characterised by a decline in share prices. Lack of confidence in governments' ability to service their debts deepened and spread beyond the problem countries. There is a strong correlation between banks' funding costs and the credit rating of their home country. Consequently, EU Member States' debt problems were reflected in an increase in banks' funding costs. There was a threat of banks cutting down on their operations rapidly as the availability of market funding began to dry up. There was a particular concern that some banks might cut their lending drastically, which would weaken economic growth. The slowing of economic growth hampers the management of sovereign debt, which in turn poses a further threat to government credit ratings. The overall situation was aggravated by the fact that the decline in share prices eroded the value of insurance sector investments, thereby increasing the threat of forced sales. The key objective of the European financial supervisors was to restrict the negative spiral in which economic recovery was threatened by government and financial sector problems.

Coordinated and effective addressing of crises

The European Supervisory Authorities (ESAs) have three types of means for addressing financial crises.

1. The ESAs (EBA, EIOPA and ESMA) assess the risks in the banking, insurance and securities markets and the threat they pose to financial stability, and they may recommend measures to mitigate said risks. The Joint Committee of the ESAs makes an overall assessment of the risks in the banking, insurance and securities markets. Their analyses are complemented by joint policy recommendations. The situation of the financial sector is also assessed by regular stress-testing. Based on the analyses, the EU supervisory authorities and national supervisors take remedial action. During the autumn, EU-level monitoring of the financial sector was stepped up, with, for example, EBA monitoring the liquidity of major banks on a weekly basis. Towards the end of the year, the insurance sector was also affected by the crisis as the decline in share prices eroded the market value of insurance companies' portfolio investments. Consequently, in their assessments, the authorities paid increasing attention to the interdependencies between the banking and insurance sectors.
2. The task of the EU supervisory authorities is to coordinate the supervisory responses of national supervisors. They have been granted the power to issue recommendations to national supervisors that promote consistent remedial action to stabilise the situation. These recommendations are not legally binding.

3. The EU supervisory authorities have also been granted special powers in the event of emergency situations. They may use their special powers only under a decision taken by the Council of the European Union determining the existence of an emergency situation. In emergency situations, the ESAs may, under certain conditions, adopt an individual decision on a supervised entity. In the year under review, the crisis situation was not an emergency situation as determined by the Council, and the supervisors therefore operated with regular powers.

The European Systemic Risk Board (ESRB) regularly assesses the macroprudential stability of the financial markets. The task of the ESRB is to identify macroprudential risks and, where necessary, issue warnings and policy recommendations. The EBA, EIOPA and ESMA are represented on the ESRB. As the sovereign debt crisis dragged on and aggravated the situation in the financial sector, the ESRB issued a statement on the situation in September. According to the ESRB, solving the crisis requires coordinated efforts by supervisors to strengthen bank capital and transparent and consistent valuation of sovereign exposures.

The EBA prepared recommendations for EU-level measures to restore investor and customer confidence in the EU financial sector. The action taken by the European supervisory authorities was significant, but insufficient to solve the debt crisis in Europe. It still has to be supported by implementation of the other consolidation measures agreed by EU Member States.

Deepening of the debt crisis triggered a reassessment of banks' sovereign exposures

The EBA conducted stress tests to assess the resilience of European banks in the face of an economic downturn and subsequent loan losses. Under such an adverse scenario, banks' should have a Core Tier 1 (CT1) capital ratio of a minimum of 5% of risk-weighted assets. Following the stress tests (conducted in the spring and results published in July), the sovereign debt crisis escalated and the CT1 ratio of 5% could not cover the increase in sovereign exposures and other risks caused by the instability of the markets. The EBA, together with national supervisors, then reassessed the sovereign exposures of the major banks. As a result, the authorities defined a new capital requirement and assessed the need for additional capital.



FIN-FSA's ESA coordinators: Ville Kajala, Market Supervisor, and Senior Risk Experts Teija Korpiaho and Juha Savela.

Temporary additional capital requirement for major banks

The EBA issued a proposal for the Council on a temporary additional capital buffer for major European banks. The EBA and the ECOFIN Council published a joint statement on 30 November, outlining the core elements of the recapitalisation plan. The threshold for banks' Core Tier 1 capital ratio was set at 9%, 4 percentage points higher than the threshold set for the stress tests. The new assessment took full account of the changes in European sovereign bond valuations. Banks are required to reach a minimum Core Tier 1 capital ratio of 9% after taking into account the capital requirement for sovereign exposures. The EBA, together with national supervisors, assessed that the banking sector's aggregate capital shortfall from the 9% target level is EUR 114.7 billion. Of this shortfall, EUR 30 billion is attributable to Greek banks.

The objective of the strengthening of capital positions was to boost investor confidence, thereby facilitating banks' access to market funding. Strong capital buffers decrease the risk of contagion in the financial sector. The temporary higher capital requirement applies to 71 major European banks, and 31⁷ banks are required to bolster their capital positions. The idea is for these banks to increase their capital ratios by augmenting their equity capital, not by selling assets. This is to avoid a reduction in lending activity and a consequent slowdown in economic growth.

The banks that have a capital shortfall are required to submit their recapitalisation plans to national supervisors in January 2012. The national supervisory authorities will monitor the recapitalisation plans and fulfilment of the related requirements. The additional capital requirement did not affect banks operating in Finland.

Consistent measurement principles for sovereign debt

Following the escalation of the sovereign debt crisis in the summer, ESMA enhanced coordination of the enforcement of IFRS financial statements. In July, ESMA issued a public statement, stressing the need for enhanced transparency of sovereign debt disclosures in listed issuers' IFRS interim and annual financial statements. When material, disclosures should be provided country by country.

During the autumn, ESMA and national authorities together conducted a fact-finding exercise on the accounting treatment of Greek sovereign debt in banks' half-year financial statements. From the perspective of investors and other market participants, the assessment of the real situation of the banks was hampered by the fact that the accounting practices with regard to Greek sovereign debt exposures varied across banks. The application of IFRS was not consistent as regards the accounting treatment of sovereign exposures. To improve the situation, ESMA issued a public statement in November aimed at enhancing the consistent measurement of these investments in future financial reporting. Key investments in sovereign debt securities have to be analysed carefully for the recognition of possible impairments. In IFRS financial statements, investors should be provided with all relevant disclosures related to the criteria used in assessing the possible impairment of financial assets. ESMA also encouraged banks to provide quantitative and qualitative information on sovereign debt-related instruments such as credit default swaps (CDS), forward contracts, options and other derivatives. When material, these disclosures should also be provided country by country. Disclosures should be provided particularly on Greek sovereign debt.

⁷ In early 2012, the EBA removed 3 banks from the list of 31 banks on account of significant ongoing restructuring at these banks.

Moving to a common culture

Coordination of the various supervisory activities (inspections, supervisory reviews) were markedly improved in the year under review. Processes were reviewed and updated.

Overhaul of the new set of regulations continued. The first regulations and guidelines were issued in the year under review.

In the early part of the year FIN-FSA conducted its first interest group survey. Two-thirds of respondents considered that FIN-FSA has successfully promoted confidence in the functioning of the financial markets, customer and investor protection and financial market stability.

The disclosure policy published in December defines the information FIN-FSA publishes and the information that is made available to the public.

In 2011, staff training concentrated on insurance sector issues. FIN-FSA's personnel also participated in training organised by the new EU authorities.

Coordination of supervisory activities was improved

Achievement of the goals set for the efficiency of key processes was monitored regularly. Coordination of various supervisory activities – inspections and supervisory reviews in particular – was improved. Measures taken by supervised entities to address FIN-FSA suggestions and recommendations made on the basis of its inspection findings were systematically monitored as part of the supervisory review process. The authorisation process was overhauled to make it more efficient through smoother handling of cases and shorter processing times.

First releases in the new collection of regulations and guidelines

The new collection of regulations and guidelines incorporates the separate sets of regulations on the insurance and financial sectors into a single FIN-FSA collection that is uniform in structure and as consistent as possible in terms of content. Drafting of individual regulations and guidelines was commenced. The reform is proceeding in phases and the bulk of the work is expected to be completed by the end of 2012. Amendments pending in national and EU legislation will be taken into account.

In the year under review, FIN-FSA issued the first regulations and guidelines in the new collection of regulations and guidelines. The new releases concerned the following subject areas: reporting to FIN-FSA by entities operating in the insurance markets, organisation of investment fund activities and code of conduct, and methods to calculate the maximum fee chargeable in cases of advance repayment of a housing loan.

In 2011, FIN-FSA also launched consultations on seven draft regulations and guidelines in the following subject areas:

1. authorisation procedures, risk management and reporting relating to mortgage banking
2. outsourcing of activities
3. code of conduct for the provision of financial services
4. auditing
5. reporting of expenses and income on long-term savings and insurance products
6. management of operational risk
7. accounting and financial reporting of hedging for insurance companies' technical provisions.

Vote of confidence from interest groups

On the basis of responses to the interest group survey conducted in January–February, two-thirds of respondents considered that FIN-FSA has successfully promoted confidence in the functioning of the financial markets, customer and investor protection and financial market stability. Of its statutory duties, FIN-FSA has successfully conducted its supervisory and inspection duties (77% and 68% of respondents, respectively), among other things. On a scale of 4 to 10, FIN-FSA was given an overall grade of 8. Cost efficiency was regarded as FIN-FSA's weakest point, even though it has improved since the merger of the former Financial Supervision authority and the Insurance Supervisory Authority in 2009. Respondents also criticised FIN-FSA for being bureaucratic.

The target group of the survey was supervised entities, listed companies, authorities, Members of Parliament, the media and FIN-FSA's other interest groups. The total number of respondents was 341, and the response rate 35%.

Disclosure policy specifies material to be published

In December, FIN-FSA published its disclosure policy, defining the information FIN-FSA actively publishes and the information that can be accessed by the public. The purpose of the disclosure policy is to serve the diverse information requirements of FIN-FSA's interest groups.

The disclosure policy specifies

- the information published on supervised entities
- the publications and press releases disseminated by FIN-FSA


- the times of release of the publications
- how FIN-FSA reports on its own activities
- how communication between FIN-FSA and its interest groups is organised.

In addition, the disclosure policy indicates, for example, whether the material is also published in Swedish or English.

However, considering the nature of FIN-FSA's activities, it has become necessary to impose strict limits on information disclosure. Many of the matters handled by FIN-FSA include information that the supervisor is not allowed to release to the public. For example, information obtained in connection with an inspection of an individual supervised entity may not be disclosed.

Information confidentiality is also of particular importance in situations where FIN-FSA examines procedures that may be in breach of legal provisions, that may lead to administrative sanctions, or regarding which a police investigation may be requested. Terminated enquiries are reported to the public only if the matter leads to an administrative sanction, such as a public reprimand. Information reported to the public also includes the number of requests for police investigation.

If FIN-FSA must rectify certain information after publication, the rectification will be clearly indicated in the already published document. If major rectification is required, a new press or news release will be published on the matter.

 For more information, please visit: **[Fin-fsa.fi > About Us > Disclosure Policy](#)**

Training

FIN-FSA staff attended a total of 480 training days (656 in 2010). Internal training was organised on such issues as Solvency II, underwriting risks and insurance companies' financial statements. FIN-FSA staff also participated in training organised by European financial supervisory authorities on the development of regulation and supervision. All FIN-FSA management supervisory staff have completed a tailored coaching programme.

Towards a global regulatory agenda

International regulatory cooperation has become particularly important in recent years on the financial markets. Measures to address the financial crisis were taken at global level. The objectives and key content of financial market regulation have been broadly agreed at G20 summits, where Finland is not represented. At EU level, the declarations of the G20 have been implemented through EU legislation.

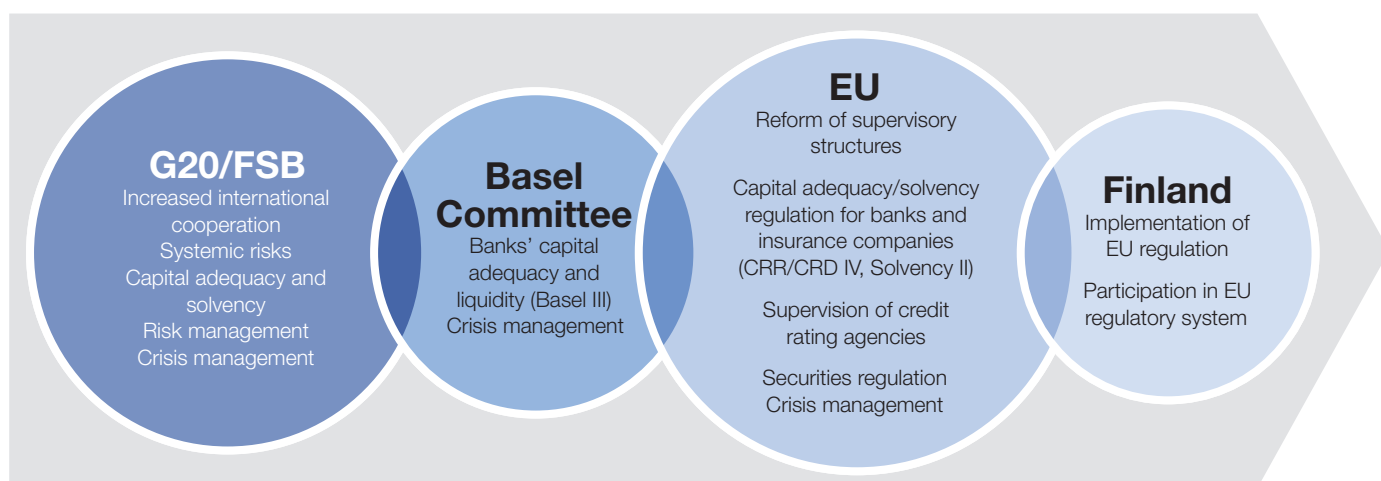
Besides the global regulatory agenda, EU legislation also emphasised the need to harmonise regulation (the single rulebook). The new proposals reduce the scope for national regulatory discretion. Increased use of directly applicable EU Regulations instead of Directives also limits national discretion.

The new EU authorities (EBA, EIOPA and ESMA) that commenced operations at the beginning of the year also

play a major role in preparing complementary legislation. Preparation of binding technical standards and advice on delegated regulation to the European Commission have required much effort from EU authorities and hence also from national authorities.

Banking and insurance sector regulation has focused on the new capital adequacy provisions and governance issues. In addition to implementation of the G20 declarations, regulatory projects relating to the securities markets sector have also been influenced by the review clauses in existing Directives, on the basis of which the Commission has proposed numerous changes. The objectives of EU regulatory projects have included achievement of greater transparency, proportionate regulation (particularly for small and medium-sized enterprises), a level playing field, harmonised powers for authorities and mitigation of short-termism in investment activities.

Global regulatory reforms influence European financial regulation and supervision



Banking sector

Significant changes to capital adequacy and liquidity regulation for the financial sector

Regulatory reforms aimed at addressing shortcomings revealed by the financial crisis in credit institutions' capital adequacy and liquidity regulation have been implemented in phases since 2010. Changes made in the first phase, such as the reform of regulation concerning large exposures

and securitisation, came into force on 31 December 2010. Changes in the second phase included amendments to regulation concerning remuneration schemes, which took effect in 2011. Amendments to market risk and resecuritisation regulation came into force on 31 December. It was found that credit institutions' internal models used for the calculation of capital requirements for market risks underestimated the risks, which necessitated a further tightening of regulation. It was also necessary to harmonise the treatment of securitised assets between the capital requirements for credit risk and market risk.

European Commission proposal for a new regulatory framework for capital adequacy and liquidity

In July, the European Commission adopted a proposal to implement the Basel III recommendations issued by the Basel Committee on Banking Supervision in 2010. The proposal aims to restore financial market stability and stable economic growth and, in particular, to promote the single rulebook for the EU. The Commission's proposal is currently under approval by the Council and the European Parliament, and the final regulatory texts will be confirmed by mid-2012. Under the Commission proposal, the new legislation would be enforced gradually so that all legislation would be fully effective as of 2019.

The proposed forthcoming Regulation will considerably increase the amount of credit institutions' higher-quality equity capital eligible for capital adequacy calculation, improving their quality and thereby the sector's ability to absorb losses. Credit institutions are also required to augment their capital buffers beyond the statutory minimum limits in order to be able to absorb losses in the event of weaker economic developments without reaching their statutory minimum limits.

To complement the risk-based minimum capital requirements, a new simple non-risk-weighted limit on leverage, ie the leverage ratio, is to be imposed on credit institutions. The thinking behind this is that the leverage ratio

will act as one of the regulatory instruments to cool overheating in the financial system.

In a situation where credit growth is too fast, it will also be possible to impose on credit institutions an obligation to accumulate additional capital buffers (countercyclical capital buffers).

The imposition of quantitative liquidity standards on credit institutions is an important reform. Credit institutions will be required to hold on their balance sheets such amounts of high-quality and liquid assets as enable them to withstand short periods of financial stress. Subsequently, credit institutions will also be faced with requirements on adequate levels of long-term funding.

The Commission's proposal for the Directive also includes new requirements on credit institutions' corporate governance, which emphasise, for example, senior management's responsibility for supervision and the role of risk management and control. In addition, it envisages improved and more harmonised sanctioning powers for supervisors in the EU. Neither of these two subject areas are included in the Basel III recommendations.

From the perspective of Finland's financial sector the most significant regulatory projects are those related to regulatory capital (own funds) and liquidity requirements. Strengthening credit institutions' capital adequacy and liquidity situation is also important with respect to the current sovereign debt crisis. The measures are expected to

New capital adequacy requirements

Minimum capital requirements and buffers (relative to risk-weighted assets), %

	Tier 1 common equity	Tier 1 capital	Total regulatory capital
Minimum amount (2015–)	4,5	6,0	8,0
Capital conservation buffer (2019–)	2,5		
Minimum amount + capital conservation buffer	7,0	8,5	10,5
Counter-cyclical buffer*	0–2,5		10,5–13,0
In addition, possible SIFI** and Pillar 2 surcharges			
Currently	2,0	4,0	8,0

* Quality requirement: common equity

** SIFI: systemically important financial institution

Timetable for leverage ratio and liquidity requirements

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Leverage ratio	Under monitoring		Comparison period 1 Jan 2013–1 Jan 2017 Disclosure obligation as from 1 Jan 2015					Binding requirement	

Liquidity risk:

Liquidity coverage ratio		Observation begins			Minimum requirement introduced				
Net stable funding ratio		Observation begins						Minimum requirement introduced	

restore investors' confidence in the banking system and promote smooth bank refinancing. The availability of refinancing and the related terms and conditions are essential for banks' ability to lend.

It is also important for Finland to ensure sufficient liquidity of foreign banking groups' subsidiaries and branches accepting deposits in Finland. Sufficient liquidity reserves must be based in Finland in order to provide safeguards for Finnish depositor interests under all circumstances. Insolvency legislation is not harmonised across EU countries, and transfers of funds from abroad to Finland cannot be guaranteed. FIN-FSA has also wanted to ensure adequate supervisory powers over branches so as to prevent branches' potential liquidity problems from spilling over to Finnish banks.

The Commission's proposal relies strongly on uniform and binding EU legislation (maximum harmonisation), and in this regard the proposal differs considerably from the Basel III recommendations. The Commission proposes that rules pertaining to the calculation of credit institutions' minimum capital adequacy and liquidity requirements be brought into effect with an EU Regulation directly binding on all member countries. Although FIN-FSA is in favour of

maximum harmonisation, it considers it important that, in future, national authorities have the possibility to temporarily tighten capital adequacy and liquidity requirements for macroeconomic reasons.

More specific regulation on remuneration

EU-level regulation on remuneration for the financial sector was implemented in Finland at the end of 2010 with amendments to the Credit Institutions Act and a Ministry of Finance decree. On 24 March 2011, FIN-FSA published a recommendation on remuneration dealing with application of the decree by credit institutions and investment firms. In its recommendation, it also encouraged insurance companies and other supervised entities to comply with the principles of the decree as well.

In its recommendation, FIN-FSA set out its view on eg the categories of staff to which the specific provisions on variable remuneration contained in the Ministry of Finance decree should be applied. FIN-FSA also drew attention to the fact that the principles of variable remuneration should be risk-based.

Crisis resolution and proactive supervisory measures to be improved

Submission of a European Commission proposal for a Directive concerning crisis management in the EU financial sector was postponed until 2012. The main objective of the EU-level reform is to resolve possible bank crisis situations without endangering financial stability and exposing taxpayers alone to bearing the costs involved. One of the goals is that authorities and major banks prepare plans in advance to enable the rapid and controlled restructuring of distressed banks. FIN-FSA considers it important that the new crisis management and capital adequacy regulation improve supervisors' scope for early intervention. Corrective measures should be taken before banks' capital adequacy has weakened to such a degree that they can no longer continue operating.

Stricter regulation planned for largest banks

In November 2011, the Financial Stability Board (FSB) representing the group of major industrial countries (G20) endorsed recommendations for measures regarding the supervision of systemically important banks. These measures aim to prevent and mitigate risks imposed by very large banks on the financial system as a whole (systemic risks). Risks associated with large banks tend to increase, as depositors and investors hold the view that large bank failures are prevented by public support measures (moral hazard).

The FSB has initially identified 29 banking groups as global systemically important financial institutions (G-SIFIs). Systemically important banking groups are so large and complex that their failure would cause significant disruption to the financial system and economic activity. Nordea is the only Nordic bank identified as belonging to the group of systemically important banks determined by the FSB.

The FSB presented the following recommendations for key measures:

- G-SIFI banks should be subject to more stringent capital requirements than other banks.
- National authorities should be given sufficient powers to resolve crises in G-SIFI banks without substantial use of taxpayers' funds.
- Banks should be required to have recovery plans for crisis situations, and authorities should prepare their own bank-specific crisis management plans, including cross-border cooperation between authorities.
- Day-to-day monitoring of systemically important banks should be increased.

G-SIFI action concerning Nordea will be discussed in the context of colleges of supervisors entrusted with the task to further strengthen common plans for crisis situations. Implementation of the FSB's policies will commence in 2012. Possible requirements to be set for the other systemically important banks are currently under discussion.

Insurance sector

Solvency II entering into force in 2014

The EU has been preparing its Solvency II reform for a long time. This will introduce uniform, risk-based solvency requirements and requirements for sound governance, particularly for the risk management function, on insurance companies operating in the EU area, as well as harmonised principles for insurance supervision. The Solvency II Directive, adopted in 2009, is still to be amended by the Omnibus II Directive, which has not yet been finally approved. Changes are to be made in eg the date of entry into force, transition rules, powers between EU institutions and certain substantive issues. The need for these changes identified already prior to the implementation of regulation stemmed from the EU's new financial sector supervisory framework and partly from the financial crisis. It has been considered appropriate to introduce elements in existing regulation that could act in a countercyclical manner, thereby promoting stability in the European financial markets while improving the protection of policyholders' interests. These initiatives have, however, delayed enforcement of the new regulation on the original timetable. The current assessment is that Solvency II will enter into force gradually in 2014.

For Finland, the key issue has been the treatment of insurance companies' equalisation provisions in solvency calculations under Solvency II. The purpose of equalisation provisions is to smooth out fluctuations in underwriting results in the long term. At the same time, equalisation provisions play a major role for insurance companies' solvency, as, for example, the equalisation provisions of Finnish insurance companies engaged in non-life insurance business amount to approximately EUR 2.2 billion. One of the main objectives pursued by FIN-FSA is that EU regulation should enable the incorporation of equalisation provisions in the highest-quality class of equity capital (Tier 1). This would seem to be realised, albeit some revisions will be needed to national legislation.

Another important issue has been to define the solvency capital requirement for non-life insurance risk so that the specific features of the Finnish insurance business are taken into account. FIN-FSA has also paid attention to the clarity and harmonised interpretation of rules pertaining to the calculation of technical provisions, requirements for internal models and their procedures for approval.

A further feature of Solvency II is harmonised reporting to supervisors. FIN-FSA's view is that reporting should be adequate from a supervisory perspective, yet it should not become unreasonably burdensome on supervised entities. FIN-FSA has considered it necessary that, in addition to data reported annually, quarterly reporting should also be sufficiently detailed. Security-by-security reporting of insurance companies' investment portfolios is also seen as important.

The Solvency II working groups set up by the Ministry of Social Affairs and Health were responsible for issuing the necessary legislative proposals by the end of 2011.

The Government proposal must also take a position on the regulation of those life and non-life insurance companies that are not compelled to comply with the Solvency II Directive. From the perspective of ensuring uniform policy-holder protection and a level playing field for large and small insurance companies, FIN-FSA considers it appropriate to extend the coverage of Solvency II requirements to all insurance companies and associations. As regards small insurance companies, FIN-FSA is in favour of partly simplified solvency capital rules that are based on Solvency II.

Review of the Insurance Mediation Directive

In spring, the Commission launched a public consultation on the review of the Insurance Mediation Directive (IMD2). Key changes proposed by the Commission concern disclosure requirements applicable to sellers of insurance products and management of conflicts of interest. FIN-FSA supports as uniform regulation as possible on conduct of business by both insurance intermediaries and providers of investment services. This would facilitate supervision and would also be beneficial to entities subject to both the MIFID and the IMD2.

Review of the Directive on occupational retirement provision

The Commission has launched a review of the Directive on the activities and supervision of institutions for occupational retirement provision and has requested EIOPA for advice on the matter. A major issue for Finland is the Directive's scope of application and its possible extension. However, it would appear that, as with current legislation, the revised Directive's scope of application would be limited to company and industry-wide funds providing supplementary occupational pensions. One of the purposes of the Directive is to make solvency requirements more risk-based.

Statement on the interest rate applied in calculating non-life insurers' technical provisions

At the end of the year, FIN-FSA issued a statement on the discount rate applied in the calculation of non-life insurance companies' technical provisions. The purpose of the statement was to ensure that non-life insurers adhere to the principle of prudence in discounting technical provisions. According to the Insurance Companies Act, non-life insurers must discount technical provisions in a prudent manner: the applied interest rate may not exceed the level of returns that, exercising caution, has been determined for investment in assets covering technical provisions, nor the maximum level of interest specified by Ministry of Social Affairs and Health decree (currently 3.5%).

Particularly because of the current low level of interest rates, FIN-FSA takes the view that insurers must pay special attention to the interest rate applied. In selecting the discount rate, insurers should especially take account of the market return on high-quality or long-term government bonds. According to FIN-FSA's interpretation, this would correspond to the return on at least AA-rated quoted debt securities or that on interest rate swaps. Market uncertainty over interest rates highlights the importance of prudent selection of the discount rate.

Standard on interest rate hedging for technical provisions

The forthcoming Solvency II reform (see page 53) concerning life-and non-life insurance companies and the existing proactive supervision of life insurers require market-based valuation of technical provisions. This means that, instead of fixed interest rates, discounting of technical provisions is based on an interest rate term structure determined on the markets. The change in the valuation of technical provisions requires considerably more active management of interest rate risk by insurance companies. Insurers can use derivative contracts to hedge against interest rate risks involved in the market-based valuation of technical provisions. So far, regulation on accounting and annual accounts has not included comprehensive and uniform provisions on the treatment of derivative contracts as instruments hedging for technical provisions.

At the end of the year, FIN-FSA launched a consultation on a Regulation concerning the treatment of interest rate hedging for technical provisions in life and non-life insurance companies' accounting and annual accounts. The Regulation will also enable more efficient risk management with regard to interest rate risk in technical provisions. At the same time, it will foster a smooth transition towards full Solvency II calculation and risk management.

Securities markets

Securities markets regulation to be reformed in 2012

FIN-FSA has worked in cooperation with the Ministry of Finance to further prepare a comprehensive reform of Finnish securities markets legislation. FIN-FSA's aim is to ensure well-balanced legislation, ensuring both investor and customer protection and the competitiveness of Finland's financial markets.

The Ministry of Finance working group set up to prepare the comprehensive legislative reform submitted their report in February. After a round of consultation, further preparation of the reform has continued in two separate projects at the Ministry.

A Government bill drafted in the first phase of the reform includes proposals for:

- a new Securities Markets Act
- a new Investment Services Act
- a new Act on Trading in Financial Instruments
- a new Act on the Book-Entry System and on Clearing and Settlement Operations
- amendments to the FIN-FSA Act and
- a new Act on Securities Accounts.

The Government bill is envisaged to be presented to Parliament in the spring 2012 term. The second phase concerns assessment of the scope for developing multi-tiered management of securities. The proposals are scheduled to be finalised by the end May 2012.

At the end of the year, the Ministry of Finance arranged a public consultation on draft proposals presented in the first phase of the reform.

It has been proposed that the public insider register of issuers be centralised in FIN-FSA. The proposed change in the register system would require allocation of more resources to FIN-FSA. The information systems costs would also be significant. FIN-FSA considers that, if it is mandated by law to keep the register, declarations of insider holdings must be submitted via issuers and an adequately long transitional period be reserved for implementing the change, because of technical reasons related to the information systems. It should also be taken into account that national legislation on insider registers is due to be replaced by EU regulation.

Changes to the Prospectus Directive ease administrative burden on issuers

The Directive amending the Prospectus Directive (2010/73/EU), which was adopted on the basis of a review of the operation of the Directive, entered into force in December 2010. The amended Directive aims to improve customer protection and ease the administrative burden on issuers. Amendments to the Directive must be transposed into national law by 1 July 2012. In Finland, the amendments are envisaged to be implemented in connection with the overall reform of the Securities Markets Act.

In particular, the amended Directive harmonises information provided on securities offered under offering programmes and the information content of prospectus summaries. In addition, the Directive eases rules pertaining to the information content of rights offerings and the prospectuses of small and medium-sized enterprises. It also raises the thresholds for the obligation to publish a prospectus.

ESMA submitted the first part of its advice to the Commission on level 2 measures with regard to the amended Directive in October. The second part of its advice is scheduled for submission in early 2012.

Proposed replacement of Market Abuse Directive with an EU Regulation

In October, the Commission presented a proposal for a Regulation on insider dealing and market manipulation (market abuse). This would replace the Market Abuse Directive and would be directly applicable throughout the EU.

The proposed Regulation would

- extend the scope of application of market abuse regulation to new market venues and financial instruments
- harmonise regulation on insider registers and on the obligation to disclose information on transactions by issuers' managers
- increase authorities' supervisory and investigation powers and
- set minimum requirements for administrative sanctions.

The proposed Regulation suggests that whistleblowers reporting suspected market abuse should be protected, and Member States could also issue related legislation on financial incentives. In addition to the Regulation, the Commission also proposed a Directive to harmonise criminal regulation concerning market abuse.

Proposal for further harmonisation of the Transparency Directive

In October, the Commission proposed amendments to the Transparency Directive on the basis of a review of the operation of the Directive. The Commission's proposal would harmonise regulation concerning the obligation to disclose holdings across the EU, but permitting national legislation to impose stricter disclosure thresholds. The proposal would also abolish the obligation to present quarterly financial reports, and listed companies would only need to publish half-yearly reports. However, stock exchange rules could still require the publication of quarterly financial reports.

Reassessment of the Markets in Financial Instruments Directive underway

In October, the Commission presented its proposals based on the review of the operation of the Markets in Financial Instruments Directive (MiFID). In addition to changes to the Directive, the Commission proposes that certain provisions of the Directive be replaced with a new EU Regulation.

The proposed changes aim to, for example,

- extend regulation to a wider selection of trading systems and facilities
- improve the transparency of trading activities
- improve small and medium-sized enterprises' access to capital markets and
- enhance investor protection by imposing stricter requirements for the offer of complex investment products.

The UCITS Directive transposed with amendments to the Act on Common Funds and FIN-FSA regulations and guidelines

Amendments to the Act on Common Funds based on changes to the UCITS Directive were approved in December and entered into force on 31 December. FIN-FSA regulations and guidelines on the organisation of investment fund activities, which implement the UCITS Directive, entered into force on 1 January 2012.

For investors, the most important change is that the simplified fund prospectus provided to investors is replaced by a Key Investor Information Document (KIID). The content, scope and format of this document are specified in detail in an EU Regulation, which facilitates, for example, better comparability of the risks and costs involved in various funds.

 For a model KIID, see: Financialcustomer.fi > **Financial products > Investments > Investment funds**

The amendments to the Investment Firms Act also enforced the Directive's broader requirements for the organisation of fund management companies' activities and risk management. In addition, management companies are obliged to report a wider range of data to FIN-FSA. At the same time, the legislative changes extended the scope of FIN-FSA's supervisory activities.

The new regulatory framework specifies and harmonises the organisation and conduct of fund operations in Europe. It enables cross-border activities for fund management companies by introducing management company passports. The Directive also enables cross-border mergers of funds. Differences in the legal forms of funds will no longer prevent mergers. The functioning of the passport requires that supervisors across Member States can rely on all countries maintaining the same level of supervision. In particular, fund management companies' activities and risk management must be organised in a reliable manner.

Alternative Investment Fund Managers Directive approved

The Directive on alternative investment fund managers (AIFMD) was approved on 8 June 2011. It must be transposed into national law by 22 July 2013.

The AIFMD pertains to alternative investment fund managers. The scope of application is broad and covers investment in private equity, real estate, commodity and hedge funds and other corresponding forms of collective investment. The Directive also regulates marketing of alternative investment funds to professional investors. Companies managing alternative investment funds are required to obtain authorisation. With a view to safeguarding the position of investors, the Directive imposes requirements on fund management companies for the organisation of operations, for example in respect of risk and liquidity management, designation of custodians and requirements regarding the disclosure of investor information.

The AIFMD extends supervision by FIN-FSA to new businesses. Companies managing special common funds, which have an authorisation granted under the UCITS Directive, need to apply for a separate authorisation to manage alternative investment funds falling within the scope of the AIFM Directive.

ESMA submitted its advice on level 2 measures pursuant to the AIFM Directive to the Commission in November 2011.

More harmonised regulation on short selling of securities and credit default swaps relating to sovereign debt

Political agreement was reached in November on an EU Regulation concerning short selling of securities and credit default swaps (CDS) relating to sovereign debt. The Regulation is due to enter into force on 1 November 2012. Current Finnish legislation and FIN-FSA guidelines do not specifically regulate short selling.

The Regulation harmonises disclosure requirements and restrictions relating to short positions throughout the EU. Depending on the size of the position, it obligates investors to notify their short positions to the authorities or disclose this information to the public. The regulation also prohibits uncovered short sales, ie short selling in situations where the investor has not ensured that the shares can be delivered for settlement at the due date. Authorities are given powers to ban short selling in exceptional circumstances. ESMA coordinates short selling prohibitions at EU level.

The Regulation is still to be complemented with level 2 legislation. ESMA is due to issue technical standards complementing the regulation in early 2012 and advise the Commission on the substance of complementary regulation.

Increased transparency in derivatives markets

The financial crisis demonstrated the failure of the markets and supervisors to obtain a clear overall view of OTC derivatives markets and the risks taken by different market participants. The Commission submitted in September 2010 a proposal for an EU Regulation seeking to increase the standardisation of OTC derivatives and central counterparty clearing, harmonise regulation on central counterparties, enhance transparency and ensure supervisors' access to information by obliging trading parties to report information on derivative contracts to trade repositories. The Commission, the Council and the European Parliament negotiated the substance of the Regulation throughout the review year. Negotiations have progressed in early 2012 and political agreement on the substance of the Regulation is expected to be reached in spring 2012. ESMA will submit technical standards regarding the regulation to the Commission by the end of September 2012.

Supervision of credit rating agencies transferred to ESMA

Supervision of credit rating agencies was transferred to ESMA on 1 July with amendments to the EU Regulation on credit rating agencies. The amended Regulation requires that, after a transitional period, credit ratings used for financial sector regulatory purposes, eg for capital adequacy calculations, must be issued by credit rating agencies registered in the EU area or in a third country whose legislation is equivalent to the EU Regulation. In December, ESMA decided to extend the transitional period to 30 April 2012.

In November, the Commission proposed its own amendments to the Regulation on credit rating agencies. The proposal aims to, for example, reduce overreliance on credit ratings, increase transparency on credit rating agencies' assessment methodologies, enhance competition in the credit ratings business and mitigate possible conflicts of interest within the business.

Financial transaction tax would undermine the position of financial markets in small countries

In autumn, the European Commission presented a proposal for a Directive on a new system of financial transaction tax. The Commission proposes that a transaction-specific tax be levied on all financial transactions. The tax rate would be 0.1% of the agreed transaction price. For derivative contracts the tax rate would be 0.01% of the notional amount of the contract. The scope of the proposed tax is relatively broad, as it would cover various financial instruments and derivative contracts in both regulated and non-regulated markets. Financial transaction tax would be levied on financial institutions on the basis of the residence principle, ie in the institution's home country.

FIN-FSA has taken a reserved stance on the introduction of the financial transaction tax due to the significant uncertainties involved. It is apparent that the proposed tax would weaken the international competitive position of small and remote financial markets such as Finland's. It is likely that the tax would result in the shift of transactions from countries within the scope of the tax to countries not subject to the tax. Among other effects, this could further weaken the functioning of stock markets in Finland and the competitive position of financial institutions operating solely on national markets relative to large international institutions. If the transaction tax is implemented, the geographical scope of application should be as wide as possible, preferably global.

Other regulatory projects

Improved customer protection in connection with packaged retail investment products

Efforts to improve customer protection in connection with packaged investment products marketed to retail investors (eg investment funds, unit-linked insurances and structured products⁸) are based on a horizontal legislative approach that covers information on both products and sales practices.

The Commission starts from the premise that customers should be provided with similar key pre-contractual information on the products irrespective of the product type (deposits, securities or insurance products). The Commission is scheduled to issue its legislative proposal by the end of April 2012.

Progress with significant IFRS projects slower than envisaged

Significant IFRS projects – financial instruments, insurance contracts, revenue recognition and lease agreements – did not advance according to the target dates set by the IASB. The revenue recognition proposal was revised and re-exposed for comments at the end of the year. Revised proposals concerning impairment and hedge accounting rules in the financial instrument standard as well as the revised proposals concerning insurance contracts and leases will also be exposed for comments. The IASB's⁹ target is that the revised accounting standards be fully effective as of early 2015. Delays with significant IFRS projects have also resulted in slower progress in the convergence of IFRS regulation and US accounting legislation, and a decision on the implementation of IFRSs in the United States has been postponed.

In April, EFRAG¹⁰ organised jointly with the IASB a training and hearing session in Helsinki on the first draft standards for revenue recognition and lease agreements. The event in Finland was targeted primarily at representatives of listed companies. Corresponding events have also been held in other European capitals. The aim of the events is to support the finalisation of standards prior to their adoption. The event was organised in cooperation with the Ministry of Employment and the Economy and the Confederation of Finnish Industries.

The Commission proposes substantial changes to auditing regulation

In November, the European Commission presented a proposal for a Directive amending the Statutory Audit Directive and a proposal for a Regulation incorporating the current and proposed stricter specific requirements on the statutory audit of public-interest entities. The amended Directive would extend the definition of public-interest entities. In addition to listed companies, banks and insurance companies, also covered would be investment firms, alternative investment funds, UCITS, payment institutions and central securities depositories.

The Commission proposes that supervisory cooperation by auditors at EU level take place within ESMA, which would be given regulatory powers in audit issues. ESMA would set up a permanent internal committee to deal with audit issues, and the members of the committee would comprise at least representatives of Member State authorities responsible for the supervision of auditors.

ESMA's task would be to issue recommendations and guidelines on issues such as

- reporting by auditors
- rotation and dismissal of auditors
- supervisory authorities' enforcement practices, quality assurance reviews, investigation, information exchange and
- cross-border cooperation with regard to quality assurance reviews.

The regulation also proposes that banking and insurance company supervisors would be under an obligation to regularly discuss supervisory matters with auditors.

⁸ Packaged Retail Investment Products, PRIIPs.

⁹ International Accounting Standards Board.

¹⁰ The European Financial Reporting Advisory Group is a private-sector body that issues comment letters to the IASB concerning IFRS regulatory changes from a European perspective and assists the European Commission in the endorsement of IFRSs in the EU.

Total number of supervised and other fee-paying entities

Fee-paying entities	31.12.2010	31.12.2011
Credit institutions	337	332
Investment firms	58	56
Fund management companies	35	35
Securities issuers	139	142
Stock exchange, clearing corporation	1	1
Finnish Central Securities Depository	1	1
Other fee-paying entities in the financial sector	29	37
Financial sector, total	600	604
Life insurance companies	11	11
Non-life insurance companies	21	21
Employee pension companies	7	7
Unemployment funds	34	32
Company and industry-wide pension funds	65	63
Sickness funds and other insurance funds	146	145
Insurance associations	70	63
Insurance brokers	63	68
Public sector pension funds	3	3
Other fee-paying entities in the insurance sector	42	44
Insurance sector, total	462	457
All supervised and other fee-paying entities, total	1,062	1,061

The Financial Supervisory Authority also supervises eg insurance agents and persons subject to the obligation to declare insider holdings.

Expenses and funding

Expenses and funding, EUR thousands	2010	2011*
Staff expenses	18,263	18,528
Staff-related expenses	869	872
Other expenses	3,551	3,871
Services	622	768
Real estate expenses	2,301	2,367
Other expenses	628	736
Depreciation	135	144
Bank of Finland services	2,530	2,685
Total expenses	25,348	26,100
Funding of operations, EUR thousands		
Supervision fees	23,047	23,513
Processing fees	960	997
Other income	69	0
Bank of Finland's contribution: 5% of expenses	1,267	1,305
Surplus carried over from the previous year	2,909	2,904
Surplus carried over to the next year	-2,904	-2,619
Total funding	25,348	26,100

*The figures for 2011 are unaudited and unconfirmed.

Set supervision fees, EUR thousands

Fee-paying entities	2010	2011
Credit institutions	11,095	11,919
Investment firms	955	1,019
Fund management companies	1,288	1,321
Securities issuers	2,213	2,020
Stock exchange, clearing corporation	439	368
Finnish Central Securities Depository	241	219
Other fee-paying entities in the financial sector	154	156
Financial sector, total	16,385	17,022
Life insurance companies	1,034	1,004
Non-life insurance companies	1,384	1,292
Employee pension companies	2,016	1,933
Unemployment funds	992	1,089
Company and industry-wide pension funds	331	269
Sickness funds and other insurance funds	120	107
Insurance associations	105	92
Insurance brokers	89	86
Public sector pension funds	448	453
Other fee-paying entities in the insurance sector	140	154
Insurance sector, total	6,659	6,479
Adjustment items carried over from previous years	3	12
Fee-paying entities, total	23,047	23,513

Processing fees, EUR thousands

Fee-paying entities	2010	2011
Credit institutions	147	133
Investment firms	49	61
Fund management companies	241	225
Securities issuers	160	162
Other fee-paying entities in the financial sector	17	69
Financial sector, total	614	650
Insurance companies ¹¹	23	30
Unemployment funds	19	15
Company and industry-wide pension funds	63	24
Sickness funds and other insurance funds	36	33
Insurance associations	20	32
Insurance brokers ¹²	178	202
Other fee-paying entities in the insurance sector	7	11
Insurance sector, total	346	347
Fee-paying entities, total	960	997

¹¹ Life, non-life and employee pension companies.

¹² Insurance brokers and agents.

The Financial Supervisory Authority's statutory responsibilities

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, the Financial Supervisory Authority 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. participate in cooperation, in the context of the European System of Financial Supervision, within the European Union, and 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;
10. monitor developments in the remuneration schemes of credit institutions and investment firms and provide information thereon to the Committee of European Banking Supervisors.

Parliamentary hearings and submissions on draft legislation

The Financial Supervisory Authority's experts were invited to hearings by various committees of the Finnish Parliament on 17 occasions. FIN-FSA gave 20 submissions on draft Finnish legislation and 62 other submissions in its field of competence.

Journal

Items initiated in the Journal in 2011 (main functions and their major categories)	Number
Governance	92
Regulation	51
Market supervision	2,436
Notifications; branches and cross-border activities	494
Articles of association, by-laws and regulations; confirmation and changes	269
Prospectuses	277
Letters by private citizens	174
Fit & Proper reports	151
Inspections	88
Authorisations; granting and expansion	33
Other	179
Domestic cooperation	75
International cooperation	41

In 2011, 2,758 entries were made in the Financial Supervisory Authority's Journal.

FIN-FSA's case management system was overhauled in 2011. The new system was introduced on 23 May 2011.

Representatives of the Financial Supervisory Authority on EU financial supervisory bodies

EBA

Board of Supervisors

Jukka Vesala, Deputy Director General, voting member
Anneli Tuominen, Director General, deputy member

Management Board

Jukka Vesala, Deputy Director General, voting member

Standing Committee on Regulation and Policy

Veli-Jukka Lehtonen, Head of Division, member

Standing Committee on Oversight and Practices

Marja Nykänen, Head of Department, member

Standing Committee on Accounting, Reporting and Auditing

Jaana Ladvelin, Head of Division, member

Standing Committee on Financial Innovation

Timo Peltonen, Head of Division, member

IT Sounding Board

Jaakko Mauranen, Head of Division, member

Impact Study Group

Olli Mattinen, Analyst, member

Stress Testing Task Force

Anton Tuomisalo, Analyst, member

Network on Equivalence

Juha Savela, Senior Risk Expert, member

Review Panel

Kaija Kilappa, Head of Division, member

EIOPA

Board of Supervisors

Anneli Tuominen, Director General, voting member
Hely Salomaa, Chief Advisor, deputy member

Solvency II preparatory committees:

Financial Requirements Expert Group

Pirkko Welin-Siikaluoma, Chief Actuary, member

Internal Models Expert Group

Laura Koskela, Researcher, member

Internal Governance, Review and Reporting Expert Group

Anne Hakkila, Legal Advisor, member

Insurance Groups Supervision Committee

Risto Poikajärvi, Senior Financial Supervisor, member

Committee on Consumer Protection and Financial Innovation

Erja Rautanen, Head of Department, member

Financial Stability Committee

Teija Korpiaho, Senior Risk Expert, member

Information Technology and Data Committee

Jaakko Mauranen, Head of Division, member

Occupational Pensions Committee

Tarja Taipalus, Chief Actuary, member

Review Panel

Eeva-Maija Österman, Legal Advisor, member

ESMA

Board of Supervisors

Anneli Tuominen, Director General, voting member
Jarmo Parkkonen, Head of Department, deputy member

Committee on Economic and Markets Analysis

Sampo Alhonsuo, Chief Analyst, member

Corporate Finance Standing Committee

Sari Helminen, Head of Division, member

Corporate Reporting Standing Committee

Tiina Visakorpi, Head of Division, member

ESMA-Pol Standing Committee

Laila Hietalahti, Market Supervisor, member

Financial Innovation Standing Committee

Anneli Tuominen, Director General, Chairman
Tero Oikarinen, Market Supervisor, member

Investment Management Standing Committee

Paula Kirppu, Market Supervisor, member

Investor Protection and Intermediaries Standing Committee

Anu Ranta, Market Supervisor, member

IT Management and Governance Group

Arja Voipio, Senior Advisor, Chairman

Jaakko Mäuranen, Head of Division, member

Post Trading Standing Committee

Arja Voipio, Senior Advisor, member

Review Panel

Olli Laurila, Senior Legal Advisor, member

Secondary Markets Standing Committee

Leena Savolainen, Market Supervisor, member

Takeover Bids Network

Ville Kajala, Market Supervisor, member

Joint Committee of the European Supervisory Authorities (EBA, ESMA and EIOPA)

Consumer Protection and Financial Innovation Sub-Committee

Anneli Tuominen, Director General, Chairman

Risk Sub-Committee

Jukka Vesala, Deputy Director General, Chairman

Anti-Money Laundering Committee

Tuija Nevalainen, Legal Advisor, member

Work Stream on the Methods of Consolidation for Financial Conglomerates

Marja Nykänen, Head of Department, Working Group
Chairman

ESRB

General Board

Anneli Tuominen, Director General, member

Advisory Technical Committee

Jukka Vesala, Deputy Director General, member

Publications, articles and annual statistics¹³

Date	Name of publication	Cut-off date	Publication/article/ annual statistics
17 March	Payments between bank accounts are processed in many systems		Article
14 April	Financial position and risks of supervised entities 1/2011	31 December 2010	Publication
14 April	Sample survey of housing loans		Publication
17 May	Consumers invest in capitalisation agreements – what is it all about?		Article
1 June	Capital adequacy of banking and insurance sector	31 March 2011	Publication
31 August	Insurance brokers 2010	31 December 2010	Annual statistics
12 September	The new Investment Fund Directive facilitates comparison between funds		Article
22 September	Insurance companies 2010	31 December 2010	Annual statistics
27 September	Financial position and risks of supervised entities 2/2011	30 June 2011	Publication
30 September	Unemployment funds 2010	31 December 2010	Annual statistics
31 October	Profitability analysis for statutory workers' compensation insurance in 2002–2010	31 December 2010	Publication
7 November	Customers' choices can often affect fees paid on basic banking services		Article
30 December	Risk is the flip side of share returns		Article
30 December	Do you know where you invest your money?		Article

 More statistical data is available at: **Fin-fsa.fi > Statistics**

¹³ Available in Finnish and Swedish only.

Press releases

Press releases and supervision releases, Markkinat (Markets, available in Finnish only), bulletins and news releases are available in full at [Fin-fsa.fi](http://fin-fsa.fi) > **Publications and press releases**. Below follows a list of the press release headings.

14 March 2011 | 1/2011

FIN-FSA Annual Report 2010: Proactive supervision to ward off financial and debt crisis threats

15 March 2011 | 2/2011

Results of the Quantitative Impact Study of the European insurance industry QIS5: Finnish insurance sector would meet the essential points of the new Solvency II capital adequacy requirements

14 April 2011 | 3/2011

Financial position and risks of supervised entities 1/2011 and a sample survey of housing loans: Risk-bearing capacity of Finnish financial sector strong, housing loan customers susceptible to interest rate risk

5 May 2011 | 4/2011

Incap Corporation reprimanded for neglect of the disclosure obligation as referred to in the EU Commission's Prospectus Regulation and the Securities Markets Act

5 May 2011 | 5/2011

Bank of Åland Plc reprimanded for neglect of disclosure of periodic information

1 June 2011 | 6/2011

The capital position of the Finnish banking and insurance sectors at 31 March 2011: The capital position of the Finnish banking and insurance sectors remained strong

15 July 2011 | 7/2011

EU-wide stress test confirmed the risk resilience of the largest banks operating in Finland

7 September 2011 | 8/2011

OP-Pohjola Group Central Cooperative reprimanded for failure to comply with the obligation to disclose major shareholdings and for the related lack of internal control

27 September 2011 | 9/2011

Financial position and risks of supervised entities 2/2011: Consequences of the debt crisis also reflected in Finland

27 October 2011 | 10/2011

EBA has assessed implications of debt crisis on banks' capital needs

23 November 2011 | 11/2011

FIN-FSA Board appointed for the next three-year term – one change in Board members

25 November 2011 | 12/2011

Capital position of banking and insurance sectors at 30 September 2011: Continued stability in the Finnish financial sector

8 December 2011 | 13/2011

EBA confirmed calculation of large banks' capital needs

Abbreviations

AIFMD, Alternative Investments Fund Managers Directive

CCP, central counterparty

CDS, Credit Default Swap

Core Tier 1 assets, core measure of capital adequacy (core capital, ie equity capital and disclosed reserves)

COREP, Common Reporting Framework, (capital adequacy reporting framework)

CRD, Capital Requirements Directive

CRR, Capital Requirements Regulation

EBA, European Banking Authority

ECB, European Central Bank

ECOFIN, The Economic and Financial Affairs Council

EFrag, European Financial Reporting Advisory Group (private sector body that issues comment letters to the IASB concerning IFRS regulatory amendments from a European perspective and assists the European Commission in the endorsement of IFRSs in the EU)

EIOPA, European Insurance and Occupational Pensions Authority

ESA, European Supervisory Authorities

ESMA, European Securities and Markets Authority

ESRB, European Systemic Risk Board

ETF, Exchange-Traded Fund

FINE, Finnish Financial Ombudsman Bureau

FSB, Financial Stability Board

G20, Group of Twenty (19 major economic countries plus the European Union)

GIIPS, Greece, Ireland, Italy, Portugal and Spain

G-SIFI, Global Systemically Important Financial Institutions

IASB, International Accounting Standards Board

IFRS, International Financial Reporting Standards

IMD2, The review of the Insurance Mediation Directive

IRBA, Internal Ratings Based Approach

KIID, Key Investor Information Document

MiFID, Markets in Financial Instruments Directive

OTC, Over the Counter (instruments traded outside regular exchanges)

PRIPs, Packaged Retail Investment Products

QIS, Quantitative Impact Study

RSC, Risk Sub-Committee (subcommittee of the Joint Committee of the ESAs)

SEPA, Single Euro Payments Area (all EU and EEA countries and Switzerland)

SHV, Actuary accredited by the Ministry of Social Affairs and Health

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

UCITS, Undertakings for Collective Investment in Transferable Securities

Virati, Joint electronic data collection system for Finnish authorities

EU Directives and Directive proposals referred to in the Annual Report

Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate; COM(2011) 453 (so-called CRD4)

Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms; COM(2011) 452 (so-called CRR)

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)

Proposal for a Directive of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority; COM(2011) 0008 (so-called Omnibus II Directive)

Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation

Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision

Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (so-called Prospectus Directive)

Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market

Proposal for a Regulation of the European Parliament and of the Council on insider dealing and market manipulation (market abuse); COM(2011) 651

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

Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities (so-called Transparency Directive)

Directive 2004/39/EC of the European Parliament and of the Council 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 (Markets in Financial Instruments Directive, MiFID)

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 (so-called UCITS IV)

Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (so-called AIFM Directive)

Proposal for a Regulation of the European Parliament and of the Council on Short Selling and certain aspects of Credit Default Swaps; COM(2010) 482

Proposal for a Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories; COM(2010) 484

Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies

Proposal for a Council Directive on a common system of financial transaction tax and amending Directive 2008/7/EC; COM(2011) 594

Proposal for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts; COM(2011) 778

Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities; COM(2011) 779

Nordic and Baltic supervisory authorities

- Finansinspektionen, Sweden, Fi.se
- Finanstilsynet, Norway, Finanstilsynet.no
- Finanstilsynet, Denmark, Finanstilsynet.dk
- Fjármálaeftirlitið, Iceland, Fme.is
- Finantsinspeksioon, Estonia, www.fi.ee
- Finanšu un kapitāla tirgus komisija, Latvia, fktk.lv
- Lietuvos Bankas, Lithuania, Lb.lt

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