



# Financial Market Report

## 3 • 2007

- Financial corporations post strong results in early part of the year
- Credit risk transfers have increased rapidly
- Subprime mortgages cause financial turbulence
- Large withdrawals – shrinking funds
- Step-up in the structural change of stock markets
- Countdown to TARGET2
- Financial and insurance supervision to be merged



Bank of Finland

Financial Markets and Statistics

29.10.2007

## Contents

1	Financial intermediation	4
1.1	Current developments in loans for house purchase	4
1.2	Financial innovations in the current decade focus on credit risk transfer	6
2	Banks and insurance corporations	8
2.1	Strong first half of 2007 for domestic banks	8
2.2	Nordic financial groups' results were good in the first half of 2007	10
2.3	Insurance corporations' profitability and solvency good in the first part of 2007	11
3	Securities markets	13
3.1	Exceptionally large withdrawals shrank fund assets in August	13
3.2	US subprime mortgages cause disturbances in the European financial markets	14
3.3	A busy week at the stock exchanges as structural changes continue	16
4	Infrastructure	18
4.1	Code of Conduct on securities trading enters second phase	18
4.2	Payment habits under pressure to change	20
4.3	Countdown to TARGET2 has begun – Finland to join in February 2008	21
5	Key regulatory and supervisory initiatives	23
5.1	Financial Supervision Authority and Insurance Supervisory Authority to merge	23
5.2	MiFID takes effect at the start of November	24
5.3	Other key projects in financial market legislation	25
6	Key corporate arrangements and events in the financial sector	27

### List of charts

Chart 1. Loans for house purchase: annual growth in the amount outstanding, and new drawdowns	4
Chart 2. New business on loans for house purchase	5
Chart 3. Share of new business on loans for house purchase tied to prime rates in the total amount of new business on loans for house purchase and the difference between average 12-month Euribor and prime rates	5
Chart 4. Nordic financial groups' market value at end-2006 and at end-September 2007	11
Chart 5. Life insurers' solvency ratio	12

### Project team

Jarmo Pesola  
Sampo Alhonsuo  
Jyrki Haajanen  
Kari Kemppainen  
Kimmo Koskinen  
Marko Myller  
Hanna Putkuri  
Pertti Pylkkönen  
Kirsi Ripatti  
Mikko Vuorikallio

### Coordination

Heikki Koskenkylä  
Kari Korhonen  
Kimmo Virolainen

### ISSN

1796-931X

Postal address  
PO Box 160  
FI-00101 HELSINKI, FINLAND

Street address Snellmanin aukio  
Phone +358 10 8311  
Fax +358 9 174 872

Email  
first.name.surname@bof.fi  
www.bof.fi

Swift SPFB FI HH  
Business ID 0202248-1  
Domicile Helsinki

Chart 6. Net subscriptions in domestic mutual funds	13
Chart 7. Development of the value of subprime-linked CDS indices	15
Chart 8. Price of collateralised and non-collateralised money on the Euro area interbank market	15
Chart 9. Value of cross-border TARGET payments in EU15 relative to GDP, quarterly data	21

### List of tables

Table 1. Credit default swaps (CDS) globally at end-2006, USD bn	7
Table 2. Key items from banks' income statements in January–June 2007	9
Table 3. Pre-tax profits and balance sheet of large Nordic financial groups	10
Table 4. Financial ratios of large Nordic financial groups	10

# 1 Financial intermediation

## 1.1 Current developments in loans for house purchase

Kimmo Koskinen

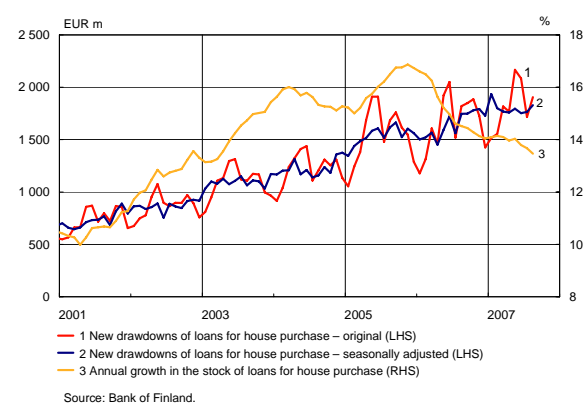
**Growth in the stock of loans for house purchase continued its moderate slowing during the summer. The average interest rate on the stock of loans for house purchase has risen to 4.85%. The share of new business on loans for house purchase tied to prime interest rates is again rising modestly.**

The annual growth in the stock of loans for house purchase continued to slow during the summer 2007. It was 13.5% in August, down from 14.0% in May. The annual growth in the stock of loans for house purchase had remained broadly unchanged, at ca 14%, since October 2006. The growth rate peaked at 16.8% in October 2005 – the fastest rate in recent years.

New business on loans for house purchase totalled EUR 2.6 billion in August, and new drawdowns of loans for house purchase amounted to EUR 1.9 billion. In looking at the volume of loans for house purchase one should take into account the strong seasonal fluctuations in the series. The amount of new drawdowns of loans for house purchase is particularly high in May–June and September–October. The seasonally adjusted figures show that the new business

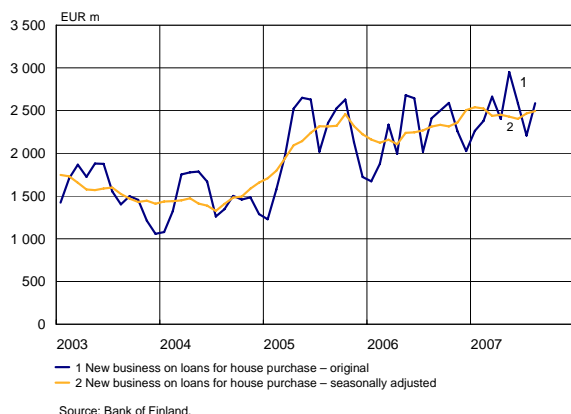
on loans for house purchase and the new drawdowns of loans for house purchase have been declining slightly from their peak in the first part of 2007.

Chart 1. Loans for house purchase: annual growth in the amount outstanding, and new drawdowns



The average interest rate on the stock of loans for house purchase was 4.85% in August and has risen by 52 basis points since January 2007. The average interest rate on new business on loans for house purchase was in August 4.91%, and the average interest rate on new drawdowns was 4.95%.

Chart 2. New business on loans for house purchase

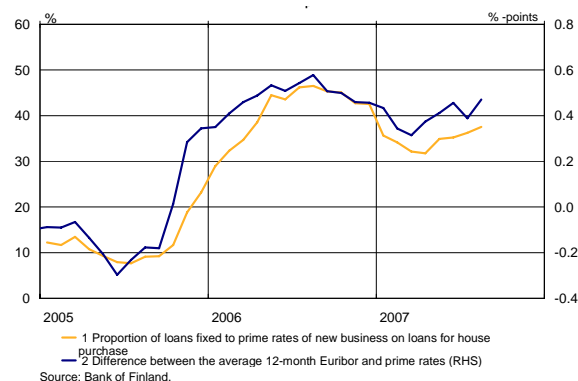


The majority of loans for house purchase are still tied to Euribor rates. In August, ca 58.7% of new business on loans for house purchase was tied to Euribor rates. The second most popular reference rates are still the banks' prime rates. In August, ca 37.5% of the new business on loans for house purchase was tied to prime rates. The share of prime rates grew slightly in summer 2007, probably due to the faster rise in Euribor rates versus prime rates.

Since August, only the following banks have raised their prime rates: Bank of Åland to 4.65%, savings banks to 4.25%, Aktia Savings Bank plc to 4.50%, Tapiola Bank Ltd to 4.25%, and the Hypo Group to 4.50%.

In August, the average prime rate was ca 4.2% and the average 12-month Euribor rate was 4.7%. It remains the case that only a very small proportion of new loans for house purchase are at fixed interest rates.

Chart 3. Share of new business on loans for house purchase tied to prime rates in the total amount of new business on loans for house purchase and the difference between average 12-month Euribor and prime rates



## 1.2 Financial innovations in the current decade focus on credit risk transfer

**Jarmo Pesola**

**Techniques for packaging and transferring credit risk, ie credit derivatives instruments, have increased as a result of innovations, and the trading volumes of credit derivatives have grown robustly. Growth in volume has been particularly strong in recent years.**

The simplest way of transferring credit risk has been to resell credit or to obtain a guarantee or insurance on it. Since the mid-1980, banks have been able to transfer credit risk to the market by using various securitisation instruments such as asset backed securities (ABS) or collateralised debt obligations (CDO). These can be issued in tranches, which differ in credit rating.<sup>1</sup>

But securitisation is very costly because of the 'special purpose vehicle' structure employed. The use of credit derivatives facilitates the transfer of credit risk, because it enables one to bypass the special purpose vehicle structure. The credit risk transfer technique is chosen based on eg liquidity needs and differences in regulation and legislation.

Most trading on credit derivatives market is in credit default swaps (CDS), CDS indices and synthetic CDO structures. In 2006, these accounted for 33%,

<sup>1</sup> For more information on securitisation techniques, see eg Taipalus-Korhonen-Pylkkönen: Arvopaperistaminen (Securitisation), Bank of Finland studies A:104.

30%, and 16%, respectively, of the global credit derivatives market.<sup>2</sup>

In a typical CDS contract, the creditor transfers to another counterparty the risk associated with the credit exposure of one debtor. The creditor buys protection against the realisation of credit risk, and the other assumes the credit risk. The protection buyer pays a regular fee to the protection seller until the contract expires or the credit risk is realised. Upon realisation of the risk, the protection buyer submits to the protection seller the debtor's debt corresponding to the nominal value of the contract, and the protection seller pays the protection buyer that amount.

In connection with statistics on OTC derivatives, the Bank for International Settlements (BIS) has since 2004 compiled statistics on the global use of CDS.<sup>3</sup> Table 1 shows the nominal or notional value of credit default swaps and their gross<sup>4</sup> market value. The gross market value shows the instrument's transferred financing risk that would materialise if settlement according to the contract were to take place at the time the statistics were compiled. Gross market value can thus be considered more comparable than nominal value relative to other economic statistics.

The table shows that credit default swaps more than doubled in 2005 and 2006. Their rate of growth has exceeded that of total OTC derivatives. The proportion of CDS in the total value of OTC derivatives (USD 415,183 bn) thus reached nearly 7% at the end of 2006.

<sup>2</sup> British Bankers' Association: Credit Derivatives Report 2006.

<sup>3</sup> Bank for International Settlements, Monetary and Economic Department: OTC derivatives market activity in the second half of 2006. May 2007.

<sup>4</sup> Here, gross value means that contracts with positive and negative replacement values with the same counterparty are not netted.

The rate of growth of credit derivatives has significantly accelerated in recent years. A regular survey by the British Bankers' Association shows that the total value of credit derivatives grew on average 100% per annum in 2004–2006. In the previous period (1998–2004) their value grew on average 56% annually.

The rapidly growing importance of credit derivatives is also revealed by comparing average growth of the credit stock over the same period. For example in the United States and the United Kingdom, the annual growth of the credit stock in 1998–2006 was on average 8% and 10%, respectively, and in Germany only ca 1%.<sup>5</sup>

Table 1. Credit default swaps (CDS) globally at end-2006, USD bn

	2004	2005	2006	Average growth (%)
Nominal value	6 396	13 908	28 838	112
Market value, gross	133	243	470	88
Proportion (%) of nominal value of total OTC derivatives	2.5	4.7	6.9	

Source: BIS Monetary and Economic Department: OTC derivatives market activity in the second half of 2006, May 2007.

<sup>5</sup> Average annual growth in the Domestic Credit stock in the countries in question. Statistic included in the IMF International Financial Statistics.

## 2 Banks and insurance corporations

### 2.1 Strong first half of 2007 for domestic banks

**Hanna Putkuri**

#### **Strong growth in income improved banks' profitability and cost efficiency in the first half of 2007.**

The first half of the year was favourable for Finnish banking business. Finnish banking and financial groups' total operating profit in January–June exceeded EUR 2 billion (up by 41% on the year-earlier period). The improved results are partly due to non-recurring income linked to structural changes. The most significant non-recurring item was the EUR 460.6 million capital gain by Sampo Bank Group on the sale of its Baltic subsidiaries to its parent company Danske Bank and the sale of Mandatum & Co Ltd to Danske Bank's Helsinki branch. Aktia Group's operating profit grew due to the start-up of life-insurance operations in January 2007. Excluding these items, banks' total operating profit would have grown by 7% in the first half of the year.

The total operating profit for Finnish banking business (a narrower concept than the above, see Table 2) grew to just over EUR 1 billion, up by 20% on the first half of 2006. Finnish banking business income grew strongly, driven by both net

interest income and other income. Growth in net interest income was based on rising market interest rates and continued strong demand for credit. Net fee income grew as demand for various savings and investment products also remained strong.

Favourable developments in income masked an accelerating rise in expenses. Growth in staff expenses was mainly due to rising wages and performance-linked bonuses. Other expenses were boosted by expanding business operations. Banks (net) impairment losses on loans and other commitments and other financial assets remained moderate.

Banks' capital adequacy remained good. Introduction of the Basel II capital adequacy calculation methods has not caused major changes in capital adequacy ratios. Some of the banks still use Basel I methods.

The insurance business of financial and insurance conglomerates operating in Finland was highly profitable. The improved results for both non-life and life insurance were mainly due to higher net investment income.

Current estimates indicate that the US mortgage problems which erupted in the summer will have only a small impact on Finnish banking business. According to a survey conducted by the Finnish Financial Supervision Authority in August<sup>6</sup>,

---

<sup>6</sup> FSA Newline 4/2007 economic issue.



Finnish banks' direct investments in instruments with subprime risk are minor. Nor have Finnish

banks invested significantly in hedge or equity funds or financed their funding sources.

Table 2. Key items from banks' income statements in January–June 2007

	Net interest income		Other income, net		Total expenses		Operating profit	
	EUR m	Change	EUR m	Change	EUR m	Change	EUR m	Change
Nordea Group	2 047	9 %	1 785	8 %	2 000	6 %	1 873	5 %
Retail banking	1 677	8 %	991	4 %	1 388	5 %	1 349	7 %
Retail banking in Finland	483	15 %	279	16 %	339	4 %	458	34 %
Life insurance	-	-	153	13 %	81	-2 %	72	36 %
*Nordea Pankki Finland Group	797	23 %	382	-25 %	452	6 %	743	-2 %
Danske Bank Group	1 581	11 %	1 452	13 %	1 682	13 %	1 350	5 %
Banking	1 390	13 %	759	2 %	1 333	8 %	815	3 %
Banking in Finland**	182	6 %	87	2 %	202	36 %	66	-44 %
*Sampo Bank Group	183	16 %	653	207 %	233	17 %	582	230 %
OP Bank Group	509	22 %	648	17 %	579	5 %	523	35 %
Banking and investment services	502	19 %	331	10 %	411	6 %	368	20 %
Non-life insurance	-	-	234	23 %	150	4 %	83	77 %
Life insurance	-	-	107	51 %	30	-19 %	77	129 %
*OKO Bank Group	58	12 %	335	18 %	228	9 %	165	31 %
Savings banks (excl. Aktia)	77	25 %	38	41 %	59	7 %	56	66 %
Aktia Savings Bank plc (Group)	42	2 %	110	321 %	112	164 %	41	58 %
Retail banking	31	-3 %	16	17 %	36	12 %	10	-21 %
Life insurance	-	-	112	-	96	-	15	-
Local cooperative banks	53	23 %	15	6 %	36	2 %	31	41 %
Bank of Åland plc (Group)	19	19 %	19	32 %	22	14 %	16	42 %
Evli Bank Group	1	80 %	43	75 %	25	5 %	10	-
eQ Group	4	58 %	23	7 %	18	27 %	8	-12 %
1. Finnish banking business	1 351	15 %	851	15 %	1 149	10 %	1 023	20 %
2. Finnish banking and financial groups	1 685	21 %	1 932	38 %	1 538	12 %	2 009	41 %
3. Financial conglomerates operating in Finland	4 332	11 %	4 134	14 %	4 534	10 %	3 907	10 %

Other income includes eg net fee income, capital gains/losses from sale of tangible and intangible assets, capital gains from sale of wound-up operations, and shares in profits/losses of associated companies. Expenses include depreciation and write-downs on tangible and intangible assets.

The various items do not equal operating profit, as some profit and loss account items (impairment losses, refunds to shareholders and customers and profit distributions to staff) are not included in the table figures.

\*\* Includes the Group's branch office in Helsinki, and Sampo Bank Group's banking business in Finland in February–June. The percentage change was calculated on comparable (pro forma) figures for January–June 2006.

1. Savings banks, Aktia Group's retail banking business, local cooperative banks, Bank of Åland Group, Evli Bank Group, eQ Group, OP Bank Group's banking and investment services, Danske Bank Group's banking business in Finland, and Nordea Group's retail banking in Finland.

2. Savings banks, Aktia Group, local cooperative banks, Bank of Åland Group, Evli Bank Group, eQ Group, OP Bank Group, Sampo Bank Group, and Nordea Bank Finland Group.

3. Danske Bank Group, Nordea Group, and Finnish banking and financial groups (excl. Nordea Bank Finland and Sampo Bank).

Source: Banks' interim reports.

## 2.2 Nordic financial groups' results were good in the first half of 2007

### Sampo Alhonsuo

**In the first half of 2007, large Nordic financial groups posted good results. Growth in income exceeded growth in expenses, and loan losses were minimal. Capital adequacy has been steady, driven by good results.**

Financial results for the largest Nordic banking and financial groups developed positively in the first half of 2007. The drivers were economic growth, favourable developments in the capital markets, and expansionary strategies.

Growth in income exceeded growth in expenses in the first part of the year. Rising interest rates, combined with the rapid growth in lending stock boosted net interest income. Demand for credit is still strong, and the lending stock has grown faster than deposits. Development in other income has also been mainly favourable, due to good market conditions. The amount of loan losses recorded has generally been very low. The groups have continued to strive for improved efficiency, despite rising expenses.

Financial performance varies between groups. For example, profits of Svenska Handelsbanken (SHB) declined on the previous year, mainly due to a reference-period change in the deferred capital contribution in insurance operations and non-recurring items in the reference period.

Table 3. Pre-tax profits and balance sheet of large Nordic financial groups

	Jan-Jun 2007 EUR m	Change on reference period 2006, %	Year 2006 EUR m	Total assets 30.6.2007 EUR bn
Danske Bank	1 350	5	2 807	412.3
Sampo Bank	528	230	354	25.8
Nordea Group	1 873	5	3 820	375.0
Nordea Bank Finland Group	743	-2	1 639	137.0
SEB	946	15	1 690	236.8
SHB	921	-7	1 864	212.7
DnBNOR	939	3	1 805	178.3
Swedbank	848	18	1 549	161.8
OP Bank Group	523	34	800	63.4
OKO Bank Group	165	31	223	25.1
Kaupthing	647	51	1 151	54.2

Sources: Groups' interim reports. Income statement figures have been converted to euro using exchange rates for January–June 2007, and total assets have been converted using the exchange rate at 30 June 2007.

Danske Bank's results are burdened by costs arising from integration of Sampo Bank into the Group, estimated to total ca EUR 215 million. Sampo Bank's results and financial ratios for 2007 are significantly improved by the integration process and internal sales of subsidiaries in the Danske Bank Group. The profitability and efficiency ratios of Nordic financial groups are good or excellent.

Table 4. Financial ratios of large Nordic financial groups

	ROE, % 1-6/2007	ROE, % 1-6/2006	Expense/ income 1-6/2007	Capital adequacy Tier 1, % 30.6.2007	Capital adequacy Tier 1+2, % 30.6.2007
Danske Bank	15.9	16.6	55	6.7	9.7
Sampo Bank	79.8	34.3	28	9.2	11.7
Nordea Group	19.5	21.2	52	7.1	9.7
Nordea Bank Finland Group	9.4	9.3	38	13.7	15.5
SEB	19.8	19.8	56	8.1	10.5
SHB	20.0	23.4	44	7.0	10.0
DnBNOR	18.8	19.2	49	7.0	9.9
Swedbank	19.5	18.5	50	6.7	10.0
OP Bank Group	14.7	11.9	49	12.6	14.3
OKO Bank Group	12.8	5.2		8.0	13.3
Kaupthing	32.0	36.2	38	10.3	13.4

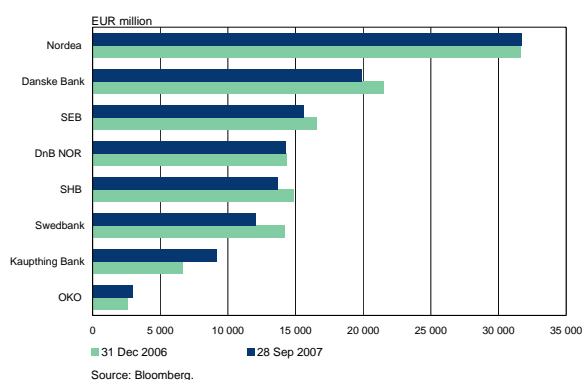
Sources: Groups' interim reports.

Typically, return on equity (ROE) is 15–20%, and 1 euro of costs yields ca EUR 2. But in terms of ROE, the profitability of many groups decreased on the year-earlier period.

The capital adequacy ratios of large groups are already affected (depending somewhat on the date of introduction and national transitional rules) by the Basel II reform on capital adequacy calculation. It is still too early to assess the impact the reform will have on the groups' capital adequacy, but eg the DnBNOR Group's capital adequacy, measured by core capital ratio (Tier 1, %), would be 0.5 percentage point higher than reported if calculated without using the transitional rules of the Basel II reform. Nordea Group's aim is to maintain the Tier 1 ratio above 6.5%. Good results have boosted the groups' capital buffers in recent years.

The turbulence and liquidity problems that commenced in the financial markets in August 2007 are also reflected negatively in the market values of Nordic financial groups. In their assessments of the possible losses resulting from the subprime mortgage problems, the groups have emphasised the indirect effect on business operations.

Chart 4. Nordic financial groups' market value at end-2006 and at end-September 2007



## 2.3 Insurance corporations' profitability and solvency good in the first part of 2007

Pertti Pylkkönen

**Companies in the insurance sector have on average very substantial solvency buffers against the recent turbulence in the financial markets.**

The favourable investment environment in the first half of 2007 bolstered financial results in the domestic insurance sector. The results continued to be mainly good. Income from insurance business and total results improved considerably, particularly for non-life insurers. Total results improved also for employee pension insurers.

Profitability in the non-life sector is good on average, due to favourable results in investment activities and an absence of major catastrophes. Improved profitability has boosted non-life insurers' solvency ratios. The solvency margin has increased relative to the minimum capital requirement, as has solvency capital relative to technical provisions. Risk carrying capacity has also improved.

The results improved for the majority of life insurance corporations that have published their results. Life insurers' total solvency ratio has declined slightly<sup>7</sup> (Chart 5).

Employee pension insurers' total results for January–June are relatively good, as a result of

<sup>7</sup> Solvency of insurance corporations and pension funds as at 30 June 2007. Insurance Supervisory Authority. Press release 5/2007 (in Finnish only).

investment income. Their total solvency ratio also improved in the period January–June 2007. On the other hand, investment risk has increased, due to the increasing weight of equity investment.

Chart 5. Life insurers' solvency ratio



Source: Insurance Supervisory Authority.

Overall, the solvency of the insurance sector at the end of June was very good. Solvency was boosted mainly by positive developments in the stock markets in the first part of the year. The situation may have deteriorated slightly in the recent turbulence in the financial markets. Insurance corporations' solvency buffers nevertheless seem strong enough, on average, to withstand the recent turbulence.

The growth of life insurers' premium income has been slow. In contrast, employee pension insurers' premium income has grown at a rapid pace, driven by improved employment and growth in aggregate wages.

Non-life and employee pension insurers' good results were also reflected in the growth of their investment stock in the first half of 2007. Employee pension insurers' investment stock grew by over 7%, to EUR 76 billion, and non-life insurers' investment stock grew by over 5%, to almost EUR 11 billion. Life insurers' investment stock has in 2007 grown by only a couple of million euro, to EUR 28.5 billion.

The structure of the investment portfolio differs considerably, depending on the insurance sector. For example, equity investments account for only just over

10% of non-life insurers' total investments, and for 15% of life insurers' total investments. In the investment portfolio of employee pension insurers, equity investments in 2007 exceeded bond investments. Equity investments already account for nearly half of the total investments, and the proportion of bonds has fallen to 37%.

Of the other investments, employee pension insurers have considerably increased their investments in hedge funds. At the turn of the year, investment in hedge funds totalled over EUR 3 billion, and in June they had already reached EUR 5.4 billion. Investments in hedge funds accounted for over 7% of total investments. Also life insurers increased their investments in hedge funds, which grew from EUR 0.7 billion to 1.4 billion in the first half of the year. Finnish insurance corporations' and pension institutions' direct investments in US subprime mortgage loans are minor or nonexistent. The industry's direct subprime exposures are also minor.<sup>8</sup>

Employee pension insurers also increased their capital investments substantially in 2007. In June, capital investments totalled EUR 1.6 billion, only one-sixth of which was in domestic investments. Life insurers' capital investments total EUR 1 billion, but they grew slowly in 2007.

Due to the nature of their operations, non-life insurers' hedge fund and capital investments are relatively small. In June, these investments totalled ca EUR 500 million. The focus of non-life insurers' investments is still on fixed-income instruments.

<sup>8</sup> Analysis of subprime risks and hedge fund investments in the insurance industry. Insurance Supervisory Authority. Press release 7/2007.

## 3 Securities markets

### 3.1 Exceptionally large withdrawals shrank fund assets in August

**Pertti Pykkönen**

**Turbulence in the global financial markets in August spread rapidly to the Finnish fund market. Over EUR 1 billion in fund assets was withdrawn in August<sup>9</sup>.**

Domestic funds' assets reached EUR 70 billion for the first time in July, and at the end of the month, they totalled over EUR 71 billion. However, the turbulence in the financial markets, which started in the United States, spread quickly also to the Finnish fund market, and fund assets decreased by over EUR 2.5 billion by the end of August.

As a result of the re-pricing of risks which started in June and growing uncertainties in the investment market, investors redeemed fund units on net by more than EUR 1 billion (Chart 6). At the same time, the value of fund assets decreased by over EUR 1.6 billion.

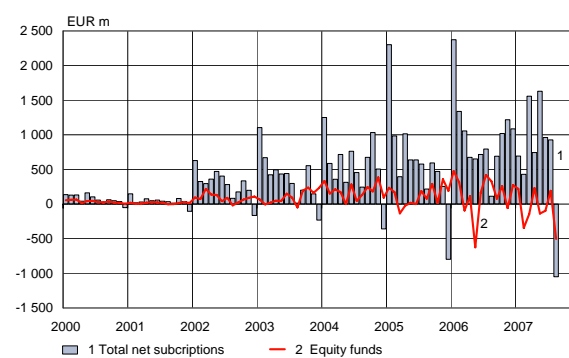
Investments were withdrawn from all types of funds. The majority of withdrawals were from equity funds, with net subscriptions totalling a negative EUR

<sup>9</sup> Mutual Fund Report, September 2007. The Finnish Association of Mutual Funds.

0.5 billion. A relatively large amount of assets (ca EUR 250 million) was withdrawn also from short-term funds. Withdrawals from short-term funds were primarily by large investors; even with negative net subscriptions, the number of investors investing in short-term bond funds increased by nearly 2,900 in August.

The wide differences in yields of short-term funds in August reveal major differences in investment strategies.

**Chart 6. Net subscriptions in domestic mutual funds**



For the majority of funds, returns were positive, but some fund management companies' short-term funds posted a clearly negative return. This suggests that some short-term funds had invested not only in traditional investment instruments but also in new investment instruments with higher levels of risk, for which they had to record value write-downs in August.

Assets were withdrawn also from long-term funds. Over EUR 200 million was withdrawn from long-term

funds investing in the euro area. Corporate funds and international long-term funds attracted some new investments.

From the other funds, over EUR 100 million was withdrawn. These withdrawals however focused on just a couple of funds, and there was no general haemorrhaging of funds. With a few exceptions, domestic hedge funds posted negative returns in August.

The total number of fund subscribers fell by nearly 10,000 in August.

### 3.2 US subprime mortgages cause disturbances in the European financial markets

**Jyrki Haajanen**

**Recent disturbances in the financial markets have been the result of growing problems in the US subprime mortgage market. The problems have had a surprisingly heavy impact on the European money market. Events have highlighted the challenges in banks' risk transferring and innovative financial products.**

The amount of so-called subprime mortgages granted to households with low credit rating has increased robustly in the United States, particularly in recent years. This growing use of subprime mortgages reflects rising housing prices and tight credit-granting conditions on standard mortgages. As housing prices rose, the terms and conditions of mortgages left an

increasing part of the population unable to acquire housing.

Regulatory changes in the late 1980s and the development of new financial products enabled the loosening of the terms and conditions of credit and made taking out a mortgage possible for an increasing number of relatively poor and low-income households. The customers – previously considered too risky by many mortgage issuers – were now granted a mortgage by either the new special credit institutions or banks. This resulted in robust growth in numbers of home owners, housing prices and hence in the stock of mortgages.

The subprime problem became exacerbated around the middle of the current decade. At that time, rapidly rising housing prices, relative to the growth in income, made it again impossible for a growing number of households to acquire housing.

To solve the problem, new forms of loans were developed. These special credits include very low repayments in the early years. At first, the borrower hardly has to pay either principal or interest, and in many cases, the loan principal actually increases over the first years, due to the fact that repayments are loaded onto the latter part of the repayment schedule.

According to estimates ca 90% (USD 550 bn) of the subprime mortgages granted in 2006 is special credit based on low repayments in the first part of the loan period. The problem remained hidden as long as interest rates were low and housing prices (and collateral values) continued to rise. The situation changed in the second half of 2006 and payment defaults started to emerge at an increasing speed.

#### **Why have US subprime mortgage problems spilled over to Europe?**

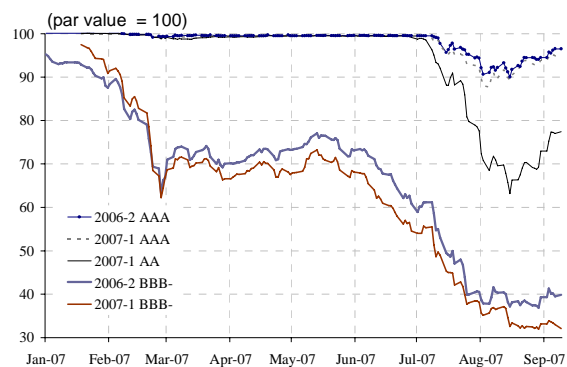
European banks have also become exposed to the US mortgage market risks. Banks have, via their US

subsidiaries, granted direct mortgages and invested in securities linked to mortgages. The amount of subprime mortgages granted by European banks is nevertheless quite small.

Securities investments have usually been made via conduits and structured investment vehicles, which have financed their operations mainly from the money market by issuing asset-backed commercial paper. According to a BIS estimate, ca USD 300 bn of the asset-backed commercial paper market<sup>10</sup> is tied to US mortgage securities. There is however no exact information on how high a proportion of this amount is tied to the higher-risk subprime mortgages.

The decline in prices of securities used as collateral for the commercial papers (Chart 7) caused financing difficulties for many conduits and structured investment vehicles.

Chart 7. Development of the value of subprime-linked CDS indices



Source: JP Morgan Chase & Co.

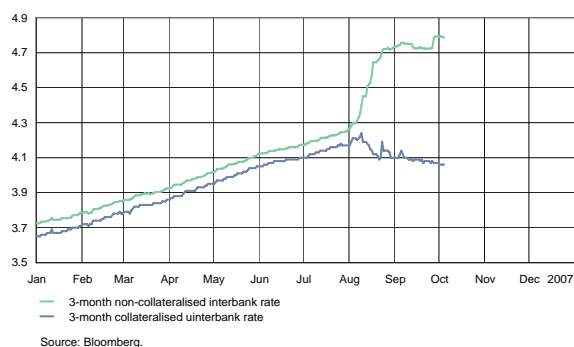
The companies had problems renewing the commercial paper programmes, and they faced liquidity problems. Some banks had however guaranteed continued financing and came to the rescue by granting additional financing when market financing dried up. This created market turbulence and

<sup>10</sup> The market for asset-backed commercial papers totals ca USD 1,500 billion (BIS Quarterly Review, September 2007).

speculation about the actual size of the problems and the location of the risks.

The uncertainty and increasing doubts were quickly reflected in a widening interest rate spread between collateralised and non-collateralised credit on the interbank money market (Chart 8).

Chart 8. Price of collateralised and non-collateralised money on the Euro area interbank market



Source: Bloomberg.

The subprime mortgage problems ignited the market's smouldering suspicions regarding new complex financing arrangements.

Previously, banks had held the majority of risks on their balance sheets, but in recent years, banks have removed a significant amount of risks from their balance sheets. The majority of interest rate risk has been transferred to households and companies, and credit risk has increasingly moved out of the banking sector. The speed of developments is evidenced by the explosive growth of the credit derivatives market (see sub-section 1.2).

### 3.3 A busy week at the stock exchanges as structural changes continue

**Marko Myller**

**The 'swallow or be swallowed' game between stock exchanges continues. The focus of attention has shifted to the Nordic countries, with the OMX Group getting its turn in the global integration of exchanges. This coincides with completion of the merger between parent companies of the London and Milan stock exchanges.**

OMX, which has actively promoted the merging of Nordic and Baltic exchanges and has recently turned its interest to Eastern Europe has now itself become an acquisition target. There are three owner candidates, and speculation on possible owners has been going on for quite some time, and this has affected the valuation of an OMX share. In May 2007, the US company Nasdaq Stock Market Inc. announced that it would make a cash and share tender for OMX. The planned merger was stirred up by Borse Dubai, which in August acquired a 4.9% stake in OMX and announced that it had signed an option agreement on the purchase of a further 23% stake. In September, Nasdaq and Borse Dubai entered into a cooperation agreement<sup>11</sup>, following entry into the melee by the state-owned Qatar Holding LLC, which acquired a nearly 10% stake in OMX.

Earlier this year, Nasdaq gave up its plans to merge with the London Stock Exchange (LSE), and in August it divested its 31% stake in LSE.<sup>12</sup> The reason

<sup>11</sup> Press release by Nasdaq and Borse Dubai, 20 September 2007.

<sup>12</sup> Financial Times, 20 August 2007.

given for the withdrawal was that the divestment was that the investment did not sufficiently reflect in the level of valuation of Nasdaq shares. Of Nasdaq's stake, 28% was acquired by Borse Dubai and the remainder by the Qatar Holding company, which raised its stake in the LSE to ca 23%.

The merger between the London Stock Exchange Group plc and Borsa Italiana S.p.A. was completed on 1 October 2007<sup>13</sup>. The annual general meeting of the London Stock Exchange Group plc in August voted almost unanimously in favour of the merger.<sup>14</sup> Borsa Italiana also accepted the offer and the necessary amendments to the bylaws of Borsa Italiana.<sup>15</sup> The amendments were approved by Italy's financial market supervisory authority in late August.<sup>16</sup> The shareholders of the London Stock Exchange Group plc hold 72% and the shareholders of Borsa Italiana S.p.A. hold 28% of the shares in the new group. The Borsa Italiana group also includes a local central securities depository (Monte Titoli) and a central counterparty (Cassa di Compensazione e Garanzia S.p.A). Although the London Stock Exchange had previously pushed hard for dismantlement of the so-called silo structures, the combined group's strategy does include provision of the most efficient post-trade services in Europe.

Structural changes in European stock exchanges continue and competition tightens. Attention is focused on the three remaining significant and independent stock exchange operators (Deutsche Börse, Swiss Exchange, and the Spanish BME), which are possible parties to the next round of mergers.

<sup>13</sup> London Stock Exchange Group plc, press release 1 October 2007.

<sup>14</sup> London Stock Exchange Group plc, press release 8 August 2007.

<sup>15</sup> Borsa Italiana S.p.A, press release 8 August 2007.

<sup>16</sup> Commissione Nazionale per le Società e la Borsa 27 August 2007.



Introduction of the MiFID<sup>17</sup> in November also creates challenges to the stock exchanges. The MiFID enables internal execution of trades and creation of alternative marketplaces.

### The MiFID era begins

The project initiated by seven large investment banks<sup>18</sup> (Project Turquoise)<sup>19</sup> on the creation of an alternative marketplace has been delayed.<sup>20</sup> The plan was to launch the trading facility in November 2007, but it has been postponed until the second quarter of 2008. The aim is to include in the trading facility the 350 most traded shares in Europe. BNP Paribas has already announced it will join the trading facility, and other banks may be looking at the prospect. The project is probably motivated by eg the banks' eagerness to reduce high trading costs. Thus far no Nordic banks have announced their participation in the trading facility.

---

<sup>17</sup> Markets in Financial Instruments Directive, see sub-section 5.2.

<sup>18</sup> Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, Merrill Lynch, Morgan Stanley, and UBS.

<sup>19</sup> Financial Market Report 2/2007.

<sup>20</sup> <http://www.finextra.com>, 7 August 2007.

## 4 Infrastructure

### 4.1 Code of Conduct on securities trading enters second phase

**Mikko Vuorikallio**

**Implementation of the Code of Conduct, aimed at increasing the efficiency of securities clearing and settlement, has entered the second phase.**

Charlie McCreevy, the European Commissioner for Internal Market and Services, announced in summer 2006 that he favours a market participant-led approach for creating efficient and safe clearing and settlement principles for the EU.<sup>21</sup> In response to the Commissioner's call, the three largest industry associations prepared a Code of Conduct.<sup>22</sup> The Code of Conduct is not inconsistent with provisions on clearing and settlement in the Directive on Markets in

Financial Instruments (MiFID)<sup>23</sup>, but is instead complementary to these.<sup>24</sup>

The Code of Conduct focuses on the transparency of pricing and services, the interoperability of clearing and settlement systems, open access to services, and on accounting separation of central securities depositories' separately defined services. Measures to increase pricing transparency were introduced at the end of 2006, and measures to achieve open access to services and interoperability were implemented at the end of June 2007. Accounting and pricing separation shall be introduced by the end of 2007.

To support implementation of the second phase, the key industry associations published a Guideline<sup>25</sup> on procedures. The Guideline defines the principles and conditions for interoperability of clearing and settlement systems and open access to services. The general principle is that market participants shall ensure that measures introduced under the Guideline maintain the efficiency of financial markets.

<sup>21</sup> SPEECH/06/450.

<sup>22</sup> 'European Code of Conduct for Clearing and Settlement' (7 November 2006) by the Federation of European Securities Exchanges (FESE), European Association of Central Counterparty Clearing Houses (EACH) and European Central Securities Depositories Association (ECSDA).

<sup>23</sup> 2004/39/EC.

<sup>24</sup> According to the MiFID, market participants shall have the right to designate the system for the settlement of transactions (see Article 34, 'Access to central counterparty, clearing and settlement facilities and the right to designate settlement system', and Article 46, 'Provisions regarding central counterparty and clearing and settlement arrangements').

<sup>25</sup> 'Access and Interoperability Guideline' (28 June 2007) by FESE, EACH and ECSDA.

In line with the Code of Conduct, the principles of the Guideline apply to market participants,<sup>26</sup> irrespective of their country of operations in the internal market. The Code of Conduct also stipulates that a market participant seeking access to services of another system shall comply with the local legislation and other regulations applicable to the other system. Moreover, the Guideline specifies that the service provider of the other system is under no obligation to change its market practices and standards towards its current users, unless mutually agreed. In addition, the service provider is not obliged to extend its product range.

The Guideline includes detailed and technical specifications on procedures, terms and conditions, and links between clearing and settlement parties. The key specifications relate to the relevant market participants as well as to the nature of links, i.e. how access to services is arranged for the participants requesting and using the services. The scope of the Guideline depends on the market participant's role in the clearing and settlement chain.

The Guideline also includes specific instructions on how market participants can seek access to systems maintained by other market participants, and on the mediation process for disputes concerning interpretation of the Code of Conduct and Guideline.

The aim of the Code of Conduct and the Guideline, designed for specifying the principles of the Code of Conduct, is to enhance clearing and settlement in regulated markets. Promoting open access to services and the interoperability of clearing and settlement systems should increase competition and reduce costs to end-users.

---

<sup>26</sup> The Guideline applies particularly to links between central securities depositories, central counterparties and trading venues.

Successful implementation of the Code of Conduct is essential for the further measures because the statement by the EU Commission welcoming self-regulatory measures also requires that the self-regulatory measures prove to be efficient.

The Code of Conduct is one of the measures promoting the efficiency of clearing and settlement in the EU. The others include the TARGET2-Securities initiative, promoting the dismantling of the Giovannini barriers, and the standards on clearing and settlement issued by the ESCB and the Committee of European Securities Regulators (CESR).

## 4.2 Payment habits under pressure to change

**Kari Kemppainen**

**Technological advance puts pressure on traditional payment methods. One of the trends is the electrification of payment transactions. The pace at which new technology comes on stream differs across countries. Some of the new and efficient payment methods are already in everyday use in the most advanced countries, and they will be introduced more widely in the near future.**

Technological advance and the opportunities afforded by it enhance the operation of financial markets and lower costs.<sup>27</sup> Technological advance also creates opportunities for payments and payment transfer that benefit both customers and service providers. New technologies as such do not enhance the operation of financial markets and payment systems. That requires also new and attractive solutions by service providers and customers' willingness to use these and to change their habits.

These issues were discussed in detail at the international seminar 'Payment Habits 2010+'<sup>28</sup> hosted by the Bank of Finland in August 2007. The seminar presentations underlined the view that both customers' payment habits and service providers' systems face

<sup>27</sup> See 'Technology-driven Efficiencies in Financial Markets', Bank of Finland publication A-106, 2006, [http://www.suomenpankki.fi/fi/julkaisut/selvitykset\\_ja\\_raportit/yleis\\_tajuiset\\_selvitykset/2006/a\\_110.htm](http://www.suomenpankki.fi/fi/julkaisut/selvitykset_ja_raportit/yleis_tajuiset_selvitykset/2006/a_110.htm)

<sup>28</sup> The seminar programme and presentations are available at: [http://www.bof.fi/en/rahoitusmarkkinat/kehityshankkeet/payment\\_habits\\_2010/seminar\\_2007/seminar2007.htm](http://www.bof.fi/en/rahoitusmarkkinat/kehityshankkeet/payment_habits_2010/seminar_2007/seminar2007.htm)

major challenges over the next decade. Along with technological developments and the launching of new applications by service providers, customers' readiness to use new electronic payment instruments is also improving. These factors create new challenges for traditional payment methods.

One payment instrument that has recently attracted wide attention is the e-invoice. In July 2007, the European Commission issued a final report on European e-invoicing.<sup>29</sup> The report underlines that European electronic invoicing is a driver of European competitiveness. The introduction of electronic invoicing could reduce costs by EUR 243 billion for Europe as a whole; it would also help streamline business processes and promote innovation. The report emphasises the importance of harmonisation for the provision of e-invoicing services in an open and interoperable manner across Europe.

An assessment of the future development of payment methods clearly shows that the progress of the SEPA (Single Euro Payments Area) initiative will promote the integration of European payment systems. This will naturally affect the payment methods and instruments offered to customers: some traditional ones will vanish from the market or undergo modification. In sum, new international and electronic payment methods will capture the market. The speed of progress however differs considerably across countries. In the most advanced countries, new electronic payment methods, eg the e-invoice, rapidly gain a foothold and enable cost savings at an early stage. These countries can then gain a competitive advantage.

<sup>29</sup> [http://ec.europa.eu/information\\_society/eeurope/i2010/docs/studies/eei-3.2-e-invoicing\\_final\\_report.pdf](http://ec.europa.eu/information_society/eeurope/i2010/docs/studies/eei-3.2-e-invoicing_final_report.pdf)

### 4.3 Countdown to TARGET2 has begun – Finland to join in February 2008

Kirsi Ripatti

**The changeover to TARGET2 will take place in three phases: the first group of countries migrates in 2007; the second group (incl. Finland) in February 2008, and the last group in May 2008.**

TARGET<sup>30</sup> can be considered the most important payment system in Europe due to its key role in the settlement of large-value payments and because all the major payment systems transfer funds via TARGET. In 2006, 89% (in terms of value) and 60% (in terms of volume) of large-value payments in euro was executed via TARGET. Relating it to total GDP of the EU15 countries shows how large TARGET is: the value of cross-border payments amounts to nearly 17.5% of total GDP. And the figure is set to rise with the changeover to the new system (Chart 9).

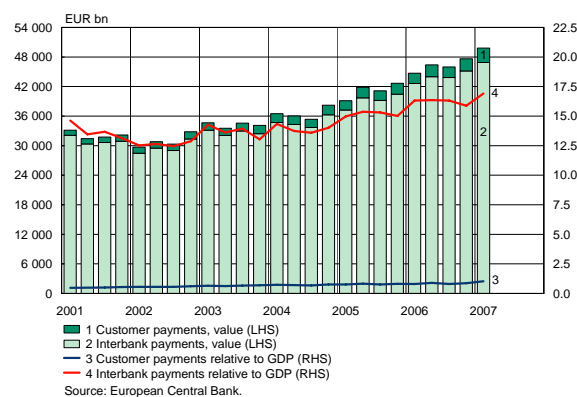
Participants use TARGET for executing payments in connection with money market, foreign exchange and securities transactions. The system can be used for interbank payments and customer payments.

Customer payments have also increased in the EU. While the number of customer payments has not increased in Finland, their total volume has grown despite the fact that banks are developing new and more efficient payment methods as part of the SEPA<sup>31</sup> project.

<sup>30</sup> Trans-European Automated Real-time Gross settlement Express Transfer.

<sup>31</sup> Single Euro Payments Area.

Chart 9. Value of cross-border TARGET payments in EU15 relative to GDP, quarterly data



TARGET2, the new generation of TARGET, is a technically centralised system with harmonised prices. Payments are processed on two platforms.

The planning of TARGET2 was initiated already in 2003. The purpose of TARGET2 is to facilitate particularly the cross-border payments in euro between multinational banks. The changeover to the new system will take place in three migration waves between November 2007 and May 2008. The first group of countries will migrate on 19 November 2007. The second group (incl. Finland) migrates on 18 February 2008, and the third group on 19 May 2008.

TARGET2 offers real-time gross settlement in central bank money for payments in euro. TARGET2 is based on a Single Shared Platform (SSP), instead of the current separate national RTGS<sup>32</sup> systems. The Eurosystem defines the technical specifications and properties of the Single Shared Platform. Three central banks (Germany, Italy and France) operating the platform, provide services to Eurosystem central banks based on separate agreements. The platform provides harmonised services, and it meets user requirements better than the current system. It provides not only

<sup>32</sup> Real-time gross settlement.

harmonised services but also a common pricing scheme and cost-efficient operations.<sup>33</sup>

In the migration stage, the Eurosystem aims at minimising the changes for account holders, project risk, and the costs to central banks and TARGET users. The task is challenging, due to the large number of different tests required by the migration and the tight timetable.

By changing over to TARGET2, central banks aim to enhance the efficiency of their systems and improve their services. The current TARGET will be shut down when all the countries<sup>34</sup> joining TARGET2 have successfully completed their migration operations.

Also under TARGET2, the national central banks will be responsible for account and business relationships with the financial institutions in their home countries. The Bank of Finland will coordinate its account holders' migration to the single shared platform. According to the migration schedule, the go-live date for Finland will be in February 2008. At the same time, the Bank of Finland will give up its own RTGS system.

---

<sup>33</sup> For more information on the TARGET2 project, see eg <http://www.ecb.int/paym/target/html/index.en.html>

<sup>34</sup> Belgium, Spain, the Netherlands, Ireland, Italy, Austria, Greece, Cyprus, Latvia, Lithuania, Luxembourg, Malta, Portugal, Poland, France, Germany, Slovenia, Finland, Denmark, and Estonia. The EPM (ECB Payment Mechanism) will also migrate to TARGET2.

## 5 Key regulatory and supervisory initiatives

### 5.1 Financial Supervision Authority and Insurance Supervisory Authority to merge

**Jyrki Haajanen**

**The major structural changes in the financial and insurance markets in recent years have created a need to reform financial supervision also in Finland.**

Integration, internationalisation, the liberalisation of regulation and technical advance has led to major structural changes in the financial and insurance markets. This has been reflected particularly in expansion of business units via mergers, acquisitions and other forms of corporate restructuring. New innovative products and increasing numbers of financial conglomerates have also blurred the traditional border between financial and insurance sectors. Characteristic of the Finnish markets is a considerable increase in foreign ownership and significant growth in investment assets managed by the insurance sector.

Rapid structural developments in the financial markets have rendered the supervision task

increasingly challenging and underlined the need for reorganising it. Financial supervision has two key objectives: to ensure financial stability and promote confidence in the operation of the financial market. Financial supervision in Finland is currently organised in the traditional manner, under two sector-specific authorities. In recent years, the international trend has however been to abandon the sector-specific supervisory model and to consolidate financial supervision, either under a single supervisory organisation or as a function-specific 'two-headed' model.

The need to reform financial supervision was also recognised in the Government Programme, which calls for merger of the Financial Supervision Authority and Insurance Supervisory Authority. The centralisation of supervisory resources in a single organisation is considered the best way of ensuring the level of competence needed for thorough assessment of supervised entities' risks and efficient utilisation of supervisory information.

The idea of the new supervisory system is that general responsibility for preparing legislation and responsibility for supervision should be kept separate. It is also important that the new authority be independent of the political process in its supervisory duties. The aim is not only to merge the two authorities but also to reform the supervisory process

to better respond to the rapid changes in progress in the markets.

The Ministry of Finance and the Ministry of Social Affairs and Health appointed a working group to prepare the merger. The group is to draft a proposal on how to organise the new financial and insurance supervision organisation, operating in connection with the Bank of Finland, so that it will be as effective, efficient, impartial and independent as possible. The group is also to draft legislation on the new financial and insurance supervision organisation and any other regulations required. The group is expected to complete its task by the end of March 2008. The new supervisory authority is to commence operations at the start of 2009.

## 5.2 MiFID<sup>35</sup> takes effect at the start of November

**Pertti Pykkönen**

**Amendments in national legislation based on the Directive on Markets in Financial Instruments (MiFID) will take effect at the beginning of November 2007. The scope of the asset transfer tax exemption will be extended to transactions in shares.**

Amendments to securities market legislation and other legislation, ie the amendments required by the MiFID directive will take effect at the beginning of November. The aim of the directive is to promote the integration and operation of European financial markets by removing barriers to the provision of

investment services and harmonising the regulatory framework of marketplaces.

The MiFID also aims to increase competition in the stock markets, between marketplaces and trading methods and to develop and harmonise regulations on investor protection.

The new Act on Investment Firms will replace the existing act and extend its scope. For small investors, the most significant reform is probably that the provision of investment advice will be subject to licensing.

The Securities Markets Act will also be amended. One of the major changes is that authorised securities exchanges, securities brokers and credit institutions will be allowed to establish alternative 'multilateral trading facilities'. This changes the competitive position of stock exchanges in Europe and will probably reduce trading costs. Brokers will increasingly prefer internal share trading to stock exchange trading. On the other hand, lower costs may also increase stock exchange trading.

The aim of the amendment is to promote small companies' acquisition of equity capital and create the conditions for trading their shares.

Extension of the scope of the Asset Transfer Tax Act is part of the transposition of MiFID. According to the current Act, exemption from asset transfer tax only applies to public trades under the Securities Markets Act, ie in practice to stock exchange trades. If the scope of application of the Asset Transfer Tax Act were not extended, trading on multilateral trading facilities and internal trading among securities brokers would be taxed. According to the Government bill, the tax exemption of share trades will be extended so that share trades on multilateral trading facilities would be exempt from tax provided the company has applied for listing on the trading facility in question and that the

<sup>35</sup> Markets in Financial Instruments Directive (Directive 2004/39/EC).



trade is executed via a securities broker. The amendments to the asset transfer tax are currently under discussion in Parliament, and they may enter into force at the same time as the amendments required by MiFID.

### 5.3 Other key projects in financial market legislation

**Jarmo Pesola**

#### Insurance Companies Act to be revised in 2008

A report published in November 2006 by the Insurance Companies Act 2005 working group, headed by the Ministry of Social Affairs and Health, proposes that the new Insurance Companies Act take account of the amendments to the Companies Act, as applicable. The proposed new legislation would take effect on 1 January 2008, and shall be entirely revamped, in accordance with the Companies Act.

The working group also proposes that the processing and granting of authorisation to life insurance and non-life insurance corporations be transferred from the Ministry of Social Affairs and Health to the Insurance Supervision Authority. For life insurance corporations, the group would like to see a new supervisory system and proactive supervision of solvency, based on analysis of the supervised entity's risk position and findings of the analysis. The working group also proposes convergence of the provisions on supervision and inspection rights of the Insurance Supervisory Authority and the Financial Supervision Authority.

#### Provisions of the directive on cross-border mergers to take effect by the end of 2007

The working group headed by the Ministry of Justice submitted in December 2006 its report on Finland's implementation of the directive on cross-border mergers of limited liability companies. The national provisions required by the directive shall enter into force by 15 December 2007. The entry into force may however be aligned with the wholly revised insurance company legislation at the beginning of 2008.

The report includes a proposal on the inclusion of provisions on cross-border mergers and demergers in the Companies Act, the Co-operatives Act, the Credit Institutions Act and other acts on financial operations. Under the new provisions, a Finnish company could take part in a cross-border merger or demerger involving the same type of companies from another EU state or a member state of the European Economic Area. Concerning financial market regulation, the working group took a particular interest in application of the provision to fund management companies.

#### Review of the deposit guarantee scheme

A project of the Ministry of Finance officers includes a review of Credit Institutions Act provisions on deposit guarantee funds. The new provisions are scheduled for introduction at the start of 2008.

The aim is to bring Finnish legislation on deposit guarantee schemes in line with ongoing changes in the Finnish financial markets and to ensure that deposit protection functions in a manner that maintains public confidence in the banking system also in changing conditions resulting from financial integration. The proposal also aims to improve the consumer protection of Finnish depositors and to simplify and clarify regulations on deposit protection.

### Legislation on the amalgamation of cooperative banks under review

The project initiated by the Ministry of Finance aims to prepare by the end of 2007 a Government bill on required legislative amendments. The Ministry of Finance is preparing the bill in cooperation with the Financial Supervision Authority, Ministry of Justice, and representatives of the member banks of the amalgamation of cooperative banks and other representatives of the industry.

The intent is to make the necessary amendments to the provisions on the amalgamation of cooperative banks included in Act on Cooperative Banks and Other Cooperative Credit Institutions. The proposed provisions aim to take account of changes in other legislation and in the market since entry into force of the current act in 1996.

### Anti-Money Laundering Directive to be implemented in December 2007

The directive on the prevention of the use of the financial system for the purpose of money laundering, including terrorist financing, and the 2<sup>nd</sup> level Commission directive on certain 'technical implementation definitions' is to be implemented by member states by 15 December 2007. A working group set up by the Ministry of the Interior is preparing a new act on money laundering and related legislative changes based on this minimum directive.

The directive harmonises and implements in EEA countries the recommendations issued by FATF<sup>36</sup>. According to the recommendations, companies providing currency exchange, payment transfer and corporate services shall be registered or their operations shall be subject to authorisation. Industries

---

<sup>36</sup> An intergovernmental Financial Action Task Force on Money Laundering and Terrorist Financing.

within the scope of money laundering legislation will also be given increasingly detailed responsibilities on customer due diligence and the nature of operations of its owners.

### Reform of the Real Estate Funds Act and Mutual Funds Act

Amendments to the Real Estate Funds Act and Mutual Funds Act entered into force on 1 May 2007. The primary aim of the reform was to promote the funds' real-estate investment activities by introducing alternative forms of real-estate investment into the market.

## 6 Key corporate arrangements and events in the financial sector

<i>Date</i>	<i>Event and description</i>
<b>January 2007</b>	<p><i>Pohjola Non-Life Insurance Company Ltd merges with OP Life Assurance Company Ltd at the start of 2007.</i></p> <p><i>Sampo Life merged its subsidiaries operating in the Baltic states into one company, SE Sampo Life Insurance Baltic. The company's domicile is Estonia.</i></p>
<b>February 2007</b>	<p><i>The Swedish bank Swedbank announces it will acquire the Ukrainian bank TAS-Kommerzbank for slightly over USD 700 million.</i></p> <p><i>FIM Group Corporation's main shareholders announce they will sell their 68.1% holding of share capital to Icelandic bank Glitnir banki hf. The transaction was finalised in March.</i></p> <p><i>Acquisition of Sampo Bank by Danske Bank Group was completed at the beginning of the month. S&amp;P raises the bank's short-term issuer rating from A-1 to A-1+, and long-term issuer rating from A to AA-. Moody's raises the bank's long-term issuer rating from A1 to Aa2.</i></p> <p><i>Moody's revises its bank rating methodology. As a result, Moody's upgrades OKO Bank's and Sampo Bank's long-term credit rating from Aa2 to Aaa. Nordea's (incl. Nordea Bank Finland) long-term credit rating is raised from Aa3 to Aaa. Aktia's short-term credit rating is upgraded from P-2 to P-1 and long-term rating from A3 to Aa2.</i></p>
<b>March 2007</b>	<p><i>Nordea acquires a 75.01% stake in the Russian bank JSB Orgresbank.</i></p> <p><i>Policyholder's of Kansa life insurance corporation to receive full compensation plus interest for their insurance premiums in 2007.</i></p> <p><i>Moody's downgrades M-Real's long-term credit rating from B2 to B3. Rating outlook stable. Also S&amp;P lowered M-Real's long-term credit rating, from B+ to B; rating outlook remains negative.</i></p>

<i>Date</i>	<i>Event and description</i>
<i>April 2007</i>	<p data-bbox="408 405 967 434"><i>Northern Rock opens a branch in Copenhagen.</i></p> <p data-bbox="408 490 1398 555"><i>The (25) companies listed on the Icelandic stock exchange become part of the Nordic List.</i></p> <p data-bbox="408 591 1398 752"><i>ABN AMRO and Barclays announce their agreement on a possible merger. A consortium formed by Fortis, Royal Bank of Scotland and Santander make a competing offer for the shares in ABN AMRO. In their offer updated in May, the consortium offers EUR 38.40 per ABN AMRO share, while Barclays offers EUR 34.87 per share.</i></p> <p data-bbox="408 788 1398 887"><i>Moody's revises bank ratings issued in February. The rating of Nordea Bank Finland's, OKO's and Sampo Bank's long-term senior bonds is lowered from Aaa to Aa1. Aktia is downgraded to A1.</i></p> <p data-bbox="408 922 1398 981"><i>The New York Stock Exchange and Euronext merge. The name of the new company is NYSE Euronext.</i></p> <p data-bbox="408 1016 1398 1081"><i>Life insurance company Duo commences operations. The company was established by the Savings Banks' Group and the insurance group Lähivakuutus.</i></p> <p data-bbox="408 1120 1398 1218"><i>The savings banks with a majority shareholding in Nooa Savings Bank redeem OKO Bank's shares in Nooa Savings Bank. Savings banks' holding in Nooa increases to 95%.</i></p> <p data-bbox="408 1254 1398 1312"><i>Skandia Life's insurance business, together with all the policies are devolved to Fennia Life Insurance Company Ltd.</i></p> <p data-bbox="408 1348 1398 1413"><i>Eurex and International Securities Exchange (ISE) announce they have signed a letter of intent on a merger. Eurex will acquire ISE for ca USD 2.8 billion.</i></p> <p data-bbox="408 1449 1398 1547"><i>OMX plans to acquire the Armenian Stock Exchange and the Central Depository of Armenia. OMX, the Central Bank of Armenia and the government of Armenia sign a letter of intent on the acquisition.</i></p>
<i>May 2007</i>	<p data-bbox="408 1583 1398 1648"><i>The Icelandic bank Straumur-Burdaras Investment Bank hf acquires a majority stake in eQ Corporation, for EUR 260 million.</i></p> <p data-bbox="408 1684 1398 1749"><i>UniCredit SpA acquires Capitalia SpA for EUR 21.8 billion. The new bank will be the largest in Italy and the second largest in Europe.</i></p> <p data-bbox="408 1785 1398 1850"><i>Banca Popolare di Milano acquires Banca Popolare dell'Emilia Romagna for EUR 5.7 billion.</i></p> <p data-bbox="408 1886 1398 1944"><i>Securities listed on the Luxembourg Stock Exchange migrate to the NSC trading platform provided by Euronext.</i></p>

<i>Date</i>	<i>Event and description</i>
	<p><i>The Oslo Stock Exchange and the central securities depository VPS agree on a merger.</i></p> <p><i>S&amp;P raises Metso Corporation's short- and long-term credit rating by a grade. Short-term from A-3 to A-2 and long-term from BBB- to BBB.</i></p> <p><i>Royal Sun &amp; Alliance Insurance Group offers DKK 6.4 billion for the remainder of shares in Codan A/S.</i></p> <p><i>The boards of directors of Nasdaq Stock Market Inc and OMX AB jointly announce that they have entered into an agreement to combine the two companies.</i></p> <p><i>E. Öhman J:or Securities Finland Ltd acquires Quorum Fund Management Company from its parent company Quorum Ltd. The new name of the fund management company is E. Öhman J:or Fund Management Finland Ltd.</i></p> <p><i>The US private equity firm Cerberus Capital Management acquires a 90% stake in the Austrian bank BAWAG.</i></p>
<b>June 2007</b>	<i>London Stock Exchange and Milan stock exchange (Borsa Italiana) announce plans to merge. The merger was completed at the beginning of October.</i>
<b>July 2007</b>	<p><i>Metso Corporation announces it will seek to delist from the New York Stock Exchange.</i></p> <p><i>Deutscher Sparkassen- und Giroverband purchases majority stake in Landesbank Berlin, for EUR 5.3 bn, as the City of Berlin sells its 81% stake.</i></p> <p><i>Deutsche Bank AG announces it will acquire Abbey Life Assurance Company Ltd from Lloyds TSB Group.</i></p> <p><i>S-Etuluotto Oy, established in 1999, merges with S-Bank Ltd.</i></p>
<b>August 2007</b>	<i>Landesbank Baden-Württemberg to buy Sachsen LB. Sachsen Finanzgruppe and the state of Saxony, the current owners of Sachsen LB, sell their stakes to LBBW and become joint owners of LBBW. Sachsen LB will be a subsidiary of LBBW.</i>
<b>September 2007</b>	<p><i>The name of OP Bank Group is changed to OP-Pohjola Group, and OKO Bank Plc will be changed to Pohjola Bank plc at the start of March 2008.</i></p> <p><i>Northern Rock forced to apply for emergency funding from the Bank of England due to liquidity problems.</i></p> <p><i>Norwegian financial services company Storebrand ASA announces it will acquire Handelsbanken's insurance subsidiary SPP, for EUR 1.9 bn.</i></p>

<i>Date</i>	<i>Event and description</i>
<b>October 2007</b>	<i>Handelsbanken seeks permission with the Swedish financial supervision authority to merge Stadshypotek Bank with Handelsbanken.</i>
	<i>S-Bank commences operations.</i>
	<i>Glitnir Bank (former FIM Securities Ltd) starts operations.</i>
	<i>The Financial Services Authority (FSA) of the United Kingdom increases the limit of Financial Service Compensation Scheme cover for deposits to 100% of the first GBP 35,000 of each depositor's claim. The previous cover for deposits was 100% of the first GBP 2,000 and 90% of the next GBP 33,000 of depositors' claim.</i>
	<i>Nasdaq announces it will acquire the Boston Stock Exchange.</i>
	<i>Nordea purchases ca 70 branches from Svensk Kassaservice, and will turn them into Nordea offices in 2008.</i>
	<i>ABN Amro completes sale of LaSalle Bank to Bank of America at the beginning of October.</i>
	<i>NetBank Inc. (established in 1996), the first US online bank, goes into liquidation. Ing Direct acquires NetBank's deposits of USD 1.4 bn for USD 14 million, and EverBank purchases NetBank's mortgages for USD 700 million.</i>