Annual Report

2000

RAHOITUSTARKASTUS
FINANSINSPEKTIONEN
FINANCIAL SUPERVISION

Director General's Review

The year 2000 saw a continuation of rapid economic growth in Finland. The euro drifted lower against the US dollar until the latter part of the year, when it began to appreciate, though it still ended the year weaker than it was a year earlier. The European Central Bank raised the interest rate on its main refinancing operations several times during the year, and these moves were reflected in market rates. In Finland the interest rate hikes led to a widening of banks' interest rate margins, as lending rates rose by considerably more than funding (ie deposit) rates. This helped to strengthen banks' net income from financial operations. Fee income also increased, and loan losses remained very small. Overall, these factors raised banks' profitability to a record high level, even though staff and other expenses increased somewhat.

Developments in the securities markets were quite mixed. Share prices fluctuated wildly, with those in the IT sector in particular declining sharply towards the end of the year. The same pattern has carried over into the early months of 2001. This can perhaps be considered to be the result of at least a partial bursting of a bubble that developed during a long period of irrational exuberance in the stock market. This was also reflected in a decline in equity offerings such that in the waning weeks of the year there were virtually no offerings at all. In fact this might be seen as a healthy development since there is good reason to suspect that at least some of the companies listed on the stock exchange may not have reached a sufficient level of maturity. Finland is not alone in this respect. The phenomenon is widespread.

The increased uncertainty was also reflected in the behaviour of market participants. The Financial Supervision Authority (FSA) was obliged to intervene regretfully often because of listed companies' laxity in informing the public. Nine requests for investigation were made to the police in connection with suspected crimes and misdemeanours related to the Securities Markets Act. We must continue to take a critical approach to corporate governance and internal management systems and their development. Certain incentive schemes - notably options programmes - also received wide public attention. It is to be hoped that discussions and experience to date will provide a solid basis for developing management, salary and company commitment arrangements in Finland that will meet the highest international standards.

Financial firms' profitability nonetheless improved, as robust trading activity boosted fees and other income. Investment in funds continued to increase, even though the rise in funds' portfolio values was halted by a decline in share prices in the later part of the year. The removal of tax-exempt status from bank deposits in June did not cause the expected large-scale reallocation of savings into other outlets, partly because of uncertainty in the stock market. However, it is worth mentioning that the rising trend in the stock of deposits levelled off as households and other economic agents found nondeposit outlets for their new wealth. It seems likely that banks' interest rate margins will narrow as the share of deposits in total funding declines and competition gradually pushes up deposit rates. The downward trend in interest rates could reinforce this tendency since changes in market interest rates are reflected more quickly in banks' lending rates than in their funding rates.

Technological progress and globalization-related structural changes in the financial markets continued in Finland as elsewhere. Of the purely domestic structural changes, the most significant was the completion of the merger between the insurance group Sampo and credit institution group Leonia. At the end of the year it was announced that Mandatum Bank would join the financial conglomerate, which led to further changes in the group's management and business strategy. In February 2001 the new financial conglomerate dropped the name Leonia, and the whole group is now known as Sampo. The Insurance Supervision Authority and the FSA have tightened their cooperative efforts in supervising the new group. A working group set up by the Ministry of Finance is now – in the early part of 2001 – studying the need for changes in legislation and regulation due to possible overlaps and gaps in supervision.

The MeritaNordbanken group expanded into Denmark and Norway and, after several name changes, is now known as Nordea. Joining the group were the Danish Unidanmark group, whose main members are Denmark's second largest commercial bank, Unibank, and the Danish insurance group Trygg-Baltica, which is also an important player in Norway. At the end of the year Nordea, by way of its Finnish subsidiary, finally succeeded in buying Norway's second largest commercial bank, Christiania Bank og

Kreditkassen, which it had bid for already in 1999. This transformed Nordea into a significant multinational financial conglomerate with notable market shares in four Nordic countries, as well as a growing presence in the Baltic countries and Poland. With the addition of the Norwegian bank, the group has become the world leader in the financing of shipping and 'off-shore' energy.

There is a pronounced difference between Nordea as a legal entity and as a business organization. This, combined with the group's multinational nature and major-player status in the Nordic countries, presents a challenge not only to the group's management but also to Nordic supervisors. In the spring the five Nordic countries signed a multilateral memorandum of understanding. The signatories for Finland were the FSA and the Insurance Supervision Authority. Sweden, Denmark, Norway and Finland approved a separate memorandum on the supervision of Nordea. Sweden's Finansinspektionen acts as the coordinating supervisor since Nordea's parent (listed) company is Swedish. The extensiveness of the group's operations, in both business and geographic terms, and its organizational complexity complicate the task of supervision, thus placing stringent demands on supervisors' expertise and ability to cooperate. It would be helpful if the group's legal and business structures were simpler and more closely aligned. However, because of national differences in tax and corporate legislation, this would not be an easy undertaking. Also from this standpoint, it is to be hoped that legislative work at EU-level will pave the way for true harmonization of the regulatory framework and eg enable the establishment of pan-European companies (Societas Europaea). This also implies a need to scrutinize European supervisory structures.

Many important projects are in progress, in Europe and around the world. Among the key ones are the work of the international Basel Committee on Banking Supervision on a new capital accord, work on its application to the EU and incorporation in EU legislation, and work on a directive on financial conglomerates. Also of great importance are the recommendations of the so-called Lamfalussy Committee of Wise Men concerning regulation of European securities markets, modernizing and increasing the flexibility of supervision, and drafting EU regulations making it mandatory to apply the International Accounting Standards in annual reports of publicly quoted companies from the beginning of 2005. All of these projects will greatly increase the demands on supervisors as regards competence and workload. The demands in terms of resources and training are also formidable. Meeting these challenges will require that harmonization and convergence in supervision at European level are speeded up and deepened. Cross-country differences remain significant, especially as concerns the powers and independence of supervisors. The FSA has presented a proposal to the Ministry of Finance aimed at improving the situation in Finland. However, Finnish legislative tradition makes it difficult to implement international recommendations regarding the powers of an administratively independent supervisory authority.

In public, this issue has taken the form of a controversial recommendation regarding a change in the status of the FSA and combining it with the Insurance Supervision Authority. The view of the FSA is that cooperation with the Insurance Supervision Authority has worked well and hence that there is no acute need to merge the two bodies. Moreover, if it is decided to combine the two bodies, it would be necessary first to unify the legislative processes for the two areas. It is imperative that any organizational reform preserve the administrative connection between the FSA and the Bank of Finland. The operational advantages of this connection are huge, in terms of both analysis of the stability of financial and payments systems and administrative efficiency.

The year 2001 will be full of challenges. But the solid financial position of the financial services industry provides a good foundation for weathering future storms. Recent developments have shown that the business cycle is not dead. The risks associated with financial activities are broadly the same as before, albeit somewhat harder to control. Under these circumstances decision-makers would be well advised to keep cool.

March 2001

Financial markets in 2000

OPERATING ENVIRONMENT

World economic situation was good

The world economic situation was good in 2000. In most developed countries the economic upswing continued and economic growth was faster than it had been for years. Many of the emerging Asian economies seemed to have recovered from the 1998 crisis and the economic outlook for the transition economies in eastern Europe improved as well. However, towards the end of the year the US economy showed clear signs of a slowdown and the state of the Japanese economy did not improve as envisaged in the most optimistic forecasts.

Between December 1999 and September 2000 world oil prices rose by 30% in dollar terms, and this may have contributed to a slight acceleration in inflation. Since the significance of oil as a factor of production has decreased over the long term, the macroeconomic effects of the oil price are now weaker than they were during the oil crisis in the 1970s. The price performance of other commodities in 2000 was mixed, but taken as a whole prices did not rise.

On international interest rate and foreign exchange markets, it was a slightly quieter year than usual. Whereas at the end of 1999 one euro had roughly equalled one US dollar, the single currency depreciated practically throughout 2000. In October it reached its lowest level against the dollar, about USD 0.83, but subsequently appreciated rapidly to about USD 0.93. The US Federal Reserve Bank raised its discount rate from 5% at the beginning of the year to 6% by May, but there were no further increases thereafter. In contrast, the interest rate and, later, the minimum bid rate on the main refinancing operations of the Eurosystem was increased several times during the year, from 3% to 4.75%.

In most countries share prices turned down already in early spring. Stock market uncertainty may have prompted investors to shift funds into interest rate instruments, and long-term market interest rates decreased particularly towards the end of the year. For example, the average interest rate on Finnish government serial bonds maturing in 2011 in trades between primary dealers fell from 5.44% in October to 5.13% in December[1].

Finnish exports increased sharply

Finland's long economic upswing continued in 2000. GDP growth accelerated from 4.2% in 1999 to about 5.7%[2]. Growth was well above the euro area average, which was about 3.4%[3].

Finnish industrial production increased more rapidly than at any time since 1994, by about 11%. Growth was particularly strong in the electronic equipment industry. Manufacture of electrical and telecommunications products grew by over 35% compared with 1999[4].

Exports increased by almost 20%, which was more than any other component of aggregate demand in the national accounts[5]. The current account surplus amounted to more than FIM 60 billion, ie about 8% of the GDP. This was reflected in the financial account, which shows movements in foreign liabilities, assets and investments. Although Finland's net foreign liabilities decreased, residents' portfolio investment abroad exceeded non-residents' portfolio investment in Finland by only a small margin. Loans, deposits, trade credits and other investments gave rise to a net capital inflow of more than FIM 50 billion. On the other hand there was a net direct investment outflow of nearly FIM 100 billion[6].

Domestic investment demand has been growing since the mid-1990s but by less than, for example, export demand. In 2000 both investment in equipment and machinery and construction were lower in real terms than in the previous economic upswing at the end of the 1980s. At the same time corporate profitability has remained strong. The demand for corporate loans has been weak in relation to the economic situation.

In 2000 there were also signs that the economic upswing might already be coming to an end, at least in some respects. The fall in unemployment slowed noticeably and the unemployment rate fell by only 0.4 percentage point compared with 1999, when it had fallen by about 1.2 percentage

[1] Bank of Finland, Financial Markets - Statistical Review.

[2] Statistics Finland, National Accounts, preliminary data.

[3] Eurostat, preliminary data, press release 27/2001.

[4] Statistics Finland, industry volume index.

[5] Statistics Finland, National Accounts, preliminary data.

[6] Bank of Finland, Finland's balance of payments XII, preliminary data.

points[7]. The rise in housing prices levelled off towards the end of the year. Nevertheless nearly all economic forecasts expect economic growth of more than 4% in 2001.

General government fiscal position improved

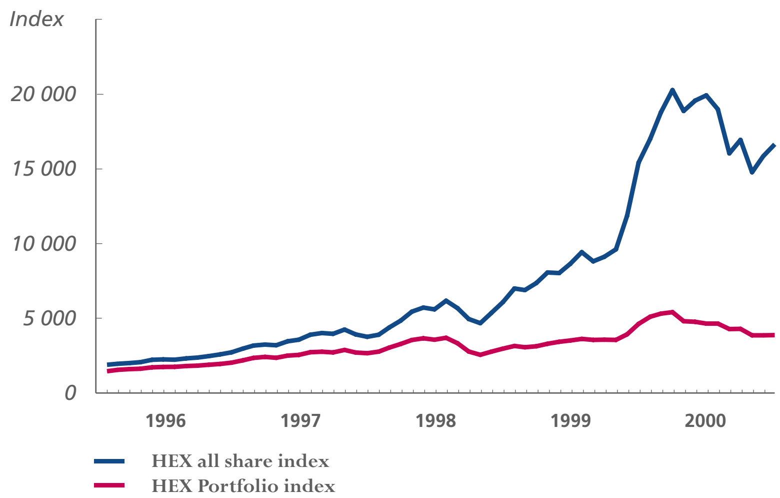
The general government fiscal position improved, because receipts from taxes paid by households and corporate entities increased against a background of continuing robust economic growth. For example receipts from income and property taxes exceeded the 1999 level by about 30%, partly because of strong growth in corporate taxes. At the same time public expenditure increased only moderately. For example, public investment remained more or less unchanged[8]. Reflecting its reduced financing needs, the central government has not issued bonds in such large amounts as it did just a few years ago.

Stock exchange turnover doubled, but prices fell

The Helsinki Exchanges had a buoyant start to the year. Shares in IT companies were in high demand, share prices rose and new issues by high-tech companies attracted the interest of investors.

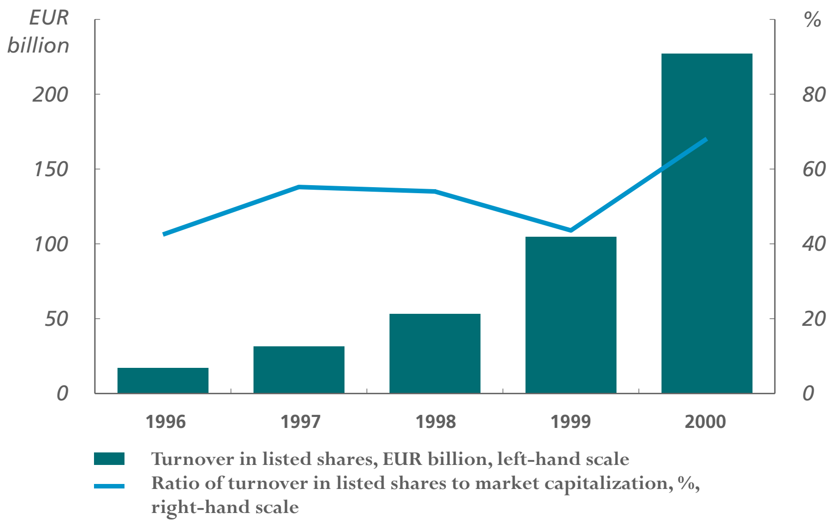
There was a turnaround in the spring and prices started to fall. Profit expectations of technology companies deteriorated. Share prices had been based on a more positive outlook for the future than new, more realistic forecasts indicated. As a technology-oriented marketplace, the Helsinki Exchanges fell together with Nasdaq.

Chart 1. Stock market indices, 1996–2000



Source: Helsinki Exchanges.

Chart 2. Share turnover on the Helsinki Exchanges, 1996–2000



Source: Helsinki Exchanges.

The Nasdaq index fell by 50% from its annual high, while the Helsinki Exchanges' NM index[9] dropped by about 80% from its February peak.

The HEX all share index fell from its early May high by 29% and by 10.6% from the beginning of the year. The weight-limited HEX portfolio index fell by 25.2% during the year (Chart 1). At the end of the year Nokia's weight in the all share index was 71.6%. The all share index did better

[7] *Statistics Finland, Labour Market, preliminary data.*

[8] *Ministry of Finance, Economic Bulletin, February 2001.*

[9] *New Market index.*

than the portfolio index because of the slight increase in the value of Nokia shares at annual level. At year end the market capitalization of the exchange amounted to EUR 316 billion.

Turnover on the Helsinki Exchanges more than doubled from EUR 104 billion in 1999 to EUR 227 billion (Chart 2). However, trading in shares other than those on the main list remained modest. The shares on the main list accounted for 99% of total turnover.

Share prices continued to fall in early 2001. By the end of February the all share index had fallen by 38 % from its value at the turn of the year. Measured in terms of the portfolio index, share prices had fallen by 18 %. The price of Nokia shares fell by nearly 48% over the same period. However, average daily turnover grew further.

COMPETITION AND PROVISION OF SERVICES IN THE FINANCIAL MARKETS

Provision of cross-border services increased

The globalization of financial markets continued at a rapid pace. The volume of investment services provided via the Internet continued to increase, and this was reflected both in the activities of domestic investment firms and notifications received from other EEA countries.

Finnish investment firms increased their cross-border provision of services mainly in other EEA countries. The FSA sent 21 notifications to the authorities in the countries concerned informing them of the intention of firms registered in Finland to provide cross-border services. The FSA received 206 new notifications on cross-border provision of investment services in Finland by investment firms registered in other EEA countries. Similarly, 2 notifications on credit institution activities were sent to the relevant authorities in other EEA countries and 46 received.

Finnish investors showed increased interest in investing outside the EEA. Therefore some Finnish investment firms started to cooperate with securities intermediaries outside the EEA to enable customers to trade in foreign securities using an on-line trading system operated via a foreign company's website.

Although cross-border provision of services in the EEA increased, Finnish investors mainly invested abroad via Finnish service providers such as fund management companies, investment firms and insurance companies.

Foreign funds increased their marketing in Finland. Eighteen new foreign collective investment schemes (UCITS) notified the FSA of their intention to start marketing their fund units in Finland in 2000. This brought the total number of UCITS to have submitted such a notification to the FSA to 70.

Part of the fund investments are direct investments and part are channelled to foreign funds via unit-linked insurance. The share of investments in foreign funds in total fund investments seems to be fairly small so far. Since no statistics are compiled in Finland on investments in foreign funds, it is hard to obtain a precise picture of the situation.

In 2000 four new management companies were authorized. At the end of the year Finland had 26 management companies managing 244 active mutual funds. The FSA and the Ministry of Finance confirmed the rules of 59 mutual funds, 27 of which were so called special funds. This brought the total number of special funds to 55. Most of the new special funds are funds of funds. Also new type of funds called absolute return funds[10] were introduced by the management companies.

Remote members increased their activities on the Helsinki Exchanges. In 2000 six new remote members established themselves and at the end of the year there were 12 remote members operating on the exchange. Together, they accounted for more than 14% of total turnover on the exchange, as compared with 6% in 1999. The most important reason for the entry of remote members was the trade in Nokia and Sonera shares. In 2000 the Helsinki Exchanges were the most important marketplace for Nokia shares in terms of trading volume.

[10] The target of these funds is to achieve a positive return on their assets regardless of general market developments. Thus the funds have no benchmark index. Among the characteristics of these funds are less risk diversification than conventional funds, use of stronger negative or positive derivative leverage, longer redemption intervals for fund units, short selling of securities and securities borrowing. Thus these funds have the characteristics of hedge funds except for the use of credit gearing, which is not yet permitted for Finnish funds.

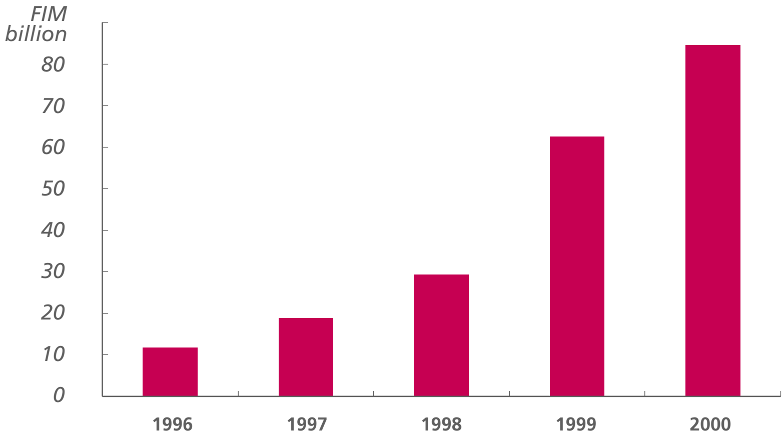
Both fund and insurance-related investment gained in popularity

For decades tax rules made bank deposits an attractive form of saving in Finland as interest rates paid on household deposits were mainly tax-exempt. At the beginning of June 2000 a withholding tax on income from deposit interest rates was introduced. The tax is collected regardless of the interest rates applied and this has made bank deposits less attractive compared with other forms of saving. Particularly in the early part of 2000 public invested noticeably more in funds than they had done in previous years. New capital flowed into funds in the latter part of the year as well, except for a small decline near the end of the year.

At the end of 2000 bank deposits totalled FIM 353 billion, which was FIM 11 billion more than one year earlier. However, alternative investments increased more rapidly than deposits.

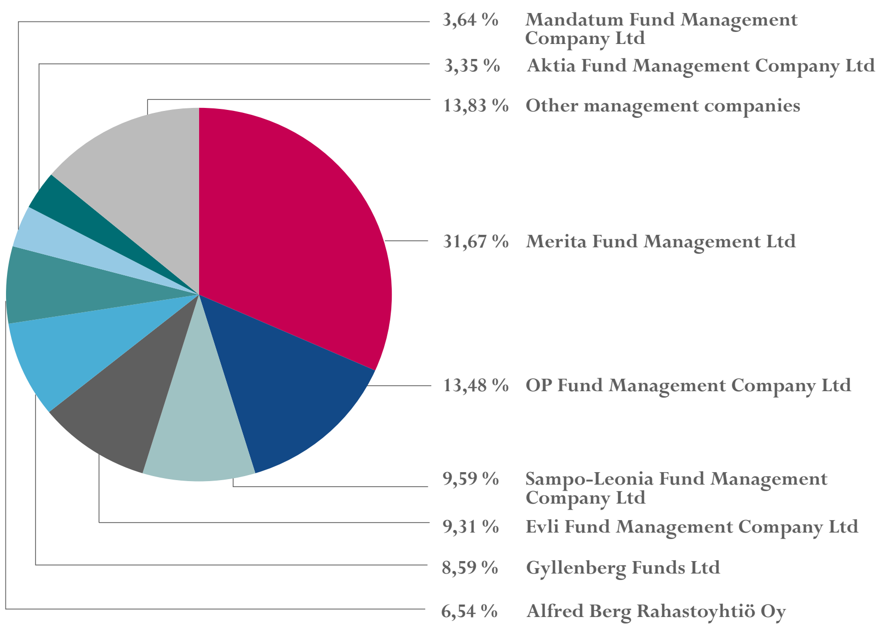
The net assets of mutual funds grew by FIM 22 billion in the course of the year to FIM 85 billion. This represented growth of 34% compared with end-1999 (Chart 3). Net assets increased mainly in the early part of the year, because in November–December they actually decreased as a result of a fall in securities prices and redemptions carried out for tax reasons. Towards the end of the year the influx of new capital to funds could no longer compensate for the effect of the fall in share prices, despite the fact that the amount of new capital received by mutual funds in 2000 totalled FIM 27 billion.

Chart 3. Net assets of mutual funds, 1996–2000



Source: Financial Supervision Authority.

Chart 4. Fund management companies: market shares, 2000

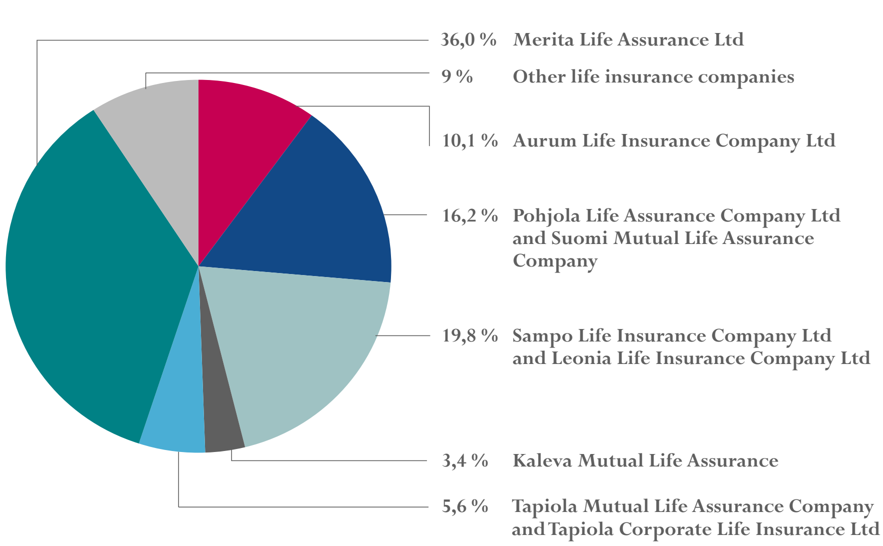


Source: Financial Supervision Authority.

Insurance-related investment also gained in popularity. Life assurance companies' total underwriting reserves increased by about FIM 23 billion, totalling FIM 109 billion at year end[11].

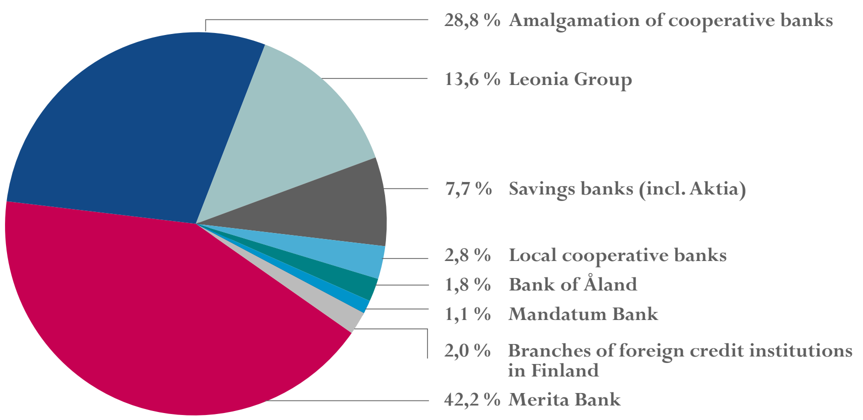
[11] The market shares for insurance-related investments have been calculated on the basis of premium income by the Federation of Finnish Insurance Companies.

Chart 5. Market shares of life insurance companies as a percentage of total premium income, 1 Jan–31 Dec 2000



Source: Federation of Finnish Insurance Companies.

Chart 6. Deposits: banking groups' market shares, 31 Dec 2000



Source: Financial Supervision Authority.

Banking groups accounted for a major share of fund and insurance-related investment

Banking groups accounted for a major share of fund and insurance-related investment in 2000 (Charts 4 and 5). At the end of 2000 the combined market shares of bank-related funds and life assurance companies exceeded 60%[12]. Merita Bank Plc Group had the largest single market share. The Amalgamation of cooperative banks and Sampo-Leonia also had large market shares.

The management companies belonging to banking groups further increased their market share. The three largest management companies commanded about 55% of all managed assets (Chart 4). All major banking groups offer fund products, and many investment firms also engage in wide-ranging fund activities through their subsidiaries.

Three largest banking groups dominated deposit-taking and lending

At the end of 2000 the three largest banking groups together accounted for about 85% of all deposits and loans (Charts 6 and 7). The Merita Bank Plc Group still had the largest individual market share, at more than 40%.

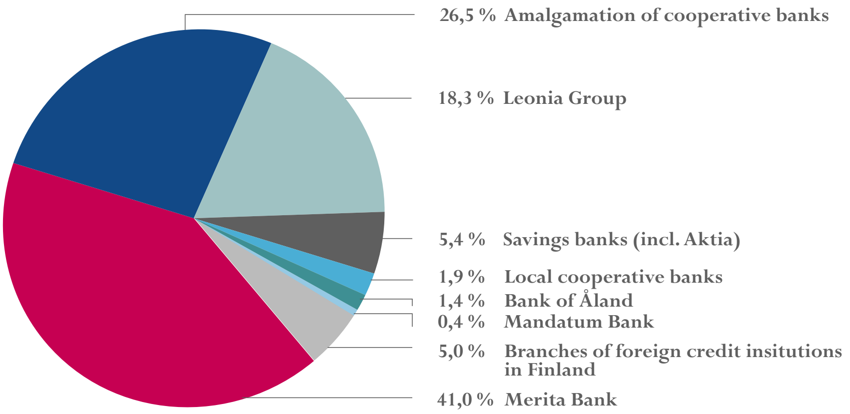
Merita Bank Plc Group experienced the largest increase (+1%) in market share of deposits (Chart 6). Bank of Åland Plc also increased its market share of deposits (+0.3%), whereas the Leonia Bank plc Group lost market share (–2.2%). Other banking groups increased their mar-

[12] Nordea Investment Funds Company Ltd, OP Fund Management Company Ltd, Sampo-Leonia Fund Management Ltd, Mandatum Fund Management Company Ltd, Aktia Fund Management Company Ltd, Handelsbanken Mutual Fund Company Ltd, Trevise Rahastoyhtiö Oy and Bank of Åland Fund Management Ltd are treated here as bank-related management companies. Merita Life Insurance Ltd, Aurum Life Assurance Company, Leonia Life Insurance Company Ltd and Sampo Life Insurance Company Ltd are treated as bank-related insurance companies.

ket shares a little compared with the situation at the end of 1999.

Branches of foreign credit institutions (+0.8%) and the Amalgamation of cooperative banks (+0.4%) recorded the biggest increases in market share of lending (Chart 7). Market share was lost mainly by the Leonia Bank plc Group, whose market share shrank by more than 1%[13].

Chart 7. Lending: banking groups' market shares, 31 Dec 2000



Source: Financial Supervision Authority.

DEVELOPMENTS IN THE FINANCIAL MARKETS

Further significant reorganizations and restructurings in 2000

Finland's first financial services group conducting banking and insurance business was created, when Leonia plc and Sampo Insurance Company plc merged at the end of 2000. Sampo-Leonia Insurance Company plc became the group's parent company. In early 2001 the group acquired Mandatum Bank plc and the name of the Leonia Bank, already operating within the group, was changed to Sampo Bank.

The final step in the formation of the financial services group will be completed in early April 2001, when the parent company, which has conducted insurance business, will be transformed into the holding company Sampo plc, whose shares will be traded on the Helsinki Exchanges. Sampo plc will directly or indirectly own the banks, investment firms and insurance companies belonging to the financial services group.

A merger between Nordic Baltic Holding (NBH) and the Danish Unidanmark was announced in March 2000. The merger was implemented as a share offer, in which Unidanmark's shareholders obtained a 30% stake and MeritaNordbanken's shareholders a 70% stake in the holding company of the new group. Earlier, in autumn 1999, MeritaNordbanken had made a bid for the Norwegian Christiania Bank og Kreditkasse. In October 2000 the Norwegian Bank Investment Fund decided to sell its holdings in the bank to MeritaNordbanken.

The group's parent company NBH received the new name Nordea after approval at an extraordinary general meeting in November 2000. In December the name of MeritaNordbanken Plc was changed to Nordea Companies Finland (NCF) Plc.

In April 2000 trading in shares of Merita Plc was terminated on the Helsinki Exchanges. At the present time Nordea shares are being traded on the Helsinki, Stockholm and Copenhagen exchanges. Admission to the Oslo exchange is being sought.

Book-entry registers were centralized

Finland abandoned its decentralized book-entry system for shares, when a single centralized book-entry register was introduced on 16 October. The independent book-entry registers maintained mainly by the banks were merged into the book-entry register of the Finnish Central Securities Depository (APK). In the change all share accounts were transferred to the APK and the former managers of the registers became account operators.

[13] Market shares of the Leonia Bank plc Group have been compared with data on the Leonia plc Group. Leonia plc's subsidiary Leonia Corporate Bank plc merged with another of the former company's subsidiaries, Leonia Bank plc, on 31 December 2000. At the same time Leonia plc merged with Sampo Insurance Company plc. The Leonia plc Group largely corresponds to the Leonia Bank plc Group formed by the merger (the current Sampo Bank plc Group).

HEX plans listing

In June 2000 Helsinki Exchanges Group (HEX) announced that it was initiating a study into the company's possible stock exchange listing. According to the study, which was completed in December, the HEX Group was eligible for listing. Accordingly, the Board of Directors of HEX decided to analyse how the possible listing could be accomplished. The actual decision on the possible listing will be made separately.

Trading in Nokia options on Eurex grew

In December the Helsinki Exchanges and Eurex decided to transfer trading in five stock options back from the Eurex trading system to the Helsinki Exchanges, because trading in several Finnish stock options on Eurex had remained modest.

However, trading in Nokia options on Eurex increased. Trading in Nokia options accounted for 89% of total trading in Finnish stock options. The volume of stock and index derivatives traded on the Helsinki Exchanges and Eurex increased from about 2 million contracts in 1999 to about 6.4 million in 2000. Trading in Finnish stock and index derivatives on Eurex started in two phases in September 1999 and January 2000. Altogether, trading in 11 stock options and FOX index derivatives was transferred to Eurex.

Trading hours at the Helsinki Exchanges will be extended in early April 2001. According to the plans of the Helsinki Exchanges, continuous trading will end at 6 pm, whereupon evening trading will commence and last until 9 pm. Evening trading will be subject to the same rules as continuous trading and the same settlement period (trade date + 3 days).

Undesirable developments in the stock market

In late 1999 and early 2000 several new companies were listed on the Helsinki Exchanges (mainly on the new market list), many of which were operating on the Internet or in some other technology sector.

These new companies had many common characteristics. They were small and relatively young compared with traditional listed companies. Because the companies were going through a phase of strong growth and expansion, their value was almost exclusively based on expectations about the future. This made movement in the prices of their shares very volatile. In addition the activities of these companies were mainly based on one or two business ideas and closely dependent on the original owners of the companies.

High faith in the new economy companies combined with their lack of experience in meeting disclosure requirements, their small size and limited resources for internal accounting led to the emergence of some undesirable phenomena. The value of the companies was very much based on future expectations, and the stock exchange announcements released by some companies seemed to push their share prices higher regardless of the contents of the announcements.

The faith in the future of these companies that existed at the time of the new issues decreased along with loss of faith in the new economy. Some companies had to issue profit warnings fairly soon after IPOs. Investors started to have doubts about the reliability of the information published in connection with the offerings. There were also shortcomings in the up-to-dateness and informative value of the stock exchange releases issued by some companies.

This situation was reflected in the work of the FSA. The FSA investigated several cases related to the meeting of disclosure requirements and the reliability of listing particulars published in connection with new issues compared with the subsequent financial performance of companies.

Supervisory Activities

SUPERVISORY APPROACH

The FSA aims at proactive supervision

The Financial Supervision Authority (FSA) takes a proactive approach to supervision, in which the supervised entities themselves, the markets and the supervisory authorities share the responsibility for supervision.

Proactive supervision emphasizes the fact that the supervised entities have the primary responsibility for their behaviour and supervision. Market-based supervision – ie market discipline – encourages supervised entities to meet their responsibilities. Market discipline is effective if the markets are provided with necessary and sufficient information about the behaviour of supervised entities. Official supervision complements market discipline and supervised entities' own responsibility. The challenge for the supervisor is to identify general and specific problems as early as possible and take appropriate action in a timely and credible fashion.

Proactive supervision is essential in promoting financial stability. In spite of supervision, financial crises can nevertheless occur. What proactive supervision can do is to prevent crises reaching proportions where they threaten the stability of the entire financial system.

In its supervision the FSA pays attention to such factors as market practices and reliable functioning of markets. Monitoring the management, internal control and risk management systems and financial condition of supervised entities is also an integral part of the FSA's work.

Supervision of financial conglomerates in cooperation with other authorities

Financial conglomerates operating across national borders and banking and insurance groups pose new challenges to supervision. In the supervision of conglomerates the FSA cooperates with supervisory authorities in other Nordic countries and with the Insurance Supervision Authority in Finland. Cooperation is based on memoranda of understanding and joint bodies set up for practical supervision work (see pages 24 and 35–36).

SUPERVISION OF MARKETS AND PRACTICES

Effective securities settlement was emphasized

In the early part of 2000 the volume of share trading grew rapidly, with the result that the APK (the Finnish Central Securities Depository) experienced capacity problems. The FSA felt that this posed large risks to the securities markets as a whole and therefore called on the parties concerned to take sufficient and effective measures to improve the situation. Intermediaries and settlement parties were urged to ensure that adequate resources were made available for the processing and settlement of trades and that technical systems functioned effectively. By these measures the FSA also tried to ensure that there were adequate collateral arrangements in settlement.

During the year the FSA made more than 20 supervisory visits to settlement parties and the APK in order to examine risk management mechanisms and backup systems in the settlement process.

The supervisory visits revealed that the APK and the settlement parties had made major efforts to guarantee settlement reliability. At the end of the year the most important indicator of smooth settlement, ie the monthly reported percentage of trades settled within the settlement interval[1], stabilized at around 95% after having been below 90% in the early part of the year.

In October Finland changed over from a decentralized book-entry register for shares to a centralized register. The reform was carried out in order to reduce settlement risks and increase the potential for development of registers and settlement in an increasingly international environment. The changes in legislation required for centralization came into force in the spring.

Although changes were quite radical, the single centralized book-entry register came on stream without any major problems. The FSA participated in the process of ensuring a smooth introduction of the new system through supervisory visits before the systems were tested in the spring and after the tests in the early autumn. In addition, the FSA participated in the preparation of necessary legal and other regulatory amend-

[1] *The proportion of total trades settled within T + 3 (trade date plus three days).*

ments. About 15 supervisory visits concerning the centralization of registers were made during the year.

Market practices in arranging issues were discussed

Issue activity was buoyant, particularly in the spring. The FSA approved a total of 109 listing particulars and prospectuses and granted 141 exemptions related to them[2].

In March the FSA held a meeting for firms arranging securities offerings and their legal advisers at which general practices applied in offerings were discussed as well as problems that had occurred in connection with equity offerings. These problems included allotment of equities to subscribers in situations where issues were heavily oversubscribed and repayment times for advance payments of subscription prices. However, demand slackened before the summer and this eliminated oversubscriptions and related allocation problems. The first allotment lottery was arranged in December.

Subscription of shares through the Internet was possible for all equity offerings. In fact, most subscriptions by the public were made via the Internet. In July the FSA published a statement which permitted subscription exclusively via the Internet (see page 30).

Mutual funds were also actively involved in equity offerings. In the spring the FSA sent a letter to management companies concerning mutual funds' bids in equity offerings. According to the FSA's interpretation, management companies may not submit bids that, if implemented as such, would lead to investment of more than 10% of the assets of a single mutual fund. This view is based on a provision in the Mutual Funds Act according to which a management company may invest the assets of a mutual fund in the securities of any one issuer up to a maximum of one-tenth of the value of the assets of the mutual fund.

Increase in investor complaints about securities markets activities

During the year the FSA received 198 written requests for investigation, 150 of which concerned credit institution activities and 48 securities markets activities.

The number of written requests for investigation and telephone enquiries concerning credit institution activities declined further. Customer complaints mainly concerned issues related to uses of accounts and collection. On the basis of the investigations carried out, practices of the bank concerned were criticized in 20 cases, and in three other cases the bank met the customer halfway on its own initiative.

The number of telephone enquiries concerning bank activities has fallen because the public is now better aware of the Advisory Office for Bank Customers, jointly established by the National Consumer Administration, the FSA and the Finnish Bankers' Association. The number of callers to the Advisory Office was about the same as in the previous year, ie more than 1,700. The Office's staff was strengthened by the recruitment of a part-time lawyer, which helped to speed up the service. The Office advises customers on questions related to banking business. It also promotes mutual trust between banks and customers and develops day-to-day banking practices.

By contrast, the number of customer complaints about the functioning of securities markets increased. In addition to written complaints, the FSA received dozens of telephone enquiries. The complaints concerned allocation in equity offerings, Internet services and related technical disturbances, asset management practices, etc.

In monitoring the terms and conditions of contracts applied by credit institutions, special attention was paid to the contract terms applied by banks in their Internet activities. The FSA published a partly revised version of a statement on marketing issued in 1999, in which it set out its views on the contract terms applied by credit institutions.

Several requests for investigation were submitted to the police

In the course of the year the FSA investigated 38 cases of suspected negligence or abuses related to securities markets. Investigations were increasingly focused on meeting disclosure requirements and price manipulation. In particular, several shortcomings were observed in the information issued by some new economy companies (see page 12).

Nine requests for investigation

[2] *Both bond and share issues are included.*

were submitted to the police. Four of these concerned suspected abuse of insider information, two offences against the disclosure requirements, two manipulation of prices and one a securities-market offence related to unauthorized provision of investment services. The requests for police investigation concerned shares of six companies. In addition an informal caution was issued to a listed company concerning its disclosure practices and the functioning of its accounting systems.

MONITORING OF FINANCIAL CONDITION AND RISK-TAKING OF SUPERVISED ENTITIES

Special emphasis on management, strategies and internal control

During the year the condition of individual entities was analysed on the basis of data obtained from inspections, supervisory visits and risk monitoring. In the analysis of the overall condition, attention was paid to structural changes, management and strategies, organization of activities, implementation of internal control, financial performance, capital adequacy, significant risks and integrity of data in annual accounts.

The operations of the major supervised entities were characterized by legal reorganizations as well as changes in the organization of business activities. The FSA considered it important that the new legal and business organizations should not become so complex that they impede official supervision or the management and internal control of the organization.

The changes in the business environment, the competitive situation and technical development were particularly evident in banks' strategies. The banks tried to find synergies in insurance, investment and banking business and growth potential abroad. The expansion in asset management services and importance of online banking activities were also reflected in strategies. On the other hand, some banks and other credit institutions based their strategy on regional factors or focused on particular financial services and customer groups.

The banks' favourable financial performance strengthened their capital adequacy. Banks started to pay more attention to the allocation of capital to different business activities and departments.

Banks reduced their real property risks in accordance with plans they had submitted to the FSA. However, property risks were not totally eliminated. The FSA monitored the banks' property risk situation and conducted property risk inspections in banks where these risks had not significantly declined.

Bank profitability continued to improve

The banks' profitability[3] remained excellent in 2000. Operating profits totalled FIM 12.1 billion as compared with FIM 8.5 billion in 1999.

Net income from financial operations amounted to FIM 16.1 billion, as against FIM 13.5 billion in 1999. Interest income grew noticeably faster than interest expense. In 2000 interest income totalled FIM 36.8 billion, up FIM 8.2 billion from FIM 28.7 billion in 1999. Interest expense increased by FIM 5.5 billion from the previous year.

The widening of the total interest rate margin was the most important reason for the growth in net income from financial operations. In the course of the year the average lending rate increased by noticeably more than the average funding rate. Most of banks' lending is linked to various reference rates, so that the rise in market rates was clearly reflected in interest income. Growth of lending also contributed to the increase in interest income and net income from financial operations.

Net income from securities transactions and foreign exchange dealing amounted to FIM 1.0 billion, more than double the FIM 0.4 billion recorded in the previous year. Particularly net income from securities increased.

In recent years fee income has increased continually, particularly income from brokerage and asset management. Net fee income increased to FIM 6.2 billion from FIM 5.4 billion in 1999.

Net income from equity investments amounted to FIM 1.3 billion, compared with FIM 0.1 billion in 1999. Much of the increase in this income is due to exceptionally large dividends of

[3] The figures include the Merita Bank Group, Amalgamation of cooperative banks, Bank of Åland Group, Mandatum Group, Skopbank Group (in liquidation), Aktia Group and other savings banks and local cooperative banks in their capacity of parent companies. In addition, the 1999 figures cover the Leonia Group and the 2000 figures the Leonia Bank (Sampo Bank) Group, which the Leonia Corporate Bank has been combined with using the pooling method.

Table 1. Key items in deposit banks' aggregate profit and loss statement, 1999 and 2000, FIM billion*

	2000	1999
Net income from financial operations	16.1	13.5
Net fee income	6.2	5.4
Net income from securities transactions and foreign exchange dealing	1.0	0.4
Other income	3.1	2.4
Administrative and operating expenses	12.2	11.5
Depreciation	1.8	1.2
Loan and guarantee losses	0.4	0.5
Operating profit	12.1	8.5

** The figures include the Merita Bank Group, the Amalgamation of cooperative banks, the Bank of Åland Group, Mandatum Group, the Skopbank Group (in liquidation), the Aktia Group and other savings banks and local cooperative banks in their capacity as parent companies. In addition, the 1999 figures cover the Leonia Group and the 2000 figures the Leonia Bank (Sampo Bank) Group, which the Leonia Corporate Bank has been combined with using the pooling method.*

Source: Financial Supervision Authority.

Table 2. Capital adequacy of deposit banks, 1999 and 2000, FIM billion*

	2000	1999
Total own funds	54.1	50.7
of which: Tier 1 capital	42.0	35.7
Risk-weighted items	465.6	426.6
Capital adequacy ratio	11.6%	11.9%
Tier 1 capital adequacy	9.0%	8.4%

** The figures cover the Merita Bank Group, the Amalgamation of cooperative banks, the Bank of Åland Group, the Mandatum Bank Group, the Aktia Bank Group and other savings and local cooperative banks in their capacity as parent companies. In addition, the 1999 figures cover the Leonia Group and the 2000 figures the combined balance sheet figures for the Leonia Bank (Sampo Bank) Group and the Leonia Corporate Bank. The Skopbank Group (in liquidation) is not included.*

Source: Financial Supervision Authority.

a one-off nature received in 2000.

By contrast, administrative and other operating expenses increased. For example staff-related expenses increased to FIM 6.2 billion from FIM 6.0 billion in 1999.

Loan and guarantee losses totalled FIM 0.4 billion in net terms as against FIM 0.5 billion in 1999 (Table 1).

Banks' own funds strengthened

Domestic banks' stock of deposits increased by about 3% in 2000. The stock of deposits decreased for most of the year, but the situation changed towards the end of the year . The amount of loans to the public grew substantially more than deposits, by about 8%.

The risk-weighted items in the capital adequacy calculations increased from FIM 427 billion to FIM 466 billion. Banks' own funds also strengthened considerably in 2000. Original own funds (Tier 1) increased from FIM 35.7 billion to FIM 42.0 billion. The banks' good profitability was one of the main reasons for the strengthening of own funds, as profits boosted non-restricted equity capital. In 2000 Tier 1 capital adequacy calculated merely on the basis of original own funds improved from 8.4% to 9.0% (Table 2).

Loan losses were still small

Banking groups' total exposures (loans + guarantees) amounted to FIM 493 billion at the end of 2000. Credit growth continued strong, but the rate of growth slowed from the previous year. In 2000 loans to the public grew by about 8 %. If loans to financial and insurance institutions are also included, growth was 10%. In the previous two years the growth rate had been 11%. The growth of lending was strongest in the household sector, which is still the main borrowing sector. At the end of 2000 households represented 44% of total exposures.

Banking groups' nonperforming assets continued to decrease (Chart 8). Nonperforming assets' share of total exposures was 0.8% as compared with 1.1% in 1999. In relative terms, trade and restaurants accounted for the largest share of nonperforming assets, as in 1999. Households' nonperforming assets decreased in spite of brisk growth of lending.

The amount of loan losses also decreased. Banking groups' loan losses totalled FIM 355 million, which is FIM 102 million less than in 1999. Loan losses accounted for only a small share, ie 0.1%, of the total exposures comprising loans and guarantees.

Turkey's financial crisis did not cause significant losses for Finnish banks

In 2000 Finnish banks' foreign claims increased by 16% to FIM 260 billion. The growth in foreign claims was mainly concentrated in the euro area, where most of the banks' liquidity management is carried out (Chart 9).

Turkey was one of the main problem areas for European banks, as the country encountered a liquidity crisis in late 2000. Finnish banks' claims on Turkish counterparties were mainly connected to Finnish companies' export activities and did not cause major loan losses for the banks. Argentina was another crisis area, but Finnish banks' exposures to Argentina were very small.

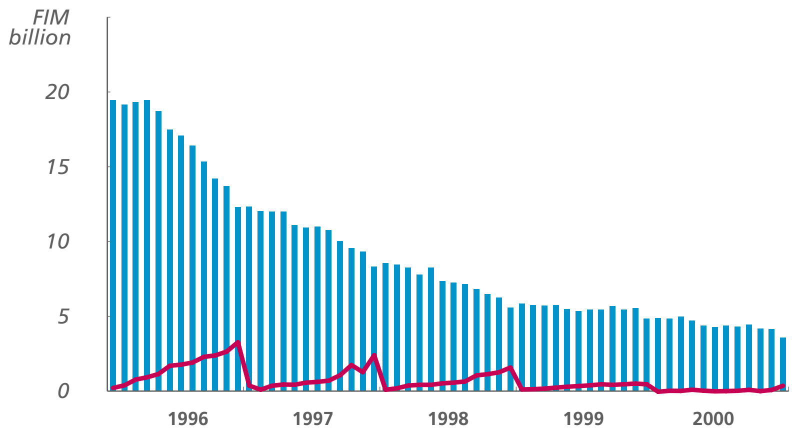
In Asia economic growth again showed signs of fading in the latter part of the year. The prevailing view is that there will be no repeat of the 1997 crisis; rather, the depth of the recession is expected to largely parallel developments in the US economy. In the course of the year Finnish banks' claims on Asian countries decreased by 10% to about FIM 12 billion, and in view of the character of activities and the guarantee and collateral arrangements involved they are not expected to lead to significant loan losses.

Developments of derivative instruments were mixed

Outstanding amounts of forward foreign exchange contracts[4] and currency options increased in 2000. Contracts with foreign counterparties already form about 80% of all forward exchange contracts. In terms of nominal value of underlying assets, interest rate futures are now more common than forward rate agreements (FRAs) in the management of interest rate risks of up to one year. The key marketplaces for interest rate futures are Eurex, the London International Financial Futures and Options Exchange and the Chicago Board of Trade.

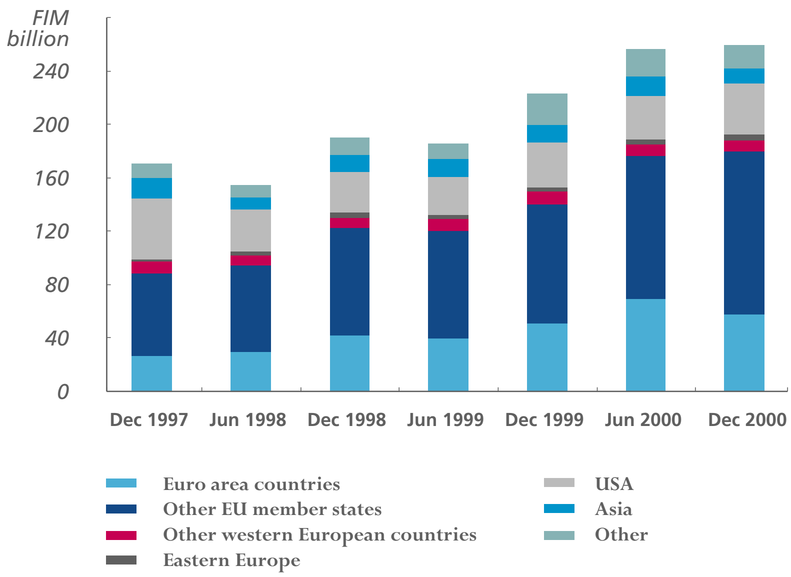
The total credit equivalent amount of nonstandardized derivatives of Finnish deposit banks increased by FIM 2.1 billion to FIM 20.4 billion. The credit equivalent amounts are derived from the banks' capital adequacy calculations and they com-

Chart 8. Deposit banks' nonperforming assets and loan losses, 1996–2000



Source: Financial Supervision Authority.

Chart 9. Foreign claims of Finnish banking groups by geographical region 1997–2000



Source: Financial Supervision Authority.

[4] *Forward foreign exchange contracts also include forward legs of currency swaps.*

Table 3. Nominal value of the underlying assets of derivatives held by banks operating in Finland, 1999 and 2000, FIM million

	Dec 2000	Dec 1999	Change	Change, %
Currency-based				
Forward contracts	275 134	187 208	87 926	47 %
Interest rate and currency swaps	28 153	36 572	–8 419	–23 %
Currency options	42 151	20 844	21 307	102 %
Interest rate-based				
Forward rate agreements and interest rate futures	65 051	123 662	–58 611	–47 %
Interest rate swaps	452 757	445 538	7 219	2 %
Interest rate options	15 380	27 297	–11 917	–44 %

Source: Financial Supervision Authority.

Table 4. Interest rate risk of the banking sector 1999–2000, FIM million

	Dec 2000	Dec 1999
INCOME RISK	**–1 157**	**–1 273**
Euro-denominated items	–1 214	–1 296
Foreign currency-denominated items	57	23
Assumption: deposits payable on demand = 10.5 months		
NET INCOME FROM FINANCIAL OPERATIONS	**12 692**	**12 140**
Risk to income ratio	–9 %	–10 %
INVESTMENT RISK	**8**	**386**
Euro-denominated items	70	380
Foreign currency-denominated items	–62	6

Given a one percentage fall in interest rates, a negative risk figure represents loss and a positive figure gain.

Source: Financial Supervision Authority.

prise replacement cost and an estimate of potential future credit risk.

The amount of guarantees and guarantee commitments granted by banks operating in Finland increased by about FIM 4 billion to about FIM 70 billion. Banks' unused loan commitments increased by 21% to FIM 63.8 billion (Table 3).

Interest rate risks decreased towards the end of the year

At the end of 2000 the banking sector's net interest income risk amounted to FIM 1,157 million. Net interest income risk is the decrease in potential net interest income over the next 12 months, should interest rates fall by one percentage point (see page 49). The banking sector's total income risk decreased by FIM 145 million from the end of 1999; at the end of September it was still FIM 1,483 million. Similarly, relative income risk in relation to net income from financial operations fell to 9% from 10% in the previous year. Investment risk, ie the risk of a change in the current price of bonds held as trading assets and derivatives in the trading book, decreased in the course of the year to as low as FIM 8 million (Table 4).

The abolition of the tax-exempt status of deposits at the beginning of June 2000 may shorten the assumed duration of deposits payable on demand in the calculation of income risk through interest rate competition. If the assumed duration used in the calculation is shortened, the banking sector's income risk decreases.

Overnight foreign exchange positions were small

In Finnish banks exchange rate risk is managed as part of the system for managing market risks in the trading function, together with interest rate, equity and other price risks. Market risks are relatively small compared with the major risk in banking, ie credit risk. Finnish banks' open overnight foreign exchange positions have remained modest in relation to their own funds. Limits on exchange rate risk positions set out in FSA guidelines apply only to overnight positions and do not constrain banks in their intraday dealing or positions in respect of foreign exchange. Dealing in foreign currencies is regulated within banks by means of an internal limit system that forms part of the system for managing market risks. The FSA regularly conducts inspections in banks to examine their systems for managing market risks.

Market value of banking groups' share holdings almost unchanged

The market value[5] of shares held by banking groups and their pension funds[6] was about FIM 10.9 billion at

[5] Market value includes all quoted shares, units of equity mutual funds and share derivatives regardless of the balance sheet item in which they are included. These shares are for the most part traded on the Helsinki Exchanges.

MONITORING GIVES A PICTURE OF THE OVERALL RISK OF THE SUPERVISED ENTITY

Through its monitoring the FSA tries to obtain a picture of the overall risk of the supervised entity. Risk-based monitoring partly focuses on institutions with a high risk profile in comparison with other institutions and partly on supervised entities that are of key importance for financial stability. The supervised entities' most important risks are credit risk, market risk, operational risk and strategic risk. Credit institutions and investment firms are exposed to the same types of risks but to different degrees.

The FSA monitors the risk-taking of the supervised entities in three ways. Quantitative or measurable risks are monitored through regularly submitted reports, ie through off-site monitoring. These reports enable monitoring of eg market risks and, to some extent, credit risks. Monitoring market risks includes liquidity risk and property risk, whereas monitoring credit risks includes nonperforming assets and loan losses.

Qualitative risks are monitored through inspections, ie through on-site monitoring, which is focused on management operations, risk management systems and level and adequacy of internal control of payment systems. Operational and strategic risks are qualitative risks.

In addition to internal risks individual institutions are exposed to risks caused by changes in the environment. International capital and financial markets are exposed to continuous structural and functional changes. The effects of these changes on the stability of the financial markets are monitored and assessed in cooperation with the Bank of Finland. The aim is to ensure financial stability, an integral element of which is to ensure that payment systems function smoothly.

A credit institution seeks to make profits through risk-taking. The task of the supervisory authority is to see to that this risk-taking does not exceed the risk-bearing capacity of the supervised entity. The primary indicator of an entity's risk-bearing capacity is its capital adequacy, ie the equity to risk positions ratio. The Finnish capital requirement against credit and market risks complies with international regulations. In addition to equity, operating profit can be considered an indicator of risk-bearing capacity. The idea here is that the larger the profits a credit institution or investment firm earns, the bigger the realized risks they can bear.

All risks can be regarded as sub-areas of strategic risk. Thus each risk can be shown as a concentric circle.

the end of 2000, some FIM 0.4 billion less than one year earlier. Equity investments in bank-owned life insurance companies increased in the early part of the year, but growth came to a halt later in the year.

Share of deposits in funding decreased

The importance of deposits as a source of bank funding steadily decreased in the late 1990s and this trend continued in 2000, as banks increased their lending. At the end of the year deposits accounted for 91% of lending. The slowing in the growth rate of lending and levelling off in the total amount of deposits were the most important changes in funding. Deposit banks increased their issues of debt securities. At the end of 2000 deposit banks had debt securities and certificates of deposit outstanding amounting to FIM 22 billion and FIM 108 billion respectively.

The deposit banks' short–term

[6] Finnish deposit banks, bank-owned and associated life insurance companies, deposit banks' pension funds and pension foundations, Finnish subsidiaries of banking groups and financial holding companies.

funding deficit[7] varied between FIM 42 and FIM 86 billion during the year. The ratio of the funding deficit to the balance sheet total varied between 6 and 12%. The deficit corresponds to the sum that the bank must raise for example via the money or capital markets[8]. Funding deficits mainly appear in the commercial banks, whereas the activities of local banks so far generated funding surpluses. A quarter of deposit banks' liabilities falls due within one month, more than one third within six months and almost half of them within one year, when it is assumed that deposits payable on demand remain unchanged. Liabilities mature sooner in commercial banks than in local banks.

Investment firms' capital adequacy and other ability to bear financial obligations

Investment firms are subject to largely the same capital adequacy regulations as credit institutions. The capital requirement concerns both market risks in the firms' own trading and credit risks related to other operations. In capital adequacy terms, the essential difference between investment firm activities and banking activities is that the core business of investment firms is providing services to investors. This does not burden the balance sheet and does not therefore give rise to capital adequacy requirements. The capital requirement against market risks is fairly small. The capital requirement against credit risks is also low, because as a rule investment firms are not allowed to grant credit.

A separate capital requirement of 25% of the fixed expenses in the confirmed profit and loss account is applied to investment firms to ensure that they can cover their operational risks. Fulfilling the capital requirement against operational risks has not caused problems for profit-earning investment firms, although it has made them pay attention to the adequacy of their own funds, for example when considering distribution of dividends.

As a result of the strong growth in share trading, securities intermediaries have had to make allowance for an ever increasing liquidity requirement in the settlement of share trades.

Investment firms' fee income increased, but their own securities operations were unprofitable

The record high level of share trading boosted the fee income of securities intermediaries in 2000. Fee income of investment firms offering asset management services also increased, because the amount of assets to be managed continued to grow. The profitability of firms acting as lead managers remained very good.

Investment firms' total fee income, including inter-firm transactions, was about FIM 2.2 billion at the end of 2000. Fee income increased by about FIM 0.7 billion from 1999. The total operating profit amounted to FIM 881 million, which was about FIM 130 million more than in the previous year.

Investment firms' total net income from trading on own account showed a loss of about FIM 60 million; in 1999 securities trading showed a profit of approximately FIM 130 million. Owing to the changes that have occurred in the sector, aggregate figures are not directly comparable with previous years.

INSPECTIONS

Management operations and internal control were inspected

A supervised entity should organize its administration in such a way that it supports the entity's business activities in the best possible way. The management of a supervised entity is in a key position in this regard, as management operations are decisive for achieving the entity's goals, maintaining its ability to operate effectively and ensuring efficient internal control. Thus management operations form part of the supervised entity's strategic and operational risks.

In its risk monitoring inspections the FSA has so far focused mainly on measurable risks, such as credit and market risks. Now the focus is switching to assessment of non-measurable, qualitative risks, partly in response to international trends in this direction. In the EU's new capital adequacy framework now under preparation, it is stressed that management opera-

[7] On- and off-balance sheet assets after deduction of on- and off-balance sheet liabilities. Here short-term items refer to assets and liabilities payable within one month.

[8] The calculation is based on the assumption that deposits payable on demand stay in the bank and that deposits remain unchanged. It is assumed here that business continues as before (the 'going concern' assumption).

tions affect the determination of the supervised entity's risk profile and thus also its capital requirement.

The FSA's assessments of the operations of the board and management of supervised entities focused on inspecting the role of the board and management. The aim of the FSA's inspections was to ensure that the supervised entities' management systems and internal control were adequate as regards controlling risk-taking and identifying potential threats and problems in the entities' operations.

In the course of the inspections the FSA examined how management affected the creation of strategies, corporate culture, the organization of activities and arrangements for internal control. The inspections were conducted on the basis of written answers to a questionnaire submitted to the board and senior management in advance and a round of interviews. The assessment results influenced the decisions taken by the FSA on the need for monitoring and how monitoring should be focused on various sectors of business activities.

The level and adequacy of internal control were estimated in several credit institutions. The inspections focused mainly on the operations and role of senior management in internal control in the credit institution, either with regard to all the activities of the supervised entity or a range of business activities specifically selected for inspection. Attention was focused particularly on management methods, control culture and organization of risk management.

On the basis of the inspections the FSA urged banks to regularly assess the adequacy of their internal control systems, particularly at times of significant changes in business activities and organization. This was done to make sure that banks identify the risks in their activities and draw up appropriate instructions for all business activities and risk management. Banks were encouraged to avoid dangerous combinations of duties, ie situations where the same persons are responsible for both the actual activities and their control. Some banks were also urged to improve the functioning of their internal auditing.

Credit risk monitoring focused on methods of credit risk management and provisioning for loan losses

Credit risk monitoring focused on lending processes, methods of credit risk management, provisioning for loan losses and quantity and quality of information in annual accounts.

The purpose of credit risk monitoring was to find out whether banks' lending processes as a whole were carefully planned and whether the related credit risk management was watertight. Attention was paid to watertight lending processes and adequate credit risk control in the largest banking groups, where recent structural changes have also affected the banks' arrangements for credit risk control. In the supervisory visits to local banks the aim was to establish whether these banks had adequate credit risk management in relation to their activities. It was ascertained whether the banks had lending strategies and instructions confirmed by the senior management. As to the organization of credit risk control, it was stressed that the risk control function should be sufficiently strong, professional and independent. Banks were urged to correct shortcomings in instructions and in decision-making and reporting systems for lending.

Large banks have increasingly started to use statistically-based models in their credit risk management. Models can be used to estimate future loan losses and determine necessary loss provisions. With the adoption of statistically-based models, banks have also had to improve the reliability of their risk classification systems and their customer monitoring. Development of risk classifications and credit risk models is increasingly important, because in the future it will be possible to use appropriate classifications and models in the application of the capital adequacy calculation framework now under preparation in the EU. Development of credit risk models is also necessary because banks can use them in their assessment of whether their own funds and capital adequacy are sufficient in relation to their credit risks.

According to the surveys and inspections conducted by the FSA, the risk classification systems of several banks still require improvements before they can be used effectively in applying the capital adequacy calculation framework now under preparation. In connection with the inspections and supervisory visits, banks were informed about the requirements that application of the future capital adequacy framework entails as regards banks' risk classification systems, collateral control and development of credit risk models.

Because of continuing robust economic growth, the banks' lending stock increased throughout the year. House, stock and other asset prices rose sharply at times during the year. The FSA stressed that the banks should make provisions for loan losses to ensure that their capital was adequate to withstand a cyclical downturn. Banks were also encouraged to make provisions for deteriorating collateral values as a result of a possible sharp fall in house and stock prices.

Domestic payment systems were inspected to evaluate the payment transfer service

In inspections of domestic payment systems, the administration and functioning of the payment systems of three banks were assessed together with the management of the associated risks. The main subject of the inspections was the payment transfer service and its backup arrangements and control procedures. In addition the risks related to payment systems, payment transfer services and products and payment service contracts were examined.

As a result of the inspections, the banks were urged to survey the risks involved in domestic payment systems, clearing and settlement of payments and payment services and payment service contracts. The FSA requested the banks to draw up contingency plans for crucial payment systems and departments. The banks were also urged to enhance the risk management of intraday credits in customers' current accounts, for example through written contracts with companies whose accounts were not checked during the day for covering funds. The FSA takes the view that non-verification of covering funds on customers' accounts should be abandoned completely in the long term. The banks were also urged to tighten up supervision and control of authorization rights in payment transfer.

The payment service contract between a bank and a customer generally comprised several individual contracts, terms and conditions and service descriptions. The FSA pointed out to the banks that the contract package would be easier for the customer to manage if the contract terms clearly specified the documents making up the contract package. In addition, there should be a clear indication in the contracts of the order of application of these documents.

Follow-up inspection of settlement risk situation in foreign exchange transactions

On the basis of recommendations by the central banks of the G10 countries and the BIS, the FSA and the Bank of Finland have together endeavoured to ensure that Finnish banks which engage in foreign exchange transactions reduce their settlement risk in accordance with international objectives. In the autumn the FSA conducted a follow-up inspection in four large banks to examine settlement risk in foreign exchange transactions. A key aim of this inspection was to find out what measures the banks had taken since the 1997 inspection visit to reduce settlement risk, what was the current risk level in the banks and how efficiently settlement risk was monitored and managed.

The banks' settlement risks and the limits on them had decreased considerably since the previous inspection, both because of the banks' own measures and the introduction of the euro at the beginning of 1999. The changeover to the single currency eliminated risk with regard to 11 currencies, reduced the amount of foreign exchange transactions and decreased the need for correspondent banks. In spite of the reduction, settlement risks were still large in comparison with the banks' own funds. The banks were urged to continue their efforts to reduce their foreign exchange settlement risks to a level corresponding to their risk bearing capacity.

Security of Internet banking services was assessed

In the course of the year the Internet banking services of four Finnish banks were inspected. The purpose was to assess the banking services offered through the Internet, the way they were organized and what strategic solutions had been applied and, in particular, the security, technical and legal aspects of these services.

With the development and spread of Internet banking services, it has become increasingly important to assess the related risks, which include strategic risk, business risks, operational risks, reputation risks and legal risks.

The FSA required the banks to make a systematic assessment of the overall risks involved in Internet banking services. In addition, the FSA stressed that the risks of individual services offered through the Internet should be estimated and risk surveys carried out before introducing the services.

The security level of the systems should be assessed and security tests performed on a regular basis. The banks should actively try to persuade their customers to make increased use in their bank connections of browsers enabling stronger encryption. Issues concerning the legal position of customers were also addressed, as too were responsibilities of various parties in the provision of portal services.

Reliably identifying and knowing your customer is part of the risk management and security of Internet business activities. It is the duty of the FSA to see to it that the supervised entities comply with anti-money laundering provisions in their operations. In connection with the inspections and supervisory visits, the FSA examined how the supervised entities observe anti-money laundering provisions within the various parts and functions of the organization. In addition the FSA provided training for representatives of the supervised entities and other stakeholders in practical application of anti-money laundering provisions.

Classification of investors was reviewed

Providers of investment services are required to classify their customers into professional and non-professional customers. Whether or not a customer is professional is decided on a case-by-case basis. The criteria for customer classification are defined in the Securities Markets Act and instructions issued by the Finnish Association of Securities Dealers. The instructions have been approved by the FSA.

For example credit institutions, investment firms and insurance companies are considered professional investors directly pursuant to the act. On certain conditions, the provider of investment services can itself notify a customer that it considers the customer to be a professional investor. Alternatively, the customer can himself notify the provider that he is a professional investor. An investor's professional skill in investment is always crucial in determining whether he is a professional investor or not.

The obligation of the provider of investment services to request and provide information and certain other obligations are significantly greater for non-professional investors than they are for professional investors. As only non-professional investors are entitled to protection under the investor compensation fund, it is only from business with these customers that service providers are required to pay a contribution to the fund. Therefore non-professional investors often cause more costs for the provider of investment services than professional investors do.

In the spring and summer of 2000 the FSA reviewed the principles and instructions applied by 19 banks and investment firms for classification of customers into professional and non-professional investors. The FSA assessed whether the classification criteria were in accordance with law, regulations and the FSA-approved instructions of the Finnish Association of Securities Dealers. At the same time the FSA tried to establish whether the reported numbers of non-professional investors used for determining the contributions to the compensation fund were correct.

No significant shortcomings were found in the customer classifications or internal instructions of the supervised entities, but some shortcomings were detected in the numbers of non-professional customers reported to the investor compensation fund. In its instructions to the supervised entities the FSA stressed that, in addition to their classification instructions, the entities should have a system indicating the professional status of each regular customer. Customers should be informed what the classification means as far as they individually are concerned. Furthermore the staff of a supervised entity providing investment services should know the entity's obligations under the Securities Markets Act when offering investment services to non-professional customers.

Issue of valuation of unlisted securities held by mutual funds was clarified

In the autumn the FSA conducted a survey to determine the extent and nature of mutual funds' investments in unlisted securities and how mutual funds value these securities.

The survey showed that in the course of 2000 an increasing number of mutual funds had invested in unlisted securities or securities that were to be listed on the stock exchange within a year. In addition, it was found that the valuation of the same securities varied between management companies. The FSA took the view that non-quotation was not a sufficient reason for continuously valuing these investments at purchase price, particularly when there has been a marked fall in the value of the investment concerned.

No single correct daily value can be determined for unlisted securities. On the other hand, it is clear that the value of unlisted securities cannot remain unchanged merely because of non-quotation in a situation where it is obvious that the previous value is no longer justified as a result of developments with the company concerned or in the economy as a whole. In the opinion of the FSA, the valuation of unlisted securities should be based on predetermined, consistently applied principles.

COOPERATION WITH OTHER AUTHORITIES IN SUPERVISION AND RELATED AREAS

In 2000 the FSA and the other Nordic supervisory authorities agreed on supervision of the Nordic financial services group Nordea. A supervision group comprising Finnish, Swedish, Norwegian and Danish financial supervisors was set up for this purpose. The group meets regularly to plan common supervisory measures and to exchange information on current issues and matters of principle.

The Swedish Finansinspektionen acts as the coordinating supervisory authority, as Nordea's parent company is located in Sweden. The supervision group has also set up task forces to examine the relevant groups of connected customers.

Towards the end of the year the FSA and the Insurance Supervision Authority signed two memoranda of understanding, one on the general principles of cooperation and the other on the supervision of the Sampo-Leonia Group. In the memorandum of understanding on the general principles of cooperation, the parties agreed on the goals of supervision work, the exchange of information, the scope of cooperation in supervision, practical aspects of cooperation and procedures.

Practical cooperation takes place eg within the common supervision group for Sampo-Leonia and the Boards of the FSA and the Insurance Supervision Authority. The task of the supervision group is to ensure that supervisory measures are adequate and appropriately targeted.

Practical cooperation between the FSA and the Bank of Finland in supervision of payment and settlement systems continued within the supervision group set up in 1999. The FSA and the Bank of Finland carried out a joint inspection of developments in settlement risks during the last three years in the foreign exchange transactions of the largest banks. In addition, the rules for banks' payment systems were inspected in cooperation with the Bank of Finland and the Ministry of Finance. The purpose was to revise the rules so as to bring them in line with the EU directive on settlement finality in payment and settlement systems and thus make it possible to report to the European Commission that the payment systems were in compliance with current provisions.

The FSA agreed on cooperation with the Ministry for Foreign Affairs in monitoring compliance with UN and EU economic sanctions in the field of foreign and security policy. In Finland the Ministry for Foreign Affairs has the main responsibility for monitoring compliance with such sanctions. Under EU Council regulations on economic sanctions, the Ministry for Foreign Affairs is entitled to obtain information subject to secrecy requirements from bodies supervised by the FSA, if such information is necessary for ensuring compliance with these regulations. Whenever necessary, the FSA may forward Ministry requests for information on these sanctions to the supervised entities.

Regulatory Activities

REGULATORY APPROACHES

Changes in the operating environment pose new regulatory challenges

Changes that have occurred in the financial markets and the experiences gained from banking crises have forced a reconsideration - at both EU and national level - of what type of regulatory and supervisory framework is best suited to meet the challenges of a changing environment. Laws and regulations must be up to date and able to respond swiftly and flexibly to changes in the operating environment. It has been suggested that what is needed is framework legislation; directives would then focus on key principles and points of departure. More detailed provisions complementing the principles would be left to regulations agreed via the comitology procedure.

Accordingly, future regulatory approaches should be sufficiently flexible at national level so that they do not impede market developments but instead offer scope for the activities warranted by changing circumstances. In addition to flexible regulation, behaviour in financial markets should be guided not only by legally binding rules but to a greater extent by good practices, eg via international best practices and core principles. Consequently, the Financial Supervision Authority (FSA) has launched an evaluation of the application of the international standards, with a view to ensuring that the FSA complies with the principles concerned and that the supervised entities have clear knowledge of them.

Credit institutions, investment firms and insurance companies have established various kinds of corporate groupings, ie financial conglomerates, at an ever increasing pace. This is a global phenomenon. The supervision of financial conglomerates calls for effective supervisory work at practical level and for regulations that acknowledge the special characteristics of conglomerates, for instance by allowing for assessment of their total risk position.

Ongoing globalization has also been one of the key trends underlying recent financial market developments. New technology is making cross-border acquisition and provision of services increasingly easy. To improve their competitiveness, companies operating in financial and capital markets devote increasing efforts to expanding their activities beyond their home country.

Globalization and cross-border activities place higher demands on cooperation between national supervisory authorities. In addition to supervisory cooperation, cross-border activities call for effective information sharing between supervisory authorities, including appropriate procedures for information exchange.

The FSA revises the process for issuing regulations and guidelines

The FSA is revising the issuing process so as to bring it better in line with the market-oriented and proactive supervisory approach laid down in the FSA's strategic guidelines. The revision of the set of regulations and guidelines highlights the key role of international standards as a basis for the regulations and guidelines and for supervisory obligations.

The revised contents of individual regulations will clearly state the background, aims and key principles of the regulation as well as the FSA's expectations regarding the supervised entities. A distinction will be made in the text between binding provisions, ie the obligations on the supervised entities based on legislation and the additional obligations based on the FSA's authority to issue regulations, and non-binding provisions, ie the FSA's interpretations of the issues in hand.

DEVELOPMENTS IN EU LEGISLATION ON FINANCIAL MARKETS

Preparation of legislation on regulation and supervision of financial conglomerates started at national and EU level

The group of experts set up by the Commission to review the supervision of financial conglomerates submitted its proposal on the regulatory needs as regards financial conglomerates to the respective committees at the end of July. Work on the proposal is continuing in the group of experts. The Commission has announced that a Directive on prudential supervision of financial conglomerates will be issued in spring 2001. The directive is not likely to take effect until 2004.

In December the Ministry of Social Affairs and Health and the Ministry of Finance set up a working group to

Table 5. The main laws for which compliance is supervised by the FSA

Credit Institutions Act (30.12.1993/1607, Ra 107)
Commercial Bank Act (28.12.1990/1269, Ra 108)
Savings Bank Act (28.12.1990/1270, Ra 109)
Cooperative Bank Act (28.12.1990/1271, Ra 110)
Act on Foreign Credit and Financial Institutions in Finland (30.12.1993/1608, Ra 112)
Mortgage Bank Act (27.12.1999/1240, Ra 112 a)
Act on Mortgage Societies (8.12.1978/936, Ra 113)
Securities Markets Act (26.5.1989/495, Ra 116)
Act on Trading in Standardized Options and Futures (26.8.1998/772, Ra 117)
Mutual Funds Act (29.1.1999/48, Ra 118)
Investment Firms Act (27.7.1996/579, Ra 119)
Act on Foreign Investment Firms' Right to Provide Investment Services in Finland (26.7.1996/580, Ra 119 a)
Act on the Book Entry System (17.5.1991/826, Ra 120)
Act on the Book Entry Accounts (17.5.1991/827, Ra 122)

Source: Financial Supervision Authority.

urgently draft the necessary legislative proposals for clarification of the competences and responsibilities of the supervisory authorities in the supervision of financial and insurance conglomerates that are currently either subject to the jurisdiction of both the Insurance Supervision Authority and the FSA or totally beyond the scope of supervision.

The working group will also draft proposals concerning the definition of financial and insurance conglomerates and their holding companies and the definition and role of the coordinating authority in the assessment of the overall financial position of financial and insurance conglomerates. The working group will also draft a proposal for provisions on the consolidated annual accounts of financial and insurance conglomerates and for the secrecy obligations applicable to companies within the same financial and insurance conglomerate in handling and sharing customer data. The working group will also consider the draft proposal for a Directive on prudential supervision of financial conglomerates currently under preparation by the European Commission.

The working group includes representatives of the Ministry of Social Affairs and Health, the Ministry of Finance, the Insurance Supervision Authority, the FSA and the Ministry of Justice. The remit of the working group expires at the end of May 2001.

Directive relating to the reorganization and the winding-up of credit institutions close to completion

Because of political disagreement, preparations for the implementation of the Directive relating to the reorganization and the winding-up of credit institutions (the Winding-up Directive) have long been at a standstill. In the spring the preparation of the Directive advanced in the EU's decision-making bodies. The Council adopted a common position on the matter in July. Towards the end of the year the European Parliament made some changes to the common position, which will be discussed in early 2001.

The Winding-up Directive will clarify the provisions governing the exchange of information between authorities and their competences during winding up or liquidation proceedings. The purpose of the Directive is not so much to harmonize legislation on material bankruptcy and winding-up as primarily to specify connecting factor rules in respect of the home member state of credit institutions and the country of residence of their branches, and in respect of the law of property.

Revision of the capital adequacy framework progresses

Following the publication of the proposals of the Basel Committee on Banking Supervision and the European Commission in 1999, work on the revision of the capital adequacy framework has progressed both globally and in Finland. Opinions were delivered on both proposals by the end of March. The FSA contributed to the revision of the framework within the EU's working groups and committees. The FSA also arranged seminars and discussion events on the revision of the capital adequacy framework.

In January 2001 the Basel Committee on Banking Supervision published a new, more detailed draft proposal for a revised capital adequacy framework. The European Commission also circulated for comment its own draft proposal for a revised capital adequacy framework, which largely conforms with that of the Basel Committee. The consultation periods for these proposals expire at the end of May 2001.

The new proposals seek to improve market and financial stability by setting requirements on the minimum amount of own funds, risk management and internal control procedures, supervisory measures and disclosure requirements. These mutually complementary areas are incorporated in the three pillars, namely minimum capital requirements, supervisory review and market discipline.

The method of calculation applicable to minimum capital requirements contains rules for calculating capital charges for credit, market and operational risks. There are various alternatives for calculating capital charges for each risk area. Consequently, supervised entities may themselves select the method that best matches their risk-taking capacity and the quality of risk management systems. The methods for calculating credit risk allow for the employment of ratings granted by external rating agencies. However, the supervised entity may also choose to employ its own internal customer ratings as a basis for the risk classification of credit.

The supervisory review serves to ensure that every supervised entity is able to assess its capital requirements in relation to risk-taking. It is the supervisor's task to assess whether the supervised entity has adequate capital with regard to its risk profile and level of risk management. This requires that supervisors and banks or investment firms thoroughly discuss risk management, risk-taking and capital adequacy.

The revised capital adequacy framework also includes more detailed disclosure requirements. These are designed to ensure that market participants are better equipped to understand the risk profiles of supervised entities and to assess their capital adequacy.

The new capital accord is expected to take effect in 2004.

Consolidated annual accounts to comply with International Accounting Standards (IAS)

In June 2000 the European Commission issued a communication to the European Parliament and the Council on the EU's financial reporting strategy, which sets out an action plan for the application of International Accounting Standards within the EU. The proposals mark a step forward in efforts to create an efficient and transparent capital market in Europe. The importance of an efficient capital market for economic growth and employment in the EU was emphasized in the conclusions of the Lisbon European Council meeting, which set the goal of completing a single European market in financial services by the year 2005.

In February 2001 the Commission issued a proposal for a regulation requiring all listed companies in the EU to prepare consolidated accounts in accordance with International Accounting Standards (IAS), with effect from accounting periods starting 1 January 2005. This requirement will also apply to new listed companies from the same date.

The FSA agrees with several other European financial regulators that the capital adequacy ratios applicable to financial services companies must be based on uniform accounting standards. Division of companies into listed and unlisted companies for accounting purposes cannot be held justifiable if equal treatment is to prevail. Therefore the individual accounts of unlisted companies subject to financial supervision should also comply with International Accounting Standards.

The Communication adopted by the Commission in summer 2000 also noted that an enforcement mechanism must be designed to ensure uniform application of the standards. This mechanism should embrace clear accounting standards, up-to-date interpretations and implementation guidelines, statutory auditing, monitoring by supervisors and effective sanctions. In its Communication, the Commission requested FESCO, the organization for cooperation between national securities markets supervisors from EEA countries, to prepare a proposal for principles governing supervision and effective sanctions. To this end, FESCO set up an accounting group to draft a proposal for general principles governing supervision. Studies show that enforcement of the current accounting standards of listed companies differ considerably between member countries in terms of both their scope and contents.

The FSA was represented on groups of experts under the Commission and FESCO which discussed the implementation of International Accounting Standards and related compliance monitoring. In October–November the FSA organized a two-day seminar on the International Accounting Standards for the supervised entities. Auditors of the supervised entities and representatives of the Ministry of Finance and the Ministry of Trade and Industry were also invited to attend the seminar.

The Electronic Money Directive took effect

On 18 September 2000, the European Parliament and Council issued Directive 2000/46/EC on the taking up, pursuit of and prudential supervision of the business of electronic money institutions. The Directive is designed to harmonize the supervision of electronic money institutions and the requirements applicable to the business of electronic money institutions. If an electronic money institution operates in one member state alone, the competent authorities may diverge from the requirements set out in the directive.

Electronic money institution means an undertaking or any other legal person, other than a credit institution as defined in Directive 2000/12/EC, which issues means of payment in the form of electronic money. Electronic money institutions are required to have an initial capital of not less than EUR one million. The electronic storage device at the disposal of bearers is subject to a maximum storage amount of not more than EUR 150. Electronic money institutions are under a contractual obligation to redeem the bearer for the amount of unused electronic money at par value. The Directive is expected to be transposed into national law during 2001. Arrangements for the supervision of operations will be made within the same time frame.

The FSA monitors electronic money institutions and amounts of money in circulation. The amounts of electronic money in circulation in 2000 were not significant in markka terms.

Preparations for amending the UCITS Directive continue

The two proposals for amending the UCITS Directive submitted in July 1998 were further discussed in the group of experts of the European Council. Amending the directive has proved to be very difficult as market structures and legal provisions differ between member states. The Council of Ministers reached political agreement on the proposal for new fund instruments (fund of funds and cash, derivatives and index fund schemes) on 17 October 2000. On 1 March 2001 political agreement was reached on the proposal for minimum harmonization of management companies and the European passport.

Proposal for amending the Money Laundering Directive advanced in the EU

The EU Council adopted a common position on the proposal amending the Money Laundering Directive, which will be submitted for a second reading by the European Parliament in spring 2001. After that any further reading of the proposal will take place under the codecision procedure.

The main amendment to the directive concerns its scope of application. According to the proposal, the scope of application of the directive will be extended to cover all credit and financial institutions and to auditors, external accountants and tax advisers, as well as to real estate agents, casinos and dealers in high value goods (yet to be defined in detail). The directive will also apply to independent legal practitioners participating in the design or implementation of different financial services on behalf of their customers. The directive also includes an article on the principles of remote customer identification.

LEGISLATIVE PROPOSALS AND OTHER INITIATIVES OF THE FSA

FSA proposal for more extensive supervisory powers

In spring the FSA submitted a proposal to the Ministry of Finance mainly concerning changes in its supervisory powers and in some other provisions of the Act on the Financial Supervision Authority. The proposal also included amendments to the provisions of the Credit Institutions Act, individual bank acts, the Investment Firms Act and the Securities Markets Act.

The FSA proposed to the Ministry of Finance that the range of sanctions available to it under the Act on the Financial Supervision Authority be widened. The new forms of sanction proposed by the FSA include an administrative sanction imposed as a fine, imposition of a ban on the business activities of a private person and use of admonitions and warnings. According to the FSA's proposal, the above sanctions could also be applied to entities other than those supervised by it.

The FSA's powers are currently limited to the conditional imposition of a fine and the submission of a motion to withdraw authorization. In the FSA's opinion these measures are too severe, especially in the case of minor violations.

The Ministry of Finance has started preparations for the extension of the FSA's supervisory powers.

The FSA calls for improvements in the procedure for the settlement of investment disputes

In the opinion of the FSA, private investors should have access to a simple, speedy and inexpensive procedure for the settlement of disputes arising between investors and investment service providers. Settlement of disputes in a general court is often a highly expensive and arduous procedure.

One alternative would be an impartial body which would settle disputes between investors and investment service providers swiftly and effectively, possibly operating within the framework of the EU-wide customer complaints network[1]. The FSA thus contacted the Ministry of Finance and the Consumer Complaint Board, as well as investment service providers and service users, to explore the possibility of developing a contractual dispute settlement mechanism for the securities markets.

Several countries have introduced contractual advisory and customer complaint boards of various kinds to provide protection for private persons, especially in the banking and insurance field. Eg the United Kingdom and the Netherlands have their own channels for investigating complaints made by investors. In Finland, the Advisory Office for Bank Customers and the Consumer Insurance Office focus on advisory functions, whereas the Insurance Board issues recommendations for the settlement of disputes arising from insurance contracts.

Preparations will continue in 2001. The issue will also be discussed by a Ministry of Trade and Industry working group that is investigating the possibility of extending the purview of the Consumer Complaint Board.

LEGISLATIVE PROJECTS

Proposal of the working group on banking services circulated for comment

The FSA participated in the working group appointed by the Ministry of Finance to draw up a proposal on acceptance of deposits and other repayable funds from the public and on revision of legislation on payment transmission. The working group submitted its report on 5 January 2001.

The working group proposes, inter alia, that provisions on the right of credit institutions and investment firms to provide services through a representative be included in the Credit Institutions Act, together with provisions on the requirements for using a representative and related compliance monitoring. It further suggests that institutions other than deposit banks and savings funds be allowed to accept funds repayable on demand from the public on customer accounts in the maximum amount of EUR 3,000 per customer. This requires that the funds deposited on customer accounts may, with the permission of the recipient or the FSA, be used as payment for goods or services provided by another company in the same group of companies, or withdrawn in cash.

The working group proposes that the special provisions governing savings funds be repealed after a five-year transition period. It also suggests that payment transmission and issue of electronic money be made subject to authorization. These operations would be subject to authorization to operate as a payment organization, which is less broad than the authorization of a credit institution. The proposal will be refined at the Ministry on the basis of responses received.

Provisions on marketing by insurance companies and credit institutions were harmonized

A proposal for amending the Insurance Companies Act and certain related acts is currently being discussed by the Finnish parliament (Government

[1] In its Action Plan to Implement the Framework for Financial Markets, the European Commission draws attention to the development of means for the settlement of disputes. In 2000 the Commission worked to develop an EU-wide network (FIN-NET) built around the national customer complaint bodies. The network was completed in January 2001.

proposal 206/2000). The main aims of the proposal are to extend the scope of business that insurance companies may pursue and to harmonize, where applicable, the provisions on the marketing by insurance companies and credit institutions and related monitoring. The proposal also includes provisions on the activities of representatives in marketing contexts.

GUIDELINES AND REGULATIONS ISSUED BY THE FSA

In spring 2000 the FSA revised its regulation on monthly reporting by mutual funds. The revised regulation was applied for the first time in the reporting of data to the FSA for the situation at the end of May. Following the reform of reporting practices, the FSA started to release monthly data on its website on the breakdown of the total net assets of Finnish mutual funds between private persons and corporate entities, and on the market shares of management companies.

The revised regulation on the accounting of credit institutions abolished the requirement for supervised entities to obtain advance approval from the FSA to make loan loss provisions on a customer-by-customer basis or in respect of a customer group or group of claims. It also includes some additions based on the key sections of the recommendation on accounting for the credit portfolio put forward by the Basel Committee.

The guideline on the authorization of credit institutions was revised. According to the revised guideline, an assessment of fitness and propriety needs to be undertaken only for those owners of credit institutions starting up business whose holding in the shares, participations or votes of the credit institution represents at least 10%.

The guideline on the contents of the fit and proper assessments of managers and directors entered into force at the same time as the guideline on the authorization of credit institutions. The contents of any fit and proper statements on new managers or directors submitted in the course of continuous supervision must be the same as that of statements submitted with applications for authorization. The guidelines set out more detailed provisions on the scope of persons covered by the reporting requirement. The reporting requirement no longer applies to members of supervisory boards.

The revised capital adequacy provisions issued by the FSA took effect in July. The revisions were related to the legislative amendments that took effect in Finland on 21 July 2000 (684/2000), implementing the amendments to directives 98/31/EC, 98/32/EC and 98/33/EC adopted by the EU in 1998. The supervised entities may employ their own models in the calculation of market risk. The 'mark-to-market' method must be used in the calculation of credit risk on all derivatives whenever a high degree of market risk is associated with the asset items of a credit institution or an investment firm. In the capital adequacy calculations, a capital charge will be imposed with respect to derivatives the underlying assets of which are shares or commodities. Furthermore, the risk-weighting for securitized mortgage lending was changed.

The regulation on reporting country risk was defined in accordance with the classification used in the joint production of statistics (VIRATI). The most recent amendments took effect at the beginning of 2001. Amendments of a technical nature were made in the regulation on reporting cash reserves. The revised regulation took effect on 31 August 2000.

FSA STATEMENTS

Share subscription exclusively via the Internet now permissible

The FSA revised its former position on the subscription of shares via the Internet. According to the new statement of the FSA, subscription exclusively via the Internet is permissible, provided that the place of subscription ensures the reliability and adequate capacity of the subscription system as well as the proper identification of subscribers.

Provision of online financial services

The statement on the provision of online financial services sets out the FSA's views and interpretations of the various issues to be considered by the supervised entities in the provision of online financial services. The statement discusses risk management, information technology and information security as well as issues pertaining to electronic contracts and electronic customer identification.

Investment firms may also offer nonstandardized commodity derivatives

The FSA revised its interpretation of the commodity derivatives business that investment firms may pursue. In its new statement, the FSA takes the view that investment firms may also offer nonstandardized commodity derivatives to their customers. Previously, only banks could offer non-standardized commodity derivatives in Finland.

Credit institutions must publish details of their property risks in their annual accounts

The property portfolios of some credit institutions still contain valuation risks that are not disclosed in financial statements and thus cannot be recognized by external appraisers when they analyze the financial position and capital adequacy of credit institutions. The statement issued by the FSA in December includes a recommendation of the additional financial information to be disclosed in annual accounts on significant holdings of non-owner-occupied property. Owing to the economic recession and reduction in the size of branch networks, holdings of non-owner-occupied property have become considerably larger than is needed by banks for operating their service networks.

The scope of application of the statement was limited to financial information to be disclosed in the annual accounts in 2000–2004. This is in line with the prevailing view that the annual accounts of credit institutions must comply with International Accounting Standards (IAS) with effect from 2005. Under IAS 40 covering investment property, investment property should be entered in the books either at fair value or at depreciated cost. In the latter case, the fair value must however be disclosed in the notes to the annual accounts.

Treatment of credit derivatives for capital adequacy and large exposures purposes

The use of credit derivatives[2] in different countries has grown rapidly during the past few years[3]. With a view to clarifying the treatment of credit derivatives for reporting purposes and removing possible obstacles to the use of credit derivatives, the FSA issued a statement on credit derivatives and large exposures treatment in December. The EU directives do not yet include provisions on credit derivatives.

The statement only applies to the most common types of credit derivative (credit default swaps, total return swaps and credit linked notes). The credit institution must consult with the FSA before it introduces other types of contract, or contracts the terms of which differ from those set out in the statement. The FSA plans to update the statement whenever changes are made to the capital adequacy framework.

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[2] Credit derivatives is a general term used to describe various financial instruments designed for effective management of credit risk. The instruments are used for reducing or assuming credit risk on loans and other assets through off-balance sheet transactions. Credit institutions can be end users of credit derivatives or parties who act as intermediaries. A credit institution that is an end user may use credit derivatives for reducing risk concentrations, diversifying credit portfolios and managing total credit risk. Credit derivatives make it possible to transfer credit risk between parties separately from other risks and can be considered an extension of other similar risk-reducing products such as interest rate and currency swaps. Properly used credit derivatives can further credit risk diversification, increase return and lower the credit institution's risk profile. Credit institutions can use credit derivatives to both transfer and assume credit risk. When a credit institution takes a risk, it assumes a credit risk that it did not have before. Credit derivatives are mainly off-balance sheet items as opposed to traditional loans entered on the balance sheet.

[3] One reason for this has been the various new tools developed for modelling credit risk and another the product standard '1999 ISDA Credit Derivatives Definitions' published by the International Swaps and Derivatives Association (ISDA).

International Activities

BASIS FOR INTERNATIONAL ACTIVITIES

Through its international activities, the FSA seeks to actively influence market practices and foster convergence of regulation and supervision, especially at EU level. The international activities of the FSA comprise participation in various fora for cooperation and cooperation in the field of supervision with the supervisory authorities of other countries.

The FSA observes international standards in its activities. The most important standards from the FSA's point of view are the IMF's Code of Good Practices on Transparency in Financial Policies, the Basel Committee's Core Principles for Effective Banking Supervision and IOSCO's Objectives and Principles of Securities Regulation.

Pressure for greater harmonization of regulation and supervision increases

The need for common regulatory standards, a code of conduct for supervision and exchange of information is growing continually, and pressure for greater convergence of regulatory and supervisory practices is increasing. The regulation and supervision of multinational financial conglomerates, which have come into being as a result of cross-border and cross-sector mergers, poses growing challenges for supervisory authorities. Moreover, a common regulatory and supervisory framework is a prerequisite for the existence of a level playing field for all financial institutions, providers of investment services and issuers of securities throughout the European Union. A further aim is to make it easier for investors and consumers to benefit from the provision of financial services on an EU-wide basis. This requires the adoption of common practices in cross-border trading and in the provision of investment and banking services, as well as a more consistent approach to consumer and investor protection.

The Brouwer group, a working group functioning under the aegis of the Economic and Financial Committee of the Council of Economic and Finance Ministers (Ecofin) examined whether the existing regulatory and supervisory structure in the European financial services industry was adequate to safeguard financial stability. The Brouwer group noted that, for the present at least, there was no need for centralization of financial supervision in a pan-European organization. Rather, it would be more important to ensure that there is adequate cooperation between supervisors and convergence of supervisory practices. The division of responsibilities between the various bodies for cooperation in the regulation and supervision of the European banking sector was discussed and clarified, particularly following the publication of the Brouwer Report.

Another working group set up by Ecofin, the Committee of Wise Men (the Lamfalussy Group), assessed the current state of regulation and supervision in the European securities markets and the need for improvement. In February 2001 the working group released a report containing proposals for developing EU legislation on securities markets. The report emphasizes the need to speed up the EU's legislative process, but in a manner which would maintain the present balance between the EU institutions, namely the European Parliament, the European Commission and the Council.

The proposal made by the Committee of Wise Men is based on a four-stage approach, the highest level of which consists of framework legislation to be enacted at directive level and containing provisions on the key principles. More detailed legal provisions subject to frequent amendment would be implemented through comitology procedures. The committee also proposes that a Securities Committee made up of representatives of the member states be set up. This committee would be a comitology committee in line with EU comitology procedures, which, under powers laid down in directives, would be able to adopt legal provisions on details concerning directives and their technical implementation. The Securities Committee would be assisted by a Regulators' Committee composed of regulators from national regulatory authorities. The Regulators Committee would participate in the comitology process by setting forth the views of regulatory authorities on the preparation of various matters. A further task of this committee would be to enhance cooperation between regulatory authorities in the regulation of markets and application of EU law. In addition, the Lamfalussy group recommends that the European Commission step up its efforts to ensure implementation and enforcement of EU legislation.

The recommendations of the Committee of Wise Men were discussed at the EU summit in Stockholm in March.

PARTICIPATION IN INTERNATIONAL FORA FOR COOPERATION

Main cooperation partners are in Europe

The most important fora for the FSA are in Europe. They comprise the Forum of European Securities Commissions (FESCO), the Banking Supervision Committee (BSC) of the European System of Central Banks, the Banking Advisory Committee (BAC) of the European Commission and the Groupe de Contact, a forum for banking supervisors from EEA countries.

These fora draw up common standards for banking and securities market supervision and regulation. At the meetings, participants exchange information on recent developments in national markets, supervisory issues and national regulations and guidelines. They also discuss financial market developments and trends of international importance. In addition to these fora, cooperation takes place within numerous expert groups working under their auspices.

Global fora for cooperation of importance for the FSA include the International Organization of Securities Commissions (IOSCO), the International Monetary Fund (IMF), the Basel Committee on Banking Supervision and the Joint Forum, which is made up of representatives from the Basel Committee, IOSCO and the International Association of Insurance Supervisors (IAIS). Although the FSA, either because of membership restrictions or lack of resources, cannot participate directly in the activities of all these fora, it nevertheless endeavours to observe the standards and recommendations adopted by these bodies in its activities.

The FSA participated in the work of numerous cooperative bodies

The FSA participated in the work of the BAC. Among other things, the BAC was involved in drafting amendments to the capital adequacy directives for credit institutions and investment firms and in preparing a draft directive on the regulation and supervision of financial conglomerates. The BAC assists the European Commission in the preparation of EU legislation on financial institutions and provides advice and guidance on other matters related to EU banking regulation and supervision. It also assists the European Commission in practical aspects of implementation of EU banking directives.

The FSA also took part in the work of the Banking Supervision Committee (BSC) of the European System of Central Banks (ESCB). The BSC assists the ESCB in its tasks related to supervision of credit institutions and financial stability. As part of this work, the BSC assesses trends in European banking and financial systems and the effects of economic developments on the banking sector. In 2000 the European Central Bank (ECB) published several reports drafted by the BSC, including Mergers and acquisitions involving the EU banking industry – facts and implications, EU banks' margins and credit standards, EU banks' income structure and Asset prices and banking stability. In addition, the BSC promoted exchange of information between banking supervisors and central banks at a general level, for example on financial stability and on cooperation in the areas of oversight of payment and settlement systems and prudential supervision of institutions.

The Groupe de Contact, the informal body for cooperation between banking supervisors from EEA countries, addressed a range of issues, including the monitoring of banks' liquidity positions, interest rate risk on credit portfolios, loan loss accounting practices in different countries and ways in which supervisors can make sure that supervised entities make timely and appropriate allowances for credit portfolio deterioration. In addition, the Groupe de Contact discussed the use of the Internet in the provision of cross-border services, drafted its annual summary on the profitability and capital adequacy of banks in the EEA countries and prepared a report on cooperation with supervisory authorities in third non-EEA countries.

The Brouwer group (see p. 32) did not consider it necessary to set up a pan-European supervisory organization. It did, however, emphasize the need for cooperation between supervisory authorities in order to achieve convergence of supervision at a practical level. In fact, the Groupe de Contact has examined, at the request of the BAC and the BSC, key areas of supervisory convergence and drawn up general principles for application in the countries concerned. Areas where convergence was considered to be most urgent were the supervisory review in accordance with the second pillar of the proposed new capital adequacy framework, ie risk evaluation, monitoring of credit risk control and credit loss accounting, liquidity control and provision of cross-border services on the Internet.

The biennal International Conference of Banking Supervisors (ICBS) was held in Switzerland in 2000. The main themes of the conference were the revision of the Basel Capital Accord and banking supervision in the 21st century.

Together with representatives of the Ministry of Finance and the Bank of Finland, the FSA took part in the work of the High Level Securities Supervisors Committee (HLSSC) set up by the European Commission. The committee discussed the implementation of on-going projects under the Financial Services Action Plan and the development of EU legislative procedures in the financial field on the basis of the proposal made by the Committee of Wise Men (see p. 32). The HLSSC has informal status, as plans to set up an official body for the securities markets correpsonding to the BAC for the banking sector are still pending owing to disputes between the EU institutions.

The FSA also took part in the work of the Financial Action Task Force on Money Laundering (FATF). The FATF is an intergovernmental working group set up by the G7 countries more than 10 years ago. Its members comprise 29 governments and 2 regional organizations. The FATF seeks to promote the adoption of anti-laundering legislation throughout the world and compliance with international standards, including FATF recommendations.

In 2000 the FATF published a report on non-cooperative jurisdictions and a list of the countries and territories concerned. These are countries or territories whose anti-laundering legal framework is inadequate and does not comply with international standards or FATF recommendations. The FATF is continuing to monitor developments in non-cooperative countries and territories. In addition, the FATF has begun to modify its 40 recommendations to make them more compatible with a changing environment.

FESCO drafted several proposals for developing the securities markets

The Forum of European Securities Commissions (FESCO), which is an organization for cooperation between securities market regulators in the European Economic Area (EEA), has established itself as an important contributor to the development of regulation and supervision of European securities markets. FESCO's work in 2000 focused on promoting cooperation between supervisory authorities in the supervision of securities markets and on implementing the Financial Services Action Plan of the European Commission.

Cooperation in the field of supervision and investigation and exchange of information took place within FESCOPOL, the cooperative body set up for this purpose. Other key FESCO working groups included the experts groups on investor protection, European public offers, market abuse, alternative trading systems and allotment and stabilization in connection with securities offerings; the last-mentioned experts group was chaired by the Director General of the FSA. In 2000 the experts groups drafted several proposals for common standards, which are described in more detail below.

In 2000 the European Commission commissioned FESCO to develop a model for supervision according to IAS standards. The preparatory work was done by an accounting group set up for the purpose, and in early 2001 a permanent Accounting Committee was set up at FESCO.

FESCO's standards for classifying investors as either professional or non-professional investors were adopted in 2000. The proposal for a conduct of business rules regulating the relationship between providers of investment services and customers was circulated for comments to market participants in February 2001.

A proposal published by FESCO on measures for facilitating cross-border issues of securities was circulated for comment in May 2000. The measures proposed include the speeding up of the procedure for approving listing particulars and harmonization of practices. FESCO proposes that listing particulars should be divided into two documents: the 'Registration Document' and the 'Securities Note'.

According to the proposal, the registration document would be approved by the issuer's home-country authority and would contain basic information concerning the issuer, eg the company's structure and financial position. The registration document should be approved in English or another language approved by the competent authority in the issuer's home country. If necessary, the competent authority may require a summary to be published in the language of the investor's home country. The securities note would then contain the conditions specific to a particular issue and be drafted in the language of the investor's home country. FESCO member states would automatically recognise listing particulars approved in other member states. FESCO members also recommend that listing particulars be distributed in an electronic format, ie via the Internet, in addition to traditional printed form.

In the autumn FESCO submitted a proposal to the European Commission on the contents of a directive on market abuse. The aim is to regulate market manipulation within the EU according to common standards. FESCO proposes that the provisions of this directive define as clearly as possible what constitutes non-permissible manipulation. FESCO further proposes that the means of intervention at supervisory authorities' disposal be enhanced by introducing administrative sanctions and increasing the authorities' investigating powers. The European Commission is expected to issue its draft directive in spring 2001. The experts group dealing with market abuse is continuing its work by defining preventative measures to combat market abuse. These measures include eg the obligation to keep registers of trading and separation of functions (Chinese walls).

The experts group on alternative trading systems submitted a proposal to the European Commission and Parliament in September. The experts group addressed issues related to the supervision and regulation of securities trading systems that have evolved outside regulated public marketplaces.

Proposals on standards for stabilization and allotment of securities were circulated for comments in September. After amendment on the basis of comments received, the standards will be recirculated for comments in spring 2001. The purpose of stabilization rules is to make it possible to support the price of a security for a limited period of time in connection with an offering without the party responsible for stabilization being guilty of market manipulation. Permissible stabilization activities include purchases undertaken to support the price of a security if it falls below its offering price. The standards proposed by FESCO stipulate, inter alia, the information concerning stabilization that should be disclosed in the listing particulars as well as when and how potential stabilization can be undertaken. The standards also include provisions on disclosure of the stabilization activities undertaken.

The aim of the proposals concerning allotment is to foster fair treatment of investors in connection with equity offerings. This is to be done by improving investors' access to information. FESCO proposes that the prospectus should give the main features how shares will be allotted among investors and whether any particular investor group, eg management or employees of the company concerned, will receive preferential treatment.

COOPERATION IN THE FIELD OF SUPERVISION

The principles of cooperation are laid down in memoranda of understanding

International cooperation between authorities responsible for the supervision of financial markets is based on bilateral documents that lay down the overall principles of cooperation in supervision matters. These documents are commonly referred to as Memoranda of Understanding (MoUs).

The MoUs and supplementary MoUs provide the basis for practical cooperation between supervisory authorities at international, and nowadays also national, level. When improving and intensifying cooperation with supervisory authorities abroad, the FSA ensures that the operations and operating units of Finnish banks and securities firms in other countries have come within the scope of supervision. Similarly, international cooperation means that the activities of other countries' banks and investment firms in Finland are supervised according to jointly agreed principles.

MoUs are documents setting out the principles governing cooperation between the authorities concerned in eg the following areas: monitoring of liquidity positions; action to be taken in crisis situations; supervision of group subsidiaries and associated companies operating in another country; and inspections conducted in branches. In addition, the MoUs define the notification and authorization application procedures to be observed in the setting up of branches and the notification procedure to be applied in the provision of cross-border financial services. MoUs also contain jointly agreed procedures and practices for exchanging information between authorities.

By the end of 2000 the FSA had signed MoUs with 12 countries: Estonia, France, Germany, Holland, Latvia, Lithuania, Luxembourg and the United Kingdom, and Denmark, Iceland, Norway and Sweden, which are parties to the pan-Nordic multilateral MoU.

As regards supervision of securities markets, the FSA is one of the parties to FESCO's multilateral MoU. The other parties are Austria, Belgium, Denmark, France, Germany, Greece, Holland, Iceland, Ireland, Italy, Luxembourg, Norway, Portugal, Spain, Sweden and the United Kingdom.

A pan-Nordic multilateral MoU was signed

A pan-Nordic multilateral MoU, replacing all earlier bilateral MoUs between Nordic countries, was signed between the five Nordic countries in spring 2000. The Nordic authorities adopted the principles and procedures agreed on in the MoU as the basis for their supervisory cooperation. The new MoU covers banking, insurance and securities market activities, thus bringing Nordic insurance institutions, securities markets and securities firms within the scope of jointly agreed general principles concerning supervision.

If the supervision of a large branch or financial conglomerate calls for special forms of cooperation or procedures not covered by the pan-Nordic MoU, the relevant authorities may draw up supplementary MoUs governing the supervision of the branch or conglomerate concerned. For example, a joint supplementary MoU of this kind was drawn up in 2000 on the supervision of the Nordea Group.

The annual meeting of the Director Generals of the financial and insurance supervision authorities of the Nordic countries was held in Turku in 2000. The meeting also marked the 75th anniversary of Nordic cooperation in the field of banking supervision. Issues addressed at the meeting included the current state of affairs and development of European financial supervision, especially in the light of the Brouwer Report, the revision of the capital adequacy framework for banks and investment firms and the supervision and regulation of financial conglomerates. Methodological issues were also discussed, namely proactive supervision and supervisors' powers.

Cooperation between the IT supervisors of the Nordic supervisory authorities was intensified. The FSA arranged two meetings in Helsinki, one in early June and another, focusing exclusively on Internet issues, in early October. As an outcome of the meetings, agreement was reached on a common Internet banking supervision model. It is intended to introduce the model in all the Nordic countries in 2001.

A meeting of the Nordic mutual fund supervisors was held in Helsinki in November. Issues discussed includes supervisory procedures relating to mutual fund rules and inspections of management companies, supervisory procedures pertaining to custodians and management companies and the new demands placed on supervision by new and increasingly complex fund products and so-called risk funds.

The annual meeting of the Nordic bank supervisors was held in Reykjavik in November. Issues discussed included general developments in banking supervision in the Nordic region and supervisory practices and bank analyses in the Nordic countries. Special attention was focused on the current revision of the capital adequacy framework and supervision of capital adequacy and the risk classification of credit institutions for supervisory purposes. The current situation as regards inspections of foreign branches of Nordic banks was also discussed.

Organizational Development

Basis for organizational development

The structural changes in the financial markets, the growth of securities investment, the increased complexity of investment products, the more widespread use of information networks in the provision of financial services and the new modes of operating by supervised entities also mean changes in the work of the supervisory authorities. This calls for a wider range of competences and increased efficiency on the part of supervisors. These changes, together with close international cooperation, require continuous development of skills and procedures and the mastering of tools and new techniques.

In spring 2000 an employee attitude survey was conducted at the FSA as part of a similar survey carried out at the Bank of Finland. The purpose of survey at the FSA was to find out employees' views on adjustment to changes in the operating environment, on the working atmosphere at the FSA and on adjustment to operational and organizational changes. The staff participated actively in the survey, the response rate being 73%. The results of the employee attitude survey exceeded the average level for Finnish experts in surveys of this kind. The results will be used for developing the FSA's activities.

Staff skills were developed to meet future needs

On the basis of its strategic objectives and the changes in financial markets, the FSA revised the goals set previously for skills development. Accordingly, training programmes were launched in the main areas selected for skills development. In addition, the FSA analyzed how revision of the capital adequacy framework would affect the FSA's activities and assessed what areas of supervisory competence need to be developed with a view to its implementation.

In cooperation with the Research Department of the Bank of Finland, the FSA arranged a course for its experts on the main principles and solution methods applied in credit risk modelling. The course was complemented by four presentations on practical applications of the model. For the purposes of assessment of operational risk, a customized course on operational risk was arranged covering issues related to risk determination, measurement, provisioning and management. In the autumn FSA employees attended a one-day seminar organized by the Insurance Supervision Authority focusing on insurance company accounting, particularly from the viewpoint of supervision of financial conglomerates.

To increase its knowledge of securities market practices, the FSA held meetings with supervised entities to discuss the newest working practices and topical problems in the markets. In 2000 representatives of the FSA also attended seminars arranged by the supervisory authorities of the United States and the United Kingdom.

A competence development plan for increasing the IT skills of the entire FSA staff was drawn up in 2000, and its implementation was begun during the year. The IT driving licence was defined as the general level of competence which all FSA employees should have passed by the end of 2001[1]. By the end of 2000 about 55 FSA employees out of a total of 130 had passed the examination.

A management training programme was arranged to instruct FSA managers on the use of human resource management tools in practical managerial work. The role of managers in achieving results was also focused on. In addition, one FSA manager joined the training programme Heading for Leadership arranged by the European Central Bank.

A three-year plan was drawn up for the development of FSA employees' communication skills. The need for development was assessed in connection with performance discussions, and on the basis of these individual development plans were drawn up.

Proactive human resource planning was used to assess future resource needs

In response to the growing demands being placed on supervision, the FSA introduced proactive resource planning based on three-year projections as part of its annual action planning. In this context, the FSA assessed resource needs and reallocation of resources owing to growing supervisory requirements and whether any tasks or routines could be discontinued or outsourced.

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[1] *The IT Driving Licence is a basic examination of IT skills jointly developed by the Finnish Information Technology Development Centre, the Ministry of Education and the Ministry of Labour.*

As a result of the assessment, the FSA decided to further intensify its activities and to improve internal processes that cut across departmental boundaries by, for example, centralizing the reception and processing of reports of similar kinds submitted by investment firms and credit institutions. The FSA also sought to use inspection resources efficiently across departmental boundaries.

In July the FSA introduced a process management model for use in regulatory activities. In addition, the FSA will develop supervisory processes that cut across organizational lines, for example, the processing of authorization applications from credit institutions, investment firms and management companies.

Job rotation was continued to strengthen operational reliability and skills development. The FSA plans to explore the possibility of discontinuing discretionary tasks during 2001. The operational strength of the FSA is projected to grow by four persons in 2001.

The procedures for managing operational risks were improved

In keeping with the principles of internal control adopted by the board of the FSA, the FSA reviewed the management of its own operational risks and related procedures as part of its annual action planning. The coverage of risk evaluation was reviewed and the evaluation method improved. The major part of risk management requirements is related to the allocation of supervisory resources and ensuring that resources are adequate with respect to identified supervisory risks. In addition, continuous skills development must take into account the requirements set by the operating environment. Management of operational risks calls for purposeful and versatile skills development, more efficient working practices and proactive resource planning.

Evaluation of goal achievement in supervision was developed

The FSA examined what methods and criteria could be used for evaluating goal achievement more effectively and reliably. The aim was to develop a performance evaluation procedure that would enable more effective use of indicators reflecting developments in the operating environment, international and domestic surveys and, where necessary, separate enquiries. The evaluation model should be based on a balanced score card similar to that used in state administration, where results are assessed from four different angles: effectiveness of supervision; supervised entities; internal procedures; and skills development. The purpose of official supervision is to ensure that supervised entities act in a way that fosters confidence and stability, that their activities are guided by the principle of own responsibility and that market discipline functions effectively. This serves as the basis for performance evaluation.

Information usability was enhanced

The FSA has extensive databases on supervision at its disposal. In June a project was launched to centralize all data on supervised entities within a single location for the benefit of information users. When the user selects a supervised entity, the web browser opens a page with links to documents containing information on the supervised entity. In principle, any information stored in the databases may be quickly accessed in this way.

In early 2001 a journal program based on the electronic document processing system Documentum was introduced at the FSA. The FSA plans to computerize its entire document management and archiving systems within the next couple of years, thus improving information searching, particularly from archived documents.

The FSA in Brief

The Financial Supervision Authority (FSA) is the authority that supervises financial markets in Finland. It was established in 1993 as part of the administrative structure of the Bank of Finland. The predecessor of the FSA was the Bank Inspectorate (later Banking Supervision Office), which functioned under the Ministry of Finance from 1922 to 1993.

The FSA is an independent supervisory authority

The FSA is connected administratively with the Bank of Finland, from which it obtains services relating to personnel and financial administration, information management, security, other areas of general administration, etc.

The FSA is independent in its decision-making. The Director General of the FSA is vested with the FSA's decision-making authority on supervisory and regulatory matters. He is assisted by an advisory Management Group. The Director General must consult the Management Group before taking decisions on important issues. The Management Group consists of seven members, namely the Deputy Directors General, a Deputy

Table 6. Financial Supervision Authority: expenses and income, 1999 and 2000

	Actual 1999 FIM 1000	**Actual 2000 FIM 1000**	Budgeted 2001 FIM 1000	Budgeted 2001 EUR 1000
EXPENSES				
STAFF EXPENSES				
WAGES				
Permanent employees	28 245	**30 967**	33 175	5 580
Fixed-term employees	3 435	**2 531**	2 548	429
Holiday substitutes	472	**430**	595	100
Other fees	328	**367**	491	83
Total	32 480	**34 295**	36 809	6 191
OTHER STAFF EXPENSES				
Staff-related expenses	9 698	**10 888**	11 730	1 973
Other staff expenses	718	**539**	823	138
Total	10 416	**11 426**	12 553	2 111
OTHER EXPENSES				
Training	1 797	**1 987**	2 366	398
Travel	1 593	**1 728**	2 412	406
IT expenses	4 378	**4 556**	5 581	939
Office services	3 595	**4 304**	5 518	928
Real estate rents and maintenance costs	4 930	**5 969**	7 532	1 267
Other expenses	3 101	**3 141**	4 690	789
Total	19 393	**21 685**	28 098	4 726
DEPRECIATION				
Acquisition of machinery	152	**732**	230	39
Total	152	**732**	230	39
TOTAL EXPENSES	62 440	**68 138**	77 690	1 305
INCOME				
Supervision fees	–58 773	**–64 494**	–74 203	–12 480
Processing fees	–3 314	**–3 576**	–3 477	–585
Other income	–346	**–105**	–10	–2
TOTAL INCOME	–62 433	**–68 174**	–77 690	–13 067

Source: Financial Supervision Authority.

Table 7. Supervision and processing fees, 1999 and 2000

	2000 FIM 1000	1999 FIM 1000
SUPERVISION FEES		
Commercial banks	**27 481**	25 859
Central institution and member banks of the amalgamation of cooperative banks	**7 501**	7 441
Local cooperative banks	**846**	846
Savings banks	**1 173**	1 138
Savings banks foundations	**877**	793
Other credit institutions	**5 721**	5 345
Guarantee funds	**204**	265
Representative offices and branches of foreign credit institutions	**278**	245
Credit institutions' holding companies	**90**	90
Pawnshops	**48**	50
Marketplaces	**2 602**	2 677
Firms offering investment services	**8 580**	6 550
Managemet companies	**3 151**	2 663
Book-entry system	**1 975**	1 331
Issuers	**2 961**	2 336
Keepers of insider registers	**1 006**	1 157
Total	**64 494**	58 785
PROCESSING FEES		
Management companies	**1 250**	1 198
Issuers	**1 941**	1 423
Others	**385**	693
Total	**3 576**	3 314
TOTAL EXPENSES	**68 070**	62 099

Source: Financial Supervision Authority.

Financial Supervision Authority Organization 31 Dec 2000

Parliamentary Supervisory Council

Board of the Bank of Finland

Board of the Financial Supervision Authority*

Matti Louekoski (Bank of Finland), Chairman
Pekka Laajanen (Ministry of Finance), Vice Chairman
Kaarlo Jännäri (FSA), Member
Markku Vesterinen (ISA), Member
Tarmo Pukkila (Ministry of Social Affairs and Health), Member
Deputy Members: Ilkka Harju (Ministry of Finance), Jorma Heikkilä (Ministry of Social Affairs and Health), Heikki Koskenkylä (Bank of Finland)

Director General
Kaarlo Jännäri

Internal Auditor

Adviser
Liisa Halme

Chief Legal Counsel
Markku Lounatvuori

Credit Institutions Department

Deputy Director General
Kaiju Kallio

Deputy Head of Department
Risto Määttänen

Sectoral Analysis Division
Kaija Kilappa

Institutional Supervision Division
Juha Savela

Legal Services Division
Ilse Lampela

Payments Systems Expert
Veikko Saarinen

Senior Risk Analyst
Monica Ahlstedt

Capital Markets Department

Deputy Director General
Anneli Tuominen

Regulations Division
Jari Virta

Supervision Division
Ari Voipio

Market Supervision Division
Jarmo Parkkonen

Support Services Department

Deputy Director General
Pirkko Pohjoisaho-Aarti

Financial Statements/ Solvency Division
Paula Launiainen

Communications and Document Services Division
Arja Lerssi-Lahdenvesi

International Affairs Coordination
Jaana Suihko

Information Systems Division
Jaakko Mauranen

Internal Services
Lumikki Korpiniitty

* FSA = The Financial Supervision Authority
ISA = The Insurance Supervision Authority

Head of Department, the Chief Legal Counsel and an Adviser. The members of the Management Group are entitled to make decisions relating to their own sectors in accordance with the division of responsibilities decided by the Director General.

The FSA Board's responsibilities include confirming regulations and guidelines that are significant or important in principle and far-reaching from the viewpoint of supervision and deciding on important matters of principle that the Director General submits to the Board. The Board also decides upon the general operating principles, the annual action plan and supervision fees. The Board approves the annual budget of the FSA to be submitted to the Board of the Bank of Finland.

The Director General of the Financial Supervision Authority and the Director General of the Insurance Supervision Authority are, ex officio, members of the FSA Board. The period of office for the other members of the Board is three years, and they are appointed by the Parliamentary Supervisory Council on the basis of proposals by the Ministry of Finance, the Bank of Finland and the Ministry of Health and Social Affairs. The Parliamentary Supervisory Council also appoints the chairman and the vice chairman of the Board. The FSA submits an annual report on its activities to the Parliamentary Supervisory Council.

The costs arising from the operations of the FSA are levied on supervised entities

At end-2000 the FSA had an operational strength of 123 persons; 111 employees had permanent positions. A total of 60 employees worked in the Credit Institutions Department, 33 in the Capital Markets Department, 25 in the Support Services Department and 5 in the Director General's staff. The share of experts in the FSA staff was about 80%.

The FSA finances its operations by levying supervision fees on supervised entities and issuers of securities. In 2000 costs arising from the operations of the FSA amounted to FIM 68.1 million. Income in the form of specific fees covered 5% of total expenses, ie FIM 3.6 million.

The objective of the FSA is to promote financial stability

Through its actions, the FSA seeks to promote stable conditions in the financial markets and confidence in the activities of supervised entities and markets.

In addition to its basic tasks laid down in law, the FSA aims at improving the markets' access to information and the structural efficiency and reliable functioning of the markets. In addition, the FSA fosters a flexible supervisory and regulatory framework which highlights the roles and the responsibilities of individual participants.

In its supervisory work, the FSA evaluates the financial standing, risk positions, risk-bearing capacity and risk management systems of supervised entities. The FSA emphasizes owners' and managers' responsibility for internal control and risk management. Supervision aims at ensuring that supervised entities have adequate financial means and other resources necessary to carry on business and that they observe proper practices in their decision-making.

In its supervision of securities markets, the FSA focuses on promoting public confidence in the markets. To this end, the FSA monitors market practices and issuers' compliance with disclosure requirements and investigates cases where there is reason to suspect abuse of insider information or other securities market crimes. The FSA seeks to promote smooth and reliable securities trading and clearing and settlement procedures.

Regulation is an important part of the activities of the FSA

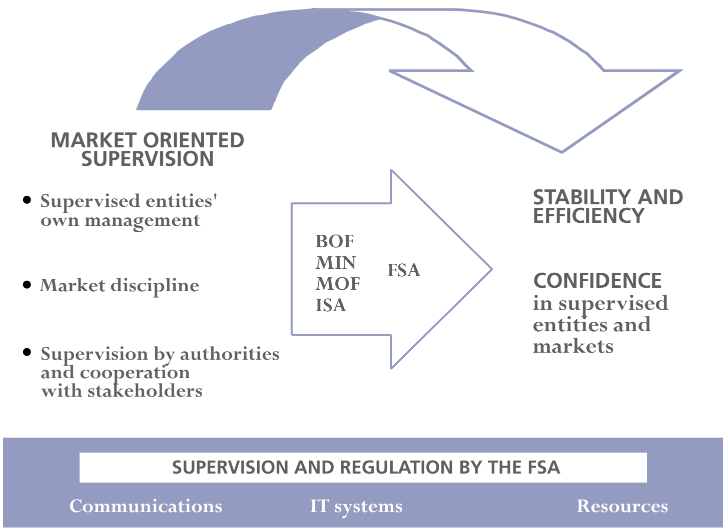
Besides supervision, regulation is a core activity of the FSA. The FSA's regulatory activities take the form of both involvement in the drafting of financial market legislation at national and international level as well as the issue of its own regulations and guidelines.

In the drafting of its own regulations and guidelines, the FSA makes use of in-house and external experts' opinions, maintains contacts with participants and offers supervised entities the opportunity to take part in preparatory work.

In addition, the FSA monitors market conditions and, where necessary, submits proposals to other authorities for legislative action or other measures. Through its initiatives and measures, the FSA seeks to improve the efficiency and reliable functioning of the markets.

Strategic directions 2001–2003

The FSA is a proactive supervisor



Vision: The FSA is a proactive supervisor

As an organization, the FSA is a respected member of the supervisor network at national and international, particularly EU, level. In our activities we focus on market-oriented measures.

Mission Statement

We are committed to fostering the stability and efficiency of financial markets as well as public confidence in the activities of supervised entities and operation of markets.

We approach our work on the basis of the FSA's values. We are an

Independent,
Transparent,
Productive and
Skilled organization.

Strategy

To achieve our vision we will

- carry out the basic tasks we have been assigned in law and
- in cooperation with stakeholders at home and abroad foster

I. markets' access to information
II. the structural efficiency and reliable functioning of markets and
III. a flexible supervisory and regulatory framework highlighting the roles and responsibilities of individual participants.

I. We will foster markets' access to information

- We will seek to ensure that supervised entities publish material and adequate information on their activities, products and financial position, in accordance with international recommendations and standards.
- We will seek to ensure that offerers of securities and listed companies comply with their obligation to provide information swiftly, promptly and in readily understandable terms.
- We will publish the supervisory measures taken by us, our opinions on supervision-related issues and the general observations made by us in the course of inspections, with a view to fostering market transparency, stability and the transparency of our activities.

II. We will foster the structural efficiency and reliable functioning of markets

- We will focus supervision and supervisory measures on institutions and systems of key importance for market stability and efficiency, notably payment and settlement systems.
- We will promote self-regulation that is binding on market participants, within the limits set by market structure, with a view to reducing the need for detailed legislation.
- We will endeavour to ensure that corporate governance and corporate culture in supervised entities develop in a direction that promotes market orientation.
- We will promote the compliance culture of supervised entities and listed companies.

III. We will promote a flexible supervisory and regulatory framework that highlights the roles and responsibilities of individual participants

- We will contribute to the preparation of legislation at both national and international level with the aim of establishing a flexible regulatory framework which can respond swiftly to changes in the operating environment and leaves scope for self-regulation in the markets and for guidance based on codes of practice. We will make an active contribution to the harmonization of legislation and codes of practice particularly at EU level (Commission, Council, BAC, ECB, FESCO, Groupe de Contact).
- We will seek to ensure that laws provide us with adequate powers, means of action and sanctions for the purposes of supervision.
- We will apply international standards [1] in our activities, with a view to enhancing supervision and our own responsibility.
- We will promote effective internal control and risk management systems within supervised entities.
- We will work closely with other supervisors at home and abroad as required for the effective supervision and regulation of financial conglomerates.
- We will cooperate with auditing and accounting organizations, with a view to introducing accounting and auditing principles based on the International Accounting Standards (IAS) and adapting them to prevailing conditions.
- We will investigate and publish details of malpractice as part of the proactive function of supervision.
- We will contribute to the development of the authorities' readiness and possibilities to work together in managing potential crises and to the development of their crisis management plans.
- We will seek to promote customer/investor protection by providing guidance on market practices.

Supporting Strategies

Communications

- We will make known the objectives of supervision, the means deployed in pursuing these objectives and the observations made by us in the course of inspections and ensure that this information is readily and easily available.

Information management

- We will exploit the opportunities offered by Internet technology in our internal information management and external communication.
- We will enhance the utility and accessibility of information pertaining to supervision.

Human resources management

- We will keep the number of staff unchanged and endeavour to meet the growing demands of supervision by prioritizing our tasks more effectively than before, developing employee skills, making use of employee skills across units and outsourcing.
- Skills development
  - We will develop employee skills through, for example, ongoing training and job rotation.
  - We will strengthen the skills required for the forthcoming reform of the capital adequacy framework, particularly in the fields of risk assessment, pricing, modelling and other qualitative supervision.
  - We will develop employees' technological and IT skills.
  - We will pay particular attention to future skill requirements when recruiting staff.
- We will develop our managerial skills, working practices and knowledge management skills.

[1] Primarily the Code of Good Practices on Transparency (IMF), the Core Principles for Effective Banking Supervision (BIS), the Objectives and Principles of Securities Regulation (IOSCO) and the detailed standards based on them.

Ethical principles of the FSA

The two main ethical principles of the Financial Supervision Authority (FSA) are loyalty and independence. These are the guiding principles that shall be observed in situations where more specific ethical principles do not exist.

Loyalty

Employees of the FSA shall, in their actions, bear in mind the goals of the FSA and work towards their achievement.

Independence

Employees of the FSA shall act in such a way as to avoid their relationships or economic ties with supervised entities becoming too close or otherwise such that their independence could be compromised. It is also important to make sure that relationships or economic ties with supervised entities do not in any other way impair confidence in the FSA.

Ethical principles based on loyalty and independence

1. Commitment to the goals and decisions of the FSA

Employees of the FSA shall offer criticism within the FSA but shall be loyal to the FSA in their external contacts. They shall have the right to express their opinion on matters under preparation and a duty to provide any information necessary for such preparation.

2. In-house treatment of information and secrecy

In their handling of confidential and delicate information, employees of the FSA shall see to it that communication of the information is limited to those persons who need it for the performance of their duties.

3. Loans, guarantees and other contingent liabilities

The terms and conditions of a loan, including the rate of interest and term of payment, granted by a supervised entity to an employee of the FSA shall be the same as the standard terms and conditions offered by the supervised entity. Similarly, the terms and conditions of a guarantee or other contingent liability granted by a supervised entity on behalf of an employee of the FSA shall not differ from the terms and conditions generally applied by the supervised entity.

It is also important to make sure that the sum total of loans granted by supervised entities and other entities and of contingent liabilities granted on behalf of employees of the FSA does not exceed a limit that could compromise the independence of the said employees.

4. Securities trading

Employees of the FSA shall refrain from acquiring shares issued by supervised entities. They shall also refrain from active trading in shares that are subject to public trading in Finland.

5. Gifts, representation, etc

Employees of the FSA shall refuse to accept a gift or decline being treated to a meal or drinks the value of which exceeds the limit of what can be considered reasonable and the acceptance of which may be suspected to compromise their independence in some other way.

Where an employee of the FSA participates in an event organized by a supervised entity, the FSA shall pay the participation costs.

6. Employment of a close relative in a supervised entity and previous employment of an FSA employee in a supervised entity

Employees of the FSA shall refrain from handling matters concerning the operations of a supervised entity in which a close relative of theirs is employed. They shall also refrain from examining their decisions or actions in a previous job.

7. Secondary occupations

Employees of the FSA shall obtain permission from the Director General or a Head of Department for the carrying on of secondary occupations and for participation in the marketing or advertising pursuits of companies.

8. Change of employment

Where an employee of the FSA has been appointed to a new post, the employee shall inform his superior of the appointment as soon as possible. Where the employee takes up employment with a supervised entity, the superior shall forthwith assign him new duties the performance of which does not involve handling confidential information about the future employer or other supervised entities.

The FSA also has a compliance officer whom staff consult before the purchase, sale and subscription of shares. Consultation is designed to ensure that no one at the FSA at the moment of the transaction possesses inside information about any detail affecting the share price.

Regulations and guidelines

Regulations and guidelines that were issued in English and entered into force in 2000. Regulations and guidelines are available on the FSA's website, www.rata.bof.fi.

Credit Institutions

101.3
Guideline on the authorization of credit institutions

101.5
Guideline on the reporting of the close links of credit institutions to the Financial Supervision Authority

101.6
Guideline on the supervision by the Financial Supervision Authority of changes in the ownership of credit institutions

101.10
Guideline on the contents of fit and proper assessments and on the reporting requirement

105.4
Regulation on reporting cash reserves

105.8
Regulation on reporting of non-performing and other zero-interest assets

105.9
Guideline on foreign currency risk limit

106.3
Regulation on the accounting of credit institutions

106.6
Regulation on the reporting of own funds and consolidated own funds

106.7
Regulation on the reporting of own funds and consolidated own funds required for covering credit risk

106.12
Regulation on the reporting of the own fonds and consolidated own funds required for covering market risk

Securities Markets

201.5
Regulation on declaration of insider holdings

201.6
Regulation on register of insider holdings

202.10
Regulation on disclosure of trading in debt securities

203.23
Regulation on the reporting of own funds and consolidated own funds

203.24
Regulation on the reporting of own funds and consolidated own funds required for covering credit risk

Regulations and guidelines issued in 2000 that enter into force in 2001

105.7
Regulation on reporting country risk

The publication series

These publications were released in English in the publication series during the year 2000. They are available on the FSA's website, www.rata.bof.fi.

Statements

- Marketing in Finland of collective investment undertaking units
- Recommendation on disclosure by credit institutions of additional financial information on non-owner-occupied property
- Credit institutions' treatment of credit derivatives for capital adequacy and large exposures purposes
- The effect of guarantees issued by certain undertakings on the risk-weighting of asset items included in the capital adequacy calculation
- Internet subscription location

Notifications

- FATF publishes a list of countries whose anti-money laundering practices are inadequate
- Less stringent requirements on reporting large exposures and changes in reporting off-balance sheet commitments
- FSA repeals six guidelines on 1 July 2000
- Financial Supervision Authority urges banks to prepare for future loan losses

Supervised institutions 1996–2000

31.12.	LP	OP	OPR	POP	SPY	SP	LL	VR	SPS	PLL	UE	ULS	AOJ	AV	SIPA	MP	RY	Oth.	Tot.	SK Tot.
1996	8	298	–	–	1	39	23	3	50	13	9	8	12	25	–	4	17	–	510	1 735
1997	9	–	250	44	1	39	23	3	43	14	7	12	12	–	40	3	17	–	517	1 645
1998	9	–	251	43	1	39	19	3	–	14	6	14	11	–	46	3	22	15	496	1 591
1999	9	–	246	43	1	39	17	4	–	13	5	18	11	–	45	2	25	13	491	1 545
2000	9	–	244	43	1	39	17	4	–	13	6	18	12	–	48	1	26	13	494	1 550

LP Commercial banks
OP Cooperative banks
OPR Amalgamation of cooperative banks
POP Local cooperative banks
SPY Limited company savings banks
SP Savings banks
LL Credit institutions
VR Banks' security funds
SPS Savings bank foundations
PLL Pawnshops
UE Finnish representative offices of foreign credit institutions
ULS Finnish branches of foreign credit institutions
AOJ Book-entry system participants
AV Securities brokerage firms
SIPA Investment firms
MP Marketplaces
RY Management companies
SK Branches
Oth. Deposit guarantee fund (1), Investor compensation fund (1), holding companies of investment firms (7), holding companies of credit institutions(3), OKOBANK Group Central Cooperative (1)
Tot. Total

Representation abroad

	1996	1997	1998	1999	2000
Subsidiaries	5	4	4	4	4
Representative offices	19	16	17	16	16
Branches	11	11	9	8	9

Journal 2000

Main items of the Journal:

	2000	1999
Internal matters	57	115
Administration of supervised entities	1,056	802
Supervision	850	962
Risk management	123	126
Accounting, annual accounts and auditing	34	32
Customer protection and safeguarding competition	290	322
Inspections	50	87
Other matters concerning supervised entities	52	50
Other external matters	130	158
Total	2,642	2,654

Major categories of journal entries:

	2000	1999
Investigation requests concerning customer protection	150	183
Listing particulars	173	127
Matters regarding rules	533	294
Notifications	254	168
International cooperation	85	99
Contractual terms	63	68
Inspections by plan	49	63
Own funds and capital support	29	37
Disclosure obligation	283	281
Prospectuses	104	71

Items recorded in the Journal of the Financial Supervision Authority amounted to 2,642, broken down by departments as follows: Capital Markets Department 1,566, Credit Institutions Department 925, Support Services Department 107 and the Director General's staff 44.

Supervised institutions, 31 Dec 2000

Credut Market Participants

Commercial banks (9)
Gyllenberg private bank ab
Leonia pankki oyj
Mandatum pankki oyj
Merita pankki oyj
Okopankki oyj
Op-kotipankki oyj
Osuuspankkien keskuspankki oyj
Yrityspankki skop oyj, selvitystilassa
Ålandsbanken abp

Other credit institutions (17)
Diners club finland oy
Eurocard oy
Handelsbanken rahoitus oyj
K-luotto oy
Kuntarahoitus oyj
Kuntien asuntoluotto oyj
Leonia corporate bank oyj
Leonia kortti oy
Leonia mb group oy
Leonia rahoitus oy
Luottokunta
Merita rahoitus oy
Oko-investointiluottopankki oyj
Op-asuntoluottopankki oyj
Op-rahoitus oy
Suomen asuntoluottopankki oyj
Suomen hypoteekkiyhdistys

Member banks of the amalgamation of the cooperative banks (244)
Alajärven osuuspankki
Alastaron osuuspankki
Alavieskan osuuspankki
Alavuden seudun osuuspankki
Andelsbanken för åland
Andelsbanken raseborg
Artjärven osuuspankki
Asikkalan osuuspankki
Askolan osuuspankki
Auran osuuspankki
Elimäen osuuspankki
Enon osuuspankki
Etelä-karjalan osuuspankki
Etelä-pohjanmaan osuuspankki
Etelä-savon osuuspankki
Eurajoen osuuspankki
Euran osuuspankki
Forssan seudun osuuspankki
Haapajärven osuuspankki
Haapamäen seudun osuuspankki
Haapaveden osuuspankki
Hailuodon osuuspankki
Halsuan osuuspankki
Haminan seudun osuuspankki
Harjavallan osuuspankki
Hartolan osuuspankki
Hauhon osuuspankki
Haukivuoren osuuspankki
Heinäveden osuuspankki
Himangan osuuspankki
Hinnerjoen osuuspankki
Hirvensalmen osuuspankki
Honkilahden osuuspankki
Huhtamon osuuspankki
Huittisten osuuspankki
Humppilan osuuspankki
Hämeenkosken osuuspankki
Hämeenlinnan seudun osuuspankki
Iisalmen osuuspankki
Iitin osuuspankki
Ikaalisten osuuspankki
Ilomantsin osuuspankki
Janakkalan osuuspankki
Joensuun osuuspankki
Jokioisten osuuspankki
Juuan osuuspankki
Juvan osuuspankki
Jämsän seudun osuuspankki
Kainuun osuuspankki
Kalajoen osuuspankki
Kalkkisten osuuspankki
Kangasalan osuuspankki
Kangasniemen osuuspankki
Kankaanpään osuuspankki
Kannuksen osuuspankki
Karjalan osuuspankki
Karkun osuuspankki
Karunan osuuspankki
Karvian osuuspankki
Kaustisen osuuspankki
Keikyän osuuspankki
Kemin seudun osuuspankki
Kerimäen osuuspankki
Keski-suomen osuuspankki
Keski-uudenmaan osuuspankki
Kestilän osuuspankki
Kesälahden osuuspankki
Kihniön osuuspankki
Kiihtelysvaaran osuuspankki
Kiikalan rekijoen osuuspankki
Kiikoisten osuuspankki
Kiskon osuuspankki
Kiteen seudun osuuspankki
Kiukaisten osuuspankki
Koillis-savon osuuspankki
Koitin-pertunmaan osuuspankki
Kokemäen osuuspankki
Kokkolan osuuspankki
Kontiolahden osuuspankki
Korpilahden osuuspankki
Korsnäs andelsbank
Kotkan seudun osuuspankki
Kouvolan seudun osuuspankki
Kronoby andelsbank
Kuhmalahden osuuspankki
Kuhmoisten osuuspankki
Kuhmon osuuspankki
Kuopion osuuspankki
Kuortaneen osuuspankki
Kurun osuuspankki
Kuusamon osuuspankki
Kuusjoen osuuspankki
Kymijoen osuuspankki
Kärkölän osuuspankki
Kärsämäen osuuspankki
Käylän osuuspankki
Köyliön osuuspankki
Lapin osuuspankki
Lappo andelsbank
Lemin osuuspankki
Leppävirran osuuspankki
Lieksan osuuspankki
Limingan osuuspankki
Liperin osuuspankki
Lohtajan osuuspankki
Loimaan osuuspankki
Loimaan seudun osuuspankki
Lokalahden osuuspankki
Lopen osuuspankki
Lounais-suomen osuuspankki
Luhangan osuuspankki
Luopioisten osuuspankki
Luumäen osuuspankki
Luvian osuuspankki
Länsi-uudenmaan osuuspankki
Maaningan osuuspankki
Marttilan osuuspankki
Maskun osuuspankki
Mellilän seudun osuuspankki
Merimaskun osuuspankki
Metsämaan osuuspankki
Miehikkälän osuuspankki
Miettilän osuuspankki
Mouhijärven osuuspankki
Mynämäen osuuspankki
Myrskylän osuuspankki
Mäntsälän osuuspankki
Mäntän seudun osuuspankki
Nagu andelsbank
Nakkilan osuuspankki
Niinijoen osuuspankki
Nilsiän osuuspankki
Nivalan osuuspankki
Nousiaisten osuuspankki
Nurmeksen osuuspankki
Orimattilan osuuspankki
Oripään osuuspankki
Oriveden seudun osuuspankki
Osuuspankki kantrisalo
Osuuspankki realum
Oulaisten osuuspankki
Oulun osuuspankki
Outokummun osuuspankki
Paattisten osuuspankki
Paavolan osuuspankki
Padasjoen osuuspankki
Paltamon osuuspankki
Parikkalan seudun osuuspankki
Parkanon osuuspankki
Pedersörenejdens andelsbank
Perhon osuuspankki
Perniön osuuspankki
Peräseinäjoen osuuspankki
Pieksämäen seudun osuuspankki
Pielaveden osuuspankki
Pihtiputaan osuuspankki
Pohjolan osuuspankki
Polvijärven osuuspankki
Porin seudun osuuspankki
Porvoon osuuspankki
Posion osuuspankki
Pudasjärven osuuspankki
Pukkilan osuuspankki
Pulkkilan osuuspankki
Punkalaitumen osuuspankki
Puolangan osuuspankki
Purmo andelsbank
Pyhäjärven osuuspankki
Pyhännän osuuspankki
Päijät-hämeen osuuspankki
Pälkäneen osuuspankki
Pöytyän osuuspankki
Raahen seudun osuuspankki
Rantasalmen osuuspankki
Rantsilan osuuspankki
Rauman seudun osuuspankki
Rautalammin osuuspankki
Riihimäen seudun osuuspankki
Riistaveden osuuspankki
Ruhtinansalmen osuuspankki
Ruoveden osuuspankki
Rymättylän osuuspankki
Rääkkylän osuuspankki
Sallan osuuspankki
Salon seudun osuuspankki
Sauvon osuuspankki
Savitaipaleen osuuspankki
Savonlinnan osuuspankki
Sideby andelsbank
Siikajoen osuuspankki
Simpeleen osuuspankki
Somerniemen osuuspankki
Someron osuuspankki
Sonkajärven osuuspankki
Sotkamon osuuspankki
Strömfors andelsbank
Sulkavan osuuspankki
Suodenniemen osuuspankki
Suomussalmen osuuspankki
Suonenjoen osuuspankki
Sysmän osuuspankki
Säkylän osuuspankki
Taivalkosken osuuspankki
Taivassalon osuuspankki
Tampereen seudun osuuspankki
Tarvasjoen osuuspankki
Tervolan osuuspankki
Tervon osuuspankki
Toholammin osuuspankki
Toijalan osuuspankki
Tornion osuuspankki
Turun seudun osuuspankki
Tuupovaaran osuuspankki
Tyrnävän osuuspankki
Ullavan osuuspankki
Urjalan osuuspankki
Utajärven osuuspankki
Uukuniemen osuuspankki
Vakka-suomen osuuspankki
Valkeakosken osuuspankki
Valtimon osuuspankki
Vammalan seudun osuuspankki
Vampulan osuuspankki
Varkauden osuuspankki
Varpaisjärven osuuspankki
Vasa andelsbank
Vehmersalmen osuuspankki
Vesannon osuuspankki
Vetelin osuuspankki
Vetelin ylipään osuuspankki
Viekin osuuspankki
Vihannin osuuspankki
Vimpelin osuuspankki
Virolahden osuuspankki
Virtain osuuspankki
Ylitornion osuuspankki
Ylivieskan osuuspankki
Ylä-kintauden osuuspankki
Yläneen osuuspankki

Ypäjän osuuspankki
Ähtärin osuuspankki
Östnylands andelsbank
Östra korsholms andelsbank
Övermark andelsbank

OKOBANK Group Central Cooperative (1)
Osuuspankkikeskus-opk osuuskunta

Local cooperative banks (43)
Alahärmän osuuspankki
Hannulan osuuspankki
Hellanmaan osuuspankki
Honkajoen osuuspankki
Isojoen osuuspankki
Joroisten osuuspankki
Jämijärven osuuspankki
Kannonkosken osuuspankki
Kauhavan osuuspankki
Keiteleen osuuspankki
Keuruun osuuspankki
Kiuruveden osuuspankki
Konneveden osuuspankki
Kortesjärven osuuspankki
Kosken osuuspankki
Kovelahden osuuspankki
Kurikan osuuspankki
Kyrön seudun osuuspankki
Kyrönmaan osuuspankki
Kyyjärven osuuspankki
Laihian osuuspankki
Lammin osuuspankki
Lanneveden osuuspankki
Lapinlahden osuuspankki
Lappajärven osuuspankki
Lapuan osuuspankki
Lavian osuuspankki
Lehtimäen osuuspankki
Liedon osuuspankki
Multian osuuspankki
Nivalan järvikylän osuuspankki
Petäjäveden osuuspankki
Piikkiön osuuspankki
Pyhäselän osuuspankki
Reisjärven osuuspankki
Sievin osuuspankki
Siilinjärven osuuspankki
Suupohjan osuuspankki
Tiistenjoen osuuspankki
Tuusniemen osuuspankki
Vaskion osuuspankki
Vieremän osuuspankki
Ylihärmän osuuspankki

Pawnshops (13)
Helsingin pantti-osakeyhtiö
Hämeen panttilainakonttori oy
Kymen panttilainaamo oy
Lahden pantti oy
Lohjan panttilaina oy
Oulun panttilainakonttori oy
Panttilainaosakeyhtiö europantti oy
Päijät-hämeen pantti oy
Rovaniemen panttilainakonttori oy
Satapantti oy
Suomen arvopantti oy
Suomen luottopantti oy
Töölön pantti oy

Savings banks (39)
Ekenäs sparbank
Eräjärven säästöpankki
Etelä-karjalan säästöpankki
Eurajoen säästöpankki
Hauhon säästöpankki
Houtskärs sparbank
Huittisten säästöpankki
Ikaalisten säästöpankki
Kalannin säästöpankki
Kiikoisten säästöpankki
Korpo sparbank
Kortesjärven säästöpankki
Kristinestads sparbank
Kuortaneen säästöpankki
Kvevlax sparbank
Lammin säästöpankki
Liedon säästöpankki
Luopioisten säästöpankki
Längelmäen säästöpankki
Länsi-uudenmaan säästöpankki
Mietoisten säästöpankki
Myrskylän säästöpankki
Nagu sparbank
Närpes sparbank
Padasjoen säästöpankki
Parkanon säästöpankki
Pyhärannan säästöpankki
Rengon säästöpankki
Someron säästöpankki
Suodenniemen säästöpankki
Suomenniemen säästöpankki
Sysmän säästöpankki
Säästöpankki optia
Tuuloksen säästöpankki
Töysän säästöpankki
Vörå sparbank
Ylihärmän säästöpankki
Yttermark sparbank
Övermark sparbank

Limited company savings banks (1)
Aktia sparbank abp

Holding companies of credit institutions (3)
Ane gyllenberg ab
Leonia oyj
Nordea companies finland (ncf) abp

Finnish representative offices of foreign credit institutions (6)
Abn amro bank n.v.
International bank of st. Petersburg
Landesbank schleswig-holstein
Nordfinanz bank zürich
Representative office of joint stock bank sobinbank in finland
Sociètè gènèrale

Finnish branches of foreign credit institutions (18)
Bmw financial services scandinavia ab
Caterpillar financial nordic services aktiebolag
Citibank international plc
Credit agricole indosuez
D. Carnegie ab
Danske bank a/s
Deutsche bank aktiengesellschaft
Ecredit ab
Fce bank plc
Ge capital equipment finance ab
Handelsbanken finans aktiebolag (publ)
Scania finans aktiebolag
Seb finans ab (publ)
Seb kort ab
Skandinaviska enskilda banken ab (publ)
Svenska handelsbanken ab (publ)
Telia finans finland
Xerox credit aktiebolag

Banks' security funds (4)
Liikepankkien ja postipankki oy:n vakuusrahasto
Osuuspankkien vakuusrahasto
Paikallisosuuspankkien vakuusrahasto
Säästöpankkien vakuusrahasto

Deposit guarantee fund (1)
Talletussuojarahasto

Capital Market Participants

Book-entry system participants (12)
Aktia sparbank abp
Hex securities services ltd oy
Leonia back office oy
Leonia pankki oyj
Merita pankki oyj
Osuuspankkien keskuspankki oyj
Osuuspankkikeskus-opk osuuskunta
Oy samlink ab
Skandinaviska enskilda banken ab (publ) helsingforsfilialen
Suomen arvopaperikeskus oy
Svenska handelsbanken ab (publ), filialverksamheten i finland
Ålandsbanken abp

Marketplaces (1)
Helsingin arvopaperi- ja johdannaispörssi, selvitysyhtiö oy

Management companies (26)
Aktia rahastoyhtiö oy
Alfred berg rahastoyhtiö oy
Aurator rahastoyhtiö oy
Carnegie rahastoyhtiö oy
Conventum rahastoyhtiö oy
Evli-rahastoyhtiö oy
Fides rahastoyhtiö oy
Fim rahastoyhtiö oy
Fondita rahastoyhtiö oy
Gyllenberg fondbolag ab
Handelsbanken fondbolag ab
Hiisi rahastoyhtiö oy
Mandatum rahastoyhtiö oy
Merita rahastoyhtiö oy
Myriadi rahastoyhtiö oyj
Op-rahastoyhtiö oy
Pyn rahastoyhtiö oy
Rahastoyhtiö 3c oy
Ramsay & tuutti rahastoyhtiö oy
Sampo rahastoyhtiö oy
Sampo-leonia rahastoyhtiö oy
Seligson & co rahastoyhtiö oyj
Tapiola rahastoyhtiö oy
Trevise rahastoyhtiö oy
Wip rahastoyhtiö oy
Ålandsbanken fondbolag ab

Investment firms (48)
Aktia asset management oy
Aktia fondkommission ab
Alexander corporate finance oy
Alfred berg finland oyj abp
Alfred berg omaisuudenhoito oy
Aros securities oy
Arosmaizels corporate finance oy
Arosmaizels equities oy
Aurator varainhoito oy
Capinordic asset management oyj
Carnegie varainhoito suomi oy
Conventum asset management oy
Conventum corporate finance oy
Conventum pankkiiriliike oy
Danske capital finland oy
Eficor oyj
Eq pankkiiriliike oy
Estlander & rönnlund financial products ab
Evli corporate finance oy
Evli rahamarkkinat oy
Evli varainhoito oy
Fides asset management oy
Fim omaisuudenhoito oy
Fim pankkiiriliike oy
Gyllenberg asset management oy
Hiisi pankkiiriliike oy
Icecapital pankkiiriliike oy
Mandatum oy
Mandatum pankkiiriliike oy
Mandatum varainhoito oy
Merita asset management oy
Opstock oy
Oy ahola & maliniemi partners ab
Oy united bankers pankkiiriliike, fondkommission ab
Pankkiiriliike evli oyj
Pankkiiriliike evli-optiot oy
Pankkiiriliike sofi oyj
Pca corporate finance oy
Sampo varainhallinta oy
Sampo-leonia omaisuudenhoito oy
Seinäjoen pankkiiriliike oy
Seligson & co acm varainhoito oy
Seligson & co oyj
Tapiola omaisuudenhoito oy
United bankers omaisuudenhoito oy
Varainhallinta tresor oy
Wahlström immonen partners oy
Ålandsbanken asset management ab

Holding companies of investment firms (9)
Bagg holding ab
Conventum oyj
Eq online oyj
Er-group oy
Finanssi-sampo oy
Firstrom oy
Hiisi group oy
Oy ub finance ab
Welnesor oy

Investor compensation fund (1)
Sijoittajien korvausrahasto

History of financial markets and financial market supervision

Period of Swedish Rule 1100-l.

1659	King Carl X Gustaf of the Kingdom of Sweden and Finland established the position of senior bank supervisor in order to supervise the Swedish Palmstruch Bank, which also had a branch in Turku. The position was, however, soon abolished when the bank ceased operations in 1668 after going bankrupt.
1668	Out of the ruins of the Palmstruch Bank grew the Bank of the Estates of the Realm (Sveriges Riksbank), the world's first central bank. Its operations were supervised by six parliamentary bank supervisors. The operations of the Bank of the Estates of the Realm covered Finland until 1840 when Swedish money was taken out of circulation for good in Finland.

Period of Autonomy under Russian Rule 1809–1917

1811	The Bank of Finland was established.
1820s	The first savings banks were established in Finland and Sweden.
1860	Finland introduced her own monetary unit, the markka.
1862	The first commercial bank (Union Bank of Finland) was established in Finland.
1866	With the emergence of a commercial banking system in Finland, the country's first banking law was enacted. Supervisory regulations were issued by the Senate and compliance with them was overseen by special agents assigned to each bank.
1868	The Bank of Finland was made subject to the Estates (later Parliament).
1895	The savings bank law entered into force, whereupon banking supervision was centralized for the first time.

Period of Independence 1917–

1920	Supervision of the cooperative banks was assigned to their own central monetary institution.
1922	The Bank Inspectorate was established under the Ministry of Finance to supervise commercial banks.
1993	The Banking Supervision Office was dissolved following the introduction of a new Act on the Financial Supervision Authority; the Financial Supervision Authority began to function in connection with the Bank of Finland.
1995	Finland became a member of the EU.
1999	The euro era started.

The supervisory scope of the FSA and its precursor has been extended on several occasions to include:

1933	Mortgage banks
1970	Savings banks, cooperative banks, credit companies and banks' security funds
1979	The Mortgage Association and representative offices of foreign credit institutions
1987	Management companies and mutual funds
1988	Postipankki Ltd. and derivatives markets
1989	Securities markets
1991	Branches of foreign credit institutions and the book-entry securities system
1992	Credit institutions as defined in the Financial Activities Act and savings bank foundations
1993	Pawnshops
1994	Credit institutions' consolidation groups and foreign service providers
1996	Investment firms

Risks associated with supervised entities

Income risk, which is the basic risk associated with banking, arises in situations where the counterparty, normally the borrower, is not able to meet his obligations. Realized credit risk takes the form of nonperforming assets and loan losses. Country risk in connection with foreign claims is also part of credit risk.

Market risk, ie position risk, includes exchange rate risk, interest rate risk, price risk on equity and real estate, and funding risk. Market risk is realized when market prices move in a direction that is unfavourable from the point of view of the supervised entity.

Operational risk is a qualitative risk related to, inter alia, the professional competence of managers and staff, the operation of systems and abuse. Operational risk may also include legal risk and reputational risk. Operational risk is the basic risk associated with the investment service industry.

Strategic risk arises when a supervised entity choses the wrong strategy in its search for profits. The wrong choice of strategy is reflected eg in operational losses, inability to meet the challenges of competition or a weakened capital position. Another aspect of strategic risk is the inability to adjust the chosen strategy to changes in the operating environment, ie in environmental risk. In addition, supervised entities must be able to adjust to developments in legal provisions and supervisory practices, both at international and domestic level.

All risks can be regarded as sub-areas of strategic risk. The composition of the credit portfolio is a strategic choice, as too is the size of market risk positions and the targetted level of staff skills and systems (see diagram on p. 19).

Assessment of the interest rate risk of deposit banks

Income risk stems from the balance sheet effects of changes in interest rates on the financing of a short-term (less than one-year) maturity deficiency or on the investment of an excess for one year, starting from the reporting date. For this reason, the income risk of euro-denominated items is calculated using different assumptions regarding repricing of sight deposits. The later the repricing of sight deposits occurs, the more favourable is the impact of an increase in interest rates on banks' earnings. For this reason, the income risk of euro-denominated items is calculated using different assumptions regarding repricing of sight deposits. Depositor behaviour has proven to be quite inflexible in response to changes in interest rates. In the calculation included in this annual report, deposits were included in the 9–12 month maturity category, ie the duration assumption is 10.5 months.

Investment risk measures the effect of a one percentage point rise in interest rate on the market value of debt securities held as trading assets. Calculation of investment risks takes account of the sensitivity of off-balance-sheet items held as trading assets to changes in interest rates (change in market value in response to a rise in interest rates).

Investment risk measures the direct change in the current value and is calculated on the basis of the maturity of debt securities and derivatives. Income risk, on the other hand, measures net interest income at a 12-month horizon. Hence, since income risk and investment risk are calculated using different time horizons, the figures are not comparable.

Abbreviations used in the annual report

FESCO	Forum of European Securities Commissions
BSC	Banking Supervision Committee
BAC	Banking Advisory Committee
IOSCO	International Organization of Securities Commissions
IMF	International Monetary Fund
IAIS	International Association of Insurance Supervisors
ICBS	International Conference of Banking Supervisors, ICBS
FATF	Financial Action Task Force on Money Laundering
FESCOPOL	The FESCO Exchange of Information and Surveillance Co-ordination Group

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