Annual Report

2001

RAHOITUSTARKASTUS
FINANSINSPEKTIONEN
FINANCIAL SUPERVISION

Director General's Review

In a review of 2001 one could hardly overlook the terrorist attack of 11 September on the United States of America. This applies equally to a review of the year's financial market activity. The criminal attack that targeted the heart of the world's largest financial centre was feared to seriously endanger the international financial system. Fortunately, it is now clear that, considering the circumstances, the backup arrangements for the financial and payment systems functioned extremely well. Central banks ensured adequate liquidity supplies during the worst moments of the disturbance, and financial supervisors' international coordinating bodies functioned in an exemplary manner.

Argentina's lapse into near chaos did not seriously shake the world's economy or financial system. Japan's problems dragged on without resolution, and it is certainly hoped that the remaining waiting time will not be long. Japan's role in the global financial system is of such significance that resolution of these problems is crucial for the stability of the system.

Toward the end of the year, broad-ranging discussions erupted in connection with Enron entering into liquidation. The problems at the centre of the discussions are indeed serious for the credibility and operability of the securities markets. Discoveries in the Enron case have given rise to critical evaluation of the central efficiency principles of a market economy. The market economy only functions well if the markets have access to extensive and reliable information. At the heart of the problem is the conduct of Enron's senior management. The keys to reliable information – accounting rules and auditing practices – have both become suspect in the world's leading market economy. Similar phenomena have been observed and discussed in Europe, including Finland. When defects are identified, effective action must be taken, since loss of credibility in the market mechanism becomes costly, not only to the financial markets but also to the real economy and hence to the welfare of ordinary citizens.

The dominant position of the large auditing firms and their extensive consulting business is a source of considerable concern. In Finland, for example, the same auditing firm audits the books of each of the three largest financial groupings. In such a situation, not only is the auditor's professional competence of utmost importance but also its standard of business ethics. Within the EU, discussions have taken place on self-regulation as well as on the effectiveness of supervision in this area. This is a timely issue also because an EU regulation on application of the international accounting standards (IAS) to the EU area is set to enter into effect in 2005.

Recommendations made by Alexandre Lamfalussy's 'Committee of Wise Men' on modernising and increasing the flexibility of regulation and supervision of EU area securities markets were approved at the start of 2002. But already in 2001, the necessary committees were established: the European Securities Committee (ESC) and Committee of European Securities Regulators (CESR). The latter replaced an informal cooperative body referred to as the Forum of European Securities Commissions (FESCO). It remains to be seen whether, with the aid of these new bodies, the creation of a single European financial market can be accelerated so as to achieve the ambitious goals set for 2003. The coming EU enlargement places further demands for flexible cooperation. If this mechanism for cooperation does not function as desired, the 2004 Intergovernmental Conference might have to consider establishing Europe-wide supervision of securities markets.

Europe also needs more effective structures for cooperation in banking supervision. The ongoing international reform of capital adequacy requirements will demand more unified supervisory procedures and powers. In the future also non-Nordic banks and other financial institutions will engage more often in cross-border alliances. By no later than 2004, the possibility of forming European companies will make it easier to set up Europe-wide branch networks via transborder mergers. In this connection, nationally based deposit protection systems will encounter a whole new set of issues. The European Central Bank has argued for a bigger role for itself in EU banking supervision. This position has its dissenters – and it is clearly not the only way of increasing the effectiveness of European supervision. In any case, a choice will have to be made within the next few years.

In Finland the discussion has focused on the idea of combining the Insurance Supervision Authority and Financial Supervision Authority (FSA). As recommended by the Ministerial Finance Committee, the issue was studied by the Secretary of State of the Ministry of Finance and Secretary General of the Ministry of Social Affairs and Health. Their recommendation was that the two bodies should be kept separate but that cooperation between them should be further tightened. The Ministerial Finance Committee approved the recommendation in February 2002. This decision provides a peaceful environment for proceeding with the practical work of upgrading cooperation.

During the year under review, the International Monetary Fund (IMF) completed an extensive study of the stability of Finland's financial markets, evaluating regulation and supervision in the context of its Financial Stability Assessment Program. Finland received very high ratings. The report however emphasised that, by international standards, the FSA does not have sufficient supervisory powers and that provisions on responsibility and accountability were inadequate. The FSA has itself on many occasions over the years made these same points and made proposals for correcting the situation. Moreover, the Ministry of Finance is presently preparing an amendment of the legislation governing the FSA. The planned changes would notably improve the situation, albeit some things would remain to be done.

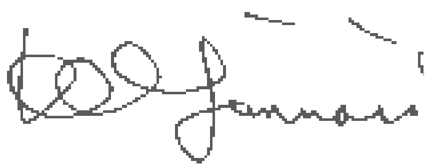
One notable defect is the slowness of investigations of possible securities market offences. The police have far too few resources for this work, and the FSA does not have the authority to engage in actual criminal investigation. As a result, even important cases drag on for years before a verdict is reached. As regards the rights of the suspected, the situation is no longer tolerable; nor does it promote public confidence in the fairness of the markets.

All in all, financial markets in Finland functioned well in 2001. Banks' profitability was good, albeit not on a par with the record level of 2000. The traditional household-oriented services, ie retail banking operations, were particularly profitable. Corporate lending, on the other hand, was again less profitable perhaps because of extremely narrow interest rate margins, considering the risks involved. Things were much worse in the securities markets. The decline in share prices made investors cautious, which was reflected in the fact that there was not one initial public offering in 2001. The FSA had to investigate numerous cases where it suspected that listed companies had not fulfilled their disclosure requirements; the disclosure of bad news was sometimes not as swift as the law would require and faults were found in the governance of many newly listed companies.

The process of organisational change continued for Nordea and Sampo. Adjustments in supervision of conglomerates will be necessary as changes occur in companies' legal and business structures, provided these changes are not illegal and do not jeopardise solvency. Obviously noteworthy is that all group members' capital judged unnecessary by a rating agency will be shifted to the holding company. Thus such 'excess' capital could be distributed to shareholders or used for expansion purposes. This type of efficient use of capital is of course desirable, but there are risks involved if the solvency ratio is pushed too close to the legal minimum. Proper valuation of balance sheet items and auditors' evaluations will thus take centre stage in determining whether a company's annual report gives a true and fair view of its financial position.

Year 2002 could be a good one for the banks. Recent forecasts do not point to a big increase in loan losses. Finnish securities markets, to be sure, are highly dependent on difficult-to-forecast international developments. However, heightened competition is clearly to be anticipated. The challenges facing the FSA are considerable, as the process of European integration moves ahead. This will also put a strain on resources. Looking ahead, the FSA will need either a larger group of highly knowledgeable and motivated employees or a lessening of its tasks.

March 2002



FSA operation strategy

Through its actions, the Financial Supervision Authority (FSA) seeks to foster the stability and efficiency of financial markets as well as public confidence in the behaviour of supervised entities and markets.

The FSA's supervisory approach is essentially market-oriented, which means that supervised entities have the primary responsibility for their own behaviour, with market discipline providing them with an additional incentive to take responsibility for themselves. The supervised entities' own responsibility and market discipline is complemented by official supervision. Effective competitive markets, sound practices in the provision of financial and investment services and adequate disclosure and transparency of information are essential conditions for market discipline.

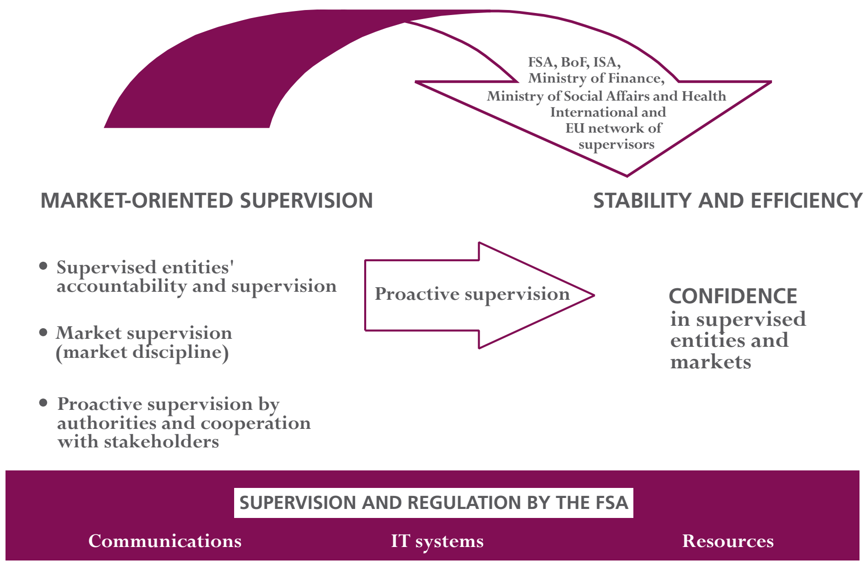
Official supervision focuses on the proactive approach (Chart 1). The key aim of proactive supervision is to identify general and specific problems as early as possible and to take appropriate action in a timely and credible fashion. It is especially important to identify problems that may threaten the stability of the financial system and weaken confidence in the operation of markets.

To maintain confidence in the behaviour of markets and market participants, it must be ensured that users of financial services and investors receive sufficient information as a basis for their decisions.

In line with its operational strategy and together with stakeholders at home and abroad, the FSA fosters

– the markets' access to information and sound market practices
– the reliable functioning and structural efficiency of markets and good corporate governance in supervised entities
– a supervisory and regulatory framework based on accountability, transparency and discretion.

Chart 1.
Market-oriented and proactive supervision



Market-oriented supervision means supervised entities taking primary responsibility for their own behaviour. The provision of material and adequate information to markets on matters related to the behaviour of supervised entities is designed to enhance market discipline and to provide an incentive for supervised entities to take responsibility for themselves. Proactive supervision by the authorities complements market discipline and the responsibility of supervised entities. Proactive supervision seeks to identify, prevent and redress problems as early as possible. The supervisor has the capacity to assess developments in the situation of the supervised entities and the ability to respond to problems swiftly if necessary. Supervised entities are also aware of the supervisory principles applied by the supervisor.

Source: Financial Supervision Authority.

The FSA's supervisory approach

With a view to ensuring financial market stability, the FSA monitors the risk-taking and capital adequacy of supervised entities. In its supervisory work, the FSA evaluates the financial standing, risk positions, risk-bearing capacity and risk management systems of supervised entities. The FSA emphasises owners' and managers' responsibility for internal control and risk management. Supervision is designed to ensure that supervised entities have adequate financial and other resources in place necessary to carry on business and that they observe proper practices in their operations.

Supervision takes a risk-based approach. Accordingly, the FSA targets supervisory measures on risk-prone institutions and systems of key importance for market stability and efficiency.

In securities market supervision, the FSA attaches considerable importance to maintaining public confidence in markets. To this end, the FSA monitors market practices and issuers' compliance with the disclosure obligation and investigates cases of suspected abuse of inside information and other securities market crimes. The FSA also seeks to promote the smooth and reliable functioning of securities trading and clearing and settlement systems.

The FSA's regulatory approach

In its regulatory work, the FSA emphasises the accountability and transparency of individual participants and the exercise of discretion by the supervisor within the limits of generally recognised rules of conduct. Regulation is thus based on framework legislation highlighting the aims and purposes of regulation, rather than the detailed provisions. Binding regulations are supplemented by recommendations guiding the behaviour of supervised entities and markets.

The FSA should have early intervention powers in place that permit prompt and clear intercession, at the FSA's discretion. The regulator must exercise the power of discretion within generally recognised limits, credibly and explicitly. An operating environment focused on the regulator's discretionary powers and effective supervisory powers must be offset by an understanding of the regulator's accountability and by efforts put into accountability. The FSA's existing powers are not sufficiently effective in that they are ungainly and reactive rather than proactive (conditional imposition of a fine and motion to withdraw authorisation.) The FSA's powers will however be enhanced in connection with the revision of the Act on the Financial Supervision Authority.

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.

A common regulatory and supervisory framework is a prerequisite for the existence of a level playing field for all financial institutions, investment service providers and issuers of securities throughout the European Union. A further aim is to make it easier for investors and users of financial services to benefit from the provision of financial services on an EU-wide basis.

The FSA participates in various international fora and cooperates with the authorities of other countries in the field of supervision. The most important fora for the FSA are in Europe, including the Committee of European Securities Regulators (CESR), the Banking Supervision Committee (BSC) of the European System of Central Banks, the Banking Advisory Committee (BAC) subordinate to the European Commission, and Groupe de Contact, the body for cooperation between the banking supervisory authorities of the member states of the European Economic Area (EEA). In addition to these fora, cooperation takes place within numerous expert groups working under their respective auspices.

These fora draw up common standards for banking and securities market supervision and regulation. The meetings address, for example, internationally significant financial market developments and trends, developments in national markets and related supervisory considerations and also seek to influence the EU regulatory framework.

Global fora for cooperation of importance to the FSA include the International Organisation of Securities Commissions (IOSCO), the International Monetary Fund (IMF), the Basel Committee on Banking Supervision, the Financial Action Task Force on Money Laundering (FATF) and the Joint Forum of banking, insurance and securities regulators, consisting of representatives from IOSCO, the Basel Committee, 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, as far as is practicable, the standards and recommendations adopted by these bodies in its activities.

Financial markets in 2001

OPERATING ENVIRONMENT

The world economy weakened[1]

Prospects for the world economy weakened considerably during the early part of 2001. Growth slowed in the United States, the euro area and Japan. The euro area posted the fastest GDP growth (about 1.5%) of these three major economic areas of the world.

The US economy, which had long been growing at a robust rate, went into a recession, and the ICT sectors of many countries faced growing problems. There were signs of a turn in the US economy already in autumn 2000, and conditions worsened as the year wound down. The slowing of the US economy quickly impacted a number of emerging Asian economies, which are particular dependent on US demand for their exports. Prospects for these economies were dampened especially by a decline in demand for ICT products.

Economic growth also slowed down in Japan. This was a result of both external factors and weak domestic demand, as companies' propensity to invest decreased and households remained cautious. Postponement of essential restructuring reinforced the deflationary tendencies of the Japanese economy.

Economic growth in the euro area began to slow already in the second half of 2000, as the growth of domestic demand decelerated partly in response to weaker developments in real income related to a temporary pickup in inflation. In early 2001 growth slowed further, as exports to non-euro countries were dampened by a growth slowdown in other parts of the world. Investment declined and inventories were run down. In contrast, private consumption continued to pick up, partly due to a reduction in taxation. Because of the slowing of growth, the lengthy downward trend in unemployment came to a halt.

Economic conditions around the world took a sharp downturn in the second half of 2001 when prospects for US economic growth were further dampened by the September terrorist attack. The Japanese economy continued the decline that had begun in the spring. The problems of many emerging economies only worsened. The Latin American countries, especially Argentina, encountered serious difficulties.

Euro area economic growth also slowed further in the latter part of 2001, as a result of decelerating growth of exports and especially investment. Private consumption nonetheless continued to increase at a respectable rate, buoyed by easier monetary and fiscal policies, a decline in energy prices and favourable income performance. Consumption possibilities were also strengthened by the fact that euro area consumers were not burdened by heavy indebtedness.

Economic growth slowed in Finland[2]

Finland's long economic boom came to a halt in 2001. According to preliminary figures, the economy grew by only 0.7% compared to a robust 5.6% in 2000. This was a result of a dampening of export demand in the midst of a global recession and difficulties in ITC sectors around the world. Export volume declined by 1% in 2001, compared to remarkable growth of 18% in the previous year. The halt in export growth acutely affected the electronics industry, which now accounts for more than a quarter of Finland's total exports.

The weakening of export demand in the first half of 2001 was reflected in a decline in industrial output. In the latter part of the year output rebounded as the manufacturing of new-type mobile telephones commenced. This boosted autumn output to the peak level of the previous year. Output of the other metal and engineering industries increased in 2001. The year was particularly positive for the engineering works industry, which received numerous orders in the early part of the year, foreign and domestic. For the forest industries, 2001 was weaker than the previous year, as the worldwide recession significantly dampened the demand for paper. The decline in exports of the forest products and electronic equipment industries was reflected indirectly in a

[1 and 2] The text is based on the Bank of Finland Annual Report 2001.

fall in the output of chemical manufacturers subcontracting for those industries. In 2001 industrial output decreased by 1%, in sharp contrast to the export-driven 11% growth rate posted in 2000.

Industrial sector planned investment for 2001 was still large in the spring but, because of the decline in exports, many projects were postponed. On the other hand, low interest rates and high profits achieved by many companies in recent years made investment attractive. And, in the forest industries, many investment projects involving basic repairs were carried to completion.

Construction growth also came to a halt in 2001. However, the volume of construction was almost unchanged from the previous year. In the first quarter of 2001, construction investment was higher than in the last quarter of 2000. The increase was based on investment in industrial and commercial construction. However, in the second half of the year, the growth of industrial construction slowed, partly because sluggish export activity meant less need for industrial facilities. Housing investment fell in 2001. Housing starts were lower in the second half than in the first half, and approvals of housing construction permits decreased notably compared to end-2000. The slowing of economic growth and general uncertainty led to further postponement of construction start-ups. Moreover, housing construction in growth centres was deterred by land shortages.

Private consumption remained fairly strong, due not only to tax cuts and strong earnings but also to continued consumer confidence. Retail sales, except for cars, increased at the same rate as in 2000. Consumers' strong confidence in the future and the low level of interest rates kept the housing market fairly active in 2001.

Considering the slowdown of economic growth, inflation remained fairly high in 2001, 2.6% on average (CPI). The rise in prices in the early part of the year, based largely on animal-disease-related rises in food prices, boosted inflation; but toward year-end inflation was dampened by a decline in the price of energy. For the whole year, Finland's inflation matched the average for the euro area.

Growth of Finland's general government surplus came to a halt in 2001. Corporate tax revenue declined sharply compared to the previous year. In 2001 the favourable trends in the labour market also came to an end. Unemployment and the general government debt are still disturbingly high, despite reductions that occurred in the years of robust economic growth in the latter part of the 1990s. Toward the end of the decade companies' financial structures also solidified and households' indebtedness decreased. Companies' profitability actually held up quite well despite the sluggish economic growth in 2001. Even with the slack in export demand, the current account again posted a sizeable surplus.

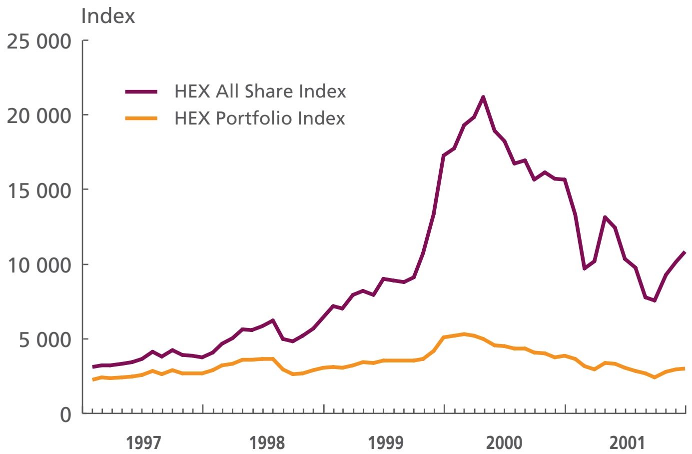
Central banks lowered their key interest rates

There was a downward movement in interest rates in the financial markets throughout the year. Owing to the slowdown in economic growth, both the Federal Reserve System of the United States (the Fed) and the European Central Bank (ECB) lowered their key interest rates in order to support economic developments worldwide. The FED started to lower its interest rates in early 2001, and by the end of the year the Fed had lowered its key interest 11 times, from 6.5% to 1.75%, thereby pulling US short-term rates below the level of the corresponding European rates for the first time in a long period. In keeping with its inflation target, the ECB did not start to lower its key interest rates until later in the year when the more moderate downward outlook for inflation allowed downward adjustment of euro area interest rates. The terrorist attacks on the USA in September gave a further boost to reflationary measures around the world, and the sharpest fall in interest rates occurred at that time. The ECB lowered the minimum interest rate on its main refinancing operations four times during the year, from 4.5% to 3.25% in all. Of the market rates, the 12-month Euribor fell from 4.45% to 3.34% and on 8 November 2001 it stood at its lowest level, 2.99%.

In foreign exchange markets, the yen strengthened and the dollar weakened, by 6.5% alike against the euro during the year. The Swedish krona weakened by 4.6% against the euro.

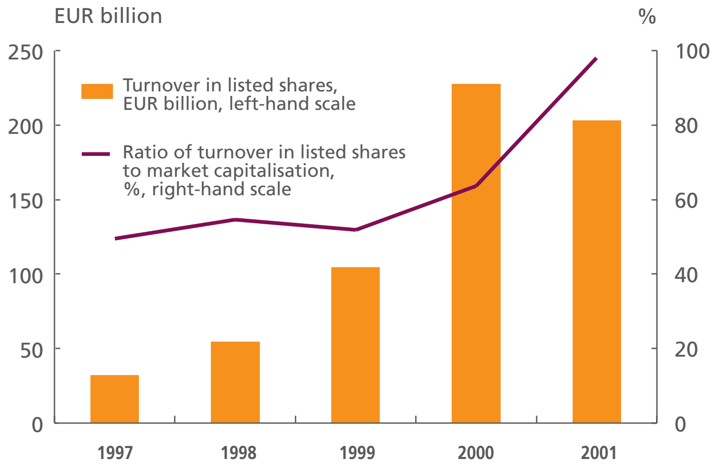
The Prime rates of the Finnish banks fell rapidly in the second half of 2001. In December the Prime rate of

Chart 2.
Stock market indices, 1997–2001



Source: Helsinki Exchanges.

Chart 3.
Share turnover on the Helsinki Exchanges, 1997–2001



Source: Helsinki Exchange.

the Bank of Åland Plc stood at 3.50% while those of the other banks stood at either 3.50% or 3.75%. The Prime rates remained unchanged in the first quarter of 2002. In March 2002 the period of falling interest rates and economic slowdown was considered to be over. There were growing expectations about a marked acceleration in economic growth later in the year. Interest rate expectations were turning upward despite the fact that inflation and growth were deemed to be in balance. The markets were expecting that the Fed would start to raise its interest rates in early summer and the ECB later in the autumn.

Decline in share prices and turnover on the HEX

In 2001 share prices fell on the Helsinki Exchanges for the second year in succession. The HEX All-Share Index fell by about 34% and the HEX Portfolio Index by about 23% (Chart 2). Shares prices reached their maximum level on 5 January (12,871.88 points) and their minimum level on 11 September (5,583.57 points).

The Insurance Index and the Tele-communications & Electronics Index were subject to the sharpest decline (-58.1% and -40.9%, respectively) The banking and finance index and the media & publishing index went down as well (-24.2% and -17.2%, respectively. On the other hand, the Other Industries and the Investment indices rose markedly (+21.3% and +31.2%, respectively). Technology companies were subject to the sharpest decline in respect of individual shares.

Turnover on the Helsinki Exchanges (Chart 3) totalled EUR 202 billion in 2001 compared with EUR 227 billion in 2000. This represented a decline of 11%.

However, the number of shares traded increased by 11 billion, ie by 79.2%. Nokia, accounting for 77.1% of the overall turnover on the HEX (66.4% in 2000), dominated share trading.

At the end of 2001 the total market capitalisation of the exchange amounted to about EUR 213 billion compared with about EUR 318 billion at the end of the previous year. Nokia shares accounted for EUR 137 billion, 63.1% (70.11% in 2001) of market capitalisation.

Nonresidents' holdings of Finnish shares decreased slightly. At the end of 2001 nonresidents owned 37% of Finnish shares, 3.7 percentage points less than at the end 2000. At end-December, 71.1% of HEX' total market capitalisation was in the hands of nonresidents compared with 73.6% twelve months earlier. Nonresidents held the majority of the shares in 14 listed companies.

Remote brokers continued to increase their share in the trading on the Helsinki Exchanges. In 2001 they accounted for 31% of the total turnover on the exchange, as compared with just over 14% in the previous year. At the end of 2001 a total of 38 broking firms were engaged in trading on the Helsinki Exchanges. Of these 20 were remote members compared with 12 in 2000.

Country and territory indices on developed countries[3] indicate that share prices fell everywhere except in New Zealand. According to an index survey of both developed and developing countries, Finland belonged to the group of countries that had the weakest performance. Only Egypt and Luxembourg ranked behind Finland. On the whole, emerging countries were more attractive to investors than developed countries. The most profitable investment opportunities were found in the Russian market where shares gave a return of as much as 48%.

In 2001 listed companies distributed dividends to the record amount of FIM 35 billion.

Issue activity focussed on bonds and covered warrants

The overall economic conditions also had its impact on share issue activities. Owing to the sluggish market situation, no initial public offer took place and only two public offerings of listed companies were made in 2001.

Numerous corporate restructurings in the form of demergers, mergers or public bids were carried out during the year. A tender offer or redemption offer was made for seven listed companies.

In 2001, 9 companies were listed and 12 companies delisted on the Helsinki Exchanges. All listings and delistings were made as a result of corporate restructuring. In addition, one company was transferred from the NM-list to the main list. At the end of the year, 175 share series of 155 companies were traded on the Helsinki Exchanges. The main list comprised 109 companies.

As there were only a few public equity offerings, issue activity focussed largely on bonds and covered warrants. The number of public bond offerings was 90. Credit institutions accounted for most of the issues; the corporate sector launched only 7 issues. In December 2000, the first covered warrants were listed on the HEX main list. A total of 112 covered warrants, launched by 5 different issuers, were issued in 2001. Covered warrants are transferable securities, the underlying asset of which may be a publicly traded share, share basket or a recognised share index. Normally, the covered warrant issuer is not the issuer of the underlying asset.

The FSA approved 39 listing particulars and 15 public-offer prospectuses, most of which concerned bond issues. Exemption in respect of the contents or publishing of listing particulars or public-offer prospectuses was granted in 152 cases. The FSA approved 12 tender documents concerning tender offers or redemption offers. The FSA recognised, on a reciprocal basis, 27 listing particulars or public-offer prospectuses that had already been approved in another EU country. In the main, mutual recognition applied to instruments offered to professional investors.

Manifold effects of the terrorist attacks on the financial markets

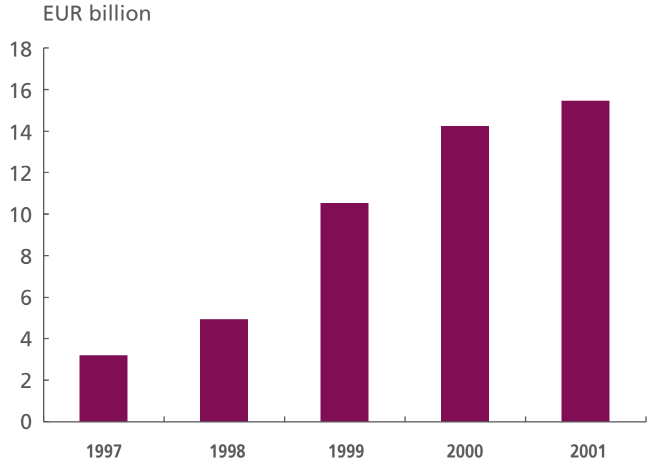
The terrorist attacks on the United States in September immediately gave rise to temporary and limited liquidity problems for the correspondent banks in New York.

The most serious effects of the terrorist attacks are likely to be felt by the Finnish financial markets via the banks' loan portfolios. The sectors where profitability will be affected most as a result of the attacks are the insurance companies and travel agencies and especially the air traffic industry that was in difficulties even before the attacks. These sectors that are hit most severely are likely to incur loan losses to the banks. According to research made by the FSA, the losses anyway appear to be limited.

The terrorist attacks also affected mutual fund activities. The stock

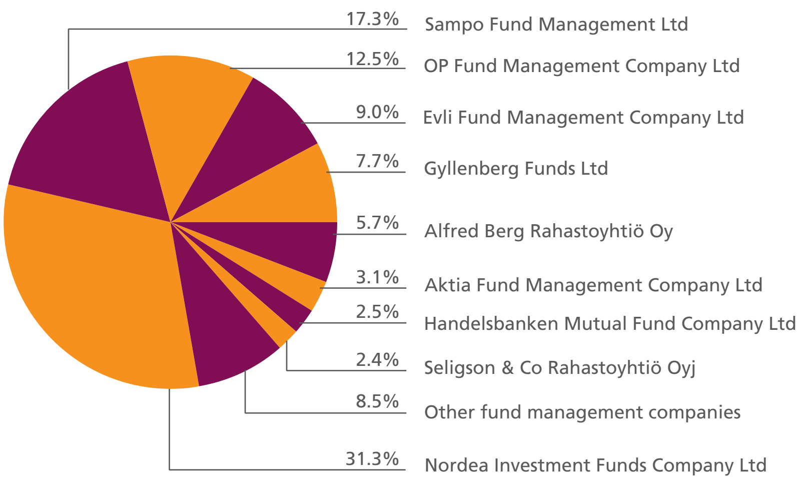
[3] Indices published by Morgan Stanley International (MSCI).

Chart 4.
Net assets of mutual funds, 1997–2001



Source: Financial Supervision Authority.

Chart 5.
Fund management companies: Market shares, 2001



Source: Financial Supervision Authority.

exchanges in United States were closed for several days, and hence in practice it was impossible to quote mutual funds whose assets were invested in the US securities markets.

The FSA instructed management companies to suspend redemptions of mutual fund units that could not be quoted. In addition, the FSA permitted management companies to interrupt subscriptions where redemption had been suspended. At its peak, the break-off concerned nearly a hundred Finnish mutual funds, one-third of the total, and mostly lasted for five business days.

In autumn 2001, following the terrorist attacks on the United States, the UN Security Council repeatedly ordained economic sanctions against the Taliban of Afghanistan. The sanctions were implemented in the EU member states through Council and Commission Regulations, including laying down that all funds and financial resources belonging to the Taliban of Afghanistan be frozen. The FSA gave the Ministry of Foreign Affairs executive assistance in this matter. In Finland as well as in other parts of the world, banks and other providers of financial services searched through customer records for assets that should be frozen. So far no assets to be frozen have been found in Finland.

The freezing of funds is part of the international foreign and security policy. The funds and financial resources subject to economic sanction can be frozen directly on the basis of regulations, since EU regulations, as such, including appendices govern laws in all member states. The EU is expected to issue further regulations on economic sanctions in 2002.

PROVISION OF SERVICES IN THE FINANCIAL MARKETS

Mutual funds investment continued to grow, whereas insurance-related investment ceased to gain in popularity

The value of mutual fund assets increased slightly in 2001, albeit clearly more slowly than in previous years.

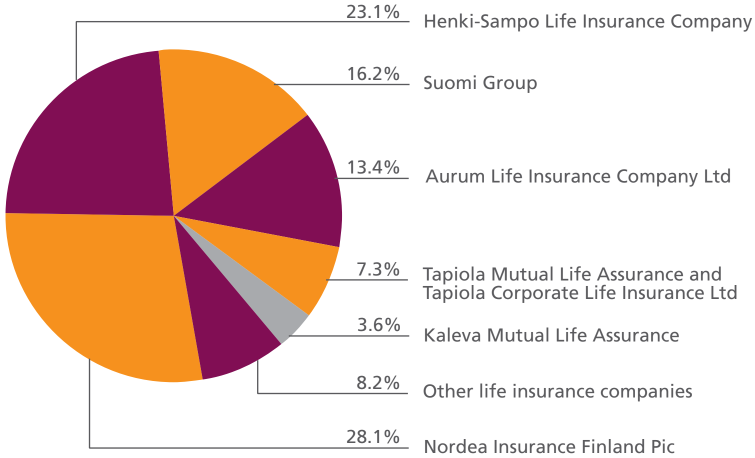
At the end of 2001, net assets of mutual funds totalled nearly EUR 15.5 billion (Chart 4), representing an increase of about EUR 1.2 billion or 9% from the previous year. Although mutual fund investments exceeded redemptions by EUR 2.8 billion in 2001, the growth of mutual fund assets was modest due to the fall in the prices of underlying assets, mainly shares. Because of uncertainty in the stock markets and the world economic situation, short-term funds recorded the largest influx of assets. The situation changed notably at the end of the year, as a result of redemption of short-term fund assets, partly for tax reasons.

Insurance investment levels remained virtually unchanged compared with 2000. Life insurance companies' total underwriting reserves increased by 1.1%, amounting to about EUR 18.5 billion at year-end. Growth slowed down significantly, from 21% in 2000.

Market shares in fund and insurance investment in 2001

The largest banking groups had a strong position in the mutual funds market. In terms of managed fund assets, Nordea Investment Funds Company Ltd, Sampo Fund Management Ltd and OP-Fund Management Company Ltd were the three largest management companies at the end of 2001. These companies commanded more than 60% of all managed assets (Chart 5). The market share of Sampo Fund Management Ltd grew in late 2001 as a result of the transfer of the mutual funds managed by Mandatum Fund Management Company Ltd to the former company. At the end of 2001, 24 management companies, managing a total of 300 mutual funds, existed in Finland.

Chart 6.
Market shares of life insurance companies, 2001



Source: Federation of Finnish Insurance Companies.

The life-insurance companies of the banking groups maintained their market shares in insurance investment, although the three largest groups' shares, calculated on the basis on premium income, became more closer in size (Chart 6). The bank-affiliated life insurance companies accounted for about 64% of life insurance investment, an increase of 4 percentage points compared to the previous year. Bank-affiliated insurance companies are Nordea Life Insurance Ltd, Sampo Life Insurance Company Ltd and Aurum Life Assurance Company (Amalgamation of cooperative banks).

STRUCTURAL AND OPERATIONAL CHANGES IN THE FINANCIAL MARKETS

Further restructurings and reorganisations

The financial and insurance conglomerate that was formed as a result of the merger between Leonia Bank plc and Insurance Company plc commenced operations in late 2000. In early 2001 Mandatum Bank plc joined the group. For the first three months, Sampo Insurance Company plc acted as the parent company of the group. Many of the subsidiaries of the former Sampo Insurance Company plc and Leonia Bank plc were reorganised in 2001. As from April 2001, Sampo plc, the holding company of the group, has directly or indirectly owned the banks, investment firms and insurance companies belonging to the group.

Two deposit banks operated within the Sampo Group until in late 2001 Mandatum Bank plc and Sampo Bank plc merged as result of restructuring. By early 2001 the name Leonia had been dropped completely.

In early 2002 the Sampo Group started to operate as financial conglomerate, in which financial enterprises form a clear majority, after its non-life insurance companies had been sold to the IF-Holding Group and only the Sampo life-insurance business remained in the hands of the Sampo Group.

At the end of August, Pohjola Group Insurance Corporation and Conventum Limited merged to become the Pohjola Group the core business areas being insurance and investment services. On 27 July 2001 Pohjola Insurance Group plc made an offer to the shareholders of Conventum Limited on the exchange of shares in the parent company of the Conventum Group for new shares in Pohjola Group Insurance Corporation. On 28 August 2001, Conventum Limited became a subsidiary of Pohjola Group Insurance Corporation. As a result of the offer of exchange and the ensuing redemption offer, Pohjola Group Insurance Corporation's holding in Conventum plc reached more than 99% in December. Pohjola Group Insurance Corporation announced that it would use its right under the Companies Act to redeem the remaining Conventum shares.

On 18 January 2002, Pohjola Group Insurance Corporation changed its name to Pohjola Group plc, waived its authorisation to carry on insurance business and became a holding company. On 22 February 2002, an arbitration court decided that, under the Companies Act, Pohjola Group Insurance Corporation had the right to redeem the minority shares in Conventum Limited. Pohjola Group Insurance Corporation posted the collateral required by the arbitration court and became the sole owner of Conventum Limited.

The restructuring of the Nordea group continued in 2001 with the aim of bringing the group's legal structure in better agreement with its business structure. The group's areas of business are retail banking, corporate and institutional banking, asset management and life and non-life insurance. The group has announced that it will give up its non-life insurance activities.

At end of April, Merita Real Estate Ltd merged with Merita Bank Plc. In June the Ministry of Finance authorised NCF Bank Abp (the former holding company Nordea Companies Finland (NCF) Oy) to carry on banking activities. At the end of September, Merita Bank Plc and its parent company NCF Bank Abp merged to become Nordea Bank Finland Abp. In December the Danish Unibank A/S became a subsidiary of Nordea Bank Finland Abp. The banking activities of the group were concentrated on Nordea Bank Finland Abp and its subsidiaries in the other three Nordic countries. The parent company is the holding company Nordea AB (Plc.) registered in Sweden.

During spring 2001 HEX acquired a shareholding of more than 60% in the Tallinn Stock Exchange (TSE). The purpose of the acquisition is to support the growth strategy of HEX and develop the capital markets in Estonia. Turnover on the TSE amounted to EUR 263 million in 2001.

On 25 February 2002 the HEX trading system was introduced on the TSE with the aim of promoting turnover and liquidity as well as making it easier for foreign investors to trade in Estonian shares. Trading on the TSE will also be regulated by Estonian law in the future. The national central securities depository (EVK), which is a wholly owned subsidiary of the TSE, handles safekeeping and settlement.

In Autumn 2001 HEX and Euronext signed an agreement facilitating cross-membership and technical access to the cash markets of the other party. Owing to the technical solutions included in the agreement, brokers can trade both on the HEX and Euronext from their own offices. Euronext was established in September 2000 as a result of a merger between the Paris, Amsterdam and Brussels exchanges. In February 2002, the stock exchange of Portugal merged with Euronext. At the end of 2001 the shares of more than 1,500 companies, representing a market value of nearly EUR 1,700 billion, were traded on Euronext.

Evli Fund Management Company Ltd became Evli Bank Plc. Investment firms have shown a certain degree of interest in becoming authorised as banks, banking licences being more comprehensive than investment firm licences. For example, authorised banks may take deposits from the public and grant loans. Moreover, in some countries access to the banks' payment systems requires a banking licence, particularly in relation to payment systems or handling customer funds.

More diverse online banking services

Online banking services became more diversified and the number of users grew so that by the end of 2001 Finnish banks had more than 2 million online customers. Finnish banks have adopted a multi-channel strategy allowing customers to use banking services through different distribution channels that complement each other, eg bank offices, telephone ATMs and the Internet. So far there are no banks in Finland that only provide online services. Nor do any banks authorised abroad provide services in Finland only through the Internet, except the Belgian EuropeLoan bank, which since late 2000 has also been offering housing loans across the border to Finland.

The sectoral shifts in the financial markets between banks and non-banks in 2001 was reflected in an increase in the number of agents outside the financial sector that provided cellular phone payment services. This was chiefly conducted on a trial basis. In addition to traditional banking services, banks have also begun to offer customers services for identifying customers and verifying electronic transactions.

Evening trading introduced on the stock exchange

In April 2001 evening trading was introduced on the HEX. Trading hours were extended in such a way that the first session of continuous trading finished at 6 pm and the second session (evening trading) at 9 pm. In December HEX announced that it was going to cut back evening trading by one hour. The decision was made in response to feedback from market participants and was taken into effect from the beginning of April 2002. Evening trading accounted for about 6% of the average HEX turnover and 2/3 of evening trading took place during the first hour.

In July HEX launched a new HEXTech index, calculated on the basis of technology shares, and trading in HEXTech index futures and options started in September.

Trading in index shares (ETF) began on 11 February 2002. An index share is an index fund unit traded on the stock exchange.

Agreement on setting up the Finnish Securities Complaint Board

At the initiative of the FSA, the FSA, the Finnish Bankers' Association, the Finnish Association of Securities Dealers, the Finnish Association of Mutual Funds and the Finnish Shareholders' Association entered into an agreement in December on setting up the Finnish Securities Complaint Board. The Finnish Securities Complaint Board started to function in early spring 2002.

The Complaint Board gives recommendations on how to resolve disputes between financial service providers, being members of the founder associations, and non-professional customers. While seeking solutions to issues brought up by individual customers, the Board also seeks to promote sound securities trading practices more generally. A solution proposed by the Complaint Board may, besides being an evaluation of the parties' actions, also comprise a view of the scope of indemnification liability. The founder associations are committed to contributing to their members' observation of the Board's recommendations. The Board does not give investment advice.

The FSA and the Finnish Bankers' Association appoint one member each to the Complaint Board, the Finnish Association of Securities Dealers and the Finnish Shareholders' Association one joint member and the Mutual Funds Association two members. An independent representative, Professor Mika Hemmo, was called as chairman of the Board. A full-time expert acts as presenter to the Complaint Board and advises customers on resolving disputes. The expert works in conjunction with the Advisory Office for Bank Customers. The Board's solutions and the expert's advice are given free of charge.

Supervisory activities

Profitability, restructuring and risk-bearing capacity in focus

The cyclical downturn affected the profitability of investment firms and fund management companies. For some of the supervised entities the year was unprofitable, and therefore the FSA paid more attention to the supervision of solvency and capital adequacy than in 2000. Some restructuring occurred in the field, which was at least partly brought about for profitability reasons. Both fund management companies and investment firms were the objects of acquisition. At the same time new investment firms and fund management companies were established.

Cooperation with the Insurance Supervision Authority was intensified in the supervision of investment firms and fund management companies. Insurance companies approached the FSA for a practical interpretation of how to proceed in their marketing of fund management company products. An amendment of the Insurance Companies Act that came into force in May 2001 made it possible for insurance companies to market financial products.

Restructuring also continued in the largest banks. The FSA examined what effects the changes due to restructuring will have on the capital adequacy and performance capacity of the banks over the long term. Inspections were also carried out on how the management system, risk management and other internal control of the banking groups meet the requirements of the new organisational structure.

In its supervision of banks' foreign operations, the FSA paid special attention to banks having strengthened the strategies and instructions for their foreign branches. The FSA also paid attention to the top management of the banks receiving adequate monitoring reports on branch operations. Risks and reasons for loan losses in foreign branches were also subject to inspections. These inspections will be continued in 2002.

Banks and other credit institutions aimed at outsourcing such activities where costs could be saved and increased efficiency achieved. These measures concerned the outsourcing of real property management, internal audit operations, data system services and accounting services. In its supervision, the FSA paid attention to the banks themselves retaining their capacity of controlling the quality of the outsourced services.

During inspection visits, the FSA examined the risk-bearing capacity of the banks and, particularly, their preparedness for risks of loan losses. Inspection visits and a questionnaire were used to examine the IT sector risks of the banks. At the time of inspection, the risks in this sector were found to be at a level that posed no threat to bank solvency.

A revision of the capital adequacy framework is under way (see page 32). The new capital adequacy requirement based on operational risk is particularly significant to investment firms. Due to the nature of business of these firms, their credit and market exposures are moderate. Therefore, consideration of the operational risk in the capital requirement calculation may multiply the capital requirement imposed on them. The European Commission and the FSA studied the subject through test calculations. Based on the information available on the reform, it was found that not all current investment firms would fulfil the new requirements.

In the autumn, the FSA surveyed how thoroughly the lead managers arranging equity offerings examine a company's qualitative listing qualifications prior to its application for admission to stock exchange listing. Significant differences were found between managers in the extensiveness of the due diligence review and the thoroughness of the process.

In 2001 the FSA particularly considered the economic prospects provided by listed companies. The FSA issued recommendations on the presentation of the prospects in a statement that came into force in March 2002 (see page 29). The FSA is of the opinion that the prospects should be motivated and that the basic grounds for them should also be disclosed. The forecast must be kept clearly separate from other information, such as business strategies or general goals of the issuer or business field prospects.

As the market growth slowed in the field of mutual fund operations, particularly fund management companies coming on stream had problems maintaining the necessary economic operating conditions. The FSA had to direct several supervised entities' attention to the safeguarding of capital adequacy. Inspection visits were paid to fund management companies to ensure the functioning of their most important operating processes, such as asset value calculation and maintenance of fund unit registers. At the inspection visits the companies were asked to focus on the functioning of the procedures of internal control, the clarification of the division of labour and responsibility, and the sufficiency of the deputy arrangements.

The FSA participated in a working group on multi-tier trading appointed for considering a revision of the book-entry system. Parallel to the working group, the FSA surveyed how to safeguard the smoothiness of insider dealing investigations in case Finland changes over to a multi-tier system where trade infomation no longer could be obtained from a centralised book-entry register. The FSA also started to examine what changes a multi-tier solution would require of the supervision of book-entry registers.

Prevention of money laundering in connection with the euro cash changeover

The supervised entities' readiness to prevent money laundering during the euro cash changeover was also subject to supervision by the FSA. The objective was to ensure uniform and thorough compliance with the regulations on prevention of money laundering. Special emphasis was placed on the training of bank employees and on the banks' internal instructions. According to preliminary information the regulations were followed carefully during the changeover period.

Requests for investigation decreased

The number of written requests for investigation received by the FSA fell by 30 from the previous year to a total of 168. Of those 136 (150 in 2000) concerned credit institution activities and 32 (48) securities markets activities. Telephone calls on the operations of credit institutions were increasingly directed to the Advisory Office for Bank Customers, which decreased the number of calls received by the FSA.

Investor complaints on the functioning of the security markets mostly focused on the procedures used in securities intermediation and asset management, whereas the subject of most of the requests for investigation in 2000 concerned allocation in equity offerings. The reason for this is probably that in 2001 no new issues were arranged due to the market situation and that only 2 public equity offerings to the public were arranged during the year.

Customer complaints concerning banking operations focused on lending, collateral and collection. The Advisory Office for Bank Customers was approached 1,701 times. Most of the approaches concerned loans, use of accounts and payments.

In August the FSA sent the supervised entities a letter concerning payments effected in incorrect currencies (FIM or EUR) at the change-over to euro. In the letter, the FSA took the view that a payment that has been effected in an incorrect currency may, as opposed to previous practice, be corrected even after the sum has been debited from the payer's account regardless of whether the mistake has been made by the bank or the customer.

In March 2002, the Finnish Securities Complaint Board was established as part of the organisation of the Advisory Office for Bank Customers. The Board will propose solutions to disputes between providers of investment services and mutual funds and their customers. No fees will be charged of the customers for the solutions provided by the Board and its expert consulting services (see page 15).

MONITORING THE FINANCIAL CONDITION OF SUPERVISED ENTITIES

Finnish banks' profitability still good

Bank profitability remained good in 2001, although the Finnish economy, as with several other economies, encountered a period of clearly slower growth. On the other hand, loan losses increased, at least partly because of the economic slowdown, after an

Table 1.
Key items in Finnish banks' profit and loss accounts 2001, EUR million

	Nordea Bank Finland Group[1)]	Amalgamation of cooperative banks	Sampo Bank Group (credit institution and investment service activities)[2)]	Other banks[3)]
NET INCOME FROM FINANCIAL OPERATIONS	2,615	875	469	338
Income from equity investments	39	95	27	17
Fee income	1,226	287	220	122
Fee expenses	–199	–42	–41	16
Net income from securities trading and foreign exchange dealing	314	–46	43	–5
Other operating income	1,324	146	36	25
Administrative expenses	–2,088	–501	–367	–246
Depreciation	–221	–164	–35	–25
Other operating expenses	–285	–132	–44	–52
Loan and guarantee losses	–208	–12	–16	–3
Profit/loss of companies consolidated by the equity method	58	–2	4	1
Net operating profit/loss	2,573	504	296	155
Income/expenditure (depreciation from expenses)	2,0	1.6	1.6	1.6
Balance sheet total	215,852	30,031	20,893	11,467
Total own funds	12,591	2,951	1,775	1,024
Original own funds	8,398	2,531	2,170	921
Risk-weighted items	135,941	19,514	13,952	4,667
Capital adequacy ratio, %	9.3 %	15.1 %	12.7 %	21.9 %
Tier 1 capital adequacy ratio, %	6.2 %	13.0 %	15.6 %	19.7 %

1) The data cover nonresident subsidiary groups, ie Nordea Bank Danmark A/S, Nordea Bank Norge ASA and Sverige AB.

2) The data cover the Sampo Bank Group, the Mandatum Bank Group, UAB Sampo Bankas, AS Sampo Bank and Mandatum Asset Management Ltd, Sampo-Leonia Fund Management Ltd and Sampo PTE SA.

3) The data cover the Aktia Bank Group, the Evli Bank Group, the Bank of Åland Group and Gyllenberg Private Bank Ltd. and local cooperative banks and savings banks on a parent bank basis.

Source: Financial Supervision Authority.

Table 2.
Capital position of banking groups 2000 and 2001, EUR million

	2001	2000
Total own funds	18 340	13 780
Of which: original own funds	14 020	9 589
Risk-weighted items	174 075	133 887
Capital adequacy ratio	10,5 %	10,3 %
Tier 1 capital adequacy ratio	8,1 %	7,2 %

The data cover Aktia Bank Group, the Evli Bank Group, Nordea Bank Finland Plc, the Amalgamation of cooperative banks, the Sampo Group's credit and fund management companies and investment services functions, the Bank of Åland Group, and Gyllenberg Private Bank Ltd and local co-operative banks and savings banks in their capacity as parent companies.

Source: Financial Supervision Authority.

exceptional low the previous year. However, in relation to the stock of lending, loan losses were still at a low level.

The banks' net income from financial operations continued to grow, even if short-term market rates were low particularly in the latter half of 2001. The growing stock of lending compensated for the low interest rate level. The banks' euro lending increased by 7% from the previous year. The low interest rate level and consumer confidence sustained the demand for lending to households[4].

Other income fell slightly from the previous year. In particular, income from securities intermediation and asset management decreased from their high of 2000. By contrast, income from lending and payment services increased due to volume growth. Income from securities transactions and foreign exchange dealing actually collapsed from the previous year. However, in 2000 very many non-recurring receipts occurred, which complicates comparison.

The banks' administrative and operating expenses continued to increase, although their rate of growth decreased slightly compared with the trend seen in 2000. Staff, IT and market expenses represented the sharpest increase. The number of employees increased and more new branch offices were opened than in 2000.

Banks' capital adequacy slightly improved

The capital adequacy of the banking sector slightly improved from the previous year and was 10.5% at the end of 2001. The banks' good profitability led to an increase in their assets and thus their capital adequacy improved, when the increase of their own funds was faster than the increase of their risk-weighted assets and liabilities. The increase of the capital adequacy calculated on the basis of the Tier I capital was even steeper; at the end of the year it was 8.1%. The corresponding figure for the previous year was 7.2% (see Table 2).

4 Source: Financial Markets, statistical review of the Bank of Finland

Developments of loan losses were moderate

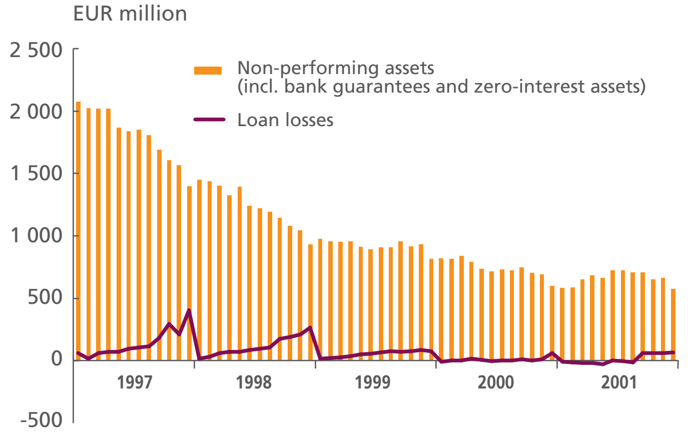
The exposures of Finnish banking groups (stock of lending + guarantees) increased by about EUR 4 billion in 2001 and amounted to EUR 87 billion at the year-end. The growth rate of lending clearly slowed from previous years. The stock of lending grew by 5% in 2001 compared with 8% in 2000. In 1999 the growth had been 11%.

Nonperforming assets decreased by about 3.7% to EUR 577 million (Chart 7). Their proportion of total exposures represented about 0.7%, whereas it had been 0.8% in 2000. In 2000 it had been 0.8%. The reason for the decrease of nonperforming assets was primarily the fall in interest rates, which made loan management easier.

Nonperforming assets in lending to nonresidents and households increased. On the other hand, nonperforming assets in lending to the corporate sector decreased.

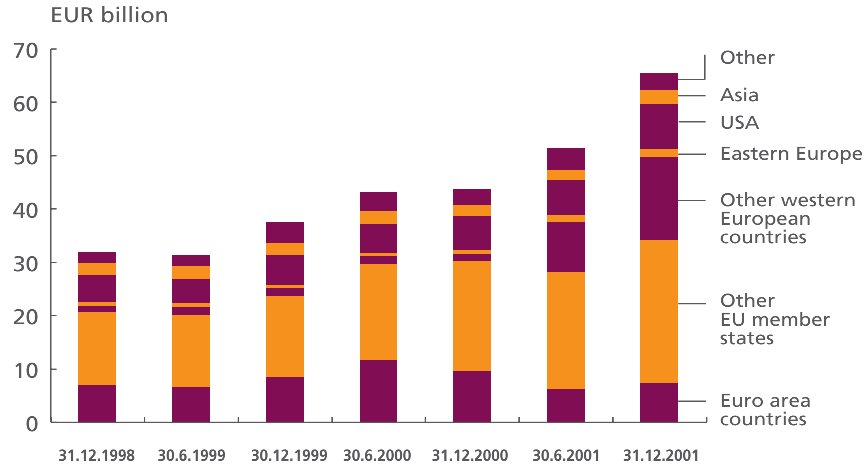
Loan losses increased by about 14% and amounted to EUR 68 million at the end of 2001. However, by historical standards loan losses were still very small, ie about 0.1% of the banking groups' total exposures. The increase of loan losses mainly concentrated to the latter part of the year, when general business conditions weakened. The largest increase in loan losses occurred in industry and lending to nonresidents.

Chart 7.
Deposit banks' non-performing assets and loan losses, 1997–2001



Source: Financial Supervision Authority.

Chart 8.
Foreign claims of Finnish banking groups by geographical region, 1998–2001



Source: Financial Supervision Authority.

Finnish banks avoided risk countries

Finnish banks' foreign claims increased by 49.5% from the previous year and amounted to a total of EUR 65.4 billion[5] (Chart 8). Nordic countries accounted for 55% of the foreign claims and 35% were on other industrial countries. Claims on Nordic countries increased by EUR 20 billion in 2001 and claims on other countries by only 6%.

The decrease of the proportion of risk country claims also followed the trend in 2001; Finnish banks' foreign claims on these countries actually decreased to 2.5% of total claims. The stabilisation of the political and economic situation in the Baltic

[5] The restructuring of Finnish banks complicates the comparison of the developments of foreign claims over the years. It is hard to tell from the figures available what proportion of the changes depends on the internal restructurings of the banking groups.

Table 3.
Nominal value of the underlying assets of derivatives held by banks operating in Finland, 2000 and 2001, EUR million

	Dec 2001	Dec 2000	Change	Change %
Currency-based				
Forward contracts	54,436	46,275	8,161	18%
Interest rate and currency swaps	5,754	4,735	1,019	22%
Currency options	3,986	7,089	–3,103	–44%
Interest rate-based				
Forward rate agreements and interest rate futures	7,478	10,941	–3,463	–32%
Currency swaps	66,735	76,147	–9,412	–12%
Interest rate options	10,247	2,587	7,660	296%

Source: Financial Supervision Authority.

Table 4.
Interest rate of the banking sector 2000-2001, EUR million

	Dec 2001	Dec 2000
INCOME RISK	259.6	256.4
Euro-denominated items	291.7	266.0
Foreign currency-denominated items	–32.1	–9.6
Assumption: deposits payable on demand = 10.5 months		
NET INCOME FROM FINANCIAL OPERATIONS	2,577.9	2,475.1
Risk to income ratio	10.1%	10.4%
INVESTMENT RISK	–58.5	–1.3
Euro-denominated items	–59.2	–11.7
Foreign currency-denominated items	0.7	10.4

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

Source: Financial Supervision Authority.

countries and Russia and a few positive forecasts increased the credit rating of these countries and thus also Finnish banks' interest in the financing of the neighbouring regions.

Argentina's unpegging of its peso from the dollar and its decision to let the currency float caused Finnish banks no considerable losses. As before, the claims on Argentina were very small.

Derivatives and other off-balance sheet commitments

In the management of foreign exchange risks, the stock of foreign exchange forwards[6] increased in 2001 while the stock of foreign exchange options decreased correspondingly. Of the foreign exchange forward contracts about 80% were still made with foreign counterparties. The growth in the stock of interest rate and currency swaps is mainly due to restructurings in the field. At the end of 2001 the stock of forward rate agreements was only EUR 2.5 billion, when at the end of 1999 it still had been EUR 17 billion. In the management of interest rate risks the use of interest rate options increased sharply.

The total credit equivalent amount of OTC-derivatives of Finnish deposit banks decreased by about EUR 1 billion to EUR 2.3 billion. The credit equivalent amounts are derived from the banks' capital adequacy calculations and consist of replacement cost and estimated future credit risk.

The amount of guarantees and guarantee commitments granted by deposit banks operating in Finland increased by more than EUR 4 billion to about EUR 16 billion. Banks' binding loan commitments increased to EUR 13.2 billion at the end of June 2001 from EUR 10.7 billion at the beginning of the year. The year-end saw a return to EUR 11.1 billion.

Finnish commercial banks' interest rate risk position fell

The income risk of the banking sector - ie the decrease in potential net interest income over the next 12 months, should interest rates fall by 1 percentage point - was about EUR 260 million at the end of 2001 (see Appendix page 51). Thus the income risk of the sector remained similar to the level at the end of 2000. Correspondingly, relative income risk compared to net income from financial operations fell to 10.1% from 10.4% at the previous turn of the year (Table 4).

The investment risk in debt securities held as current assets and in related interest rate derivatives increased to EUR 104.4 million over the year. Investment risk is the change in value of debt securities held as current assets and related derivatives as a result of a 1 percentage point change in interest rates. Current assets, ie the trading book and other

[6] Foreign exchange forwards also include forward legs of foreign exchange swaps.

debt securities held as trading assets as well as related derivatives, were exposed to an interest rate increase, ie the value of the trading book decreases as interest rates rise.

The income risk was primarily increased by the large restructurings in the banking sector and the steady growth of the stocks of lending and deposits. The abolition of the tax-exempt status of deposits from the beginning of June 2000 has had no significant impact on the volume of deposits payable on demand, as there rather was an increase in the volume of them in 2000 due to the uncertainty of alternative forms of investment. Still the major proportion of the interest rate risk can be attributed to euro-denominated items.

Overnight foreign exchange positions were small

In Finnish banks the 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 remained small in relation to their own funds. Limits concerning 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.

Banking groups' direct equity risk slightly decreased

The market value of shares held by banking groups and their pension funds[7] was about EUR 1.6 billion at the end of 2001. The market value fell compared to the end of the previous year by about 15% or EUR 0.3 billion. Bank-owned life insurance companies' stock of equity investments remained nearly unchanged. The market value of shares includes all quoted shares, units of equity mutual funds and share derivatives regardless of the balance sheet items in which they are reported. Most of the shares are traded at the Helsinki Exchanges.

Deposit banks' liquidity improved

In 2001 public deposits grew by more than the long-term average. In an unstable market situation, deposit saving was considered safer than equity and fund saving. At the end of 2001 deposits covered 93% of the lending of Finnish deposit banks. At the same date deposits' proportion of the balance sheet total was 43%. The proportion of deposit bank funding represented by debt securities issued to the public (bonds and certificates of deposit) remained unchanged. On the other hand interbank funding grew, but the increase was exclusively due to Nordea Bank Finland Plc arranging euro funding for the other banks in the Nordea financial group.

The FSA performs monthly check-ups of the liquidity status of the banks using funding deficit indicators[8]. In 2001 the liquidity status of deposit banks improved. Deposit banks' short-term funding deficit[9] varied between EUR 3 and 9 billion during the year. The ratio of the funding deficit to the balance sheet total varied between 2 and 7%. Commercial banks naturally run funding deficits because they utilise the monetary and financial markets for their business financing.

Assuming that total deposits payable on demand remain unchanged, a quarter of deposit banks' liabilities will fall due within 1 month, nearly half within 6 months and half within 1 year. Two thirds of the liabilities are euro-denominated.

Investment firms' economy weakened

The FSA paid attention to the weakened profitability of investment firms. Due to reduced income, investment firms had to lighten their cost structure. However, profitability comparisons show that 2000 was an exceptionally good year for investment firms. Investment firms had no significant capital adequacy problems.

In 2001 share prices fell, the euro-denominated share trading shrank by about 10% and the competition for

[7] 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.

[8] The funding deficit is calculated by deducting liabilities from assets. Both balance sheet and off-balance sheet items are here considered in assets and liabilities.

[9] Short-term here refers to one month. The funding deficit is calculated based on the assumption of unaltered deposits and total lending (the 'going concern' assumption).

market shares in share brokerage tightened when foreign remote members increased their brokerage activities at the Helsinki Exchanges. Equity offerings also decreased from the previous year. As a result investment firms' brokerage commission, asset management fees and arrangement of issues fees clearly deteriorated from 2000.

At the end of 2001 there were 51 authorised investment firms in Finland, with aggregate fee income of about EUR 265 million compared with EUR 370 million at the end of 2000. The net operating profit decreased from EUR 148 million to EUR 78 million. However, owing to the changes in the sector, aggregate figures are not directly comparable with the figures for previous years.

INSPECTIONS

Banks' annual accounts were drawn up in compliance with FSA regulations

The banks' annual financial reports were inspected for the integrity and sufficiency of the information disclosed and were checked in particular for compliance with FSA regulations, guidelines and statements.

In general, the banks' annual accounts had been drawn up in compliance with the FSA regulations, and the information on risks in banking operations disclosed in the annual accounts had increased. At its inspection visits the FSA encouraged banks to develop their systems so that the information disclosed in their annual financial reporting could be improved even further.

Instead, not all banks had disclosed the fair values of real property in their annual accounts in compliance with the relevant FSA statement. Because the disclosure of fair real property values is important to get a true and fair view of the banks' economy, the FSA continues to monitor the banks' measures to remedy the observed problems.

At inspections of interim reports the FSA found that the information on risk management disclosed by some local banks in their financial reports was scarce.

Implementation of the banks' action plans for reducing real property risks was inspected in individual banks. The inspection findings varied. In some banks the value of the stock of real property had not been determined in accordance with issued regulations and write-downs of poorly performing real properties had not been entered quickly enough, whereas elsewhere the amount of real property risks had been reduced faster than originally intended.

Banks were urged to prepare for future loan losses

Risk management, risk position and particularly threats of loan losses were inspected in several banks and other credit institutions. For several years the financial results of these supervised entities have been good, which has also strengthened their capital adequacy.

Based on the inspections and considering the risk-bearing capacity of the inspected banks and other credit institutions, it was assessed that the threatening loan losses were still at a level that posed no risk to capital adequacy. However, from time to time growth in nonperforming assets could be observed. Still this could be regarded more as a return to normal than as a sign of future problems. The banks' stock of nonperforming assets has been historically low in recent years. Despite this, the supervised entities were encouraged to prepare for an economic regression, competition, or other factors that may weaken long-lasting favourable developments. During several inspections deficiencies were also found in the banks' internal instructions and risk control. The supervised entities were urged to find remedies for these deficiencies.

One aspect of the credit risk inspections was the banks' customer-risks, particularly those of IT companies. At the end of 2000, the largest banks' total commitments (lending, off-balance sheet items and direct investments) to the IT sector amounted to EUR 4.77 billion (FIM 28.4 billion). IT-related loan losses estimated by the banks were small. Based on the risk reports submitted by the banks the FSA continues to monitor the risks posed by the IT sector.

The policy and instructions governing loans to related parties were studied in the three largest banks. In general, subsidiaries and associated companies, banks' largest shareholders, members of the top management and their family members are all considered related parties. Some banks had given the matter due consideration, but some had not addressed it specifically. According to banks' own assessments, lending to related parties forms no significant problem. The FSA assessed the future demand for closer regulation and regular reporting of this type of lending.

Repos and securities lending inspected for the first time

For the first time a market survey and inspection of repos and securities lending was conducted in the three largest supervised entities. In a market survey carried out in connection with the inspection, the scope of the markets, the operating methods, the various products etc. were examined. By contrast, the inspection focused on the credit, market and operational risks involved in the operations.

In repos and securities lending, market funding is acquired against securities as collateral - as opposed to normal uncollateralised monetary market funding. Therefore, reliable operations require monitoring of collateral values and collateral deficiency calculations. In relation to the scope of operations, the deficiencies were not alarming. However, extended operations require further development of the collateral calculation and management.

Shortcomings found in asset management

Asset management was one of the focal points of inspections carried out at providers of investment services in 2001. An enquiry on the procedures of asset management firms was carried out to prepare for the asset management inspections. On the basis of the enquiry, shortcomings were observed in contracts, reporting to customers, internal control and treatment of customer complaints. Asset managers were urged to take measures to overcome the shortcomings.

The inspections of individual asset managers were started in late spring and will be continued in 2002. In the inspections already performed, shortcomings were found in data systems, the division of trades, the calculation and reporting to the customers of performance-based commission and the control of investment limitations.

The classification of asset management customers into professional and non-professional that had been brought up already in 2000 was inspected at visits to six asset managers.

Newly listed companies fulfilled their disclosure obligations reasonably well

In inspections of the fulfilment of the regular reporting requirements by newly listed companies, the disclosure of information by 33 companies listed in 1999 and 2000 was looked at. The purpose was to study the companies' general disclosure level and how well the new companies had fulfilled their regular reporting requirements. Accounting methods were not considered in the inspection.

The inspection showed that as a rule the newly listed companies fulfilled their regular reporting requirements reasonably well. Significant negligence or deficiencies were found only in a few companies.

The companies' interim reports, year-end reports and annual accounts mostly comprised the required numeric data. On the other hand orally presented information contained faults or the presentation was superficial. Most frequently there were deficiencies in the fulfilment of the reporting requirements laid down in the general guideline of the Accounting Board. A procedure where the official financial information was replaced by pro-forma data was considered significantly negligent by the FSA, as was a procedure where no auditors' report had been presented in connection with the annual accounts.

Banks must still develop the risk management of their online banking services

The FSA considers it important that the risk management and other internal control of a supervised entity's online banking services and systems are sufficiently advanced in relation to the nature and scope of the operations. When new services are introduced or changes made in the existing ones, the related risks must be surveyed, evaluated and limited. The FSA recommends that the supervised entities report new online banking services or significant changes to such services in good time in advance.

The FSA continued the inspection process of online banking services that was started in 2000. The purpose of the inspections was to evaluate the risk management, organisation, strategies and especially security, technical solutions and legal aspects related to the online banking services. In addition, the FSA evaluated aspects of reliable customer identification, prevention of money laundering, portals and outsourcing of operations. The inspections were focused on banking services offered to private persons through the Internet.

The FSA found no significant deficiencies in the inspected online banking functions. However, the banks should develop the risk assessment of their online banking services. In addition, the banks should revise the operating methods and instructions for some of the sub-sections of online banking.

In November–December the banking supervisors of the Nordic countries performed their first joint Nordic inspection of online banking services. Each supervision authority inspected the online banking services provided in its country by the domestic subsidiary of the Nordic banking group.

Inspections of outsourced IT services started

In autumn 2001 the FSA started inspections of outsourced IT services, and the intention is to continue these inspections in spring 2002. The purpose of the inspections was to get a general picture of the principles applied by the banks in their outsourcing of IT services and of the scope of outsourcing. Particularly the monitoring of outsourced IT functions, the assessment and management of risks related to outsourcing, and the ensuring of the continuity of outsourced operations were investigated.

On the basis of its inspection visits the FSA urged the banks to describe their outsourcing process, revise parts of their instructions on outsourcing and compile their instructions into one single collection.

Banks to survey their EBA clearing risks

The FSA inspected the EBA clearing[10] in four Finnish banks. The EU-internal EBA clearing system is a system for netting euro-denominated bank payments transferred via the system. Member banks have bilateral limits within which payments can be transferred. Collateral has been set for the limits.

The aim of the inspection was to gain an idea of the effects of the EBA clearing on the banks' management of euro-denominated payments and on their liquidity and risks. Special attention was paid to commitments between various offices in the bank and the division of tasks between them in the EBA clearing, the settlement and monitoring process, the analysis of risks and preparations for various disruptions.

As a result of the inspections the FSA urged the banks to survey their EBA clearing risks as part of their risk management and draw up missing contingency plans.

Risk surveys of the conversion to euro and cash changeover were missing

In the early part of 2001 the FSA inspected the euro readiness of banks and Automatia by paying supervisory visits to the major supervised entities. After the inspections the progress of the euro readiness was monitored through quarterly reports submitted to the FSA and enquiries on additional information.

The changeover to the euro largely proceeded as planned. According to the monitoring reports, small delays and rescheduling of the euro changes occurred in some banks. There were no delays of a critical nature that would have threatened the changeover to the euro concerning any important banking service. The euro cash changeover at the turn of the year succeeded without significant disruptions.

At the inspections it was found that risk surveys on the conversion to the euro and the cash changeover were missing in the banks. The FSA required risk surveys by the banks as well as detailed plans for euro-related turn-of-the-year measures, contingency plans for safeguarding operations against disruptions, and necessary stand-by arrangements.

According to the Bank of Finland[11] the introduction of euro notes and coins in January–February 2002 went very smoothly in Finland as in the

[10] EBA = Euro Banking Association.

[11] Press release No 10 of the Bank of Finland, 1 March 2002.

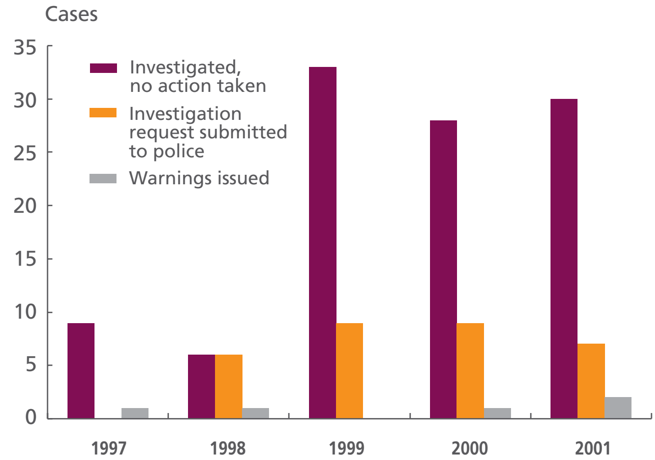
whole euro area. In practice, Finland had changed over completely to the euro era by the end of January. By that time, more than 95% of all cash transactions and almost all vending machine sales were by euro.

By contrast, the counting of coins and companies' daily cash takings faltered in the banks. According to an investigation by the FSA the amount of coins submitted for counting exceeded the bank estimates and thus also the capacity reserved for the function by the banks and cash centres. Delays occurred particularly in large population centres and in banks having outsourced the function to cash centres. Banks performed the counting of companies' cash takings in a reasonable time, ie in 1–5 business days, but there were some long delays in the counting of the contents of private customers' money boxes.

7 investigation requests submitted to the police

In the course of the year the FSA investigated 39 cases of suspected abuse in the securities markets. They resulted in totally 7 offences reported to police, of which 5 concerned abuse of insider information and 2 negligence of a disclosure obligation (Chart 9). In addition, the FSA issued 3 admonitions, of which 1 was issued to an issuer of securities concerning its disclosure requirements and 2 to brokers regarding trading procedures.

Chart 9.
Cases of suspected market abuse, investigated by the FSA, 1997–2001



Source: Financial Supervision Authority.

COOPERATION IN THE FIELD OF SUPERVISION

There was intense cooperation in the supervision of the Sampo conglomerate by the FSA and the Insurance Supervision Authority (ISA) throughout the year. The purpose of supervision cooperation is to ensure comprehensive monitoring of the financial conglomerate and see to that there are no dead zones in the supervision. Supervision cooperation grants uniform assessment of risk management and risk management systems of the conglomerate and its associated companies.

A supervision group made up of FSA and ISA representatives met regularly. The task of the supervision group is to plan and coordinate the monitoring of the conglomerate and ensure that supervisory measures are adequate and appropriately allocated. The supervision group also closely monitors the conglomerate's operations.

In 2001 joint inspections concerned both the Sampo conglomerate's holding company and its subsidiaries. Practical cooperation was also carried out in the FSA and ISA Boards of Directors. The Boards are almost identical, which also contributes to the flexibility of the supervisory cooperation. The new act on supervision of financial and insurance conglomerates requires uniform guidelines and regulations the preparation of which was commenced towards the end of the year.

The basis of the supervisory cooperation between the FSA and the ISA is made up of two Memoranda of Understanding (MoU), one on the general principles of cooperation and the other on the supervision of the Sampo conglomerate. The MoU contain agreements on the goals of supervisory work, the exchange of information, the scope of supervisory cooperation and the practical aspects of supervisory cooperation and procedures.

Practical cooperation between the FSA and the Bank of Finland in the supervision of payment and settlement systems continued under the auspices of a joint supervision group. The IMF assessed the Finnish financial sector (FSAP), and as part of this assessment the FSA and the Bank of Finland jointly assessed the payment systems' compliance with international recommendations.

The FSA and the other Nordic supervision authorities continued their established supervisory cooperation regarding the monitoring of the Nordea financial group. The aim of this supervisory cooperation is the efficient supervision of the financial group.

The Nordea supervision group, which has members from each Nordic country, met eight times. The supervision group functions as a coordinator when joint supervisory plans and comprehensive risk assessments for the whole financial group are prepared. At the meetings of the supervision group, subjects such as current financial group issues, restructurings and new supervisory challenges were discussed. Task forces function under the supervision group.

Several joint inspections of the Nordea financial group were conducted during the year. In addition, a joint assessment of the status of the financial group was given, which was submitted to the supervisors' management in August.

Two Memoranda of Understanding have been signed on the supervision of the Nordea financial group, one on the general principles of the cooperation of the supervisors and the other on the supervision of the Nordea financial group. The intention is to update the latter in 2002 to correspond to the supervisory obligations brought about by the current restructuring.

In 2001 the IT inspectors of the Nordic financial market supervisors conducted their first joint inspection of online banking services. The inspection was carried out utilising the new inspection model approved in May, which has been planned for inspecting banking services provided over the Internet.

The annual meeting of the Director Generals of the financial and insurance supervision authorities of the Nordic countries was held in Reykjavik, Iceland. The revision of the capital adequacy framework for banks and investment firms and practical issues of the Nordic supervisory cooperation, such as supervision of stock exchanges, banks and financial conglomerates, were discussed at the meeting.

At the beginning of 2001, a Memorandum of Understanding on cooperation between payment systems overseers and banking supervisors in stage three of economic and monetary union came into force. This MoU is primarily aimed at promoting cooperation between EU-country central banks and supervision authorities concerning large-value interbank fund transfer systems. The goal of the cooperation is to ensure the stability of these systems. Cooperation and communication between the signers of the MoU is carried out and developed particularly when a new counterparty joins an existing system or when a totally new system is established. The MoU is also applied to the ongoing operations of the systems and to crisis management situations.

During the year a cooperation agreement on securities markets supervision was prepared together with the Estonian authority for supervision of the securities market. The agreement was signed in early 2002 and in general it follows the agreement governing the cooperation of the CESR members signed in 1999.

Regulatory activities

NATIONAL LEGISLATIVE CHANGES AND LEGISLATION PROJECTS

Act adopted on the supervision of financial conglomerates

In December 2001, the Finnish parliament adopted the Government proposal for an Act on the supervision of financial conglomerates and for Acts amending certain related Acts. The aim of the Act, which took effect on 1 February 2002, is to clarify the division of responsibilities between the authorities and to ensure no omissions in the supervision of financial conglomerates. An EU Directive on the prudential rules for financial conglomerates is under preparation and expected to be implemented by member states at the beginning of 2004 at the very earliest (see page 32).

The Financial Supervision Authority (FSA) and the Insurance Supervision Authority (ISA) cooperate in the supervision of financial conglomerates, with principal supervisory responsibility being determined according to the dominant sector of the conglomerate, whether financial or insurance. The relative shares of the two sectors are calculated on the balance sheets and capital charges of the companies in the relevant sector, as detailed within the Act.

Existing legislation on financial and insurance undertakings (ie the Credit Institutions Act, the Insurance Companies Act and the Investment Firms Act) was harmonised in line with the new Act, for instance as regards the provisions on fitness and propriety of directors and managers, corporate governance, auditing and acquisition of foreign subsidiaries.

Several amendments to securities market legislation

Several major amendments to securities market legislation were passed by the Finnish parliament in December 2001. The amendments took effect at the beginning of 2002, save for some exceptions.

The key amendment was the introduction of a more flexible definition of the concept of 'securities' that in turn defines the scope of the Securities Markets Act. The aim is to promote the introduction and public trading in Finland of new types of financial instruments developed in national and international securities markets, including weather derivatives and exchange traded funds (ETF).

Another reform related to the scope of the Securities Markets Act was the abolition of the restriction applicable to private limited companies. Consequently, private limited companies offering securities to the public must, for example, publish a prospectus as referred to in the Securities Markets Act. This serves to improve investor protection in connection with offerings of the securities of private limited companies.

The reforms are also designed to increase competition between service providers in the securities markets, both nationally and internationally. For example, following the repeal of the prohibition against parallel listing, securities already listed on the official list may also be admitted to another regulated market. Changes in the provisions applicable to the trading participants of regulated markets also serve to promote competition, in that they, for instance, allow for greater flexibility in admitting institutional investors as direct participants.

Another reform was the introduction of a new type of organised market (not qualifying as a regulated market due to less stringent regulation). It is mainly targeted at securities issued by private limited companies. The reform is designed to direct trading in such securities from OTC-markets to markets that are more liquid and transparent and hence offer better investor protection.

New legislation was introduced to tighten the requirements governing self-regulation of markets. This includes enhanced requirements for the corporate governance of listed companies. Stock exchange rules must also include provisions on the performance of the supervisory duties entrusted to stock exchanges.

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

Credit Institutions Act (30.12.1993/1607, Ra 107)
Act on commercial banks and other limited-liability credit institutions (28.12.2001/1501, Ra 108)
Savings Bank Act (28.12.2001/1502, Ra 109)
Act on cooperative banks and other cooperative credit institutions (28.12.2001/1504, 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.

Legislation on the winding up of credit institutions clarified

The Government proposal for laws on the winding up of credit institutions was completed in late 2001. Parliament adopted the relevant Acts towards the end of December and they took effect from 1 January 2002. The new provisions are especially designed to redress earlier legislative omissions related to creditor protection in the context of various corporate restructurings and the procedures applicable to the winding up or reorganisation of credit institutions. New provisions on transfer of business and voluntary renunciation of authorisation were also now written into the Acts.

In connection with the reform, new Acts were introduced to replace existing banking Acts (Commercial Bank Act, Savings Bank Act and Cooperative Bank Act) and an Act on the temporary suspension of the business of a deposit bank was passed. The Credit Institutions Act and the Act on Mortgage Societies were also amended and the Act on the conversion of savings banks into limited liability banks was repealed.

From the beginning of 2002, the provisions of the Companies Acts will in principle be applicable to the mergers, demergers and winding up of commercial banks (and other limited liability credit institutions), while the provisions of the Cooperative Societies Act will be applicable to the mergers, demergers and winding up of cooperative banks (and other cooperative credit institutions). Equivalent principles apply to the restructuring of savings banks as to restructuring of commercial and cooperative banks.

The provisions on suspension of business in the Commercial, Savings and Cooperative Bank Acts have now been written into the Act on the temporary suspension of the business of a deposit bank (Suspension of Business Act). A bank's business may temporarily be suspended by a Ministry of Finance decision if the continued operation of the bank would jeopardise the position of depositors or other creditors or the stability of financial markets, or would otherwise cause serious disruptions in the financial market. If necessary, suspension of business offers a more flexible approach to reorganising a deposit bank than the normal procedures of company law. The operations of a deposit bank, the control of its assets, recovery by way of suspension and the bank's liabilities are governed by the legislation on business reorganisation, as detailed in the Suspension of Business Act.

ISSUE OF REGULATIONS AND GUIDELINES BY THE FSA

Revision of the FSA's process for issuing guidelines and regulations in progress

The reform of the FSA's issuing process continued in the year. The principles of compliance with international standards in the FSA's regulatory and supervisory work were approved and key international standards were identified and prioritised. Practices for the application of international standards were also adopted, with the main rule being that regulation is closely linked to the core principles of supervision and regulation issued by international organisations. A decision to revise the set of regulations and guidelines was taken in May.

The new set will include both the FSA's legally binding regulations and the recommendatory guidelines. In connection with the reform, the FSA will move away from the practice of handling separate issues for credit institutions and investment firms towards the issue of domain-specific rules.

The new set of regulations and guidelines will divide into the following seven sections: principles of the FSA's regulatory policy, corporate governance and business activity, code of conduct, accounting and auditing, capital adequacy and risk management, disclosure of information and reporting to the FSA.

Implementation of the reform will be phased in, with the new structure and basic regulatory guidelines being introduced first. The individual regulations and recommendatory guidelines will later be converted into domain-specific standards. The FSA's board discussed the structure and regulatory guidelines in January 2002, whereafter they were circulated for comment.

Sound securities markets practice

Work on the revision of the 'Guideline on securities offerings and obligation to provide information under the Securities Markets Act' (204.1) started in summer 2001. The contents of the Guideline were divided into five more easily manageable and user-friendly statements. The statements took effect from 1 March 2002 and Guideline 204.1 was repealed on the same date.

The new statements are 'Interpretation of the provisions on securities offerings in the Securities Markets Act', 'Interpretation of the provisions on ongoing disclosure obligation under the Securities Markets Act', 'Interpretation of the provisions concerning the obligation to disclose major holdings in the Securities Markets Act', 'Interpretation of the provisions on tender offers and redemption offers in the Securities Markets Act' and 'Disclosure of pro forma and restated comparative information in listing particulars'.

Through its statements the FSA wanted to convey its interpretation and views on sound securities markets practices to a larger audience. The statements mainly contain the FSA's interpretation of the purpose and meaning of some of the provisions of the Securities Markets Act. The statements also recommend a more extended obligation to provide information than that required in the legal provisions in order to further both the information to investors and the reliability of markets. They also set out general procedures for contact with the FSA and the delivery of documents to the FSA.

The FSA issued a statement on the disclosure of pro forma and restated comparative information in listing particulars. The statement sets out the FSA's views on the interpretation of the guideline on disclosure of pro forma financial information in prospectuses prepared in accordance with the Securities Markets Act. The guideline, which was issued by the Finnish Institute of Authorised Public Accountants, assists companies in preparing and disclosing pro forma information in line with international practice. The FSA participated in the preparation of the guideline.

Pro forma and restated comparative information is designed to improve the information to investors by enhancing the comparability of annual accounts. Pro forma information illustrates the effect that planned or recent transactions or structural changes could have had on official annual accounts had they occurred earlier, at an imaginary time. Restatements, in turn, illustrate the effects of realised business transactions or structural changes in a way that makes it easier for investors to assess and foresee the company's financial position after the changes.

Electronic financial services

The statement on electronic financial services represents a composite of the FSA's views on risk management in connection with the provision of electronic financial services. The statement addresses key aspects of electronic services, including information security, electronic contracts, customer identification and prevention of money laundering.

No restrictions on outsourcing

The FSA revised its statement of 1999 on outsourcing of activities by supervised entities. The new statement emphasises that use of an agent or other types of outsourcing can in principle be considered acceptable.

The statement does not impose any restrictions on outsourcing by supervised entities. However, it needs to be taken into account when outsourcing certain functions related to the securities markets, such as asset management, that taken as a whole the outsourced function may only be entrusted to a service provider that is properly licensed. Supervised entities must file an advance notification of their outsourcing plans with the FSA only in the case of outsourcing to companies not belonging to the consolidation group.

Outsourcing must not impair supervision of the entity. Measures must be taken especially to ensure the management's own ability to monitor the supervised entity and the FSA's ability to supervise the supervised entity, including outsourced functions. The service provider must make all necessary information for purposes of official supervision, risk management and internal control available to the supervised entity. The conditions on access to information and on the FSA's right of inspection must be included in the contract with the service provider.

INTERNATIONAL REGULATION AND REGULATORY PROJECTS

Regulation on the Statute for a European company (SE) adopted

The Council Regulation (EC) No 2157/2001 on the Statute for a European company (EU)[12] was adopted in October 2001. The Regulation will take effect in October 2004 and will as such be binding on Member States. The provisions of the related Directive on worker involvement must be incorporated into national law before the Regulation takes effect.

With the Regulation, a new European cross-border corporate structure will emerge, largely similar to that of a public-liability company. European companies will be recognised in all EU Member States and may thus operate both in the home Member State and in other member states, without having to set up subsidiaries or branches, as is the case currently.

The Regulation includes provisions on the formation of a European company, on its registered office and the transfer of the registered office to another Member State, as well as on certain issues related to the administration of the company. The other provisions applicable to European companies are, in practice, based on the laws governing public-limited companies in the Member State where the company has its registered office.

Establishment of European companies opens up prospects for cross-border corporate structures. A European company may, for example, be set up by merger with a company operating in another Member State. Cross-border mergers are not possible under existing law. The registered office of a European company may also be transferred to another Member State, subject to the transfer provisions entailed in the Regulation. Under existing rules such transfer is only possible following the winding up of the company and its subsequent re-establishment in another Member State.

The minimum capital of a European company is set at EUR 120,000 and registration of the company is subject to completion of the arrangements for worker involvement in the company as provided in the applicable Directive (No 2001/86/EC).

Amendments to the UCITS Directive adopted

The two proposals for amending the UCITS Directive presented in July 1998 were adopted by the EU Council and the Parliament in late 2001. The scope of the Directive, and therewith the UCITS passport, was broadened to include new types of funds, such as fund of funds, money market, cash, derivatives and index funds.

Management companies will be given a European 'passport', ie authorisation to provide services to other member states on a cross-border basis, following harmonisation of the administrative and capital requirements applicable to them. The scope of activities available to management companies will also be enlarged. This means that they will now also be allowed to provide individual portfolio management services in addition to engaging in the mutual funds business. Furthermore, the Directive introduces a simplified prospectus with a view to promoting the information to investors.

[12] SE=Societas Europea.

Second EU Anti-Money Laundering Directive now effective

The Second Anti-Money Laundering Directive of the European Parliament and of the Council (2001/97/EC) took effect on 28 December 2001. The Directive must be transposed into national law within 18 months from its adoption. Like the other Member States, Finland will implement the Directive without delay. The necessary amendments to the Act on prevention and detection of money laundering are currently being drafted by the Ministry of the Interior. The scope of the Directive was so extended that the Money Laundering Act will now apply not only to credit institutions, financial institutions, investment firms, management companies and others covered by the reporting requirement under the law but also to other professionals, including independent legal professionals, auditors, accountants, dealers in high-value goods and carriers of money and valuables. The Directive also includes an article on non-face to face transactions.

The Second EU Anti-Money Laundering Directive will not have any major immediate consequences for the activities of the entities supervised by the FSA. By contrast, the ongoing review of the 40 FATF recommendations will, in due course, also prompt regulatory changes as well as changes in the practices of financial market participants and supervisor responsibilities. The review will, for example, affect the banks' know-your-customer (KYC) policies. These issues are addressed in the recommendation of the Basel Committee of October 2001 entitled 'Customer due diligence for banks'.

Commission proposal for a Directive on prospectuses

At the end of May 2001, the European Commission issued a proposal for a new Directive on prospectuses, which sets out provisions on the prospectus to be published in connection with public securities offerings and on the information to be included in the prospectus. The proposed Directive will replace the existing regime, ie the Directives on listing particulars and prospectuses. Discussion of the Directive by the Council started in July 2001 and will continue in 2002.

A cornerstone of the proposed Directive is the introduction of a single passport for issuers. This means that securities may be offered to the public or admitted to trading throughout the European Union on the basis of a simple notification procedure after the prospectus has been approved in one of the Member States. Under the new system, the authorities of other Member States would no longer have the right to ask for additional information to be included in the prospectus, nor for its translation. However, this requires adoption of broadly harmonised disclosure standards across Member States as regards exemptions from the obligation to publish a prospectus and from the contents of the prospectus. It is therefore proposed that the exemptions be automatically written into the Directive and no longer left to the discretion of the competent authority, which may, however, make the system more rigid.

The proposed commitology procedure is another fundamental difference as compared to the former regime. According to the proposal, the framework principles and key rules will be laid down in the Directive, whereas the implementing technical rules will be the responsibility of the newly established Securities Committee.

Proposal for a Directive on market abuse

The European Commission issued a proposal for a Market Abuse Directive in June 2001. The proposal has been discussed by the EU Council and the European Parliament delivered its opinion on the proposal in March 2002.

The proposed Directive will update the provisions on insider dealing at Community level and harmonise the provisions on market manipulation. It will also contribute to more effective financial market supervision and enhance cooperation between the regulators as regards compliance with the provisions of the Directive. Furthermore, the Directive requires inclusion of administrative sanctions in national legislation.

If adopted, the Directive will bring some changes to current Finnish practice as existing Finnish law only provides criminal sanctions for securities market crimes. Adoption of the Directive would also mean greater investigative powers for the FSA.

NEW CAPITAL ADEQUACY ACCORD

The capital adequacy framework under revision is based on three pillars, namely minimum capital requirements, supervisory reviewand 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 alternative methods of calculation for each risk area. Supervised entities may themselves select the method that best matches their risk-taking capacity and the quality of risk management systems.

Banks and investment firms must themselves calculate that they have adequate own funds with regard to their risk taking. In addition, the supervisor assesses whether the supervised entity has adequate own funds in relation to its risk profile and level of risk control. Depending on the amount of risk taking and the level of risk control of the supervised entity, the capital requirement may be set above the current level of 8%.

Disclosure requirements provide more detailed disclosure of information on risk management and risk taking.

Amendments to Investment Services Directive under preparation

The proposal of the European Commission for amending the Investment Services Directive (ISD) was circulated for comment in autumn 2001. The amendments are, on the one hand, designed to include new services (investment advice) and new products (commodity derivatives) in the field of application of the Directive and, on the other, to impose more detailed rules on regulated markets and on the relationship between traditional stock exchanges and Alternative Trading Systems (ATS). The Commission is expected to publish its official proposal for amending the ISD in 2002.

Preparations for the revision of the capital adequacy framework continued

Work on the new capital adequacy framework progressed both in Finland and globally. In early 2001, new proposals were put forward by both the Basel Committee on Banking Supervision and the European Commission, attracting a considerable number of comments internationally. The proposal of the European Commission largely conformed to that of the Basel Committee. The FSA, the Bank of Finland and the Ministry of Finance presented their common views on the proposals.

In autumn the Basel Committee published several working papers on the calculation of capital charges for various risk areas. The papers serve as a basis for further elaboration of the new capital adequacy framework.

Discussion and information meetings on the proposals for a new capital adequacy accord were arranged for credit institutions and investment firms both in spring and in autumn 2001.

Together with banks and national supervisory authorities, the Basel Committee on Banking Supervision in spring 2001 made a study of the impact the new proposals would have for banks' own funds and capital adequacy in different countries. The results indicate that the proposals would deliver an increase in capital requirements under both the standardised approach to credit risk and the foundation internal ratings based approach. In contrast with the objectives of the Basel Committee, the foundation internal ratings based approach would generate even higher capital requirements than the standardised approach. These results will be taken into account in the preparation of the proposal for the following round of consultations. The Basel Committee will carry out a second study of the impact of the proposals for banks' own funds and capital adequacy in autumn 2002. Finland will also contribute to this study.

Work on the preparation of the new capital adequacy framework will continue. In its final recommendation, the Basel Committee will take into account the results of the impact study and the new round of consultations. At the European Commission, preparation of the Directive progresses in line with the schedule of the Basel Committee. Finland participates in the work of the Commission through membership of various working groups and committees.

In summer and autumn 2001, the European Commission made a study of the impact of operational risk for investment firms' own funds and capital requirements (see page 16). Operational risk will be a new risk area in the capital adequacy framework under revision. The Commission's study, to which Finland also contributed, is designed to ensure that the special characteristics of the business of investment firms is taken into consideration in the calculation of the capital charge for operational risk.

EU Directive on the prudential rules for financial conglomerates under preparation

In April 2001, the European Commission issued a proposal for a Directive, which includes definitions of coordinating supervisory authority responsible for the supervision of international financial conglomerates and the principles applicable to capital adequacy calculations. The Directive is expected to take effect in Member States at the beginning of 2004 at the very earliest.

In the supervision of international financial conglomerates, there has been a special need for clarification of which of the national supervisory authorities will be responsible for supervising the conglomerate and assessing the total financial position of the conglomerate. More specific rules for determining the national legislation applicable to supervisory activities are also warranted.

In Finland, the Act on the supervision of financial conglomerates took effect in February 2002 (see page 27).

Commission proposal for a Regulation on the application of IAS standards

In February 2001 the European Commission issued a proposal for a Regulation requiring all listed companies in the EU, including companies in the financial and insurance sector, to prepare consolidated accounts in accordance with International Accounting Standards (IAS), starting from accounting periods commencing on 1 January 2005. The aim is to enhance the comparability of financial statements prepared by listed companies throughout Europe. However, the legislative project has not kept to the schedule set by the Commission, but work is expected to be completed in the course of spring 2002.

In Finland, the requirement to adopt IAS would apply both to listed companies and to companies whose securities have been admitted to trading on the I and NM lists, as well as to issuers of bonds. Issuers of bonds would, however, be subjected to an additional transitional period of two years. Member States may also extend the mandatory scope of the Directive. Finland has yet to take a decision on the national field of application.

Incorporation of IAS with the 'acquis communautaire' has necessitated the introduction of a specific endorsement mechanism, which combines both a regulatory level and an expert level. The regulatory level will be represented by the Accounting Regulatory Committee, which is made up of representatives of member states. The expert level, in turn, will be represented by the European Financial Reporting Advisory Group (EFRAG) set up in June 2001 by private sector organisations. It will mainly operate through the Technical Expert Group. The Technical Expert Group will both provide the Commission with the assistance needed to assess IAS and communicate the EU's views on new IAS in the early phases of the standard setting process already. The Commission and the Committee of European Securities Regulators (CESR) have observer status in the Technical Expert Group.

A permanent group set up in spring 2001 assists the observer appointed by the CESR in which the FSA also has a representative.

To ensure consistent application of IAS standards, the EU Financial Reporting Strategy of the Commission involves the creation of an enforcement mechanism comprising statutory auditing as well as monitoring by supervisors and effective sanctions. The Commission expects the CESR to develop a common approach to enforcement to foster investor confidence in the financial reporting of listed companies, including its consistency within the EU. To this effect, the CESR set up another group in spring 2001 in which the FSA also participated. In other respects, member states can themselves choose how to organise enforcement. The Finnish approach has yet to be decided.

The new CESR groups together with the coordinating permanent committee of CESR-Fin ensure the active involvement of securities market regulators in the implementation of the Commission's Financial Reporting Strategy in Europe.

Fair Value Directive now effective[13]

In September 2001, the European Parliament and the Council changed the valuation rules for financial instruments contained in the current Accounting Directives with a view to allowing member states to apply IAS 39 on the recognition and valuation of financial instruments. The amendment of the Directive applies to both financial and other enterprises, in the same wording. Member states must transpose the amendments into national law by the start of 2004.

Member states must permit or require valuation at fair value of financial instruments. The permission or requirement may be restricted to certain classes of companies, eg financial companies, or to consolidated accounts. Accordingly, financial assets are, as a rule, measured at fair value in the accounts, whereas fair value accounting is only applied to financial liabilities held for trading purposes or connected with derivatives. Fair value accounting would not, however, be applicable to financial assets held up to the date of maturity, nor to loans granted by the company itself that are not held for trading purposes, such as loans granted by credit institutions.

It should be noted that financial companies' holdings of securities in the trading book have already been valued at fair value on closing date from the beginning of 1998, following the amendment of section 36 of the Finnish Credit Institutions Act to this effect. Under existing law, fair value changes are entered in the profit and loss account and the distribution of profits has not been restricted by other laws.

Where necessary, the FSA will revise the valuation rules contained in the accounting regulations applicable to supervised entities after the amendments have been incorporated into the Finnish Credit Institutions Act.

IASC proposal for fair value accounting of all financial instruments

In December 2000 the Joint Working Group (JWG) comprising representatives of the IASC[14] and a number of national standard-setters issued a draft standard[15], which was circulated for comment. The Draft Standard proposes adoption of fair value accounting for all financial instruments and disclosure of valuation results in the profit and loss account. The provisions would be applicable to all companies, including banks and insurance companies.

The proposal of the JWG sets out uniform valuation principles for all financial instruments. This means that fair value accounting would also be applied to loan portfolios and deposits.

In March 2001 the Banking Advisory Committee (BAC) set up a working group to review the implications of the valuation principles set out in the JWG Draft Standard for the annual accounts of banks. This work was part of the process of drafting the European Union's common position on the JWG proposal.

The JWG Draft Standard has generally been considered to constitute an improvement on the concept of fair value accounting applicable to financial instruments. Nevertheless, adoption of fair value accounting for all financial instruments is not held realistic in the short term. For example, the fair value accounting of banks' loan portfolios and deposits warrants closer examination and further development, considering that there are no liquid markets or public quotations for these items.

[13] 2001/65/EC.

[14] The International Accounting Standards Committee, as of April 2001 the International Accounting Standards Board (IASB).

[15] Joint Working Group of Standard Setters, Draft Standard and Basis for Conclusions, Financial Instruments and Similar Items, International Accounting Standards Committee, December 2000.

International cooperation

IMF financial system stability assessment on Finland

The Financial Sector Assessment Programme (FSAP) jointly developed by the IMF and the World Bank was carried out in Finland in 2001. In addition to the Financial Supervision Authority (FSA), the other authorities involved in the assessment included the Ministry of Social Affairs and Health, the Bank of Finland, the Insurance Supervision Authority (ISA) and the Ministry of Finance. The assessment concerned financial markets in Finland and the current regulatory and supervisory framework.

The IMF found the operation of financial markets in Finland to be effective and the risk carrying capacity of Finnish financial institutions to be highly adequate. According to the IMF, financial market supervision and applicable legislation in Finland are largely based on international recommendations in the area of financial market supervision.

However, the IMF points to some deficiencies in the provisions on the supervisory powers and accountability of the FSA. The major deficiency is the absence of early intervention powers, ie powers to intervene before the capital adequacy or stability of the supervised entity is put into jeopardy.

Accordingly, the IMF recommended harmonisation of supervisory and regulatory powers across financial, insurance and securities markets. It also recommended transfer of the licensing authority to the FSA and clarification and expansion of the FSA's supervisory powers. As regards securities market supervision, the IMF recommended that the FSA's powers to deal with market abuse and failure to comply with disclosure requirements be extended so that not all cases have to be reported to the police for investigation. The responsibility of the FSA's board should be so strengthened that the board would then decide on the granting and withdrawal of authorisations, the FSA's budget and significant decisions influencing financial stability.

The Financial Sector Assessment Programme (FSAP) emerged in the wake of the financial crises witnessed in the late 1990s. The programme is designed to promote financial stability in member countries. The assessment seeks to identify strengths and weaknesses in the target country's financial system and its regulatory and supervisory framework. Assessment of the country's compliance with international financial sector standards and codes constitutes an integral part of the programme.

A pilot programme extending over one year was launched in May 1999, covering 12 nations, both developing and industrial countries. The IMF and the World Bank were pleased with the results of the pilot year and decided to continue with the programme. By the end of 2001, altogether 45 countries had either been or were currently subjected to an assessment under the FSAP.

An FSA employee was part of the IMF delegation undertaking the financial system stability assessments on Sweden and Iceland.

Closer international co-operation in the aftermath of terrorist attacks

The terrorist attacks on the United States resulted in closer international cooperation and increased efforts to combat terrorism. At its extraordinary meeting in September, the European Council declared that terrorism poses a real challenge to Europe and the world in general, and that the fight against terrorism will be a priority objective of the European Union (EU).

Many concrete measures and their prompt implementation have been agreed on by international fora. Legislative changes affecting the responsibilities of both financial market participants and regulators are also under way in Finland. The legislative proposals scheduled for introduction in spring 2002 include amendments of the Penal Code and the Act on prevention and detection of money laundering.

The 19 conclusions adopted by the October summit of the joint Ecofin/JHA Council include several obligations concerning the prevention of money laundering and financing of terrorism. The UN Security Council adopted resolution 1373 (2001) reinforcing measures particularly aimed at preventing the financing of terrorism and encouraging the freezing of terrorist assets. In December the EU Council adopted two common positions and a regulation enforcing the obligations of the UN resolution in the EU member states. Finnish legislation still warrants certain amendments.

In October, the Financial Action Task Force on Money Laundering (FATF) decided to expand its mandate beyond money laundering to include efforts to combat the financing of terrorism. FATF adopted a set of eight new Special Recommendations against financing of terrorism. The 29 FATF members agreed to implement the recommendations by the end of June 2002. FATF members also agreed to ratify the United Nations Convention for the Suppression of the Financing of Terrorism and implement UN Security Council Resolution 1373. They also agreed to criminalise financing of terrorism and pass legislation designating such offences as money laundering predicate offences. Member countries have also agreed to extend the reporting obligation applicable to money laundering to the financing of terrorism. Likewise, member countries have agreed to supervise the transfer of different payments and assets more effectively, to intensify international cooperation and to step up efforts to prevent non-profit organisations from using collected funds for terrorist purposes and financing of terrorism.

Anti-money laundering provisions and systems are virtually identical across countries and have thus come to play a key role in global anti-terrorism actions. They provide a ready mechanism for the global exchange of information, legal assistance and other cooperation. With the criminalisation of financing of terrorism and the extension of the reporting obligation as well as asset freezing applicable to money laundering related to the financing of terrorism, their importance will become further accentuated.

FSA PARTICIPATION IN INTERNATIONAL FORA FOR COOPERATION

The CESR commenced operations

In February 2001, the Committee of Wise Men, also called the Lamfalussy Group, submitted its report with proposals for the improvement of securities market regulation within the EU. The group proposed that only key issues be regulated in the EU Directives (framework directives) and that detailed provisions be adopted under the commitology procedure. It also suggested the establishment of a Securities Committee made up of representatives of member countries and a Committee of Regulators made up of authorities responsible for securities market supervision.

Following the proposals of the Lamfalussy Group, the European Commission in June set up two committees: the Committee of European Securities Regulators (CESR) and the European Securities Committee (ESC). The European Securities Committee took on the functions of the existing High Level Securities Supervisors Committee, which convened at the summons of the European Commission. The Committee includes representatives of the EU member states, with the Finnish committee member representing the Ministry of Finance.

CESR, in turn, will carry on the work of FESCO, the Forum of European Securities Commissions. All the recommendations adopted by FESCO will also be binding on the members of CESR, and the working groups set up by FESCO will continue their work.

The mission of CESR is to promote cooperation between the authorities responsible for securities market supervision and to advise the European Commission on issues relating to the development of EU legislation. Its key policy is prior consultation of a broad range of interested parties during the preparatory stage. Member countries are represented by the heads of the securities regulators. The director general of Autoriteit-FM, the Dutch securities market regulator, Arthur Docters van Leeuwen was elected Chairman, and the FSA's director general Kaarlo Jännäri was elected Vice-Chairman of CESR.

Several securities market projects currently in progress

The FESCO working groups continued their work in 2001 within the framework of CESR.

The mission of the Primary Market Practices Group is to harmonise the regulation of stabilisation and allocation in connection with equity offerings and the regulations governing allotment of securities. The purpose of stabilisation 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 stabilisation being guilty of market manipulation. Permissible stabilisation activities include eg purchases undertaken to support the price of a security if it falls below the offering price.

In line with the Directive Proposal on Market Abuse, the Expert Group on Market Abuse drafted preliminary rules for harmonisation of the preventive measures available to market participants in their efforts to prevent abuse of inside information and market manipulation.

The mission of the Experts Group on Standards for Investor Protection is to harmonise the core conduct of business rules between investment service providers and investors.

The Experts Group on Alternative Trading Systems has reviewed the need for regulation in the field, with the aim of harmonising regulations applicable to regulated markets, irrespective of the form of trading conducted on the regulated market.

Towards the end of 2001, CESR and the European Central Bank (ECB) set up a joint working group on securities clearing and settlement systems. CESR also has two permanent working groups designed to step up practical cooperation between financial market regulators (CESR-Pol) and to promote the implementation of International Accounting Standards IAS within the EU (CESR-Fin).

Work of committees in the field of banking supervision and regulation

In the course of 2001, the Banking Advisory Committee (BAC), which is subordinate to the European Commission, addressed the revision of the capital adequacy framework applicable to credit institutions and investment firms, the proposal for a directive on the supervision and regulation of financial conglomerates, the accounting regulations applicable to credit institutions and official action to combat the financing of terrorism amongst other issues. The FSA participated in the work of the Committee, together with the Bank of Finland and the Ministry of Finance. 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.

Together with the Bank of Finland, the FSA also took part in the work of the Banking Supervision Committee (BSC) of the European System of Central Banks (ESCB). As part of this work, the BSC assessed trends in European banking and financial systems and the effects of economic developments on the banking sector. In addition, the BSC promoted the exchange of information between banking supervisors and central banks at a general level. The exchange of information concerned, for instance financial stability and cooperation in the areas of oversight of payment and settlement systems (which is the responsibility of central banks) and prudential supervision of institutions (which is the responsibility of banking supervisors). The BSC assists the ESCB in tasks related to supervision of credit institutions and financial stability and the ECB in the preparation of opinions on proposals for financial legislation for the Community or the member states, requested by the European Council, the European Commission or the member states.

In 2001, Groupe de Contact, the unofficial body for cooperation between the banking supervisory authorities of the EEA countries, prepared core principles for supervision in the context of the revision of the EU capital adequacy framework. The group also worked out principles for monitoring loan loss provisions. Other issues addressed by the group include outsourcing of bank functions, cross-border provision of online banking services, crisis contingency plans and the annual capital adequacy analysis of European banks. The FSA participated in this work.

The mission of Groupe de Contact is to promote cooperation and information exchange between regulators. Comparisons of supervisory practices and working methods in different countries are designed to converge supervision practice between EEA countries. In recent years, Groupe de Contact has increasingly assumed the role of establisher of supervisory principles and best practices in the field of supervision.

Development of the FSA's own activities

In 2001, the objective of developing the FSA's own activities was to further intensify activities in line with changes in the financial markets, improvements in EU legislation and international recommendations on supervision.

The FSA is preparing for the implementation of the revised Basel Capital Adequacy Accord and the introduction of International Accounting Standards, which will tie up considerable resources over the next few years. These reforms will require regulatory changes and their implementation will call for changes in practical supervision.

Supervision will be increasingly proactive. Proactive supervision necessitates not only the capacity to assess developments in the situation of markets and supervised entities but also the ability to respond to problems swiftly if necessary. Close international cooperation also requires continuous development of skills and procedures.

Efforts devoted to monitoring the operating environment

The FSA devotes special efforts to monitoring the operating environment, with a view to minimising the risk of drawing inadequate or erroneous conclusions about the changing environment. During the year a project was launched to monitor the operating environment that aims at promoting the FSA's strategy process. The project employs scenario analyses to identify key trends in financial markets over the next few years and their implications for the FSA's activities. The project will continue in 2002.

Regulatory process further improved

Regulatory activities at the FSA are managed as a process that cuts across units, which imposes a particular challenge for the strategic management of the process.

The steering model of the regulatory process was improved during the year. The aim of the development of the regulatory process is to ensure harmonised regulatory activities across the FSA.

Staff skills were developed to meet future needs

The financial market reforms currently under way, the increased complexity of financial instruments and investment products, the provision of on line financial services and the new modes of operating being introduced by the supervised entities mean that FSA employees must display more versatile skills and greater efficiency.

Several in-house training sessions were organised to keep up the development of supervisor skills necessitated by the new Capital Adequacy Accord. Eight seminars were arranged for supervised entities on the reform of the Capital Adequacy Accord. The in-depth training courses on IAS Standards arranged in 2001 focused on financial instruments.

The implementation of the IT skills development plan was continued in 2001. In the plan, the Computer Driving Licence was taken as a measure of general IT skills. By the end of 2001, nearly 100 out of 130 FSA employees had passed the Computer Driving Licence examination.

Staff communication skills continued to be improved in line with the action programme adopted in 2000.

With a view to enhancing their management skills, FSA managers participated in the Bank of Finland's management training programme.

Resource adequacy and means of resource management were assessed using proactive human resources planning

Financial market and supervisory changes entail growing supervisory requirements and resource pressures. The proactive human resources plan, which is based on three-year projections, was revised accordingly. The plan now sets out the FSA's assessment of resource adequacy for different areas, skills requirements and means of managing resource pressures. The aim is to identify means of reallocating resources and ways of discontinuing certain tasks or procedures or outsourcing tasks, so as to ensure that future challenges can be met as well as possible. The assessment is still in progress and the conclusions have yet to be drawn.

Evaluation of goal achievement in supervision developed

The FSA's Board adopted the principles for the development of the performance evaluation of the regulator. The aim is to improve performance evaluation and the underlying criteria, so that better use could be made of the indicators reflecting developments in the operating environment, international and domestic surveys and, where necessary, separate enquiries.

The aim is also to develop a tool for strategic management and operational assessment to assist management in the evaluation of goal achievement and the prospects for future goal achievement and thereby contribute to greater efficiency of activities. Performance evaluation will be based on a balanced score card similar to that used in many other public and private sector organisations. Performance evaluation at the FSA is thus approached from four different angles: market activities (ie the impact of the FSA's activities on the markets), expectations of supervised entities, flexibility and effectiveness of internal processes and skills development. In 2001 goal achievement was evaluated for the first time on the basis of the balanced score card system. Evaluation criteria and indicators will be further developed.

Bond register available on the FSA's new website

A list of bonds with prospectuses approved by the FSA under the Securities Markets Act is now made available to the public on the FSA's new website. It should be noted that the technical concept adopted lends itself to broader implementation in providing different target groups access to the FSA's databases.

Accessibility and utility of information further enhanced

The FSA plans to centralise all data on a particular supervised entity in a single location for the benefit of information users. The basic design of this new system continued in 2001 with the revision of the register on supervised entities. This is a register with basic information on supervised entities and individuals, the FSA's guidelines and regulations, as well as details of inspections and supervisory visits. The first applications of the system are scheduled for introduction towards the end of 2002.

The electronic document processing system Documentum was introduced in early 2001.

The FSA in brief

The Financial Supervision Authority (FSA) supervises financial markets and those who participate in these markets in Finland. The FSA was established in 1993 as part of the administrative structure of the Bank of Finland to continue the work of the Banking Supervision Office. The Bank Inspectorate (later the Banking Supervision Office) functioned under the Ministry of Finance from 1922 to 1993.

The FSA is connected administratively with the Bank of Finland; it takes all its operational decisions autonomously. The Bank of Finland provides the FSA with services relating to personnel and financial administration, information management, security, other areas of general administration, etc.

Table 6.
Financial Supervision Authority: expenses and income, 2000 and 2001, EUR 1000

	Actual 2000	**Actual 2001**	Budgeted 2002
EXPENSES			
STAFF EXPENSES			
WAGES			
Permanent employees	5,208	**5,517**	6,468
Fixed-term employees	426	**560**	526
Holiday substitutes	72	**99**	123
Other fees	62	**64**	102
	5,768	**6,240**	7,218
OTHER STAFF EXPENSES			
Staff-related expenses	1,831	**2,002**	2,293
Other staff expenses	91	**121**	136
	1,922	**2,123**	2,429
Total staff expenses	7,690	**8,363**	9,647
OTHER EXPENSES			
Training	334	**312**	396
Travel	291	**319**	400
IT expenses	766	**807**	886
Office services	724	**666**	919
Real estate rents and maintenance costs	1,004	**1,176**	1,657
Other expences	528	**713**	1,105
Total	3,647	**3,993**	5,362
DEPRECIATION			
Acquisition of machinery and fittings	123	**11**	27
Total	123	**11**	27
TOTAL EXPENSES	11,460	**12,366**	15,036
INCOME			
SUPERVISION FEES			
Periodical fees	–10,841	**–11,720**	–14,446
Processing fees	–601	**–637**	–589
Total Supervision fees	–11,442	–12,357	–15,035
OTHER INCOME			
Miscellaneous income	–18	**–10**	–1
Total	–18	**–10**	–1
TOTAL INCOME	–11,460	**–12,366**	–15,036

Source: Financial Supervision Authority.

The FSA is independent in its decision-making

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. The Director General is assisted by an advisory Management Group, consisting of the Deputy Directors, the Deputy Department Head, the Chief Legal Counsel and the Chief Legal Adviser. The Director General must take decisions on important issues in meetings with and after consulting the Management Group. Each member of the Management Group is entitled to make decisions relating to his own sector in accordance with the division of responsibilities decided by the Director General.

The 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 decides upon the general operating principles, the 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 Parliamentary Supervisory Council appoints the members of the FSA Board on the basis of proposals by the Ministry of Finance, the Bank of Finland and the Ministry of Health and Social Affairs for three years at a time. 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 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.

Table 7.
Supervision fees, 2000 and 2001, EUR 1000

	2001	2000
CREDIT MARKET FEES		
Commercial banks	**5,065**	4,622
Central institution and member banks of the amalgamation of cooperative banks	**1,287**	1,262
Local cooperative banks	**146**	142
Savings banks	**204**	197
Savings banks foundations	**155**	147
Other credit institutions	**563**	962
Guarantee funds	**32**	34
Representative offices and branches of foreign credit institutions	**50**	47
Credit institutions’ holding companies	**13**	15
Pawnshops	**8**	8
Total	**7,523**	7,436
CAPITAL MARKET FEES		
Marketplaces	**449**	438
Firms offering investment services	**1,707**	1,443
Management companies	**656**	530
Book-entry system	**325**	332
Issuers	**871**	498
Keepers of insider registers	**189**	169
Total	**4,197**	3,410
PROCESSING FEES		
Management companies	**238**	210
Issuers	**343**	326
Others	**56**	65
Total	**637**	601
TOTAL FEES	**12,357**	11,447

Source: Financial Supervision Authority.

The objective of the FSA is to promote stability and confidence

The objective of the FSA is to promote stability and efficiency in the financial markets and confidence in market participants and markets. In addition to carrying out the 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 and regulatory activities, the FSA applies principles that comply with international standards. The aim is to ensure that the supervised entities have a clear knowledge of the principles concerned.

In its supervisory work, the FSA evaluates the financial standing, risk positions, risk-bearing capacity and risk management systems of supervised entities. The FSA emphasises 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.

The FSA has extensive powers of inspecting supervised entities and obtaining information from them. Inspections are performed as

Financial Supervision Authority Organisation 31 Dec 2001

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
Hely Salomaa (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)

Internal Auditor

Chief Legal Counsel
Markku Lounatvuori

Director General
Kaarlo Jännäri

Chief Legal Adviser
Liisa Halme

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

frequently and extensively as is necessary.

The FSA's regulatory activities take the form of both involvement in the drafting of financial market legislation at national and international level and 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.

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

At the end of 2001 the FSA had an operational strength of 125 persons (123 in 2000); 113 (111) employees had permanent positions. A total of 56 (60) employees worked in the Credit Institutions Department, 37 (33) in the Capital Markets Department, 27 (25) in the Support Services Department and 5 (5) in the Director General's staff.

The FSA finances its operations by levying fees (supervision fees and periodic fees) on the entities supervised by the FSA and issuers of securities. The right to levy fees is based on the Act on the Financial Supervision Authority and the criteria for determining fees on the Act on the Grounds for Levying Government Fees.

In 2001 costs arising from the operations of the FSA amounted to EUR 12.4 million (EUR 11 million in 2000). Income in the form of specific fees covered 5% (5%) of total expenses, ie EUR 0.6 million (EUR 0.6 million).

The FSA moved to new premises

The FSA moved to Snellmaninkatu 6 in October 2001.

Strategic directions 2002–2004

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. As an organisation, we are

Independent
Transparent
Productive
Skilled.

Our vision is to be a market-oriented and proactive supervisor

Market-oriented supervision means supervised entities taking primary responsibility for their own behaviour. The provision of material and adequate information to markets on matters related to the behaviour of supervised entities is designed to enhance market discipline and to provide an incentive for supervised entities to take responsibility for themselves. Proactive supervision by the authorities complements market discipline and the responsibility of supervised entities. Proactive supervision seeks to identify, prevent and redress problems as early as possible. The supervisor has the capacity to assess developments in the situation of the supervised entities and the ability to respond to problems swiftly if necessary. Supervised entities are also aware of the supervisory principles applied by the supervisor.

Strategy

To achieve our vision we will, in cooperation with our stakeholders at home and abroad, foster

I. markets' access to information and sound market practices
II. the reliable functioning and structural efficiency of markets and good corporate governance in supervised entities
III. a supervisory and regulatory framework based on accountability, transparency and discretion.

The following task complexes built around the strategy will be translated into practical measures in the action planning undertaken by the departments. We will base our activities on the basic tasks and procedures that we have been assigned in law[1].

I We will foster markets' access to information and sound market practices

- 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 consistently, timely and in readily understandable terms.
- We will seek to promote customer and investor protection by providing guidance on market practices.
- 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 enhancing market practices and preventing malpractice.
- As one of several active influences in Finland we will contribute to the development of the International Accounting Standards (IAS) and their adaptation to Finnish conditions.

II We will foster the reliable functioning and structural efficiency of markets and good corporate governance in supervised entities

- We will focus supervision on risk-prone institutions and systems of key importance for market stability and efficiency.
- We will endeavour to ensure good corporate governance in supervised entities and, especially, the reliable functioning of internal control and risk management systems[2].
- We will deepen cooperation with supervisors at home and abroad for the effective supervision and regulation of financial conglomerates.
- We will seek to improve supervisory measures in line with the requirements of proactive supervision and international standards and obligations[3].

III We will promote a supervisory and regulatory framework based on accountability, transparency and discretion4

- We will make an active contribution to the harmonisation of legislation and procedures at EU level.
- We will prepare for structural changes in the regulatory and supervisory framework resulting from the emergence of cross-border European companies.
- We will seek to ensure that laws provide us with adequate powers, means of action and sanctions for the purposes of proactive supervision and will accordingly enhance the supervisor's accountability in our own activities.
- We will promote the self-regulation of market participants with a view to reducing the need for detailed legislation within the limits set by market structure.

Supporting Strategies

- We will use communication to support proactive supervision and ensure that any information produced and disclosed by the FSA is promptly and readily available.
- We will enhance the accessibility and utility of information in IT services and ensure system reliability.
- We will take good care of our resources, develop employee skill and improve resource utilisation.
  - We will develop employee skills, especially the skills required for the forthcoming reform of the capital adequacy framework and the introduction of International Accounting Standards and increase our knowledge of market practices, products and services.
  - We will improve resource utilisation by prioritising our tasks more effectively than before and by making use of resources across units.

---

[1] Section 4 of the Act on the Financial Supervision Authority.

[2] This also applies to the compliance culture of listed companies.

[3] 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.

[4] Key aspects of a regulatory framework based on accountability, transparency and discretion:

- *Regulation is based on framework legislation rather than detailed provisions.*
- *Binding regulations are supplemented by guidance based on codes of practice.*
- *Supervisory powers allow the supervisor to exercise discretion within the limits of generally recognised rules of conduct.*
- *Supervisory powers are exercised credibly, explicitly and promptly.*
- *The supervisor is accountable for its activities vis-à-vis both the legislator and supervised entities.*

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 may not be suspected to 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 or 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 organised 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 2001.
Regulations and guidelines are available on the FSA's website, www.rata.bof.fi.

Credit Institutions

102.4
Guideline on the cancellation of payments from customers' accounts

105.7
Regulation on reporting country risk

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

The publication series

These publications were released in English in the publication series during the year 2001.
They are available on the FSA's website, www.rata.bof.fi.

Statements

- Use of an agent in the business functions of credit institutions and investment firms and other outsourcing of activities
- Unsecured debentures included in own funds – redemption of minor amounts before maturity
- Electronic financial services

Notifications

- Cash changeover and prevention of money laundering
- FATF publishes a list of countries whose anti-money laundering practices are inadequate
- New schedule of specific fees to take effect on 1 March 2001

Journal 2001

Main items of the Journal:

	2001	2000
Internal matters	47	57
Administration of supervised entities	588	1056
Supervision	475	850
Risk management	52	123
Accounting, annual accounts and auditing	24	34
Customer protection and safeguarding competition	221	290
Inspections	59	50
Other matters concerning supervised entities	58	52
Other external matters	101	130
Total	1625	2642

Major categories of journal entries

	2001	2000
Investigation requests concerning customer protection	170	150
Listing particulars	171	173
Matters regarding rules	172	533
Notifications	239	254
International cooperation	65	85
Contractual terms	37	63
Inspections by plan	57	49
Own funds and capital support	12	29
Prospectuses	58	104

Items recorded in the Journal of the Financial Supervision Authority amounted to 1,625, broken down by departments as follows: Capital Markets Department 1,044, Credit Institutions Department 470, Support Services Department 84 and the Director General's staff 27.

Supervised institutions 1997–2001

31.12.	LP	OPR	POP	SPY	SP	LL	VR	SPS	PLL	UE	ULS	AOJ	SIPA	MP	RY	Oth.	Tot.	SK tot.
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
2001	9	244	42	1	39	16	4	–	13	7	20	12	50	1	24	13	494	1,579

LP Commercial 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
SIPA Investment firms
MP Marketplaces
RY Management companies
SK Branches
Oth. Deposit guarantee fund (1), Investor compensation fund (1), holding companies of investment firms (8), holding companies of credit institutions (2), OKOBANK Group Central Cooperative (1)
Tot. Total

Representation abroad	1997	1998	1999	2000	2001
Subsidiaries	4	4	4	4	7
Representative offices	16	17	16	16	11
Branches	11	9	8	9	11

Supervised institutions, 31 Dec 2001

Credit market participants

Commercial banks (9)

Evli pankki oyj
Gyllenberg private bank ab
Nordea bank finland abp
Oko osuuspankkien keskuspankki oyj
Okopankki oyj
Op-kotipankki oyj
Sampo pankki oyj
Ålandsbanken abp

Other credit institutions (16)

Aktia hypoteksbank abp
Diners club finland oy
Eurocard oy
Handelsbanken rahoitus oyj
K-luotto oy
Kuntarahoitus oyj
Luottokunta
Mandatum pankki oyj
Nordea rahoitus suomi oy
Op-asuntoluottopankki oyj
Op-rahoitus oy
Sampo kortti oy
Sampo luotto oyj
Sampo mb group oy
Sampo rahoitus oy
Suomen hypoteekkiyhdistys
Suomen asuntoluottopankki oyj

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
Lehtimäen osuuspankki
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
Nilsiän 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
Yläneen osuuspankki
Ypäjän osuuspankki
Ähtärin osuuspankki
Östnylands andelsbank
Östra korsholms andelsbank
Övermark andelsbank

Okobank group central cooperative (1)
Osuuspankkikeskus-OPK osuuskunta

Local cooperative banks (42)
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
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 oy
Mandatum holding oy
Sampo oyj

Finnish representative offices of foreign credit institutions (6)
ABN AMRO bank N.V
International bank of St. Petersburg
Nordfinanz bank Zürich
Representation of JSC CB Bankirskiy dom in Finland
Representative office of joint stock bank Sobinbank in Finland
Societe Generale

Finnish branches of foreign credit institutions (20)
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)
Kontotjänst i Sverige aktiebolag – Baltic credit
Landesbank Schleswig-Holstein girozentrale
Norddeutsche landesbank girozentrale
Skandinaviska enskilda banken AB (publ)
Svenska handelsbanken AB (publ)
Scania finans aktiebolag
SEB finans AB (publ)
SEB kort AB
Telia finans Finland

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 back office and custody services oy
Nordea bank Finland abp
OKO osuuspankkien keskuspankki oyj
Osuuspankkikeskus-OPK osuuskunta
Oy Samlink AB
Sampo pankki oyj
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 (24)
Aktia rahastoyhtiö oy
Alfred Berg rahastoyhtiö oy
Aurator rahastoyhtiö oy
Carnegie rahastoyhtiö oy
Evli-rahastoyhtiö oy
Fides rahastoyhtiö oy
FIM rahastoyhtiö oy
FirstNordic rahastoyhtiö oy
Fondita rahastoyhtiö oy
Gyllenberg fondbolag ab
Handelsbanken fondbolag ab
Hiisi rahastoyhtiö oy
Mandatum rahastoyhtiö oy
Nordea rahastoyhtiö oy
OP-rahastoyhtiö oy
Pohjola rahastoyhtiö oy
PYN rahastoyhtiö oy
Rahastoyhtiö 3C oy
Ramsay & Tuutti rahastoyhtiö oy
Sampo rahastoyhtiö oy
Seligson & Co rahastoyhtiö oyj
Tapiola rahastoyhtiö oy
WIP rahastoyhtiö oy
Ålandsbanken fondbolag ab

Investment firms (50)
Oy Ahola & Maliniemi partners ab
Aktia asset management oy
Aktia fondkommission ab
Alexander corporate finance oy
Alfred Berg Finland oyj abp
Alfred Berg omaisuudenhoito 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 corporate finance oy
Eficor oyj
eQ pankkiiriliike oy
Estlander & Rönnlund capital management oy
Estlander & Rönnlund financial products ab
Evli corporate finance oy
Evli investment management oy
Evli varainhoito oy
Pankkiiriliike Evli-optiot oy
Fides asset management oy
FIM corporate finance oy
FIM omaisuudenhoito oy
FIM pankkiiriliike oy
Gyllenberg asset management oy
Head asset management oy
Hiisi pankkiiriliike oy
Hiisi varainhoito oy
Icecapital pankkiiriliike oy
Mandatum & Co oy
Mandatum omaisuudenhoito oy
Mandatum pankkiiriliike oy
Mandatum varainhoito oy
Nordea investment management Suomi oy
Nordea securities corporate finance oy
Nordea securities oyj
Opstock oy
PCA corporate finance oy
Privanet securities oy
Privanet ventures oy
Seinäjoen pankkiiriliike oy
Seligson & Co ACM varainhoito oy
Pankkiiriliike Sofi oyj
Tapiola omaisuudenhoito oy
Varainhallinta Tresor oy
United bankers omaisuudenhoito oy
United bankers pankkiiriliike oy
Wahlström Immonen partners oy
Ålandsbanken asset management ab

Holding companies of investment firms (8)
Conventum oyj
eQ online oyj
Estlander & Rönnlund group oy
Hiisi group oy
Mandatum holding oy
Privanet capital oyj
Oy UB finance ab
Seligson & Co oyj

Finnish branches of foreign investment firms (3)
Danske securities ab
EFG fondkommission ab
Enskilda securities

Investor compensation fund (1)
Sijoittajien korvausrahasto

History of financial markets and financial market supervision

Period of Swedish rule 1100–

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 centralised 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.

2002 Euro banknotes and coins became legal tender.

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

Abbreviations used in the annual report

BAC	Banking Advisory Committee
BSC	Banking Supervision Committee
CESR	Committee of European Securities Regulators
EBA	Euro Banking Association
EFRAG	European Financial Reporting Advisory Group
FATF	Financial Action Task Force on Money Laundering
FSAP	Financial Sector Assessment Program
IAIS	International Association of Insurance Supervisors
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions

Assessment of the interest rate risk of deposit banks

Income risk stems from the balance sheet effects of a change of one percentage point in interest rate 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. So far, depositor behaviour has proven to be quite inflexible in response to changes in interest rates. However, the income risk of euro-denominated items is calculated using different assumptions regarding repricing of sight deposits. The purpose is to assess the effects of such assumptions on risk calculations. The later the repricing of sight deposits occurs, the more favourable is the impact of an increase in interest rates on banks' earnings. 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 direct effect of a one percentage point rise in interest rate on the market value of debt securities held as current assets. Besides trading assets, current assets also include other debt securities held as current assets. Calculation of investment risks takes account of the sensitivity of off-balance-sheet items held as current assets to changes in interest rates (change in market value in response to a rise in interest rates).

Since income risk and investment risks are calculated in somewhat different ways, eg using different time horizons, the figures are not comparable.

P.O.Box 159 • FIN-00101 Helsinki, Finland
Telephone +358 9 183 51 • Telefax +358 9 183 5328
www.rata.bof.fi