# Market newsletter 3/2013

October 2013



*The Market newsletter addresses topical matters concerning interpretations, regulation, as well as supervisory findings relating to listed companies' disclosure obligation, financial reporting enforcement, securities trading and insider issues. Articles other than those pertaining to IFRS enforcement will appear mainly in English. The newsletter is published by FIN-FSA's Market Supervision.*

**In this newsletter we will discuss the following topics:**



## Results of investor enquiry support FIN-FSA's view on supervision focus areas

In the summer, FIN-FSA conducted an enquiry on the use of investor information disclosed by listed companies and information sources used by investors. Responses were solicited from persons using investor information for making investment decisions or producing investment analyses.

Almost 250 persons responded to the enquiry, and 90% of them considered themselves as non-professional investors. The other respondents were either professional investors or employed by a provider of investment services.

The responses suggest that investors are most interested in information on companies' financial position and financial performance. Information is sought particularly through the media but also directly from company announcements. Almost all respondents professed to read regular financial reports. The respondent's assessments varied as to the sufficiency of the information disclosed as support for investment decisions. In general, the level of disclosure was considered relatively good, but some responses reflected contrasting opinions. Quality was perceived to vary across companies.

### Media in important role as mediator of investor information

Almost half of the respondents receive the information they need primarily via news media. Newspapers and television were mentioned as sources of information clearly more often than news agencies, such as Reuters and Bloomberg. Stock exchange releases are almost equally important as an information source, and they are followed on the commercial channels and company websites. Stock exchange releases are sought from the official appointed mechanism (OAM)[1] clearly less frequently than in other channels.

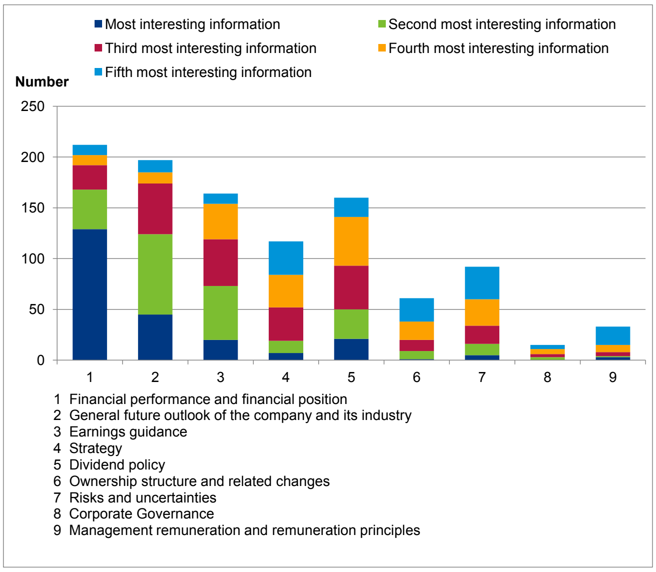
As important channels of investor information, the respondents also highlighted wealth managers, investment experts, stockbrokers and analysts as well as events held eg by the Finnish Foundation for Share Promotion and the Shareholders' Union of Finland. Many respondents also professed to monitor investment blogs and investment-related discussion forums on the Internet actively.

1 The officially appointed mechanism is based on the Securities Markets Act and maintained by the Helsinki Stock Exchange. Companies file their releases there simultaneously with their dissemination and the stock exchange keeps them available to the public at least for five years. The officially appointed mechanism is available at www.tiedotevarasto.com.

### Financial performance and financial position by far the most interesting information

Over half of the respondents indicated past financial performance and financial position as the most important information disclosed by companies, and almost 90% selected it as one of the five most interesting pieces of information. The pieces of information ranked the next most interesting were general future outlook of the company and the industry (20% of respondents) and earnings guidance (almost 10% of respondents). However, dividend policy drew as many 'most interesting' mentions as did earnings guidance and was rated among the five most interesting pieces of information more frequently than eg company strategy. Only 40% of respondents rated risks and uncertainties related to future performance among the five most interesting pieces of information, and only a few rated information on corporate governance, including management remuneration and remuneration principles, as the most interesting piece of information. Based on the responses, persons other than non-professional investors are more interested in company strategy and less interested in dividend policy.

**Chart 1. Interest level of information disclosed by companies**




### Financial reports read on a regular basis

The respondents said they read interim reports and financial statement releases on a regular basis: less than 10% read them only seldom or never. The respondents look to the reports mainly for information on financial performance, financial position and prospects. Only slightly more than half of the respondents read information on risks and uncertainties as well as on the market/competitive situation. However, professional investors pay equal attention to these topics as to financial performance and financial position.

Financial reports are considered excellent sources of information, and they enable one to stay up to date on companies' financial performance and future prospects. According to the responses, the reports are an integral part of the assessment of the attractiveness of investments. However, some responses pointed out that the reports are not always comparable across companies.

Annual reports are read almost as actively as interim reports and financial statement releases. The most actively read part of the annual report is the report by the Board of Directors, but about half of the respondents also claim to read the IFRS financial statement. In the responses, annual reports were considered excessively long and detailed, but on the other hand, they were considered good overviews of the companies' activities and thus complementary to the view of the company in conjunction with stock exchange releases. As interesting pieces of information in annual reports, the respondents highlighted the ownership structure and composition of the Board of Directors and Executive Board.

### Different views among investors on sufficiency of information

Information presented in interim reports and financial statement releases was considered sufficient on average. However, there are considerable differences across topics. Over 60% of the respondents agreed strongly or somewhat that information on financial performance and financial information presented in tables was sufficient, and about a fifth considered this information insufficient. As regards other information, there was more deviation. For example, a good 30% of the respondents felt that companies do not provide sufficient information on risks and uncertainties, while slightly less than 30% claimed the opposite. Opinions as to the sufficiency of information on future prospects and market/competitive situation showed a similar pattern.

Open-ended comments drew attention to the excessively general nature of information on the market/competitive situation and on the insufficiency of information in general. According to the responses, companies should analyse in more detail the financial information and factors that affect the profit for the report period, as financial performance is often presented only as figures copied from the tables. Companies should also give more details than presently on the impacts of business acquisitions on their financial position, explain the grounds for profit forecasts and describe goodwill in plain language. Many respondents regarded CEO's reviews mostly as "marketing speeches" and often even as information directed to an audience other than the investors.

### Quality of disclosure varies

The quality of companies' disclosure is considered fairly good on average, although it is perceived to vary both in terms of quality and quantity. According to some responses, short releases and financial reports sometimes may give the impression that the company only intends to meet the minimum legal requirements.

Many respondents felt disclosure should be clearer and more focused on topics relevant to investors. Some respondents drew attention to the presentation of extraordinary items: on the one hand, their presentation may promote comparability, but on the other hand highlighting extraordinary items may cloud the actual figures.

### The summary is the most important source of information in a prospectus

More than 90% of respondents indicated they had participated in share offerings and/or debt security offerings. Particularly in connection with initial public offerings and other share offerings, the respondents said they studied the offering and listing prospectuses. The summary of the prospectus was most often cited as the most important source of information. In addition, the respondents study information in prospectuses on the company's operating and financial review as well as risk factors associated with the issuer and the security. Future business prospects as well as the terms and conditions of the offering were also rated among the five most important pieces of information by almost half of the respondents.

**Chart 2. Is information content of interim reports and financial statement releases sufficient?**

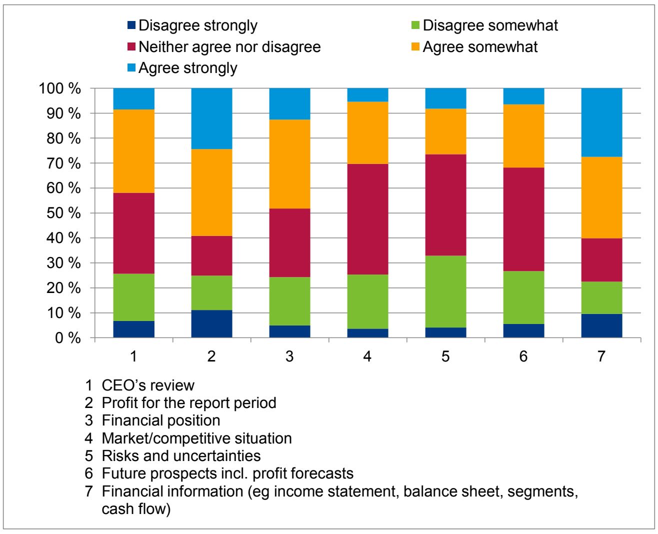
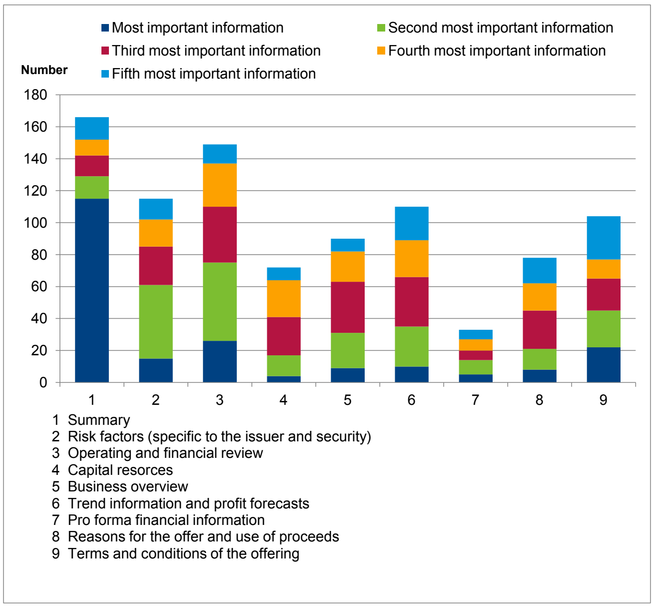



**Chart 3. Most important information in companies' share and/or debt security prospectuses**



Many respondents consider prospectuses too extensive and complex, shadowing the big picture and failing to distinguish clearly between material and immaterial matters. In addition, the language used in prospectuses was considered difficult to understand.

### Focus areas of supervision unchanged

Responses to the investor enquiry provide valuable information to FIN-FSA on topics considered important by investors.

In recent years, FIN-FSA has emphasised the clarity and consistency of disclosure in the supervision of disclosure by listed companies, and it has drawn attention to companies' obligation to analyse their financial position and financial performance in their regular financial reports. FIN-FSA has also emphasised that companies must provide justifications for any future prospects presented. Responses to the survey indicate that investors have also highlighted the same issues as important for their information needs, and FIN-FSA will continue to emphasise these in its supervision. FIN-FSA also highlights the significance of transparency in disclosure: investors should have as good preconditions as possible to monitor companies and their business activities in a consistent manner.

Although information on risks and uncertainties did not rank particularly high in the enquiry among the most interesting pieces of information disclosed by companies, FIN-FSA considers its presentation important: risks and uncertainties are clearly linked to information on future prospects, and therefore they will remain a supervisory focus area going forward. FIN-FSA also recommends that the description of risks and uncertainties be prepared as "company-specific" as possible. The description should encompass the risks and uncertainties associated in particular with the company, its business and industry.

One supervisory focus in the supervision of prospectuses is the summary of the prospectus, which received the most citations in the enquiry as the most important part of the prospectus. As of 1 July 2012, the summary has been more standardised in terms of format due to regulatory changes. Supervision pays particular attention on compliance with the regulations on the summary as well as on the clarity and comprehensibility of the summary.

## Survey on publication and content of listed companies' disclosure policies

In summer 2013, FIN-FSA conducted a survey of listed companies' practices in the publication of a disclosure policy and on the information included by listed companies in their disclosure policy. The survey included all companies quoted on 1 July 2013 on the Helsinki Stock Exchange (125 companies).

The survey assessed the following issues:

Existence of a disclosure policy and its publication on the company website

- how many companies have a disclosure policy
- whether company size[1] has an impact on the publication of a disclosure policy
- if a company has not published a disclosure policy, does its website contain other information related to its disclosure practices
- how many companies have indicated the date of approval/updating the disclosure policy.

Content of disclosure policy

- what information companies include in their disclosure policy
- whether company size has an impact on the extent of a disclosure policy.

### 38% of listed companies have published a disclosure policy on their website

The survey showed that 48 listed companies (38%) had published their disclosure policy on their website and that 77 companies (62%) had not done so. Moreover, information on the websites of seven companies indicated that the company had a written disclosure policy or disclosure principles.

Company size had some impact on the publication of a disclosure policy. Of the large-caps, 13 companies (46%) had published a disclosure policy on their website, 2 companies (7%) stated one exists, and 13 companies (46%) gave no information on their disclosure policy. Of the mid-caps, 18 companies (45%) had published a disclosure policy on

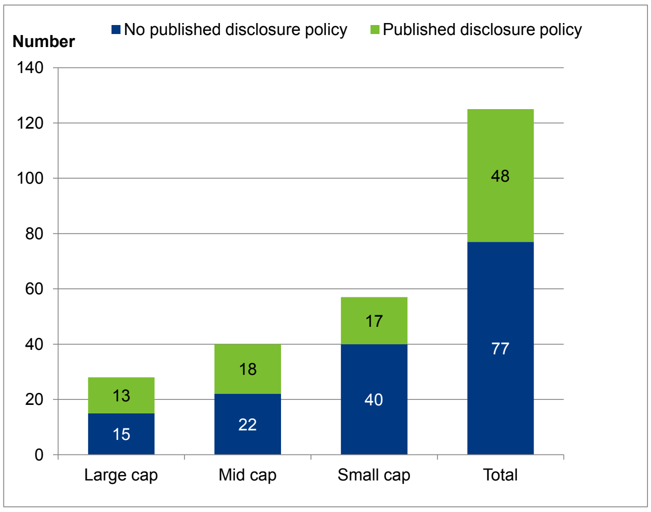
1 Issuers are divided into large-cap, mid-cap and small-cap companies according to the classification used by the Helsinki Stock Exchange.

their website, 2 companies (5%) stated one exists, while 20 companies (50 %) gave no information on their disclosure policy. And of the small-caps, 17 companies (30%) had published a disclosure policy on their website, 3 companies (5%) stated one exists, while 37 companies (65%) gave no information on their disclosure policy.

In those cases where the company had not published their disclosure policy, 47 companies had some information on disclosure or investor communications on their website, typically the objectives of disclosure/investor communications and the duration of the silent period. In addition, the responsibilities in investor communications, reporting language and IR material had been published. In contrast, 23 companies had no information on disclosure or investor communications on their website ("contact information" was not counted as such).

Of the companies that had published a disclosure policy, a majority (39 companies) indicated when the disclosure policy had been approved. However, only 14 companies stated when the disclosure policy had been last updated. Four companies stated when their disclosure policy had been last updated but failed to reveal the original approval date.

**Chart 1. Publication of disclosure policy**




### Extent of disclosure policy varied across companies

In the survey, the topics addressed in the disclosure policies published by the companies were separated into 23 subject areas, as presented in chart 2 (page 6). The order of presentation reflects how many disclosure policies included information on each topic.

The disclosure policies were also analysed as to how much the subject areas varied across companies. All disclosure policies contained a statement of the legislation and recommendations that the company shall comply with in its disclosure. Almost all of them also contained a mention of the objectives of the disclosure policy or the principles followed in disclosure. In more extensive disclosure policies (18 subject areas or more), the variation generally was only in respect of the five last items in Chart 2, whereas all the other subject areas were, as a rule, covered. In more condensed disclosure policies, there was variation as to whether they stated the principles regarding the presentation of earnings guidance or a profit warning, the position on analysts' market forecasts, the schedule of financial reporting, or principles regarding other communications (for example press releases). The most condensed disclosure policies (12 or less subject areas) contained no information on the six last items in Chart 2, and the presentation of other topics varied across companies.

The size of the company did not seem to notably affect the number of subject areas covered by the disclosure policy. For example, among the companies with the most extensive disclosure policies, there were four large-cap, five mid-cap and three small-cap companies.

### FIN-FSA recommends the preparation of a disclosure policy

In its regulations and guidelines[2], FIN-FSA recommends that the issuer determine the operating principles and procedures it applies in communicating with the capital markets and that these be compiled into a written disclosure policy. In its disclosure policy, an issuer may specify eg the persons responsible for investor relations activities and objectives for investor relations activities, procedures followed in investor and analyst meetings, how the materiality of information to be disclosed is assessed, and principles for issuing future

2 Regulations and guidelines 7/2013: Disclosure obligation of the issuer, chapter 4.

prospects and internal procedures in different disclosure circumstances, including potential crisis situations. The extent and content of the disclosure policy may naturally vary across issuers.

An issuer may publish any applicable parts of its disclosure policy on its website, so that different market participants can understand and anticipate the activities of the issuer in different circumstances. However, the issuer itself decides on the publication of its disclosure policy.

FIN-FSA's survey concerned published disclosure policies, and therefore it does not offer a comprehensive picture of how many companies have prepared a disclosure policy. FIN-FSA welcomes the fact that so many companies have published a disclosure policy.

It was found in the survey that even where companies' disclosure policies contained an extensive selection of subject areas associated with the disclosure obligation, the content of the subject areas was in sometimes relatively limited.

For example, the issues to be disclosed were listed, but an actual determination of company-specific material issues to be disclosed (chapter 6, section 4 of the SMA) had not been made. In addition, all aspects of the disclosure policies were not always up to date. For example, some disclosure policies contained references to the obsolete Securities Markets Act and operating procedures deriving from previous law made obsolete by the amendment of the Act (for example content requirements for the financial statement release and the period of keeping regulated information available on the company website). FIN-FSA considers it good practice that the disclosure policy be reviewed regularly eg on an annual basis or more frequently if necessary, if there are changes in the company or regulatory environment. It would also be advisable to state in the disclosure policy when it was prepared and last updated.

**Chart 2. Subject areas covered by disclosure policy**

## Extended possibility to prepare interim management statements

According to the chapter 7, section 10, subsection 2 of the Securities Market Act (746/2012), an issuer may, subject to certain conditions, decide to publish an interim management statement instead of an interim report for the first three and nine months of the financial period. The provisions of the SMA and the Decree of the Ministry of Finance on the regular disclosure obligation (1020/2012, Decree) changed as at the start of 2013 to the effect that the threshold to disclose a statement based on the issuer's market capitalisation increased from EUR 75 million to EUR 150 million. This threshold on market capitalization is checked on the date when an issuer makes public its decision to disclose an interim management statement in the following financial period. The issuer decides to disclose an interim management statement for one year at a time, and whether the market capitalisation threshold is exceeded during the year does not affect the decision concerning the present year.

Other requirements for making an interim management statement include stability of the nature of the issuer's industry or business. The requirements are listed comprehensively in section 4 of the Decree.

### Date and report period of the statement

Interim management statements are disclosed during the first and second six-month periods of the financial period. According to chapter 7, section 14, subsection 2 of the SMA, the statement may be disclosed at the earliest 10 weeks after the beginning of the relevant six-month period, and it must be disclosed at the latest six weeks before the end of the period. If the financial period of the company is the calendar year, this means in practice that the first statement is disclosed roughly between mid-March and mid-May, and the second statement roughly between mid-September and mid-November. Hence, the statement is not disclosed for the "traditional" three- or nine-month report period, but it always covers the period between the start of the financial period and the date of disclosure of the statement. For example, if the company discloses its statement on 15 April, it covers the period from 1 January to 15 April. However, the statement may present numeric information for a period shorter than the report period, for example for a quarter, but even in this case financial performance should always be described verbally as from the start of the financial period to the date of disclosure. Depending of the definition of the report period, the interim management statements of different issuers may cover periods of varying lengths.

### Content of the statement

According to chapter 7, section 14, subsection 3 of the SMA, the interim management statement shall give a general description of the financial performance and financial position of the issuer as well as of their development during the report period. The statement shall explain any material events and transactions as well as their impact on the financial position of the issuer.

FIN-FSA recommends that the content of the interim management statement reflect the special characteristics of the industry and the issuer, and describe in particular the factors that are material for the business of the issuer and for related risks and uncertainties. As a rule, the interim management statement should describe similar matters as the explanatory statement in an interim report, but the description may be more condensed. The statement may for example describe the impacts of business acquisitions and other similar significant arrangements disclosed in the financial period. However, the statement need not contain numeric information on financial performance or financial position.

The principles of consistency and comparability should be taken into account in preparing an interim management statement. Consistent business review in the statement in different report periods enables one to monitor the development of issuer's business performance. If the issuer presents information on its revenue and results in the statement, these should be compared to the revenue and results in the comparison period of the previous financial year.

FIN-FSA further reminds that the interim management statement must be clearly named as an interim management statement. The purpose is to ensure that interim management statements are clearly differentiated from interim reports and other releases made by the issuer.

### Transition to preparing interim management statements

When an issuer decides on the preparation of interim management statements, it must disclose this decision before the start of the next financial period. This information is disclosed separately for each financial period. Chapter 7, section 14, subsection 1 of the SMA also requires issuer to disclose the grounds for not publishing the interim reports for the three and nine first months of the financial period.

During a financial period, an issuer preparing interim management statements discloses, in addition to the statements, an interim report for the six first months of the financial period and a financial statement release. These reports shall present condensed financial statements in accordance with IAS 34.

For the time being, only a few issuers have made use of the possibility to disclose an interim management statement. The increase in the threshold on market capitalisation due to the new SMA to EUR 150 million enables "lighter" reporting twice a year instead of interim reports for a larger number of companies.

## National Board of Patents and Registration to be the authority issuing LEI identifiers

Prior to Government proposal 126/2013, Finland did not have an appointed issuer of LEIs[1]. The National Board of Patents and Registration is proposed as the authority issuing the LEIs and FIN-FSA as the authority coordinating international cooperation related to the allocation of the LEIs.

Organisation of the allocation of LEIs is an urgent matter, since the identifier will be needed at the onset of reporting of derivatives under the EMIR[2] regulation. Every counterparty to a derivatives contract must obtain a LEI, which is used to identify the reporting company itself and the counterparty of a derivatives contract in derivatives reporting. A company may obtain an identifier itself or authorise another party to procure one on its behalf. The latest estimate of the European Securities and Markets Authority (ESMA) for the date when the reporting will commence is 12 February 2014. The National Board of Patents and Registration will disclose practical arrangements on how to obtain LEIs on its website in the future.

Further information is available in the EMIR section of FIN-FSA's website at: http://www.finanssivalvonta.fi/fi/Saantely/Saantelyhankkeet/EMIR/Pages/Default.aspx (in Finnish).

Other sources of information include the EMIR section of the ESMA's website at: http://www.esma.europa.eu/ page/European-Market-Infrastructure-Regulation-EMIR and the website of the EU Commission at: http:// ec.europa.eu/internal_market/financial-markets/derivatives/ index_en.htm.

The topic is also addressed in the Markets releases 2/2013 (also in English) and 4/2012 (only in Finnish).

1 LEI = Legal Entity Identifier.

2 Regulation EUR 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR = European Market Infrastructure Regulation, the regulation's working title which has remained in use).

## Opinion of the Accounting Board on notes to the financial statement on listed companies' management pension commitments has been published

As part of its supervision of related-party disclosures, FIN-FSA requested the Accounting Board to provide an opinion based on the accounting ordinance on the information to be disclosed on pension commitments in financial statements. The Accounting Board has now issued its opinion, which is available on its website. Related party disclosures is one of the issues addressed in FIN-FSA's event for listed companies in December.

The opinion is available (in Finnish) at http://ktm.elinar.fi/ktm/fin/kirjanpi.nsf > Lausunnot ja poikkeusluvat > 2013 > Listayhtiön johdon eläkesitoumuksia koskevista liitetiedoista.

## Structured investment products difficult for consumers

The European Securities and Markets Authority (ESMA) has launched an extensive survey of the markets and characteristics of structured products. According to ESMA's observations, complex structured products originally intended for institutional investors are being increasingly offered to consumers in Europe. It may be difficult for consumers to understand the characteristics of complex products. According to ESMA, investors should be given clearer information on these products than has been the case in the past.

At the beginning of July, ESMA published a survey analysing, inter alia, the market and the characteristics and returns on structured investment products sold in the European markets. For purposes of the survey, ESMA studied 2,750 structured investment products sold in the European markets in 2007–2012.

It is ESMA's opinion that understanding the relation of risk and return in structured investment products requires a level of expertise and knowledge that is not common among retail investors. It is especially difficult for retail investors to assess the value and expected returns for these products.

According to ESMA's survey, the credit risk often embedded in structured investment products may also be difficult for consumers to understand. As the capital protection included in the product may also be linked to the performance of the underlying, assessment of the expected return becomes even more difficult.

On the other hand, a complex product may be profitable for the seller. An analysis of a sample consisting of 76 structured investment products sold to retail investors revealed that these products were sold on average at a premium of 4.6%. Moreover, taking into account the additional return requirement of investors due to the issuer credit risk, the average premium increases to 5.5%. According to ESMA's observations, the performance of capital-protected structured products analysed in the survey was low, as compared to the risk free interest rate.

ESMA concluded that retail investors should be provided clearer information on structured investment products. First, there should be a higher degree of transparency regarding the total cost of the products. Second, there should be clearer disclosure of the risks associated with the products, in particular the issuer credit risk and its implications.

In August, FIN-FSA published the findings of its survey on marketing material for index-linked bonds and other structured bonds sold in Finland. The survey was targeted at the marketing material for index-linked bonds and other structured bonds issued and marketed in Finland and covered new supervised entities and supervised entities whose marketing material had not been assessed previously by FIN-FSA. FIN-FSA's survey did not assess the products' returns for investors or profitability for providers.

Based on the survey, FIN-FSA considered that the description of capital protection could be clarified and issuer credit risk should be referred to consistently by the same term. Examples of return should account for all expenses, and the comparison periods and instruments used to describe the historical performance of the underlying should be chosen consistently, and all of the choices should be justifiable. Risks and other characteristics of the products should be presented in a balanced manner in the brochures.

Finland is one of the few European countries where the industry itself has recommended that the structuring cost be presented in the marketing material. Even if the structuring cost does not always accurately reflect the expense burden of a product, it does increase the transparency as to the product-related expenses.

According to the Finnish Structured Products Registered Association, the total sales of structured products in 2012 amounted to EUR 2.3 bn. Compared to the previous year, sales declined by 9.5%. In Europe, the stock of structured products stood at about EUR 770 bn at the end of 2012.

In 2012, total issuance of these products amounted to EUR 110 bn. Italy accounted for 27% of the stock of structured products, Germany for 17%, France for 11%, Belgium for 10% and United Kingdom for 8%. According to FIN-FSA's survey, the stock of structured products in Finland stood at EUR 7.9 bn at the end of September 2012, of which 71% was capital protected. Retail investors had purchased 52% of the stock.

Link: Supervision release 12.8.2013–60/2013, http://www.finanssivalvonta.fi/fi/Tiedotteet/Valvottavatiedotteet/Pages/60_2013.aspx (in Finnish).

Structured investment products are products, often bonds, whose return is determined by a specific formula based on the performance of an underlying.

Premium refers to the differential between the fair value of a structured product and its subscription price, ie the cost of the product from the customer's viewpoint. The costs of an investment product always affect the return received by the customer.

## Events for listed companies in 2013

An information session on listed companies' financial reporting is held, as in previous years, at the beginning of December. The events will be preliminarily held on 3 and 10 December, but the dates will be confirmed later. Invitations to the event will be sent closer to the date of the event to the Chief Financial Officers of listed companies and persons who have given their contact information in previous events for listed companies. Events will be held in Finnish.

Some of the topics to be covered in the event are supervisory observations in IFRS supervision made in 2013 and the focus areas of supervision in 2014, the quality and significance of notes to financial statements, major IFRS initiatives and review of the framework, related-party disclosures, as well as the results of the report of the working group on the comparability of financial information of financial institutions. Topical issues related to listed companies' disclosure obligation will also be discussed.

**For further information, please contact**

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