Market newsletter 2/2013

July 2013

The Market newsletter addresses topical matters concerning interpretations, standards and 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:

New FIN-FSA regulations and guidelines entered into force on 1 July 2013

FIN-FSA has issued the following regulations and guidelines regarding the operation of the securities markets:

- Securities offerings and listing (6/2013)
- Disclosure obligation of the issuer (7/2013)
- Disclosure of major holdings and voting rights (8/2013)
- Takeover bids and mandatory bids (9/2013)
- Notification obligation relating to market abuse (10/2013)
- Production and dissemination of investment recommendations (11/2013)
- Transaction reporting (12/2013)
- Public insider registers of market participants and fund management companies (13/2013)
- Trading participants in third countries (14/2013)

Regulations and guidelines concerning issuers' public and company-specific insider registers are still included in FIN-FSA's Standard 5.3 Declarations of insider holdings and insider registers, as amended.

According to the transitional provision of the new Securities Markets Act (746/2012), the provisions of the Securities Markets Act to be repealed will apply to issuers' public insider declarations and registers until the Ministry of Finance issues a Decree on the application of the provisions of the new Securities Markets Act. In contrast, the provisions of the new Securities Markets Act are applicable to the keeping of company-specific insider registers. Standard 5.3 will be incorporated into the new set of FIN-FSA regulations and guidelines after the Ministry of Finance has issued the above Decree on the application of the new provisions.

These regulations and guidelines as well as the amended Standard have entered into force on 1 July 2013.

You will find the regulations and guidelines on FIN-FSA's website at http://www.finanssivalvonta.fi/fi/Saantely/Maarayskokoelma/Uusi/Pages/Default.aspx (in Finnish) and http://www.finanssivalvonta.fi/se/Regelverk/Foreskriftssamling/Ny/Pages/Default.aspx (in Swedish). English-language translations of the regulations and guidelines will be published later.

Content and objective of regulations and guidelines

In issuing the current regulations and guidelines, FIN-FSA integrated the standards on the operation of the securities markets into its new set of regulations and guidelines. At

the same time, the necessary amendments were made to the contents of the regulations and guidelines, taking into account:

- the revised securities markets legislation
- the amended Prospectus Directive[1] and the Commission's Prospectus Regulation[2]
- recent FIN-FSA interpretations.

Regulations and guidelines regarding trading participants in third countries concern a subject area on which no previous standards have been issued.

Some of the regulations and guidelines include new binding FIN-FSA regulations based on FIN-FSA's powers or obligation to issue regulations, as laid down in the Securities Markets Act, or on certain implementing directives of the Commission.

The objective of the regulations and guidelines is to inform market participants of FIN-FSA's regulations concerning the operation of the securities markets, as well as of FIN-FSA's recommendations and interpretations. Via its interpretations, FIN-FSA seeks to answer recurrent questions as to how it interprets legislation. Another objective of the interpretations is to promote transparency and predictability in the activities of the authorities. Recommendations and interpretations also provide desired guidance to small companies and give them an opportunity to upgrade their investor information. On top of this, in its regulations and guidelines, FIN-FSA gives practical instructions for application and procedure as well as examples.

Repealed standards

The new FIN-FSA regulations and guidelines have repealed the following FIN-FSA standards in full:

- Disclosure of periodic information (5.1)
- Securities offerings and listing (5.2a)
- Disclosure obligation of the issuer and shareholder (5.2b)
- Takeover bids and mandatory bids (5.2c)
- Investment recommendations and accepted market practices (5.5)
- Notification of suspicious securities transactions and other suspect transactions (RA2.1)
- Transaction reporting (RA5.1).

The following FIN-FSA standards have been repealed in part:

- Of Standard 5.3 Declarations of insider holdings and insider registers, sections concerning public insider registers of market participants and fund management companies have been repealed.
- Of Standard 2.4 Customer due diligence – Prevention of money laundering, terrorist financing and market abuse, chapters 6 and 7 have been repealed.

Opinions submitted

Opinions on draft regulations and guidelines were requested from 26 addressees by 15 February 2013. Opinions were received from 16 respondents. Some of the respondents stated their opinions only on part of the draft regulations and guidelines. In addition, three respondents indicated they had no opinion to provide on the matter.

Feedback summaries of the opinions submitted were compiled in respect of each regulation and guideline. Part of the respondents made general comments on all regulations and guidelines circulated for consultation. Such general comments concerned, for example, sound securities market practice, the legal basis of FIN-FSA guidelines, the structure of the regulations and guidelines and the consistency of the regulations and guidelines with legislation and stock exchange rules. A separate feedback summary of the general comments was prepared.

Feedback summaries and opinions received are displayed on FIN-FSA's website in connection with each regulation and guideline (only in Finnish).

1 The Prospectus Directive 2003/71/EC of the European Parliament and of the Council was amended by Directive 2010/73/EU; the amendments were to be transposed into national law by 1 July 2012.

2 The Commission's Prospectus Regulation (EC) No 809/2004 was amended via three Commission Delegated Regulations during 2012.

A report on changes in the practices of providing assessment of future prospects

The new Securities Markets Act (SMA) entered into force at the beginning of 2013, and in this connection the requirement for presenting an assessment of the future prospects in the interim report and the financial statement release was removed from the Act. The future prospects need to be presented only in the management report by virtue of the Accounting Act. Issuers may continue presenting the future prospects in their interim reports and financial statement releases as before, if they wish to do so.

On the basis of financial statement releases in 2012, FIN-FSA explored how listed companies provided information on the future prospects and whether they had changed their practices of presenting the future prospects in the manner enabled by the Securities Markets Act. Financial statement releases in 2012 from 118 listed companies were reviewed for this purpose. It became evident that almost all listed companies continued presenting the future prospects as before. Only one company had entirely ceased reporting on the future prospects in its interim reports and financial statement release. Moreover, one company stated that it would present the future prospects only in its financial statement release, but not in its interim reports. No significant changes in the accuracy of the information on the future prospects were discovered either: 104 (about 88%) of the companies covered by the analysis presented the future prospects as a profit forecast, as in the previous year. Four companies abandoned the presentation of the profit forecast, providing instead a general future outlook.

On the basis of the analysis, it seems that barely any changes have taken place until now in the practice of presenting the future prospects. FIN-FSA recommends that the now adopted practice of presenting the future prospects be complied with consistently. If a company decides later to change its practice of presenting the future prospects, FIN-FSA recommends prior notification of the change. This may be done, for example, in connection with the disclosure of the following year's events calendar.

Even if an issuer decides to abandon the presentation of the future prospects in its interim reports or financial statement release and to only provide such prospects in its management report, it will be obliged to issue a profit warning, whenever necessary, by virtue of section 6, subsection 4 of the Securities Markets Act.

Submission to FIN-FSA of marketing material related to prospectuses

According to the Securities Markets Act (746/2012, SMA), marketing material related to an offer or stock exchange listing must be submitted to FIN-FSA no later than the marketing begins. The material is to be delivered by email to: esitteet(at)finanssivalvonta.fi. Pursuant to the Securities Markets Act, marketing material must refer to the relevant prospectus and mention the place where the prospectus is available. The obligation to submit marketing material relates to situations where a prospectus approved by FIN-FSA needs to be issued in connection with offering or listing.

The deadline for submitting marketing material to FIN-FSA changed in the new Securities Markets Act. The old Act required submission of marketing material to FIN-FSA within two business days of the submission of the prospectus for approval. Thus, currently, marketing material needs to be submitted no later than the marketing begins, irrespective of the time of approval of the prospectus.

Although, as a rule, FIN-FSA does not comment on marketing material, it may request such material for comment during the examination of the prospectus, for example, from those issuers of prospectuses who offer securities or apply for listing for the first time. In its supervisory work, FIN-FSA gives particular consideration to ensuring that information in the marketing material is consistent with the prospectus.

Marketing material related to an offer of securities need not be submitted to FIN-FSA in the following situations:

- the denomination per unit of the securities is at least EUR 100,000
- the securities are offered to less than 150 investors other than qualified investors
- the securities are offered exclusively to qualified investors.

However, if such securities are listed, potential marketing material related to the listing must be submitted to FIN-FSA.

A breach of the provision concerning the submission of marketing material may lead to the imposition of an administrative fine as set out in the Act on the Financial Supervisory Authority.

FIN-FSA provides closer guidance on the submission of marketing material in its regulations and guidelines 6/2013 Securities offerings and listing, and on the content of marketing material in its regulations and guidelines 15/2013 Marketing of financial services and products. The above regulations and guidelines have entered into force on 1 July 2013.

Implementation of EMIR continues

The EMIR[1] regulating the operations of central counterparties and trade repositories became effective on 16 August 2012. The Regulation applies to all users of derivatives. Market newsletters 2/2012 and 4/2012 provided information on the Regulation and commencement of its implementation. In this article we report on the current situation, particularly from the viewpoint of non-financial users of derivatives.

Key provisions for non-financial counterparties

Counterparties to derivative contracts are subject to an overall reporting obligation in respect of all derivative contracts and modifications in them. The obligation applies to derivative contracts outstanding on 16 August 2012 and entered into thereafter, regardless of whether they will still be in force when receipt of reports begins. The reporting obligation is imposed on both counterparties separately, and also covers intragroup derivative contracts and modifications in them. There are no exemptions from the reporting obligation. The aim of the reporting obligation is to improve access to information by the authorities and the markets.

Liquid OTC derivatives are also subject to clearing obligations. At this stage, there is no definite timetable for the setting of clearing obligations, but in practice spring 2014 appears plausible. Derivatives subject to the clearing obligation need to be submitted to a central counterparty for clearing. The clearing obligation seeks to mitigate counterparty risk and improve risk management. A large part of non-financial counterparties will be exempted from the clearing obligation. Other counterparties may, on certain conditions, be exempted from the clearing obligation in respect of intragroup transactions.

The EMIR sets certain basic requirements for each corporation's management of risks associated with derivatives. Such basic requirements for the management of risks associated with OTC derivatives not subject to the clearing obligation apply to all counterparties. Additional requirements are imposed on the risk management of non-financial corporations active in taking positions in derivatives (those

1 Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR = European Market Infrastructure Regulation, a working title given to the Regulation at the preparatory stage and remained in use).

exceeding the clearing threshold) and financial counterparties. Financial counterparties include banks, investment firms and other entities supervised by FIN-FSA.

Clearing thresholds

The clearing threshold is a key concept for non-financial corporations. Groups are obliged to establish whether the gross notional values of group companies' OTC derivatives other than those entered into for hedging purposes exceed the clearing threshold. Exceeding of the threshold is calculated separately for interest rate swaps, credit default swaps, foreign exchange swaps, equity swaps or commodity swaps and other derivatives. If any of the thresholds is exceeded, each group company registered in the EEA is required to notify the supervisory authorities in its own country and the European Securities and Markets Authority (ESMA). The thresholds are, however, considerably high. The threshold for credit default swaps and equity swaps is EUR 1 billion for each separately, and the threshold for interest rate swaps, foreign exchange swaps or commodity swaps and other derivatives is EUR 3 billion for each separately. In practice, most European groups never exceed any clearing thresholds. If a group's OTC derivatives business is particularly extensive, the exceeding of the clearing thresholds needs to be verified by calculating individual gross positions of all companies belonging to the group, in compliance with the rules governing the calculation of the thresholds.

If any of the clearing thresholds is exceeded, the group must comply with the clearing obligation in respect of all OTC derivatives subject to the obligation. At the same time, appropriate risk management procedures must be in place (bilateral margin requirements and daily valuation) for all OTC derivatives of each group company registered in the EEA.

Legal Entity Identifier

Each counterparty is required to acquire for itself a Legal Entity Identifier (LEI), which is needed in derivatives reporting to specify its own company and counterparties to derivative contracts. The LEI is a type of global business ID. At the initial stage, counterparties need to obtain the LEI themselves or authorise someone to do so on their behalf.

The LEI is based on agreement among the G20 countries. A specific global Regulatory Oversight Committee (ROC) has been formed to oversee the system of legal entity identification. The establishment of the system itself is still in progress. The aim is to designate country-specific providers of LEIs. In Europe, three such providers have been designated until now, known temporarily as preLOUs (preparatory Local Operating Units). As the creation of the system advances, these units will become permanent and their designation will change into LOU.

So far, Finland has no preLOU of its own. The system of issuing LEIs being incomplete, there is no certainty yet of the provider of LEIs to Finnish counterparties.

Reporting of derivative contracts

Derivative contracts will be reported to trade repositories (TRs) registered with ESMA. These are mainly regional or global operators accepting reports from several different countries. According to currently available information, the first trade repositories will be registered no earlier than late summer. ESMA has not publicly announced the number of registration applications submitted. On the basis of announcements by the operators themselves, it can be estimated that there will be a few trade repositories relevant for corporations operating in Finland. Reporting entities may themselves choose the trade repository they want to submit their own reports to. Not all trade repositories will necessarily accept all reports on derivative contracts, as some may be specialised in, for example, foreign exchange swaps or credit default swaps. The matter will be confirmed as soon as ESMA has completed its registration of trade repositories.

Anyone subject to the reporting obligation may outsource the reporting to a counterparty or a third party. However, responsibility for reporting continues to lie with the party subject to the reporting obligation, at all times. Service providers transmitting reports to one or more trade repositories are likely to interpose themselves between trade repositories and parties subject to the reporting obligation.

To ensure reporting coverage, parties subject to the reporting obligation should carefully consider how they intend to meet their reporting obligation. Outsourcing the reporting to counterparties will not be particularly simple if there are several counterparties. The reporting entity always needs to make sure, independently, that all its derivative contracts are duly reported. In any case, reporting of intragroup derivative

contracts must be organised separately even if the reporting of derivative contracts entered into with other parties were outsourced to counterparties.

According to currently available information, reporting of credit default swaps and interest rate swaps will begin in November 2013 and that of other derivative contracts from the beginning of 2014. The timetable is linked with the dates when trade repositories apply for registration and when ESMA gets them registered.

Setting of clearing obligations

Clearing obligations cannot be set until central counterparties dealing with them have authorisations according to the EMIR. Clearing obligations will be set under Regulatory Technical Standards prepared by ESMA. According to the current estimate, these will be submitted to the Commission for endorsement between 15 March and 15 September 2014. The European Commission's adoption process will take some months; so, the first clearing obligations could take effect no earlier than late spring 2014. This, too, may be an overly optimistic timetable. The Commission has also promised a transitional period for non-financial counterparties. Accordingly, the clearing obligation will initially only apply to OTC derivatives within the financial sector and, even after the transitional period, to a relatively small group of non-financial corporations. Subsequently, it will also be possible to obtain exemptions, on certain conditions, from the clearing obligation regarding intragroup transactions.

Risk management concerning non-centrally cleared OTC derivatives

Since 15 March 2013, all users of OTC derivatives have been required to comply with the following basic risk management rules regarding OTC derivatives not subject to the clearing obligation:

1. The counterparties are required to agree in advance on the process to resolve disputes. It may take the form of a standard process. The most important aspect is that the process has been agreed in advance in writing or in another similar manner. Disputes must be recorded and their resolution made more effective if disputes are not resolved within five business days.
2. Counterparties must confirm transactions according to a graded schedule, depending on the type of derivative:
   - currently, within 5–7 days
   - from 31 August 2013 onwards, within 3–4 days and
   - from 31 August 2014 onwards, by the end of the second business day.
3. OTC derivatives must be reconciled once a year or more frequently. A party exceeding the clearing threshold and holding a significant amount of derivatives is obliged to reconcile derivative portfolios on a daily basis.

What should non-financial corporations do now?

1. Check whether any clearing threshold is exceeded in connection with group OTC derivatives. Whenever necessary, submit notifications to ESMA and FIN-FSA.
2. Prepare for the beginning of derivatives reporting. Attention should also be focused on reporting intragroup derivatives.
3. Ensure that risk management meets the new requirements.

Further information

Please see FIN-FSA's webpages regarding EMIR (available only in Finnish): http://www.finanssivalvonta.fi/fi/Saantely/Saantelyhankkeet/EMIR/Pages/Default.aspx.

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

Market newsletter now also in English

Starting from the 2/2013 issue, FIN-FSA will also publish the Market newsletter in English, in part. As a rule, articles other than those pertaining to IFRS enforcement will be published in English. The English-language Market newsletter will be released after the corresponding Finnish-language publication has come out and will be available on FIN-FSA's English-language website. Please subscribe to the Market newsletter on our website.

FIN-FSA's investor enquiry

FIN-FSA is examining the use of investor information published by Finnish listed companies and investors' information sources. For this purpose, FIN-FSA solicits replies from those persons in particular who use investor information in making their investment decisions or providing investment analyses.

The replies will be made use of in targeting the supervision of listed companies' investor information and investor protection. The results of the enquiry will be reported in the Market newsletter in autumn 2013.

The enquiry will be available on FIN-FSA's website until 16 August 2013 (only in Finnish).

For further information, please contact

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