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RAHOITUSTARKASTUS  
FINANSINSPEKTIONEN  
FINANCIAL SUPERVISION

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# Director General's Review

The year 1998 was one of great changes in the Finnish financial markets. Finland, together with ten other EU member states, decided to proceed to Stage Three of Economic and Monetary Union (EMU) and adopt the single currency, the euro, from the beginning of 1999. As part of this process, the European Monetary Institute ceased operations and was replaced by the European Central Bank in June 1998. At the same time the Bank of Finland, with which the Financial Supervision Authority (FSA) is connected administratively as an independent authority, became part of the European System of Central Banks. Although Finnish markka notes and coins will not be replaced by the euro until 2002 and the markka will, until then, be one of the eleven national denominations of the euro, the decision on participation in Stage Three of EMU entails a fundamental change in our financial markets. In fact we can no longer really speak about Finnish financial markets, since they constitute but a small part of large markets embracing the entire euro area. Accordingly, one of the challenges we face in the future is to ensure that the circumstances in respect of the technical infrastructure of the financial markets, the legislation, official regulations and guidelines governing them and their supervision and taxation are such as to permit the continuation of efficient and competitive, yet stable and secure, financial activities in Finland as part of the single euro area.

In terms of information technology the changeover to the euro was an enormous task, which was nevertheless carried through successfully. This gives

us reason to believe that the IT problems associated with the year 2000 can be solved without any major disruptions to society or businesses. The year 2000 problem should not be underestimated, however. The FSA will ensure for its own part that the year 2000 preparations are taken seriously, that all necessary test runs are carried out and that contingency plans are drawn up to deal with any unforeseen problems.

The profitability of the banking sector improved in 1998 and is now at a reasonably good level. Loan losses fell further and are at a level where there is probably little room for further improvement. Though the interest rate margin narrowed, this was offset by increased lending, and as a result net income from financial operations improved slightly. Because of narrow margins and slack demand for credit, corporate finance was not a very profitable area. Provision of banking services to the household sector, ie the core banking operations, continues to constitute the backbone of banks' profitability. Particularly towards the end of the year, the growth of lending to households gathered pace, perhaps even too rapidly. On the whole, however, the banks' lending policies still seem to be soundly based. Moreover, provision of asset management services to the general public is becoming an increasingly important and profitable part of core banking operations.

Banks' balance sheets continue to be burdened by substantial holdings of real estate, largely dating from the banking crisis of the early 1990s. The MeritaNordbanken Group has made

determined efforts to solve this problem. The situation is not so favourable as regards all banks, however. In the FSA's view, the only way to remove for good the shadow of the banking crisis that still overhangs the Finnish banking system is through sales or downward adjustment of book values that are too high compared with expected returns in the market. The FSA aims to ensure that the markets continue to be provided with reliable information on the values of and returns on real estate holdings, and it also requires the banks to put forward explicit plans to remedy the situation. Now should be an opportune time to do this given that profitability is otherwise good and economic conditions are still quite favourable.

The competition for customers' savings is intensifying. So far, the switch out of bank deposits into securities has not reached major proportions, but the trend is nonetheless clear. Investment in equity and debt securities, mutual funds, life saving insurance and private pension schemes linked to securities are becoming increasingly popular. Besides investment firms of their own, bank groups have set up companies providing life insurance and voluntary pension insurance, which compete with specialized companies in this field. This underscores the need to harmonize the regulation and taxation of investment products. Through its supervision and regulation of investment firms, the FSA seeks to promote good securities market practices and market transparency.

In its supervision of the securities markets in 1998 the FSA had to intervene to deal with omissions and mal-

practice on the part of both supervised entities and investors. Some cases were even investigated by the police, leading to prosecutions. Legal proceedings are, however, a very slow and cumbersome way of dealing with minor offences. Therefore, more needs to be done to enable the FSA to react more quickly and impose penalties that are more severe than admonitions. The credibility of the Finnish securities markets could be impaired, if the public gains the impression that the possibilities to deal with insider offences are restricted or that fair play is not being observed in share issues. In the worst case, lack of credibility and reliability will make investors vote with their feet and invest their funds elsewhere. But on the other hand, the rules applied in Finland must not be too strict – rather we must pursue best practices that are internationally accepted.

At international level, the financial crises in Asia, Russia and Latin America have prompted a discussion on how to better safeguard the stability of the global financial system. There has been talk of the need for a new international financial architecture. Central to this discussion is the need to step up the supervision of the financial system and improve the reliability and up-to-date-ness of available market information. Discussion of the issues has spread from practitioners' circles to the political level and is now high on the agenda of the G-7 leading industrial nations as well of the various EU institutions, the International Monetary Fund (IMF), the Bank for International Settlements (BIS) and organizations for cooperation between financial supervisors. It is to be hoped that the debate will lead to

concrete results. Finland can also contribute to this discussion during its EU presidency in the second half of 1999.

Finland's main aim in this regard is to maintain the good performance of its own economy and support worthy international initiatives and their preparation within the EU context. The FSA is involved in such preparatory work eg in the European Commission's Banking Advisory Committee (BAC), the European Central Bank's Banking Supervision Committee and the Forum of European Securities Commissions (FESCO), which is discussed in more detail below. The FSA also participates in the working groups of these bodies.

A positive development in Finland's own financial infrastructure was the announcement in December 1998 that the activities of the Helsinki Exchanges and the Finnish Central Securities Depository Ltd (APK) were to be combined in the same holding company. The Helsinki Exchanges and the APK also made strategic decisions concerning their international operations by entering into cooperation with stock exchanges and clearing and settlement systems in Germany and other continental European countries. These decisions are likely to help ensure that the Finnish securities markets can continue to function effectively as part of the large euro area.

International networking between stock exchanges and clearing houses increases the need for coordinated supervision. An important forum for such coordination from Finland's viewpoint is FESCO, the organization of securities markets supervisors in the European Economic Area, which was established in 1997. In 1998 FESCO

drew up a multilateral agreement on supervisory cooperation between EEA supervisors, and the agreement was signed in Paris in January 1999. On other hand, plans to set up a securities markets committee alongside the EU's existing Banking Advisory Committee (BAC) and Insurance Committee again came to nothing because of an ongoing dispute between the European Commission, the Council and the European Parliament concerning the powers of the proposed committee.

In Finland the FSA's cooperation with the Ministry of Finance (especially the Financial Markets Department), the Bank of Finland and the Insurance Department of the Ministry of Social Affairs and Health was excellent. FSA representatives participated in several working groups engaged in drafting legislation. It is particularly worth noting the group that drew up a proposal on the establishment and organization of an insurance supervision authority. The new Insurance Supervision Authority, which falls within the purview of the Ministry of Social Affairs and Health, will begin to operate on 1 April 1999. Cooperation between the FSA and the Insurance Supervision Authority is regulated by law, and the compositions of both authorities' Boards are largely uniform. The Boards are responsible for, inter alia, taking more detailed decisions on the principles underlying cooperation between the two authorities.

Another significant event was the commencement of work in September by the Advisory Office for Bank Customers, which was established jointly by the National Consumer Administration, the Finnish Bankers'

Association and the FSA. The Office has very quickly proved its worth as demonstrated by the considerable number of enquiries and requests for investigation that it has received during the short time it has been in operation.

Expected major mergers between banks and insurance companies did not materialize during the year under review. Although such mergers are still possible in the future, a more likely outcome is that the establishment of the euro area will gradually give rise to pressures for cross-border mergers and alliances. Finland alone is too small a market area. Competition in the euro area is intensifying and this will lead to major structural changes in the European financial markets. Advances in information technology will also

increase pressures and opportunities for sectoral overlaps outside the traditional financial sector, eg between commerce, telecommunications and financing. These developments will impose heavy demands as regards improved legislation and supervision, both in the EU as a whole and globally.

The year 1999 seems likely to be a significant one in many respects. The euro markets are beginning to take shape; competition in Europe is sharpening; and old structures are breaking down. A vast number of new opportunities have opened up for skilled operators. If all goes well, these developments will lead to more efficient financial activities and the provision of a wider range of services. This, in turn, will be beneficial to national economies and release resources for use in other

productive activities, thereby increasing well-being, prosperity and stability, whether in Finland or in Sicily.

However, a number of risks attach to these developments. The breaking down of old structures and ways of thinking could also trigger crises that make adaptation to the new conditions a painful experience.

Consequently, financial supervision is facing great challenges. The single euro area needs supervision, procedures and rules that are more uniform than ever. This does not necessarily mean abandoning national supervision in favour of centralized supervisory machinery, but cooperation between national authorities will have to be deepened. This is already well under way. But is it taking place sufficiently quickly? Time will tell.

March 1998

# Operating Environment

The financial markets have developed favourably in recent years. The year 1998 was actually one of the best in the 1990s as regards the stability of the financial markets.

The domestic economy continued to perform well. The economic and financial difficulties in Asia and Russia had only a minor impact on the Finnish financial markets, the only noteworthy effect being a temporary dip in share prices. Share prices rose by 68,5% in the course of the year and real estate prices also moved higher. The rise in share and real estate prices improved the financial situation of the banks and helped to reduce their credit risks.

The onset of Stage Three of EMU at the beginning of 1999 already began to have an impact on operating conditions in 1998. Exchange rates between currencies to be transformed into the euro fluctuated very little during the latter half of the year. Interest rates, which were also fairly stable, fell on average, probably partly because of expectations regarding monetary union.

The favourable economic situation was also reflected in brisk share trading. Turnover reached a record level of FIM 323 billion, ie nearly 71% higher than in 1997 (see Chart 2).

## STRUCTURAL CHANGES IN THE FINANCIAL MARKETS

### Several reorganisations in the banking sector

Around the beginning of 1998, ownership of the state-owned Postipankki plc and Finnish Export Credit Ltd was transferred to the same holding company (PV Group plc). Later the names

were changed to Leonia Bank plc, Leonia Corporate Bank plc and Leonia plc respectively.

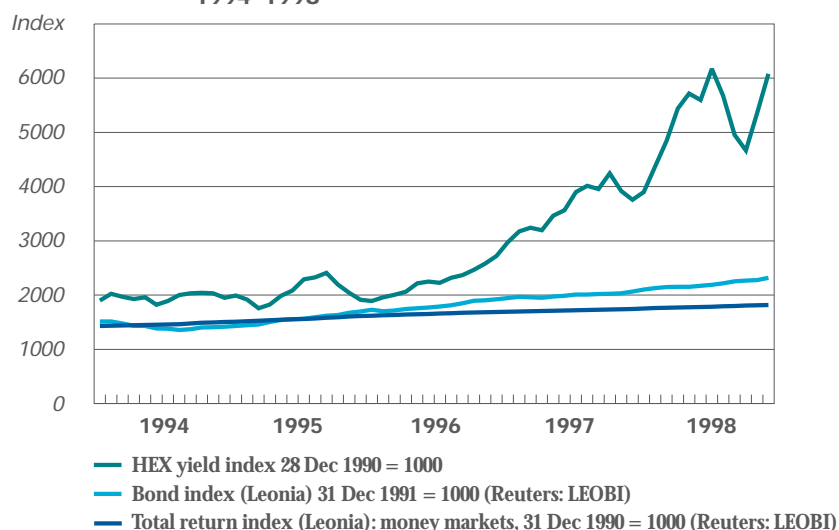
At the beginning of 1999 the activities of Kera Oyj and the Finnish Guarantee Board were combined to form Finnvera plc, which is not supervised by the FSA.

On 1 January 1999 Skopbank entered into voluntary liquidation proceedings.

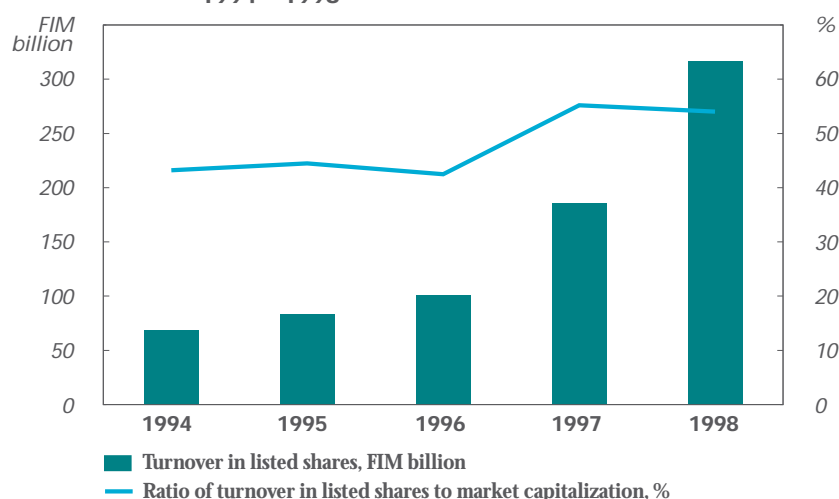
Interbank Ltd and Mandatum & Co Ltd were merged at the beginning of August to form Mandatum Bank plc, and in September the group acquired Protos Stockbrokers Ltd. The securities broking operations of Protos and Mandatum were merged to form a subsidiary called Mandatum Stockbrokers Ltd.

During 1998 local cooperative banks separated from the Amalgamation of

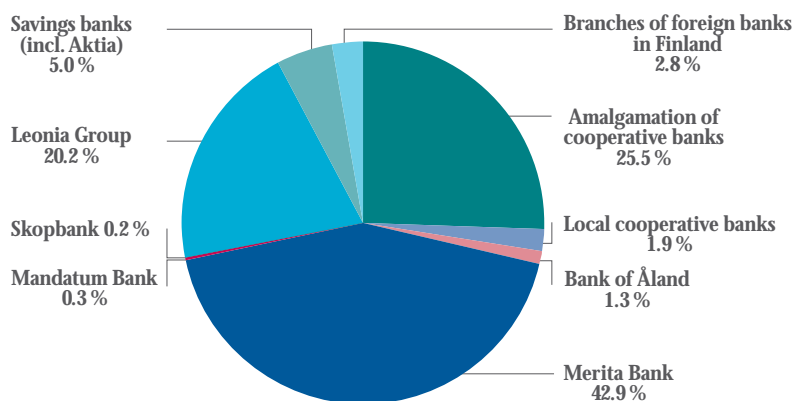
**Chart 1. Total return indices: equity, debt and money markets, 1994-1998**



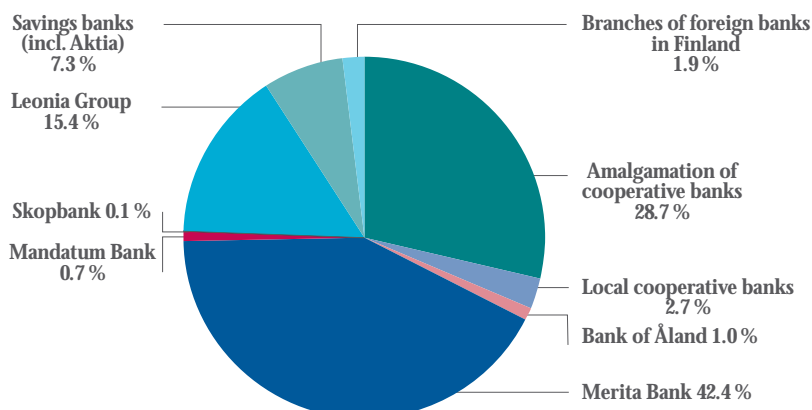
**Chart 2. Share turnover on the Helsinki Exchanges, 1994 - 1998**



**Chart 3. Lending: banks' market shares, 31 Dec 1998**



**Chart 4. Deposits: banks' market shares, 31 Dec 1998**



cooperative banks. In the autumn, these banks commenced joint usage of an IT system with the savings banks, and Aktia Savings Bank plc took over as their central financial institution.

An amendment to the Credit Institutions Act, which enabled the winding up of the cooperative banks' security fund and the cooperative banks' separation from it, entered into effect on 9 December 1998. Already in October, the OKOBANK Group Central

Cooperative (authorized representative of the member banks) and the Association of Finnish Local Cooperative Banks had agreed on a division of the liabilities of the cooperative banks' security fund. At the end of the year all of the cooperative banks announced they were withdrawing from the security fund. Their withdrawal will become effective when the banks have fully paid their share of the fund's liabilities.

### A German partner for the Helsinki Exchanges and the Finnish Central Securities Depository

The Finnish Central Securities Depository (APK) and Deutsche Börse Clearing AG concluded an agreement at the beginning of November that will enable entities using the APK's facilities to handle the safekeeping of their foreign securities within the domestic book-entry system. The first links to be established will be for money market instruments and bonds.

In November the Helsinki Exchanges announced its intention to enter into an agreement on cooperation with Eurex AG and Deutsche Börse AG. The aim is to initiate trade in the Helsinki Exchanges' derivative products on Eurex in autumn 1999. Moreover, members of the Helsinki Exchanges will be able to trade in all instruments traded on Eurex. As regards the stock market, the aim is to set up a cooperative arrangement whereby the Helsinki Exchanges could use the trading system of the Deutsche Börse and be linked with all participating stock exchanges. The arrangement would provide a large number of participants with the same technical possibility to trade directly on the Helsinki Exchanges or any other participating exchange.

### The Helsinki Exchanges and the Finnish Central Securities Depository to join forces

In December a proposal was approved that will bring together the Helsinki Exchanges and the APK in the same group. The group will comprise the holding company Helsinki Exchanges

Group Ltd Oy and subsidiaries that will handle stock exchange, central securities depository, book-entry register and clearing house operations. The new group will come into being in April 1999.

## COMPETITION IN DEPOSIT TAKING AND LENDING

Banks' competition for deposits remained fairly restrained and there was no notable upward pressure on deposit rates. The banks' market shares did not change significantly. The combined market share of the three largest banks/banking groups did however decline slightly, from 88 % at end-1997 to 86.4 % at end-1998 (see Charts 3 and 4).

On the other hand, competition was much tighter in respect of lending, and seems to have increased in comparison with the previous year. The

heightened competition also led to changes in market shares. The biggest gainers of market share were the savings banks group and branches of foreign credit institutions. The share of the three largest banks/banking groups declined.

### Survey on competition in lending

In the autumn the FSA carried out a survey on interbank competition in lending and also asked the banks for their views on current competitive conditions. On the basis of the survey, it is clear that there was a pronounced change in competition in 1998. On the one hand, demand increased as customers once again took out housing and consumer loans while, on the other hand, new competitors entered the markets and small banks actively sought to expand their market shares. The survey responses indicate that households were more inclined than

before to make interbank comparisons and to base their choices on banks' offers. This was another factor behind the heightened competition.

According to the survey, there were large geographical differences in competitive conditions, with competition being clearly strongest in the growth centres. The effects of the removal of stamp duty on the demand for credit were judged by respondents to have been moderate. However, it did intensify interbank competition as well as customers' readiness to change banks. The banks indicated that, under the prevailing competitive conditions, they have been flexible in pricing credit but not in regard to the quality of their loan portfolios. In addition to collateral, banks paid particular attention to customers' ability to service their debts. Cash flow was regarded as the primary criterion for granting credit.



# Activities 1998

In keeping with its action plan, the activities of the Financial Supervision Authority (FSA) in 1998 focused on promoting a market-oriented approach and transparency in the financial markets and the efficiency and reliable functioning of markets. The FSA also stepped up its cooperation with other authorities and the supervised institutions.

## IMPROVING MARKET ORIENTATION AND TRANSPARENCY IN THE FINANCIAL MARKETS

The FSA participated in the development and reform of self-regulation and the code of market conduct in the securities market. With a view to introducing a more precise code of market conduct, the FSA amended its guideline on practices to be applied in the provision of investment services and issued a new guideline on segregation of securities business functions from other business functions (Chinese walls).

The FSA also sought to improve the quality and coverage of the financial and other information published by the supervised entities, the aim being to improve market accessibility to information and promote the transparency of communication.

To increase market reliability, the FSA issued statements on the assessment of the fitness and propriety of directors and managers of credit institutions, the issuance and sale of shares via the Internet and identification of a remote customer.

### Market practices and code of market conduct specified

During the year under review the

practices applied in the securities markets were the subject of wide public debate.

With a view to maintaining public confidence in the market and clarifying market practices, the Finnish Securities Dealers Association amended its insider and trading code. The code is now more stringent than before. For instance, the duration of the prohibition against short-term trading has been extended from one month to three months, which means that at least three months must now elapse between the purchase and sale or sale and purchase of the same share. The prohibition against short-term trading applies to management and employees as defined in the code, as well as to persons under their guardianship and corporate entities in which they exercise control. Under the FSA guideline on practices to be applied in the provision of investment services, the code is applicable to all investment firms and credit institutions providing investment services, irrespective of whether they are members of the Association.

The FSA amended the guideline on practices to be applied in the provision of investment services and issued a new guideline on segregation of securities business functions. The guideline is intended to improve the protection afforded to individual investors and increase investor confidence in the practices applied in the securities markets.

The purpose of the guideline on segregation is to ensure that transmission of confidential information on securities and customers is limited to the employees authorized to handle such information. This makes it possible for firms to simultaneously engage

in activities that might otherwise cause conflicts of interest between the firm and its customers, or between individual customers. Segregation of the securities business functions will also help prevent abuse of insider information.

The FSA participated in the work of an unofficial working set up by the Minister of Finance to examine the code of market conduct for the securities markets and to determine whether there was a need to review the effectiveness of legislation and self-regulation in this field. The working group was set up in response to frequent public allegations that securities market participants were not fully committed to the code of market conduct. Criticism had, among other things, been directed at the way insider registers are made accessible to the public and delays in declaring insider holdings.

The working group put forward several proposals for improving the reliability and public status of insider registers. It maintained that its recommendations could be implemented primarily by market participants themselves, and the latter have, in fact, already taken measures to this effect. One aim is to make information on insider holdings available on the Internet. Furthermore, an ethical code on trading by the management of listed companies is under preparation.

### Use of the Internet for equity issues and secondary placings

In 1998 investors were for the first time offered the opportunity to subscribe shares via the Internet. The FSA issued a statement on this subject, which was aimed at facilitating the identification and management of

risks associated with the introduction of new technology.

In its statement, the FSA presumed that an investment firm acting as a member of the selling group in equity issues be able to establish the identity of its customers and obtain adequate verification of the validity and extent of a proxy. Uniform practices must be applied both in equity issues and secondary placings irrespective of the medium used.

The FSA further noted the need to pay particular attention to the procedures used for customer identification and to any special circumstances surrounding the subscription, such as interruption of subscription, payment immediately upon subscription and availability of the prospectus on the Internet. It also highlighted the need to make sure whether an offering via the Internet is intended only for investors resident in Finland. If this is not the case, the issuer also has to take account of foreign legislation governing securities markets.

### Uniform practices for assessing fitness and propriety

In its supervisory work, the FSA paid attention to the steps taken by credit institutions to ensure compliance with the fitness and propriety criteria applicable to the directors and managers of credit institutions and examined the assessment procedure applied by credit institutions.

With a view to introducing uniform practices in credit institutions, the FSA issued a statement in December on the assessment of the fitness and propriety of the directors and managers of credit institutions. One aim was to promote the systematic integration of

fitness and propriety assessment procedures into internal control.

### Prevention of money laundering

During its inspections and supervisory visits, the FSA examined the measures taken by the supervised entities to combat money laundering. The aim was also to make sure that the supervised entities observed good banking practices in accordance with the Act on Prevention of Money Laundering and complied with sound market practices.

Other important activities by the FSA in this area included dissemination of information and provision of training to supervised entities and cooperation between supervised entities and supervisory authorities at home and abroad. The FSA also issued a statement on the identification of a remote customer, the purpose of which was to encourage the introduction of uniform customer identification methods in financial markets.

The Financial Action Task Force on Money Laundering (FATF) carried out a mutual evaluation of Finland in March.

According to the inspection report, the Finnish anti-money laundering programme complied with nearly all of the FATF's 40 recommendations. The report further noted that Finnish legislation in this field, especially the provisions governing international mutual legal assistance, was exemplary and that the administration of the programme was soundly based. It also encouraged the FSA and other supervisory authorities to continue to work in close cooperation, especially with those parties under obligation to report who are covered by the Act.

The Council of Europe has launched cooperation with the countries of eastern and central Europe and the Baltic States to combat money laundering. Like the FATF, the Council of Europe also carries out mutual evaluations in the 21 countries participating in the programme. A representative of the FSA participated on behalf of the FATF in the country inspection of Slovakia.

### Suspected cases of abuse of insider information referred for police investigation

In the course of 1998 the FSA investigated several cases of suspected abuse of insider information. Of the cases referred for police investigation, seven concerned suspected abuse of insider information and three suspected violations of derivatives market legislation. The requests for police investigation concerned the shares or stock derivatives of seven different companies.

### The FSA participated in the drafting of legislation on reorganization of credit institutions

In 1998 the FSA participated in the work of the working group developing legislation on credit institutions. The working group was set up to draft legislation on the reorganization and winding up of credit institutions. The working group's proposal for legislative amendments will be published in March 1999 (see page 28).

### More specific instructions concerning information to be reported in annual accounts

To improve the availability of information to the markets, the FSA issued

more specific instructions concerning the contents of the information to be reported in annual accounts (see page 23). The issue of a regulation on the interim reports of deposit banks made it possible for depositors to obtain more information than before on the financial condition of banks.

The FSA sent a notification to the supervised entities dealing with the consequences of the introduction of the euro for the drawing up of annual accounts. It was accompanied by another notification containing instructions on how Year 2000 preparations were to be reported in annual accounts. The Helsinki Exchanges and the FSA together issued a statement advising companies whose shares are publicly traded how to inform the markets about their Year 2000 preparations and the progress made in implementing them.

## PROMOTING THE EFFICIENT AND RELIABLE FUNCTIONING OF MARKETS

The FSA attached special attention to the risk management and internal control systems of supervised entities and issued relevant regulations and guidelines in April. In addition, the FSA monitored the readiness of supervised entities for the changeover to the euro and for implementing the changes in IT systems required to achieve Year 2000 compliance.

The FSA also examined the efficiency of the clearing and settlement of share transactions and the problems that had come to light in that connection. A simulation of these problems

was carried out in cooperation with the Helsinki Exchanges and the Finnish Central Securities Depository Ltd (APK). The FSA called for prompt action to improve the clearing and settlement of trades.

## Inspections of internal control in supervised entities started

In autumn 1998 the FSA started to inspect internal control<sup>1</sup> in the supervised entities. At the same time assessment of the internal audit function<sup>2</sup> in credit institutions was started.

Internal control in the supervised entities is one of the key areas subject to inspection by the FSA. Like the FSA, supervisory authorities in many other countries have designated internal control as a priority area. This reflects the fact that shortcomings in the internal control have contributed significantly to the cause and magnitude of damage incurred in connection with several failures and abuses in the financial sector in recent years.

In April the FSA issued regulations to the supervised entities on the requirements for internal control. At the same time it issued guidelines on the principles of internal control and on the internal audit function.

<sup>1</sup> Internal control is a process aimed at ensuring accomplishment of stated goals and objectives, economical and efficient use of resources, adequate control of the various risks inherent in operations, the reliability and integrity of financial and other management information and compliance with laws and regulations, strategies, plans, internal rules and procedures.

<sup>2</sup> The internal audit function refers to an independent group of professionals within an organization, who report directly to the managing director and who analyse the operational processes of the organization, issuing recommendations and statements on the basis of their analyses.

## Special monitoring of year 2000 compliance

In addition to the euro changeover, preparation for the year 2000 was an important IT project for the entities supervised by the FSA.

In the early part of 1998 the FSA drew the supervised entities' attention to the need to be aware of the IT problems related to the millennium change and urged the supervised entities to take measures to identify and solve the problems without delay. In addition to special year 2000 enquiries and inspections, the FSA arranged year 2000 seminars and other events together with the Bank of Finland and other major operators in the financial markets.

During the latter part of 1998 the FSA focused on inspecting the year 2000 compliance plans of banks and other supervised entities. At the same time it promoted joint testing and preparation of contingency plans in the financial sector.

In Finland, as in many other countries, the financial sector is ahead of other organizations in its year 2000 preparations. Banks completed most of the necessary changes to their IT systems in 1998. One full year therefore remains for them to carry out internal and external tests and to finalize contingency plans to deal with possible disruptions. The readiness of investment firms varied, but since these firms are generally smaller than the banks and their IT systems are relatively straightforward, their situation does not give rise to particular concern.

Most of the changes made by the FSA to its own IT systems had been completed by the turn of the year, and

testing of the systems will be completed by the end of June 1999.

### Readiness for the euro was also the subject of inspection

The FSA made supervisory visits to major banks, securities intermediaries and clearing parties to determine the readiness of the financial markets for the euro changeover. In addition, the FSA supervised joint euro testing in the stock and derivatives markets. The Finnish Bankers' Association and the Association of Savings Banks actively contributed to their members' euro preparations. The FSA required the supervised entities to draw up detailed plans for the euro changeover.

In the financial markets the euro changeover took place without any notable disruptions, and no major problems regarding the functioning or stability of markets were reported to the FSA. The successful euro changeover was largely a result of the careful preparatory work undertaken in the extensive EMU projects of the banks and other supervised entities.

### Inspections of risk management in payment and settlement systems

The principles, subjects and division of responsibilities in supervising payment and settlement systems were clarified in cooperation with the Bank of Finland. The FSA and the central bank work together in the supervision of these systems. The FSA monitors and inspects the payment transactions of individual supervised entities. The task of the central bank is to ensure the stability of systems. Actual implementation of the joint supervision mea-

asures was postponed until 1999 in anticipation of the European Central Bank's confirmation of the principles to be applied in the oversight of payment systems.

The FSA inspected the foreign payment systems of two banks and the domestic and foreign payment systems of one bank. In the course of the inspections the banks' arrangements for risk identification, internal control, risk management and readiness to deal with disruptions were evaluated. Shortcomings were found, inter alia, in risk identification, IT system access and contingency plans. To increase risk awareness the FSA, in cooperation with the central bank, published a report on payment system risks in Finland and the need for regulation and supervision.

During the year inspections were also performed of the clearing, settlement and IT systems for securities trading in the Finnish Central Securities Depository (APK), which is responsible for securities clearing and settlement. In addition, the book-entry register and the payment and settlement processes of one large bank were inspected. In cooperation with the central bank, the FSA monitored the measures taken by the major banks to reduce settlement risk in connection with currency trading.

### Action by the FSA to improve the clearing and settlement of share transactions

In 1998 the FSA carried out a survey of problems in the clearing and settlement of share transactions. The problems were largely connected with the decentralized structure of the book-

entry system, but they were also partly due to procedures established by market participants. The FSA performed inspections at securities intermediaries and clearing parties to examine the procedures applied in the clearing and settlement of share transactions and the reasons for delays in deliveries.

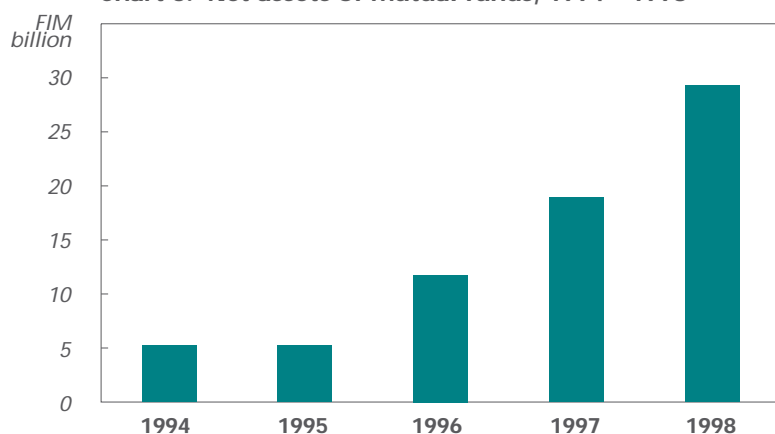
A particular problem is that many of the transactions are not settled in time, ie within T + 3 days (trade date + three business days). On average, 84.9% of transactions were settled on time; in 1997 the share had been 88.5%. The settlement percentage was at its lowest point, 79.4%, in September.

In May the FSA requested the APK, the Helsinki Exchanges and the Finnish Securities Dealers Association to submit a report on projects to make the clearing and settlement of share transactions more efficient and to minimize settlement risks. In the same connection the FSA decided to allow joint custody under certain conditions, upon application by a securities intermediary.

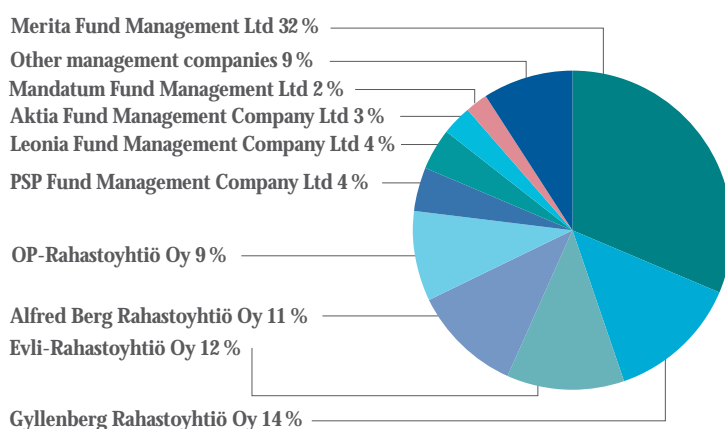
The APK, the Helsinki Exchanges and the Finnish Securities Dealers Association have taken steps to make clearing and settlement more efficient. General conditions for securities lending were confirmed in the autumn and lending operations started in November. A liquidity clause for securities intermediaries was introduced in the APK's clearing and settlement rules. Steps were also taken to start developing an enhanced procedure of penalties for delay and preparing rules on short selling.

The development of the clearing and settlement of share transactions will continue in 1999. The decision to

**Chart 5. Net assets of mutual funds, 1994 – 1998**



**Chart 6. Fund management companies: market shares, 1998**



combine the Helsinki Exchanges and the APK in the same group and the planned centralization of the book-entry system in one single book-entry register is expected to make it easier to implement structural reforms of clearing and settlement operations.

### Supervision of procedures in credit institutions

The supervision of procedures in credit institutions focused on standard terms and conditions applied in contracts used for deposits and lending. Both the imminent euro changeover and the plan to discontinue quoting do-

mestic market rates gave rise to pressures to revise these documents.

In the new contracts the Euribor rates and the banks' own prime rates are the most important reference rates. In the case of current contracts the reference rates were changed by legislation so that Helibor rates were replaced by Euribor rates through a Ministry of Finance decision. As for the reference rate in contracts where the interest rate had previously been tied to the 3 or 5-year market rate, credit institutions and customers may agree mutually on the new rate to be applied. Changes in the terms and condi-

tions of deposit and loan contracts were discussed with the Finnish Bankers' Association.

The terms and conditions to be used in relevant standard agreements were drawn up in cooperation with the Finnish Association of Pawnshops (Suomen Panttilainauslaitosten Yhdistys) and the consumer ombudsman.

The number of requests for investigation continued to decrease and amounted to 217, compared with 287 in 1996. There were 533 telephone enquiries, which only was about half the number in the previous year. Most of the enquiries still concerned issues related to lending, collateral and collection. On the basis of the answers given by the FSA two general statements were prepared, one on collection and good collection practices and the other on bank competition and customers' right to switch banks.

## MONITORING THE FINANCIAL CONDITION OF SUPERVISED ENTITIES

### Investment firms' fee income and operating profits

At the end of 1998 there were 46 authorized investment firms in Finland, with aggregate fee income (incl. intra-group transactions) of about FIM 1,114 million and a combined gross turnover of about FIM 575 million. The corresponding figures for 1997 were about FIM 748 million and FIM 426 million.

Aggregate figures for this sector are not directly comparable with previous years. However, the data suggest that turnover increased compared with

the preceding years. Investment firms' aggregate net income from trading on own account was clearly positive (approximately FIM 100 million). Their own funds have been sufficient as defined by the Investment Firms Act.

### Mutual fund assets

Mutual funds had net assets totalling FIM 29 billion at the end of 1998. The growth from the previous year, about 55%, was achieved despite a temporary reversal of growth as a result of a decline in share prices in August–October and uncertainty in the financial markets (see Chart 5).

During the year authorizations were granted to 48 new mutual funds and six new management companies. The funds set up by management companies focus largely on international investment portfolios. Some of these funds specialize in certain industries such as the pharmaceutical and technology industries. At year-end there were a total of 22 management companies managing 129 mutual funds.

### Banks' profitability

Finnish banks' profitability continued to improve in 1998. Aggregate operating profit amounted to FIM 12.6 billion in 1998. The return on equity was about 23%. Banks' profitability was especially good compared with that of other companies. For example, the average return on equity for the largest companies whose shares are traded on the Helsinki Exchanges was several percentage points below 20%.

Banks' income from financial operations continued to grow, by about 2% in 1998 compared with 1997. The increase was almost entirely due to

**Table 1. Key items in the banks' aggregate profit and loss statement, 1997 and 1998, FIM billion\***

	1998	1997
Interest income	48.1	47.2
Interest expense	29.0	28.5
Net income from financial operations	19.1	18.7
Fee income	7.0	6.5
Other income	7.2	5.7
Operating expenses	17.3	16.5
Loan and guarantee losses	1.4	2.7
Depreciation	2.0	1.7
Operating profit	12.6	9.9

\* The figures cover the MeritaNordbanken Group in its entirety, the Leonia Group, the Amalgamation of cooperative banks, the Mandatum Bank Group (1997: Interbank Group), the Bank of Åland Group, the Aktia Bank Group, the Skopbank Group and the parent companies of the savings and local cooperative banks. The 1997 figures for the Leonia and MeritaNordbanken Groups are based on pro forma annual accounts data.

growth in lending and deposits.

Although tightening competition in lending squeezed banks' interest rate margins on new lending, the interest rate margin on the stock of markka lending vis-à-vis deposits narrowed only slightly towards the end of the year. The aggregate margin, according to the Bank of Finland's financial markets statistics, was about 4 percentage points at year-end.

There are other reasons for the continuous improvement in profitability besides the growth in income from financial operations. Loan and guarantee losses continued to decline, all in all by 47% on 1997. Banks have not experienced such small loan losses since before the banking crisis. Fee income has developed favourably, rising by 7% from 1997. The biggest percentage gains were in fees for asset management and securities broking.

Net income from securities transactions and foreign exchange dealing has generally fluctuated widely. The start of Stage Three of EMU may reduce banks' opportunities for capital gains on securities and currency trades, as well as their interest and exchange

rate risks. Already in 1998 there were signs that both gains and losses on securities and foreign exchange transactions were shrinking. However, for the whole banking sector, net income from securities transactions and foreign exchange dealing rose by 39% from 1997. The banks reduced their share holdings, which was reflected in large aggregate capital gains.

Even though profitability improved, it was impaired by cost developments. For the most part, banks' costs have been falling during the 1990s, but in 1998 administrative and other operating costs began to increase again. The rise in costs may be partly explained by temporary factors such as the widespread need for new IT systems in connection with the changeover to EMU and Year 2000. Banks' staff-related costs were broadly the same as in 1997 (see Table 1).

### Structure of banks' balance sheets and solvency

Markka deposits held in transaction accounts grew by 5% in 1998, according to the Bank of Finland's financial statistics. One likely reason for the growth was a lack of attractive invest-



**Table 2. Solvency of deposit banks, FIM billion\***

	31 Dec 1998	31 Dec 1997
Total own funds	64	66
of weight: Tier 1 capital	47	44
Risk-weighted assets and liabilities	577	559
Solvency ratio	11.1 %	11.9 %
Ratio of Tier 1 capital to risk-weighted assets and liabilities	8.2 %	7.9 %

\* The figures cover the MeritaNordbanken Group, the Leonia Group, the Amalgamation of cooperative banks, the Mandatum Bank Group (1997: the Interbank Group), the Aktia Group, the Bank of Åland Group and the parent companies of the savings and local cooperative banks. The solvency figures do not include the Skopbank Group. The 1997 figures for MeritaNordbanken and Leonia are based on pro forma data.

**Table 3. Nominal value of the underlying assets of derivatives held by banks operating in Finland, 1997 and 1998, FIM million**

	31 Dec 1998	31 Dec 1997	Change	Change, %
Currency-based				
Forward contracts	415 257	618 026	-202 769	-33 %
Interest rate and currency swaps	26 480	33 506	-7 026	-21 %
Currency options	24 182	49 049	-24 867	-51 %
Interest rate-based				
Forward rate agreements and interest rate futures	1 417 980	3 269 224	-1 851 244	-57 %
Interest rate swaps	559 359	643 992	-84 633	-13 %
Interest rate options	28 724	77 487	-48 763	-63 %

ment outlets owing to the low level of interest rates.

Total markka-denominated lending increased by 12%, according to the Bank of Finland's financial statistics. Lending to households also recorded notable growth. This was probably the result of numerous factors such as an improvement in the employment situation, lower interest rates and less uncertainty regarding interest rates.

Banks have reduced their bond holdings. In prior years many banks invested their excess liquidity in bonds, and thus the amount of bond holdings in the balance sheet depended largely on the amount of surplus deposit funding. The shrinking of banks' portfolios of bonds and money market instruments reflects the strengthening in the demand for credit.

The start of Stage Three of EMU is probably having its most profound

impact on the money market. A distinctive feature of the Finnish money market has been the important role played by certificates of deposit. In 1998 the stock of CDs issued by deposit banks remained at a high level. Europe-wide interbank markets for deposits have not, at least yet, displaced the domestic CD market.

Many banks are attempting to reduce their share and real estate holdings. Real estate holdings included on banks' balance sheets in fact declined by about 14% in 1998, largely on account of write-downs. Market conditions are also helping banks to reduce their real estate holdings via sales.

The banks' capital position weakened slightly because of increases in risk-weighted assets, investments and off-balance sheet items. A decrease in Tier 2 capital also had a negative effect on the capital position. However, as

Tier 1 capital grew faster than risk-weighted assets and liabilities, 'Tier 1 solvency' improved. For many banks, profits in 1998 bolstered the capital position despite a decline in capital loans on the banks' balance sheets. The balance sheets of the large banks no longer include any government capital investments dating from the banking crisis (see Table 2).

### Off-balance sheet items

After several years of growth, activity in derivative instruments declined in 1998. The stock of outstanding forward exchange contracts of banks operating in Finland decreased by 33%, to FIM 415 billion. The banks and corporates had less need to protect themselves from exchange rate risk as the launch of the euro approached. The stock of FRAs and interest rate futures fell by 57%, to FIM 1,418 billion, as measured by the nominal value of underlying assets. One factor behind the drop has been the low volatility of short-term interest rates. The decrease in the stock of derivative instruments is also reflected in the decline in the credit-equivalent amount of nonstandardized derivative contracts by FIM 13.8 billion, from FIM 42.1 billion in 1997 to FIM 28.3 billion in 1998 (see Table 3).

Loan guarantees and guarantees commitments amounted to FIM 50 billion in 1998. Guarantees decreased by a few billion FIM from 1997, owing to a decrease in TEL-renting. Increased loan sales boosted the amount of banks' unused loan commitments by FIM 12.1 billion to FIM 48.9 billion. Banks' uncommitted credit limits and overdraft limits on cheque accounts increased by FIM 1.7 billion to FIM 46.8 billion.

## RISK MONITORING

The FSA's activities are aimed at promoting financial stability and confidence in the activities of supervised entities and the markets. To this end, the FSA both encourages the supervised entities to develop their own monitoring and risk management capabilities and monitors their risk taking. If a particular institution appears to be taking on excessive risks, the FSA will take up the matter with the institution.

### Quality of the lending stock improved

The stock of bank lending grew in 1998 and amounted to FIM 367 billion at the end of the year, which was 9.8% higher than one year earlier.<sup>3</sup> The main borrowing sector was the household sector.

While banks' lending stock has been growing, its quality has been improving. One measure of the quality is the ratio of nonperforming assets to lending stock. This ratio was 1.5% at end-1998 as against 2.4% a year earlier. The construction industry can still be regarded as the sector with the lowest quality of lending, since the ratio of nonperforming assets to lending stock is still the highest for that sector.

Nonperforming assets also decreased in absolute terms. At the end of 1998, they amounted to FIM 5.6 billion, which was 33% less than a year earlier.

The banks recorded loan losses of FIM 1.4 billion in 1998, which was FIM 1.3 billion less than in 1997. The decrease was partly due to a fall in the unemployment rate, a rise in market prices of real estate and shares used as

Chart 7. Deposit banks' nonperforming assets and loan assets, 1994 – 1998

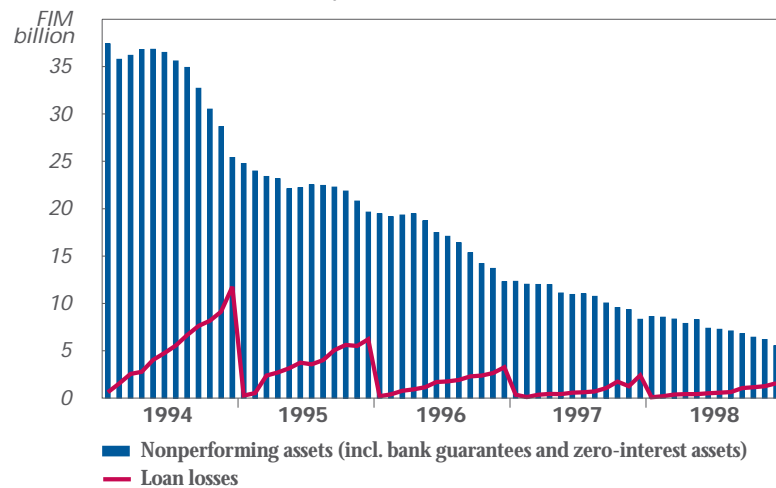
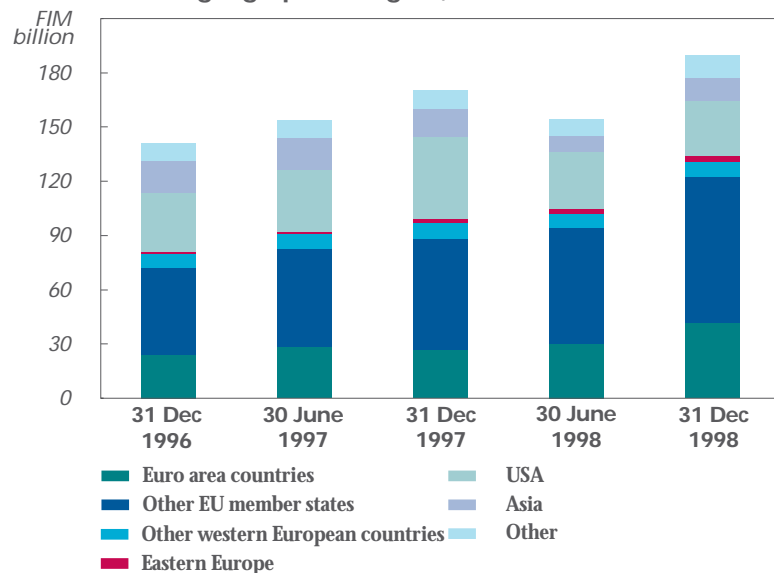


Chart 8. Foreign claims of Finnish banking groups by geographical region, 1996 – 1998



collateral and a decline in bankruptcy filings and payment disturbances.

<sup>3</sup>Stock of lending = balance sheet item 'claims on the public and public sector entities'. It includes both markka- and foreign currency-denominated items of domestic banks incl. those of Leonia pro forma (Postipankki and Finnish Export Credit Ltd) and Finnish branches of foreign deposit banks.

### Finnish banks only moderately exposed to crisis regions

The Asian countries' economic and financial difficulties that began already in 1997 have caused considerable losses to European banks. In particular, German, French, Austrian and British banks have sizable exposures in the Asian markets. The situation has eased



**Table 4. Effect of a one percentage point change in interest rates on the banks' interest rate risk position: income risk and investment risk, FIM million**

	31 Dec 1998 Whole banking sector	31 Dec 1997 Whole banking sector
<b>Net income from financial operations, 31 Dec 1997</b>	<b>12 298</b>	<b>11 468</b>
<b>INCOME RISK</b>		
Markka-denominated items		
a) Assumption: sight deposits < 1 month	1 143	1 082
b) Assumption: sight deposits < 12 months	-619	541
Foreign-currency-denominated items (aggregated, excl. FIM)	59	-12
<b>INVESTMENT RISK</b>		
Balance sheet items	607	513
Derivatives	-235	9
<b>TOTAL INTEREST RATE RISK (INCOME RISK + INVESTMENT RISK)</b>		
a) Assumption: sight deposits < 1 month percentage of net income from financial operations	<b>1 574</b> 12.8 %	<b>1 592</b> 13.9 %
Memorandum item: investment risk of investment portfolio	957	647
<b>MEANING OF SIGNS</b>	+ sign	- sign
1 %-pt rise in interest rates	Loss	Gain
1 %-pt fall in interest rates	Gain	Loss

somewhat since Japan introduced its bank support programme.

Losses incurred in the crisis areas are not expected to cause a direct threat to the European banking system. Nor is the stability of the Finnish banking system at risk, since Finnish banks are not heavily exposed to these countries. It has been the strategy of Finnish banks to gradually shift their business away from the crisis areas. The Asian crises are not expected to cause significant losses in the future, even though Finnish banks' claims on Asia countries at end-1998 amounted to about FIM 12.5 billion. For more than half of these claims the ultimate risk is borne by another party on the basis of guarantees.

The Russian economic crisis, which came to a head in August, has had a negative impact on European banks' financial results. In relative terms, the

German and Austrian banks have had the largest exposures to Russia. At the end of 1998 Finnish commercial banks had claims on Russia amounting to about FIM 400 million after loan losses (see Chart 8, page 17). Compared with other banks in the euro area, Finnish banks have not been especially active in Russia or in the closely-linked Baltic economies. Although loan losses related to the Asian and Russian crises did increase in 1998, overall loan losses were smaller than in 1997. Nor is the deepening of the crisis in Latin America expected to have a significant impact on Finnish banks' financial results.

#### Monetary union reduced exchange rate risks

During the year the banks made preparations for Stage Three of EMU, which was launched at the beginning of 1999. In the euro area, risks involving the

exchange rates of participating currencies have been eliminated whereas risks vis-à-vis other currencies remain.

Banks that believed the change-over to the euro would go ahead as planned made larger profits on foreign exchange dealing in 1998 than in 1997, but income from this business is expected to decline in the future. As the year drew to a close, trading volumes declined. Net income from foreign exchange dealing, which already now accounts for a only small part of banks' total income, will be based on a smaller set of currency pairs in the monetary union environment.

Exchange rate risk – a component of market risk – continues to be relatively insignificant as compared with interest rate risk and, above all, credit risk. Finnish banks have for years had relatively small overnight open positions. Limits on exchange rate risk positions set out in FSA guidelines apply only to overnight positions and do not constrain banks in their intraday dealing or positions in respect of foreign exchange. The main constraints on banks' position taking in foreign exchange are their internal risk-weighted limits.

Part of the FSA's monitoring of exchange rate risks comprises evaluation of banks' internal limits and risk management procedures, and in this connection the control of intraday positions can be scrutinized.

#### Slight decrease in interest rate risk

Banks' interest rate risk remained at the same level as in December 1997. The total interest rate risk amounted to just over FIM 1.57 billion at end-

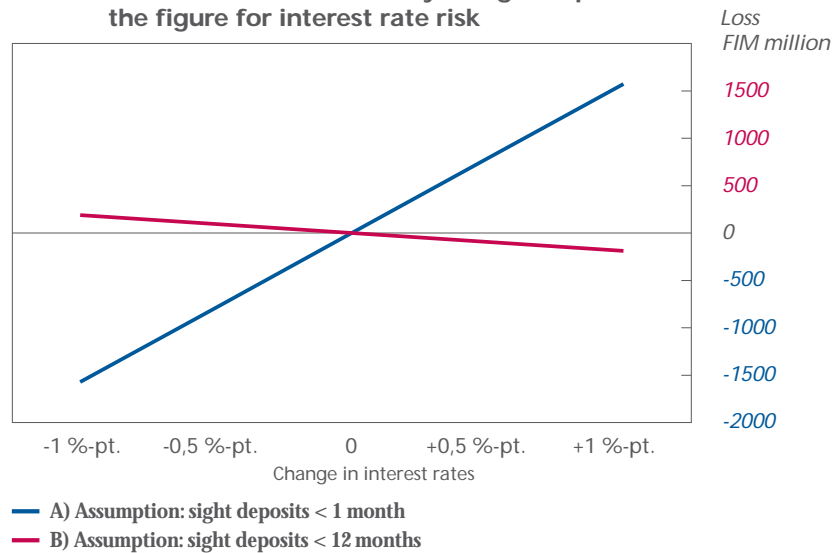
December 1998 compared with FIM 1.59 billion at end-December 1997. These figures indicate the aggregate loss to banks as a result of a 1 percentage point rise in the level of interest rates (see Appendix page 38). Banks' net income from financial operations developed favourably and the relative interest rate risk, ie the ratio of the markka value of interest rate risk to net income from financial operations, fell from 13.9% to 12.8% (see Table 4).

The assumptions used have a significant effect on the final result of this type of calculation: the above figures are based on the assumption that a change in the level of interest rates is immediately reflected in the interest rates that must be paid on deposits. If, instead, it is assumed that such a change has no effect on rates paid on sight deposits during the period studied, the banks' total interest rate risk is - FIM 1.9 million and the relative risk -1.5 %; in other words the banks benefit from a rise in the level of interest rates. Chart 9 shows the effect of the assumptions on the final outcome of the analysis.

### Equity risks of banking groups and their pension funds

Equity risk refers to the effect of changes in prices of shares on the value of equities held by a particular entity. This risk is also affected by holdings of equity-based derivative instruments. There is a direct connection between changes in the market value of shares and the market value of a company that owns such shares. For example, a 20% fall in share prices during the year would mean a FIM 1.5 billion fall in the market value of Finnish banks. The effect on a credit

**Chart 9. Effect of different assumptions concerning the interest rate sensitivity of sight deposits on the figure for interest rate risk**



institution's financial results would depend on how the shares in question are valued on its books.

The market value of shares held by banking groups and their pension funds<sup>4</sup> was about FIM 7.5 billion at the end of 1998. This figure includes all quoted shares and units of equity mutual funds, regardless of the balance sheet items in which they are included. These shares are for the most part traded on the Helsinki Exchanges. The proportion of foreign shares included is small. Life insurance companies and pension funds and foundations accounted for FIM 3.5 billion of the market value of these holdings. The MeritaNordbanken Group, in particular, reduced its shareholdings during 1998.

<sup>4</sup> These include Finnish deposit banks and life insurance companies, pension funds and pension foundations that they own, as well as subsidiaries and holding companies in Finnish groups.

### Banks' liquidity surplus declined

The banks' surplus liquidity is decreasing as lending increases. The banks

have funded the growth in lending, inter alia, by reducing their holdings of debt securities. These holdings decreased by FIM 16 billion to about FIM 96 billion in 1998. But the most liquid component of these holdings, ie debt instruments entitling banks to central bank financing<sup>5</sup>, remained virtually unchanged at about FIM 46 billion, or about 47% of holdings of all debt securities. The average maturity of deposits held by the public has declined as debts payable on demand have increased and other debts have decreased.

<sup>5</sup> These are assets such as Treasury bills and other debt securities approved as collateral by the Bank of Finland.

### Funding deficits

In 1998 the banks' cumulative funding deficits decreased on average. Funding deficits increased in the second quarter but decreased in most banks in the second half of the year. The ratio of the one-month funding deficit to banks' aggregate liabilities fluctuated

between 3% and 14% compared with a range of 5–15% in 1997. One of the key figures used to depict funding deficits is the ratio of the one-month cumulative deficit to banks' aggregate liabilities. The figure is based on the assumption that 30% of deposits payable on demand mature in one month's time and the rest are held permanently. Debt instruments are valued according to actual maturities.

#### Maturity structure of liabilities

The maturity structure of liabilities decreased in the second quarter of the year and increased again during the remaining part of the year. In 1998 liabilities maturing in a month accounted for 44% of the balance sheet total on average and liabilities maturing in six months for 60% of the balance sheet total. The corresponding figures for 1997 were 41% and 59%. These calculations are based on the assumption that 30% of deposits payable on demand mature in one month's time and the rest are held permanently.

## INSPECTIONS

### Observations concerning inspections of firms operating in the capital markets

The focus of the FSA's supervisory measures and inspections was on the supervised entities' regular reporting to the FSA, trading carried out by personnel, risk management systems, efficiency of the clearing and settlement of share transactions, asset management and provision of investment services via the Internet. In the inspections particular

attention was paid to internal control.

The accuracy of the regular reports to the FSA was inspected in all investment firms. On the basis of these inspections, the regulations and guidelines for investment firms were amended.

Inspections of investment services provided via the Internet were performed with the aim of examining how securities intermediaries and parties handling subscriptions carried out their tasks. Efforts focused particularly on finding out if the procedures applied in trading on the Internet differed from those applied in traditional media (telephone or fax). The survey showed that subscription via the Internet does not differ essentially from subscription carried out in other ways. As yet only a few investment firms afford their customers the possibility of placing orders via the Internet. As this area of business is expected to expand, the FSA will take a stand on investment firms' Internet business in 1999.

Custodians for mutual funds were inspected in spring 1998. Though no shortcomings in custody operations were discovered by the FSA, the inspections nevertheless revealed the need to clarify the contents of the supervisory responsibilities of custodians. This was done in connection with the revision of the Mutual Funds Act, when the relevant sections of the law were amended. In the autumn the unit-holder registers of mutual funds were inspected. The inspections showed that operations in this area had been organized appropriately and thus the FSA had no special comments to make on this subject.

In the case of the Helsinki Exchanges and the the Finnish Central

Depository (APK), supervision by the FSA focused mainly on the effects of their extensive system projects on market operations. The Helsinki Exchanges' major system projects comprised the new trading system, which was introduced in September, the euro changeover and the start of the year 2000 preparations. When combined in the same group, the Helsinki Exchanges and the APK will be responsible for maintaining and developing the most important IT systems for the Finnish securities markets. The FSA will continue to monitor the prioritization, resource allocation and progress of the system projects.

### Observations concerning bank inspections

Unprofitable items in the loan portfolios of the largest banks and an extensive survey of the banks' real estate risks were central issues in the inspections of credit institutions. Through surveys and supervisory visits, the FSA examined the readiness of supervised entities for the system changes required by the euro changeover and the millennium change. In addition, monitoring inspections were carried out in nearly all foreign branches of Finnish credit institutions. The inspections of and supervisory visits to local savings and cooperative banks were continued.

The purpose of the inspections of the unprofitable items in the loan portfolios was to assess the credit risks inherent in these items. The largest shares of below-market-rate and unprofitable loans were found in real estate services, the construction sector, retail trade and hotel and restaurant

services. The inspections showed that the potential credit risks associated with unprofitable loans did not give cause for concern, although there were differences between different sectors and banks. Banks have already booked loan losses attributable to their unprofitable loans. Moreover, the outstanding amount of unprofitable loans has decreased.

The survey of the banks' real estate risks showed that their real estate holdings are still unprofitable. At the end of 1997 the banks' total real estate holdings amounted to about FIM 40 million or nearly 7% of the banks' combined balance sheet total. About a quarter of real estate was in own use. According to the survey, the average return on real estate not in own use amounted to about 4.5%. This return can be regarded as no more than adequate. In addition, about one-third of the banks' real estate not in own use generated a return on capital of no more than 3%.

The FSA has called on the banks to continue their efforts to run down their real estate holdings and increase the return on such holdings. According to the FSA, the banks should reduce their real estate risks by either selling off real estate or lowering their book value to a realistic level. The FSA further called on the large banks to provide information on real estate holdings and a breakdown of their returns on these holdings in a more detailed form than in their 1997 annual reports. The FSA regulation on the annual accounts of credit institutions that came into force in June requires banks to disclose their real estate holdings in the notes to their accounts, broken

down according to rate of return and type of real estate holding.

In connection with comprehensive inspections of smaller banks, the FSA found it necessary to draw the banks' attention to the general quality of management and point out shortcomings in internal control. In some cases the bank's management had consistently failed to observe their own guidelines and internal rules. On the other hand, the administrative bodies that had confirmed these rules had not always monitored compliance with the rules.

## COOPERATION WITH OTHER AUTHORITIES

### Supervision of payment and settlement systems

The FSA continued to cooperate with the Bank of Finland in the supervision of payment and settlement systems. The FSA and the Bank of Finland clarified the principles underlying supervision in this area, the objects of supervision and the related division of responsibilities. One purpose of this exercise was to define the tasks of the central bank in the supervision of payment and settlement systems. Another purpose was to determine to what extent the central bank could rely on support from the supervisory authority in pursuing its objectives with regard to the stability and efficiency of payment and settlement systems and the transmission mechanisms of monetary policy.

### Joint production of statistics with other authorities

The FSA, the Bank of Finland and

Statistics Finland continued their joint project for the production of statistics. The purpose of this project is to harmonize the contents and format of the reports submitted by credit institutions to the authorities concerned. Some changes were made in data collection procedures to take account of the introduction of the euro.

In the course of 1998 the electronic format used for collection of data on capital adequacy was changed to bring it in line with the format used in other electronic data collection. The collection of country risk data will be changed correspondingly at a later date.

As from the beginning of 1999 financial statements data for investment firms were included in the joint production of statistics by the three authorities.

### Reform of insurance supervision and financial supervision

The FSA participated in the working group on development of insurance and financial supervision as well as in the task forces set up by the working group.

The task of the working group was to take a stand on the reorganization of insurance supervision, in addition to developing cooperation between the supervisory authorities. The task forces, in turn, examined questions related to supervision of financial conglomerates and marketing of investment products.

The relevant acts on the establishment of an insurance supervision authority were passed by Parliament in December 1998. The new Insurance Supervision Authority will start functioning on 1 April 1999 as an independent authority, administratively subor-

dinate to the Ministry of Social Affairs and Health. The aim is to ensure that, as from 1 April 1999, the compositions of the Boards of the FSA and the new Insurance Supervision Authority are as similar as possible so as to enable closer cooperation between the two supervisory authorities.

The task force on supervision of financial and insurance conglomerates and cooperation between the competent authorities drew up a memorandum containing a proposal for an act on supervision of financial and insurance conglomerates.

The task force on marketing of investment products drew up a memorandum in which it identified areas in the present legislation that needed to be made more precise. It also proposed that cooperation in the supervision of marketing be intensified.

### Advisory Office for Bank Customers

The Advisory Office for Bank Customers, established jointly by the National Consumer Administration, the Finnish Bankers' Association and the FSA, started functioning on 7 September 1998. In September–December the office received about 750 enquiries, mainly concerning lending and collateral.

The task of the Advisory Office for Bank Customers is to promote mutual trust between banks and their customers and to develop day-to-day banking practices. The office advises customers on questions related to banking business, eg in solving problems connected with interpretation of agreements between banks and their customers, and on procedures for resolving disagreements with banks and giving feedback to banks.

The FSA is represented on the Board and the Commission of the Advisory Office for Bank Customers.

### Cooperation in the supervision of MeritaNordbanken

In the autumn the FSA and the Swedish supervisory authority, Finansinspektionen, agreed on common procedures to be applied in the supervision of the MeritaNordbanken Group. Agreement was also reached on the exchange of information and the holding of regular meetings between officials of the two authorities.

In the course of the year the FSA and Finansinspektionen carried out several joint inspections in the MeritaNordbanken Group. In addition, information related to supervision was exchanged on a regular basis.

The FSA is responsible for supervision of the MeritaNordbanken Group while Finansinspektionen is responsible for the supervision of the Nordbanken Group.

### International cooperation

As in previous years the FSA participated in the work of the European Commission's Banking Advisory Committee and the High Level Securities Supervisors Committee. FSA experts also participated in EU legislative work in the context of various working groups of the European Commission and the Council of the European Union.

The European Monetary Institute ceased to function when the European Central Bank (ECB) commenced operations on 1 June 1998. The FSA continued to participate in the work of the

Banking Supervision Committee under the ECB and the Committee's various working groups.

The Groupe de Contact is an unofficial body for cooperation between the banking supervisory authorities of the EEA countries. Among the issues addressed by the Groupe de Contact in 1998 were measures undertaken by the supervisory authorities in preparation for the euro and the year 2000, cross-border supervision of credit institutions, supervision of financial conglomerates and supervision of owners. The Groupe de Contact also drew up a memorandum on principles governing outsourcing of credit institutions' functions. The Groupe de Contact assists the Banking Advisory Committee and the ECB's Banking Supervision Committee by producing reports and surveys. The FSA has been a member of the Groupe de Contact since 1994.

The FSA's participation in FESCO (Forum of European Securities Commissions), the body for cooperation between securities markets supervisors in the EEA, centred mainly on the activities of the working groups. A proposal for the drawing up of common fit and proper standards was completed. In addition, a cooperation agreement covering all members was adopted. At the beginning of February 1999 a coordination group called FESCOPOL, consisting of senior market supervisors from member countries, was established under the auspices of FESCO with the aim of intensifying cooperation in practical areas of supervision and the exchange of information. FESCO is continuing its work on establishing common standards for

regulated markets in member countries and harmonizing conduct of business rules for market participants.

The FSA also took part in the preparation of EU-related matters in Finland by participating in the section on financial services and capital flows operating under the Committee for EU Affairs. The section cooperated closely with Finland's EU representation in Brussels.

The FSA intensified its cooperation with the authorities of the Baltic States and cooperation is being developed further in various forms.

## THE FSA'S REGULATORY ACTIVITIES

The FSA's regulatory activities are aimed at promoting the stability of the financial markets and confidence in the operations of supervised entities and markets. Through its initiatives and measures the FSA seeks to improve the efficiency and reliable functioning of the markets. The FSA's regulatory activities take the form of both active involvement in the drafting of financial market legislation and the setting of its own regulations and guidelines.

In its capacity as the supervisor of the financial markets, the FSA participates as an expert in the drafting of legislation at both national and EU level. Its general objective is to ensure that regulation focuses on the essentials and meets the criterion of cost effectiveness. It also seeks to ensure that the regulatory framework in Finland is no stricter than that in other EU member states.

The FSA aims at making financial market legislation more market-orient-

ed. Among important development projects planned for the near future are promotion of investor protection and more precise rules on insiders. Working together with other authorities and the supervised entities, the FSA also seeks to improve the quality and coverage of financial and other relevant information published by supervised entities. The aim is to ensure that market participants have better and broader access to key information and that the information is in a form that is readily understandable.

### Guidelines and regulations on internal control

Regulations on internal control of credit institutions and investment firms and guidelines on internal control principles and the internal audit function of credit institutions and investment firms came into effect on 1 April 1998.

### Conduct of business guideline

The so-called conduct of business guideline concerning securities intermediaries (Guideline on practices to be applied in the provision of investment services) was revised and the new version took effect on 1 January 1999. The scope of the guideline has been extended to include issues not dealt with before, such as the 'know your customer' principle and questions related to investment analyses. The regulation applies to all investment services.

### Guideline on segregation of securities business functions

The guideline on segregation of securities business functions (the so-called Chinese walls guideline) took effect on 1 September 1998 (see page 10).

### Regulation on segregation of customer funds

The new regulation on segregation of customer funds came into effect on 1 October 1998. It concerns the segregation, custody, processing and clearing and settlement of customers' cash funds and other assets, pledging of customers' securities and safeguarding the position of customers in clearing and settlement. The regulation is intended to safeguard customers' right of separation in all situations. It applies to all securities intermediaries, including credit institutions.

### Guidelines and regulations on annual accounts, the solvency ratio and large exposures

In summer 1998 the FSA issued updated regulations on annual accounts, the solvency ratio and large exposures of credit institutions and investment firms. In addition, the general guideline on consolidated supervision was revised. A new regulation was issued on interim reports of deposit banks, which improves depositors' access to information on the financial position of banks.

The changes in the updated regulations were designed to promote market orientation and included the requirement that credit institutions and investment firms submit a report on their risk taking and the principles and procedures that they apply in the management of their credit and market risks. Other significant changes were a provision allowing securities held for trading purposes to be valued at market value and the recasting of the notes to the annual accounts so as to comply better with international



guidelines. The new regulation on annual accounts requires banks to publish information on their real estate holdings in the notes, indicating both the types of real estate held and the rates of return on them.

### Euro-related amendments to regulations and guidelines

In the course of 1998 the FSA prepared amendments to the regulations and guidelines necessitated by the introduction of the euro. The amendments took effect at the beginning of 1999.

## DEVELOPMENT OF THE FSA'S OWN ACTIVITIES

### Principles of internal control

In autumn 1998 the FSA's Board adopted the principles that were to serve as the basis for the organization of internal control within the FSA. The key areas of internal control were defined as the internal division of responsibilities, the planning and steering of activities, the management of operating risks, information systems (supervision and financial administration) and the supervisory culture (the FSA's values and ethical codes). The FSA's operating risks are factors that could have an adverse effect on the attainment of the FSA's objectives (stability and confidence).

Internal control is part of the management system by which the FSA's management steers the activities of the organization and which provides management with information necessary for decisionmaking and evaluation of activities. In developing its internal control, the FSA also evaluated the means available for managing its oper-

ating risks, their practicality and the areas where they needed to be improved.

### Definition of minimum and normal levels of supervision

With a view to making its inspections more efficient, the FSA defined minimum and normal levels of supervision for its internal use.

On the basis of these definitions, the FSA devised a classification framework for determining the appropriate supervisory measures according to the risk attached to a supervised entity and the business it pursues. When determining the content of supervisory measures, the FSA takes account of the frequency with which it is necessary to inspect a supervised entity and the form the inspections takes. If the business carried on by a given entity does not involve any significant risks to market stability, the FSA may restrict supervision to regular reporting by the entity.

The FSA intends to start using this new model from the beginning of the year 2000. The aim is to revise the classification of supervised entities at regular intervals. Supervision in accordance with the minimum and normal levels will influence the allocation of the FSA's resources, since the content of supervision will in the future be determined by this classification.

### Development of information systems

The FSA's monitoring of the financial position and risks of supervised entities is based on the so-called Riski data system, which has functions for verification, storage, monitoring and analysis of data reported by the supervised

entities. During the year under review a number of changes were made to the Riski system to enable a change-over to electronic reporting of solvency data (so-called Vaka data collection) as from 31 December 1998.

Some changes had to be made to the data systems for collection, storage and monitoring of reports because of the introduction of the euro. During the transitional period the supervised entities have the choice of reporting their monetary information in either euro or markkaa.

The first stage in the construction of the Early Warning system for the supervision of local banks was completed. It is intended to use the system to identify the banks to be inspected in accordance with the minimum and normal levels of supervision.

With the increasing popularity of investment in funds, the growing number of mutual funds and the vigorous growth of their net assets, there is a need to ensure that supervision of the investment limits laid down in the Mutual Funds Act keeps pace with market developments. In 1998 the FSA constructed a system for the collection, storage and monitoring of mutual funds' monthly reports. The storage and monitoring functions were integrated into the existing Riski storage and monitoring programmes. The first data to be collected using the new system will concern the situation as at 31 January 1999.

### Means of assessing the strategic readiness of supervised entities for EMU

The FSA arranged an in-house seminar for its experts dealing with the forces

for change associated with the transition to the Third Stage of EMU and their impact on the activities of the supervised entities. In connection with this seminar the FSA constructed a framework for assessing the supervised entities' strategic readiness for EMU and other forces for change in their operating environment. The most significant forces are the globalization of financial markets, the strengthening of competition, technological progress and the growing risks that these forces entail. In the course of 1999 the FSA will elaborate this analytic framework with a view to using it in inspections.

### Training of staff

During the year under review the skills of FSA staff were maintained and developed in many ways. In accordance with the FSA's key areas of activity, training focused on internal control systems, data and payment systems and important amendments to legisla-

tion. Three experts spent a total of five months abroad with foreign supervisory authorities (in Sweden and Germany) studying local supervisory practices and working methods. FSA staff were also encouraged to pursue private studies leading to degrees (CIA, CISA).<sup>6</sup> Together with the Swedish School of Economics and Business Administration, the FSA organized a tailor-made training programme for its experts on the subject of financial instruments.

Integrated training of supervisory assistants and secretaries started in spring 1998. Language courses were designed to equip staff with the skills needed to meet the challenges of supervision in an increasingly international context. The staff's communication skills were also developed.

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<sup>6</sup> CIA = Certified Internal Auditor; CISA = Certified Information Systems Auditor.

### Increased transparency in communications

To provide the markets with better access to information, all the notifications, requests for comment, discussion papers and statements sent by the FSA to the supervised entities were posted on the FSA's website. The FSA also upgraded its provision of information service at international level by publishing key guidelines and regulations in English on the Internet.

The FSA began publishing a bulletin targeted at the mass media. This bulletin, called 'Rahoitustarkastus tiedottaa', appears four times a year and provides up-to-date background information on the FSA's activities, its statements and other matters concerning financial markets.



# Legislation

## DEVELOPMENTS IN EU LEGISLATION ON FINANCIAL MARKETS

The regulation on the introduction of the euro entered into force at the beginning of 1999. The regulation lays down, inter alia, transitional provisions to be applied during the transitional period. The regulation is directly binding on the member states and does not require national implementing legislation.

The directive on settlement finality in payment and securities settlement systems (98/26/EC) was adopted in May 1998. The directive aims at reducing systemic risk in payment and securities settlement systems. The directive must be implemented in national legislation by 11 December 1999.

In June 1998 the Council of the European Union and the European Parliament adopted three directives (98/31/EC, 98/32/EC and 98/33/EC) amending, inter alia, the previous directives on capital adequacy and the solvency ratio. The new directives contain provisions on the treatment as regards capital adequacy of claims secured by mortgages on commercial premises and of equity and commodity derivatives and on the use by institutions of their own models for calculating market risks. As for claims secured by mortgages on commercial premises, the amendment means that EU member states may, on certain conditions, allow inclusion of such credit in the same risk category as credit secured by mortgages on residential property. The amendments in national legislation called for by the directives must be implemented by 21 July 2000 at the latest.

In July 1998 the European Commission submitted two proposals for directives that were intended to revise the existing directive on mutual funds (85/611/EEC) to bring it in line with market developments and to eliminate some major uncertainties concerning interpretation that prevented the directive from being applied in a uniform manner. One of the proposals aims mainly at widening the range of permissible investment activities for mutual funds, whereas the other proposal is intended to update the regulation of management companies and bring it in line with the regulation of suppliers of competing financial services.

In September 1998 the Commission put forward a proposal for a directive on the taking up, pursuit and prudential supervision of the business of issuers of electronic money, together with a related proposal for amending the first banking coordination directive (77/780/EEC).

In November 1998 the Commission submitted a proposal for a directive on the remote selling of financial services. The proposal concerns the provision and selling of financial services to consumers through remote media.

## LEGISLATIVE CHANGES

### New deposit guarantee scheme

The Finnish deposit guarantee scheme and its coverage were revised as from the beginning of 1998. Under the new scheme, bank deposits are guaranteed up to a maximum of FIM 150,000 per depositor per bank. Previously the deposit guarantee covered bank deposits in full.

The new deposit guarantee scheme is applied to deposits held in accounts that fulfil the general terms and conditions for deposit accounts approved by the FSA. The scheme also provides protection for claims that are in the process of payment transmission but have not yet been entered into accounts. The guarantee also covers foreign currency deposits.

Depositors' claims are guaranteed by a single deposit guarantee fund to which all deposit banks belong. Membership of this fund is mandatory. The fund is supervised by the FSA.

At the end of June 1998 the deposit guarantee fund collected FIM 291.7 million from its member banks as contributions for that year. As at the end of 1998 the assets of the fund were invested in short-term Treasury bills with an annual yield of some 3.4 – 3.7%. In the calculation of the first contributions it transpired that the guaranteed deposits amounted to just over FIM 210 billion, which is about two-thirds of the total funds on deposit.

### Amendment of the Act on Restrictions on Competition

The Act on the Amendment of the Act on Restrictions on Competition entered into force in October 1998. Provisions on supervision of business acquisitions were added to the act. By removing the FSA's subsidiary right of proposal and revoking the provisions on supervision of competition in the Credit Institutions Act, the supervision of credit institutions' competition was brought completely within the scope of the general provisions on supervision of competition. In future the FSA's special expertise in this area will be

utilized through cooperation between the competent authorities.

### Act on the Insurance Supervision Authority

The Act on the Insurance Supervision Authority was passed in December 1998 and enters into force on 1 April 1999 (see page 21).

### Real Estate Funds Act

The Real Estate Funds Act took effect on 1 March 1998. The Act applies to participation by the public in pooled investment in real estate through the subscription, purchase or acquisition by other means of shares of public limited companies. No real estate funds have been established in Finland so far.

### Amendment of the Act on Asset-transfer Tax

Under an amendment to the Act on Asset-transfer Tax that became effective on 1 June 1998, it is no longer necessary to pay asset-transfer tax on transfers of securities in connection with implementation of lending contracts involving securities to be settled by the Finnish Central Securities Depository Ltd (APK), provided the securities are returned to their original owner within 10 days on which the APK is open for clearing and settlement business. Market participants have proposed to the Ministry of Finance that the lending period should be extended to one year, which they claim is a prerequisite for well-functioning securities markets.

### Investor compensation fund

In keeping with a directive of the Council of the European Union and the

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

Credit Institutions Act (30.12.1993/1607, Ra 107)
Commercial Bank Act (28.12.1990/1269, Ra 108)
Savings Bank Act (28.12.1990/1270, Ra 109)
Cooperative Bank Act (28.12.1990/1271, Ra 110)
Postipankki Ltd Act (11.12.1987/972, Ra 111)
Act on Foreign Credit and Financial Institutions in Finland (30.12.1993/1608, Ra 112)
Act on Mortgage Societies (8.12.1978/936, Ra 113)
Act on the Conversion of Savings Banks into Limited Banks (6.11.1992/972)
Act on the Government Guarantee Fund (30.4.1992/379, Ra 115)
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)
Act on the Book Entry System (17.5.1991/826, Ra 120)
Act on the Book Entry Accounts (17.5.1991/827, Ra 122)
Investment Firms Act (26.7.1996/579, Ra 119)
Act on Foreign Investment Firms' Right to Provide Investment Services in Finland (26.7.1996/580, Ra 119 a)

European Parliament, an investor compensation fund was established in Finland in autumn 1998. The task of the compensation fund is to protect non-professional investors in the event of the insolvency of an investment firm or credit institution. If the investment firm or credit institution cannot fulfil its obligations, eg transfer to an investor money or securities that belong to the investor in connection with a brokerage order, the fund can pay the investor compensation up to EUR 20,000. The fund does not compensate investors for losses incurred in investment activities.

Membership of the compensation fund is mandatory for all investment firms and credit institutions providing investment services. The fund is financed by contributions collected from its members. It has a minimum capital of FIM 50 million.

The FSA supervises the investor compensation fund.

### New Mutual Funds Act

The new Mutual Funds Act took effect 1 February 1999. The new act clarifies

the scope of application and structure of the previous act and the division of competence between the authorities. The criteria for granting an authorization to a management company are now formulated more precisely as regards the trustworthiness of the administration of a company. All changes of a specified magnitude in the voting rights and controlling power in the management company must be reported to the FSA. Regulation of the solvency of management companies has been harmonized with international practice.

The act defines more precisely than before the tasks of a mutual fund's depository, especially the measures the depository is required to take to fulfil its supervisory obligations. Special funds have greater freedom of choice than before as regards the investment policies they can pursue, thus providing scope for product development in mutual funds' business. One example of the new types of fund that may be established are funds investing in other funds. At the same time the disclosure requirements applicable to

special funds have been widened. They are now required to publish a simplified fund prospectus and a quarterly interim report. The obligation regarding customer identification has been extended to management companies and depositories.

### Other legislative changes

The Act on Amendment of the Act on Certain Terms and Conditions of Trading in Securities and Currencies entered into force at the beginning of 1999. The amendment widens the scope of the original act to include transactions effected via the payment system of the central bank or any other clearing house.

The Act on the Amendment of the Act on the Book-Entry System was ratified on 18 December 1998 and took effect at the beginning of 1999. The act takes into account the establishment of international connections between central securities depositories and the management in Finland of securities that are entered into the book-entry system via these connections. The act also lays down more precise rules governing the inclusion of foreign securities in the book-entry system.

## LEGISLATION UNDER PREPARATION

An amendment to the Securities Markets Act takes effect at the beginning of April 1999. The amendment tightens the requirement concerning regular reporting by issuers of securities subject to public trading and the provisions on shareholders' obligation

to disclose large holdings. The issuer of a share or a security entitling to a share is now required to publish three interim reports during its financial year. Less stringent requirements may, however, be applied in the case of companies that are not on the official stock exchange list. This is possible if it is provided for in the rules of the organizer of public trading in the shares of such companies. Issuers of bonds subject to public trading are required to publish one interim report during their financial year.

The duty of shareholders to disclose large holdings is to be tightened by setting additional limits for disclosure, and the lowest limit is now 5% instead of the previous 10%. From the beginning of April 1999 the disclosure limits are 5, 10, 15, 20, 25, 33 <sup>14</sup>, 50 and 66 <sup>14</sup>%. The new limits are 5, 15 and 25%. The FSA may grant a professional investor exemption from the duty of disclosure, provided that the investor does not seek to influence the management of the company in question.

The penal provisions concerning securities market offences are being revised. The provisions on the most reprehensible offences are to be transferred from the Securities Markets Act and the Act on Trading in Standardized Options and Futures to the Penal Code. At the same time more severe penalties than before are to be prescribed for the most serious offences. For instance, the maximum penalty for aggravated abuse of insider information and aggravated distortion of a share price is four years' imprisonment. The amendments will take effect in summer 1999.

## LEGISLATIVE PROJECTS

### Supervision of financial and insurance conglomerates

In January 1999 the task force on supervision of financial and insurance conglomerates and cooperation between the competent authorities submitted a memorandum to the working group on development of insurance and financial supervision. The memorandum contained a proposal, in the form of a Government bill, for an act on supervision of financial and insurance conglomerates.

The task force on marketing of investment products submitted its memorandum to the working group on development of insurance and financial supervision in October 1998. In the memorandum the task force identified those areas in current legislation that needed to be made more precise. It also proposed that cooperation in the supervision of marketing should be intensified.

The memorandums of both task forces have been circulated for comment.

### Reorganization and winding up of credit institutions

In March 1999 the working group for the development of legislation on credit institutions, set up by the Ministry of Finance on 30 September 1997, is due to submit a memorandum containing a proposal, in the form of a Government bill, for a law on the reorganization and winding up of credit institutions.

The working group proposes that legislation on credit institutions should be supplemented and clarified so as to regulate, on as uniform a basis as pos-

sible for all types of credit institutions, mergers, demergers, transfer of business, voluntary renunciation of authorization, reduction of restricted equity capital, suspension of business, liquidation and bankruptcy.

The proposals of the working group aim at promoting voluntary restructuring by credit institutions in situations where this is necessary for ensuring continuity of an individual credit institution's business, efficient functioning of markets or stability of the financial system. The proposals also aim at clarifying and supplementing the provisions on the winding up of a credit institution in cases where reorganization is not possible or appropriate.

### Government proposal for an act on credit transfers

A working group on credit transfers, set up by the Ministry of Justice, submitted its report on 22 April 1998. In accordance with its remit the working group drafted a Government proposal for implementation of the directive (97/5/EC) on credit transfers in Finland. The proposed act would also apply to domestic credit transfers.

The working group also proposes that the Act on Credit Transfers contain provisions on certain legal effects of credit transfers. The working group considers that the supervision of banks and similar institutions executing credit transfers is already sufficiently regu-

lated, and therefore the proposal does not contain any provisions on supervision. The act would apply to all credit transfers executed in Finland and to credit transfers between Finland and a member state of the European Economic Area which do not exceed EUR 50,000 and which are executed in the currency of an EEA member state or in euro. Most of the proposed provisions would regulate the legal relationship between the originator of the payment order and the originator's institution.

# The FSA in brief

Through its actions, the Financial Supervision Authority (FSA) seeks to promote stable conditions in the financial markets and enhance public confidence in market behavior. The FSA considers it important that the supervised entities develop their own risk management systems and that market participants improve their self-regulation. The FSA is part of the supervisory network within the EU single market.

The FSA was established in October 1993, when the former Banking Supervision Office was abolished and its activities were linked with the Bank of Finland. The FSA is connected administratively with the Bank of Finland.

## Decisionmaking in the FSA

The FSA is independent in its decision-making. Its is headed by the Director General, who is vested with the FSA's decisionmaking authority. The Director General is assisted by an advisory Management Group, consisting of the Deputy Directors, the Deputy Department Head and the Chief Legal Counsel.

The Board of the FSA comprises, in addition to the Director General of the FSA, representatives from the Bank of Finland, the Ministry of Finance and the Ministry of Social Affairs and Health. In April 1999 the Director-General of the newly established Insurance Supervision Authority will become a member of the Board (see page 21). The Board's responsibilities include confirming regulations that are significant or important in principle and far-reaching from the viewpoint of supervision. The Board also decides

upon supervision fees and far-reaching, important matters of principle that have been submitted by the Director General. The Board's duties further involve consideration of the FSA's annual budget, which is approved by the Board of the Bank of Finland.

## Staff

At the end of 1998 the FSA employed 123 persons (1997: 122), of whom 65 (68) worked in the Credit Institutions Department, 30 (27) in the Capital Markets Department, 24 (23) in the Support Services Department and 4 (4) in the Director General's staff. A total of 105 employees had permanent positions and 18 were on fixed-term contracts.

## Operating expenses

The operating expenses of the FSA are covered out of supervision fees and processing fees paid by the supervised entities. In 1998 the operating expenses amounted to some FIM 59.5 million. Income in the form of processing fees collected covered 4.5% of total expenses, ie FIM 3.2 million.

## Supervised entities

At the end of the year the number of supervised entities totalled 496.

## Core operations

The FSA's core operations are supervision and regulation. Supervision is concerned, in particular, with the risk management and internal control systems applied by the supervised entities. The supervisory work also emphasizes the accountability of the manage-

ment of supervised entities and the effective functioning of the internal control and risk management systems of the supervised entities. Inspections of supervised entities constitute an essential element of the FSA's supervisory work. Moreover, the FSA monitors the supervised entities' financial condition and risk-taking on the basis of reports that they submit to the FSA.

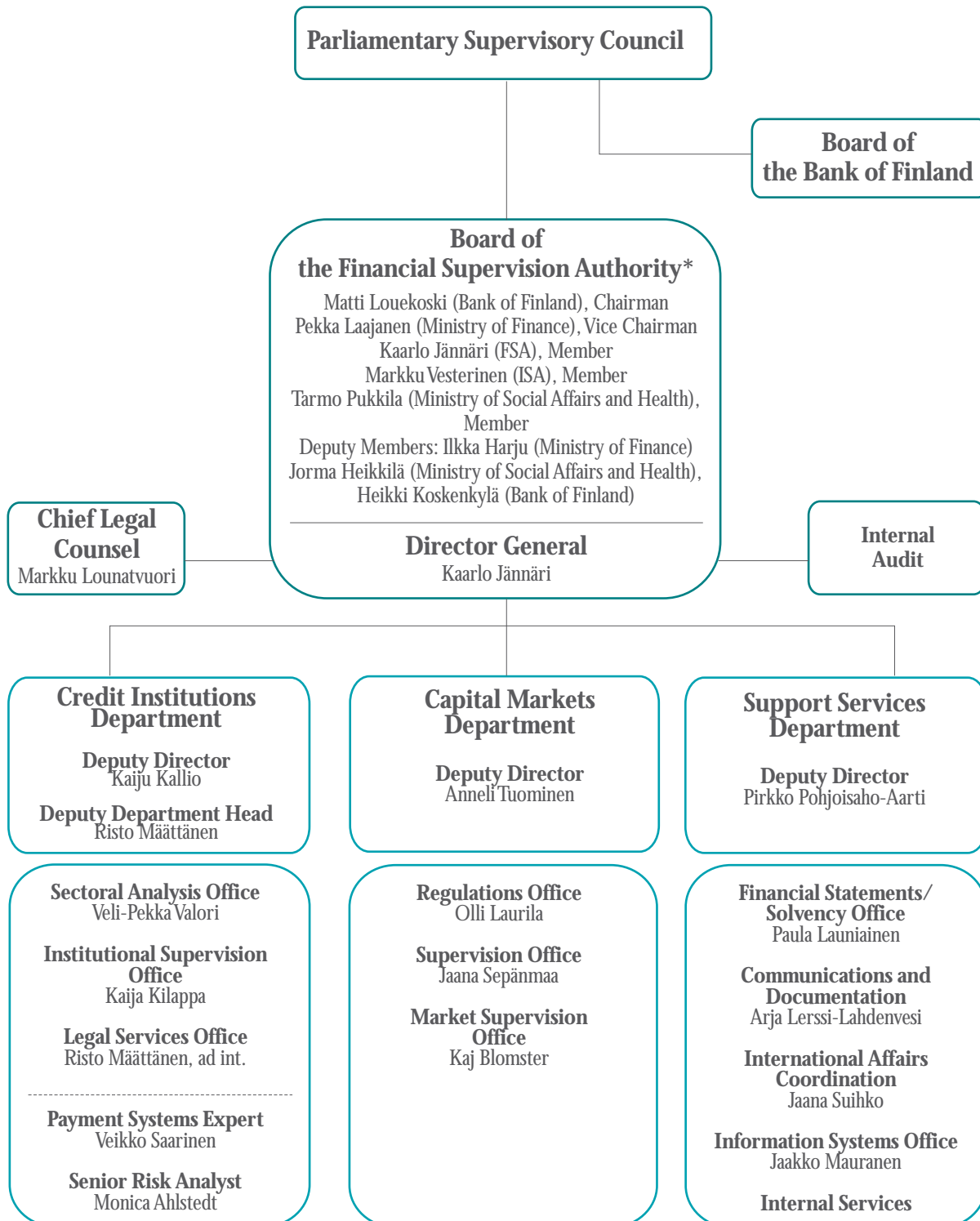
In its capital markets supervision, the FSA attaches considerable importance to maintaining public confidence in markets. To this end, the FSA, inter alia, monitors securities market practices and issuers' compliance with disclosure requirements and investigates cases where abuse of insider information and other offences are suspected. The FSA seeks to promote the smooth and reliable functioning of trading and clearing and settlement as well as the reliability of asset management services, which are becoming increasingly important.

The FSA monitors market conditions and, where necessary, submits proposals to other authorities for legislative action or other measures. The FSA also participates in numerous legislative projects within its sphere of activity.

## Supervisory cooperation with other authorities

The FSA cooperates in supervisory matters with other authorities, notably the Bank of Finland, the Ministry of Finance, the Ministry of Social Affairs and Health, the Insurance Supervision Authority and foreign supervisory authorities.

## Organization, 1 April 1999



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

**Financial Supervision Authority:  
expenses and income, 1998**

**Supervision and processing fees, 1998**

	Actual 1997 FIM 1000	Actual 1998 FIM 1000	Budgeted 1999 FIM 1000	Budgeted 1999 EUR 1000		1997 FIM 1000	1998 FIM 1000
<b>EXPENSES</b>					<b>SUPERVISION FEES</b>		
<b>STAFF EXPENSES</b>					Commercial banks	24 158	25 932
Wages and salaries	29 372	31 546	31 981	5 379	Amalgamation of cooperative banks	7 301	7 288
Other staff expenses	9 433	9 935	10 243	1 723	Local cooperative banks	837	841
Total	38 805	41 481	42 224	7 102	Savings banks	973	1 065
<b>OTHER EXPENSES</b>					Limited company savings banks	573	624
Training	1 361	1 520	2 174	366	Savings banks foundations	84	
Travel	1 382	1 345	2 080	350	Other credit institutions	6 065	6 135
IT expenses	4 075	3 866	5 265	886	Security funds	290	301
Office services	3 738	3 914	4 411	742	Representative offices and branches of foreign credit institutions	177	215
Real estate rents and maintenance costs	4 107	4 195	4 531	762	Credit institutions' holding companies		80
Other expenses	2 139	3 139	4 293	722	Pawnshops	49	51
Total	16 802	17 979	22 754	3 827	Marketplaces	2 275	1 330
<b>INVESTMENTS</b>					Provision of investment services	3 948	5 598
Acquisition of machinery	379	68	222	37	Management companies	1 636	2 370
Total	379	68	222	37	Book-entry system	1 365	1 866
<b>TOTAL EXPENSES</b>	55 987	59 528	65 200	10 966	Issuers	4 363	2 170
<b>INCOME</b>					Keepers of insider registers		190
Supervision fees	54 116	56 063	61 905	10 412	Currency exchange offices	21	7
Processing fees	1 585	3 187	3 035	510	Total	54 116	56 063
Other income	294	276	260	44	<b>PROCESSING FEES</b>		
<b>TOTAL INCOME</b>	55 995	59 526	65 200	10 966	Management companies	791	974
					Issuers	794	1 710
					Other	0	503
					Total	1 585	3 187



# Ethical principles

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

## Ethical principles based on loyalty and independence

### 1. Commitment to the goals and decisions of the FSA

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

### 2. In-house treatment of information and secrecy

In their handling of confidential and delicate information, employees of the FSA shall see to it that communication of the information is

limited to those persons who need it for the performance of their duties.

### 3. Loans, guarantees and other contingent liabilities

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

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

### 4. Securities trading

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

### 5. Gifts, representation, etc

Employees of the FSA shall refuse to accept a gift or decline being treated to a meal or drinks the value of which exceeds the limit of what can be considered reasonable and the acceptance of

which may be suspected to compromise their independence in some other way.

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

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

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

### 7. Secondary occupations

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

### 8. Change of employment

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

# Strategic directions of supervision and regulation

## The FSA's vision for 2002

The FSA contributes to the stability of and confidence in Finnish financial markets in an integrating Europe.

The FSA promotes continuous development of supervised entities' control and risk management systems, and encourages self-regulation of markets to ensure the stability and efficient functioning of financial markets.

- The FSA seeks
- to remain independent, credible and transparent in its supervision of financial markets
- to make a valuable contribution through its participation in domestic and international supervisory networks
- to promote a market-oriented view.

## Strategic directions, 1999–2002

- Transparency and market orientation
- Efficient operations, effective measures
- Cooperation

## Transparency and market orientation

- The FSA promotes the development of self-regulating markets through a market-oriented view
- The FSA encourages supervised entities and companies whose shares are publicly traded to be more active in informing the public

about matters affecting their financial results

- The FSA aims at improving the quality of financial statements and other similar information published by supervised entities, in cooperation with them and other authorities
- The FSA seeks to increase and systematize publication of supervisory opinions aiming at simultaneous dissemination to all supervised entities

## Efficient operations, effective measures

- The FSA seeks efficiency and reliable function of markets through its initiatives and measures
- The FSA can adjust the focus of inspection in accordance with the needs of the type of activity supervised
- The FSA determines and affirms the frequency and extent of supervision needed for institutions, services and market practices
- Where possible, the FSA utilizes the internal control systems of supervised entities
- The FSA participates in the preparatory work of the EU, Ministry of Finance and Ministry of Justice to create a cost-effective regulatory framework that focuses on essential matters. The FSA also strives to prevent Finland's regulatory framework from becoming more burdensome than frameworks in other EU Member States
- The FSA seeks to ensure that legal provisions guarantee it sufficient statutory authority, available measures and sanctions to

do its job effectively

- The FSA seeks to be more systematic and effective in assuring that supervised entities implement measures recommended by the FSA to correct deficiencies found in inspections

## Cooperation

- In response to corporate consolidations, the FSA is preparing its organization for closer cooperation with other Finnish and foreign supervisors
- The FSA participates in developing regulations for efficient supervision of consolidated financial groups, and seeks to develop efficient supervision practices in cooperation with Finland's Insurance Supervision Authority and Ministry of Social Affairs and Health
- The FSA continues to improve cooperation with auditors. The FSA participates in developing auditing in various cooperation bodies to make audit reports more informative. Auditors' statements should mention that the financial statements have been prepared in accordance with the supervisory agency's regulations and guidelines.
- The FSA seeks to intensify joint cooperation with other authorities in management of crises.
- When preparing regulations, the FSA seeks to make greater use of recommendations from internal and external experts as well as maintain a good dialogue with market participants



# Journal 1998

## Main items of the Journal

	1998	1997
Internal matters	104	58
Administration of supervised entities	571	548
Supervision	592	596
Risk management	214	238
Accounting, annual accounts and auditing	77	109
Customer protection and safeguarding competition	359	402
Inspections	94	73
Other matters concerning supervised entities	92	197
Other external matters	137	98
<b>Total</b>	<b>2 240</b>	<b>2 319</b>

## Major categories of journal entries

	1998	1997
Investigation request concerning customer protection	217	305
Listing particulars	196	175
Matters regarding rules	194	149
Notifications	142	163
International cooperation	106	63
Contractual terms	83	76
Inspections by plan	77	73
Own funds and capital support	75	78
Disclosure obligation	63	73
Prospectuses	58	52

Items recorded in the Journal of the Financial Supervision Authority amounted to 2,240, broken down by departments as follows: Capital Markets Department 1,079, Credit Institution Department 939, Support Services Department 170 and the Director General's staff 52. The handling of 223 items was referred to the following year.

## Supervised institutions 1980–1998

31 Dec	LP	OP	OPR	POP	SPY	SP	LL	VR	SPS	PLL	UE	ULS	AOJ	AV	SIPA	MP	RY	Oth.	Tot.	SK tot.
1980	7	372	-	-	-	275	8	3	-	-	2	-	-	-	-	-	-	-	667	2 715
1981	7	371	-	-	-	274	8	3	-	-	2	-	-	-	-	-	-	-	665	2 755
1982	10	371	-	-	-	272	8	3	-	-	1	-	-	-	-	-	-	-	665	2 777
1983	10	371	-	-	-	270	8	3	-	-	1	-	-	-	-	-	-	-	663	2 830
1984	10	370	-	-	-	263	8	3	-	-	5	-	-	-	-	-	-	-	659	2 877
1985	10	370	-	-	-	254	9	3	-	-	7	-	-	-	-	-	-	-	653	2 915
1986	10	370	-	-	-	241	11	3	-	-	8	-	-	-	-	-	-	-	643	2 943
1987	10	369	-	-	-	231	11	3	-	-	9	-	-	-	-	-	5	-	638	2 902
1988	12	367	-	-	-	211	12	3	-	-	8	-	-	-	-	2	6	-	621	2 979
1989	14	360	-	-	-	178	12	3	-	-	9	-	-	30	-	13	8	-	627	3 019
1990	15	338	-	-	-	150	12	3	-	-	9	-	-	28	-	13	10	-	578	2 839
1991	15	329	-	-	-	86	11	3	-	-	8	3	14	29	-	11	13	-	522	2 660
1992	12	310	-	-	-	40	32	3	-	-	8	3	17	25	-	8	16	-	474	2 454
1993	13	304	-	-	-	39	38	3	52	11	8	3	14	25	-	8	17	-	535	2 640
1994	11	302	-	-	-	40	33	3	51	13	6	8	14	23	-	6	17	-	527	2 149
1995	8	301	-	-	-	39	29	3	51	14	11	8	13	25	-	8	18	-	528	1 953
1996	8	298	-	-	1	39	23	3	50	13	9	8	12	25	-	4	17	-	510	1 735
1997	9	-	250	44	1	39	23	3	43	14	7	12	12	-	40	3	17	-	517	1 645
1998	9	-	251	43	1	39	19	3	-	14	6	14	11	-	46	3	22	15	496	1 591

<b>LP</b>	Commercial banks
<b>OP</b>	Cooperative banks
<b>OPR</b>	Amalgamation of cooperative banks
<b>POP</b>	Local cooperative banks
<b>SPY</b>	Limited company savings banks
<b>SP</b>	Savings banks
<b>LL</b>	Credit institutions
<b>VR</b>	Banks' security funds

<b>SPS</b>	Savings bank foundations
<b>PLL</b>	Pawnshops
<b>UE</b>	Finnish representative offices of foreign credit institutions
<b>ULS</b>	Finnish branches of foreign credit institutions
<b>AOJ</b>	Book-entry system participants
<b>AV</b>	Securities brokerage firms

<b>SIPA</b>	Investment firms
<b>MP</b>	Marketplaces
<b>RY</b>	Management companies
<b>SK</b>	Branches
<b>Oth.</b>	Deposit guarantee fund (1), Investor compensation fund (1), holding companies of investment firms (10), holding companies of credit institutions (3)

## Representation abroad

	1994	1995	1996	1997	1998
Subsidiaries	13	7	10	5	4
Representative offices	33	29	26	19	17
Branches	19	17	10	11	19

# Supervised Institutions, 31 Mar 1999

## Credit market participants

### Commercial banks (9)

GYLLENBERG PRIVATE BANK AB  
LEONIA PANKKI OYJ  
MANDATUM PANKKI OYJ  
MERITA PANKKI OYJ  
OKOPANKKI OYJ  
OP-KOTIPANKKI OYJ  
OSUUSPANKKIEN KESKUSPANKKI OYJ  
YRITYSPANKKI SKOP OYJ  
ÅLANDSBANKEN ABP

### Other credit institutions (19)

DINERS CLUB FINLAND OY  
EUROCARD OY  
HANDELSBANKEN RAHOITUS OYJ  
HSB-FINANS AB  
K-LUOTTO OY  
KUNTARAHOITUS OYJ  
KUNTIEN ASUNTOLUOTTO OYJ  
LEONIA CORPORATE BANK OYJ  
LEONIA KORTTI OY  
LEONIA KUNTAPANKKI OYJ  
LEONIA MBGROUP OY  
LEONIA RAHOITUS OY  
LUOTTOKUNTA  
MERITA ASIAKASRAHOITUS OY  
MERITA RAHOITUS OY  
OKO-INVESTOINTILUOTTOPANKKI OYJ  
OP-RAHOITUS OY  
SUOMEN HYPOTEEKKIYHDISTYS  
VOLVO FINANS FINLAND AB

### Amalgamation of cooperative banks (247)

ALAJÄRVEN OSUUSPANKKI  
ALASTARON OSUUSPANKKI  
ALAVIESKAN OSUUSPANKKI  
ALAVUDEN SEUDUN OSUUSPANKKI  
ANDELSBANKEN FÖR ÅLAND  
ANDELSBANKEN RASEBORG  
ARTJÄRVEN OSUUSPANKKI  
ASIKKALAN OSUUSPANKKI  
ASKAISTEN 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  
HAUHOEN 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  
ITTIN OSUUSPANKKI  
IKAALISTEN OSUUSPANKKI  
ILOMANTSIN OSUUSPANKKI  
JANAKKALAN OSUUSPANKKI  
JOENSUUN OSUUSPANKKI  
JOKIOISTEN OSUUSPANKKI  
JUUAN OSUUSPANKKI  
JUVAN OSUUSPANKKI  
JÄMSÄN SEUDUN OSUUSPANKKI  
KAINUUN OSUUSPANKKI  
KALAJOEN OSUUSPANKKI  
KALKKIISTEN 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  
KIHTELYSVAARAN OSUUSPANKKI  
KIKKALAN REKJOEN OSUUSPANKKI  
KIKOISTEN OSUUSPANKKI  
KISKON OSUUSPANKKI  
KITEEN SEUDUN OSUUSPANKKI  
KIUKAISTEN OSUUSPANKKI  
KOILLIS-SAVON OSUUSPANKKI  
KOITIN-PERTUNMAAN OSUUSPANKKI  
KOKEMÄEN OSUUSPANKKI  
KOKKOLAN OSUUSPANKKI  
KONTIOLAHDEN OSUUSPANKKI  
KORPILAHDEN OSUUSPANKKI  
KÖRSNÄS ANDELSBANK  
KOTKAN SEUDUN OSUUSPANKKI  
KOUVOLAN SEUDUN OSUUSPANKKI  
KRONOBY ANDELSBANK  
KUHMALAHDEN OSUUSPANKKI  
KUHMOSTEN OSUUSPANKKI  
KUHMON OSUUSPANKKI  
KUOPIOEN OSUUSPANKKI  
KUORTANEEN OSUUSPANKKI  
KURUN OSUUSPANKKI  
KUUSAMON OSUUSPANKKI  
KUUSIOEN OSUUSPANKKI  
KYMIOEN OSUUSPANKKI  
KÄRKÖLÄN OSUUSPANKKI  
KÄRSÄMÄEN OSUUSPANKKI  
KÄYLÄN OSUUSPANKKI  
KÖYLJÖN OSUUSPANKKI  
LAILAN OSUUSPANKKI  
LAPIN OSUUSPANKKI  
LAPPO ANDELSBANK  
LEMIN OSUUSPANKKI  
LEPPÄVIRRAN OSUUSPANKKI  
LIEKSAN OSUUSPANKKI  
LIMINGAN OSUUSPANKKI  
LIPERIN OSUUSPANKKI  
LOHTAJAN OSUUSPANKKI  
LOIMAAN OSUUSPANKKI  
LOIMAAN SEUDUN OSUUSPANKKI  
LOKALAHDEN OSUUSPANKKI  
LOPEN OSUUSPANKKI  
LUHANGAN OSUUSPANKKI  
LUOPIOISTEN OSUUSPANKKI  
LUUMÄEN OSUUSPANKKI  
LUVIAN OSUUSPANKKI  
LÄNSI-UUDENMAAN OSUUSPANKKI  
MAANINGAN OSUUSPANKKI  
MARTTILAN OSUUSPANKKI  
MASKUN OSUUSPANKKI  
MELLILÄN SEUDUN OSUUSPANKKI  
MERIMASKUN OSUUSPANKKI  
METSÄMÄEN OSUUSPANKKI  
MIEHIKKÄLÄN OSUUSPANKKI  
MIETTILÄN OSUUSPANKKI  
MOUHJÄRVEN OSUUSPANKKI  
MYNÄMÄEN OSUUSPANKKI  
MYRSKYLÄN OSUUSPANKKI  
MÄNTSÄLÄN OSUUSPANKKI  
MÄNTÄN SEUDUN OSUUSPANKKI  
NAGU ANDELSBANKEN  
NAKKILAN OSUUSPANKKI  
NIINIJOEN OSUUSPANKKI  
NILSIÄN OSUUSPANKKI  
NIVALAN OSUUSPANKKI  
NOUSIAISTEN OSUUSPANKKI  
NURMEKSEN OSUUSPANKKI  
ORIMATTILAN OSUUSPANKKI  
ORIPÄÄN OSUUSPANKKI  
ORIVEDEN SEUDUN OSUUSPANKKI  
OSUUSPANKKI KANTRISALO  
OSUUSPANKKI REALUM  
OSUUSPANKKIKESKUS - OPK OSUUSKUNTA  
OULAISTEN OSUUSPANKKI  
OULUN OSUUSPANKKI  
OUTOKUMMUN OSUUSPANKKI

PAATTISTEN OSUUSPANKKI  
PAAVOLAN OSUUSPANKKI  
PADASJOEN OSUUSPANKKI  
PAIMION OSUUSPANKKI  
PALTAMON OSUUSPANKKI  
PARIKKALAN SEUDUN OSUUSPANKKI  
PARKANON OSUUSPANKKI  
PEDERSÖRENJDENS ANDELSBANK  
PERHON OSUUSPANKKI  
PERNIÖN OSUUSPANKKI  
PERÄSEINÄJOEN OSUUSPANKKI  
PIEKSAMÄEN SEUDUN OSUUSPANKKI  
PIELAVEDEN OSUUSPANKKI  
PIHTIPUTAAN OSUUSPANKKI  
POHJOLAN OSUUSPANKKI  
POLVJÄRVEN OSUUSPANKKI  
PORIN SEUDUN OSUUSPANKKI  
PORVOON OSUUSPANKKI  
POSION OSUUSPANKKI  
PUDASJÄRVEN OSUUSPANKKI  
PUKKILAN OSUUSPANKKI  
PULKKILAN OSUUSPANKKI  
PUNKALAITUMEN OSUUSPANKKI  
PUOLANGAN OSUUSPANKKI  
PURMO ANDELSBANKEN  
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  
SIKAJOEN 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  
UUDENKAUPUNGIN SEUDUN OSUUSPANKKI  
UUKUNIEMEN OSUUSPANKKI  
VALKEAKOSKEN OSUUSPANKKI  
VALTIMON OSUUSPANKKI  
VAMMALAN SEUDUN OSUUSPANKKI  
VAMPULAN OSUUSPANKKI  
VARKAUDEN OSUUSPANKKI  
VARPAISJÄRVEN OSUUSPANKKI  
VASA ANDELSBANK  
VEHMERSALMEN OSUUSPANKKI  
VESANNON OSUUSPANKKI  
VETELIN OSUUSPANKKI  
VETELIN YLIPÄÄN OSUUSPANKKI  
VIEKIN OSUUSPANKKI  
VIHANNIN OSUUSPANKKI

VIMPELIN OSUUSPANKKI  
VIROLAHDEN OSUUSPANKKI  
VIRTAIN OSUUSPANKKI  
YLITORNION OSUUSPANKKI  
YLIVIESKAN OSUUSPANKKI  
YLÄ-KINTAUDEN OSUUSPANKKI  
YLÄNEEN OSUUSPANKKI  
YPÄJÄN OSUUSPANKKI  
ÄHTÄRIN OSUUSPANKKI  
ÖSTNYLANDS ANDELSBANK  
ÖSTRA KORSHOLMS ANDELSBANK  
ÖVERMARK ANDELSBANK

#### Local cooperative banks (43)

ALAHÄRMÄN OSUUSPANKKI  
HANNULAN OSUUSPANKKI  
HELLANMAAN OSUUSPANKKI  
HONKAJOEN OSUUSPANKKI  
ISOJOEN OSUUSPANKKI  
JOROISTEN OSUUSPANKKI  
JÄMIJÄRVEN OSUUSPANKKI  
KANNONKOSKEN OSUUSPANKKI  
KAUHAVAN OSUUSPANKKI  
KEITTELEEN OSUUSPANKKI  
KEURUUN OSUUSPANKKI  
KIURUVEDEN OSUUSPANKKI  
KONNEVEDEN OSUUSPANKKI  
KORTESJÄRVEN OSUUSPANKKI  
KOSKEN OSUUSPANKKI  
KOVELAHDEN OSUUSPANKKI  
KURIKAN OSUUSPANKKI  
KYRÖN SEUDUN OSUUSPANKKI  
KYRÖNMAAN OSUUSPANKKI  
KYJJÄRVEN OSUUSPANKKI  
LAIHIAN OSUUSPANKKI  
LAMMIN OSUUSPANKKI  
LANNEVEDEN OSUUSPANKKI  
LAPINLAHDEN OSUUSPANKKI  
LAPPAJÄRVEN OSUUSPANKKI  
LAPUAN OSUUSPANKKI  
LAVIAN OSUUSPANKKI  
LEHTIMÄEN OSUUSPANKKI  
LIEDON OSUUSPANKKI  
MULTIAN OSUUSPANKKI  
NIVALAN JÄRVIKYLÄN OSUUSPANKKI  
PETÄJÄVEDEN OSUUSPANKKI  
PIIKKIÖN OSUUSPANKKI  
PYHÄSELÄN OSUUSPANKKI  
REISJÄRVEN OSUUSPANKKI  
SIEVIN OSUUSPANKKI  
SIILINJÄRVEN OSUUSPANKKI  
SUUPOHJAN OSUUSPANKKI  
TIISTENJOEN OSUUSPANKKI  
TUUSNIEMEN OSUUSPANKKI  
VASKION OSUUSPANKKI  
VIEREMÄN OSUUSPANKKI  
YLIHÄRMÄN OSUUSPANKKI

#### Pawnshops (14)

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 PANTTIKONTTORI OY  
SATAKUNNAN PANTTILAINAAMO OY  
SUOMEN ARVOPANTTI OY  
SUOMEN LUOTTOPANTTI OY  
TAMPEREEN PANTTI-OSAKEYHTIÖ  
TÖÖLÖN PANTTI OY

#### Savings banks (39)

EKENÄS SPARBANK  
ERÄJÄRVEN SÄÄSTÖPANKKI  
ETELÄ-KARJALAN SÄÄSTÖPANKKI  
EURAJOEN SÄÄSTÖPANKKI  
HAUHON SÄÄSTÖPANKKI  
HOUTSKÄRS SPARBANK  
HUUTTISTEN SÄÄSTÖPANKKI  
IKAALISTEN SÄÄSTÖPANKKI  
KALANNIN SÄÄSTÖPANKKI  
KIIKOISTEN SÄÄSTÖPANKKI  
KORPO SPARBANK  
KORTESJÄRVEN SÄÄSTÖPANKKI  
KRISTINESTAD 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  
VÖRÄ SPARBANK  
YLIHÄRMÄN SÄÄSTÖPANKKI  
YTTERMARK SPARBANK  
ÖVERMARK SPARBANK

#### Limited company savings banks (1)

AKTIA SPARBANK ABP

#### Holding companies of credit institutions (3)

ANÉ GYLLENBERG AB  
LEONIA OYJ  
MERITANORDBANKEN ABP

#### Finnish representative offices of foreign credit institutions (6)

ABN AMRO BANK  
CREDIT SUISSE FIRST BOSTON  
INTOURBANK  
LANDESBANK SCHLESWIG-HOLSTEIN  
GIROZENTRALE  
NORDFINANZ BANK ZÜRICH  
SOCIÉTÉ GÉNÉRALE

#### Finnish branches of foreign credit institutions (14)

CTIBANK INTERNATIONAL PLC  
CREDIT AGRICOLE INDOSUEZ  
D. CARNAGIE AB  
DEN DANSKE BANK AKTIESELSKAB  
ELLOS FINANS AKTIEBOLAG  
FCE BANK PLC  
GE CAPITAL EQUIPMENT FINANCE AB  
HANDELSBANKEN FINANS AKTIEBOLAG (JULK.)  
SCANIA FINANS AKTIEBOLAG  
SKANDINAVISKA ENSKILDA BANKEN AB (PUBL)  
SVENSKA HANDELSBANKEN AB (PUBL)  
TELIA FINANS FINLAND  
UNIBANK A/S  
XEROX CREDIT AKTIEBOLAG

#### Banks' security funds (3)

LIIKKEPANKKIEN JA POSTIPANKKI OY:N  
VAKUUSRAHASTO  
OSUUSPANKKIEN VAKUUSRAHASTO  
SÄÄSTÖPANKKIEN VAKUUSRAHASTO

#### Deposit guarantee fund (1)

TALLETUSSUJARAHAHASTO

#### Capital market participants

##### Book-entry system participants (12)

AKTIA SPARBANK ABP  
HELSINGIN ARVO-OSUUSKESKUS OY  
LEONIA CORPORATE BANK OYJ  
LEONIA PANKKI OYJ  
MERITA PANKKI OYJ  
OSUUSPANKKIEN KESKUSPANKKI OY  
OSUUSPANKKIKESKUS-OPK OSUUSKUNTA  
OY SAMLINK AB  
SKANDINAVISKA ENSKILDA BANKEN AB (PUBL)  
SUOMEN ARVOPAPERIKESKUS OY  
SVENSKA HANDELSBANKEN AB (PUBL)  
ÅLANDSBANKEN AB

##### Marketplaces (3)

EL-EX SÄHKÖPÖRSSI OY  
HEX OY, HELSINGIN ARVOPAPERI- JA JOHDANNAIS-  
PÖRSSI, SELVITYSYHTIÖ  
SUOMEN OPTIOPÖRSSI OY FINLANDS  
OPTIONSBORS AB

#### Management companies (22)

AKTIA RAHASTOYHTIÖ OY  
ALFRED BERG RAHASTOYHTIÖ OY  
CARNAGIE RAHASTOYHTIÖ OY  
CONVENTUM RAHASTOYHTIÖ OY  
DIANA RAHASTOYHTIÖ OY  
EVLİ-RAHASTOYHTIÖ OY  
FIDES RAHASTOYHTIÖ OY  
FIM RAHASTOYHTIÖ OY  
FONDITA RAHASTOYHTIÖ OY  
GYLLENBERG FONDBOLAG AB  
HANDELSBANKEN FONDBOLAG AB  
LEONIA RAHASTOYHTIÖ OY  
MANDATUM RAHASTOYHTIÖ OY  
MERITA RAHASTOYHTIÖ OY  
OP- RAHASTOYHTIÖ OY  
PSP RAHASTOYHTIÖ OY  
PYN RAHASTOYHTIÖ OY  
RAHASTOYHTIÖ BALTIC BELT FUND  
MANAGEMENT OY  
RAHASTOYHTIÖ PROTOS INTERNATIONAL OY  
SELIGSON & CO RAHASTOYHTIÖ OY  
WIP RAHASTOYHTIÖ OY  
ÅLANDSBANKEN FONDBOLAG AB

#### Investment firms (46)

ACM OY ACTIVE CASH MANAGEMENT  
AG PANKKIIRILIIKE OY  
AKTIA ASSET MANAGEMENT OY  
ALEXANDER CORPORATE FINANCE OY  
ALFRED BERG FINLAND OY AB  
ALFRED BERG OMAISUUDENHOITO OY  
AROS SECURITIES OY  
AURATOR VARAINHOITO OY  
CARNAGIE VARAINHOITO SUOMI OY  
CONVENTUM CORPORATE FINANCE OY  
CONVENTUM PANKKIIRILIIKE OY  
EQ PANKKIIRILIIKE OY  
EVLİ CORPORATE FINANCE OY  
EVLİ FONKKOMMISSION ABP  
EVLİ RAHAMARKKINAT OY  
EVLİ VARAINHOITO OY  
FIDES ASSET MANAGEMENT OY  
FIM OMAISUUDENHOITO OY  
FIM PANKKIIRILIIKE OY  
FSB PANKKIIRILIIKE OY  
GYLLENBERG ASSET MANAGEMENT  
PANKKIIRILIIKE OY  
GYLLENBERG INVESTMENT MANAGEMENT AB  
MANDATUM PANKKIIRILIIKE OY  
MANDATUM SECURITIES OY  
MERITA ASSET MANAGEMENT OY  
MERITA CORPORATE FINANCE OY  
MERITA DELTA OY  
MERITA PANKKIIRILIIKE OY  
NHP NORDIC FINANCIAL PRODUCTS AB  
NILES TRADING OY  
OPSTOCK OY  
OY AHOLA & MALINIEMI PARTNERS AB  
OY TREVISE AB  
OY UNITED BANKERS PANKKIIRILIIKE,  
FONDKOMMISSION AB  
PANKKIIRILIIKE BBL FINLAND OY  
PANKKIIRILIIKE EVLİ-OPTIOT OY  
PANKKIIRILIIKE PROTOS OY  
PANKKIIRILIIKE SOFI OY  
PCA CORPORATE FINANCE OY  
SAMPO VARAINHALLINTA OY  
SEINÄJOEN PANKKIIRILIIKE OY  
SELIGSON & CO VARAINHOITO OY  
STUDE OY  
UNITED BANKERS OMAISUUDENHOITO OY  
VARAINHALLINTA TRESOR OY  
WALSTRÖM IMMOMEN PARTNERS OY

#### Holding companies of investment firms

ALFRED BERG HOLDING OY  
BAGG HOLDING AB  
CONVENTUM OYJ  
FINANSSI-SAMPO OY  
KUISLA-YHTIÖT OY  
OY UB FINANCE AB  
PCA CAPITAL ASSOCIATES OY  
UGGLA, RUTANEN, SELIGSON & CO  
WELNESOR OY

#### Investor compensation fund (1)

SUOITTAJEN KORVAUSRAHASTO

# Regulations and guidelines

Regulations and guidelines that were issued in English and entered into force in 1998. Regulations and guidelines are available on the FSA's website ([www.rata.bof.fi](http://www.rata.bof.fi)).

## Credit institutions

- 105.5**  
Regulation on reporting liquidity risk
- 105.6**  
Regulation on reporting interest risk
- 106.1**  
Regulation on the annual accounts of credit institutions
- 106.2**  
Regulation on the consolidated accounts on credit institutions
- 106.3**  
Regulation on accounting of credit institutions
- 106.4**  
Guideline on applying for exemption from the provisions concerning the extent of consolidation groups and consolidated accounts
- 106.15**  
Regulation on the interim reports of deposit banks
- 107.1**  
Regulation on auditors' reports
- 107.3**  
Guideline on supervising the independence of auditors and deputy auditors of credit institutions and their subsidiaries
- 108.1**  
Regulation on internal control of credit institutions

- 108.2**  
Guideline on internal control principles and the internal audit function of credit institutions

## Securities Markets

- 201.5**  
Regulation on declaration of insider holdings
- 201.6**  
Regulation on registers of insider holdings
- 201.12**  
Guideline on segregation of securities business functions
- 201.13**  
Regulation on customer funds
- 202.6**  
Regulation on the accounting and annual accounts of options corporations
- 203.13**  
Regulation on the annual accounts of investment firms
- 203.14**  
Regulation on the consolidated accounts of investment firms
- 203.25**  
Guideline on applying for exemption from the provisions concerning the extent of consolidation groups and consolidated accounts

- 203.26**  
Regulation on the reporting of capital requirements and consolidated capital requirements against market risk

- 203.27**  
Regulation on internal control of investment firms

- 203.28**  
Guideline on internal control principles and the internal audit function of investment firms

- 204.1**  
Guideline on securities offerings and obligation to provide information under the securities markets act

## Regulations and guidelines issued in 1998 that enter into force in 1999

- 105.7**  
Regulation on reporting country risk
- 105.8**  
Regulation on the reporting of non-proforming and other zero-interest assets
- 105.9**  
Guideline on foreign currency risk
- 201.7**  
Guideline on practices to be applied in the provision of investment services

# The publication series

These publications were released in English in the publication series during the year 1998. They are available on the FSA's website, [www.rate.bof.fi](http://www.rate.bof.fi).

## Statements

- Assessing the fitness and propriety of directors and managers of credit institutions
- Hybrid instruments eligible for inclusion in Tier 1 capital
- Declaration of insider holdings and the register of insider holdings
- Identification of a remote customer

## Notifications

- Schedule of specific fees charged by the Financial Supervision Authority

# 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 centralized for the first time.

Period of Independence  
1917–

- 1920 Supervision of the cooperative banks was assigned to their own central monetary institution.
- 1922 The Bank Inspectorate was established under the Ministry of Finance to supervise commercial banks.
- 1993 The Banking Supervision Office was dissolved following the introduction of a new Act on the Financial Supervision Authority; the Financial Supervision Authority began to function in connection with the Bank of Finland.
- 1995 Finland became a member of the EU.
- 1996 Investment firms legislation entered into force.
- 1999 The euro era started.

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

- |   |  |
|---|--|
| 1933 Mortgage banks   | 1988 Postipankki Ltd and derivatives markets   |
| 1970 Savings banks, cooperative banks, credit companies and banks' security funds       | 1989 Securities markets  |
| 1979 The Mortgage Association and representative offices of foreign credit institutions | 1991 Branches of foreign credit institutions and the book-entry securities system                |
| 1987 Management companies and mutual funds  | 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  |

## Assessment of the interest rate risk of deposit banks<sup>1</sup>

Income risk stems from the balance sheet effects of changes in interest rates on the financing of a short-term (less than one-year) maturity deficiency or on the investment of an excess for one year, starting from the reporting date. Depositor behaviour has proven to be quite inflexible in response to changes in interest rates. For this reason, the income risk of markka-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.

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

In assessing interest rate risk, account is taken of the combined effect of income risk and investment risk. Measuring the interest rate risk of all banks in the same manner makes it possible to compare banks with each other and identify those banks that incur excessively large interest rate risks relative to risk-bearing capacity. The measure estimates the total loss in actual income resulting from a one percentage point

rise in interest rates, assuming that sight deposits are re-priced immediately. The interest rate risk obtained in this manner is calculated in relation to net income from financial operations at the end of the previous year.

<sup>1</sup> For a more detailed description of the monitoring of interest rate risks by the FSA, see Kangas, P (1998): Talletuspankkien korkoriskin seuranta, Rahoitustarkastuksen työpäpaperi (Monitoring of the in-terest rate risk of deposit banks, FSA working paper), TP/6/98/LLO ([www.rata.bof.fi/suomi/julkaisut/julkaisut.html](http://www.rata.bof.fi/suomi/julkaisut/julkaisut.html)).

