Annual Report

1999

RAHOITUSTARKASTUS
FINANSINSPEKTIONEN
FINANCIAL SUPERVISION

Director General's Review

1999 was an eventful year for financial markets both in Finland and globally, and developments were, by and large, positive. Transition to the single currency, the euro, was completed successfully in Finland and the other ten countries participating in the Third Stage of Economic and Monetary Union. The changeover to the new millennium also went smoothly, without any major IT problems. At least part of the credit for this must go to cooperation between financial supervisors around the world.

The financial services industry in Europe is undergoing structural change at a record pace, driven by technical progress, the euro and the growing need for cost-effective corporate restructurings in the face of competitive pressures. In Finland the first major step towards consolidation of the banking and insurance sectors was taken when the insurance group Sampo and the banking group Leonia announced their intention to merge. Although the Sampo-Leonia financial conglomerate will not formally come into being until the latter part of 2000 when all the necessary legal and authorization arrangements have been completed, this was one of the top financial stories in Finland in 1999. Another important event was the reorganization of the legal structure of MeritaNordbanken, the Swedish-Finnish financial services group, and the group's take-over bid for Christiania Bank og Kreditkasse ASA, Norway's second largest bank. The ultimate fate of the bid was still unknown at the time of writing. An even bigger story was the announcement in March 2000 of a planned merger between MeritaNordbanken and Unidanmark, the Danish banking group.

In early 2000 ownership of the MeritaNordbanken group was transferred in full to a newly formed holding company, Nordic Baltic Holding, which is registered in Sweden. MeritaNordbanken plc, the holding company for the group's banking operations, is nevertheless still legally domiciled in Finland. Moreover, it is planned that the Danish Unibank will also operate as part of MeritaNordbanken. The insurance business of Nordic Baltic Holding will include the Danish insurance group, Tryg-Baltica A/S, which has a large subsidiary in Norway. Organizing supervision of this very complex whole in an appropriate manner among the Nordic supervisory authorities will be a demanding task

Cross-border mergers and corporate restructurings are certain to increase in other parts of Europe as well, thereby adding to pressure for harmonization of supervision. For now, however, there is no desire to abandon the principle of national, or 'home country', supervision. There is even less desire to assign authority in the field of banking supervision to the European Central Bank or some other supranational body. The work by FESCO[1], the forum for cooperation between regulators in the European Economic Area, on developing common standards for securities markets made good progress in 1999 and this gives cause to believe that banking supervision can also move forward on a national basis but by way of closer cooperation.

The most significant event in the world of supervision in Finland was the commencement of activities by the Insurance Supervision Authority in April 1999. Cooperation between the new body and the Financial Supervision Authority (FSA) has got off to a good start. It can be expected to increase and strengthen following the formation of the Sampo-Leonia financial conglomerate Sampo-Leonia. The growing trend towards the creation of large financial conglomerates has also prompted the EU to begin work on a draft directive on the supervision and reporting of financial conglomerates.

The publication in June 1999 of a proposal for a new capital adequacy framework for banks by the Basel Committee on Banking Supervision, which works under the auspices of the Bank for International Settlement (BIS), was a very important step. This was quickly followed by an EU consultative document that adapts the proposal to the European legal framework. These proposals are discussed in more detail in another section of the Annual Report. It is nevertheless worth noting that, although it will take some years before the revision to the capital adequacy framework is finalized, it will have a major impact not only on developments in the banking and investment services industry but also on the focus of supervision and the demands placed on it.

Banks' profitability in 1999 was good. Despite strong growth of lending, net income from financial opera-

[1] *Forum of European Securities Commissions.*

tions declined to some extent from the previous year. Intense competition continued to squeeze interest rate margins. Loan losses were again very small. Fee income generated by the provision of investment services increased further, boosted by the high level of stock market activity and the popularity of mutual funds. Reflecting their good results, the capital position of the banking sector as a whole actually improved, even though the stock of lending grew by 13%.

Risks attach to strong growth of lending. In the confident atmosphere that prevails during a boom, banks may not make adequate provisions for future loan losses. Towards the end of the year the FSA reminded the banks of the need to make provisions for future loan losses now, when profitability is good. The practices and rules pertaining to loan loss provisions should be modified to make it easier than at present for banks to make loan loss provisions. However, this involves difficult accounting and taxation issues, which will have to be resolved so that a set of coherent and clear rules can be put in place. At worst, current practice could increase the amplitude of cyclical fluctuations, as losses are realized during recessions and erode profits and capital ratios.

The real estate exposures of Finnish banks continue to be rather high by international standards. Though banks have made strenuous efforts to reduce these exposures, much still remains to be done. This applies particularly to some of the member banks of the Amalgamation of cooperative banks. The good overall profitability and capital position of the Amalgamation offers a good opportunity to tackle the issue, if only the parties concerned can find the common will to do so. It is important that all banks publish details of the returns on their real estate holdings and the valuation methods they apply for assessment by markets and depositors to at least the level of detail required by the FSA.

In contrast to bond markets in other euro area countries, the Finnish bond market did not grow significantly in 1999. Part of the reason for this may be the fact that interest rate margins on corporate bank loans are still rather narrow from the risk point of view. Firms were able to borrow more cheaply from banks than from the bond market, and so the need for bond financing was slack. Investors were more interested in the equity market.

It was a record year for the Helsinki Exchanges. Activity grew dramatically in terms of both value and the number of transactions. There was also a marked increase in initial public offerings. The same trend seems likely to continue in 2000. Some disquieting features attach to the sharp increase in equity prices. But it is worth remembering that, in line with the global trend, the rise in values has focused on the technology sector, which accounts for an exceptionally large proportion of the shares quoted on the Helsinki Exchanges. Performance has been noticeably more moderate in other sectors.

The high level of stock market activity has also been accompanied by some undesirable features, such as misuse of inside information and manipulation of prices. The FSA has reported numerous cases to the police for investigation. Problems have also arisen in connection with equity offerings notably when heavily oversubscribed. It is difficult, if not impossible, to treat all categories of investors fairly when an issue is oversubscribed many tens of times. Special attention needs to be paid to the codes of conduct and ethical integrity of firms that arrange share issues and sales. Similar problems have been encountered in other countries. FESCO has begun work on developing common European standards for equity offerings, including allotment principles.

The boom in share prices and the wave of large mergers have highlighted the importance of corporate governance. In a business community that is becoming increasingly international, smooth cooperation between executive management and the board representing the interests of the owners is becoming more and more important. Even some Finnish firms have grown so large that it is probably not possible for the same person to serve effectively as a member of the boards of several companies while working full-time as key executive of another major company.

The growth in the volume of share transactions has exceeded all expectations and the capacity of the clearing and settlement system for trades has been pushed to the limit. The FSA and the other relevant authorities have strongly supported the HEX Group, brokerage firms and securities depositories in their efforts to ensure that the entire process from trading to clearing and settlement functions smoothly. However, the present decentralized book-entry system will have to be upgraded by replacing it with a centralized system. In fact, under a Ministry of Finance decision, centralization will have to take place by 16 October 2000. In the ongoing development work in connection with improving the clearing and settlement process due care must be taken to ensure that, for example, the scope for supervising the reliable functioning of the system and investigation of insider trades is not impaired.

Overall, 1999 was a good year for Finnish financial markets. Forecasts for 2000 are also positive. However, rapid technological progress, especially in Internet technology, and the process of internationalization associated with it and the introduction of the euro are breaking down traditional financial market structures at such a pace that market participants, let alone supervisors and legislators, cannot afford to be complacent for a second. The challenges are growing and with them also the possibility of both success and failure. This calls for vigilance.

March 2000

Operating Environment

Favourable operating environment

With the start of Stage Three of European Economic and Monetary Union (EMU) at the beginning of 1999, the Finnish markka became one of the national denominations of the euro. Interest rates are now determined by the same factors throughout the euro area and the bilateral exchange rates of member state currencies no longer fluctuate.

Transition to Stage Three of the EMU was expected to stabilize money and capital markets. These expectations seem to have been largely borne out. Both short-term money market interest rates and long-term bond yields remained low and relatively stable, although market interest rates did rise somewhat in the second half of the year. The euro's depreciation against the Japanese yen and US dollar improved export competitiveness, but had little effect on the euro area economy or capital markets.

The Finnish economy continued to grow at a steady pace in 1999, albeit slightly slower than in the previous year. Real GDP increased by 3.5% compared with 5.0% in 1998[1]. Nevertheless the Finnish economy continued to grow at a faster rate than the economies of most other euro area countries. Unemployment continued to fall slowly.

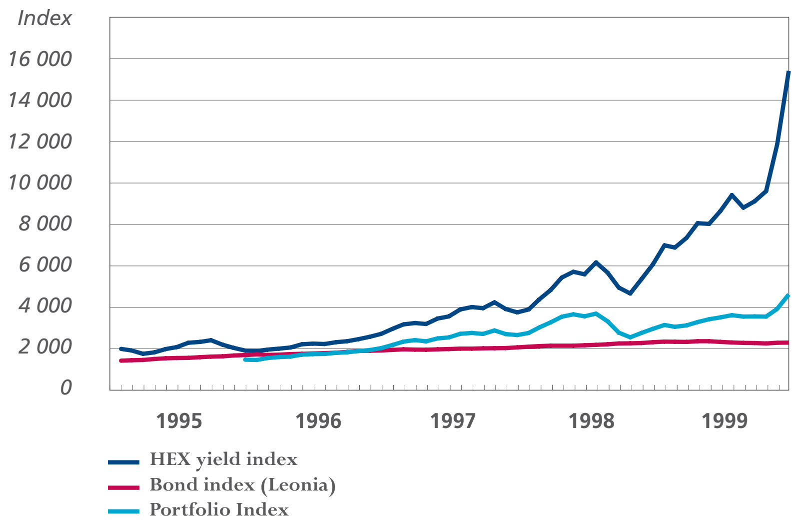
Real estate and other asset prices rose futher; for example, the HEX portfolio index of the Helsinki Exchanges rose by 66% during 1999 (see Charts 1 and 2). House purchases were also brisk and housing prices continued to rise.

For the global economy 1999 was a more favourable year than 1998, which had been characterized by the Asian and Russian crises. In autumn 1999 the OECD revised upward the growth forecast for its member countries. The increase in oil prices seems to have had only a minor impact on macroeconomic performance.

Stock exchanges are seeking ways of working together

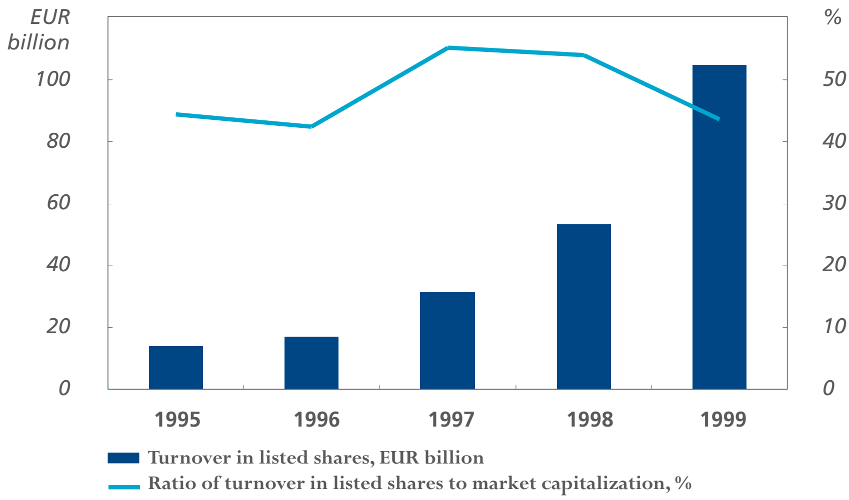
The rapid technological development of stock exchanges, networking of

Chart 1. Total return indices: equity, debt and money markets, 1995–1999



Source: Helsinki Exchanges.

Chart 2. Share turnover on the Helsinki Exchanges, 1995–1999



Source: Helsinki Exchanges.

[1] *Statistics Finland.*

marketplaces and use of Internet for provision of services have further intensified competition between marketplaces. Many European stock exchanges are seeking ways of working together so as to enable them to maintain their competitive position.

The German and Swiss derivatives exchanges have founded the Eurex derivatives exchange, which the Helsinki Exchanges cooperate with.

For Finnish securities intermediaries and market makers who have been accepted as members of Eurex this cooperation represents an opportunity to trade in all the products available on Eurex (see page 19). As for the stock markets, Helsinki Exchanges have sought to be involved in European cooperation in this area.

Increased use of the Internet for provision of services

Financial market participants have increasingly begun to make their services available on the Internet. Finnish banks, in particular, have been pioneers in utilizing the Internet.

In 1999 the number of customers using Internet services continued to grow. Banks already have more than one million Internet customers. The Internet is mainly used for paying bills and services purchased via the net. The range of net services is gradually being widened to include eg consumer loans and student loans.

Securities intermediaries on the Helsinki Exchanges have also increased their use of the Internet. At the beginning of 2000 eight intermediaries offered their customers the possibility of placing orders via the Internet. The Internet is being used as a subscription channel in equity issues.

In 1999 the HEX Group started to develop the Internet-based eHex system for intermediaries, and the first version of the system should be ready in spring 2000. eHex makes it possible for intermediaries to offer their customers on-line brokerage services in share trading and real-time market information. It is planned to expand the system to include, for example, a facility for trading derivatives via the Internet

STRUCTURAL CHANGES IN THE FINANCIAL MARKETS

Formation of Finland's first financial conglomerate is under way

In September 1999 MeritaNordbanken Plc made a cash offer for the shares of Christiania Bank og Kreditkasse ASA. The duration of the public purchase offer, which was made to the shareholders of Christiania Bank, was extended several times. The offer was still open at the time of writing. In early March 2000 Unidanmark A/S and Nordic Baltic Holding AB (publ) agreed on a merger, which is to be implemented as a share exchange offer by the beginning of April.

In September Merita Plc and Nordbanken Holding AB (publ) entered into a merger agreement with the purpose of simplifying the legal structure of MeritaNordbanken. Nordbanken Holding, which is listed on the Stockholm Stock Exchange under the temporary name of Nordic Baltic Holding (NBH) AB (publ), is the holding company for the Group.

In October the Boards of Leonia plc and Sampo Insurance Company plc signed a contract according to which the companies will merge as equals to form a new group called the Sampo-Leonia Group. According to the Draft Terms of Merger approved by the parties at the beginning of February 2000, Leonia plc will be merged with Sampo Insurance Company plc at the end of 2000. After the merger the group will adopt a holding company structure. A condition for the merger is that Parliament gives its consent to the merger and repeals the Act on Postipankki. Sampo-Leonia will be the first Finnish financial conglomerate.

In December the OKOBANK Group Central Cooperative, the pension insurer Ilmarinen and the insurance company Suomi announced plans to form a client-owned alliance, which will offer a full range of banking and insurance services. Each alliance member will concentrate on its own core business but utilize the alliance's distribution channels.

A large number of banks decided to establish separate mortgage banks. This became possible at the beginning of 2000, when the Mortgage Bank Act entered into force. A mortgage bank raises funds by issuing mortgage-backed mortgage bonds to investors.

Cooperation between Leonia Bank plc and Finland Post Ltd, which goes back more than a hundred years, will terminate at the end of 2000. This means that Leonia's banking services will no longer be provided in post offices.

The Helsinki Exchanges started cooperation with Eurex

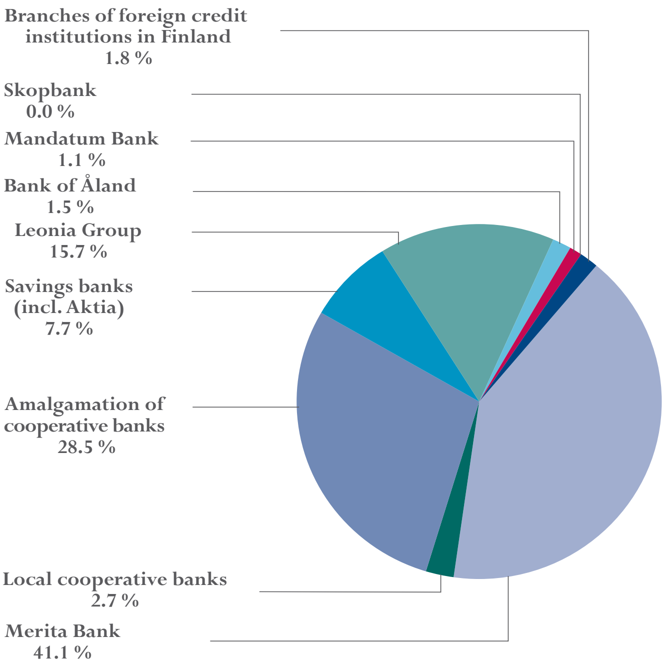
In April 1999 HEX Ltd and the Helsinki Exchanges entered into a cooperation agreement with the German-Swiss derivatives exchange Eurex AG on the transfer of their share derivatives trade to Eurex.

The derivatives products were transferred to Eurex in two stages. In the first stage, at the end of September, standardized index derivatives and more liquid share derivatives were transferred. In the second stage other standardized derivatives products were transferred.

The derivatives that have been relocated to Eurex are no longer traded on the Helsinki Exchanges. The products concerned are subject to German law and Eurex rules. Lending contracts, stock futures and some stock options are still traded on the Helsinki Exchanges.

With the transfer of derivatives trading to Eurex, operating procedures for securities intermediaries that had traded derivatives on the Helsinki Exchanges changed. In Finland securities markets participants have traditionally handled the whole customer service process themselves and in addition acted as clearing parties. Finnish securities intermediaries cannot gain authorization as clearing members of Eurex. Therefore foreign members of Eurex with no established place of business in Germany enter into clearing agreements with German clearing members.

Chart 3. Deposits: banking groups' market shares, 31 Dec 1999



Source: Financial Supervision Authority.

COMPETITION IN THE FINANCIAL MARKETS

Number of remote members on the increase

At the end of 1999 six remote members operated on the Helsinki Exchanges and their combined share of annual turnover was 6%. However, the remote members are increasing their market share, and in December their share of the trading on the Exchange had already risen to 10%. In addition, four new remote members have been authorized to start trading on the Exchanges.

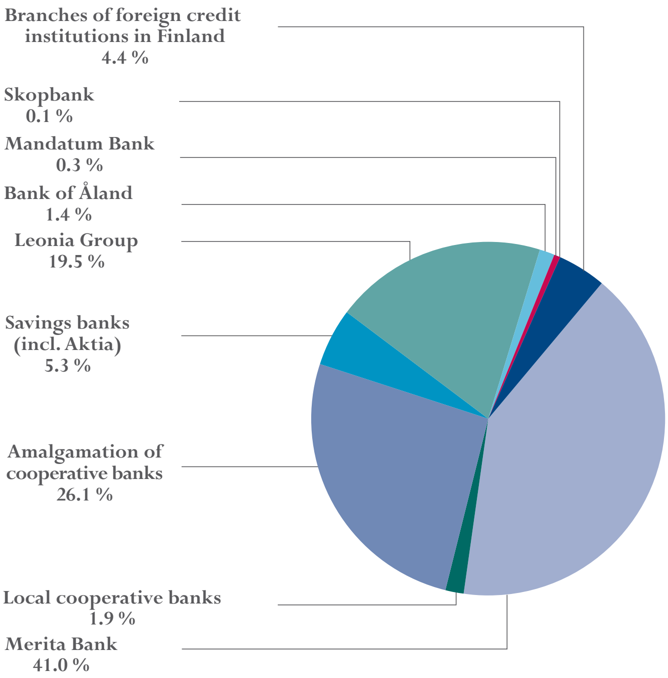
Other forms of saving are gaining popularity

Bank deposits grew slightly in 1999. However, the share of traditional bank deposits in total savings is falling, as savings are increasingly being channelled into mutual funds. Similarly, investment in personal pension schemes has grown.

Assets of bank-related[3] funds more than doubled in the course of

[3] Merita Fund Management Ltd, OP Fund Management Company Ltd, Leonia Fund Management Ltd, Leonia MM Fund Management Company Ltd, Mandatum Fund Management Ltd, Aktia Fund Management Company Ltd, Handelsbanken Mutual Fund Company Ltd, Trevise Rahastoyhtiö Oy and Bank of Åland Fund Management Ltd are defined here as bank-related funds.

Chart 4. Lending: banking groups' market shares, 31 Dec 1999



Source: Financial Supervision Authority.

1999 and they grew faster than funds on average. Bank-related funds' share of total fund assets at the end of 1999 was a little more than 60%.

Banks' market shares in respect of total deposits changed. Merita Bank Plc and, to some extent, also the Amalgamation of cooperative banks, lost market share whereas the other banks increased their shares (see Chart 3). Deposit rates were little used as a means of competition as there were only small changes in interest rates in 1999. Instead regular-customer benefits and comprehensive customer benefits and related service packages were actively marketed to customers.

Lending continued to grow strongly. Competition in respect of lending was still very tight. Merita Bank and Leonia Group each lost market share, and their combined market share decreased from 63.1% to 60.5% (see Chart 4). The biggest gains in market share were by the branches of foreign credit institutions and to some extent also the Amalgamation of co-operative banks.

FSA survey on growth in the stock of housing loans

In June–July 1999 the FSA carried out a survey on the growth in the stock of housing loans granted by banks and the reasons underlying it. In January–June 1999 new housing loans totalling FIM 25 billion were granted. When refinancings, transfers and repayments are taken into account, actual lending for home purchase in the first six months of the year was estimated a FIM 13 billion. At the end of June the stock of housing loans amounted to FIM 121 billion.

In January–June banks' interest rate margin narrowed by 0.1 percentage point and loan periods increased to as much as 30 years. According to internal bank rules, housing collateral is generally valued at 70% of the collateral's current value. Higher collateral values were also used.

All banking groups emphasized the importance of ability to pay in loan decisions. However, the survey revealed that not all banks have clear rules on drawing up reports on ability to pay. The FSA expressed concern that if monthly loan service costs are set at the upper limit of borrowers' ability to pay, higher interest rates could make it difficult for them to keep up their monthly payments.

Activities Based on the FSA'S Strategic Objectives

The strategic objectives of the Financial Supervision Authority (FSA) are to promote market orientation and provision of information to markets, to contribute to the efficiency and reliable functioning of markets and to foster cooperation with stakeholders at home and abroad. These objectives provided a clear basis for activities in 1999.

PROMOTION OF MARKET ORIENTATION AND PROVISION OF INFORMATION TO MARKETS

The FSA promotes market orientation, inter alia, by seeking through its actions to contribute to the efficiency of market activities and sound market practices. In its supervisory work, the FSA imposes requirements on the supervised entities as regards the information to be disclosed by them and the transparency of their activities, and conducts inspections of the management, internal control and procedures of the supervised entities.

To improve the availability of information to the markets, the FSA issued a recommendation in December in which it pinpointed areas where the information content of the annual accounts of credit institutions needed to be improved. For its part, the FSA decided that it would start disclosing information on its supervisory measures from the beginning of 2000.

The FSA modified the code of conduct for the securities markets by laying down more precise rules governing the practices to be applied in equity offerings. It also submitted a proposal to the Ministry of Finance for extending the scope of regulation and supervision as regards provision of investment advice. The FSA also approved the criteria for professional investors drawn up by the Finnish Securities Dealers Association.

Enhanced disclosure of information on financial instruments in annual accounts

The FSA complemented its regulations on annual accounts by issuing a recommendation to the credit institutions concerning the kind of additional information on financial instruments, risk management and risk exposures they should disclose in their annual reports and in the notes to their annual accounts. In the recommendation, the FSA stated that the level of detail to be disclosed on financial instruments in the annual accounts should, in accordance with the materiality principle, reflect each institution's operating conditions and the nature and size of its activities.

Introduction of a uniform marketing code

The FSA and the Insurance Supervision Authority launched a joint study on issues related to the marketing of investment products. The study was prompted by the need to introduce, to the extent possible, a uniform code for the marketing of investment products, irrespective of whether the products are provided by insurance companies, credit institutions or investment firms.

In May the FSA revised its guideline on procedures to be observed in the marketing of securities, which lays down the principles of sound marketing practices. According to the guideline, the marketing of securities should focus on facts that are relevant from the point of view of the security in question, and the attention of the investor should not be attracted exclusively to just one or a few specific characteristics. In any promotional material it has to be clearly stated who is issuing or offering the securities.

Guidelines regulating the marketing of insurance products are under preparation at the Insurance Supervision Authority.

In a statement issued in the autumn, the FSA drew the credit institutions' attention to their marketing practices (see page 12).

Market practices specified

The FSA issued a notification setting out its views on the practices applied by securities intermediaries in equity offeings and on allotments of shares to investors.

The FSA called upon securities intermediaries to draft internal guidelines on the procedures used for customer identification and for verifying customers' creditworthiness in equity offerings.

In publishing its views on allotment principles, the FSA sought to ensure equal treatment of investors belonging to the same category. A member of a selling group should not give preference to its own customers and the size of allotments should not be dependent on any current or future customer relationship between the member of the selling group and the investor. The prospectus or listing particulars should also indicate whether the issuer and the seller have decided to give preference to a particular category or group of investors. The issuer and seller bear ultimate responsibility for the allotment principles.

The FSA issued a statement on the fee structures of mutual funds, the aim being to draw management companies' attention to the fact that fee structures should be clear and transparent and that unitholders should be treated equally. The rules of the mutual fund should clearly set out the criteria according to which fees are charged.

If a management company wishes to differentiate subscription, redemption or management fees, the differentation criteria must treat investors equally and be justified objectively. In setting fees, consideration may be given to the investor's total holdings in funds managed by the company.

The FSA submitted a proposal to the Ministry of Finance in which it called for a widening in the scope of regulation and supervision in Finland as regards provision of investment advice. In particular, this would improve the protection afforded to private investors and increase public confidence in securities market activities.

The FSA takes the view that all investment advice services provided in the financial markets should be subject to supervision, irrespective of the service provider and the investment product. Although investment advice provided by investment firms and credit institutions currently falls within the scope of regulation and supervision, there are several investment advice companies in the market which are not subject to regulation and supervision. According to the FSA's proposal, the regulation of investment advice should focus primarily on conduct of business rules. Capital requirements and other conditions for authorization applicable to investment advice companies could be less stringent than those for investment firms.

At the request of the Finnish Securities Dealers Association, in June the FSA approved the criteria for recognition as professional investors. When assessing whether their customers meet these criteria, investment firms should pay attention to, inter alia, the organization of the customer's investment activities, the continuity and regularity of such activities and the amount of funds available for investment.

The Helsinki Exchanges, the Finnish Chamber of Commerce and the Federation of Finnish Industries and Employers drew up an insider code designed to enhance the management of insider issues[1] in companies whose shares are publicly traded. The code includes procedures to be applied in the identification and determination of insider status, the processing and management of inside information and legitimate trading in its own securities by the company's insiders. The code, which will take effect from the beginning of March 2000, recommends that companies keep project-based insider registers.[2]

Supervision of practices applied by credit institutions

In the supervision of practices applied by credit institutions, the FSA focused attention on both the changes in contractual arrangements for guarantees and third-party pledges following the introduction of new legislation and the marketing practices of credit institutions.

The Act on Guarantees and Third-Party Pledges took effect on 1 October 1999 and led to a revision of the standard collateral contracts used by credit institutions. Model contracts were negotiated with the Finnish Bankers' Association. With the entry into force of the new Act on Credit Transfers in August, the Finnish Bankers' Association revised the general terms and conditions applicable to payment transfers.

As regards the marketing practices of credit institutions, the FSA discovered certain inaccuracies and shortcomings to which it urged the supervised entities to pay attention. In its statement on marketing practices, the FSA set out its views on the most common problems identified in the field of marketing.

The total number of written requests for investigation received by the

[1] Insider management consists of following tasks.
- *company's internal informing of insider issues,*
- *training in insider issues within the company,*
- *receipt, examination and forwarding of insider declarations of the permanent insiders of the company*
- *the drawing up and maintenance of project-specific instructions or registers of insiders,*
- *supervision of insider issues.*

[2] Project-based insider registers are lists maintained by the company of persons who have knowledge of projects of material importance to the company, such as acquisitions and reorganizations in the banking sector. The project-based insider registers facilitate management of inside information in the company. The FSA may access these registers whenever necessary. The registers are used for supervising compliance with the prohibition against abuse of inside information.

FSA fell further to 183. The number of telephone enquiries also declined. The fall in the number of contacts was partly due to the fact that the Advisory Office for Bank Customers had gained an established position. The division of responsibilities between the Advisory Office and the FSA was clarified so that issues of importance for supervision are dealt with by the FSA, whereas problems which clearly relate to day-to-day banking servcies are handled by the Advisory Office.

The FSA enhances transparency through disclosure of information on supervisory measures

The FSA decided that it would start disclosing information on its statutory supervisory measures in 2000. These measures include, for example, appointment of a special representative, conditional imposition of a fine and withdrawal or restriction of authorization. Furthermore, the FSA will in the future issue statements more often if it finds it necessary to interfere with prevailing market practices or the activities of individual supervised entities.

Improvements in reporting on fitness and propriety

The FSA decided to issue a new guideline on reporting by credit institutions on the fitness and propriety of their managers and directors, with a view to improving reporting practices. According to the draft guideline, which has been circulated for comment, the supervised institutions must provide the FSA with more details on the fitness and qualifications of their managers, directors and owners. Reporting practices will also be revised. The previous practice of annual notifications is to be abandoned. Henceforth, credit institutions will notify the FSA whenever a new manager or director is appointed.

PROMOTING THE EFFICIENCY AND RELIABLE FUNCTIONING OF MARKETS

The reliable functioning of financial markets constituted one of the main areas of supervision in 1999. The transfer of trading in Finnish derivative contracts from HEX to Eurex was monitored especially closely.

The FSA monitored the Year 2000 preparations of the supervised entities in number of ways. It required the supervised entities to draw up contingency and transition plans for the changeover to the year 2000 and emphasized management's responsibility for monitoring preparations.

With a view to ensuring the reliable functioning of the clearing and settlement of share trades, the FSA called on market participants to take measures to safeguard clearing and settlement operations. In 1999 more than 92% of all transactions were settled in time, ie within T + 3 days (trade date + three business days). The corresponding figure for 1998 was only about 84%.

Close monitoring of the Eurex project

The FSA closely monitored the progress of the Eurex project and stepped up cooperation with the German supervisory authorities. It also familiarized itself with the activities of German settlement banks. Furthermore, the FSA made supervisory visits to all the Finnish securities intermediaries and market makers that had switched to trading on Eurex.

The prime responsibility for supervising derivatives trading rests with the German authorities. The FSA supervises the services provided by Finnish securities intermediaries in Finland and the compliance of Finnish securities intermediaries and market makers with the conditions for authorization. Eurex sees to it that the relevant reports are filed with the authorities. There are three supervisory authorities in Germany: the supervisory authority of the federal state of Hesse (the local Ministry of Trade and Industry), BAWe[3] and the supervisory unit of Eurex, which has the status of an authority under German law on stock exchange trading.

In the course of its supervisory visits, the FSA determined the readiness of Finnish securities intermediaries to switch to trading and clearing and settlement on Eurex. It also carried out a survey of intermediaries' risk and liquidity management principles with regard to trading on Eurex.

The Finnish securities intermediaries were not completely ready to start trading on Eurex in September, because not all of them were equipped with facilities for client-based position management and collateral calculation. Furthermore, the application de-

[3] *Bundesaufsichtsamt für den Wertpapierhandel.*

veloped by HEX to support the back office functions for trading on Eurex did not become available until later than planned. Therefore, not all of the securities intermediaries who had wanted to switch to trading on Eurex had done so by the end of the year. At the end of 1999 15 Finnish securities intermediaries were members of Eurex. Two investment firms that had carried on derivatives trading decided to discontinue their securities brokerage or market making services, mainly for cost reasons.

Attempts to solve problems in the clearing and settlement of share trades

In the course of the year trading and settlement volumes on the stock exchange increased rapidly in terms of both value and numbers. The number of transactions approached the limits of the capacity of the clearing and settlement system.

The FSA actively sought to solve the problems connected with the clearing and settlement of share trades. It made supervisory visits to securities intermediaries and clearing parties to examine their liquidity position and how they were coping with the increased collateral requirements arising from the growing level of trade. During these on-site visits it emerged that the liquidity position of some securities intermediaries was not satisfactory. Some of them were experiencing difficulties from time to time in meeting collateral requirements. Some shortcomings were also identified in respect of risk management.

The FSA called upon market participants to take action to reduce the problems associated with clearing and settlement of share trades already before the planned centralization of book-entry registers in one book-entry register in autumn 2000. This is expected to enhance the prospects of further developing clearing and settlement operations. In a centralized system, the clearing and settlement of share trades can be improved through the establishment of an effective share borrowing pool and through the introduction of an RTGS[4] system, which promotes the reliability and safety of clearing and settlement operations. Centralization also affords an opportunity for a multi-tier ownership structure.

Towards the end of the year the Helsinki Exchanges and the Finnish Central Securities Depository Ltd (APK) had to introduce temporary measures to safeguard clearing and settlement operations. The Helsinki Exchanges imposed trading restrictions by raising the round lot of the most heavily traded shares and by limiting the time allowed for odd-lot trading to half an hour a day. The schedule for clearing and settlement operations was revised. In early 2000 the computer capacity of the APK was enlarged.

Year 2000 (Y2K[5]) preparations actively monitored by the authorities.

In the financial sector, the changeover to the year 2000 took place without any disruptions in information systems.

The FSA and the other supervisory authorities actively monitored Y2K preparations in financial markets. The supervisory authorities (the FSA, the Bank of Finland, the Ministry of Social Affairs and Health, the Ministry of Finance and the Insurance Supervision Authority) cooperated within the framework of the Finland Joint Year 2000 Council, established already in 1998, to coordinate supervision of Y2K compliance, prepare joint reports and exchange information on progress made. The supervision of Y2K compliance was based to a large extent on the recommendations of the Joint Year 2000 Council[6].

In the spring and autumn, the FSA conducted inspections of the Y2K readiness of the major supervised entities and also inspected the Y2K compliance of the foreign branches of Finnish banks. In April the supervised entities received a letter urging the senior management of the supervised entities to monitor, on a monthly basis, the progress made in achieving Y2K compliance within their own organization. The inspections conducted in the spring focused on, inter alia, the current status of IT system renovations and internal and external testing. The purpose of the supervisory visits made in the autumn was to ascertain the adequacy of the Y2K contingency, information and transition plans of the supervised entities.

[4] Real-time gross settlement

[5] Year 2 Kilos.

[6] The Joint Year 2000 Council was established at a BIS meeting in April 1998 to promote the Y2K preparations of supervisory authorities in the international context. It consists of representatives of the Basel Committee on Banking Supervision, the Committee on Payment and Settlement Systems (CPSS) of the G10 countries, the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO).

A survey was made of IT security and inspections of payment systems were continued

The FSA performed on-site visits at the four largest banks and banking groups to determine their level of IT security. The purpose of these visits was to obtain an overall picture of the principles of IT security policy applied by the banks and to review key controls, instructions and potential security risks related to IT and system security. No serious shortcomings in IT security were discovered, but the banks' attention was drawn to the importance of assessing the level of IT security and related security risks and the need for up-to-date instructions, as well as to reporting and training in the field of IT security.

In the early part of the year, the FSA also carried out a survey of the consequences of the changeover to the euro for the payment and cash management systems of major banks. With the replacement of 11 national currencies by the euro, the correspondent banking system had clearly started to lose importance for payment transfers. Instead, banks started to use TARGET and the EBA's Euro Clearing System for executing payments. The liquidity surplus built up in the euro area was repatriated daily by the banks to their current accounts with the central bank, which became an important instrument for banks' day-to-day cash management.

The follow-up inspections conducted at the major banks in the autumn focused on the measures for balance control of customers' accounts and related risk management and other procedures. The FSA required banks to impose intraday limits on the accounts to ensure adequate risk management in cases where only end-of-day balances were checked and intraday overdrafts were allowed on customers' accounts. The long-term objective should be to check also intraday balances on customers' accounts.

The FSA also commenced inspections of domestic payment systems and clearing operations. Although inspections focus on the adequacy of the risk identification, management and control systems, they also cover management and reporting, internal control and guidelines, operational processes and contingency planning.

Banks were required to draw up plans for reducing their real estate risks

The FSA required banks to take action to reduce risks associated with their real estate holdings. In the autumn the banks submitted to the FSA revised plans for reducing real estate risk in the period up to the end of 2003. Although the plans were appropriately focused, some of them did not pay adequate attention to requirements imposed on real estate investments in, for example, the real estate market. If the plans are implemented, the real estate risk of the banking sector will be reduced significantly.

Under current FSA regulations, the information disclosed by banks in their annual accounts should include details of capital invested in holdings of real estate that are not in own use, classified by rate of return. The FSA and the Ministry of Finance intend to work together to clarify the principles of valuation applied to banks' holdings of real estate that are not in own use.

Statement on outsourcing

The FSA issued a statement on outsourcing to the supervised entities, setting out the criteria for outsourcing. In its statement, the FSA underlined that the supervised entities may not outsource core functions or other critical functions.

It is also important to ensure that outsourcing does not hamper the exercise of supervision. The management of an authorized entity is not released from its liability following outsourcing. Rather, the supervised entity remains under obligation at all times to report to the FSA on outsourced functions.

The entities supervised by the FSA have outsourced functions either to separate companies set up expressly for this purpose or to external service providers. Investment firms have primarily outsourced asset management services, whereas banks have outsourced processes related to foreign exchange trading or administrative support functions.

Registrars were reminded of delays in declaring insider holdings

The FSA called upon registrars[7] to remind persons subject to the disclosure

[7] Registrars are stock exchanges, other organizers of public trade, option corporations, securities depositories, issuers of publicly traded shares and securities carrying entitlement to shares, Finnish and foreign investment firms, and Finnish credit institutions and foreign credit institutions and financial institutions offering investment services.

requirement of the two-week time limit for declaration of insider holdings and changes in holdings and of due compliance with the disclosure obligation. Registrars were also required to regularly review registered data.

In a statement issued in autumn 1998, the FSA required registrars to inform the FSA of all delayed declarations by insiders. After publication of the statement, the FSA received hundreds of reports on delayed declarations.

Dissemination of information as part of efforts to combat money laundering

The FSA contributed to the dissemination of information on anti-money laundering provisions at various events arranged by the interested parties and organized a seminar for the supervised entities on both prevention of money laundering and electronic customer identification.

In cooperation with the FSA, the Finnish Association of Mutual Funds drafted a recommendation on customer identification and prevention of money laundering. To make the provisions and responsibilities concerning prevention of money laundering easily accessible, an anti-money laundering information pack was posted on the FSA's website.

The FSA also participated in international cooperation to combat money laundering (see page 17).

Anti-money laundering legislation now covers the whole financial sector in Finland. In practice, the legislation applies to all entities supervised by the FSA. With the entry into force of the new Mutual Funds Act, management companies and securities depositories were also brought within the scope of the legislation. Through its supervisory measures, the FSA seeks to ensure that the supervised entities observe uniform practices in keeping with the act and regulation on prevention and detection of money laundering.

INTERNATIONAL COOPERATION

International cooperation in the field of regulation and supervision is growing in importance. The underlying principles of national supervision and regulation are increasingly modelled on recommendations and directives agreed in international fora.

The FSA is involved particularly in cooperation at European level. Cooperation between EU member states takes place in, for example, groups of experts set up by the European Commission, in working groups appointed by the Council of the European Union and within the framework of the European System of Central Banks (ESCB) and the Forum of European Securities Commissions (FESCO).

The FSA makes an active contribution to work in areas it considers to be of particular importance for its activities and for Finnish financial markets, and seeks to have an influence already during the preparatory stage. In addition to EU cooperation, other important fora include the International Monetary Fund (IMF), the World Bank, the Bank for International Settlements (BIS), the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO) and the Joint Forum on Financial Conglomerates.

The FSA participated in the work of the ESCB and the EU

The FSA took part in the work of the European System of Central Banks (ESCB) in the context of the Banking Supervision Committee (BSC) and related working groups. The ECB published the BSC report Possible effects of EMU on the EU banking systems in the medium to long term in February and the report The effects of technology on the EU banking systems in July.

The FSA also participated in the work of the Banking Advisory Committee of the European Commission and the High Level Securities Supervisors Committee. Among the subjects discussed by the Banking Advisory Committee were the revision of the capital adequacy framework, the current state and structures of financial market supervision and preparations by the banking sector and banking supervisors of the accession countries for entry into the EU.

The Groupe de Contact, an unofficial forum for cooperation between banking supervisors of EEA member states, addressed a wide range of issues, including the Y2K preparations of banks and supervisory authorities, the supervision of financial conglomerates and corporate governance in the banking sector. The group discussed a number of issues concerning the application of the EU directives on banking supervision and exchanged information on current developments in the field of banking supervision in individual member states. It was also commissioned by the Banking Advisory Committee and the ESCB's Banking Supervision Committee to draw up reports on the banking sector (eg on capital adequacy and profitability).

The European Commission published a progress report on implementation of the Financial Services Action Plan in May 1999. The aim of the plan is to promote the creation of an efficient single market for financial services in a short timescale. During the Finnish presidency of the EU, a number of proposals for directives were discussed, and FSA experts were involved in the drafting of most of these proposals (see below).

A representative of the FSA attended the meetings of the working group of the Council of the European Union that discussed the proposal of the European Commission and European Parliament of July 1999 for a directive amending the 1991 anti-money laundering directive. Among the main points of the proposal are the possible extension of the obligations of the anti-money laundering directive to non-financial professions and institutions, such as auditors, accountants, lawyers and casinos as well as dealers in high value goods (yet to be defined in detail). It also includes principles to be applied in identification of customers in non-face to face transactions. Discussion of the proposal will continue until at least spring 2000.

The FSA was also involved in the work of the Money Laundering Contact Committee of the European Commission, attended the meetings of the Financial Action Task Force (FATF) and participated in the work of the FATF Committee for Finland. The FATF Committee for Finland includes representatives of different ministries, the Money Laundering Clearing House (special investigative unit for money laundering) and the supervisory authorities. It is responsible for coordinating and disseminating information on the activities of the FATF and the anti-money laundering provisions in Finland.

Several directives currently under preparation

A proposal for a directive on the distance marketing of financial services was completed towards the end of 1999. The proposal seeks to harmonize the provisions on markets for consumer financial services and sales techniques. To protect consumers against the unsolicited use of marketing techniques (high-pressures selling), the proposal includes provisions on cancellation of contracts and prohibition of marketing. The directive also includes a general right of withdrawal[8], which only applies to financial products whose price is not dependent on fluctuations in the financial market. The Directive will probably be adopted in 2000.

Two proposals for amending the UCITS Directive were widely debated in a group of experts set up by the Council of the European Union during the Finnish presidency. Amending the directive has been on the agenda practically throughout the 1990s, and it has proved difficult mainly because of the differing market structures and legislative provisions of EU member states.

The Finnish compromise proposal with regard to the Commission proposal for new investment instruments (unit, cash, derivatives and index fund schemes) gained wide support among member states. The compromise was intended to clarify the structure of the Commission proposal and, in particular, to introduce a common issuer-based investment restriction for the various investment instruments of a mutual fund. The committee will continue its work during the Portuguese presidency in spring 2000.

The FSA was involved in the drafting of the directive on electronic money within a group of experts set up by the Ministry of Finance. During the Finnish EU presidency, this group assisted the working group appointed to draft the directive. The proposal will be finalized during the Portuguese presidency.

FESCO stepped up its activities

The Forum of European Securities Commissions, FESCO, stepped up its activities considerably in the course of the year. In addition to the growing need for cooperation between supervisory authorities, the increased activity was due to the fact that FESCO had been assigned the responsibility for the implementation or preparation of several of the projects or parts of projects included in the Financial Services Action Plan.

The members of FESCO signed a cooperation agreement aimed at promoting cooperation between the authorities in the area of supervision and investigation and furthering the ex-

[8] The customer is entitled to cancel services purchased within a prescribed period.

change of information. The FESCO Exchange of Information and Surveillance Co-ordination Group (FESCOPOL), consisting of experienced market supervisors, was set up for this purpose.

In the year under review, the first FESCO standards were approved: the Fit and Proper Standards; the Standards for Regulated Markets; and the Market Conduct Standards for Participants in an Offering.

In January 2000 the experts group on standards for investor protection completed the first part of its mandate, which was to draw up standards for categorization of investors for the purpose of conduct of business rules. These standards were adopted at the FESCO meeting in February. The experts group will now concentrate on the second part of its work, ie harmonization of conduct of business rules in relations between investors and investment service providers.

Another four experts groups were set up in the course of the year to consider ways of facilitating mutual recognition of listing prospectuses and to address the issues of market abuse, alternative trading systems and allotments.

The task of the experts group on Europe-wide public offers is to make proposals for facilitating cross-border issues, eg by simplifying prospectuses.

The remit of the experts group on market abuse is to draft a common approach by the supervisory authorities to the regulation of inter alia price manipulation. A proposal will then be submitted to the European Commission for use in the drafting of a proposal for a directive on market manipulation.

The experts group on alternative trading systems addressed issues related to the supervision and regulation of securities trading systems that have evolved outside public marketplaces. The work is related to the plans of the European Commission to supplement the provisions of the Investment Services Directive.

The remit of the fourth experts group is to draw up standards for stabilization and allotment in equity offerings. The group is chaired by Mr Kaarlo Jännäri, director general of the FSA.

COOPERATION WITH OTHER AUTHORITIES

Cooperation in the supervision of MeritaNordbanken continued in accordance with agreed policies

The FSA continued to cooperate with Finansinspektionen, the Swedish financial supervisory authority, in the supervision of the MeritaNordbanken Group in line with agreed policies. After the reorganization of the legal structure of the MeritaNordbanken Group, the responsibility for supervision will be shared by the FSA and Finansinspektionen, which was previously responsible for the supervision of the Nordbanken Group.

Insurance Supervision Authority established; the FSA represented on its supervisory board

The Insurance Supervision Authority started to function in April 1999. In that connection, the compositions of the boards of the Insurance Supervision Authority and the FSA were made as identical as possible. The director general of the FSA is a member of the board of the Insurance Supervision Authority by virtue of his office.

The FSA has worked together with the new supervisory authority since its inception. The emergence of new financial conglomerates will further increase the need for cooperation, for example in enhancing supervision of financial and insurance groups. In early 2000 the FSA and the Insurance Supervision Authority revised the memorandum of understanding concluded with the Ministry of Social Affairs and Health.

FSA represented on working groups set up by the Ministry of Finance

The FSA was represented on a number of working groups appointed by the Ministry of Finance. Regular monthly meetings were held to discuss matters of topical interest in the securities markets. During the Finnish presidency of the EU, representatives of the FSA were involved in EU projects headed by the Financial Markets Department of the Finnish Ministry of Finance, either in their capacity as deputies for national delegates or as members of working groups set up in support of the Finnish presidency.

Principles of cooperation in the field of payment and settlement systems approved

In autumn 1999 the FSA and the Bank of Finland approved the principles of cooperation and the division of responsibilities in respect of the supervision of payment and settlement systems, following adoption by the Governing Council of the ECB of the general oversight policy applicable to the payment systems of the euro area national central banks. The FSA and the Financial Markets Department of the Bank of Finland set up a joint body to implement cooperation in this area.

Extended data collection for the joint production of statistics

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.

In the course of the year electronic data collection was extended to include reports on capital adequacy. The electronic format used for collection of country risk data was changed to bring it in line with the format used in other electronic data collection, with effect from the end of 1999.

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

The Advisory Office for Bank Customers established its position

In the course of the year the Advisory Office for Bank Customers received 1,730 enquiries, more than a quarter of which concerned the customer's debt relationship with the bank. However, there are signs that eg questions concerning use of accounts are increasing in number.

Less than ten cases involving issues of far-reaching importance were submitted for review to the Board of the Advisory Office. The Advisory Office has clearly established its position and also supports the FSA in the performance of its supervisory function.

DEVELOPMENT OF THE FSA'S OWN ACTIVITIES

Inspection pools were introduced by the Institutional Supervision Division of the Credit Institutions Department towards the end of 1999. The institutional supervision groups were replaced by groups specializing in different areas of supervision (credit risk, internal control, accounting and annual accounts, general inspections). A similar model was already applied in the department's Sectoral Analysis Division. The Legal Services Division was reorganized to better support the supervisory role of the FSA.

With a view to enhancing the investigation of insider trading, the Capital Markets Department introduced a new IT system application to support investigations.

The adequacy of reporting by supervised entities was reviewed

To update reporting practices related to the continuous supervision of supervised entities, a project was launched to evaluate the adequacy and relevance of reporting. A comprehensive review was made of existing reporting practices and the relevance and adequacy of individual reports was assessed from the point of view of supervision. It was also determined to what extent the FSA could benefit from reports prepared by the supervised entities for their own purposes.

The project showed that current legislation allows little scope for any reduction in existing reporting. The effectiveness of continuous supervision can primarily be improved by refining and further developing existing reporting. IT systems should be improved so that the data collected in electronic format constitute an integrated and user-friendly whole.

Staff skills were developed to meet future needs

The changes under way in the financial markets are also expected to bring about changes in the work of the supervisory authorities. This calls for ongoing skills development in traditional and new areas of supervision. On the basis of its strategic objectives and the changes in financial markets, the FSA defined its core areas of competence and the areas where skills need to be developed and identified the main areas of skills development in the years 2000–2002.

Competences were divided into two categories: competences to be developed by the whole FSA staff and special competences to be developed by certain experts. Skills development will be based on customized in-house training programmes, external courses and seminars and job rotation. Private studies leading to degrees will also be encouraged (CIA, CISA)[9].

In the training of experts, the focus continued to be on risk management and related methods. Some FSA experts attended international seminars on current issues in the field of banking supervision arranged by other supervisory authorities or partners. An extensive course on accounting and annual accounts, intended mainly for the FSA's legal advisers, was arranged in cooperation with the Helsinki School of Economics and Business Administration within the framework of the Executive Education programme. The entire FSA staff received training on the new legal provisions on the openness of government activities and their implications for the activities of the FSA. Language and communication training was continued.

The procedures for managing operating risks were reviewed

In keeping with the principles of internal control adopted by the board of the FSA, the FSA reviewed the management of operating risks and related procedures as part of its annual action planning. Existing methods were judged to be adequate. It was decided that increasing efforts be devoted to monitoring the operating environment and market practices.

The board of the FSA also adopted general operating principles to be observed by the FSA in managing exceptional situations in the financial markets.

Findings of corporate image study provide a basis for further development of activities

The FSA commissioned a corporate image study to find out the opinions and views of key stakeholders on the FSA and its activities. The findings of the study, which was carried out in June–July 1999, will serve as a basis for the further development of the FSA's activities.

The findings of the study indicate that the FSA was perceived as being more transparent and active than before. Respondents nevertheless thought that there was a need for even greater transparency and faster speed of response and for more effective communication. They felt that the FSA had become more service-minded and cooperation-oriented and that it had improved its information services.

Revision of guidelines and regulations

The project for revising the FSA's guidelines and regulations with a view to improving their transparency, clarity and comprehensibility continued. The aim is to simplify the structure and contents of the set of guidelines and regulations and to enhance their readability and usability. The revision will be completed within three years.

IT strategy was defined

The FSA adopted its IT strategy for the years 2000–2002. The strategy defines priorities in respect of IT applications, technical requirements and the targeted level of staff IT skills.

According to the IT strategy, all information concerning a particular supervised entity will be available to users in a single location. The new services will be implemented using web technology. This will enable the linking of related matters and lower the threshold for using services. Development of the staff's IT skills constitutes a key strategic priority.

The Y2K renovations of the FSA's applications were successfully completed, and applications have functioned normally since the millennium changeover.

The Riski data system[10] designed for monitoring the financial position and risks of supervised entities was further developed. The system was equipped with a facility for monitoring the capital adequacy of supervised entities. Data on profitability, capital adequacy and liquidity, together with data on most market risks, can now be accessed using the same system.

The monitoring of mutual funds was also incorporated into the Riski data system. Collection of data on mutual funds began with the situation as at 31 January 1999. Integration of the collection of country risk data into the Riski data system was commenced and the new format for collection of country risk data was introduced at the end of 1999.

The FSA and the Bank of Finland decided to purchase an electronic document management system to facilitate the classification, search and processing of documents. The aim is to achieve complete computerization of document management at the FSA within a few years.

[9] CIA = Certified Internal Auditor; CISA = Certified Information Systems Auditor.

[10] The FSA uses the Riski data system to monitor the financial position and risks of supervised entities.

Monitoring Activities 1999

In recent years the FSA has systematically sought to enhance the efficiency of its activities. In its inspections and supervision this has meant that the FSA increasingly determines its supervisory measures according to the risk associated with a supervised entity and the business it pursues. Inspections are concentrated on the supervised entities of major importance for market risks and the functioning of markets.

The focus of risk monitoring has been purposefully shifted from quantitative to qualitative risks, ie to strategic and operational risks. The goal is to achieve a comprehensive evaluation of the situation of the supervised entities, covering all their risk positions. Consideration of qualitative risk is also included in the proposal for a new international capital adequacy framework (see page 30).

Since qualitative risks cannot be measured on the basis of reported figures, a review process based on interviews was introduced. The purpose of this new approach is to find out the supervised entity's own views on its risks and risk positions.

The evaluation of qualitative risks was initiated by carrying out a survey of the strategic EMU readiness of the supervised entities and assessing the activities of their management and effectiveness of their corporate governance systems.

To evaluate the readiness for EMU, supervisory visits were made in spring and autumn 1999. The questionnaire devised as a tool for assessing management activities was completed in December and will be tested and finalized in spring 2000.

Several reports on corporate governance were prepared, which dealt with Finnish legislation on corporate governance and the characteristics of existing alternative international systems. In March 2000 the FSA published an article on corporate governance and related problems in its Internet newsletter.

MONITORING FINANCIAL CONDITION AND RISKS

Profitability of the banking sector[1] remained excellent

In 1999 banks' profitability was almost as good as in the previous year. Return on equity was 20%, which is a high level by any criterion.

Banks' net income from financial operations shrank. In 1998 net income from financial operations had amounted to FIM 19.0 billion, but in 1999 it was only FIM 18.6 billion. Both loans and deposits grew, but the average margin between lending and deposit rates narrowed. At the end of January 1999 the margin between average euro-denominated lending and euro-denominated deposit rates was 3.8 percentage points. Although the average interest rate on the lending stock rose somewhat towards the end of the year, the interest rate margin was only 3.5 percentage points at the end-December[2]. In addition, the interest expense of group companies operating in other fields increased.

Net fee income increased from FIM 7.0 billion to FIM 7.7 billion. In particular, fee income from asset management grew, whereas, for example, fee income from bank guarantees decreased.

Net income from securities transactions and foreign exchange dealing fell substantially compared with 1998. It amounted to only FIM 0.8 billion, ie about one third of the FIM 2.3 billion recorded the previous year. There were several reasons for this decline. With the introduction of the euro, the volume of customer trade in foreign exchange dealing decreased, and trading in currency derivatives also declined because of reduced hedging requirements. Capital gains on share sales were not as large as in previous years.

The main reason for the good profitability performance was a fall in the amount of loan and guarantee losses. In 1998 banks had suffered from loan and guarantee losses totalling FIM 1.4 billion, but in 1999 these losses were only FIM 0.3 billion.

A fall in administrative and operating costs from FIM 17.2 billion to FIM 16.4 billion also contributed to the good profitability performance. For example staff-related expenses totalled FIM 8.8 billion in 1998 compared with only FIM 8 billion in 1999 (see Table 1).

[1] As defined here, the Finnish banking sector comprises the MeritaNordbanken Group, the Amalgamation of cooperative banks, the Leonia Group, the Aktia Group, the Bank of Åland Group, the Mandatum Bank Group, the Skopbank Group (in liquidation) and the parent companies of savings and local cooperative banks.

[2] Statistical source: Financial Markets–Statistical Review, Bank of Finland.

Table 1. Key items in the banks' aggregate profit and loss statement, 1998 and 1999, FIM billion*

	1999	1998
Interest income	43.6	48.0
Interest expense	25.0	29.0
Net income from financial operations	18.6	19.0
Fee income (net)	7.7	7.0
Other income	5.1	6.4
Administrative and operating expenses	16.4	17.2
Loan and guarantee losses	0.3	1.4
Depreciation	1.8	2.0
Operating profit	12.9	11.8

** The figures cover the MeritaNordbanken Group, the Amalgamation of cooperative banks, the Leonia Group, the Bank of Åland Group, the Mandatum Bank Group, the Skopbank Group (in liquidation), the Aktia Bank Group and the parent companies of the savings and local cooperative banks.*

Source: Financial Supervision Authority.

Table 2. Capital adequacy of deposit banks, 1998 and 1999, FIM billion*

	1999	1998
Total own funds	74.9	62.5
of which: Tier 1 capital	54.8	45.7
Risk-weighted asset items and off-balance-sheet items and capital requirement against market risk	625.6	577.7
Capital adequacy ratio	12.0 %	10.8 %
Tier 1 capital adequacy	8.8 %	7.9 %

** The figures cover the MeritaNordbanken Group, the Amalgamation of cooperative banks, the Leonia Group, the Bank of Åland Group, the Mandatum Bank Group, the Aktia Bank Group and the parent companies of the savings and local cooperative banks. The figures do not include the Skopbank Group.*

Source: Financial Supervision Authority.

Banks' capital adequacy improved

The banks' capital position improved. At the end of 1998 the banking sector's capital adequacy ratio had been 10.8%. By the end of 1999 it had risen to 12%.

The improved capital position was mainly due to an increase in original own funds (Tier 1 capital). There was little change in the level of additional own funds (Tier 2 capital). Excellent profitability has helped the banks to maintain their capital adequacy, because accrued profits have boosted their capital. The Tier 1 capital ratio, which is calculated solely on the basis of original own funds, improved from 7.9% to 8.8%.

In contrast, credit growth has slowed the strengthening in the banks' capital position. The combined sum of risk-weighted assets items and off-balance-sheet items increased from FIM 539 billion to FIM 601 billion. Imputed market risks decreased, however, from FIM 38.7 billion to FIM 24.5 billion (see Table 2).

Banking sector's balance sheet total increased

In 1999 the banks' combined balance sheet total increased by about 10%, from FIM 912 billion to FIM 1,002 billion. The main part of the growth occurred during the last quarter of the year.

On the assets side, claims on the public and public sector entities increased from FIM 556 billion to FIM 628 billion. The relative share of this item increased from 61% to 63% of the balance sheet total. Some other balance sheet items, such as debt securities and liquid assets, also increased in 1999, but no other item recorded growth comparable to claims on the public and public sector entities. Of the main balance sheet items, only tangible assets declined, from FIM 35 billion to FIM 32 billion. This item comprises mainly real estate holdings.

Changes also occurred on the liabilities side. Banks' equity capital increased by about 24%, from FIM 50 billion to FIM 62 billion. Most of this growth is due to profits resulting from the banks' excellent profitability, which has boosted non-restricted equity capital, in particular. Liabilities to the public and public sector entities increased from FIM 438 billion to FIM 485 billion and debt securities issued to the public from FIM 215 billion to FIM 250 billion. By contrast, liabilities to other credit institutions declined from FIM 124 billion to FIM 109 billion.

Quality of the lending stock is still good

Banking groups' total exposures (loans + guarantees) amounted to FIM 451 billion at the end of 1999. Guarantees decreased slightly, but loans increased by 11%, ie at the same rate as in 1998. Households still constituted the main borrowing sector, and their liabilities grew faster than those of other sectors. At the end of the year households accounted for 45% of the total liabilities of all sectors.

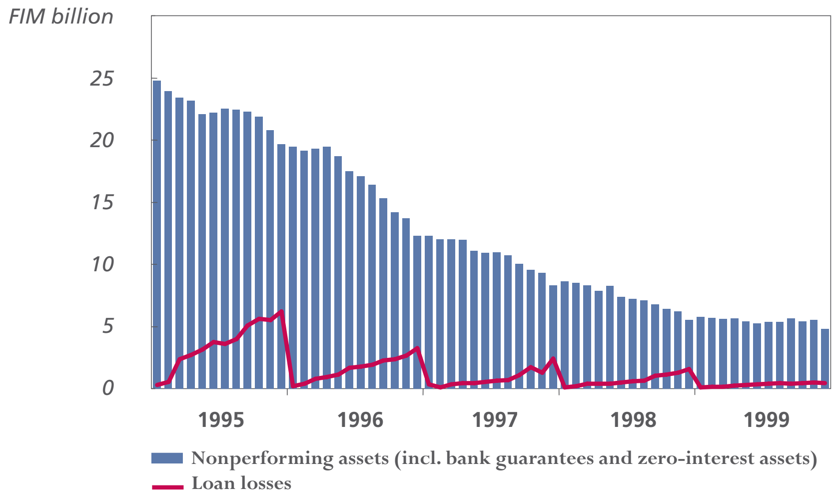
The decline in banks' nonperforming assets, which has continued since 1994, is coming to an end. In markka terms nonperforming assets decreased only slightly in 1999 (see Chart 5). In relation to the lending stock, the share of nonperforming assets was small at 1.1%, and thus close to the previous year's level of 1.3%.

The weakest sector in 1999 was trade and restaurants, when measured by ratio of nonperforming assets to the sector's total liabilities. In terms of this measure, construction, which for long had been the weakest sector, recovered more quickly than trade and restaurants in 1999.

Reported loan losses were small in relation to total exposures, accounting for only 0.1% of total loans and guarantees. Finnish banks did not report such modest loan losses even in the late 1980s before the banking crisis. Therefore the level of loan losses is not expected to fall further in the years ahead.

In a letter sent in December 1999 the FSA urged the banks to prepare for possible loan losses in connection with new lending. During the good years banks have been able to strengthen their capital positions and build up their original own funds, which can be used to cover future loan losses. Banks should ensure that these assets are actually available for covering losses, if necessary. According to the FSA, banks should pursue modest dividend policies or retain enough profits to cover potential loan losses, either by making general loss provisions or other voluntary provisions.

Chart 5. Deposit banks' nonperforming assets and loan asstes, 1995–1999



Source: Financial Supervision Authority.

Foreign exposures of Finnish banks were modest

The total foreign claims of Finnish banking groups increased by FIM 5 billion and amounted to FIM 194 billion at end-1999.

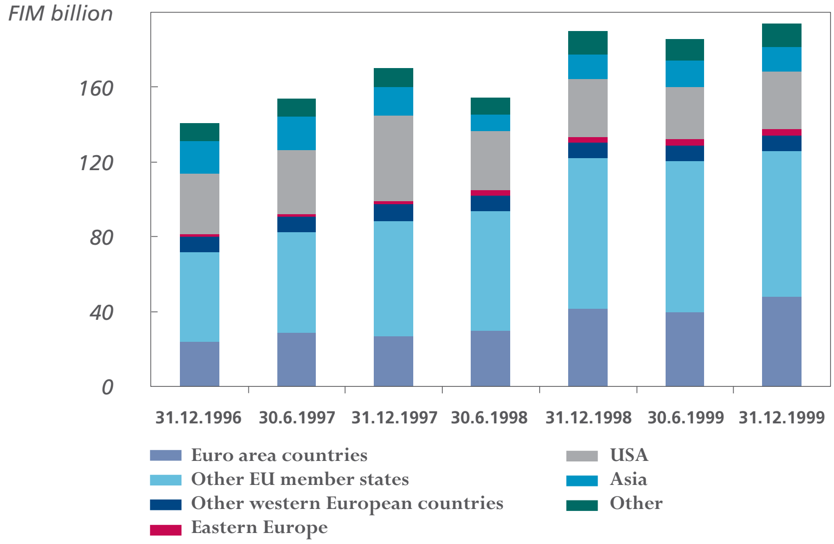
Finnish banking groups' claims on Asian countries increased by about FIM 1 billion to FIM 13.4 billion. Most of the growth occurred in trade-related financing. The economies of the Asian countries show clear signs of recovery and Finnish banking groups are not expected to incur larger-than-normal loan losses in this region in the future (see Chart 6).

The economic situation in Russia also improved in spite of political uncertainty. Finnish banks' claims on Russian counterparties remained small in 1999.

In 1998 it was predicted that Latin America could be a possible future crisis area. The floating of the Brazilian real and the subsequent depreciation by around 40% against the US dollar in early 1999 eased the economic situation. Finnish banks had no significant claims on Latin America.

Towards the end of 1999 banks increased their liquidity in anticipation of, inter alia, the millennium changeover and imminent restructurings. This was reflected above all in a marked increase in euro area claims, the growth of which was also partly due to the elimination of exchange rate risk at the start of 1999.

Chart 6. Foreign claims of Finnish banking groups by geographical region, 1996–1999



Source: Financial Supervision Authority.

Further decrease in derivatives activities of deposit banks operating in Finland

The contraction in derivatives activities[3], which had started in 1998, continued in 1999. The stock of outstanding forward exchange contracts of banks operating in Finland fell by a half to FIM 187 billion. After the markka market had ceased to exist, the stock of FRAs and interest rate futures fell to less than one-tenth (FIM 124 billion) of its previous level, as measured by the nominal value of underlying assets. In the case of FRAs, the change was also due to a shift from OTC instruments to standardized products, for which only the nominal value of the outstanding position is reported.

In 1999 the credit-equivalent amount of nonstandardized derivatives used by Finnish deposit banks in their capital adequacy calculations decreased by FIM 10.1 billion to FIM 18.3 billion.

Issued guarantees and guarantee commitments remained unchanged at FIM 66 billion. Banks' unused loan commitments increased by FIM 3.1 billion to FIM 52.4 billion. The reason for this was increased loan sales (see Table 3).

Management of exchange rate risks became easier after the introduction of the euro

In 1999 exchange rate risk – a component of market risk – remained relatively insignificant in comparison with credit risk and interest rate risk. Following the introduction of the euro, Finnish credit institutions have continued to pursue their policy of maintaining moderate overnight positions. Limit systems regulating banks' intraday risks are used to keep exchange rate risks within given constraints. Generally banks seek to cover the exchange rate risks of their core business operations.

The introduction of the euro has made it easier for credit institutions to manage their exchange rate risks, as the risks associated with 10 foreign currencies were eliminated at the beginning of 1999. In their foreign currency operations banks made allowance for the uncertainties related to the millennium changeover by reducing the number of outstanding contracts and transactions. For this reason the volume of transactions fell to an exceptionally low level.

Relative interest rate risk increased

At the end of 1999 the banking sector's interest rate risk amounted to FIM 916 million. This figure indicates the amount that banks would gain as a result of a one percentage point rise in interest rates or, conversely, lose as a result of a one percentage point fall in interest rates. At the end of 1998 the corresponding figure was FIM 744 million[4]. Thus the relative interest rate risk rose from 6% to just under 8% (see Table 4). The banking sector's interest rate risk also grew slightly in markka terms, as banks' net income from financial operations did not change significantly. The changes in investment risks (see Table 4) are

[3] According to outstanding contracts. Owing to the reporting method, the figures include intra–group contracts.

[4] The 1999 figures differ from the figures in the 1998 Annual Report partly because the introduction of the euro brought about a change in the reporting framework at the beginning of 1999. In addition, the FSA also revised some of the assumptions used earlier (such as the treatment of deposits payable on demand and prime rate–based loans).

largely due to the fact that before 1999 most of the banks' foreign currency-denominated investment risks were in currencies that are now national denominations of the euro.

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 changes in market rates are reflected in interest rates on deposits payable on demand with a lag of one year. If the assumption concerning the interest rate sensitivity of deposits is changed to a lag of less than a month, the final result of the calculation changes radically. If it is assumed that deposits payable on demand have a maturity of less than one month, the total interest rate risk increases from FIM 916 million to FIM 1,492 million and the effect of interest rate changes is the reverse (see Chart 7). Another key assumption is that prime rate-based loans are repriced within 1–3 months[5].

Market value of shares held by banking groups rose

The market value of shares held by banking groups and their pension funds[6] was about FIM 11.4 billion at end-1999. This represents an increase of around FIM 3.9 billion, or 52% , from one year earlier. The increase is due to a rise in share prices and growth in the holdings of life insurance companies owned by the banks.

The figures include all quoted shares, units of equity funds and share derivatives regardless of the balance sheet items in which they are included. These shares are for the most part traded on the Helsinki Exchanges.

Deposits' relative share of funding decreased

Continued credit growth throughout the year and preparations for the millennium changeover were the most important factors influencing asset management by the banks. At the end of the year deposits covered a little more than 90% of deposit banks' lending. The relative importance of

Table 3. Nominal value of the underlying assets of derivatives held by banks operating in Finland, 1998 and 1999, FIM million

	31.12.1999	31.12.1998	Change	Change, %
Currency-based				
Forward contracts	187 208	415 257	–228 049	–55 %
Interest rate and currency swaps	36 572	26 480	10 092	38 %
Currency options	20 844	24 182	–3 338	–14 %
Interest rate-based				
Forward rate agreements and interest rate futures	123 662	1 417 980	–1 294 318	–91 %
Interest rate swaps	445 538	559 359	–113 821	–20 %
Interest rate options	27 297	28 724	–1 427	–5 %

Source: Financial Supervision Authority.

Table 4. Interest rate risk of the banking sector[1] 1998–1999, FIM million

	31.12.1999		31.12.1998
INCOME RISK	**–1 302**		**–1 117**
Euro-denominated items	–1 458	Markka-denominated items	–1 175
Foreign currency-denominated items	157	Foreign currency-denominated items	59
INVESTMENT RISK	**386**		**372**
Euro-denominated items	380	Markka-denominated items	607
Foreign currency-denominated items	6	Foreign currency-denominated items	–235
INTEREST RATE RISK	**–916**		**–744**
Assumption: deposits payable on demand < 1 month	1 492		1 018
Net income from financial operations	**12 140**		**12 381**
Relative interest rate risk	**–8 %**		**–6 %**

[1] Assumption: deposits payable on demand < 12 months

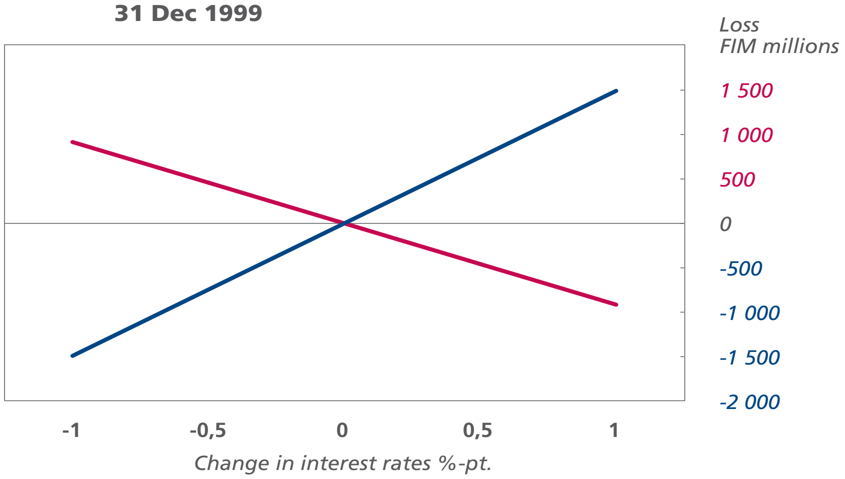
Meaning of signs	+	–
1 %-point rise in interest rates	Loss	Gain
1 %-point fall in interest rates	Gain	Loss

Source: Financial Supervision Authority.

[5] The assumption that prime rate-based loans are repriced within 1–3 months means that prime rates react to changes in the general interest rate level with a lag of about two months.

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

Chart 7. Interest rate risk of the banking sector, 31 Dec 1999



A) Assumption: sight deposits < 1 month
B) Assumption: sight deposits < 12 months

Source: Financial Supervision Authority.

deposits as a source of funding has decreased as banks have run down their surplus liquidity.

Banks prepared for the additional liquidity needed for the millennium changeover in a number of ways. The sufficiency of collateral for central bank financing was safeguarded in advance and funding extending beyond the turn of the year was raised on the capital and money markets. The millennium changeover took place without any liquidity problems.

End of year funding deficits smaller than usual

The deposit banks' short-term funding deficit[7] fluctuated between FIM 48 and FIM 74 billion during the year. The ratio of the funding deficit to the banks' combined balance sheet total fluctuated between 5% and 7%. The calculation is based on the assumption that deposits payable on demand remain in the bank[8]. Particularly towards the end of the year funding deficits were smaller than usual as banks built up surplus liquidity in anticipation of the turn of the year. A quarter of the deposit banks' total liabilities mature within one month, 40% within half a year and half of them within one year.

Monitoring risks of investment firms

Investment firms are subject to largely the same capital adequacy regulations as credit institutions. The capital requirement applies to both market risks associated with investment firms' own trading and credit risks associated with other operations. The capital requirement against market risks of investment firms has been fairly modest in relation to their own funds; a major part of the operations consists of execution of orders on clients' behalf. The capital requirement against credit risks is also low, because as a rule investment firms are not allowed to grant credit.

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

As a result of the strong growth in share trading, securities intermediaries have had to make allowance for increasingly large liquidity requirements in the clearing and settlement of share trades.

Fee income of investment firms grew

At the end of 1999 there were 44 (46 in 1998) authorized investment firms in Finland, with an aggregate fee income (incl. inter-firm transactions) of FIM 1.5 billion (about FIM 1.1 billion in 1998) and a combined net operating profit of about FIM 750 million (about FIM 575 million in 1998). Investment firms' aggregate net income from trading on own account grew to

[7] On- and off-balance sheet assets after deduction of on- and off-balance sheet liabilities. Here short-term items refer to assets and liabilities payable within 1 month.

[8] It is assumed here that business continues as before (the 'going concern' assumption). If it is assumed that 30% of deposits payable on demand fall due in 1 month, the aggregate funding deficit doubles.

FIM 130 million (about FIM 100 million in 1998). Owing to changes that have occurred in the sector, aggregate figures are not directly comparable with previous years.

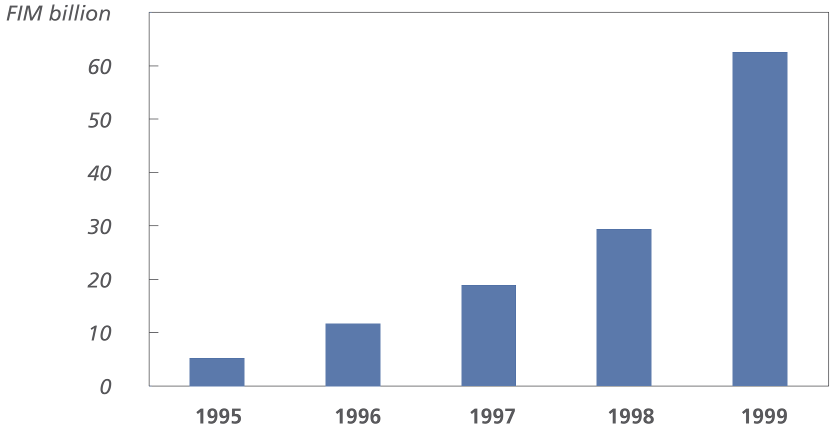
The increasingly widespread use of the Internet for securities broking has intensified fee competition. On the other hand, the strong growth in share trading, especially in late 1999, boosted brokers' fee income. In asset management the increased number of firms providing services has tightened competition, but strong growth in assets managed and the channelling of assets either via mutual funds or directly to portfolio managers has increased fee income significantly. Fee income of managers of equity offerings has grown, in part because of the record number of share sales and issues.

Income of management companies increased

Mutual funds had net assets exceeding FIM 62 billion at the end of 1999 (see Charts 8 and 9). This represents growth of around 113%, or more than FIM 33 billion, compared with the previous year. The additional assets derived from both new capital invested in funds and a rise in securities prices. During the year new capital totalling FIM 19 billion was invested in mutual funds. In particular, mutual funds belonging to banking groups attracted large amounts of new capital, and at the same time they increased their market share of the total mutual fund assets.

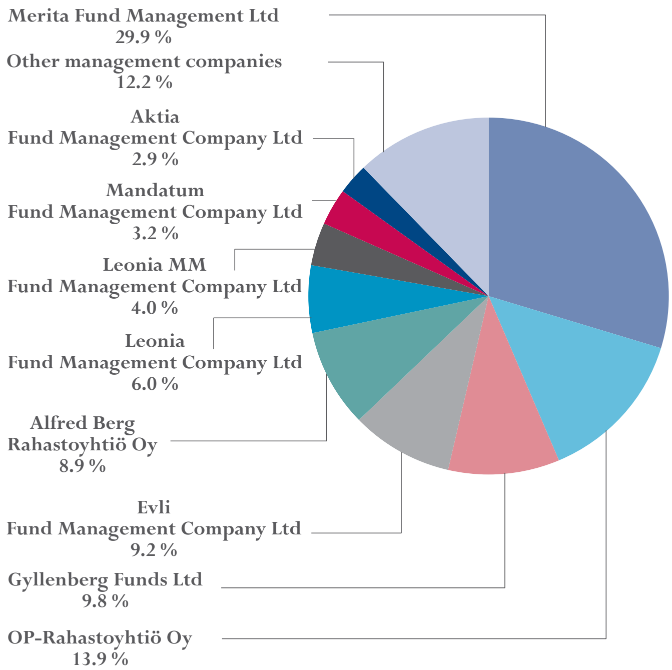
The number of mutual funds increased as well. During the year the

Chart 8. Net assets of mutual funds 1995–1999



Source: Financial Supervision Authority.

Chart 9. Fund management companies: market shares, 1999



Source: Financial Supervision Authority.

FSA approved the rules of 75 new mutual funds. At the end of 1999 there were 25 management companies in Finland managing 187 mutual funds. Three new management companies commenced operations during the year.

In 1999 both the growth in mutual fund assets and the good return on investments in mutual funds boosted the income of the management companies[9]. The profit performance of management companies in 1999 was good.

INSPECTIONS

The strategic readiness of supervised entities for EMU and their internal control and risk management arrangements were key issues for supervisory visits to and inspections of credit institutions in 1999. Capital market inspections focused on, inter alia, the calculation of the net asset value of mutual funds, management companies' readiness for international investments and fund prospectuses.

The transfer of trading in Finnish derivatives to Eurex was the subject of special monitoring and towards the end of the year attention was also focused on counterparty and settlement system risks. These are reported in more detail on pages 13 and 14.

During the year the FSA also conducted inspections of payment systems and of supervised entities' arrangements for the year 2000 changeover and information security. In addition it carried out a survey of banks' outstanding housing loans, the interest rates applied and the collateral put up for these loans. Procedures applied in the issue and sale of shares were also inspected (see pages 10, 11, 14 and 15).

Banks' strategic readiness was examined

EMU and other medium and long-term forces for change are more a source of opportunity for the banking sector than a potential threat. This was the view expressed by the banks in a survey[10] of their strategic readiness conducted by the FSA in spring and autumn 1999. The banks identified technological advances and their increased application, structural changes and ongoing globalization as the forces having the greatest effects on their operations. Although these effects were felt to be stronger in big banks than in small banks, all the banks were agreed about which were the most important forces for change.

The survey confirmed the view that the forces for change were strongest in the fields of securities broking, deposits from the public and other investment services. In securities broking, technological development and continued globalization are increasing competition from abroad. Deposits are becoming less attractive because of investors' demands for higher returns, provision of banking services by non-banks, abolition of tax-exempt deposits and technological advances. In investment services, the key factors are investors' demands for higher returns and the new investment opportunities afforded by globalization.

Inspections of internal control continued

Supervisory visits and inspections of supervised entities' internal control systems continued, with the focus on various sub-areas of internal control.

The responsibility of board directors and senior management for internal control was emphasized. Inspections focused particularly on management methods and the supervisory environment, risk management systems and independent organization of risk monitoring. Attention was also paid to the arrangements made by management for monitoring the effectiveness of internal control and the functioning of internal control.

The FSA urged the management of supervised entities to ensure that the internal control measures mentioned in FSA regulations and guidelines on internal control and internal audit are actually implemented.

Risk management practices were examined in special inspections

Risk management inspections focused on both market risk supervision and financial risk management. Inspections of the correctness of the capital adequacy calculation were also performed, as in 1998.

A new area for inspection was index-related securities issued by major supervised entities and the hedging of

[9] Most (over 90%) of management companies' income consists of management fees levied on mutual funds and subscription and redemption fees levied on unitholders. In practice there are two types of management fees: fixed and performance-based. In the case of fixed fees, management company fees are influenced both by the size of the mutual fund and by a flat–rate fee levied on each mutual fund managed. In the case of performance–based fees, management company fees are influenced by the income of the mutual fund, which is compared with a mutual fund income index. In practice, no mutual funds pay only a performance-based fee. A fixed management fee of given size is always used in addition to the performance-based fee.

[10] The aim of the survey was to assess the implications of EMU and other medium and long-term trends and forces for change for banks' business and strategic planning and how well banks are prepared to meet these challenges.

them. These inspections also drew attention to the fact that proper risk management requires that risk measurement and booking principles be defined and approved when new products are introduced.

System defects and problems in monitoring and handling of unprofitable loans had been observed in a special inspection carried out mainly in 1998, and these problems were addressed further in 1999. It appears that the problems have been handled well, but credit risk management and supervision will require additional efforts in the future, given rapid credit growth.

Methods for calculating the net asset value of mutual funds were checked by sampling

The methods for calculating the net asset value of mutual funds were checked by sampling. Staff resources, technical implementation and timing of calculations, errors and corrections of errors were inspected. Management companies had adequate personnel to calculate net asset value, but not all companies had paid appropriate attention to stand-by arrangements.

Sampling was also used to examine the capacity of management companies and investment firms providing asset management services to engage in international investment activity. Among the subjects for inspection were selection of international partners, contractual procedures and control of investment operations. The companies inspected had mainly selected large and well-known institutions as their partners. The contents and scope of the cooperation agreements varied widely. The inspections also revealed shortcomings in internal control and reporting of international investment operations.

Other inspections carried out during the year

The FSA evaluated the internal control system of the three largest supervised entities using international internal control standards as a tool. Follow-up inspections will be conducted at regular intervals.

A special inspection of management companies' fund prospectuses revealed that, for the most part, the prospectuses met the requirements laid down by law and the relevant Ministry of Finance decision. Significant shortcomings were observed in individual cases, however.

Several requests for investigation submitted to the police

In the course of 1999 the FSA investigated several cases of suspected abuse in the securities markets. In all, eight requests for investigation were submitted to the police, six of which concerned suspected abuse of inside information and two suspected violations of securities markets legislation. The requests for investigation concerned trading in the shares of ten different companies.

Regulatory Activities

The Financial Supervision Authority (FSA) took an active part in the drafting of legislation at both EU and national level. In addition, it set rules and standards for the entities it supervises by issuing regulations, guidelines and opinions.

In 1999 the FSA gave opinions on, inter alia, draft legislation concerning cooperative societies, mortgage banks, financial conglomerates and the winding up and reorganization of credit institutions. It also delivered opinions on draft decisions by the Ministry of Finance on the duty of issuers of securities to regularly provide information; information to be reported in connection with the disclosure and publication of holdings; and mutual recognition of listing particulars and prospectuses approved in the European Economic Area.

The FSA extended the scope of its guideline on securities marketing and regulation on insider holdings to include persons who in the course of their work have access to inside information. In addition, the FSA issued a recommendation concerning financial instruments in annual accounts (see p. 11) and a statement on outsourcing (see p. 15).

A wider range of sanctions desirable

The FSA has proposed to the Ministry of Finance that the range of sanctions at its disposal be widened. Some of the current sanctions are too severe or their consequences too difficult to manage for them to be used effectively by the FSA to maintain market discipline or monitor the conduct of markets and supervised entities. At present, the FSA has the powers to prohibit, for example, supervised entities from implementing decisions that are contrary to legal provisions or regulations. In addition, the FSA may impose a conditional fine to enforce a prohibition or propose to the Ministry of Finance that an authorization be cancelled.

Sanctions should be clear and quickly implementable. For example, it should be possible to impose penalties similar to the fines (administrative fines) levied under civil law. Civil fines would, for example, be useful in cases of recurrent violation of regulations. Moreover, civil fines could be used instead of damages. Of course, fines should be subject to the right of appeal. There is a need to enlarge the range of FSA sanctions to include the possibility to issue admonitions or, in more serious cases, warnings.

The disclosure of sanctions would help to enhance market discipline, and the threat of disclosure would in itself have a pre-emptive effect.

DEVELOPMENTS IN EU LEGISLATION ON FINANCIAL MARKETS

Capital adequacy framework under review

In June the Basel Committee on Banking Supervision published a proposal for a fundamental review of the capital adequacy framework. It was followed in November by a similar, but more detailed, proposal by the European Commission.

The Commission Proposal contains the same three pillars as the Basel Committee Proposal: revision of minimum capital requirements; strengthening the supervisory review of capital adequacy; and improving the prerequisites for market discipline.

A primary objective of the first pillar contained in the proposals is to apply more sophisticated methods for differentiating the degrees of credit risk in the calculation of the capital requirement. In addition, the aim is to supplement the current capital adequacy framework by introducing capital charges for risks other than credit risk and market risk, eg the interest rate risk and operational risk which is due to different maturity schedules for borrowing and lending. Another issue addressed is whether credit ratings granted by external rating agencies could form the basis for the standard models used in calculating capital adequacy. It is further proposed that banks be allowed to use the internal ratings assigned to their customers as a basis for the risk weighting of capital items.

The second pillar of the proposals of both the Basel Committee and the European Commission considers issues relating to the supervisory review of banks' capital adequacy. The pillar adds to the minimum capital requirements elements that are relevant to a qualitative assessment of supervisory review and risk control. In connection with the supervisory review of the capital adequacy position of individual banks, special attention is drawn to risk profiles and risk management techniques. As banks' risk profiles differ in this respect, it is considered necessary not only to review risk weights but also to allow capital requirements to vary accordingly. A general 8% capital adequacy requirement applicable to all banks can no longer be considered adequate for promoting a safe and sound financial system.

The third pillar of the proposals seeks to promote the potential for effective market discipline by increasing disclosure requirements. The basic principle is that supervision by the markets should complement that by the authorities and thereby help to increase financial stability. According to the proposals, credit institutions should disclose information not only on their activities and financial position but also on their risk-taking strategy, risk profile, risk management, structure of their capital base and risk sensitivity of capital items.

The reform is expected to encourage banks and investment firms falling within its scope to enhance their risk management methods. The proposed tightening of disclosure requirements with regard to risk profiles and risk management methods is expected to improve transparency of markets and harmonize risk management methods globally.

If implemented, the proposal will also increase supervisors' powers to take action. The proposed framework will enable supervisors, whenever necessary, to set higher minimum charges for individual banks in situations where a bank's own funds are not considered adequate with regard to its financial position and risk-taking. At the same time, this will place heavier demands on the expertise of supervisors, as assessment of capital adequacy levels requires not only a neutral but a more comprehensive analysis of activities than at present.

Under the EU Commission's Action Plan to Implement the Framework for Financial Services, work on reviewing the capital adequacy framework is advancing in parallel with that of the Basel Committee on Banking Supervision. Both the Basel Committee and the European Commission have requested responses to their proposals by 31 March 2000.

Within the EU, the national authorities are responsible for the consultation process. By contrast, the Commission is consulting directly with the European associations of credit institutions, investment firms and consumer organizations. The FSA participated in various working groups involved in the drafting of the EU's Consultation Document.

The new regulatory framework is not expected to come into force until 2003 at the earliest.

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

Credit Institutions Act (30.12.1993/1607, Ra 107)
Commercial Bank Act (28.12.1990/1269, Ra 108)
Savings Bank Act (28.12.1990/1270, Ra 109)
Cooperative Bank Act (28.12.1990/1271, Ra 110)
Act on Foreign Credit and Financial Institutions in Finland (30.12.1993/1608, Ra 112)
Act on Mortgage Societies (8.12.1978/936, Ra 113)
Act on the Conversion of Savings Banks into Limited Banks (6.11.1992/972)
Mortgage Bank Act (27.12.1999/1240)
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, Ra 118)
Investment Firms Act (27.7.1996/579, Ra 119)
Act on Foreign Investment Firms' Right to Provide Investment Services in Finland (26.7.1996/580, Ra 119 a)
Act on the Book Entry System (17.5.1991/826, Ra 120)
Act on the Book Entry Accounts (17.5.1991/827, Ra 122)

Source: Financial Supervision Authority.

Ongoing developments in EU accounting standards

According to the European Commission's Action Plan to Implement the Framework for Financial Markets, comparable, transparent and reliable financial information is fundamental for an efficient and integrated capital market. One of the objectives of the Action Plan is modernization of the 4th and 7th company law directives to take into account developments in the setting of international accounting standards. In the Commission's view, International Accounting Standards (IAS)[1] seem the most appropriate benchmark for financial reporting.

In 1999 the Commission also worked on a draft proposal for a directive to amend the 4th and 7th company law directives as concerns 'mark-to-market' evaluation of certain on-balance-sheet items. In addition,

[1] IAS is developed and maintained by the International Accounting Standards Committee (IASC).

work continued on finalizing the Commission recommendation on the disclosure of financial instruments.

Work began on drafting a supervisory and regulatory framework for financial conglomerates

In November an expert working group appointed by the European Commission began drafting prudential rules for financial conglomerates. The aim of the preparatory work is to address loopholes in the current legislation and assess the need for regulation. The work is focusing on regulation of capital adequacy and risks other than credit risk and market risk, issues related to the fitness and propriety of owners and managers, the exchange of information between authorities and coordination of supervision. The proposal for a directive is expected to be completed towards the end of 2000.

LEGISLATIVE CHANGES

Penal provisions of the Securities Markets Act were transferred to the Penal Code

On 1 June 1999 an amendment to the Securities Markets Act took effect that revised the penal provisions concerning securities market crimes. The provisions on the most reprehensible offences were transferred from the Securities Market Act and the Act on Trading in Standardized Options and Futures to the Penal Code.

At the same time more severe penalties than hitherto were prescribed for the most serious offences. The current provisions on misuse of inside information were complemented by a new provision concerning gross abuse of inside information.

Manipulation of security prices became a punishable offence, no matter who commits it, where-as formerly only certain methods by which security prices could be distorted were illegal.

A provision concerning offences in breach of the obligation to provide securities market information was also written into the Penal Code. The provision applies to the disclosure of untruthful or misleading information in connection with professional marketing or acquisition of securities for business purposes and the violation of the major disclosure requirements laid down in the Securities Markets Act.

The penal obligation of legal persons prescribed in the Penal Code is applicable to the new security market crimes included in the Penal Code. A corporate fine can be imposed on a legal person.

Amendment of legislation governing trading in derivatives and securities markets

In connection with the agreement between the Helsinki Exchanges and Eurex to transfer trading in derivative instruments to Germany, several amendments were made to the Act on Trading in Standardized Options and Futures and the Securities Markets Act. These amendments took effect on 1 November 1999.

The major legal amendments comprised extension of the scope of derivatives regulation, partial repeal of the marketing restrictions included in the Act on Trading in Standardized Options and Futures and harmonization of the authorization procedures and fit and proper provisions to apply also to securities exchanges, options exchanges and central securities depositories.

In future, Finnish law will recognize options and futures as referred to in the Act on Trading in Standardized Options and Futures, derivatives comparable to the afore-mentioned instruments, eg Eurex and OM-traded derivatives, and other derivative instruments (mainly OTC derivatives). Derivatives are subject to the prohibition of misleading and false marketing, the code of conduct for securities intermediaries, the obligation to report trades (not applicable to OTC products) and the obligation to declare insider holdings. In the same context, the absolute trading ban applicable, under the Act on Trading in Standardized Options and Futures, to certain managers and employees of exchanges and securities intermediaries was lifted.

Some of the legal restrictions on marketing were repealed. Standardized derivatives can be marketed to all types of customers. Moreover, securities intermediaries may market OTC derivatives to all types of customers, whereas other parties may only market them to professional investors.

Amendments were made to the Asset Transfer Tax Act and the Income Tax Act, whereby the transfer of standardized derivatives and comparable instruments was exempted from asset transfer tax. The provisions on capital gains and losses on the transfer of standardized derivatives were extended to apply to instruments comparable to standardized derivatives.

Other legislative changes

A new Mutual Funds Act entered into force on 1 February 1999. It clarifies the scope and structure of the Act and the division of powers between the relevant authorities. In the same context, the Money Laundering Act and the Act on the Financial Supervision Authority were amended. The reporting requirement referred to in the Money Laundering Act was extended to apply to the fund management companies and custodians as referred to in the Mutual Funds Act.

The Act on the Insurance Supervision Authority and the related Acts took effect on 1 April 1999, when the Insurance Supervision Authority started functioning under the Ministry of Social Affairs and Health (see p. 18) .

An amendment to the Securities Markets Act entered into force on 1 April 1999. The revisions concerned the disclosure requirement applicable to issuers of securities and major shareholders. The obligation to publish interim reports was extended to all issuers of publicly traded securities. The requirement to report shareholdings was tightened by adding new trigger points for the reporting of holdings and lowering the minimum proportion to 5%.

The new Act on Credit Transfers took effect on 14 August 1999. It implemented the directive on cross-border credit transfers in Finland. In addition, the new legal act seeks to complement existing law with respect to the legal effects of credit transfers. On certain conditions, credit transfers between Finland and countries belonging to the European Economic Area also fall under the scope of the law.

The Act on Guarantees and Pledges on Another Party's Behalf came into force on 1 October 1999. The purpose of the new law is to improve, in particular, the position of guarantors who are private individuals.

The Act on the Openness of Government Activities entered into force on 1 December 1999. The aim of the law is to increase the openness of government activities, to improve access to information on government activities and to documents dealing with such activities and their preparation, to promote good information management procedures and to clarify the secrecy criteria.

The Act on Certain Conditions Applicable to Trade in Securities and Foreign Exchange became effective on 11 December 1999. It implemented the directive on settlement finality in payment and securities settlement systems.

The Mortgage Bank Act came into force on 1 January 2000. The Act applies to activities whereby credit institutions issue mortgage bonds as referred to in the Act and use the funds thus acquired to grant mortgages to the general public. Only mortgage banks as referred to in the Act may carry on such activities. The FSA supervises mortgage banks. At the time of writing, no mortgage bank had as yet started to operate.

GUIDELINES AND REGULATIONS ISSUED BY THE FSA

An amended guideline on procedures to be observed in the marketing of securities entered into force on 1 May 1999. The guideline applies to all marketing and acquisition of securities and standardized derivatives in Finland and to all cross-border marketing of these products in Finland. It does not apply to marketing aimed at professional investors only (see p. 12).

Provisions on minimum requirements for adequate risk management were added to the FSA regulation and guideline on risk management and other aspects of internal control in credit institutions. Some other revisions of a technical nature were also made. The amendments took effect on 1 August 1999.

The regulations on insider holdings were amended as from 15 December 1999 with the aim of specifying more closely the persons subject to the disclosure requirement. The majority of employees of credit institutions and members of supervisory boards were exempted from the disclosure requirement. As a result, these persons are only entered in the insider register if they have access to inside information in the course of their work. In addition, more detailed provisions were laid down concerning the requirement of foreign counterparties to maintain registers of insider holdings. On the basis of the new Mutual Funds Act, regulations on disclosure of insider holdings[2] applicable to fund management companies and their associated custodians were drawn up. They entered into force on 15 December 1999.

Some technical revisions were made to the regulation on reporting own funds for covering market risk The amendments took effect on 31 December 1999.

LEGISLATION UNDER PREPARATION

The Ministry of Finance is preparing proposals on legal amendments made necessary by the plan to combine all book-entry registers in the Finnish Central Securities Depository (APK). In the future, all book-entries and book-entry accounts will be managed by the APK, which will thus become the sole book-entry registrar in Finland. In line with international trends, the current registrars will become account-keeping entities with the authority to make entries in the book-entry register. The reason for centralizing book entry registers is to rationalize the register structure and to make the Finnish securities markets and clearing and settlement procedures more competitive.

In September 1999 the Ministry of Finance set up a working group to assess whether amendment of legislation on activities involving the taking of deposits and similar funds from the general public and credit transfers is required. The term of the working group expires on 31 December 2000.

Implementation of amended capital adequacy directives in Finland

In 1998 the EU approved three amendments to three directives: 98/31/EC, 98/32/EC and 98/33/EC (the Luxembourg compromise). These directives amend Council Directive 89/647/EEC on a solvency ratio for credit institutions and Council Directive 93/6/EEC on the capital adequacy of investment firms and credit institutions, and they must be implemented by 21 July 2000.

The directives permit supervised entities to use their own models in the calculation of market risk. In addition, they impose a capital charge with respect to derivatives the underlying assets of which are shares or commodities (including gold). They also make it compulsory to use the 'mark-to-market' method in the calculation of credit risk on all derivatives whenever a high degree of market risk is associated with the asset items of a credit institution or an investment firm. Moreover, the amendments to the directives lower the risk-weighting of securitized mortgage lending from 100% to 50%.

In autumn 1999 the FSA delivered an opinion on the legal proposal issued by the Ministry of Finance on the subject. The FSA also drafted revisions to its CAD regulations and circulated them for comment in January 2000.

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[2] In Finland insider holdings are public. Insiders are considered to be:

– a member or deputy member of the board of directors or the supervisory board, the managing director or deputy managing director of the company which has issued a share that is subject to public trade, the central securities depository, the stock exchange, the securities intermediary as well as another corporation which organizes public trade in such securities or a auditor, deputy auditor and employee of an audit organization having the main responsibility for the audit for its accounts and a broker.

The FSA in Brief

The Financial Supervision Authority (FSA) is the authority that supervises financial markets in Finland. It was established in 1993 as part of the administrative structure of the Bank of Finland, but it functions as an independent decision-making authority.

At the end of 1999 the FSA had a staff of 123 persons, of whom 110 had permanent positions. A total of 65 employees worked in the Credit Institutions Department, 29 in the Capital Markets Department, 25 in the Support Services Department and 4 in the Director General's staff. About 80% of the FSA's employees serve as experts in their respective fields.

Supervision stresses responsibility of owners for risk management and internal control

The objective of the FSA is to promote financial stability and confidence in the activities of supervised entities and markets.

In its supervisory work, the FSA emphasizes owners' and managers' responsibility for internal control and risk management. These are also priority areas for the supervision conducted by the FSA. Another essential element of supervisory work is inspections focusing on the supervised entities of prime importance for the functioning and risk exposure of the market. In addition, inspections focusing on a particular subject are carried out whenever necessary. On the basis of reporting by the supervised entities, the FSA monitors their financial conditions, risk-taking and operating conditions.

In its supervision of capital markets, the FSA attaches considerable attention to maintaining public confidence in markets. To this end, the FSA monitors market practices and issuers' compliance with disclosure requirements and investigates cases where there is reason to suspect abuse of inside information or other securities market crimes. Through its actions, the FSA seeks to promote smooth and reliable securities trading and clearing and settlement procedures.

The FSA cooperates in supervisory matters with other authorities, notably the Bank of Finland, the Insurance Supervision Authority and the Ministry of Finance. Cooperation with supervisory authorities in other countries is close and becoming increasingly important.

The FSA participates in the drafting of legislation and issues its own regulations and guidelines

The FSA's regulatory activities take the form of both involvement in the drafting of financial market legislation at national and EU level as well as the issue of its own regulations and guidelines. The FSA takes the view that regulation should focus on the essentials and meet the criterion of cost effectiveness. It also seeks to ensure that the regulatory framework in Finland is no more onerous than in other EU member states.

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

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

The FSA is independent in its decision-making

The FSA is headed by the Director General, who is vested with the FSA's decision-making authority. He bears responsibility for ensuring that the FSA performs its tasks in an efficient, economical and appropriate manner. The Director General is assisted by an advisory Management Group, consisting of the Deputy Director Generals, the Deputy Department Head and the Chief Legal Counsel. The members of the Management Group are entitled to make decisions concerning their own sectors in accordance with the division of responsibilities decided by the Director General.

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, the Insurance Supervision Authority and the Ministry of Social Affairs and Health. The Board's responsibilities include approving regulations that are significant or important in principle and far-reaching from the viewpoint of supervision.

Financial Supervision Authority Organization 1.2.2000

Parliamentary Supervisory Council

Board of the Bank of Finland

Board of the Financial Supervision Authority*

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

Director General
Kaarlo Jännäri

Chief Legal Counsel
Liisa Halme

Internal Auditor

Credit Institutions Department

Deputy Director General
Kaiju Kallio

Deputy Head of Department
Risto Määttänen

Sectoral Analysis Division
Veli-Pekka Valori

Institutional Supervision Division
Kaija Kilappa

Legal Services Division
Ilse Lampela

Payments Systems Expert
Veikko Saarinen

Senior Risk Analyst
Monica Ahlstedt

Capital markets Department

Deputy Director General
Anneli Tuominen

Regulations Division
Jarmo Parkkonen

Supervision Division
Ari Voipio

Market Supervision Division
Kaj Blomster

Support Services Department

Deputy Director General
Pirkko Pohjoisaho-Aarti

Financial Statements/ Solvency Division
Paula Launiainen

Communications and Document Services Division
Arja Lerssi-Lahdenvesi

International Affairs Coordination
Jaana Suihko

Information Systems Division
Jaakko Mauranen

Internal Services

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

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

	Actual 1998 FIM 1000	**Actual 1999 FIM 1000**	Budgeted 2000 FIM 1000	Budgeted 2000 EUR 1000
EXPENSES				
STAFF EXPENSES				
WAGES				
Permanent employees	25 630	**28 245**	30 248	5 087
Fixed-term employees	4 115	**3 435**	2 534	426
Holiday substitutes	470	**472**	560	94
Other fees	1 330	**328**	395	66
Total	31 546	**32 480**	33 737	5 674
OTHER STAFF EXPENSES				
Staff-related expenses	9 506	**9 698**	10 686	1 797
Other staff expenses	429	**718**	720	121
Total	9 935	**10 416**	11 406	1 918
OTHER EXPENSES				
Training	1 520	**1 797**	2 263	381
Travel	1 345	**1 593**	2 288	385
IT expenses	3 866	**4 378**	4 636	780
Office services	3 914	**3 595**	4 771	802
Real estate rents and maintenance costs	4 195	**4 930**	6 272	1 055
Other expenses	3 139	**3 101**	4 660	784
Total	17 979	**19 393**	24 890	4 186
DEPRECIATION				
Acquisition of machinery	68	**152**	637	107
Total	68	**152**	637	107
TOTAL EXPENSES	59 528	62 440	70 669	11 886
INCOME				
Supervision fees	–56 390	**-58 773**	–68 156	–11 463
Processing fees	–3 187	**-3 314**	–2 496	–420
Other income	–276	**-346**	–18	–3
TOTAL INCOME	–59 853	-62 432	–70 669	–11 886

Source: Financial Supervision Authority.

Table 7. Supervision and processing fees, 1999

	1999 FIM 1000	1998 FIM 1000
SUPERVISION FEES		
Commercial banks	**25 859**	25 932
Central institution and member banks of amalgamation of cooperative banks	**7 441**	7 288
Local cooperative banks	**846**	841
Savings banks	**1 138**	1 065
Savings banks foundations	**793**	624
Other credit institutions	**5 345**	6 135
Quarantee funds	**265**	301
Representative offices and brances of foreign credit institutions	**245**	215
Credit institutions' holding companies	**90**	80
Pawnshops	**50**	51
Marketplaces	**2 677**	1 330
Firms offering investment services	**6 550**	5 598
Managemet companies	**2 663**	2 370
Book-entry registers and Finnish Central Securities Depository LTD	**1 331**	1 866
Issuers	**2 336**	2 170
Keepers of insider registers	**1 157**	190
Currency exchange offices		7
Total	**58 785**	56 063
PROCESSING FEES		
Management companies	**1 198**	974
Issuers	**1 423**	1 710
Others	**693**	503
Total	**3 314**	3 187
TOTAL EXPENSES	62 098	59 251

Source: Financial Supervision Authority.

Costs are covered by levying supervision fees

In 1999 costs arising from the operations of the FSA amounted to FIM 62.4 million. Costs are covered by supervision fees, which are levied on supervised entities and issuers of securities. Part of the supervision fees is levied in the form of specific fees. In 1999 5.3% (FIM 3.3 million) of the costs was covered by specific fees.

Supervision fees are set by the Board of the FSA. In contrast, the annual budget of the FSA is approved by the Board of the Bank of Finland.

Strategic directions 2000–2003

Mission Statement

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

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

Independent,
Transparent,
Productive and
Skilled organization.

Vision

The FSA is dedicated to furthering financial market stability and public confidence in markets within an integrating Europe.

As an organization the FSA seeks to be

- a financial supervisory authority which is independent, reliable and transparent
- a respected member of the supervisor network at national and international, particularly EU, level.

Strategy

To achieve its vision the FSA will

- carry out the financial supervision and other basic tasks it has been assigned in law and
- foster

I. market orientation and markets' access to information
II. the efficient and reliable functioning of markets and
III. cooperation with stakeholders at home and abroad.

I. We will foster market orientation and markets' access to information

- We will promote self-regulation that is binding on market participants, within the limits set by market structure, with a view to reducing the need for detailed legislation.
- We will seek to ensure that supervised entities publish essential and adequate information on their financial position and activities, in accordance with international recommendations and standards, and that supervised entities and firms whose shares are publicly traded actively inform the public about any matters affecting their financial results in readily understandable terms.
- We will increase the publication of supervisory measures and opinions on supervision-related issues with a view to fostering market transparency and stability.
- We will seek to promote customer/investor protection by providing guidance on market practices.

II. We will foster the efficient and reliable functioning of markets

- We will focus supervision and our supervisory measures on institutions and systems of central importance for market stability and efficiency, taking into account any shifts that occur in risk-taking in the financial system.
- We will seek to ensure that laws provide the FSA with adequate powers, means of action and sanctions.
- We will endeavour to ensure that corporate governance in supervised entities develops in a direction that strengthens market discipline.
- We will seek to enhance supervision by developing our own activities and the assessment of their results and effectiveness.

III. We will intensify cooperation with stakeholders at home and abroad

- We will contribute to the preparation of legislation by the EU, the Ministry of Finance, the Ministry of Justice and the Ministry of Social Affairs and Health with the aim of establishing a cost-effective regulatory framework that focuses on essential matters. We will further endeavour to ensure that the national regulatory framework does not become more onerous than corresponding frameworks in other EU member states.
- We will work closely with other supervisors at home and abroad as required for the effective supervision and regulation of financial conglomerates.
- We will further intensify our cooperation with auditors with a view to making auditors' reports more informative.
- We will contribute to the development of the authorities' plans for and readiness to work together in managing potential crises.
- In preparing regulation, we will make use of views and opinions solicited from experts, requests for comment, contacts with market participants and experiences and practices of other EU member states.
- We will focus our international cooperation particularly on the EU (Commission, Council, BAC, ECB, FECSO etc).
- We will promote public awareness of legal provisions on prevention of securities crime and money laundering and participate in national and international cooperation concerning prevention of such crime.

Supporting Strategies

Communications

- We will use communications to support the achievement of the objectives of supervision by informing supervised entities, the authorities, the media and other stakeholders about these objectives and our observations, opinions and measures with respect to supervision.

Information management

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

Human resources management

- We will keep the number of staff unchanged and endeavour to meet the growing demands of supervision by targeting work more effectively, by developing employee skills and by outsourcing. We will develop employee skills through, for example, ongoing training and job rotation. We will pay particular attention to future skill requirements when recruiting new staff.
- We will utilize the skills and expertise of the entire staff by allocating resources to priority areas across the borders of organizational units.
- We will develop employees' technological and IT skills.
- We will develop management skills and working methods.

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

Ethical principles based on loyalty and independence

1. Commitment to the goals and decisions of the FSA

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

2. In-house treatment of information and secrecy

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

3. Loans, guarantees and other contingent liabilities

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

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

4. Securities trading

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

5. Gifts, representation, etc

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

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

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

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

7. Secondary occupations

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

8. Change of employment

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

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

The publication series

These publications were released in English in the publication series during the year 1999. They are available on the FSA's website, www.rata.bof.fi.

Statements

- Recommendation concerning enhanced disclosure of information on financial instruments in annual accounts
- Transparency of mutual funds' fee structures and differentiation of fees of mutual funds
- Interpretation of disclosure provisions contained in the Securities Markets Act
- Right of credit institutions and investment firms to provide investment services based on commodity derivatives
- The effect of guarantees issued by certain undertakings on the risk weighting of asset items included in the capital adequacy calculation
- Outsourcing by supervised entities
- Accounting treatment of index-linked and other debt instruments not tied to an interest rate

Notifications

- Financial Supervision Authority confirms criteria for professional investors

Journal 1999

Main items of the Journal:

	1999	1998
Internal matters	115	103
Administration of supervised entities	802	570
Supervision	962	591
Risk management	126	214
Accounting, annual accounts and auditing	32	77
Customer protection and safequarding competition	322	359
Inspections	87	94
Other matters concerning supervised entities	50	92
Other external matters	158	137
Total	2 654	2 237

Major categories of journal entries:

	1999	1998
Investigation requests concerning customer protection	183	217
Listing particulars	127	196
Matters regarding rules	294	193
Notifications	168	142
International cooperation	99	106
Contractual terms	68	83
Inspections by plan	63	77
Own funds and capital support	37	75
Disclosure obligation	281	63
Prospectuses	71	58

Items recorded in the Journal of the Financial Supervision Authority amounted to 2,654, broken down by departments as follows: Capital Markets Department 1,680, Credit Institution Department 762, Support Services Department 153 and the Director Generals staff 59.

Supervised institutions 1995–1999

31.12.	LP	OP	OPR	POP	SPY	SP	LL	VR	SPS	PLL	UE	ULS	AOJ	AV	SIPA	MP	RY	Oth.	Tot.	SK Tot.
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	1 590
1999	9	–	246	43	1	39	17	4	–	13	5	18	11	–	45	2	25	13	491	1 545

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

Representation abroad

	1995	1996	1997	1998	1999
Subsidiaries	10	5	4	4	4
Representative offices	26	19	16	17	16
Branches	10	11	11	9	8

Supervised institutions, 31 Dec 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, selvitystilassa
Ålandsbanken Abp

Other credit institutions (17)

Diners Club Finland Oy
Eurocard Oy
Handelsbanken Rahoitus Oyj
K-Luotto Oy
Kuntarahoitus Oyj
Kuntien Asuntoluotto Oyj
Leonia Corporate Bank Oyj
Leonia Kortti Oy
Leonia Kuntapankki Oyj
Leonia MB Group Oy
Leonia Rahoitus Oy
Luottokunta
Merita Asiakasrahoitus Oy
Merita Rahoitus Oy
OKO-Investointiluottopankki Oyj
OP-Rahoitus Oy
Suomen Hypoteekkiyhdistys

Member banks of the amalgamation of the cooperative banks (246)

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
Hauhon Osuuspankki
Haukivuoren Osuuspankki
Heinäveden Osuuspankki
Himangan Osuuspankki
Hinnerjoen Osuuspankki
Hirvensalmen Osuuspankki
Honkilahden Osuuspankki
Huhtamon Osuuspankki
Huittisten Osuuspankki
Humppilan Osuuspankki
Hämeenkosken Osuuspankki
Hämeenlinnan Seudun Osuuspankki
Iisalmen Osuuspankki
Iitin Osuuspankki
Ikaalisten Osuuspankki
Ilomantsin Osuuspankki
Janakkalan Osuuspankki
Joensuun Osuuspankki
Jokioisten Osuuspankki
Juuan Osuuspankki
Juvan Osuuspankki
Jämsän Seudun Osuuspankki
Kainuun Osuuspankki
Kalajoen Osuuspankki
Kalkkisten Osuuspankki
Kangasalan Osuuspankki
Kangasniemen Osuuspankki
Kankaanpään Osuuspankki
Kannuksen Osuuspankki
Karjalan Osuuspankki
Karkun Osuuspankki
Karunan Osuuspankki
Karvian Osuuspankki
Kaustisen Osuuspankki
Keikyän Osuuspankki
Kemin Seudun Osuuspankki
Kerimäen Osuuspankki
Keski-Suomen Osuuspankki
Keski-Uudenmaan Osuuspankki
Kestilän Osuuspankki
Kesälahden Osuuspankki
Kihniön Osuuspankki
Kiihtelysvaaran Osuuspankki
Kiikalan Rekijoen Osuuspankki
Kiikoisten Osuuspankki
Kiskon Osuuspankki
Kiteen Seudun Osuuspankki
Kiukaisten Osuuspankki
Koillis-Savon Osuuspankki
Koitin-Pertunmaan Osuuspankki
Kokemäen Osuuspankki
Kokkolan Osuuspankki
Kontiolahden Osuuspankki
Korpilahden Osuuspankki
Korsnäs Andelsbank
Kotkan Seudun Osuuspankki
Kouvolan Seudun Osuuspankki
Kronoby Andelsbank
Kuhmalahden Osuuspankki
Kuhmoisten Osuuspankki
Kuhmon Osuuspankki
Kuopion Osuuspankki
Kuortaneen Osuuspankki
Kurun Osuuspankki
Kuusamon Osuuspankki
Kuusjoen Osuuspankki
Kymijoen Osuuspankki
Kärkölän Osuuspankki
Kärsämäen Osuuspankki
Käylän Osuuspankki
Köyliön Osuuspankki
Laitilan 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
Metsämaan Osuuspankki
Miehikkälän Osuuspankki
Miettilän Osuuspankki
Mouhijärven Osuuspankki
Mynämäen Osuuspankki
Myrskylän Osuuspankki
Mäntsälän Osuuspankki
Mäntän Seudun Osuuspankki
Nagu Andelsbank
Nakkilan Osuuspankki
Niinijoen Osuuspankki
Nilsiän Osuuspankki
Nivalan Osuuspankki
Nousiaisten Osuuspankki
Nurmeksen Osuuspankki
Orimattilan Osuuspankki
Oripään Osuuspankki
Oriveden Seudun Osuuspankki
Osuuspankki Kantrisalo
Osuuspankki Realum
Oulaisten Osuuspankki
Oulun Osuuspankki
Outokummun Osuuspankki
Paattisten Osuuspankki
Paavolan Osuuspankki
Padasjoen Osuuspankki
Paimion Osuuspankki
Paltamon Osuuspankki
Parikkalan Seudun Osuuspankki
Parkanon Osuuspankki
Pedersörenejdens Andelsbank
Perhon Osuuspankki
Perniön Osuuspankki
Peräseinäjoen Osuuspankki
Pieksämäen Seudun Osuuspankki
Pielaveden Osuuspankki
Pihtiputaan Osuuspankki
Pohjolan Osuuspankki
Polvijärven Osuuspankki
Porin Seudun Osuuspankki
Porvoon Osuuspankki
Posion Osuuspankki
Pudasjärven Osuuspankki
Pukkilan Osuuspankki
Pulkkilan Osuuspankki
Punkalaitumen Osuuspankki
Puolangan Osuuspankki
Purmo Andelsbank
Pyhäjärven Osuuspankki
Pyhännän Osuuspankki
Päijät-Hämeen Osuuspankki
Pälkäneen Osuuspankki
Pöytyän Osuuspankki
Raahen Seudun Osuuspankki
Rantasalmen Osuuspankki
Rantsilan Osuuspankki
Rauman Seudun Osuuspankki
Rautalammin Osuuspankki
Riihimäen Seudun Osuuspankki
Riistaveden Osuuspankki
Ruhtinansalmen Osuuspankki
Ruoveden Osuuspankki
Rymättylän Osuuspankki
Rääkkylän Osuuspankki
Sallan Osuuspankki
Salon Seudun Osuuspankki
Sauvon Osuuspankki
Savitaipaleen Osuuspankki
Savonlinnan Osuuspankki
Sideby Andelsbank
Siikajoen Osuuspankki
Simpeleen Osuuspankki
Somerniemen Osuuspankki
Someron Osuuspankki
Sonkajärven Osuuspankki
Sotkamon Osuuspankki
Strömfors Andelsbank
Sulkavan Osuuspankki
Suodenniemen Osuuspankki
Suomussalmen Osuuspankki
Suonenjoen Osuuspankki
Sysmän Osuuspankki
Säkylän Osuuspankki
Taivalkosken Osuuspankki
Taivassalon Osuuspankki
Tampereen Seudun Osuuspankki
Tarvasjoen Osuuspankki
Tervolan Osuuspankki
Tervon Osuuspankki
Toholammin Osuuspankki
Toijalan Osuuspankki
Tornion Osuuspankki
Turun Seudun Osuuspankki
Tuupovaaran Osuuspankki
Tyrnävän Osuuspankki
Ullavan Osuuspankki
Urjalan Osuuspankki
Utajärven Osuuspankki
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

OKOBANK Group Central Cooperative (1)
Osuuspankkikeskus-OPK Osuuskunta

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

Pawnshops (13)
Helsingin Pantti-Osakeyhtiö
Hämeen Panttilainakonttori Oy
Kymen Panttilainaamo Oy
Lahden Pantti Oy
Lohjan Panttilaina Oy
Oulun Panttilainakonttori Oy
Panttilainaosakeyhtiö Europantti Oy
Päijät-Hämeen Pantti Oy
Rovaniemen Panttilainakonttori Oy
Satakunnan Panttilainaamo Oy
Suomen Arvopantti Oy
Suomen Luottopantti Oy
Töölön Pantti Oy

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

Limited company savings banks (1)
Aktia Sparbank Abp

Holding companies of credit institutions (3)
Ane Gyllenberg Ab
Leonia Oyj
Meritanordbanken Abp

Finnish representative offices of foreign credit institutions (5)
Abn Amro Bank
Credit Suisse First Boston
Landesbank Schleswig-Holstein,
Nordfinanz Bank Zürich
Sociètè Gènèrale

Finnish branches of foreign credit institutions (18)
BMW Financial Services Scandinavia AB
Caterpillar Financial Nordic Services Aktiebolag
Citibank International plc
Credit Agricole Indosuez
D. Carnegie AB
Den Danske Bank Aktieselskab
Ellos Finans Aktiebolag
FCE Bank plc
GE Capital Equipment Finance Ab
Handelsbanken Finans Aktiebolag (publ)
Scania Finans Aktiebolag
SEB Finans AB (publ)
Skandinaviska Enskilda Banken AB (publ)
Svenska Handelsbanken AB (publ)
Telia Finans Finland, filial till Telia Finans Aktiebolag
Trevise Pankki Oyj
Unibank A/S
Xerox Credit Aktiebolag

Banks' security funds (4)
Liikepankkien ja Postipankki Oy:n Vakuusrahasto
Osuuspankkien Vakuusrahasto
Paikallisosuuspankkien Vakuusrahasto
Säästöpankkien Vakuusrahasto

Deposit guarantee fund (1)
Talletussuojarahasto

Capital market participants

Book-entry system participants (11)
Aktia Sparbank Abp
HEX Securities Services Ltd Oy
Leonia Pankki Oyj
Merita Pankki Oyj
Osuuspankkien Keskuspankki Oyj
Osuuspankkikeskus-OPK osuuskunta
Oy Samlink Ab
Skandinaviska Enskilda Banken AB (publ)
Suomen Arvopaperikeskus Oy
Svenska Handelsbanken AB (publ)
Ålandsbanken Abp

Marketplaces (2)
Helsingin Arvopaperi- ja johdannaispörssi, selvitysyhtiö Oy
Helsinki Exchanges Group Ltd Oy

Management companies (25)
Aktia Rahastoyhtiö Oy
Alfred Berg Rahastoyhtiö Oy
Aurator Rahastoyhtiö Oy
Carnegie Rahastoyhtiö Oy
Conventum Rahastoyhtiö Oy
Diana Rahastoyhtiö Oy
Evli-Rahastoyhtiö Oy
Fides Rahastoyhtiö Oy
FIM Rahastoyhtiö Oy
Fondita Rahastoyhtiö Oy
Gyllenberg Fondbolag Ab
Handelsbanken Fondbolag Ab
Leonia MM Rahastoyhtiö Oy
Leonia Rahastoyhtiö Oy
Mandatum Rahastoyhtiö Oy
Merita Rahastoyhtiö Oy
Myriadi Rahastoyhtiö Oyj
OP-Rahastoyhtiö Oy
PYN Rahastoyhtiö Oy
Rahastoyhtiö Protos International Oy
Sampo Rahastoyhtiö Oy
Seligson & Co Rahastoyhtiö Oyj
Trevise Rahastoyhtiö Oy
WIP Rahastoyhtiö Oy
Ålandsbanken Fondbolag Ab

Investment firms (45)
ACM Oy Active Cash Management
Aktia Asset Management Oy
Alexander Corporate Finance Oy
Alfred Berg Finland Oy Ab
Alfred Berg Omaisuudenhoito Oy
Aros Securities Oy
Aurator Varainhoito Oy
Carnegie Varainhoito Suomi Oy
Conventum Asset Management Oy
Conventum Corporate Finance Oy
Conventum Pankkiiriliike Oy
EQ Pankkiiriliike Oy
Estlander & Rönnlund Financial Products Ab
Evli Corporate Finance Oy
Evli Rahamarkkinat Oy
Evli Varainhoito Oy
Fides Asset Management Oy
FIM Omaisuudenhoito Oy
FIM Pankkiiriliike Oy
FSB Pankkiiriliike Oy
Gyllenberg Asset Management Pankkiiriliike Oy
Hiisi Pankkiiriliike Oy
IFA Varainhoito Oy
Leonia Omaisuudenhoito Oy
Mandatum Pankkiiriliike Oy
Mandatum Varainhoito Oy
Merita Asset Management Oy
Merita Delta Oy
Merita Pankkiiriliike Oy
MNB Maizels Oy
Opstock Oy
Oy Ahola & Maliniemi Partners Ab
Oy United Bankers Pankkiiriliike, Fondkommission Ab
Pankkiiriliike BBL Finland Oy
Pankkiiriliike Evli Oyj
Pankkiiriliike Evli-Optiot 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
Wahlström Immonen Partners Oy

Holding companies of investment firms (7)
Alfred Berg Finland Oy Ab
Bagg Holding Ab
Conventum Oyj
Finanssi-Sampo Oy
Oy UB Finance Ab
Uggla, Rutanen, Seligson & Co
Welnesor Oy

Investor compensation fund (1)
Sijoittajien korvausrahasto

Regulations and guidelines

Regulations and guidelines that were issued in English and entered into force in 1999. Regulations and guidelines are available on the FSA's website (www.rata.bof.fi).

Credit Institutions

105.2
Regulation on the reporting of shares and real estate held by credit institutions and their consolidation groups

105.7
Regulation on reporting country risk

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

105.12
General guideline on the risk management of derivatives

106.8
Regulation on submission of annual accounts and relevant accounting information by credit institutions and their groups to the Financial Supervision Authority

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

106.13
Guideline on interim reports of credit institutions whose securities are subject to public trading

106.14
Guideline on annual accounts announcements of credit institutions whose shares are subject to public trading

108.1
Regulation on risk management and other aspects of internal control in credit institutions

108.2
Guideline on risk management and internal control principles as well as internal audit function of credit institutions

Securities Markets

201.2
Guideline on procedures to be observed in the marketing of securities

201.5
Regulation on declaration of insider holdings

201.6
Regulation on registers of insider holdings

201.7
Guideline on practices to be applied in the provision of investment services

202.13
Guideline on risk management and other aspects of internal control in stock exchange

203.8
Regulation on monthly reporting by investment firms

203.18
Guideline on interim reports of investment firms whose securities are subject to public trading

203.19
Guideline on annual accounts announcements of investment firms whose shares are subject to public trading

203.27
Regulation on risk management and other aspects of internal control in investment firms

203.28
Guideline on risk management and internal control principles as well as internal audit function of investment firms

206.4
Guideline on risk management and other aspects of internal control in central securities depository

Regulations and guidelines issued in 1999 that enter into force in 2000

105.9
Guideline on foreign currency risk limit

Assessment of the interest rate risk of deposit banks

Income risk stems from the balance sheet effects of changes in interest rates on the financing of a short-term (less than one-year) maturity deficiency or on the investment of an excess for one year, starting from the reporting date. Depositor behaviour has proven to be quite inflexible in response to changes in interest rates. For this reason, the income risk of euro-denominated items is calculated using different assumptions regarding repricing of sight deposits. The purpose is to assess the effects of such assumptions on risk calculations. The later the repricing of sight deposits occurs, the more favourable is the impact of an increase in interest rates on banks' earnings.

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 risks takes account of the sensitivity of off-balance-sheet items held as trading assets to changes in interest rates (change in market value in response to a rise in interest rates).

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 not repriced until one year later. The interest rate risk relative to risk-bearing capacity is obtained by expressing the interest risk thus obtained as a percentage of net income from financial operations at the end of the previous year.

The FSA monitors foreign activities of credit institutions

Monitoring of country risk is concerned with analysis of counterparty risk and the geographical concentration of claims, ie assessing the magnitude of credit institutions' risk exposures in different countries.

International economic crises may affect the Finnish banking sector either directly, through lending, financial assets or other foreign claims, or indirectly, if the effects of the crisis are transmitted to eg credit demand in the form of general economic uncertainty. If, for example, export firms get into difficulties, this may lead to an increase in loan losses.

In their country risk reports, credit institutions and their groups are required to analyse their foreign claims by maturity and sector. In addition, each credit institution is required to report its foreign liabilities broken down by currency. The foreign claims of credit institutions subject to the reporting requirement constitute about 99% of the foreign claims of the entire banking sector.

History of financial markets and financial market supervision

Reriod 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.

1999 The euro era started.

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

1933 Mortgage banks

1970 Savings banks, cooperative banks, credit companies and banks' security funds

1979 The Mortgage Association and representative offices of foreign credit institutions

1987 Management companies and mutual funds

1988 Postipankki Ltd. and derivatives markets

1989 Securities markets

1991 Branches of foreign credit institutions and the book-entry securities system

1992 Credit institutions as defined in the Financial Activities Act and savings bank foundations

1993 Pawnshops

1994 Credit institutions' consolidation groups and foreign service providers

1996 Investment firms

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