Contents

Operating environment of financial markets in 2003

In the first half of 2003, global economic developments were clouded by various uncertainties, such as the Iraq war and the SARS epidemic. However, economic growth picked up considerably after early autumn, mainly on the back of improved outlook for the US economy. Expectations of a pick up in economic growth also strengthened in the euro area and Finland. Both money market rates and bond yields started to rise again following a decline in the beginning of 2003. Interest rates are expected to remain at last year's levels in 2004 and to increase in 2005–2005. In the foreign exchange markets, the euro appreciated considerably against the dollar in 2003.

Anatomy of an investment scam

This article describes an investment scam in the form of a three-act play. In the event that customers suspect they have fallen victim of a fraudulent investment, they should contact the FIN-FSA while discussions with the so-called service provider are still under way. Otherwise it may be too late, from the customer's perspective, for the authorities to become effectively involved.

Instant loan over the mobile phone?

The real rate of interest charged on an instant loan may amount to more than 300% per annum. Fast loan provision by itself does not require authorisation and hence such activity is not supervised by the FIN-FSA. The position of the customer is protected by consumer law. Consumer protection authorities may intervene in business activities that are deemed unfair to consumers.

Trend in index-linked notes towards offering a more comprehensive investment portfolio

Index-linked notes are more and more often comprehensive investment products, which increasingly resemble mutual fund or asset management products. This increases the investor's need to carefully scrutinise the terms of the yield calculation of the note and consider the issuer's loan servicing ability. The ever more individual and various index-linked notes pose challenges to issuers too.

FIN-FSA studied realised values of index-linked notes' indicative terms

The final terms of index-linked notes mostly seem to be realised in compliance with the preliminary terms presented at the offer stage. In subscribing to the note, the investor should still remember that the terms of the note do not necessarily have to be realised in accordance with the preliminary values.

Basic banking services reasonably priced, no change in availability

According to a survey conducted by the FIN-FSA, the prices of basic banking services are reasonable on average and have not changed significantly since autumn 2004. Cash payment of bills in a bank is by far the most expensive basic banking service. There was no change in the availability of banking services compared to last year.

Supervised entities’ order handling and trade allocation procedures are appropriate

In spring 2005, the FIN-FSA performed nine inspections which focused on stock brokers’ and asset managers’ order processing and trade allocation procedures. No major problems were detected with safeguarding the interest of customers, the equitable treatment of customers or

the management of conflicts of interest. Questionnaires sent in advance to 43 stock market operators preceded inspections.

Banks' information security is adequate, but threats to networks have increased

Attacks by various malicious programs, such as worms, viruses and spamming software have become more common in recent years. During supervisory visits made in spring 2005, the FIN-FSA examined how well banks had prepared for possible attacks on their IT systems. For the most part, provisions made by banks for possible security breaches were adequate.

Supervised entities' readiness to prevent money laundering fairly good

In spring 2005, the FIN-FSA conducted a survey on supervised entities' compliance with requirements under the Anti-Money Laundering Act. On the basis of the survey, there is room for improving KYC (know your customer) procedures. About 130 companies participated in the survey.

Process started for approval of advanced credit risk approaches

The new capital adequacy regulation enters into force at the beginning of 2007. This will make it possible for the supervised entities to use their own internal ratings based approaches (IRBA) instead of standardised approaches in their calculation of capital requirements for credit risk. However, approval of the approach by the supervising authority is required.

Unregulated situation as regards emission rights accounting: how to proceed after the withdrawal of the IFRIC interpretation?

Recording carbon dioxide emission rights, or allowances, in listed companies' financial statements has proven problematic, since there is at present no particular guidance on how they should be accounted for. Companies are left to decide for themselves which regulations they apply to emission allowances in their accounting. Emission rights concern fewer than 15 Finnish listed companies.

CEBS to develop European supervisory culture

The Committee of European Banking Supervisors (CEBS) faces major challenges in harmonising European supervisory practices within the banking industry. The new framework for capital adequacy and its implementation provide supervisors with a unique window of opportunity to move towards a common European supervisory culture.

Rulings of the Securities Complaint Board

This article presents cases solved by the Securities Complaints Board that may have broader impact in the markets. The descriptions have been shortened with the aim of explaining only the key facts of each case.

Recent events

New Anti-Money Laundering Directive approved – Two new FIN-FSA standards dealing with issues such as customer identification and due diligence as well as notification of suspicious securities transactions – FIN-FSA investigations into suspected cases of securities market abuse.

Anatomy of an investment scam

Over the years, the mechanics of investment scams have become increasingly complex and sophisticated. It is, for example, easy to offer investment products via the telephone, Internet or similar remote means of communication to citizens in different countries.

A phone call from an unknown investment expert from abroad has attracted the interest of many a Finn, too. The thought of a windfall behind the taxman's back arouses easily an irresistible sense of greed. Any risks involved are ignored when a smooth-talking 'expert' swears as to the uniqueness of the offer.

The old saying 'if you can't stand the heat, stay out of the kitchen' is harsh reality to someone who has lost their own as well as borrowed money, let alone the money of friends and acquaintances, and who – after the initial shock – is thinking 'how on earth did it all happen and how the authorities could assist me in getting my money back?'.

The three-act play described in this article is based on accounts by persons who have fallen prey to these tricksters.

Act I: Initial hook

In January 1999, investor A was contacted by telephone by an American investment expert known as John Lord. He offered investor A a total of 500 shares of a technology company called Lyx Inc, which was seeking listing on the stock exchange, at a price of USD 1,000. Investor A bought these shares and has held on to them ever since. Investor A has understood that the company was never listed. That is why they had considered their investment practically lost.

In March 2005, investor A received a phone call from New York from a person named Zak Starky, who was a representative of Alton Asset Management (hereafter Alton). Starky enquired from investor A if they held Lyx Inc shares, and investor A said they did. Starky told them that the company was currently subject to a hostile take-over. That is why Starky's client was ready to pay investor A a total of USD 10 per share, ie, USD 5,000 altogether. Starky emphasised the confidential nature of the matter. As a result of the conversation, investor A expressed their willingness to sell and authorised Starky to investigate the exact number of shares they held. Appropriate contracts were made via telefax. A customer relationship had been established.

A couple of days later Starky called investor A again to report that according to the share register, investor A owned 1,500 Lyx Inc shares, because the share had been split into three for about a year earlier. Starky also told investor A that the shares are subject to a selling restriction (under US Securities and Exchange Commission rule 144), but that the restriction could be revoked. In fact, only the removal of the selling restriction in the share register would enable the free selling of the shares. The selling restriction would be eliminated, if investor A paid USD 0.90 per share ie USD 1,350 in total. This sum would be reimbursed to investor A as part of the purchase price. Starky sent the payment instructions to investor A, who paid the fee for the removal of the selling restriction to the company's account at a bank in Panama. After this, investor A began to wait for the sales price to be credited to their account.

A week from the previous contact, investor A received another phone call from Oliver Sweeney, also a representative of Alton. He told investor A that each share entitled them to a subscription of four new shares at a price of USD 4 each. The subscription period would expire within 3 days. Sweeney offered investor A the possibility to subscribe to 6 000 new shares at a price of USD 4 each. Sweeney also assured investor A that the original buyer of their shares would also buy investor A's new shares at the same price of USD 10 each. Investor A accepted the offer and paid USD 24 000 to the company's bank account in Panama. Investor A calculated they now owned 7,500 shares to a total value of USD 75,000.

After this, Sweeney sent investor A an email with the form W8-BEN as an attachment for the US tax authorities. In his message, Sweeney told investor A that because they they were not a US citizen, and did not have a Green Card, they were obliged to pay taxes in the amount of USD 15,000. This sum, however, would be reimbursed to them a week after the conclusion of the deal as they were not a US citizen. Investor A paid the "tax" to the company's Panamanian bank account. In the same message, Sweeney informed

investor A of the possibility to get a guarantee for the forthcoming share transaction via the guarantee firm Intercapital Management Group used by the company.

Any doubts that investor A may have had as to the risks involved vanished when they signed a letter of guarantee on the last day of March. According to the letter of guarantee, Intercapital Management Group as guarantor assumed liability for USD 40,000 of the sum total of the share transaction in question. Investor A paid a guarantee fee of USD 5,000 to the company's bank account in Panama. The letter of guarantee was subject to Panamanian law.

On 7 April, Zak Starky telephoned investor A to inform them of a successful share transaction and of the transfer of the monies the following week, via Panama, to investor A's bank account.

The monies were never credited to investor A's account, and investor A has not been able to get in touch with any of the persons involved in the transaction.

Investor A's losses: USD 1,000 + 1,350 + 24,000 + 15,000 + 5,000 = USD 46,350

Act II: Leeching

Some months later, investor A received a phone call from Illinois from a person named Luke Scott, who represented Bryce & Sons Ltd. Luke Scott declared he represented an authorised asset management company offering an officially approved arrangement known as the Capital Recovery Program, specifically designed by them for unsuccessful investors such as investor A. All investor A had to do was to send to the company all documents relating to the lost investment capital together with an authorisation to act as agent as well as sign a customer agreement. After this, the company would file an application on behalf of investor A to the US investor compensation fund. All this would be done if investor A paid to the company represented by Scott a registration fee of 10% of the lost share capital ie USD 7,500.

Investor A hesitated but the thought of reclaiming the lost capital made them send the requested sum to the company. Investor A is still waiting for the promised compensation. Where the company had obtained investor A's personal details remained unclear.

Act III: Last hope

Investor A would like to forget the entire sequence of events, but the personal and contact details that have been circulated continue to attract new scamsters. In September 2005, investor A received a telephone call from Chicago from a person named Lisa Cruz, who introduced herself as being employed by an auditing firm called Chicago Accounting. The company was interested in investors such as investor A, who owned shares of companies that were not currently in operation. Cruz referred to the US Tax Code Section 165, whereby investor A's investment losses could be employed in the tax planning of another of Cruz's customers. In order for this to be possible, investor A was to send Cruz the purchase and identification documents relating to the shares held by investor A to enable Cruz to calculate the sum total of final losses. Investor A hung up before Cruz had time to declare the size of the advance payment.

Investor A's total losses amounted to USD 53,850. Investor A pulled themselves together and contacted the FIN-FSA.

Identify a scam

Scams have many common features, such as:

- Means of contact is the telephone or the Internet or both.
- Telephone calls are typically made from ETA countries, the Far East or the United States.
- Potential customers are contacted on a constant basis.
- The investment target is normally shares in a company currently seeking listing on a stock exchange.

- Investors have insufficient data on the investment target.
- The information given to customers about the company is insufficient.
- Customers are given sketchy replies to any questions concerning the service provider (authorisation, address, details of the contact person, reporting, custodian).
- The investment target is said to be risk-free and very lucrative.
- The expense structure of the service offered to customers is vague.
- Payments must be effected in advance.
- Contracts and any other possible documents are vague.
- Service providers are only intermittently in contact with their customers and in the event of problems, they are difficult to reach or cannot be contacted at all.

When alarm bells should go off

"The five pillars" of a scam are as follows:
1) brokers operate in one country
2) customers operate in another country
3) shares or fund units are registered in a third country
4) payments are effected into a fourth country
5) the scamsters operate in a fifth country.

Final act

The FIN-FSA has very limited possibilities to affect investor A's position at this stage of the procedure. Essential for further investigations is that investor A draws up an overall picture of the sequence of events, supported by the relevant documents, and files a police report concerning the offence. International cooperation by the police may provide further insight into the matter. The FIN-FSA may also contact the market supervisor of the target country in order to obtain further information, but this procedure is rarely initiated as these types of operators are already on the warning lists of different countries.

The FIN-FSA has far better possibilities to affect investor A's position and other comparable situations if investors contact the FIN-FSA when discussions with the 'service provider' are still under way. Danger signals can be analysed together, and investors can also test the reliability of the service provider. In these kinds of situations, the FIN-FSA's warning recommendations have usually proven fruitful.

For further information, please contact
Mr Harri Hirvi, tel. +358 10 831 5284.

Instant loan over the mobile phone?

Late last spring, a new type of credit product entered the market, promising customers smooth and easy mini loans for short periods at high interest. Loans are granted in the amounts of 100 to 200 euro at a cost of 20 to 50 euro. Converted into annual rates of interest, the real interest on these loans is 300% to 350%. In general, loans must be paid back within one to three weeks.

A common criterion for these loans is that they are granted to solvent adults with regular income and require no security. Loan applications are submitted by text message or via the Internet. The loan sum is instantly credited to the customer’s bank account. Some loan providers also require that previous loans have been paid back before new ones can be granted.

Taking out an instant loan requires forethought

Plenty of arguments for and against this new form of credit have been presented. On the one hand, the range of credit instruments has been expanded as a result of the availability of speedy loans and demand for

such instruments does exist. On the other hand, the risk of excessive indebtedness has also increased. Excessive indebtedness is a serious risk particularly when the solvency of the borrower is poor and fast credit is obtained simultaneously from different lenders.

It is important that a person intending to borrow considers at least the following matters:

- Is it necessary to take out a loan?
- What kinds of loans are available and what do they cost? What kind of a loan is the most appropriate in the given situation? It is always useful to ask for offers from different loan providers and compare them.
- Is the borrower in a position to pay back the loan?

Fast lending by itself does not require authorisation

A frequently asked question is whether fast lending activity requires authorisation and who supervises it. Basically, lending activity does not require authorisation. Only when lending is financed by repayable funds accepted from the public, the activity may require authorisation and hence need to be supervised by the FIN-FSA.

Anyone who plans to set up such business should first check with the FIN-FSA whether the services intended require authorisation or not. Relevant background information can be found in the first chapter of the Credit Institutions Act (1607/1993).

Consumer protection authorities may intervene

As long as the activities of an enterprise do not require authorisation, its business or performance is not supervised by authorities.

However, the interests of the consumer are secured through consumer protection legislation. Consumer protection authorities may intervene in the activities of an enterprise if they are considered unfair to consumers.

If you plan to borrow, check the following:

- Consider whether you need to borrow or may be able to reach your target by saving in advance.
- If you decide to take a loan, consider different options carefully.
- Keep in mind that a loan must always be paid back: over the longer term, your earnings and outlays must be in balance.

For further information, please contact

Ms Ilse Lampela, Legal Counsel, telephone +358 10 531 5292, or
Mr Risto Määttänen, Adviser, telephone +358 10 831 5304 (authorisations).

Trend in index-linked notes towards offering a more comprehensive investment portfolio

The number of index-linked notes issued has grown rapidly in recent years. A large variety of products have been introduced to the market, providing more alternatives to investors. Also the number of issuers of index-linked notes has increased. In addition to Finnish market participants, some international participants also offer index-linked notes in Finland.

Calculation of yield on index-linked notes in transition

In recent years the character of index-linked notes as investment products has changed clearly. Previously the yield of an individual index-linked note was often primarily linked to the value development of one single investment object. Nowadays index-linked notes are increasingly diversified so that the underlying is composed of up to 3–5 different indices. The investor can diversify risk either across lines of business or geographical locations, when the underlying is represented by, for example, several stock indices.

Diversification of the underlying has, however, been taken one step further by introducing different asset types. Lately, for example, foreign exchange rates, various commodities or comprehensive commodity indices have increasingly been used as the underlying of index-linked notes.

In addition to the wider diversification of the underlying, new features have also been introduced in the calculation of yield. In many cases, a more active nature of the index-linked note has been pursued so that the calculation of the yield and the underlying of the individual note can react to changes in the market. One example of this is an index-linked note where the indices included in the underlying are regularly reweighted during the maturity of the note. There are also index-linked notes for which the yield is calculated on several diversified asset portfolios and the yield received by the investor is determined on the basis of the best-performing portfolio.

Consequently the index-linked note does not necessarily represent a single investment product to the investor but a more comprehensive solution, in which a widely diversified, actively changing investment portfolio can be acquired through one investment product. The biggest step towards a comprehensive and actively managed investment portfolio has been taken in such index-linked notes where the calculation of yield is based directly on active asset management.

Marketing of index-linked notes' security not problem-free

Security is a significant sales argument used for index-linked notes. The security of index-linked notes is often marketed as principal-protected. Issuers use the term to emphasise the difference between index-linked notes and, for example, direct stock investments. In direct stock investments the investor loses his principal, if the share price falls, but in an index-linked note the nominal amount invested, as typically in bonds and notes, is repaid in full, even if there should be an unfavourable development in the value. The nominal amount invested in an index-linked note can only be jeopardised in case the issuer cannot meet his obligations.

It is not necessarily easy to communicate understandably to investors the security of index-linked notes. In addition to the above-mentioned issuer risk, the investor should know that the repayment of principal only comprises the nominal amount of the loan. Thus the investor may fully or partly lose a premium paid.

Certificates increase risk

An alternative to security-geared index-linked notes is offered by certificates pursuing higher yield at higher risk. In their case an unfavourable value development may lead to partial or even full loss of principal. As opposed to the risk of loss of principal, certificates offer a chance to achieve significantly larger yields. In general, yield structures of certificates are more advanced than those of other index-linked notes, and they may correspond with, for example, investment strategies known from the derivatives markets. Thus the

purpose of certificates is not to offer comprehensive investment solutions but to provide transactions in the investment portfolio in order to, for example, utilise effectively a certain market view.

In the marketing of certificates it is particularly important to communicate clearly to investors that certificates involve larger risk of loss of principal than other index-linked notes. However, certificates have been issued quite sparingly in Finland, and investments have been concentrated in index-linked notes offering better protection of the principal.

Development of products poses a challenge both to investors and issuers

In subscribing to index-linked notes, investors nowadays acquire an increasingly comprehensive investment product, which more and more resembles mutual fund or asset management products. In this way a single index-linked note can also constitute a larger share of an individual investor's investment portfolio. In such a case, it is surely increasingly important that the investor carefully scrutinises the terms of the yield calculation of the index-linked note and also considers the significance of the issuer's loan servicing ability.

In addition to the marketing of security, the rapid development of the products as such also poses a challenge to the issuers. As index-linked notes become increasingly individual and diverse, also a growing number of different product-related terms must be managed in the product sales. This creates a need for continuous training of the investment advisers selling the products.

For further information, please contact
Mr Tero Oikarinen, Market Supervisor, tel. +358 10 831 5241.

FIN-FSA studied realised values of index-linked notes' indicative terms

As part of its security market supervision, FIN-FSA has studied how well confirmed, final terms of index-linked notes have corresponded with the indicative or preliminary terms presented in marketing. When an issuer offers an index-linked note to an investor it is possible that some term related to the note yield calculation (for example yield factor, minimum interest or interest premium) is provided as a preliminary value. The final value is not confirmed until later, when the subscription time of the note has expired.

According to the FIN-FSA study, the final value corresponded with the indicative variable in most cases. Moreover, in cases of deviation from the indicative value, the confirmed, final term was better than the indicative term in more cases than vice versa.

In addition to the indicative value, the terms of the note also comprise a range within which the final value will be confirmed when the offer has expired. Not a single final term of the notes studied had been confirmed at the lowest/weakest value of the range indicated in the terms of the notes. For example, the yield factor of a note can be assessed as 70% and the range as 60–80% in the terms of the note. According to a preliminary assessment by the issuer, the yield factor should thus be 70%, but if market conditions change it could be confirmed as 60% at the lowest. Should the changes in the market be so big that the issuer cannot offer a 60% yield factor for the note, the issuer cancels the issue of the note altogether.

Table 1: How well have final terms corresponded with indicative terms?

Number of notes	Final term compared with preliminary term		
	lower	unchanged	better
157	23	100	34

No major differences between issuers

The results of the study show that there are no essential differences between issuers as to how final terms of index-linked notes are distributed in relation to indicative terms. Only one issuer had confirmed final terms that were lower/weaker than the indicative values in more cases than vice versa. However, the number of notes is so small that no generalisation can be made and no conclusion drawn on the basis of them.

By contrast, there is a difference between the issuers as to how the final term exactly matches the indicative value. For some of the issuers the final term nearly always corresponded with the indicative value, whereas for others the final term mostly deviated from the indicative value in one direction or the other. The explanation for this variation is that some of the issuers use a variable issue price together with the indicative terms. Thus the issuer can react to market changes also by changing the issue price.

Why are indicative terms used?

By using indicative terms issuers try to ensure that in a changing market they can still influence the terms of the note up until the time of the issue. After all, hedging his position causes uncertainty to the issuer, as the issuer does not yet know at the offer stage whether the issue will be fully subscribed. If the terms were final already at the start of the offer, the issuer would have to prepare for market changes prior to the time of issue already when the terms are set. This could lead to terms more unfavourable to the investor.

However, the use of indicative terms is not the issuer's only alternative to flexible pricing of notes. The issue price of the note can be variable, which means that the issuer can react to market changes by changing the issue price. It is also possible to use both indicative terms and a variable issue price in the same note.

Investors must take into account that note terms are only preliminary at the offer stage

The final terms of index-linked notes mostly seem to be realised in compliance with the indicative terms. If the final terms have deviated from the indicative terms, they have been better for the investor than the indicative ones on more occasions than vice versa.

However, the investor should always when subscribing to securities take into account that the terms may not necessarily be realised in accordance with the indicative values but may deviate from them within the limits set by ranges stated in the terms of the notes. In assessing the favourability of an index-linked note and in making a comparison among the notes, the investor should also take into account the issue price paid.

After the issue has been completed the issuer must always disclose the final terms of the note. This provides the investor with an opportunity to follow the realised terms' relation to the indicative terms at a general level.

Study sample

FIN-FSA targeted its study on index-linked notes offered to the public 1 January 2002–30 April 2005. During that period a total of 157 index-linked notes with indicative terms were issued. A total of 9 issuers used indicative terms. The number of notes with indicative terms varied from 1 to 55 among the issuers.

For further information, please contact
Mr Tero Oikarinen, Market Supervisor, tel. +358 10 831 5241.

Basic banking services reasonably priced, no change in availability

According to a survey conducted by the FIN-FSA, the prices of basic banking services are reasonable on average and they have not changed significantly since autumn 2004. Nor has there been any change in the availability of banking services compared to last year. The availability and fees charged on banking services were examined in a survey of deposit banks that offer basic banking services. The price level and supply of banking services are monitored on a regular basis. The previous survey was conducted in 2004.

Basic banking services comprise: an ordinary bank account (transactions account), a medium for its use (an ATM card or a debit card) and payment facilities.

The FIN-FSA may also, if necessary, intervene concerning fees other than basic banking service fees. The FIN-FSA takes action regarding a particular fee if a supervised entity regularly or radically deviates from the prevailing fee level without special grounds. In such cases, the FIN-FSA will initially discuss the pricing criteria with the supervised entity in question.

Fees charged on basic banking services remain reasonable

According to the survey, fees on basic banking services remain reasonable on average and have not changed markedly in a year’s time. Cash payment of bills over the counter remains by far the most expensive basic banking service. There are, however, other ways of paying bills. For example, direct debiting is provided free of charge by all banks while paper-based credit transfers handled through their payment services cost 0–2 euro per bill.

The fees levied on other basic banking services range from 0 to 3 euro. Withdrawals from one’s own account over the counter are free of charge in all banks. Some banks offer a basic service package costing 0–2.90 euro.

There are also service options available for special groups in the population that are unable to use Internet banking services (direct debiting, postal payment services). These services are much less expensive than personal visits to the bank.

No marked change in the supply of basic banking services

According to the survey carried out by the FIN-FSA, there was very little change in the service supply over the past year.

Finnish banks have a total of 1,640 local branches. In addition, many banks maintain service points, for example, in shopping centres, providing some banking services but normally not cash transaction services. There are about 1,800 ATMs for the payment of bills; this number reflects a slight decline from the previous period. Some of the ATMs have been replaced by customer terminals maintained by banks (about 1,600). There are about 1,700 cash dispensers in the country.

These numbers do not, as such, demonstrate that banking services are evenly available around the country. However, no one has contacted the FIN-FSA about a lack of banking services. One explanation may be that customers to an increasing degree handle their day-to-day banking business via the Internet at times most convenient to them. Another reason is the continuing growth of debit card purchases.

For further information, please contact
Ms Ilse Lampela, Legal Counsel, telephone +358 10 831 5292.

Supervised entities' order handling and trade allocation procedures are appropriate

Finnish stock brokers and asset managers are aware of the importance of treating customers equitably managing conflicts of interest in their order handling and trade executing procedures. Many trading processes have been automated to a considerable extent. During inspections, no problems were detected with the processing of orders received via the Internet insofar as the interest and equitable treatment of customers or conflicts of interest were concerned.

This is evident from the FIN-FSA's examinations and subsequent inspections which focused on stock brokers' and asset managers' order handling and trade allocation procedures. Special attention was paid to the methods used to ensure that equitable treatment of customers would not be at risk or suffer as a result of supervised entities' trading on own account.

In this respect, the supervised entities' methods varied considerably, for example, depending on their size, market segments and products. There are several acceptable methods used that guarantee equitable treatment of customers and management of conflicts of interest, as long as core regulatory principles are complied with.

It is important to consider each service, customer group and product separately

Inspections brought to light the fact that not all aspects of equitable treatment of customers and management of conflicts of interest had been analysed separately for each service, customer group and product. It is necessary that investment service providers, in particular, identify in their business and pay consideration to all such services, situation and products for which the equitable treatment of customers must be guaranteed or concerning which conflicts of interest may arise.

Service providers must apply predetermined principles and procedures in their allocation of short trading amounts and in their handling of incorrect trades.

Asset managers must pay consideration to procedures in advance

In asset management, equitable treatment of customers and management of conflicts of interest can only be realised if this has been taken account of in advance in drawing up the asset management agreements and in the investment decisions that are based on them.

Asset management customers and trading customers must be served on an equal basis. In trading on behalf of customers, providers of asset management services must also comply with normal order handling rules, such as the obligation to inform customers, documentation of orders and the order in which trades are executed.

Asset managers must record all individual orders and collated orders from several customers, as well as planned and actual allocation of trades, on a sound and ongoing basis.

A stock broker's own trading must be segregated from customer trading

A stock broker may enhance the execution of customers' orders by trading on his/her own account. Procedures on own account trading in connection with customer trading must be in place and followed in such a way that the brokers' own trading does not compromise customers' interest. A stock broker's own active trading, not related to customer trading, must be segregated from customer orders.

Practices and principles need to be documented and guidelines established. Brokers themselves should monitor compliance with internal instructions.

Service providers’ internal control is of key importance

Service providers must maintain systematic and independent internal control processes so as to ensure that customers are treated equally in practice and possible conflicts of interest are recognised and dealt with. In its continuous oversight, FIN-FSA pays attention to supervised entities’ management of conflicts of interest and equitable treatment of customers.

The Securities Markets Act provides the legal framework

The Securities Markets Act lays down many requirements on investment service providers, including the obligation to exercise due diligence, apply sound practices and act in the best interest of customers. Furthermore, investment service providers must seek to avoid situations that may give rise to conflicts of interest. If, however, a conflict of interest does arise, the customer must be informed of this.

Providers of investment services, in particular, are required to treat their customers on an equal basis and not to let the interest of another customer or the issuer or their own interest affect the execution of a customer’s order.

The FIN-FSA has issued more detailed guidelines for investment service providers on safeguarding the interests and equitable treatment of customers.

For further information, please contact
Mr Esa Pitkänen, Market Supervisor, telephone +358 10 831 5248.

Banks’ information security is adequate, but threats to networks have increased

In spring 2005, the FIN-FSA investigated how the major Finnish banks had prepared for various kinds of information security incidents, such as virus attacks, intrusion into IT systems and data seepages. These inspections focused on surveillance, measures and reports in response to attacks. In addition, the FIN-FSA investigated what methods banks had used to patch vulnerabilities in IT systems.

In the opinion of the FIN-FSA, the banks’ handling of information security incidents was appropriate. However, the challenge remains for banks to shorten the time that elapses between the announcement of an IT security vulnerability and correction of the vulnerability, testing and installing the appropriate patch. If possible, this time should be cut down even further.

The FIN-FSA supervisors also discovered some minor shortcomings, for example, in the instructions for the handling of certain information security incidents.

Systematic preparation for security threats is required

The FIN-FSA demands that supervised entities be in a position to detect, analyse and record any information security incidents and report them to the designated unit within the organisation. The FIN-FSA standard on management of operational risk, which took effect earlier this year, contains binding rules and recommendations pertaining to information technology, information security and business continuity planning.

The launchers of malicious programs and abusers of IT system security deficiencies seek to exploit system vulnerabilities before the target of the attack has time to fix the cracks in the system. Supervised entities should therefore test and install patch files to make up their information security deficiencies before a malicious program can spread in the system.

Various kinds of malicious programs, such as worms, viruses and spamming software have become more common. In 2004, the CERT-FI unit set up by the Finnish Communications Regulatory Authority to focus on information security breaches and their prevention received twice the number of notices of information security breaches than in 2003.

For further information, please contact
Mr Markku Koponen, Banking Supervisor, telephone +358 10 831 5389.

Supervised entities' readiness to prevent money laundering fairly good

In spring 2005, the FIN-FSA conducted a survey on supervised entities' compliance with customer identification and KYC (know your customer) requirements and certain other obligations under the Anti-Money Laundering Act. The aim of the survey was also to find out to what extent supervised entities' procedures will have to be changed as a result of the third EU anti-money laundering directive recently adopted by the EU.

The outcome of the survey suggests that most of the respondents comply with current legal provisions on customer identification. It is also evident that supervised entities take a serious approach to money laundering and other kinds of misconduct.

The respondents have, almost without exception, organised their operations and risk management in such a way that they are in a position to prevent money laundering and abuse posing a threat to their business. Almost every company has appointed a contact person to be responsible for internal coordination of anti-money laundering measures and contacts with authorities. Similarly, virtually all respondents have drawn up internal instructions and organised training sessions for their staff. These measures are crucial for keeping staff vigilant.

However, there is room for improving KYC procedures. Not only must customers be identified, it is also necessary to monitor their financial position and business activity and use of services on a regular basis. Under the new Anti-Money Laundering Directive, recently approved by the EU, procedures to be used for obtaining information on customers' business and assessing customer relationships will be subject in due course to more explicit requirements, so-called customer due diligence.

Increase in money laundering reports made by banks

Of the entities supervised by the FIN-FSA, banks continue to account for most of the reports on suspected cases of money laundering. So far, banks' reports of suspicious incidents to the Money Laundering Clearing House have increased to some extent every year. In 2004, reported cases amounted to 450, and 20% of these were forwarded for further, pre-trial investigation. The number of reports is anticipated to remain unchanged in 2005. Usually, the reports concerned the use of accounts, cash payments and foreign and domestic fund transfers. However, most of the cases put forward to the police for further investigation involved tax fraud or other kinds of fraud, defalcation by a debtor, fraud involving payment instruments and drug-related crimes.

Survey sample

The FIN-FSA questionnaire was returned by 130 companies, ranging from credit institutions, investment firms, management companies and Finnish branches of foreign credit institutions and investment firms. In addition to surveys, the FIN-FSA conducts regular supervisory visits and inspections concerning anti-money laundering procedures and organises training sessions on the subject matter.

For further information, please contact
Ms Tuija Nevalainen, Legal Counsel, telephone +358 10 831 5294.

Process started for approval of advanced credit risk approaches

The general purpose of the new capital adequacy framework (Basel II) entering into force at the beginning of 2007 is to increase the use of more advanced risk management systems. Instead of the standardised approach, the supervised entities can use so-called advanced approaches or internal ratings based approaches (IRBA), in which the assessment of credit risk is based on the supervised entity's own risk rating system and own internal estimates of loss given default (LGD estimates). Using these methods, the minimum capital required for covering credit risk corresponds more closely with the credit risk taken by the supervised entity. Introduction of advanced approaches requires approval by the supervising authority. The supervised entity's IRBA is assessed in the Financial Supervision Authority's (FIN-FSA) IRBA approval process.

International banking groups operating within the EU area are aiming at introduction of IRBA on a broad scale at the beginning of 2007. As a result, national supervising authorities have gradually started an IRBA approval process concerning supervised entities submitting their application in the first stage.

Those of FIN-FSA's supervised entities that aim to introduce their IRBA directly at the start of 2007 have had to submit their advance notification to FIN-FSA by the end of September. The actual IRBA application must be submitted by the end of November at the latest.

An assessment for approval of IRBA is a large process starting with assessment of the quality of the application and the IRBA implementation plans. In addition, the IRBA-related risk management arrangements and all minimum requirements for use of IRBA are examined. These requirements comprise internal control and reporting, internal risk rating system, and LGD estimates in the calculation of capital requirement.

Supervisors cooperate in approval of IRB models of international banking groups

The capital adequacy directive regulates the IRBA approval in such groups of supervised entities which have subsidiaries in other EU countries. The approval process is coordinated by the supervised entity's home country supervisor, and the supervisors of the subsidiaries of the group participate in the IRBA approval process as agreed between the supervisors.

The target of the joint approval process is to make a joint decision on the IRBA application. If no joint view can be reached, the coordinating supervisor makes the decision. The decision shall be made within 6 months of the supervised entity's submission of a complete IRBA application to the coordinating supervisor.[1]

Aiming at harmonised methods and criteria in the approval process

In July, the Committee of European Banking Supervisors (CEBS) published preliminary guidelines on the harmonisation of the approval of advanced measurement approaches to operational risk and internal ratings based approaches to credit risk at the European level. The consultation period for the preliminary guidelines expired on 30 October 2005.

The preliminary guidelines contain the crucial operating principles for approval of advanced approaches. Also the instructions on cooperation between supervisors in cross-border approval processes constitute a significant part of the guidelines. In addition, the guidelines comprise essential general criteria to be applied by the supervisors in the approval of advanced approaches. The final CEBS guidelines will also be taken into account in the FIN-FSA standards on the use of advanced approaches in the capital adequacy calculation.

1) The 6-month deadline enters into force when the capital adequacy directive has been implemented on 1 January 2007.

For further information, please contact

Mr Juha Savela, Head of Division, tel. +358 10 831 5384.

Unregulated situation as regards emission rights accounting: how to proceed after the withdrawal of the IFRIC interpretation?

Recording industrial carbon dioxide emission rights (allowances) in financial statements in accordance with the International Financial Accounting Standards (IFRS) has proven problematic for listed companies. There is at present no particular guidance as how they should be accounted for, since the EU did not endorse the interpretation on the accounting for emission rights (IFRIC 3)[1] issued at the end of 2004 by the International Financial Reporting Interpretations Committee (IFRIC), a body of the International Accounting Standards Board (IASB). The IASB withdrew the interpretation in June 2005.

Several listed companies in Finland applied this interpretation in their first quarterly interim financial statements for 2005 although the EU had not yet endorsed it and although it was subsequently withdrawn. This caused a difficult situation for these companies: which regulations should they apply to the recognition and measurement of emission allowances in their future interim and year-end financial statements?

This unregulated situation will probably prevail at least until the preparation of financial statements for 2005, and even longer. During this time, companies should make sure that they disclose a sufficient level of information on the effects of emission allowances and emissions in their notes to financial statements. Information to be disclosed concerns each company's situation as regards allowances held, actual emissions made and the accounting method adopted.

Why was the interpretation withdrawn?

The IASB argued that the withdrawal of the interpretation was needed in both the light of thin emission rights markets in the EU as well as the fact that some countries had not yet issued allowances to companies. The European Financial Reporting Advisory Group (ERFAG) had recommended the EU Commission not to endorse the interpretation. It argued that the application of IFRIC 3 will not always result in relevant financial information because in certain cases it does not faithfully represent economic reality.

The IASB has decided to reconsider the issue and to address the accounting for emission rights in a more thorough and comprehensive manner.

How to proceed after the withdrawal of the IFRIC 3?

In a situation in which there is no particular guidance on the accounting for emission rights, companies should follow IAS 8[2], which has been endorsed by the EU Commission. According to this standard, in the absence of a standard or an interpretation that specifically applies to a transaction, it is the management's task to judge which accounting method best reflects the transaction in question. This view was also supported by the Accounting and Regulatory Committee (ARC), an advisory body to the EU Commission in matters related to the adoption of IFRSs, at its meeting in July 2005. The ARC also noted that the application of IFRIC 3 is not the only interpretation of existing standards; rather, existing IFRSs also include alternative accounting treatments that IFRIC 3 ruled out.

In this situation, it is also possible to account for emission allowances and emission obligations by adopting a net presentation approach. The majority of Finnish listed companies had chosen this approach in their second quarterly interim financial statements for 2005. Under this approach, allowances received free of charge are measured at nominal value in intangible assets and a provision is recognised only for the difference between actual emissions produced and corresponding allowances. In order to ensure that this approach represents economic impacts of emission rights fairly, companies should reflect in their financial statements the overall and price situation of the allowances held, the actual emissions produced and allowances traded, as well as their effects on the company's income statement and balance sheet.

There have also been discussions about the alternative approach to treating emission rights as a hedging instrument used to hedge against the price risk of emissions. Should this approach be approved, standards concerning financial instruments would have to be amended.

New guidance on the accounting for emission rights will enter into force either through the revision of existing standards or the issuance of a new standard or interpretation on emission rights. It now appears that a proposal concerning the methods of accounting for emission rights will not be presented until 2006. A final standard, interpretation or revision to existing standards is not to be expected until some time in 2007.

Contents of the withdrawn interpretation

The IFRIC interpretation was based on existing IFRSs on intangible assets,3 government grants[4] and provisions.[5] The following describes the contents and accounting effects of the withdrawn IFRIC 3:

According to IFRIC 3, allowances received free of charge are recorded in the balance sheet on the grant date as intangible assets and deferred income, and will subsequently be recognised as income in the income statement over the compliance period. Acquisition of additional emission rights increases the amount of intangible assets. According to the interpretation, both allowances received free of charge ('government grant') and purchased allowances are measured initially at fair value.

Application of the cost model

If a company applies the cost model to the valuation of intangible assets, allowances received free of charge will be recorded as income according to the initial fair value of allowances. The expense and liability entries arising from emissions produced will be measured at best estimate of the expenditure required to settle the present obligation at the balance sheet date. This mixed measurement of income and expenses may result in income statement information that does not faithfully represent economic reality. The sum of allowances held, and the obligation to deliver allowances to cover emissions produced, entered as a liability, are settled annually. Under the cost model, the difference arising from the different valuation of the corresponding balance sheet items will be recognised in the income statement upon settling the allowances and the obligation to deliver allowances.

Application of the revaluation model

The effects of emission rights and emissions on the income statement and the balance sheet as well as equity are different if a company applies the revaluation model to intangible assets. Under this model, the portion of allowances received free of charge that offsets the cost of emissions in the period is recognised in the income statement by using the fair value of allowances at the initial grant date of emission rights.

Allowances recorded in the balance sheet are continuously measured at fair value, but changes in fair value are recognised directly in equity and not in the income statement. Expense and liability entries arising from emissions produced are recognised as in the cost model. In interim financial statements, a mismatch is also created by the different amounts of emission rights and emissions produced. When the revaluation model is used, the settlement of allowances and the obligation to deliver allowances for past year's emissions does not have an effect on the income statement.

All in all, the application of IFRIC 3 will lead to different effects on equity and the balance sheet depending on whether a company chooses to apply the cost or revaluation model to intangible assets. In addition, income and expense entries fall partially to different time periods.

Emission rights can be bought and sold

The Kyoto Protocol aims at reducing industrial countries' emissions of greenhouse gases by 5% over the period 2008–2012. An agreement on the allocation of emission reduction targets across the EU countries was reached at the Bonn conference in 1998.

Emission trading under the so-called 'cap and trade scheme' can partly help EU member states in achieving compliance with their commitment to reduce emissions. This means that, in addition to their respective emission rights quotas, countries can buy emission rights (allowances) from each other. In Finland, allowances for the period 2005–2007 were issued to companies and production plants free of charge in accordance with Finland's national allocation plan.

Many companies will need to buy more emission allowances in addition to allowances received free of charge.

1) IFRIC INTERPRETATION 3: Emission Rights.
2) IAS 8, paragraphs 10–12, accounting policies, changes in accounting estimates and errors.
3) IAS 38 Intangible Assets.
4) IAS 20 Accounting for Government Grants and Disclosure of Government Assistance.
5) IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

For further information, please contact
Ms Riitta Pelkonen, Accounting Expert, tel. +358 10 831 5420.

CEBS to develop European supervisory culture

In Europe, there are more than 8,000 credit institutions and 2,000 investment firms, whose operations are supervised by the authorities of each EU country, according to a set of various principles. The number of supervisors also varies, as the granting of licences, prudential supervision, market supervision and the monitoring of financial risks have been divided among different authorities. In Spain, the Netherlands and Italy, for example, prudential supervision is part of normal central bank work. Banking supervision in Finland and the UK has been concentrated on a single authority, although cooperation with the central banks is close.

Following financial market integration and mergers within the EU, banks' requirements vis-à-vis supervisors have also increased. Cross-border provision of services has grown and the largest banking and insurance groups operate in a number of EU countries, in which they are confronted with different supervisory principles. Overlapping and sometimes even contradictory guidelines and rules cause multinational banks extra work and administrative expenses. In addition, there are differences in the regulations and technical solutions for submitting required data to the authorities. These are problems for which large banks want to have an immediate remedy.

The European Commission has responded to banks' criticism. The Irish Commissioner Charlie McCreevy, responsible for the internal market, has promised to focus on promoting a level playing-field and updating old banking regulations, instead of making new legislative initiatives. His aim is to provide ‘better regulation’, which has been widely interpreted as also meaning less new regulation.

The Committee of European Banking Supervisors (CEBS) is the cooperation forum of all EU banking supervisors. It seeks to contribute to improved regulation through the convergence of supervisory practices and measures. Committee members comprise EU banking supervisors and representatives of central banks. The main responsibility of CEBS is to ensure consistent, EU-wide implementation of the new capital adequacy framework, known as Basel II, as soon as the relevant Capital Requirements Directive enters into force at the beginning of 2007.

CEBS relies on consensus

Financial market integration in Europe received a substantial boost from the euro changeover at the turn of the millennium. The launch of the euro also saw the implementation of the Financial Services Action Plan (FSAP), which seeks to foster financial market integration and safeguard the stability of the banking system. The Committee of Wise Men, set up in 2000 and chaired by Baron Alexander Lamfalussy, focused on reforming securities market regulation and supervision; subsequently, however, the Committee proposals for a more flexible and faster legislative process were also extended to banking and insurance supervision.

The Financial Services Action Plan has been implemented for the most part by streamlining EU-level regulation. To ensure flexibility and consistency in regulation, new committees were established for the securities market, banking and insurance supervision on the basis of the Lamfalussy proposals. The

Committee of European Securities Regulators (CESR), which was the first to start operations, is based in Paris, whereas the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) has its headquarters in Frankfurt and CEBS in London.

The work of these three, level 3 committees is based on voluntary cooperation between members. Decisions are made on a consensus basis, which often raises questions concerning the effectiveness of the committee's work. So far, there have been no serious problems in CEBS work and member country authorities have been committed to decisions made.

Four-level Lamfalussy process

Level 3 committees are cooperation organs for supervisory authorities, on whose expertise the Commission relies in preparing primary legislation, ie, level 1 directives and regulations. Detailed technical implementing measures are adopted in level 2 comitology procedures, attended not only by the committees of supervisors but also by the higher-ranking committees of regulators. Level 2 committee members are representatives of finance ministries.

CEBS and its sister committees CESR and CEIOPS issue regulatory guidelines and recommendations, and publish standards. One of their key tasks is to harmonise supervisory methods through closer cooperation not only in their respective areas of operation but also between the committees.
Level 4 of the Lamfalussy process is concerned with the monitoring of compliance with EU legislation, which is the responsibility of the European Commission, in particular.

Common principles are expected to lead to a gradual convergence of supervisory practices across Europe. This should guarantee neutral and equitable terms of competition for all banks, whether multinational financial conglomerates or small local banks. The purpose of the comitology process as a whole is to ensure that regulation could respond quickly and flexibly to changes in the markets.

Towards risk-based banking supervision

The new capital adequacy framework for banks not only harmonises capital requirements but also encourages banks to improve their risk management processes. The more advanced methods the banks have in place, the more effectively they can use their capital for business expansion. In practice, good risk management benefits customers in the form of smaller margins.

The introduction of the new capital adequacy framework is no simple venture, given the very different points of departure from which European banking supervisors start changing over to the new system. In some countries, the supervisory emphasis is more on contacts between supervisor and supervised entity, public financial reporting documentation and on-site inspections, whereas, in other countries, supervisors rely in their assessments on separately required numerical data, which differ in terms of quality and quantity from one country to another.

CEBS is currently working on guidelines related to the key area of the new capital adequacy framework; supervisors are expected to comply with these guidelines in performing overall assessments of banks' risk and capital management processes. Such supervisory review includes the principles for the supervised entity's internal capital adequacy assessment process and the supervisor's evaluation process. The purpose is to ensure that supervised entities have adequate capital resources to cover all essential risks incurred. In addition, the supervisory review process seeks to promote ongoing development of risk management and contribute to interaction between supervisor and supervised entity.

CEBS already published 11 consultation papers

CEBS commenced operations at the beginning of 2004, but did not see the establishment of its permanent secretariat in London until September of the same year. The initial stages of the Committee have been marked by urgency, as, in addition to the capital adequacy reform, the Committee has made a number of initiatives for convergence of supervisory practices. Overall, CEBS has published 11 consultation papers, of which the most important ones concern the above-mentioned supervisory review process and cooperation

between home and host country supervisors. Furthermore, CEBS is currently developing guidelines for the approval of advanced risk measurement approaches in the prudential supervision of international banking groups.

The need to review the supervision of banking groups with cross-border operations has become increasingly topical within the EU, as market development has led to large and multinational companies, which are active in a number of countries but in which risk management, for instance, may be concentrated in a single unit. Under current regulations, supervision of the parent company and its branches lies with the home country supervisor whereas subsidiaries with company status, based in another country, are supervised by the host country supervisor. The situation requires new guidelines to serve as a basis for exchanging information between home and host country supervisors, carrying out cooperation and establishing a clearer division of responsibilities among supervisors.

One of the large banks' requirements has been the centralisation of banking supervision so that each multinational banking group would have only one principal supervisor – the home country authority. Occasionally, the establishment of a European banking supervision board has also been discussed, but the European Commission has abandoned the idea at least for the time being, requiring instead that national banking supervisors engage in a wider exchange of information and work more closely together on a practical level. Centralisation of supervision is hampered by political and legal questions of responsibility and the fragmented structure of European deposit guarantee schemes, which will be revised in the next few years. The key question is who will ultimately pay the bill if a large multinational banking group comes up against difficulties.

A common framework for reporting to the authorities

One of the large banks' concerns has focused on the reporting of data to the authorities, which is incoherent and in some countries places a heavy burden on the reporting institution; this, in turn, reflects differences in supervisory cultures. A reporting framework that is disorganised and technically fragmented leads to extra costs to large banking groups and unnecessary bureaucracy. CEBS has made an initiative to harmonise reporting and recommends the introduction of a common technical solution, XBRL, which would facilitate and speed up the flow of information between the authorities and render comparability of reported data possible.

Banks have basically welcomed the initiative, but are also demanding farther-reaching harmonisation. They naturally hope that regular reporting to the authorities could be kept to a minimum. Small national banks have expressed concern about the initial costs of the reporting reform; in any case, it would be most advantageous to implement the reform now that the capital adequacy framework is under revision and is causing software changes in all banks. Supervisors in different countries have also failed to reach full unanimity on the extent of required reporting to the authorities, and a compromise has already been under negotiation for months.

Supervisors required to disclose information

The new Capital Requirements Directive will impose a wider disclosure obligation on banking supervisors. The authorities must be capable of clearly informing their supervised entities and the general public of the way in which regulations will be applied in their particular country. The Directive requires comparability of information so that differences, if any, in the legislative enforcement and implementation process become clearly visible.

Supervisory disclosure will be carried out via the CEBS homepage www.c-ebs.org by linking the Committee pages and the pages of national supervisors. The common language will be English as soon as translations are available from the authorities.

Clarity and transparency in the provision of information will add to market pressures on countries where regulations are applied contrary to mainstream practice or where there are delays in implementation. In the final analysis, the goal is to increase consistency and cost-effectiveness in European banking supervision.

For further information, please contact
CEBS communications officer Mr Jouko Marttila, jouko.marttila@c-ebs.org.

Rulings of the Securities Complaint Board

An order to subscribe to shares, negligence of order, new order, cancellation, compensation claim. Securities Markets Act APL 12/2005, 5 April 2005

On 7 February 2000, customer A gave bank B an order to subscribe on A's behalf to 200 TJ Group Oyj shares in a combined share issue and sale of shares. The purchase price was EUR 22 per share at the maximum. However, bank B neglected the order and informed customer A of the situation on 11 February 2000. During the telephone conversation, bank B told customer A that they could still acquire the said shares at an issue price to be determined on 14 February 2000. Bank B assured they would rectify the error they had made. However, customer A remained uncertain as to the ultimate aim of bank B's phone call, if it was still possible to carry out the share subscription regardless of the neglect.

On 25 February 2000, customer A received by mail a written notice of confirmation from bank B, saying that bank B had acquired the said shares via the stock exchange at a price of EUR 20.45 per share plus the broker's fee. In the public issue, the subscription price had been set at EUR 17.60. Customer A contacted bank B without delay and demanded that they be charged the same subscription price and that the 'overcharged amount' be returned to them. Customer A was also discontented at being charged a broker's fee and demanded compensation under penalty of annulling their order issued on 7 February 2000. Bank B assured they would rectify the matter as soon as they had received a written complaint from customer A.

Customer A submitted the complaint to bank B on 28 February 2000. On 14 March 2000, bank B enquired from customer A whether they had really been told that the price would be determined on the basis of the quotation of the shares as at 14 February 2000. On 16 March 2000 customer A was again requested to draw up a written compensation claim to bank B.

On 20 March 2000, bank B informed customer A of their willingness to pay the difference (EUR 20.45–EUR 17.60), but they refused to compensate to customer A the losses caused by the share price risk. Customer A believed that the losses due to the change in the share price had been caused by bank B's negligence.

According to customer A,

- bank B failed to rectify the matter in accordance with the agreement
- customer A did not order bank B to acquire the shares from the stock exchange at a maximum price of EUR 22 each
- it was bizarre that bank B had not taped the conversation of 11 February 2000
- bank B carried out the order in a faulty manner and against customer A's request
- bank B cannot prove that customer A had given bank B the order that they claim they had
- the extent of the loss incurred by customer A has been exacerbated by bank B's delay in the handling of the matter
- customer A did not sell the shares, because they assumed it to be impossible due to the complaint they had submitted
- bank B did not handle the matter in accordance with good banking practices and with due diligence.

Customer A demanded that bank B pays a compensation in the amount of EUR 4,400 (200 x EUR 22) on account of the unprofessional completion of the order.

Rejoinder by bank B

Bank B demands that customer A's claim be rejected in terms of both quantity and cause.

According to bank B,

- The Securities Complaints Board is not competent in the matter because 1) the matter was handled in 2000 at the Advisory Office for Bank Customers, 2) the customer has not been in contact with the bank after the handling of the matter, 3) there are no cogent reasons for taking up the matter again
- bank B noticed on 9 February 2000 that customer A's order had not been processed in bank B's organisation
- bank B informed, on 11 February 2000, customer A of their error and the possibility to acquire the said shares directly from the stock exchange at the price of EUR 19–20 prevailing at the time
- the share price was at that time lower than the maximum price in the share issue/sale of shares
- customer A was told that they could get the shares via the stock exchange at the quoted daily price, not at a price to be determined after the share issue, which according to the prospectus would be EUR 22 at the maximum
- as agreed, bank B gave an order for 200 shares to be acquired at the daily price, and the order was executed at EUR 20.45, which was lower than the maximum price in the share issue
- the subscription price of the original order was determined on 14 February 2000 and nobody could know the daily price for that day nor the final subscription price, because the agreed transaction was carried out on 11 February 2000
- the subscription price on 14 February 2000 was confirmed to be EUR 17.60 per share, and this price was disadvantageous to customer A
- to avoid misunderstanding, bank B offered on 20 March 2000 to reimburse to customer A the difference between the price paid by customer A (EUR 20.45) and the subscription price determined in the share issue (EUR 17.60), ie EUR 570 altogether
- in their complaint of 28 February 2000, customer A demanded that the entire order be cancelled
- bank B refused to cancel the order as it would have meant that the share price risk would have been transferred from investor A to bank B

Solution proposed by the Board

Competence

In the opinion of the Board, there were two weighty reasons for handling the case. First, finding a solution to the alleged delay in the carrying out of the share transaction can be considered to have overall significance for investors and for sound securities market practices. Second, the matter had been delayed because of customer A's illness.

Recommended solution

The Board took the view that the matter was concerned with investment advice and securities trading offered by an investment services firm, as prescribed in the Act on Investment Services Firms, Securities Markets Act and the FSA Guideline no. 201.7.

The Board held that:

- It is not evident from the sequence of events what the parties agreed on 11 February 2000 as to the rectifying of the error by bank B. Did customer A give their permission for the acquisition of the shares only by subscribing to them and did bank B inform customer A that the shares in question could only be purchased on the basis of a normal stock exchange order?
- Bank B has been prepared to reimburse to customer A the difference between the subscription price (EUR 17.60) and the listed price (EUR 20.45), totalling EUR 570.
- Bank B has attempted to place A in the same position they were in, in the original order
- That customer A did not receive the shares via a public issue does not entitle them to demand cancellation of the transaction/order and regret their own investment decision, only to demand rectification of an error.
  bank B cannot be held responsible for customer A's exposure to share price risk
- It was reasonable for customer A to expect that the order be rectified without undue delay and that customer A will be obliged to limit their own losses

The Board took the view that customer A could have incurred potential losses, if the realisation of the shares would have been delayed because of the investigations and if the delay could have been shown to result from bank B's neglect.

Customer A did not sell their shares at that time nor later. Therefore, bank B cannot be held accountable for the share price risk of customer A.

The Board recommended that bank B reimburse to customer A a total of EUR 570 plus the legal penal interest for the period 16 March–30 June 2000.

Mutual fund, marketing, bank's disclosure and discovery requirements, liability for damages. Act APL 90/2004, 5 April 2005

Bank B had contacted customer A in writing to offer them personal investment advice. On the basis of the letter, a meeting was arranged. In connection with the meeting on 20 September 2000, customer A intended to renew his/her fixed-term deposit. However, the bank B employee involved had not agreed to renew the deposit, but had instead spoken and behaved in such a way that customer A had invested his/her money in a previously unknown mutual fund product.

Customer A's explanation of events was as follows:

- He/she is 86 years of age and has a bad eyesight.
- He/she did not and still does not understand the features of the product in question.
- He/she received no spoken or written information of the product.
- Customer A had felt a great deal of pressure and the employee had made the decisions on behalf of customer A.

According to the complaint:

- Bank B did not give customer A appropriate information on investing in mutual funds nor on the risks involved.
- Bank B employee exploited their position, customer A's advanced age and ignorance.

Customer A demanded that bank B compensate with interest the funds he/she had lost in the one-off and interest investments.

Rejoinder by bank B:

Bank B denied the allegations and compensation claim put forward by customer A as unjustified and considered that they had acted in accordance with the principles governing investment advice and marketing of mutual funds units.

Bank B's declaration of events was as follows:

- Customer A was a long-term customer at bank B.
- At the meeting, the parties had discussed customer A's entire business from daily services to investment needs.
- When discussing different investment alternatives, customer A had voiced his/her desire to invest funds on a longer-term basis and earn a yield that would exceed the yield generated by fixed-term deposits.
- Different investment alternatives were presented to customer A.
- Customer A was explained the characteristics of funds, their relevant yield expectations, the recommended period of investment, the volatility in the value of fund investments and the risks involved.
- Customer A selected at his/her own initiative a one-off investment in a low-risk balanced fund and a monthly investment in a slightly more risky balanced fund.

- Customer A has signed the orders relating to both investments and confirmed to have received the fund brochures and regulations.
- The parties have met several times after the investment was made and in those connections, customer A has not voiced his/her dissatisfaction with the investments.
- Customer A has also invested in other products offered by bank B.
- According to bank B, redemptions and the discontinuation of the monthly investments during 2001–2003 imply that customer A has understood the risks involved.

Ruling of the Securities Complaint Board

According to the Board, the matter was concerned with the provision of investment services and securities marketing as prescribed in the Act on Investment Services Firms and the Securities Markets Act. These acts are supplemented by the FIN-FSA guidelines 201.7. and 201.2.

The Board held that:

- The recommended solution can only be based on facts that are stated in the documents supplied.
- The views of the parties deviate as regards bank B's fulfilment of the know-your-customer principles and the provision of information in connection with making the fund subscriptions.
- There is no evidence to suggest that customer A has a poorer than normal or weakened ability to understand the legal actions he/she has committed.
- The age or poor vision of customer A cannot be the sole reasons for refraining from marketing or offering certain investment services; instead, other more personal criteria and evaluations are needed.
- With his/her signature, customer A has confirmed that the bank B employee has explained the characteristics of the mutual fund products in question as well as their possible depreciation in value. No conflicting reports have been presented to the Board.
- Customer A has monitored the development of his/her investment and has reacted to any changes.
- Bank B has not been shown to have provided misleading information nor in any other way to have neglected their obligations as per the Mutual Funds Act.
- After having notified to have received the documents required by the Mutual Funds Act, customer A himself/herself is responsible for the risks, orders and share price changes.The Board did not recommend compensation in the matter.

Recent events

New Anti-Money Laundering Directive approved

The fully amended Third Anti-Money Laundering Directive of the EU will enter into force during 2005. The provisions of the directive will be transposed into national law by the end of 2007.

The directive ensures that EU member countries adopt the revisions of 2003 put forward by the Financial Action Task Force, an international body combating money laundering and terrorist financing – the FATF Recommendations. The aim is to further strengthen measures taken against money laundering and terrorist financing. The directive introduces providers of financial services and other professionals subject to it more detailed obligations in respect of measures relating to the identification of the customer and knowledge of the customer's business. The directive uses the term 'customer due diligence' for these measures.

According to the directive, those subject to it shall take, depending on the complexity or risk-sensitivity of products offered to the customer, a wider or a narrower scope of customer due diligence measures. The directive uses the terms 'enhanced due diligence' and 'simplified due diligence' to describe differences in approach and risk management.

The directive also contains the requirement that the services used by the customer are to be monitored on an ongoing basis. However, the directive does not define how and what kinds of business transactions the providers of financial services shall monitor. The basic premise is, as in risk management in general, that the service provider knows his own customer base, assesses his own risks and adapts his risk management accordingly.

For further information, please contact
Ms Tuija Nevalainen, Legal Adviser, tel. +358 10 831 5294.

Two new FIN-FSA standards dealing with issues such as customer identification and due diligence as well as notification of suspicious securities transactions

The FIN-FSA has issued two new standards: Customer identification and due diligence, prevention of money laundering, terrorism financing and market abuse (Standard 2.4), and Notifying the Financial Supervision Authority of suspicious securities and other transactions (Standard RA2.1). The standards came into force at the beginning of September. The English translations will be available at our website shortly.

The standards aim at promoting thorough and common practices in financial markets, risk management related to the supervised entities' customer relations and the prevention and detection of financial system and market abuse.

The new standards require that supervised entities know their customer base well and that their employees apply due diligence measures. It is essential that supervised entities instruct and train their employees as well as provide for sufficient levels of internal audit and control.

The new standards do not have a substantial effect on services offered to customers. Providers of financial services were already subject to corresponding objectives before these standards were issued.

Standard on customer identification and due diligence

The standard comprises obligations related to the subject matter in existing legislation. It does not take into account the contents of the new EU Anti-Money Laundering Directive. The standard will be amended, as necessary, when the new directive is implemented in Finland.

The central obligations imposed by the standard are customer identification, know-your-customer procedures, obligation to detect and identify unusual transactions (due diligence), obligation to report suspicious cases to the Money Laundering Clearing House and the specific obligation to keep records. When a report is submitted, it is not required that the reporting institution knows what crime has possibly been committed in the context of an asset transfer; rather, it is sufficient that the case departs from the customer's previous activities or financial position. Due diligence is essentially related to the obligation that employees are given instructions and trained on an ongoing basis, that a company has appointed an anti-money laundering contact person and that the company provides for a sufficient level of internal control. All suspected cases of money laundering are forwarded to the Money Laundering Clearing House of the Finnish National Bureau of Investigation.

Standard on notification of suspicious securities transactions

The standard is mostly applicable to such credit institutions, investment firms, management companies and branches of comparable foreign companies operating in Finland that are engaged in securities brokerage and asset management.

A notification of suspicious securities transactions is submitted to the FIN-FSA if a securities or another transaction is suspected of being linked to the misuse of inside information or market price manipulation. The standard includes examples of suspicious securities transactions.

The standard on the notification of suspicious securities transactions is based on the so-called Market Abuse Directive (2003/6/EC) and the new section 5b in chapter 4 of the Securities Markets Act, which entered into force on 1 July 2005.

For further information, please contact
Ms Tuija Nevalainen, Legal Adviser, tel. +358 10 831 5294.

FIN-FSA investigations into suspected cases of securities market abuse

	1999	2000	2001	2002	2003	2004	Situation on 7 Oct 2005
Total investigations	**42**	**38**	**38**	**65**	**57**	**61**	**41**
On-going investigations							14
Abuse of inside information	27	25	23	24	28	24	24
Market manipulation	6	6	4	11	11	12	2
Obligation to provide information	7	5	10	30	18	21	13
Other	2	2	1	0	0	4	2
Requests for police investigation	9	11	7	6	7	5	–
Public admonitions							2
Admonitions	0	1	2	7	10	6	–

To date in 2005, the FIN-FSA has investigated 41 cases of suspected securities market abuse, of which 14 are still ongoing.

It has forwarded 10 requests for further investigations concerning these cases to the police. It has also received four notifications from the market of suspicious securities or other financial transactions (Standard RA2.1, valid from in 1 September 2005).

Of the cases the investigation of which has been completed, the FIN-FSA has issued two public admonitions, one concerning a procedure in contravention of good business practices in the securities markets and the other concerning a breach of disclosure requirements. The decisions issued can be viewed on the FIN-FSA website.