



FINLAND

FINANCIAL SECTOR ASSESSMENT PROGRAM TECHNICAL NOTE ON REGULATION AND SUPERVISION OF LESS SIGNIFICANT INSTITUTIONS

February 2023

This Technical Note on Regulation and Supervision of Less Significant Institutions for the Finland FSAP was prepared by a staff team of the International Monetary Fund as background documentation for the periodic consultation with the member country. It is based on the information available at the time it was completed on January 20, 2023.

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International Monetary Fund
Washington, D.C.



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FINANCIAL SECTOR ASSESSMENT PROGRAM

January 20, 2023

TECHNICAL NOTE

REGULATION AND SUPERVISION OF LESS SIGNIFICANT INSTITUTIONS

Prepared By
**Monetary and Capital Markets
Department**

This Technical Note was prepared by IMF staff in the context of the Financial Sector Assessment Program that visited Finland in March 23–April 13, 2022. It contains technical analysis and detailed information underpinning the FSAP’s findings and recommendations. Further information on the FSAP can be found at <http://www.imf.org/external/np/fsap/fssa.aspx>

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Glossary

ACI	Act on Credit Institutions
AFA	Act on the Financial Supervisory Authority
AML & CFT	Anti-Money Laundering and Combatting Financing Terrorism
BCP	Basel Core Principles
BoF	Bank of Finland
CET1	Common Equity Tier-1
CIR	Cost to Income Ratio
CP	Core Principle
C&E	Climate Related and Environmental
CET1	Common Equity Tier 1
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
DG	Director General
EBA	European Banking Authority
E&C	Environmental and Climate
ECB	European Central Bank
ECL	Expected Credit Losses
EEA	Euro Economic Area
EIM	Early Intervention Measures
EU	European Union
FFSA	Finnish Financial Stability Authority
FIN-FSA	Finnish Financial Supervisory Authority (Finanssivalvonta)
FOLTF	Failing or Likely to Fail
FSAP	Financial Sector Assessment Program
FTE	Full-Time Employee
G-SI	Global Systemic Institution
HH	Household
HI	High Impact
HP	High Priority
HR	High Risk
ICAAP	Internal Capital Adequacy Assessment Process
ICT	Information and Communication Technologies
IMF	International Monetary Fund
IT	Information Technology
IFRS	International Financial Reporting Standards
ILAAP	Internal Liquidity Adequacy Assessment Program
IRRBB	Interest Rate Risk in the Banking Book
JST	Joint Supervisory Team
LSI	Less Significant Institution
MOF	Ministry of Finance
MoU	Memorandum of Understanding

MREL	The minimum requirement for own funds and eligible liabilities
MYA	Multi-Year Approach
NCA	National Competent Authority
NFC	Non-Financial Corporations
NPL	Non-Performing Loans
O-SI	Other Systemic Institution
P2G	Pillar 2 Guidance
P2R	Pillar 2 Requirement
RAS	Risk Assessment System
REC	Recommendation
ROE	Return on Equity
RWA	Risk-Weighted Assets
SI	Significant Institution
SME	Small and Medium Enterprises
SSM	Single Supervisory Mechanism
SSM FR	Single Supervisory mechanism Framework Regulation
SREP	Supervisory Review and Evaluation Process
TN	Technical Note

EXECUTIVE SUMMARY

The Financial Sector Assessment Program (FSAP) conducted a focused review that primarily assessed banking regulation and supervision of Finland’s less significant institutions (LSIs).¹

LSIs account for around 16 percent of Finland’s banking sector and the regulation and supervision of the rest of the banking sector takes place within the European Central Bank’s (ECB) Single Supervisory Mechanism (SSM). The Finnish Financial Supervisory Authority (FIN-FSA) is under the oversight of the ECB, responsible for the supervision of LSIs.

Finnish banks’ financial indicators remained strong despite the pandemic. Banking sector’s capital adequacy ratio and CET1 ratio are at 21.4 percent and 17.8 percent respectively as of December 2021. Banks’ high investments in digital services and population’s preference to use digital services resulted in reduction in number of branches and personnel in Finnish banks, that supported profitability. Banks’ Non-Performing Loans (NPL) ratios are at 1.3 percent and 2.1 percent for household (HH) loans and Non-Financial Corporations (NFC) loans respectively as of December 2021. However, loan loss coverage is low at 19 percent for HH loans and 43 percent for NFC loans.

The authorities made good progress on the implementation of the recommendations of the 2016 Basel Core Principles (BCP) assessment. However, important issues around strengthening operational independence of the FIN-FSA and legal protection of its staff are pending. Loan level data collection is improved by the introduction of regulatory report on new household mortgage loans in 2016. The legal process for the establishment of a Credit Registry that will initially cover data on consumer loans is about to be completed, and it is expected that the Credit Registry will be operationalized in Spring 2024.

On the other hand, the legal framework in Finland limits FIN-FSA’s power to issue binding regulations. High level provisions are stated in Acts. Most of the time, European Banking Authority (EBA) Guidelines, which are naturally non-binding, are referred to for implementation details or for areas that are not covered by the legislation. This system increases the importance of supervision to ensure that banks’ activities are aligned with best practices.

However, the assessment revealed that availability of resources is a challenge for the FIN-FSA.

Under the SSM arrangements, although the ECB directly supervises significant institutions (SIs), a significant share of supervisory resources come from the FIN-FSA.² The SSM LSI methodology is derived from the SI methodology which is significantly more comprehensive compared to FIN-FSA’s pre-SSM approach. Furthermore, new risks and challenges are emerging which reform the supervisory practice and processes and require the acquisition of new skills such as: the challenges of cyber resilience, the potential opportunities of fintech, the growing sophistication of threats from criminal activity (money laundering and terrorist financing), or the impact of environmental and

¹ The review reflects the regulatory and supervisory frameworks as per April 2022.

² The 2018 Euro Area Policies FSAP stated that around ¼ come from the ECB and rest from the NCAs.

climate (E&C)-related risks on banking. There are a couple of LSIs that are renewing their core banking systems and most LSIs do not have enough information technology (IT)-risk specialists in their second and third line of defense, which underscores the importance of the FIN-FSA having necessary resources to assess banks information and communication technologies (ICT) risks. Meanwhile, FIN-FSA's activities are mainly financed by supervision fees and the FIN-FSA sees a risk that, starting in 2024, fees might not cover expenses. Therefore, it is important that the budget envelope for the FIN-FSA is increased to recruit and retain quality staff across a full range of skills and experience in both traditional and emerging risks like ICT, cyber, and climate.

The supervisory approach and tools of the FIN-FSA improved conspicuously but there is room for further improvement. The authorities rolled-out the ECB/SSM approach to the Supervisory Review and Evaluation Program (SREP) to all LSIs in 2019–20. FIN-FSA's SREP assessments are comprehensive and reflect a thorough analysis of LSI's risk profile and capital requirement. However, the supervisory approach should further be strengthened by: (i) increasing the number and scope of on-site inspections, especially conducting on-site inspections on corporate governance and risk management frameworks of banks; with a broader scope (ii) meeting with banks' board of directors and bilaterally with independent board members and external auditors at least once a year for high-impact (HI) LSIs; and (iii) including an assessment regarding board and senior management competence, collective suitability of the boards and overall group structure and risks stemming from related parties in SREP reports. Additionally, although the broader group in which amalgamation institutions take part does not constitute a group in the meaning of accounting consolidation, it should be assessed as a group from a supervisory perspective.

Given the principle-based nature of IFRS-9 provisioning and it is relatively new, it is important that the FIN-FSA conducts regular analysis on banks' implementation. The FIN-FSA conducted an analysis of the IFRS 9 provisioning and the expected credit losses (ECL) methodology in the Finnish financial institutions especially in the light of the COVID-19 pandemic. Conducting that kind of analysis even after the pandemic ends and using the results for further analysis (targeted on-site inspections, deep dive analysis, and regular dialogues with credit institutions and external auditors) would strengthen the supervision.

While some important enhancements in credit institutions' corporate governance framework have been made with Law 233/2021 that amends the Act on Credit Institutions (ACI), it could be further strengthened. The assignment to credit institutions of the responsibility of ensuring that the composition of the board of directors satisfies continuous requirement of collective suitability and that the members of the management fulfill the qualification and time commitment and fitness and propriety requirements is important development. On the other hand, it is equally important that board of directors ("supervisory boards" if board of directors' duties are assigned to them) of all banks include enough independent members who meet clearly determined independency criteria. Considering that the board of directors of the central institutions of amalgamations are mostly composed of managing directors of member institutions, ensuring that these institutions have a sufficient number of independent members is absolutely essential.

It is important for the FIN-FSA to complete the necessary work for supervisory boards to be covered by the regulatory and supervisory framework. Amalgamations' Central institutions' supervisory boards are given some of the tasks of board of directors. However, members of the supervisory boards have not yet been subject to a fitness and propriety assessment, nor has the collective suitability of supervisory boards been assessed by the FIN-FSA.³ This assessment of the allocation of tasks would also need to be made for other co-operative banks that have supervisory boards to whom the tasks of the board of directors are most likely to assigned. Additionally, SREPs would need to be broadened to assess supervisory boards within "Governance and Risk Management" and (as necessary) in other components assessments. In all assessments of member credit institutions also central institutions' obligation to control, give instructions, confirm general principles and supervise member credit institutions should be taken in account in the FIN-FSA's risk-based processes.

³ The FIN-FSA plans to complete these assessments by 2022 year-end.

Table 1. Finland: Recommendations on Regulation and Supervision of Less Significant Institutions		
Recommendation	Priority¹	Timeframe
Supervisory Responsibilities, Objectives and Powers		
Strengthen the legal protection of FIN-FSA staff and ensure that staff is adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith. (MoF)	H	NT
Secure FIN-FSA's independence by ensuring that: (i) future Board members have diverse background and experience in FIN-FSA's purview; (ii) they are not officials of Ministries; and (iii) a statement of the reasons for the dismissal of Director General is clearly in the law and publicly disclosed if a dismissal should ever take place. (MoF)	H	NT
Increase the budget envelope for the FIN-FSA to recruit and retain quality staff across a full range of skills and experience in both traditional and emerging risks like ICT, cyber, and climate. (MoF)	H	NT
Broaden the use of external experts in areas that requires specific expertise. (FIN-FSA)	H	I
Supervisory approach, tools, and reporting		
Meet with banks' board of directors and bilaterally with independent board members and external auditors at least once a year for HI LSIs. (FIN-FSA)	H	I
From a supervisory perspective, assess amalgamations and entities that are owned by institutions in the amalgamations as a group. (FIN-FSA)	H	I
Investigate whether AnaCredit data could be used more widely by the FIN-FSA in credit risk analysis. (BoF, FIN-FSA)	H	I
Increase the number and scope of on-site inspections, include banks' corporate governance in on-site inspections, and expand the scope of loan portfolio on-site inspections (such as corporate loans, SME loans, related-party exposures, collateral valuation procedures and practices, loans that are not modified, lending processes and procedures). (FIN-FSA)	H	NT
Further strengthen the supervisory approach by (considering proportionality): (i) Including an assessment regarding board and senior management competence, continuing collective suitability of the boards, and overall group structure and risks stemming from related parties in SREP reports. (ii) Conducting further analysis on banks' IFRS-9 implementation, more specifically regarding staging of exposures and functioning of ECL models (regular dialogue with credit institutions, bilateral meetings with credit institutions' external auditors, benchmarking and peer review analysis and targeted on-site inspections). (FIN-FSA)	H	I
Ensure that SREP assessments cover "Supervisory Board" structure in "Governance and Risk Management Assessment" and (as necessary) in other components. (FIN-FSA)	H	I
¹ In terms of priorities, H, M, and L stand for high, medium, and low. In terms of time frame, I, NT, and MT stand for immediate (within one year), near-term (within 2–3 years), and medium-term (within 3–5 years).		

Table 1. Finland: Recommendations: Regulation and Supervision of Less Significant Institutions (Concluded)		
Recommendation	Priority	Timeframe
Regulatory Framework and Supervisory Guidance		
Make necessary changes in national regulations to request a “no objection letter” from host authorities in case a credit institution from a non-EEA member state applies to establish a subsidiary in Finland. (MoF, FIN-FSA)	M	M
Include rules on the appointment of a sufficient number of independent directors (supervisory board members) and independency criteria in the legislation. (MoF, FIN-FSA)	H	NT
Ensure that Audit and Risk committees are chaired by independent members who are not the chair of the board or other committees. (MoF, FIN-FSA)	H	NT
Conduct fit and propriety assessment and other assessments (time commitment) for supervisory board members and collective suitability assessment of supervisory boards in central institutions where and in the extent the duties of the board of directors are assigned to the supervisory board. (FIN-FSA)	H	I
Consider issuing binding rules on economic dependency criterion which will enable the FIN-FSA to decide a group of connected counterparties and banks’ related parties on a case-by-case basis, and further aligning related party exposures with BCP 20. (MoF, FIN-FSA)	H	NT
Guide banks to assess the situation of the borrowers in case they use automatic payment holiday options embedded in the loan agreements (embedded forbearance clause). (FIN-FSA)	H	I
Other		
Build internal capacity for supervision of climate risks and start supervisory dialogue to increase the awareness of LSIs of the potential impact of C&E risks on their financial conditions. (FIN-FSA)	H	NT
Encourage LSIs to do cyber security self-assessments to gain a better understanding of their level of cyber preparedness. (FIN-FSA)	H	NT

INTRODUCTION¹

A. Context and Scope

1. **Finland is the only Nordic country which is part of the euro area.**² Therefore, the supervision of banks takes place within the European Central Bank's Single Supervisory Mechanism (SSM). The European Central Bank (ECB) has the direct responsibility for the supervision of Finland's largest institutions (Significant Institutions (SIs)). FIN-FSA is under the oversight of the ECB, responsible for the direct supervision of other smaller banks (Less Significant Institutions or LSIs).
2. **To avoid duplication with the 2018 Basel Core Principles (BCP) assessment for the euro area, the current review focusses on the regulation and supervision of Finnish LSIs.** The Banking Regulation and Supervision of LSIs workstream of the FSAP program involved the assessment of the selected Core Principles (CPs),³ of COVID-19 and climate risk developments, and of the progress regarding the recommendations of the 2016 Finland BCP assessment with a focus on LSI regulation and supervision by the national competent authorities, and a review other relevant developments and potential areas for further enhancement.
3. **The review of LSIs supervision was based on the analysis of the authorities' self-assessment against the BCP, responses to the complementary questionnaire, detailed discussions, and the review of other documentation.** The Finnish authorities provided a partial self-assessment of compliance with the 2012 BCP and responses to a complementary questionnaire. The ECB also provided responses to a dedicated questionnaire, and the authorities provided examples of actual supervisory practices and assessments. The FSAP review team benefitted greatly from the inputs received and exchanging of views during meetings with supervisors, banks, industry associations, and other market participants
4. **The assessor wishes to thank the authorities and private sector participants for their excellent cooperation.** The mission which initially had been planned to take place fully on-site, was conducted on-site at the Finnish authorities' premises between March 23–April 1, and the rest of the meetings were conducted remotely. The Finnish authorities' swift adaptation to the change in the modality of the mission have greatly facilitated the work of the mission.
5. **This Technical Note (TN) discusses the main observations and recommendations of the assessment on LSI regulation and supervision in Finland.** The TN begins with a brief overview of the market structure and the review of the institutional setting in Finland. The TN then discusses the main observations and recommendations regarding the supervisory approach, tools and reporting relevant to LSIs, and the legal and regulatory framework. The final section discusses the impact of

¹ This Technical Note was prepared by Ebru Sonbul Iskender (IMF).

² The Nordic countries are Denmark, Sweden, Norway, Finland, and Iceland.

³ CP 1-6, CP 8-20, CP 22, CP 25, and CP 26.

COVID-19 on credit institutions and regulatory and supervisory measures taken to alleviate the impact of it on banking.

B. Market Structure

6. The Finnish banking sector is characterized by high concentration. The three largest banking groups account for approximately 80 percent of the sector measured by total assets. The Finnish banking sector is also large relative to the size of the Finnish economy. The assets-to-GDP ratio of the Finnish banking sector is among the highest in Europe with 380 percent.

7. The Finnish banking sector has been subject to structural changes in the past few years. Nordea Financial Services Group, originally formed in 2000 by merging Danish, Finnish, Norwegian, and Swedish banks, first changed its legal structure to operate most of its non-Swedish activities through branches. In January 2017, Nordea Bank Denmark A/S, Nordea Bank Finland Plc, and Nordea Bank Norge ASA were changed from Danish, Finnish, and Norwegian subsidiary banks, respectively, to branches of the Swedish parent company Nordea Bank AB. This “branchification” aimed to align the legal structure of the bank with its centralized operations. Later, the parent company of the Group was moved to Finland as of October 1, 2018. With the reverse merger and relocation in headquarters, Nordea Bank AB (domiciled in Sweden) became Nordea Bank Abp (domiciled in Finland).

8. The number of SIs increased to four after Danske Bank’s Finnish branch was classified as an SI starting from 2022. Other SI banks are Nordea Bank, OP Group, and Municipality Finance—a non-deposit taking institution formed jointly by the municipalities. Although the asset size of Nordea is three times larger than OP Group, OP Group has a higher market share in Finland in main balance sheet items. Around 70 percent of Nordea’s balance sheet is outside of Finland.

9. Although the number of credit institutions is nearly 230, most of these are cooperative banks and savings banks belonging to amalgamations of deposit institutions (See Box 1). Among amalgamations, OP Group is an SI and POP Group, and Savings Bank Group are LSIs. There are seven other LSIs, five of which have the FIN-FSA as home supervisor. There are also 44 foreign branches and representative offices in Finland, with Danske Bank’s Finnish branch and the three branches of Svenska Handelsbanken being the largest ones.

Box 1. Finland: Amalgamation of Deposit Banks

Under the Deposit Bank Amalgamation Act (599/2010) an amalgamation of deposit banks is formed by a co-operative central institution, the companies belonging to its consolidation group, the member credit institutions and the companies belonging to the member credit institutions' consolidation groups, as well as credit institutions, financial institutions and service companies controlled jointly by the above. The general conditions for the establishment of an amalgamation are (1) The central institution shall control and supervise its member credit institutions; 2) The minimum consolidated capital requirement for and the liquidity of the companies within the amalgamation shall be controlled on a consolidated basis at the amalgamation level; 3) the central institution shall be liable for its member credit institutions' debts and the member credit institutions shall participate in any necessary support measures aimed at preventing another member credit institution from going into liquidation, and pay a debt for an individual member credit institution; and 4) the majority of the member credit institutions shall be deposit banks.

The central institution of the amalgamation is licensed by the FIN-FSA. The Deposit Bank Amalgamation Act imposes some responsibilities to the central institution. The central institution is under an obligation to supervise the operations of its member credit institutions, issue instructions to them on risk management, good corporate governance and internal control to secure liquidity and capital adequacy, as well as instructions on compliance with standardized accounting policies in the preparation of the amalgamation's consolidated financial statements.

According to the Deposit Bank Amalgamation Act, the FIN-FSA may grant the central institution permission to decide to exempt, in full or in part, its member credit institutions and companies belonging to their consolidation group from the application of capital, liquidity and risk management provisions of the ACI. In practice, the FIN-FSA granted the central institutions waivers for their member institutions on LCR, NSFR, and for internal exposures.

Amalgamations' members of Board of Directors are appointed by Supervisory Board, and they are mostly composed of Managing Directors (CEO) of member institutions, but also include members who are not CEOs of member institutions.

10. In Finland there are three financial conglomerates led by banks. Nordea and OP Financial Group (amalgamation) are SIs that are considered as financial conglomerates. Aktia Bank, an LSI, has wholly owned subsidiaries in life insurance and fund management. Savings Bank Group and POP Bank Group, which include amalgamations within the group, are not legally considered as financial conglomerates because of being below determined thresholds.⁴ Amalgamations in Finland can be part of larger financial groups which could be owned by member institutions and other entities of the amalgamation or group. These larger groups have entities other than credit and financial institutions or service companies. The most important of these are the insurance companies. Although the accounts of all entities would not be consolidated since there is not a holding company that owns shares of the entities within the group, these institutions should be assessed as a group from supervisory perspective.

⁴ It is entities' responsibility to monitor the thresholds and notify the authorities about becoming part of the conglomerate.

11. Finnish banks' financial indicators remained strong despite the pandemic (Figure 1).

Banking sector's capital adequacy ratio and CET1 ratio are at 21.4 percent and 17.8 percent respectively as of December 2021. The banking sector's RWA density is around 30 percent, lower than European Union (EU) average. Finnish banks' profitability is higher than European averages. Finnish banks' high investments in digital services and population's preference to use digital services resulted in a reduction in number of branches and personnel in Finnish banks, that supported profitability. Banks' NPL ratios are at 1.3 percent and 2.1 percent for HH loans and NFC loans, respectively, as of December 2021. However, loan loss coverage is low at 19 percent for HH loans and 43 percent for NFC loans.

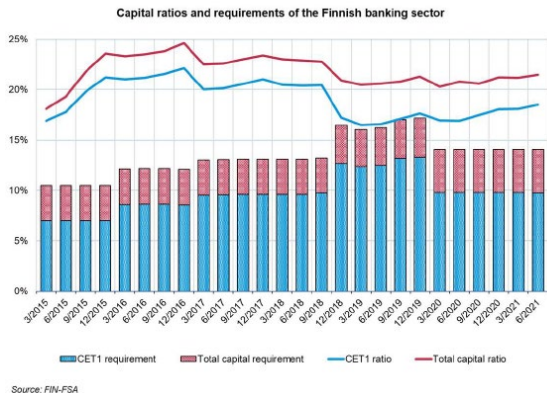
12. Finnish banks' loan to deposit ratio is around 140 percent as of December 2021 (the euro area average is around 100 percent). Wholesale funding is high both for SIs and LSIs mainly because of a high share of covered bonds in the funding structure. This has led to a high asset encumbrance level for Finnish banks. Covered bonds may be issued by a separate mortgage bank specializing only in mortgage banking, by a deposit bank authorized for mortgage banking, or by another credit institution which carries on mortgage banking in addition to its other credit institution activities. Most banks in Finland either established a separate mortgage bank or received authorization to engage in mortgage banking activities. The maturities of the bonds are largely close to 10-year maturities. Finland is in the process of issuing a new law, The Mortgage Banks and Covered Bonds Act will abolish the current Mortgage Banking Act the changes resulting from the Covered Bonds Directive will be reflected to this new Act. The main changes are an increase in the collateral value of mortgage loans from 70 percent to 80 percent of the fair value of the real collateral of the loan, removal of maturity restrictions on covered bonds, inclusion of soft bullet conditions in the legislation,⁵ and clarification of the obligation to assess the risks associated with balance sheet commitment for a credit institution belonging to the same consolidation group located in another European Economic Area (EEA) state.

13. Mortgage lending is the primary business activity in Finnish LSIs (59 percent of total and 78 percent of HH loans). On the other hand, 95 percent of these loans are variable rate loans most of which is linked to EURIBOR rate with a 0 percent floor. The rise in interest rates will benefit LSIs directly but will have an indirect adverse effect on them because of a possible deterioration of credit repayment capabilities of borrowers. The FIN-FSA has been recommending financial institutions, since 2010, that they complete a calculation of available funds for all new housing loan applicants in their lending decision. In this calculation, the interest rate should be set at least at 6 percent, and the maturity of the loans should be shorter than 25 years.

⁵ A bullet condition sets the postponement of the maturity of a covered bond.

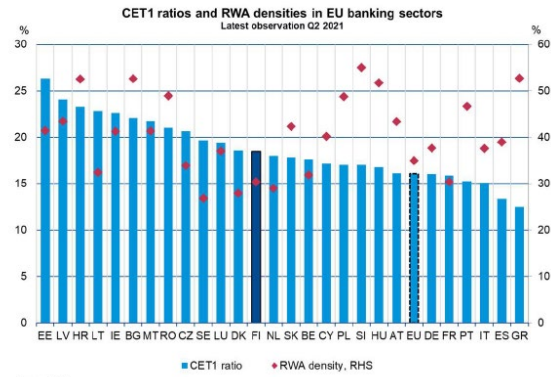
Figure 1. Finland: Financial Indicators of Finnish Banking Sector

Finnish banks' capital ratios are well above the minimum requirements...



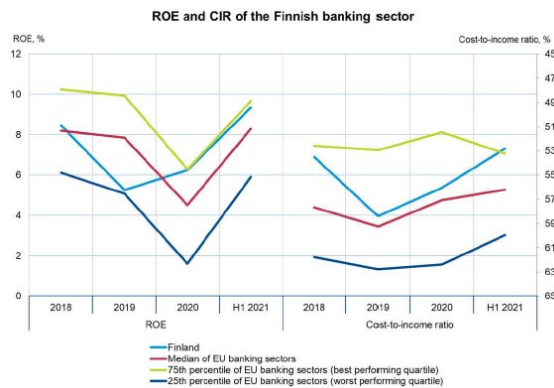
Source: FIN-FSA

Finland's banking sector's average CET1 ratio is a little higher than EU average. RWA density is among the lowest.



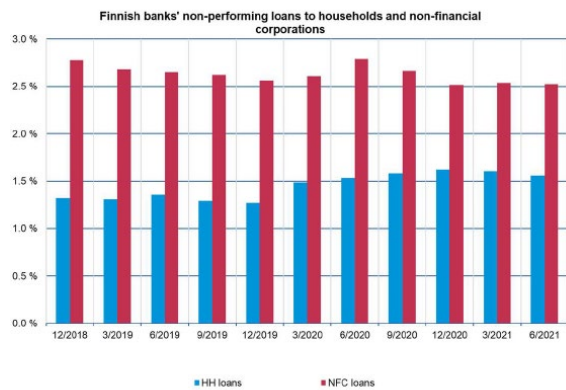
Source: ECB

Finnish banks' profitability is higher than EU average and it remained relatively strong during the pandemic.



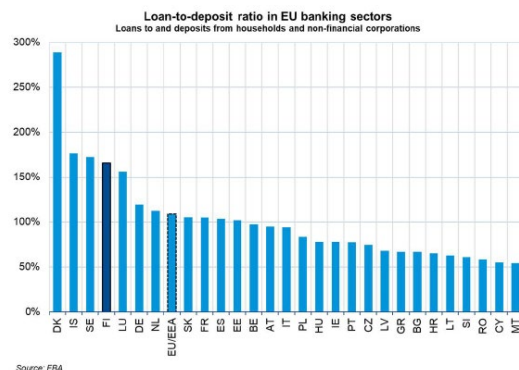
Source: FIN-FSA, ECB

NPL ratios in Household loans (HH) and non-financial corporations' loans are 1.3 percent and 2.2 percent respectively.



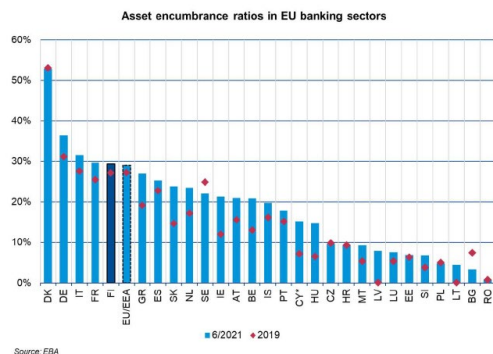
Source: FIN-FSA

Finnish banks' wholesale funding reliance is among the highest in EU as demonstrated by high loan to deposit ratios.



Source: EBA

A high share of covered bonds in funding results in high asset encumbrance levels for Finnish banks.



Source: EBA

14. Finnish banking sector's direct exposures to Russia, Belarus, and Ukraine are limited.⁶ However, Finnish corporations' businesses in Russia may pose credit risk for Finnish banks. Finland's banks and authorities adjusted their 2022 GDP growth expectations downward due to the invasion of Ukraine.

INSTITUTIONAL SETTING

A. Supervisory Responsibilities, Objectives, and Powers

15. The FIN-FSA is the supervisory authority for Finland's financial sectors and the Director General participates in the Supervisory Board of the SSM. By the law, the FIN-FSA is mandated to ensure financial stability and the necessary smooth operation of credit, insurance and pension institutions, and other supervised entities, to safeguard the interests of the insured and maintain confidence in the financial markets. The entities supervised by the FIN-FSA include banks, insurance, and pension companies as well as other companies operating in the insurance sector such as investment firms, fund management companies, payment institutions, virtual currency providers, and the Helsinki Stock Exchange. Currently, small lending institutions are not subject to supervision by the FIN-FSA but there is a government initiative to include them under the supervision of FIN-FSA.

16. The Single Supervisory Mechanism (SSM), composed of the ECB and the National Competent Authorities (NCAs), is the legislative and institutional framework that grants the ECB a leading supervisory role over banks in the EU.⁷ The ECB, working closely with the NCAs, is directly responsible for the supervision of SIs and oversees the supervision of LSIs as conducted by the NCAs. FIN-FSA is involved in ECB's SI supervision via its participation in the joint supervisory teams (JSTs). In addition to its oversight role for LSI supervision, the ECB has direct responsibility (proposals for approval drafted by the NCA) for licensing withdrawal of licenses, and qualifying holdings in LSIs. Authorization of third-country bank branches is the responsibility of the NCAs.

17. The FIN-FSA is governed by a Board which is limited to a maximum of six members. The Board decides the overall strategy of FIN-FSA, sets operational objectives, and directs and supervises achievement of the objectives and compliance with the strategy. Board members are appointed by Parliamentary Supervisory Council for a three-year term. The Ministry of Finance, the Ministry of Social Affairs and Health, and the Bank of Finland each nominate one board member and the Parliamentary Supervisory Council chooses at least two further members. The board members appointed at the recommendation of the Bank of Finland, the Ministry of Finance, and Ministry of Social Affairs, are all officials currently serving in these agencies. Although AFA provisions that Board

⁶ FIN-FSA officials estimated that Finnish banks' exposures to Russian clients is less than 0.1 percent of total assets.

⁷ The SSM Regulation and the SSM Framework Regulation set out the fundamental principles governing collaboration within the SSM.

members and deputy board members must be conversant with the activities of the financial markets, it does not lay out specific qualifications.

18. As expressed in previous FSAPs, the composition of the Board, with officials from Ministry of Finance and Ministry of Social Affairs serving as board members, creates the appearance of a lack of independence. This structure could create conflicts between the mandate of the FIN-FSA and agenda of these Ministries.

19. The FIN-FSA is led by Director General (DG) whose term of office is five years with an opportunity to be appointed again. Parliamentary Council appoints and dismisses, upon proposal by the Board, the Director General. No specific justification for removal is required, although there had never been a situation where the Parliamentary Council has removed the DG.

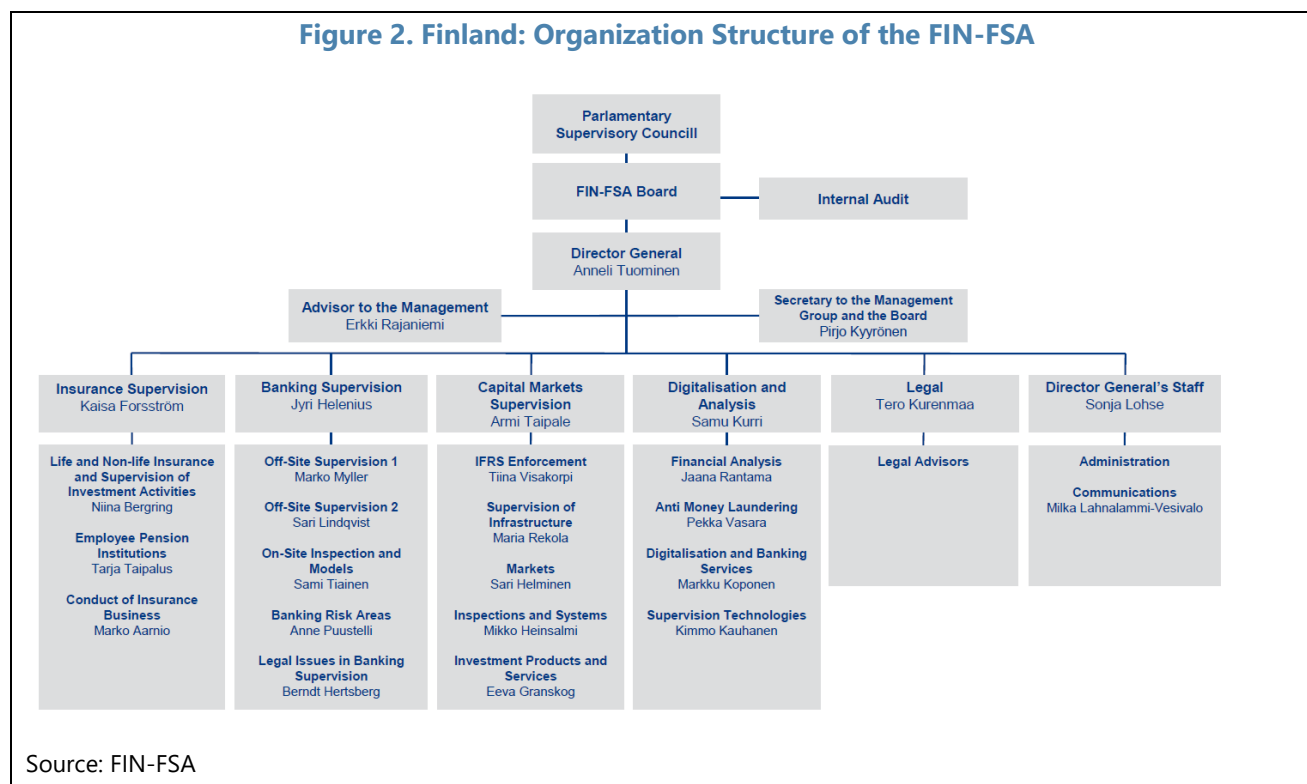
20. The Financial Supervisory Authority operates administratively in connection with the Bank of Finland. The Deputy Governor of the Bank of Finland (BoF) is the Chairman of the FIN-FSA Board. The FIN-FSA's Information Technology (IT) and Human Resources (HR) functions are supplied by the BoF. The FIN-FSA employees are in a public-service employment relationship with the Bank of Finland. The salary level of FIN-FSA employees is determined by the BoF. The budget of the FIN-FSA should also be approved by the Board of the BoF. In practice no adjustments are made by the BoF Board to the budget because it already takes part in the processes prior to the FIN-FSA's submission of the budget to the BoF Board.

21. Because of the Constitution, FIN-FSA's direct regulatory role is narrow and comprises mainly regulations of a technical nature. According to the Constitution, the FIN-FSA may be authorized to issue binding regulations by law only if there is a special reason pertinent to the subject matter and if the material significance of the rules does not require that they be laid down by an Act or a Decree. Also, the scope of such an authorization should be precisely circumscribed in the law. The FIN-FSA may also issue non-binding guidelines. In practice most of these non-binding guidelines include FIN-FSA's recommendations on compliance with the guidelines and recommendations issued by the European supervisory authorities.

B. FIN-FSA's Organization and Resources

22. The FIN-FSA's organizational structure has changed since the previous FSAP. With this change the departments are now organized on a sectoral basis: Banking Supervision, Insurance Supervision, and Capital Markets Supervision Departments and two Departments that are supporting these (Digitalization and Analysis, Legal Department), in addition to a supporting department for the DG (See Figure 2). As a result of this change, the FIN-FSA has adapted its banking supervision organization to conform to the structure of the ECB—with dedicated teams devoted to on-site inspections.

Figure 2. Finland: Organization Structure of the FIN-FSA



23. Department and division heads constitute a “Management Group,” which provides an advisory function for the DG. According to the internal written procedure of the FIN-FSA, approved by the Parliamentary Supervisory Council, matters that are essential and important for supervision are to be handled by the FIN-FSA Management Group. The Management Group meets at least weekly. Decision-making power lays, however, with the DG supported by the members of the Management Group. The Management Group also develops performance targets and performance measurements and submits these to the FIN-FSA's Board for approval. Performance targets and Key Performance Indicators are public, included in the Board's yearly report to the Parliamentary Supervisory Council. At the FIN-FSA level the implementation of inspections and thematic reviews have been significantly lower than their target levels for the last couple of years (2017–19).⁸

24. As expressed in the previous FSAP, legal protection of FIN-FSA officials and staff should be strengthened. According to the Tort Liability Act, the State will be vicariously liable in damages for injury or damage caused by an employee through an error or negligence at work. The same Act also provisions that a public official will be liable for damages for injury or damage caused by him/her through an error or omission at service. Third parties may take legal action directly against FIN-FSA officials and staff. According to the Constitution the officials will be held liable in

⁸ These measures were not used in 2020 because of the COVID-19 pandemic.

case of unlawful act or omission. However, there is not a provision that protects staff against the costs of defending their actions and/or omissions made while discharging their duties in good faith.

25. The operations and activities of the FIN-FSA are financed mainly by levying supervision fees on its supervised entities, as well as various processing fees. Supervised entities provide 95 percent of the financing needed to cover its activities, and the remaining 5 percent comes from the Bank of Finland. However, the FIN-FSA pays the BoF for its administrative services, which constitutes around 16 percent of total expenses. Staff expenses account for the largest share of the budget (66 percent). Staff expenses have increased around 20 percent in 2018 and 2019 due to Nordea's change in domicile and have then slowed to seven percent in last two years. The Board decides the supervision fees to be levied within the maximum limit provided in Act on the Supervision Fees of the FIN-FSA. Starting from 2024, the FIN-FSA sees a risk that its financial solvency be uncertain depending on how the economic situation of the financial sector and the supervised entities develop. If key financial figures of supervised entities do not increase in coming years, when using the maximum supervision fees allowed by the law, there would no longer be a financial buffer in the FIN-FSA's budget, and a risk that supervision fees won't cover all FIN-FSA's costs.

26. Availability of resources is a challenge for the FIN-FSA. The creation of the SSM and placing SIs under ECB's direct supervision has not freed resources: rather, under the new set-up the supervision is becoming more intrusive and requiring more resources. Under the SSM arrangements, although the ECB directly supervises SIs, a significant share of supervisory resources come from the FIN-FSA. The FIN-FSA directly supervises LSIs, but under the general oversight of the ECB to promote a more consistent supervisory approach across the SSM. The SSM LSI methodology is derived from the SI methodology which is significantly more comprehensive compared to FIN-FSA's pre-SSM approach. Furthermore, new risks and challenges are emerging which reform supervisory practice and processes and require acquisition of new skills. These include the challenges of cyber resilience, the potential opportunities of fintech, the growing sophistication of threats from criminal activity (money laundering and terrorist financing), and the impact of E&C related risks on banking. It is important that the necessary resources are made available to the FIN-FSA, possibly through an increase in the budget envelope, to recruit and retain quality staff across the full range of skills and experience in both traditional and emerging risks like ICT, cyber, and climate.

27. The rate of staff turnover in banking supervision is high at 18 percent. The redomiciliation of Nordea resulted in hiring new supervisors at the FIN-FSA, but many new hires have left for private sector positions. The FIN-FSA itself does not have any cooling off requirements. A cooling-off period is applicable only to the Director General and her deputy due to their involvement in the European Central Bank SSM Supervisory Board (and stipulated in ECB policies.)

28. The FIN-FSA might consider external experts with specific expertise until it is able to fill relevant skill gaps. The Act on the Financial Supervisory Authority (AFA) authorizes the FIN-FSA to employ an auditor, or other outside expert advisor, for purpose of supervision that requires special expertise. However, this option is not commonly utilized.

C. Cooperation and Collaboration and Home-Host Relationships

29. The FIN-FSA works in close cooperation with Financial Stability Authority (FFSA), which is the Finnish resolution authority. While the FIN-FSA is responsible for the supervision of credit institutions on a going-concern basis and has powers to apply Early Intervention Measures (EIM) once the institution is failing, the FFSA also conducts annual preparatory measures on going-concern such as drafting resolution plans, setting MREL requirements, taking measures to ensure resolvability, and collecting contributions to the resolution fund. The FFSA has to consult FIN-FSA on the resolution plans, MREL requirements and removal of substantive impediments to resolution for LSIs. Once an institution enters the early intervention phase, the FIN-FSA still is the responsible authority, but the FFSA has some joint powers. Namely the power to order a failing institution to search for itself a buyer (prior resolution) and preparing the Failing or Likely to Fail (FOLTF) assessment. Once an institution is assessed being FOLTF (by FIN-FSA or FFSA) the FFSA must take a decision on its resolution according to the Resolution Act or initiate normal insolvency proceedings based on the banking act.

30. The Memorandum of Understanding (MOU) between FFSA and FIN-FSA has been updated and signed on December 21, 2021. It lists the information to be exchanged between FIN-FSA and FFSA regarding continuous monitoring of LSI, regulatory reporting and/or other information, both authorities' obligations under recovery and resolution planning, use of early intervention measures, and crisis management. The FFSA and FIN-FSA meet on a regular basis to discuss the LSIs.

31. While Finland hosts foreign branches and subsidiaries, Finnish LSIs do not have many operations abroad.⁹ The FIN-FSA is a member in the supervisory colleges of Svenska Handelsbanken, Skandinaviska Enskilda Banken and Danske Bank. The Swedish FSA chairs supervisory colleges as the home competent authority for SHB and SEB and the Danish FSA for Danske Bank. The FIN-FSA has been participating in the work of the colleges based on risk-based evaluation, such as providing the home authority with risk assessment statements by risk areas when deemed necessary. The FIN-FSA completed a SREP of SHB's Finland branch and Danske Bank's Finland branch and provided the report to the home supervisors. However, Danske Bank's Finland branch has subsequently been classified as significant institution starting from January 1, 2022, and is thereafter to be supervised by the ECB.

32. The Nordic MoU of December 2016 (expanded in 2017) signed between Finland, the ECB, Denmark, Sweden, and Norway covers various areas of supervisory coordination with regards to significant branches. The MoU includes provisions on information exchange, communication with the bank, consumer protection supervision, reciprocity of prudential requirements, conducting on-site inspections. It also covers the consultation of the host supervisor before the capital and liquidity SREP decisions and before the assessment of the recovery plan on the group level, and the right for host supervisors to provide assessments prior to decisions on

⁹ Only one LSI has a branch in an EEA country.

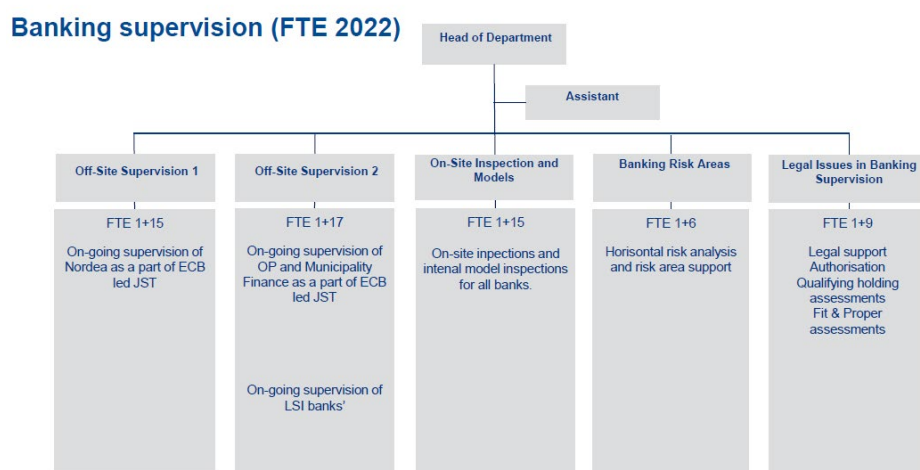
internal models. The MoUs are basically non-binding documents setting out an intention to cooperate, and they work well when there are no acute problems with supervised entities. However, in the Nordic context, the functionality of non-binding MoUs has not yet been tested during crises, and it therefore remains to be seen how they perform in crisis situations.

SUPERVISORY APPROACH, TOOLS AND REPORTING

A. Organization of Supervision

33. Redomiciliation of Nordea in Finland led to a structural change in the organization of banking supervision. The banking supervision department previously consisted of two divisions responsible for on-site and off-site supervision. Now, the banking supervision department has five divisions, two of which are off-site supervision divisions dedicated to ongoing supervision (Figure 3). One of the off-site supervision divisions is responsible for day-to-day supervision of Nordea with the ECB, the other off-site supervision division supervises 3 SSM institutions and LSIs, where approximately 9.0 FTEs (out of 18) are allocated to the LSI supervision. The On-site inspections and Models Division assesses banks' internal models in addition to conducting on-site supervision of SIs and LSI. The Banking risk area division supports horizontally LSI supervision and performs sectoral analysis and thematic reviews for LSIs and is also responsible for reviewing and performing quality assurance for every LSI SREP. The Legal Issues in Banking Supervision Division provides legal support in qualifying holding and fit and proper assessments. The majority of banking supervision staff are experienced in banking business.

Figure 3. Finland: Organization Structure of the Banking Supervision Department



Starting from 2022 Danske Bank branch was designated as an SI. It is under Off-Site Supervision 2.

Source: FIN-FSA

34. The Digitalization and Analysis department supports the Banking Supervision

department in certain areas. The department is responsible for regulatory reporting, macro-prudential supervision, analysis of the banking sector, AML & CFT supervision, operational risk supervision of LSIs,¹⁰ and all banks' conduct supervision. The prospective transfer of regulatory and supervision responsibility of consumer lending institutions would add responsibilities to both departments.

B. Supervisory Approach and Tools

35. Since the 2016 FSAP, the FIN-FSA has adopted the SSM LSI Supervisory Review and Evaluation Process (SREP) Methodology.¹¹ The SREP is a main tool of the FIN-FSA to steer the supervisory process and assess on an ongoing basis the nature, impact, and scope of risks for LSIs. It involves a comprehensive assessment of LSIs' strategies, processes, and risks, and takes a forward-looking view to determine how much capital and liquidity each LSI needs to cover its risks. The overall SREP assessment underpins a wide range of possible supervisory outcomes, including decisions on the institution's capital or liquidity adequacy or other qualitative or quantitative measures. The SSM SREP for LSIs is built on four elements (See Box 2 for details of the methodology). The methodology aims to foster convergence with regard to the way NCAs in the SSM conduct their SREP, to facilitate the creation of minimum level playing field across countries and to build a continuum in the supervision assessment of SIs and LSIs.

36. The SREP methodology for LSIs warrants a certain degree of flexibility for the NCAs to take into account proportionality as well as specifics related to the LSI population.

Where Risk Assessment System (RAS) and related capital adds-on is more harmonized with the SSM approach in general, risk-by-risk assessment of an institution's quantification of its capital and liquidity needs and stress tests are areas where flexibility in implementation of SREP come into play for SSM countries. The application of the proportionality is reflected in the frequency, scope, and granularity of the assessments as well as supervisory expectations.

37. According to the SSM LSI SREP methodology, the national supervisor must define the minimum supervisory measures to be assigned to the supervised entity on a risk-based basis.¹² These are determined by taking into account the rating of the supervised entity and the SSM prioritization

Examples	Intensity of assessment
	<ul style="list-style-type: none"> ➢ Annual frequency for the full SREP assessment for high-priority LSIs, but lower minimum frequency for non-high-priority LSIs; for all LSIs: annual update of the SREP ➢ For every LSI, the risk (sub)categories are assessed only if deemed material
	Supervisory expectations
	<ul style="list-style-type: none"> ➢ For instance, depending on the nature, size and complexity of the institution and its businesses, the risk management methodologies and processes (in particular for non-high-priority LSIs) can be less complex
	Information needs
	<ul style="list-style-type: none"> ➢ Methodology tailored to information reporting requirements applicable to LSIs, e.g. FINREP (which, when compared with FINREP for SIs, is significantly reduced in terms of scope), but also any other supervisory data available at NCA

¹⁰ On-Site Inspection and Models division at Banking Supervision department is responsible for operational risk inspections also for LSIs'.

¹¹ LSI SREP Methodology complies with applicable EBA Guidelines, namely those EBA Guidelines on common procedures and methodologies for SREP and supervisory stress testing, and on ICAAP and ILAAP information collected for SREP purposes.

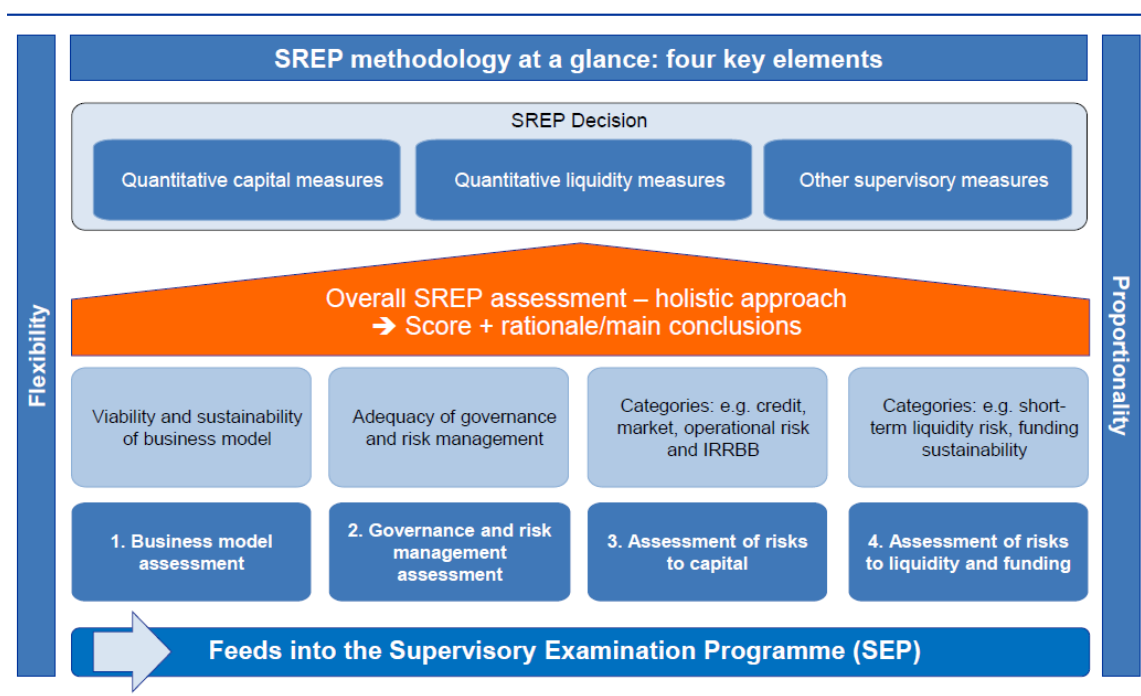
¹² [SSM LSI SREP Methodology](#).

methodology which classified LSIs as high-priority (HP), medium priority, or non-high priority (non-HP) institutions according to their impact on the national economy, size, and complexity of their activities. Based on this methodology, the FIN-FSA determined three groups for minimum engagement levels (intensified, enhanced, and standard).

Box 2. Finland: SSM LSI SREP Methodology

The methodology is built on four elements.

- Business model assessment: includes an assessment of business model viability and sustainability.
- Internal governance and risk management assessment: assesses internal governance framework, risk management framework and risk culture, risk infrastructure, internal data, and reporting and remuneration policies and practices.
- Risks to capital: includes assessment of capital related risks (credit, market, IRRBB, operational). Also, the bank's perspective is included in the assessment through ICAAP and a forward-looking perspective is included in stress testing exercises.
- Risk to liquidity: includes assessment of short-term liquidity, funding stability, ILAAP, and sensitivity analysis based on prudential reporting.



Source: ECB, SSM LSI SREP Methodology

38. The ECB changed the classification framework of LSIs that became effective in 2022. Future supervisor engagements depend on the classification of LSIs depending on their impact, risk and size and complexity of their operations assessed through some indicators.

Owing to LSIs differences in terms of size, complexity and risk profile, ECB classifies these institutions based on their impact on the financial system and their risk profile. As of 2022, impact criteria and risk criteria are being assessed separately. High-impact LSIs are determined once a year for each of the countries participating in European banking supervision. Criteria for HI category are (i) size, (ii) importance for the economy, (iii) potentially significant institution, (iv) cross border activities, and (v) business model. The NCAs must identify at least three HI LSIs. In case there are less than three HI LSIs in a NCA captured by the HI criteria (also including HI LSIs under the stability rule), the HI status is assigned to the next largest LSI (in terms of total assets).

39. Based on the above criteria the FIN-FSA classified three HI LSIs in 2022. Four of the LSIs are classified as non-high impact LSIs and two are as non-high impact, small non-complex LSIs (NHI, SNC LSIs). The assessment frequency of all components of SREP will be annual for HI LSIs. A comprehensive or a base SREP assessment should be done for every risk category annually (MYA) so that each risk category is assessed comprehensively at least once in three years. For non-HI LSIs a comprehensive SREP including all material risks is required every three years. MYA can also be applied for NHI-LSIs, if seen as appropriate by the FIN-FSA. NHSNC LSIs will be subject to comprehensive SREP every three years. LSIs ICAAPs and ILAAPs are assessed during the SREP assessments (and therefore have the same frequency with SREP assessments). For all LSIs, all material risk categories and sub-categories are analysed, but for non-high impact LSIs, scoring and narrative is provided only on the risk category level. For high impact LSIs scoring and narrative are mandatory for credit risk/concentration and operational risk/ICT sub-categories. For non-high impact LSIs which are SNCI only, the comprehensive assessment is used.

40. The comprehensive SREP assessment is a resource intensive process and takes around half a year. The process involves a review of the banks' policies, procedures, regulatory reports, management information reports, internal audit reports board and committees' minutes, external audit reports, on-site inspection reports and thematic reviews and interviews with the senior management (CEO, CRO, CFO, Head of Internal Audit, Head of Compliance). A base assessment demands approximately two times less resources than a comprehensive one. When the SREP assessment is completed it is first reviewed, risk by risk, by Senior Risk Experts from Banking Risk Areas Division and Heads of AML/Operational Risk Divisions, whereafter the Head of Off-site Supervision Division reviews it as a whole. Then it is reviewed by SREP assessment council, whose members are Heads of Banking Supervision Divisions and Heads of AML/Operational Risk Divisions. The assessment is then sent to the Management Group for review and final decision is given by DG. The FIN-FSA shares the SREP report with the respective bank. The report includes the SREP P2R decision and main observations on four components, the bank's recovery plan, and ICAAP and ILAAP documents. The FIN-FSA asks the bank to deliver an action plan to improve the findings. Off-site supervision monitors the realization of the action plan.

41. Pillar 2 Capital add-on (P2R) are prevailing for three years for LSIs. A change of P2R in under three years has happened once, when the yearly SREP assessment of a bank led to a

change in the P2R. Changes in quantitative key indicators are captured through quarterly monitoring. It is also important that the LSI P2R is updated in case of important developments (i.e., business model change, acquisition/merger activity, change in ownership, renewal of core systems) that are yet to be reflected in financial results but increase risks of the institution.

42. Recovery plan assessments, inspection frequencies, and the minimum level of dialogue with bank management of LSIs depend on the classification category. Recovery plan assessments are annual for all LSIs except NHI, SNC LSIs. On-site inspection frequency is three years, five years, and ten years for HI, NHI and NHI SNC LSIs, respectively. Dialogue with management is determined to be every three years for all bank categories. For HI LSIs meetings with senior management will be annual and meetings with auditors will be bi-annual. At present, the FIN-FSA rarely meets with banks' board of directors, and every 2-3 years with external auditors. The FIN-FSA is recommended to meet annually with HI LSIs' Board of Directors and external auditors to discuss the risk profile, main developments, and plans.

43. The FIN-FSA has implemented the LSI stress testing process according to the EBA's stress testing timeline. Stress testing is carried out every second year, although the COVID-19 pandemic postponed the latest stress testing one year further to 2021. The FIN-FSA has not yet used the stress test results for determining the P2G to the LSI sector, but it plans to implement the methodology according to the ECB's guidelines developed for the LSIs (according to current plan during late 2022–23). The ECB expected NCAs to implement the P2G by 2021, in line with the revised EBA Guidelines on SREP.

44. The ECB/SSM's oversight function impacts the supervisory strategy of NCAs. In its oversight function, the ECB works closely with national supervisors to foster a common application of rules governing banking supervision, while also working towards the consistent application of "joint supervisory standards" across the Euro system for LSIs.¹³ For Finnish authorities, this implies consideration of the ECB/SSM's supervisory priorities for determining supervisory priorities for Finnish LSIs. Under the scene set by the ECB on the SSM level, the FIN-FSA identified its 2022 supervisory priorities as credit risk, governance, and IT/Cyber risks among others. The work for the two areas that are determined among the supervisory priorities for the LSIs (integration of climate risk in supervision, supervision of digitalized banking sector) in 2021, has been planned to continue during the upcoming years. The scarcity of resources at the FIN-FSA limits dedication of resources for ad-hoc inspections or for the horizontal projects at the ECB. However, the FIN-FSA delivered all requested data to the ECB activities.

45. LSIs are rated from one to four (one being the highest and four the lowest) quarterly by the FIN-FSA. The starting point is automatic scores generated by the indicators. If there is something that the automatic scoring doesn't reflect properly, expert judgement can be

¹³ As the ECB is responsible to ensure the effective and consistent functioning of the SSM, the ECB may, where deemed necessary for the prudential supervision of LSIs, adopt, among other things, guidelines (binding legal instruments) and recommendations (non-banking legal instruments) applicable to NCAs. The NCAs have the discretion to adopt certain LSI supervisory practices that suit the specificities of their jurisdiction.

used, and an LSI's score is adjusted accordingly. The table of scorings and overall rating will be attached to the quarterly report prepared by Financial Analysis division. Any changes to the overall ratings or causes for concern are communicated to the Management group when presenting the quarterly results of the banking sector.

46. On-site inspections conducted in LSIs are limited in number and scope. Over the last three years (2019–21), the FIN-FSA has carried out 12 targeted on-site inspections. Six of these on-site inspections were conducted by the Digitalization and Analysis Department on operational risk topics, and six by the Banking Supervision Department on household loans secured by residential real estate, prudential operational risk management and IRBA models. Household loan inspections focused on the review of individual modification of the payment program. The inspection team looked through the credit files of individual payment program changes to obtain an estimate of the functioning of the following processes in the bank: (i) recognition of forbearance exposures: (ii) identification, probation, recovery, and the link to non-performing identification. One inspection also reviewed documentation related to provisions and ECL models in order to assess the functioning of the staging process, identification of SICR (significant increase in credit risk), the validity of the methods and models to calculate the ECL amount and their validation, where the main emphasis was on how the bank assures that methods and models are valid for use (activities like validation, monitoring, etc.), and inclusion of FLI (forward-looking information) in SICR identification and ECL calculation. Although the findings have an implication for banks' classification of specific loans and on the amount of provision for impairment, the inspections did not result in these implications being directly reflected in accounting. The Banking Supervision Department has launched four on-site inspections in 2019 and 2020. Inspections in 2020 and 2021 were conducted remotely based on virtual interviews, walkthroughs, data analysis and documentation received from banks.

47. Currently, several LSIs are renewing their core banking systems which requires the FIN-FSA to intensify its supervision on operational risk, specifically the ICT risk of these banks. Operational risk is assessed by the FIN-FSA through SREPs and on-site inspections. The Digitalization and Banking Services Department is responsible for preparing operational risk assessments in SREPs. On-site inspections are conducted by On-site Inspections and Models division. There is a multi-year interval for operational risk on-site inspections in a single bank. Usually, on-site inspections focus on certain areas or services rather than full-scope operational risk inspections. The current resources¹⁴ at the FIN-FSA allows two or three targeted on-site inspections on operational risk annually. Banks are required to self-assess their operational risks annually. This self-assessment does not include cyber risk aspects. Additionally, most LSIs, naturally, do not have necessary resources at the second and third line of defense level for ICT risks, which underscores the importance of the FIN-FSA's supervision.

¹⁴ There are currently three specialists (soon to be two) that conduct operational risk supervision (on-site and off-site) of all LSIs and insurance companies.

48. The FIN-FSA’s supervisory approach also includes thematic reviews covering all banks, or just LSIs. The purpose of thematic reviews, with a questionnaire, is to observe unwarranted practices or patterns without thorough individual verification. These reviews can be followed-up with supervisory letters that include recommendations or with discussions with banks’ management. The Banking Supervision Department conducted three thematic reviews in last three years. In addition to thematic reviews, the FIN-FSA prepares on a quarterly basis a banking sectoral analysis report, covering all risk areas. A version of the report, without bank specific information, is published in the FIN-FSA’s website twice a year.

49. The authorities’ supervisory approach is significantly improved and became more comprehensive with adoption of SSM LSI SREP methodology, although there is room for further improvement. The SREP assessments provide thorough analysis of risks and vulnerabilities of credit institutions. Nevertheless, these could be further improved by including an assessment regarding board and senior management competence, collective suitability of the boards and overall group structure, and risks stemming from related parties. As explained in paragraph 71, in some banks, the tasks of board of directors are assigned to a different body, a Supervisory Board, according to their Statutes. It is necessary to ensure that SREP assessments cover this structure in “Governance and Risk Management Assessment” and as necessary in other components. Additionally, the supervisory approach could further be improved by conducting analysis on banks’ IFRS-9 implementation, more specifically regarding staging of exposures and functioning of ECL models. For this purpose, regular dialogue with credit institutions, analysis work, bilateral meetings with credit institutions’ external auditors, benchmarking and peer review analysis, and targeted on-site inspections would be useful.

C. Supervisory Reporting

50. In addition to Common Reporting (COREP) and Financial Reporting (FINREP) which are applied across Europe, the FIN-FSA has some national regulatory reporting requirements for credit institutions. Stock of loans and guarantees, overdue and non-performing assets and impairment losses report (covering only loans to Finnish housing corporations), interest rate risk report, loan to collateral report, calculation and reporting of capital adequacy of financial and insurance conglomerates report, and reporting of mortgage bank operations are collected annually. Moreover, the FIN-FSA collects risk assessment questionnaires (related to AML/CFT supervision) on an annual basis.

51. Regulatory reporting requirements might vary based on LSI classification and legal status. NHISNC LSIs’ reporting obligations will be simplified after their classification is formally approved. Regulatory reporting obligations of the Finnish subsidiaries of foreign (non-SSM) banks are more comprehensive than those applicable to the domestic credit institutions on the solo level. The branches of foreign banks have fewer mandatory regulatory reports to be submitted.

52. Finland does not have a public credit register at present. A credit bureau operates in the country, but it is only of a ‘negative’ nature (i.e., it only reports delinquencies). The FIN-FSA

does not receive regular reporting on defaults of individual counterparties; such information is only requested in connection with credit risk inspections, e.g., when choosing a sample of loans to look at more closely. The preparatory work for the introduction of the Positive Credit Registry is under way. The data content of the registry was completed, and the legal act governing the Positive Credit Registry was submitted to the Finnish Parliament in early 2022. According to the current plans, the Positive Credit Registry will be launched in spring 2024. Lenders start reporting information on February 1, 2024 and can start using the information in the register from April 1, 2024. The data in the upcoming registry is expected to provide a more comprehensive and accurate overview of the credit market for all borrowers (e.g., loan sizes and numbers, repayment methods, interest rate hedges, interest margins and arrears). The data will also include income information on the borrowers. However, data will initially cover consumer loans and will be expanded gradually to include housing company loans. The authorities' plan is to add housing company loans to the database at the earliest in 2025. Lenders will be required to review the data on their loan applicants during the credit origination process.

53. There is some loan-level data collection at present, but it does not cover all loans and the usage of the data is limited. Loan-level flow data on natural person's new housing loans is collected quarterly by the FIN-FSA to monitor compliance with binding loan-to-collateral limits since 2016. Loan-level data on banks' loans to legal entities (e.g., corporates, public sector entities), so called AnaCredit data, is collected on a monthly/quarterly basis by the Bank of Finland. This data is occasionally used by the FIN-FSA. (Access within the FIN-FSA is limited and the outcome of the analysis of the data cannot be shared with those without corresponding access rights).¹⁵ It is important that after credit registry is operationalized its data would be used for supervisory purposes by the FIN-FSA.

D. Climate

54. The ECB published its Guide on climate-related and environmental risks in November 2020. The Guide describes how the ECB expects institutions to consider Climate Related and Environmental (C&E) risks when formulating and implementing their business strategy and their governance and risk management frameworks, including stress testing. In early 2021, the ECB asked SI institutions to conduct a self-assessment in the light of the supervisory expectations outlined in the Guide and to draw up implementation plans to advance their management of C&E risks. The ECB's assessment highlighted that none of the SIs are close to fully aligning their practices with supervisory expectations.

¹⁵ The Anacredit data is collected in accordance with Council Regulation (EC) No 2533/98 concerning the collection of statistical information by the European Central Bank. The dataset contains 'confidential statistical information' (Article 1(12) thereof). The physical and logical protection of such confidential information must be ensured (Article 8(3) thereof). The data can only be used for predefined purposes (SSM use is defined as one of those purposes) and it can only be shared with other staff members working for the Eurosystem or the SSM and having received the system owner approval to access the data. In the ESCB, the access to confidential data is given on a need-to-know basis. Results based on Anacredit data may be shared with other staff members working for the Eurosystem or the SSM, but confidential data can only be shared among those who have been approved to access the data.

55. The ECB and NCAs conducted supervisory dialogue with each SI by Joint Supervisory Teams between August and September 2021. ECB Banking Supervision in 2022 will be carrying out a climate stress test, considered to be a learning exercise for both banks and supervisors, and a thematic review to assess banks' progress towards achieving this objective. Supervisors will also conduct on-site inspections and engage with institutions with material deficiencies in their management of climate-related and environmental risk, to ensure that they implement sound remedial action plans in good time, and monitor compliance with upcoming regulatory requirements.

56. The FIN-FSA's approach for LSIs is yet to be decided. The FIN-FSA has not started its supervisory dialogue with LSIs on C&E risks. As international bodies are accelerating their work on climate, it would be important for the FIN-FSA to build internal capacity for supervision of climate risks and start supervisory dialogue to increase awareness of LSIs in potential impact of C&E risks on their financial conditions.

LEGAL AND REGULATORY FRAMEWORK

A. Legal Framework

57. Since the 2016 assessment, the European authorities made further progress with the implementation of Basel III and other relevant Basel standards. The Capital Requirements Directive (CRD) IV and Capital Requirements Regulations (applicable per January 1, 2014) implemented the June 2011 revised version of the Basel III framework,¹⁶ as well as the liquidity coverage ratio. CRR II (effective June 28, 2021) complements the framework with the implementation of the Net Stable Funding Ratio (with a proportionate approach for small and non-complex institutions), leverage ratio (for SIs as well as LSIs), standardized approach for counterparty credit risk (with a proportionate approach for LSIs), and some Pillar 3 changes. In addition, CRR II completed the implementation of the 2014 Basel Supervisory framework for measuring and controlling large exposures. These recent changes will also need to be embedded in the supervisory approach for Finnish LSIs going forward. The "Basel III: post crisis reforms (December 2017)" and the minimum requirements for market risk (revised by the BCBS in January 2019), have not yet been transposed into European regulations.¹⁷

58. CRR II and CRD V were transposed into Finnish legislation through amendments to the Act on Credit institutions (ACI) on April 1, 2021. The most relevant changes to the ACI involve:

- Supervisory measures and powers (mainly specifications on setting a pillar 2 requirement and a new pillar 2 guidance on discretionary own funds requirement).

¹⁶ European regulations have direct applicability in member countries (including Finland), while directives need to be transposed into the domestic legislative framework of NCAs.

¹⁷ The European Union announced in October 2021, that it plans to delay the foreseen implementation per January 2023 to January 2025 (with a 5-year transition period, i.e., full implementation by January 2030).

- Recalibration of macroprudential toolkit: (i) systemic risk buffer is applied in addition to higher of the Other systemic institutions (O-SII) and Global systemic institutions (G-SII) buffers; (ii) possibility of simultaneous use of the requirement for all exposures (general systemic risk buffer) and one or more claims for partial exposures (sectoral systemic risk buffer) (iii); removal of possibility to impose several different additional capital requirements on the basis of the same risk.
- Requirements relating to the organization and management of credit institutions: (i) introduction of collective suitability requirements for credit institutions' board; (ii) the explicit requirement for credit institution to ensure that the composition of the Board and the members of the management have required qualifications.
- Authority is given to the FIN-FSA to request new standardized approach for calculating interest rate risk in the banking book (IRRBB) in cases where bank's own internal model is considered unsatisfactory.

B. Regulations and Guidance

Licensing, Change in Significant Control

59. The ECB is the competent authority for authorization of credit institutions and for withdrawal of authorization. According to the SSM Framework Regulation (SSM FR) Article 73, an NCA that receives an application for an authorization to take up the business of a credit institution to be established in a participating Member State, should notify the ECB regarding the application and should also inform it of the time limit within which a decision on the application has to be taken and notified to the applicant in accordance with the relevant national law. It is the NCA's responsibility to assess whether the applicant complies with all conditions for authorization laid down in the relevant national laws. If the NCA is satisfied that the application complies with all conditions for authorization laid down in the relevant national law, it prepares a draft decision proposing that the ECB grant the applicant authorization to take up the business of a credit institution. The authorization decision itself will be granted by the ECB. NCAs are fully integrated in the authorization process and authorization decisions are taken on the basis of applicable national law. The EBA has drafted Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) harmonizing the information requirements in the authorization process across the EU in 2017 but these drafts have not been adopted by the European Commission yet. The EBA has also drafted guidelines on the authorization of credit institutions in 2021 and these have entered into force on April 8, 2022.

60. The information required for the acquisition of qualifying holdings in credit institutions is regulated in a Government Decree, which covers information on the financial strength of acquirers and on the group structure. According to ACI, anyone who intends to acquire, directly or indirectly, shares of a credit institution should notify the FIN-FSA in advance if this holding is at least 10 percent of the share capital of the credit institution. If the holding is to be increased so that as a result of the acquisition the holding is at least 20, 30, or 50 percent of the share capital of the credit institution or the credit institution would become a

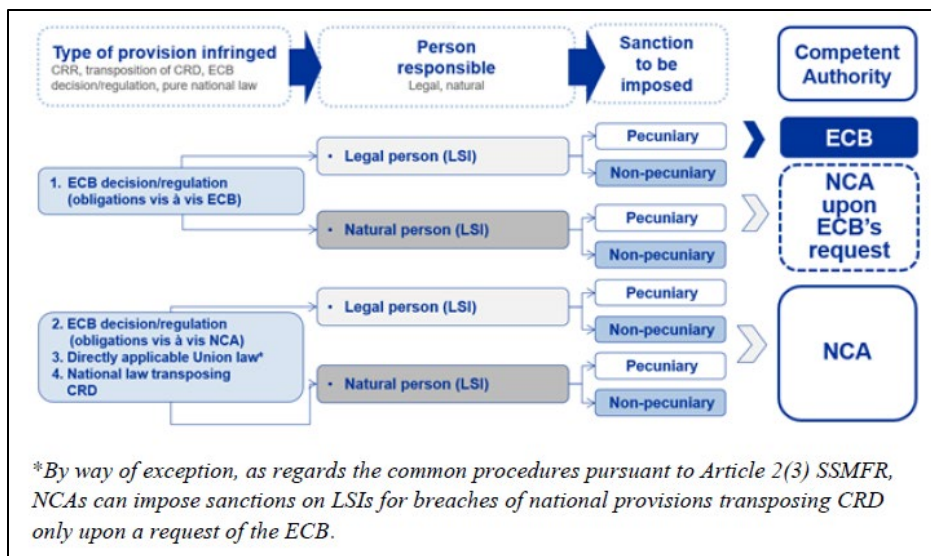
subsidiary, this acquisition has to be notified in advance to the FIN-FSA.

61. Additionally, national regulations do not require host authorities to provide no objection in case a credit institution applies to establish a subsidiary in Finland. On the other hand, if an organization applying for an authorization is a subsidiary of a foreign credit institution authorized in another EEA member state, the opinion of the relevant supervisory authority of that state shall be requested on the application. In the case of branches of non-EEA member states' country credit institutions, the applicant needs to include an authorization by the relevant authority of the home state to establish a branch in Finland if such authorization is a prerequisite for the establishment of a branch under the legislation of the home State of the credit institution. This requirement should be expanded to cover when a non-EEA member state country credit institution applies for establishment of a subsidiary.

Corrective and Sanctioning Powers of Supervisors

62. The SSM framework for enforcement and sanctioning is based on a combination of powers assigned either to the ECB or the NCAs. Where the ECB lacks the powers to directly impose enforcement measures or sanctions on banks, it can request or instruct NCAs to act, based on the powers available to them.

According to Article 18(7) SSMR and Council



Regulation 2532/1998, the ECB may impose pecuniary penalties on LSIs for breaches of ECB regulations or decisions imposing on those entities obligations vis-à-vis the ECB. In addition, as regards breaches of rules on "common procedures" (i.e., concerning granting and withdrawal of bank licenses and the acquisition of qualifying holdings) in the case of LSIs, the ECB may request the relevant NCA, pursuant to Article 18(5) of the SSM Regulation (Council Regulation (EU) No 1024/2013), to open national sanctioning proceedings.

63. The powers granted to the FIN-FSA by the ACI have been strengthened with latest ACI changes, although there is still room for clarity. ECB has broad powers granted by Article 16 of the SSMR. The powers granted to the ECB are available not only when the institution is breaching requirements, but also when the ECB has evidence that a bank is likely to breach applicable legal requirements specified in Article 4(3) of the SSMR within the next

12 months; or when, based on the SREP, the ECB considers that the arrangements, strategies, processes, and mechanisms implemented by the institution and the own funds and liquidity held by it do not ensure a sound management and coverage of its risks. Powers granted to the ECB, among others, include requiring institutions to apply a specific provisioning policy, restricting, or limiting business operations or network of institutions or to request divestment of risky activities, requiring the reduction of the risk inherent in the activities, products, and systems of institutions. The FIN-FSA is given some of these powers¹⁸ with the ACI and FIN-FSA Act. According to the ACI, the FIN-FSA can take supervisory actions:¹⁹ (i) if it estimates on the basis of a stress test or has other weighty reasons to presume that, during the next twelve months, a credit institution probably cannot meet the requirements for authorization or its liabilities; or (ii) a credit institution, or a company belonging to its consolidation group, violates its obligations provided for in this Act or in the Capital Requirements Regulation. The FIN-FSA can take early intervention measures (i.e., restricting variable remuneration, obligating to change the strategy or administrative structure, limiting distribution of funds) if it assesses that “the adequacy of own funds or liquidity of a credit institution in relation to the total risk cannot be verified in another appropriate manner.” In practice this assessment is done through SREPs. However, in the CRD and the BRRD, the supervisory powers are not linked to SREP. The wording of the ACI could also be better in terms of clarity when it combines the supervisory powers of the CRD as well as early intervention powers of the BRRD. These measures have not been exercised yet. Currently, supervisory judgement regarding riskiness of operations of a credit institution or weaknesses in risk management are reflected through SREP Pillar 2 additional capital requirements and other recommendations, rather than orders/requests.

64. The sanctioning powers of the FIN-FSA include administrative fines, public warnings, and penalty payments. The FIN-FSA may impose an administrative fine on anyone who willfully or negligently fails to comply with or violates the specific obligations stated in the FIN-FSA Act or in other legislation governing financial markets. In practice, administrative fines have been imposed for neglect of minor cases (e.g., to companies which have failed to submit the regular reports by a given deadline). The FIN-FSA may issue a public warning to a supervised entity or other financial market participant that willfully or negligently violates the provisions governing financial markets or the regulations issued thereunder. However, a public warning

¹⁸ Powers given to FIN-FSA are narrower. For instance, the FIN-FSA cannot enforce a specific provisioning policy as an early intervention power.

¹⁹ The exact wording of the related article is as follows. The Financial Supervisory Authority may, under the conditions laid down in sections 6, 9, 10 and 10 a, take supervisory measures pursuant to said sections, if: 1) the Financial Supervisory Authority estimates on the basis of a strain test in accordance with section 4 or has other weighty reasons to presume that, during the next twelve months, a credit institution probably cannot meet the requirements for authorisation or its liabilities; or 2) a credit institution or a company belonging to its consolidation group otherwise violates its obligations provided for in this Act or in the Capital Requirements Regulation. The Financial Supervisory Authority may also take the supervisory measures referred to in subsection 1, if a credit institution has stated its need for extraordinary public financial support referred to in Chapter 4, section 1, subsection 2, paragraph 3 of the Resolution Act, or if a credit institution fails to meet the own funds requirement confirmed pursuant to Chapter 8, section 7a, subsection 4 or section 7e, and the minimum requirement concerning eligible liabilities. (233/2021)

may be issued only in cases other than the offences covered by administrative fine and penalty payment. Penalty payment is the administrative sanction for the most serious offences. The FIN-FSA will impose a penalty payment on anyone who willfully or negligently fails to comply with or violates the specific provisions or decisions as referred to in the FIN-FSA Act or in other legislation (e.g., the Act on Credit Institutions chapter 20). Penalty payments not exceeding the sum of EUR 1 million are imposed by the FIN-FSA. In other cases, the penalty payment is imposed by the Market Court on proposal of the FIN-FSA. Pursuant to Article 18 (5) SSMR, for SIs, the administrative fine, public warning, and penalty payment are applied only upon ECB's request.

Corporate Governance and Risk Management

65. Some enhancements to credit institutions' corporate governance framework have been made with Law 233/2021 that is amending the ACI. Credit institutions have been given responsibility to ensure that the composition of the Board of Directors satisfies these requirements, and that members of management fulfill the qualification and time commitment requirements. On the other hand, the Act on the FIN-FSA gives power to the FIN-FSA to prohibit a person from acting as a Board member or senior manager position if that person: (i) has shown obvious incompetence or carelessness in the performance of duties (lack of fitness and propriety) and it is apparent that his or her participation may seriously jeopardize the achievement of the objectives for financial supervision; or (ii) fails to fulfil the requirements for professional competence and trustworthiness. However, the acts do not give explicit power to the FIN-FSA to request a change in the composition of the board based on its assessment on collective suitability of the board.²⁰

66. Rules on the appointment of a sufficient number of independent board members, and independency criteria, should be included in the legislation. Existing rules do not ensure that all credit institutions have sufficient independent board members. The Corporate Governance Code, which is applied for listed companies, based on a "comply or explain principle" has recommendations on independent board members and independency criteria, but not all banks are listed in Finland. The ACI requires G-SIs, O-SIs to have an audit committee composed of Board members, and at least one of those Committee members should be independent of the credit institution and its significant shareholders. However, independency criteria do not exist in the ACI. For LSIs, an audit committee is not mandatory and if it does not exist the Board of Directors or the Board of Governors should be responsible for these tasks.²¹

67. While the establishment of Audit, Risk, Nomination and Remuneration Committees is obligatory for G-SI or O-SI credit institutions, most LSIs have these committees. LSIs can

²⁰ The FIN FSA according to Act on FIN-FSA has power to prohibit a board member under some conditions (carelessness, incompetence, trustworthiness). However, having power to change the composition of the board is a broader authority than this.

²¹ The Board of Governors is a structure for amalgamations. The CEOs of member credit institutions constitute the Board of Governors.

decide to have these committees and can also have combined Audit and Risk Committees. However, if these Committees do not exist, the Board of Directors or the Board of Governors should be responsible for these tasks. With the requirement to have sufficient independent board members (with clear independency criteria), it is important to ensure that if LSIs have Audit and/or Risk committees, that they are chaired by independent members who are not the chair of the board or other committees.

68. The ACI requires a credit institution to have a risk supervisory function, a function that is supervising compliance with the regulations and internal principles and internal audit function; and that all should have adequate administrative position, powers, and resources to perform their tasks. While the ACI states general provisions on these functions, the FIN-FSA recommends credit institutions to follow EBA guidelines for details (i.e., organization and tasks of these functions, roles, and qualifications of heads of these functions).²² The SREP process requires these functions to be assessed within the “Internal governance and risk management assessment.” The FIN-FSA’s assessments have revealed concerns related to the knowledge and competence of the risk management functions of the LSIs with regard to internal model development, ESG risks, ICT risks or digitalization. In addition, the resourcing of the three independent control functions in the LSIs continues to be a concern for the supervisor. On the other hand, since the guidelines are not binding in Finland, the findings related to these areas are considered, indirectly, in risk assessment scoring and reflected to P2R. The FIN-FSA also communicates these SREP findings as recommendations to the credit institutions.

69. In Finland, Amalgamation Central Institutions and their member banks might have another organ, a “Supervisory Board,” in their governance structure.²³ According to the Cooperatives Act, the provisions on the Supervisory Board will be included in the statutes of the co-operative. Duties that fall within the general competence of the Board of Directors may be assigned to the Supervisory Board. Additionally, a wide range of duties could be assigned to the Supervisory Board with the Statutes, for example appointment of Board of Directors and Managing Director and remuneration of them, significant reduction, or enlargement of the business of the cooperative, or material change in the organization of the co-operative. Members of the Supervisory Board are appointed by Annual General Meeting or Delegates chosen by Annual General Meeting.

70. The ACI acknowledges that some duties of the Board of Directors could be assigned to Supervisory Boards. For instance, if the bank does not have an Audit Committee, Risk Committee, Nomination Committee, Remuneration Committee, the tasks of these committees, if their statutes assign these tasks, would be conducted by Supervisory Board. On the other hand, the ACI requires that if a credit institution has a Supervisory Board, the provisions of Corporate Governance and Remuneration apply to the Supervisory Board to the extent that it has, by Articles of Association or by-laws, been allocated tasks that otherwise

²² EBA/GL/2021/05, Guidelines on internal governance under Directive 2013/36/EU

²³ In Finland, all three amalgamations’ central institutions have supervisory boards.

belong to the Board of Directors. The FIN-FSA has detected that amalgamations' central institutions have supervisory boards, and some tasks of board of directors are assigned to them. However, members of the supervisory boards have not been subject to fit and propriety assessment by supervisor in their central institution role, but their roles in member credit institutions have been under supervision. Also, the collective suitability of Supervisory Boards had not been assessed by the FIN-FSA. However, the FIN-FSA has been completed for these central institutions to be subject to these requirements, with deadline of August 31, 2022 (delivering individual applications and collective suitability assessment and end of 2022 (supervisory assessment)). This assessment of allocation of tasks would also need to be made for other co-operative banks that have supervisory boards to whom tasks of board of directors are most likely to assigned. Additionally, SREPs would need to be broadened to assess Supervisory Boards in the extent these Supervisory Boards have Boards of Directors tasks in Governance and Risk Management, and (as necessary) in other assessments.

Credit Risk, Concentration Risk, Large Exposures, and Related Party Lending

71. Credit risk is the most relevant risk for Finnish LSIs. Loan advances constitute 78 percent of LSI banks' assets as of December 2021. The ACI grants power to the FIN-FSA to issue provisions on Credit Risk. Based on this power, the FIN-FSA introduced regulations regarding credit analysis, collateral management, credit planning process, measurement of credit risk and management information systems, mitigation of credit risk, credit management and customer monitoring. On the other hand, some member banks in amalgamations are lacking an independent credit review function, whose main tasks are identification and classification of loans having credit weaknesses and evaluation of the activities of lending personnel. In some LSIs, the independent credit review function is assigned to risk management department mainly on an overall portfolio basis.

72. There is a concentration in all Finnish LSI-banks to exposures which are collateralized by immovable property. The share of loans collateralized by immovable property in total loans is 80 percent of LSIs and 59 percent for all banks. The share of these exposures in relation to total exposures has risen in recent years, as highlighted by the FIN-FSA in its publications. This high concentration level underscores the importance of the FIN-FSA assessing banks' immovable property valuation processes and procedures.

73. In this regard, the FIN-FSA conducted a thematic review on "Valuation practices for the residential and commercial real estate collateral of banks under its direct supervision" in 2021. This thematic review revealed that these practices did not adhere to regulations in all respects. The FIN-FSA requires its supervised entities to correct shortcomings identified in valuation practices. However, the FIN-FSA sent supervisory letters to those supervised entities in whose activities the most shortcomings were identified. The main findings of the thematic review were:

- For some banks, the valuation of residential real estate collateral in connection with the granting of credit is based solely on a deed of sale or a valuation produced by a statistical

model, even though a final valuation should be made by an internal or external valuer, according to EBA Guidelines on loan origination and monitoring.

- In addition, the statistical model used to assist the valuer is not always validated, nor its reliability verified. For some banks, there are shortcomings in the use of international valuation standards and in internal guidelines on valuation methods in connection with the granting of credit for commercial real estate.
- In the monitoring and revaluation of the market values of residential real estate, the need for some banks to ensure that monitoring is carried out with sufficient frequency was evident.
- With regard to commercial real estate, some banks lack the capacity for more frequent monitoring when the market situation changes. In addition, in the case of some banks there was evidently a need to ensure that the residential and commercial real estate valuer responsible for revaluation is independent of the decision-making process for granting credit.

74. For covered bonds, Finland uses some exemptions based on member state option provided by Article 493(3) of the CRR, and implemented in Finnish legislation, which are not compliant with the Basel regime. The Basel regime establishes that a covered bond meeting certain conditions can be assigned an exposure value of no less than 20 percent of the nominal value of a bank's covered bond holdings. The member state option provided under Article 493(3) does not mention the 20 percent floor; nevertheless, the Finnish national legislation (Decree of the Ministry of Finance 699/2014) based on Article 493(3) provides for an exemption of 90 percent of the nominal value of covered bonds. Additionally, the Finnish national legislation (ACI chapter 10, section 11, subsection 3 and Decree of the Ministry of Finance 699/2014, section 2, paragraph 4) based on Article 493(3) of the CRR provides for a full or partial exemption of "exposures incurred by an institution to its parent undertaking or subsidiaries" which does not exist in the Basel regime.

75. The absence of binding regulations that clarify the criteria for interconnectedness might lead to different interpretations by credit institutions on the identification of connected parties. While CRR Article 4 (1) explicitly defines conditions under which counterparties, owing to control or economic connections, must be treated as a group of connected counterparties, EBA/GL/2017/15 Guidelines on connected clients give further detailed guidance to institutions on how to apply interconnectedness based on economic dependency criterion. Although the FIN-FSA referred to this Guideline in its "Regulations and Guidelines on Management of credit risk and assessment of creditworthiness by supervised entities in the financial sector (4/2018)," the non-binding nature of the Guidelines could result in inconsistent interpretations in the banking industry.

76. The definition of related parties was expanded with the recent changes to the ACI. On the other hand, there are some areas for further improvement for aligning the rules with CP 20. For instance, the ACI requires that loans and other comparable financing to be granted to banks' related parties be approved by Board of Directors, it is not clear whether this will include all transactions (i.e., service agreements, asset sales) with related parties and write-offs regarding

related parties. Additionally, the ACI does not grant power to exercise discretion in applying related party definition on a case-by-case basis. The FIN-FSA has also ceased the regular collection of LSIs related party lending data, and with recent amendment in the ACI provisioned that the information on related party lending, will be notified to the FIN-FSA upon request. The FIN-FSA plans to collect this information during LSIs' SREP assessment. The FIN-FSA has stated that it expects LSIs to comply with EBA/GL/2021/05 paragraph 125-131 and the contents of the former report was assessed as not useful in connection with new ACI provisions and EBA/GL/2021/05 (paragraph 120-131). However, it should be noted that inclusion of related party lending in the FIN-FSA's database could enable the FIN-FSA compare banks and determine outliers and/or increase in risks.

COVID-19

77. Supervisory relief measures applied to the Finnish banking sector were mostly decided collectively at the European level (ECB, EBA). Most of the measures taken by ECB Banking Supervision (and applied directly to SIs) were accompanied by the corresponding measures taken by the FIN-FSA and applied to LSIs (See below table for pandemic measures in banking). The FIN-FSA's recommendation to refrain from distributing dividends was not followed by all LSIs. Additionally, several fiscal measures were also taken during the pandemic although their extent was quite moderate compared to other euro area countries.

Box 3. Finland: COVID-19 Measures in Banking Regulation and Supervision

Date	Measure
03/17/2020	FIN-FSA decided to remove the SyRB and adjust credit institution-specific requirements. As a result of this decision, structural buffer requirements of all credit institutions would fall by 1 percentage point.
03/30/2020	FIN-FSA decided to issue a recommendation to credit institutions under its supervision to refrain from dividend distributions until October 1, 2020. Later this was extended until January 1, 2021, and September 30, 2021. This measure is unwound on September 30, 2021.
06/25/2020	FIN-FSA incorporated EBA's Guidelines on treatment of public and private moratoria in light of COVID-19 crisis into its regulations and guidelines.
06/29/2020	FIN-FSA increased the loan cap for residential mortgage loans other than first-home loans to 90 percent from 85 percent. Later, on June 29, 2021, it decreased to 85 percent.

78. The FIN-FSA also re-adjusted its supervision activities and priorities based on pandemic conditions. The FIN-FSA intensified off-site supervision activities during 2020 and 2021, and regularly contacted LSI management bodies. With the start of the pandemic, on-site inspections in credit institutions' premises stopped and have yet to resume. In order to mitigate the potential risks of suspending on-site inspections, new techniques were developed with the ECB (e.g., to collect authentic electronic data, arrange virtual process walk-throughs and review IT-systems).

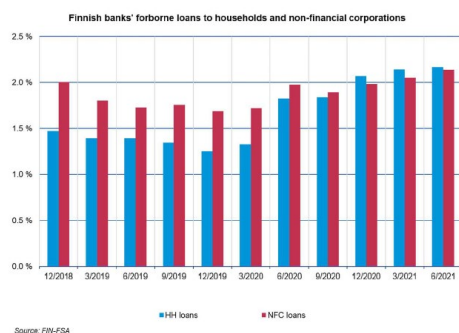
79. General or public moratoria were not applied, but Finnish banks voluntarily granted a significant amount of payment holidays to corporate and household customers at the onset of the pandemic. The duration of payment holidays was generally varied between

3-12 months. In addition, due to the legislative moratoria in another country, part of a Finnish bank's loan portfolio in that country was under EBA compliant moratoria. On September 30, 2021, most of these repayment holidays had expired without signs of asset quality deterioration. During March–December 2020, the FIN-FSA, BoF and MoF jointly conducted biweekly surveys on Finnish banks' corporate lending. Between August 2020–September 2021, the FIN-FSA collected monthly credit risk surveys for all credit institutions that covered monthly credit risk data (NPLs, forbore loans, loans under payment relief measures) that were not available in regular reporting frameworks.

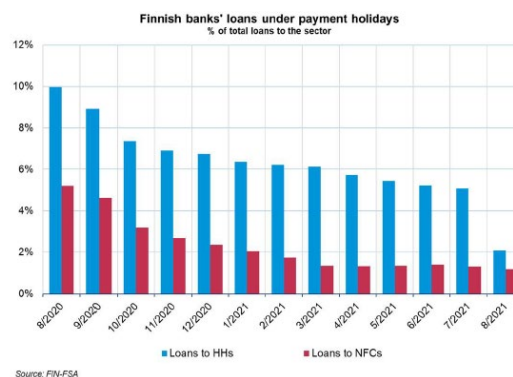
80. There was variable treatment by Finnish banks of payment holidays. A case-by-case analysis of borrowers' likeliness to pay was not possible in some banks. Some of the banks used the flexibility in the recognition of forbearance and have not recognized loans that are benefiting from payment holidays as forbore exposures. Some banks' lending agreements in general provide borrowers automatic payment holiday options embedded in the loan (embedded forbearance clause) and forbearance is not identified/assessed in these situations at all.

Figure 4. Finland: Forborne Loans and Payment Holidays

Forborne loans increased slightly though there is high level of heterogeneity in banks' classification and identification practices.



Finnish banks granted significant amount of repayment holidays voluntarily at the beginning of the pandemic, but the data collection started in August 2020.



81. The FIN-FSA made an analysis on credit institutions' IFRS-9 provisioning and the ECL methodology during the pandemic. The analysis was based on the EBA's IFRS-9 indicator time series until end-2020 and the disclosures and the supervisory reporting of the banks. The report revealed that management overlays varied a lot between the Finnish banks. Some banks did remarkable overlays, and some stated that there was no need for overlays due to reasoning that the changes to the macro-scenarios or parameters were sufficient. Additionally, the analysis regarding the development of ECL and coverage ratios in stages and the development of movements between stages has shown variability existed between banks both in the coverage ratios and development of movements between stages. It is important that this analysis be conducted regularly (for instance annually), even after the pandemic ends, and results would be used to conduct deep dive analysis in identified practices and banks. The FIN-FSA might also consider discussing the findings with banks' external auditors.

**Appendix I. Finland: Updates on the Implementation of the
Recommendations from the 2016 FSAP Review
(Basel Core Principles)**

Progress on Implementing the 2016 FSAP Recommendations			
Basel Core Principle (BCP)	Recommendation	Authorities' Response	Assessment of the Mission
BCP1 Responsibilities, objectives, and powers	1) Ensure that the Finnish legislation grants the FIN-FSA all the powers it needs according to the CRD to impose decisions on capital and liquidity requirements and supervisory measures on LSIs. (MoF)	REC1: Fully implemented. The national act on credit institutions has been amended. Please see also the responses in the self-assessment template concerning the corresponding Core Principle.	REC 1: Implemented
BCP3 Cooperation and collaboration	4) Seek a supervisory memorandum of understanding with the Swedish authorities covering large significant foreign branches, providing for enhanced access to information and supervisory engagement with the branches and parent banks. (ECB, FSA) 5) Raise with the European Commission the question of how the CRD might be amended to retain the original objective of encouraging the free flow of financial services within the EU while, at the same time, providing host supervisors with additional authority over systemically-important institutions, in close collaboration with the home supervisor. (MoF, ECB)	REC4: Fully implemented. EBA Guidelines on supervision of significant branches and MoU on prudential supervision of significant branches in Sweden, Norway, Denmark and Finland has been finalized and are used by Nordic supervisors. Please see also the responses in the self-assessment template and in the questionnaire concerning the corresponding Core Principle. REC5: FIN-FSA has sent letter to European Commission. Please see also the responses in the self-assessment template and in the questionnaire concerning the corresponding Core Principle.	REC4: Implemented REC5: Action was taken
BCP9 Supervisory techniques and tools	7) Analyze, within the SSM and in collaboration with the other supervisors in the EU, the risks possibly stemming from the crossholding of bonds, in particular covered bonds and consider imposing concentration limits. (ECB, FSA) 11) Update the on-site methodology to ensure that the samples of loan files analyzed during inspections are selected	REC7: In general, the interconnectedness (e.g., via crossholdings of bonds) between banks and financial sectors is analyzed in the context of both microprudential and macroprudential supervision at the FIN-FSA and Bank of Finland and in the euro area/EU-level fora. However, any specific concentration limits on, for example, holdings of covered bonds have not been considered. REC11: Targeted at the ECB.	REC7: Not implemented

Progress on Implementing the 2016 FSAP Recommendations			
Basel Core Principle (BCP)	Recommendation	Authorities' Response	Assessment of the Mission
		positive credit registry will be used for analysis and supervisory purposes in the future (see also the response to Question 28 in the questionnaire).	
BCP16 Capital adequacy	6) Proceed with the announced comprehensive review of banks' internal models and devise, for the future, a sustainable form of ongoing model monitoring to prevent banks from reducing again the degree of conservatism in their models. (ECB, FSA) 13) Closely monitor the impact on the bank's loss absorbency of the 'Danish compromise' waiver (allowing banks in financial conglomerates not to deduct insurance participations). (ECB)	REC6: Fully implemented. Models have been assessed as part of model supervision. There has been the ECB TRIM project focusing on SI banks and same supervisory principles has been applied for LSIs'. Please see also the responses in the self-assessment template and in the questionnaire concerning the corresponding Core Principle. REC13: Targeted at the ECB. This waiver currently not used by the Finnish LSI banks.	REC6: Implemented
BCP17 Credit risk	10) Continue to closely monitor banks' loan portfolios to verify the evolution of renegotiated loans. (ECB, FSA)	REC10: Fully implemented. Banks' loan portfolios are closely monitored. Especially during the COVID-19 crisis portfolio development and different credit quality indicators were intensively monitored and additional data requests have been in place. Please see also the responses in the self-assessment template and in the questionnaire concerning the corresponding Core Principle (as well as COVID-19 related questions in the questionnaire).	REC10: Requires further work
BCP21 Country and transfer risks	14) Analyze the impact of the proposed law restraining municipalities tax-raising powers on Municipality Finance and the other banks. (ECB, FSA)	REC14: Fully implemented. The initially planned four-year cap on municipal tax-raising powers was not implemented in the approved 2021 healthcare and social welfare reform legislation package. Based	REC14: Implemented

Progress on Implementing the 2016 FSAP Recommendations

Basel Core Principle (BCP)	Recommendation	Authorities' Response	Assessment of the Mission
		on our preliminary assessment, the approved package does not seem to contain provisions which would call for a reassessment of the CRR risk weight for exposures to municipalities. The topic is being further assessed still.	
BCP22 Market risk	12) Establish a regular program to directly verify the correct classification and valuation of fair-valued positions and any consequent need for additional valuation adjustments in banks with consistent amounts of Level 2 and 3 assets. (ECB, FSA)	REC12: Fully implemented. Assessed as a part of ongoing supervision and on-site inspections. However, this is mostly relevant for SIs (supervised by the ECB). Please see also the responses in the self-assessment template and in the questionnaire concerning the corresponding Core Principle.	REC12: Directed to the ECB