

S U M M A R Y

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Lessons learned from supervision and regulatory development Supervision Report 2010

Summary

FI's annual Supervision Report discusses areas in which fundamental issues with regard to supervision and regulatory development have come to the fore-front during the past year. This year's report describes the lessons learned from the financial crisis as well as more general issues regarding consumer protection on the mortgage market, the advice of insurance intermediaries and how the interests of the customer are protected in investment funds and insurance companies.

LESSONS LEARNED FROM SUPERVISION AND REGULATORY DEVELOPMENT

FI has at its disposal a number of tools to fulfil its tasks of contributing to a stable financial system and ensuring adequate consumer protection, for example using rules and regulations to place requirements on and set limitations for companies' operations, using supervision to monitor compliance with these regulations and, when needed, intervening to penalise non-compliance. FI also maintains an ongoing dialogue with financial companies and their customers.

FI aims to use these tools to influence the behaviour of companies and consumers. Effective supervision places substantial focus on the prevention of problems, rather than simply focusing on after-the-fact intervention. Therefore, a large portion of FI's activities consist of ongoing supervision that does not result in intervention or policy changes.

Occasionally, issues may arise that give cause to more fundamental considerations. A number of these issues are presented in this year's Supervision Report. Some are the result of situations in which the existing legislation is insufficient and FI has identified a need for modified legislation or regulations, while others relate to behaviour that is not acceptable in licensed operations. As the intent is to create an annual report, only issues that have arisen during the past year, in this case 2009 through to this report's date of publication, are discussed. The issues touched on in the report stem from the work with financial stability following the financial crisis, consumer protection and more general

topics concerning internal control and accounting supervision, which are essential for both maintaining stability and protecting consumers.

Measures taken in response to the financial crisis

The financial crisis and the continued fragility of the world economy has naturally resulted in a review of the regulatory framework for the financial sector in order to protect financial stability. FI would like to focus in particular on the following initiatives:

Supervision of cross-border operations. The development within the EU is quickly moving toward a more in-depth and comprehensive co-operation within supervisory colleges with regard to large groups. This issue is of particular interest for FI since Sweden's financial sector is very international. With regard to smaller branches, structures for cross-border co-operation must be created at a more general level.

New regulations concerning the management of liquidity risks. The financial crisis has demonstrated that the supervision and regulation of liquidity risks must be tightened substantially. FI considers this area to be a high priority and started to develop new regulations in 2009 concerning the management of liquidity risks. The next step is reporting and quantitative regulation that is being developed internationally and by the EU.

Supervisory review and evaluation process and capital planning. In addition to the minimum capital requirement in effect for credit institutions and investment firms, FI will conduct a supervisory review and evaluation process within what is known as the Pillar 2 regulations. During this process, consideration will be given to risks other than credit risks, market risks and operational risks, which are covered by the legal minimum capital requirement. The material importance of such a process was illustrated by the financial crisis. FI increased its focus on the supervisory review and evaluation process and capital planning after the financial crisis and will continue to do so during 2010.

Regulation of remuneration policies. One topic that came into the spotlight as a result of the financial crisis is the remuneration systems of financial companies. During 2009 FI implemented new regulations for remuneration policies within financial companies that aim to prevent excessive risk-taking.

Measures to strengthen consumer protection

FI works continuously to increase consumers' awareness about financial issues in order to help them make informed decisions when they are active on the financial markets. However, financial issues are often very complex and therefore supervision and regulation are required to help consumers. FI would like

to direct attention to a number of issues in which its supervision has identified deficiencies with regard to consumer protection.

Limitation of loan-to-value ratio for mortgages. Because mortgages constitute a dominant part of the indebtedness of Swedish households, they are an important component in FI's analysis. FI's proposed regulation limiting the loan-to-value ratio of mortgages is due to a concern regarding the over-indebtedness of some households. As a result of an extremely low interest rate level, the continued rise in household debt and the unstable macroeconomic situation, FI conducted an extensive review of the mortgage market during the winter of 2009. The conclusions drawn from this review were that the risks for the financial system as a whole were low, but that the situation for households with high loan-to-value ratios presents a cause for concern. On 5 May 2010, FI published for consultation a proposal for general guidelines regarding the limitation of the loan-to-value ratio of mortgages, proposing that a maximum of 85 per cent of the market value of the property should be pledged.

Insurance intermediaries' advice and marketing. Financial advice to consumers is extensively regulated, but the protection varies depending on the type of advisor the customer is consulting and the type of investment being made. Insurance intermediaries have taken on an increasingly larger role with regard to financial advice, but, according to an investigation by FI, many of them fail to comply with applicable laws and regulations. FI will therefore increase its supervision of intermediaries and review the regulations relating thereto. Furthermore, FI believes that the division between what constitutes financial advice/intermediation and what constitutes marketing must be more clearly defined.

Protection for mutual fund and insurance customers. An important part of FI's supervision with regard to consumer protection relates to the protection of the customers' assets. During 2009, FI reviewed depositaries and the registers of assets covering technical provisions in insurance companies. The conclusion drawn was that the control function of the depositaries was insufficient, as was the handling of the register in insurance companies. The course of events in Aspis Liv, an insurance company, highlights the need for additional protection for policy holders, similar to investor protection schemes, when a company fails to comply with the protective framework laid down by legislation.

Conversion of life insurance companies. Conflicts of interest can arise in a number of different contexts within the financial sector and therefore form an important basis for consumer protection. One situation in which the risk for conflicts of interest is clear is during the conversion of insurance companies operating under mutual principles into companies that distribute profits. During 2009, FI decided to disallow the conversion of Länsförsäkringar Liv into a profit-distributing company. FI concluded in this matter that the legislation's regulations governing conversions must be clarified in order to increase the ability of policy holders to influence the conversion. It is also important when reviewing that the rights of policy holders have not been compromised that FI

critically evaluates the assumptions the company makes about the future to ensure that they are sustainable from a long-term perspective.

In addition to issues related to financial stability following the financial crisis and consumer protection, FI also raises in the report questions regarding organisation, internal governance and internal control in financial companies, which is important for stability, risk control and the management of conflicts of interest. FI also raised once again the issue of weaknesses in the current system with regard to supervision of accounting that could jeopardise the credibility of the regulated Swedish securities markets and companies listed on them.

Finally, the report discusses several changes that FI considers important for the future, such as the establishment of a new supervisory structure and more stringent requirements on capital, liquidity and crisis management.