Supervisory Review Procedures

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1 Introduction

The sound operation of financial markets and entities supervised by FIN-FSA requires that their capital adequacy assessment process has been organised in a reliable manner. Reliable capital adequacy assessment process is one of the fundamentals for the operation of supervised entities. At the same time, sound assessment processes contribute to overall financial stability.

FIN-FSA is vested with the task of reviewing the organisation of capital adequacy assessment by supervised entities. In its supervisory review process, FIN-FSA applies uniform principles even if there are differences in the sector-specific legislation for different types of supervised entities, particularly in terms of calculating the capital requirement. However, linking capital adequacy assessment with the organisation of corporate governance and business planning is key element in all sectors of supervised entities.

This document describes how FIN-FSA conducts its supervisory review process. Paragraphs 3, 4, 6.1 and 7 of the document are only applied to supervised entities in the financial sector.[1] This document will be updated with respect to supervised entities in the insurance sector after the finalisation of Solvency II regulation.

The review procedures for supervised entities in the financial sector are primarily based on recommendations provided by the Basel Committee on Banking Supervision, provisions laid down in the Capital Requirements Directive for credit institutions and guidelines of the European Banking Authority (EBA/CEBS) on procedures concerning risk management and control as well as evaluation of the adequacy of own funds and the liquidity position of supervised entity.

This document does not repeal the provisions laid down in the FIN-FSA Standard 4.2 on the internal capital adequacy assessment process. The regulations and guidelines provided in Standard 4.2 remain in force, and this document supplements them.

This document repeals other previously published descriptions of the supervisory review process of the Financial Supervisory Authority or its predecessor, the Financial Supervision Authority.

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[1] In this document, financial sector refers to credit institutions, investment firms, management companies engaging in asset management, the amalgamation of cooperative banks and its central body.

2 Objectives

The objective of FIN-FSA’s activities is the stable operation of credit, insurance and pension institutions and other supervised entities required for the stability of the financial markets. Another objective is to safeguard the interests of the insured and to maintain confidence in the financial markets. Furthermore, it seeks foster compliance with good practices in the financial markets and public awareness about the finacial markets. These objectives and tasks have been laid down in the Act on the Financial Supervisory Authority.

In addition, sector level legislation may require that the operation and risk management of supervised entities must be organised in a reliable manner. In addition, it has been provided that a supervised entity may not assume such risks in its operation as to cause material danger to its capital adequacy or liquidity.[2]

The general aim of FIN-FSA's process of reviewing capital adequacy assessment has been to contribute to achieving FIN-FSA’s objectives and to ensure that supervised entities do not take such risks as to compromise their capital adequacy. Therefore, the review process[3] is aimed at generating a comprehensive view of supervised entities' risks, adequacy of their risk management and control procedures and the adequacy of their own funds in case the risks should materialise. Also, the aim is to form a view of supervised entities' liquidity risk and liquidity buffers.

This document seeks to inform supervised entities about the procedures FIN-FSA follows in reviewing supervised entities' risks, adequacy of their risk management and control procedures and organisation of capital adequacy assessment. The supervisory review is based on information accumulated on the supervised entity, such as observations made during on-site inspections or other supervisory meetings conducted by FIN-FSA and information received through regular financial reports.

Supervised entities in the financial sector must create a separate description of their capital adequacy assessment.[4] Another aim of this document is to specify what aspects of capital adequacy assessment and risks related to the activities of the supervised entity should, in FIN-FSA’s opinion, be covered at the minimum in the description, and the manner in which supervised entities should present the methods used in assessing the adequacy of their own funds.

The main characteristics of FIN-FSA's supervisory review process are described in Annex 1.

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[2] See for example section 49 of the Credit Institutions Act, section 30 a of the Mutual Funds Act or section 33 of the Investment Firms Act.
[3] In the following, the supervisory review and assessment process is also called supervisory review.
[4] See section 54, subsection 2 of the Credit Institutions Act.

3 Regulatory framework of capital adequacy assessment and review in the financial sector

The supervisory review process of financial sector entities is based on the provisions of the Credit Institutions Directive, Credit Institutions Act and regulations provided by the European Banking Authority (EBA) on capital adequacy assessment. Capital adequacy related regulation in the financial sector is founded on three pillars. Pillar 1 regulates the technical capital adequacy calculation and minimum requirements for capital for credit, market and operational risk. Pillar 2 regulates the assessments made by both the supervised entity and the supervisory authority on the total capital requirement for the supervised entity. Pillar 3 regulates the disclosure requirements.

According to section 85 of the Credit Institutions Act, FIN-FSA must conduct supervisory review at least annually and assess whether supervised entities meet the financial requirements set for the activities of a credit institution. Sections 86–88 of the same Act provide for corrective actions a supervised entity must take if the requirements provided in the Act are not satisfied. The frequency and scope of FIN-FSA's evaluation must take into account the nature and scale of the supervised entity's business and the entity's importance for financial stability.

The Basel Committee on Banking Supervision has published a Basel III capital adequacy framework. As a consequence, there will be amendments made to the legislation. The key characteristics of the capital adequacy framework founded on the pillars remain unchanged, but the content of the pillars will be more detailed and extensive. This document will be updated after the relevant regulation has been finalised.

4 Description of the capital adequacy assessment process (ICAAP)

This paragraph is only applicable to supervised entities in the financial sector.

According to FIN-FSA's standard 4.2 *Internal Capital Adequacy Assessment Process,* entities in the financial sector under FIN-FSA's supervision must describe their capital adequacy assessment strategy and process in writing. The description must cover the bases, objectives, outlining principles and internal capital adequacy assessment by the supervised entity for own funds required for the various risks. The description must be submitted to FIN-FSA at least on an annual basis. More detailed guidelines and regulations on the processes and other matters to be taken into account are provided in FIN-FSA standard 4.2 *Internal Capital Adequacy Assessment Process*.

In the description of a supervised entity's capital adequacy assessment, FIN-FSA pays attention to the following issues, among others:

- description of the methods of capital adequacy assessment
- comprehensiveness of the description of various businesses/companies
- coverage of risk areas in the description
- use and justifiability of economic capital models and results
- application of diversification effects and justifiability of the results
- methods in which the supervised entity's own stress tests are conducted, the severity of the scenarios and the justifiability of the results
- corporate governance related to capital adequacy assessment, such as the linkage of capital adequacy assessment to the supervised entity's other business planning and strategy.

FIN-FSA recommends that the description of a supervised entity's capital adequacy assessment (ICAAP) specifies and evaluates separately **at least** the following risk areas both qualitatively and quantitatively:

- corporate governance
- business and strategic risk
- credit and counterparty risks
- concentration risk of credit risk and residual risk
- market risks
- securitisation
- interest rate risk in the banking book (IRRBB)
- operational risks
- liquidity risk
- insurance risks
- model risks related to the use of Pillar 1 calculation methods
- settlement risk for all operations
- risks related to external operating environment.

A supervised entity should provide separate justifications in its description of capital adequacy assessment, if

1. it considers its business is not exposed to some of the above risks
2. it considers that theres is no need to allocate own funds for some of the above risks or any other risk related to its activities.

Assessment on the adequacy of own funds presented in the ICAAP should be well justified, and the assumptions underlying the assessments should also be stated. It is recommended that the analysis be supplemented with quantitative indicators and key figures.

If a supervised entity uses the economic capital model or another internal model (for example a statistical model built to model Pillar 2 risk), the parameters of the model and choices made in building the model should be presented at a precise level in the ICAAP or in its annexes. A mere general description of the model or general overview of the results generated by the model is not considered sufficient.

A supervised entity may decide itself when to create its description of capital adequacy assessment. The description should cover the present year and the two following years. The supervised entity should however ensure that there is a close connection between the supervised entity's capital adequacy assessment process and its business and other planning processes. The supervised entity should submit the description to FIN-FSA without delay after it has been completed and approved so that the supervisory review of capital adequacy would be based on as current information as possible.

Reliable capital adequacy assessment process and supervisory review process are based on a forward-looking approach. Therefore, supervised entities must take into account any changes for example in their strategy, business plans or governance structure, that is, factors that may change their risk position. Supervised entities must create a plan (capital plan) about how the amount and quality of their own funds will correspond with a higher risk position. The capital plan must be part of the description of capital adequacy assessment.[5]

[5] For more details, see chapter 6.8 of Standard 4.2 *Internal Capital Adequacy Assessment Process*.

5 Components of FIN-FSA's supervisory review process

5.1 Consideration of FIN-FSA's strategy

All FIN-FSA activities are guided by its latest strategy. Therefore, FIN-FSA's strategy is also taken into account when planning the supervisory review process. FIN-FSA's strategic objectives in 2012-2014 include efficient operation and supervision that follows risk-based approach. For the supervisory review process this means that different types of supervised entities can be reviewed at different frequency and/or scope depending on their risk position or significance. However, solid risk-bearing capacity and high-quality corporate governance are key issues for all supervised entities.

5.2 Coverage of business sectors

FIN-FSA's supervisory review process is applied to supervised entities in both the financial and insurance sectors. Due to differences in sectoral legislation, there are differences in the details of the process. However, the main principles are applied similarly to the each sector.

5.3 Coverage of activities of an institution

FIN-FSA's supervisory review generally looks into the entire business of an individual supervised entity, a group of companies or conglomerate and the resulting risks. However, the written outcome of the supervisory review seeks to address only the businesses and/or functions that are materially relevant in terms of the adequacy of own funds. The coverage of activities in the supervisory review report reflects the supervised entity's business, risk positions, risk controls as well as quality and amount of own funds at the time of the review and the expected future state.

5.4 Coverage of risks

The supervisory review process generally covers all risks with relevance to the adequacy of own funds. The review covers at the minimum the following risk areas:

- corporate governance
- business and strategic risk
- credit and counterparty risks
- concentration risk of credit risk and residual risk
- market risks
- securitisation
- Interest rate risk in the banking book (IRRBB)
- operational risks
- liquidity risk
- insurance risks
- model risks related to the use of Pillar 1 calculation methods
- settlement risk in all activities
- risks of the external operating environment.

The list above is not exhaustive, and the review will be extended to other risks or their components as necessary. The depth of the review within a single risk area may also be different for different supervised entities or for a single supervised entity at different times. The depth and scope of the review reflects the business, risk positions, risk controls as well as quality and amount of own funds at the time of the review and the expected future state.

5.5 **Review of risk positions and controls**

FIN-FSA’s supervisory review process covers an evaluation of both risk positions and risk controls. As a starting point it is expected that supervised entities’ risk management systems meet the requirements of legislation as well as FIN-FSA regulations and guidelines in accordance with the principle of proportionality.

Legislation and FIN-FSA’s regulations and guidelines contain minimum requirements on how risk management should be organised for a given risk area. In its risk assessment, FIN-FSA pays attention on how reliably and systematically the supervised entity has identified, evaluated, measured and controlled its risks and how it reports its risks to senior management and operative management, such as the board of directors and management team.

The risk of loss and hence the need for capital is higher for supervised entities with inadequate management systems and processes. Shortcomings in the supervised entity’s operations may have been found during the supervisory review or already previously as a result of on-site inspections and other supervisory activities. In such cases FIN-FSA requires supervised entities to take corrective actions regarding the risk management (controls) and/or risk positions.

Corrective actions taken by the supervised entity are taken into account in the supervisory review. Poorly designed or implemented corrective actions may increase the supervised entity's potential losses and therefore also its capital requirement. Therefore, the supervisory review of the supervised entity's risk management is more critical if corrective actions required by FIN-FSA are not taken properly.

5.6 **FIN-FSA’s inspection findings**

Findings made in on-site inspections have an effect on the outcome of the supervisory review. Good corporate governance and risk management require that FIN-FSA's on-site inspection findings are addressed properly. Corrective actions implemented in a deficient manner may increase the supervised entity's potential losses and therefore also its capital requirements.

5.7 **Scoring scale**

FIN-FSA uses both a verbal description and a numeric evaluation when summarising the outcome of the supervisory review. The numeric evaluation complies the the four-tiered scoring scale provided in EBA Guidelines[6] where 1 = "Strong controls" / "Low risk" and 4 = "Inadequate controls" / "High risk".

The numeric score is assigned for individual risk areas, quality of the ICAAP (including an evaluation of the assessment process and its written description) and adequacy of own funds.

Regarding the individual risk areas, both the position and risk control is evaluated whenever possible.[7] In addition, risk control and risk positions are evaluated separately and no average of the scores will be presented.

The scoring scale and descriptions of the scores are presented in Annex 2.

5.8 **Use of weighting factors**

Individual risk areas (for example operational risk) typically consists of several sub-risks. However, the supervisory review process covers the risk area and management of that risk as a whole. The scoring of risk areas is not based on weighting factors for different risk components.

[6] Guidelines for the joint assessment of the elements covered by the supervisory review and evaluation process (SREP) and the joint decision regarding the capital adequacy of cross-border groups (GL 39).
[7] For example regarding operational risk, only risk control is given a numeric evaluation.

6 Stress tests as part of the supervisory review and capital adequacy assessment

6.1 The supervised entity's own stress tests

According to Standard 4.2, supervised entities in the financial sector must determine the factors for which stress testing must be performed, based on their risk profile and the essential risks to their activities. The stress tests must be based on exceptional but possible circumstances. Stress tests must be made at least annually and they must cover material risks related to the activities of the supervised entity.

As the outcome of the assessment, the supervised entity should have a clear understanding of how external conditions affect the ability of the firm to maintain adequate capital levels and liquidity position and what kind of measures are required to improve the capital adequacy or liquidity position. The stress tests should have a concrete impact on the risk management and decision making of the supervised entity.

In addition to quantitative results, FIN-FSA pays attention to the processs of designing the stress tests, the severity of the scenarios used and how the results are used by the supervised entity. FIN-FSA evaluates for example the participation of the management of the supervised entity, choice of scenarios, calculation methods and reliability of the systems used in the calculation as well as the use of the results of the stress tests. If necessary, the supervised entity may be requested to conduct additional tests under specified assumptions.

The designing of stress tests has been regulated in more detail in FIN-FSA Regulation 4.2 *Internal Capital Adequacy Assessment Process*. In addition, supervised entities must take into account EBA's guideline on stress testing[8].

6.2 Stress tests conducted by FIN-FSA

As a main rule, FIN-FSA conducts stress tests on an annual basis for its most significant supervised entities in the financial and insurance sector. The test results provide an overall view of the adequacy of the supervised entities' own funds in an exceptional but possible stress scenario. The scenario covers the next two years.

The results of the stress tests ran by FIN-FSA constitute a commensurate indicator for assessing the adequacy of the own funds of an individual supervised entity. The supervised entity must have sufficient own funds also after the stress test. The adequacy of own funds is evaluated on case by case, taking into account the severity of the scenario used, the nature and scope of the supervised entity's activities and its possibilities for corrective actions.

[8] Guidelines on Stress Testing (GL32).

7 Supervisory review of risks and the level of own funds

This paragraph is only applicable to supervised entities in the financial sector.

FIN-FSA's evaluation of the adequacy of own funds is based on the so-called Pillar 1+ framework. In the framework, the starting point for the evaluation of the adequacy of own funds is the risk profile of the supervised entity and the Pillar 1 capital calculation results.

FIN-FSA adds the own funds required for the materialisation of risks under Pillar 2 to the own funds calculated for the materialisation of risks under Pillar 1. Hence, evaluation of the adequacy of own funds is always based on Pillar 1 calculation.

Below is a description of FIN-FSA's procedures used in supervisory review process, i.e. in the comparison of the risks related to the business of the supervised entity and the adequacy of its own funds. Paragraphs 7.1 - 7.5 describe concepts and components related to the evaluation. Paragraph 7.6 describes the use of the Pillar 1+ framework in more detail.

7.1 **Initial capital**

Initial capital is the amount of own funds required prior to authorisation. Therefore, a supervised entity's own funds may never fall below the initial capital amount without breaching the legal requirements for the authorisation.

7.2 **Minimum capital requirement**

The minimum capital requirement is the amount of own funds a supervised entity must have at the minimum for the materialisation of unexpected credit, market and operational risks.[9] The minimum amount of own funds is also often called "Pillar 1 requirement", "regulatory minimum" or "regulatory capital" to illustrate that it is the minimum amount required for the supervised entity to be able to pursue its activities provided in sections 55 and 87 of the Credit Institutions Act. The nature of the requirement is illustrated by section 87 of the Credit Institution Act providing that when own funds fall below the minimum capital requirement, the required minimum level must be met within a fixed period indicated by FIN-FSA "under the threat of withdrawal of the authorisation".

7.3 **Supervised entity's own assessment of the adequacy of own funds**

The supervised entity's own assessment of the adequacy of own funds should also cover the risks not taken into account in calculation of the

[9] For example the Basel II calculation rules for own funds to be reserved for Pillar 1 risks are related specifically to the calculation of the minimum capital requirement. There are many methods available for calculating the minimum amount of own funds for a credit institution's credit, market and operational risks.

minimum capital requirement. The own assessment is also known as "supervised entity's Pillar 2 assessment", "supervised entity's risk-based assessment" or "ICAAP assessment". FIN-FSA recommends that supervised entities in the financial sector, in assessing their own funds, cover at least the risk areas listed in paragraph 4. However, the list of risks in paragraph 4 is not exhaustive and therefore the supervised entity itself must take into account the nature and scope of its business in determining the scope of the assessment.

FIN-FSA Standard 4.2 *Internal Capital Adequacy Assessment Process* contains more detailed guidelines and regulations on how the minimum amount of own funds should be determined.

7.4 **Consideration of diversification effects**

For the time being, FIN-FSA takes a critical view towards accepting diversification effects presented by supervised entities in the financial sector. Diversification effects are based on calculating correlations between different risks. The correlations may, however, be unstable and increase steeply when the financial markets are under stress. Therefore, correlations calculated before a financial market downturn (and own funds reserved on this basis) may underestimate the prevailing risk level in the markets. For the time being, FIN-FSA monitors developments in the calculation of diversification effects in the markets and takes a stance on the diversification effect calculations presented by supervised entities on a case by case basis. Therefore, chart 1 below does not include diversification effects.

7.5 **Business and strategic risks**

There is a wide range of definitions of business and strategic risks. Broadly interpreted, the definitions cover all risks regarding the business operations of supervised entities. Although business and strategic risk definitions are somewhat overlapping, it is possible to distinguish between them based on the observation period applied. FIN-FSA defines business risk as a risk related to the *current* business of a supervised entity. In contrast, strategic risk is a risk related to *changes* in business operations or in the operating environment.

In the supervisory review process, FIN-FSA assesses business risk in a narrow way due to the overlapping nature of business risk with other risks. Therefore, capital adequacy assessment is based on the financial solvency of the supervised entity over a time horizon of three years, ceteris paribus.

Strategic risk is assessed separately. The assessment takes into account changes in business operations, mergers and acquisitions and changes in the product portfolio and strategic risks due to changes in the regulatory environment. Thus, the FIN-FSA assessment framework for strategic risk covers risk factors that are not covered elsewhere.

7.6 **Determination of the adequacy of the own funds**

FIN-FSA's starting point in assessing the adequacy of own funds is the supervised entity's risk position and the results generated by Pillar 1 calculation methods regarding own funds needed for credit, market and operational risks.

FIN-FSA **adds** the assessed own funds needed for Pillar 2 risks on top of Pillar 1 risks. Hence the framework is called the "Pillar 1+" framework.

The chart below presents the relationships of components related to the assessment of the adequacy of own funds.[10]

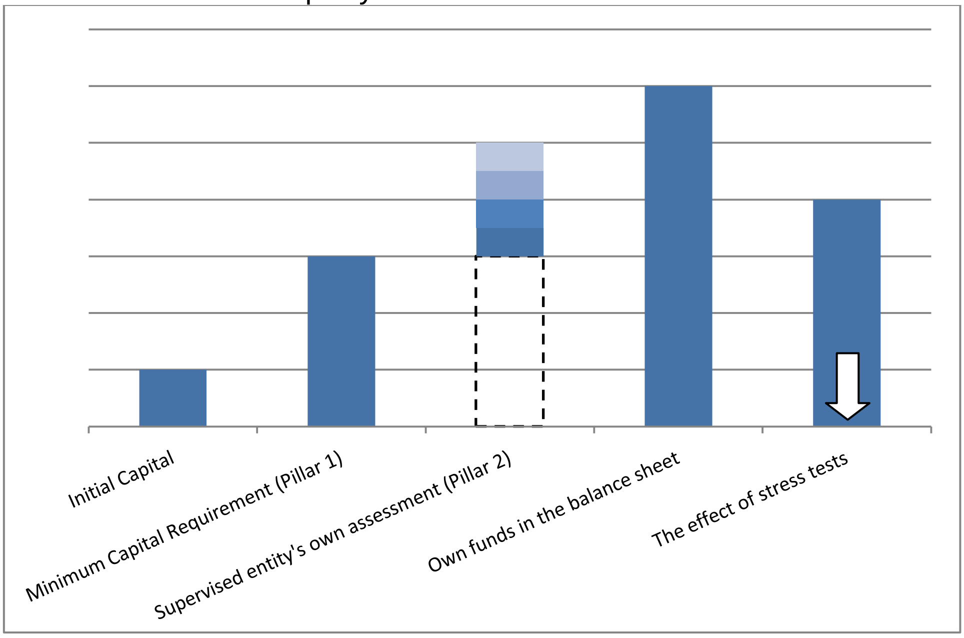

Chart 1. Components of assessing the adequacy of own funds.

(1) A supervised entity's own funds must always add up at least to the statutory amount of initial capital. The initial capital required in connection with initiating supervised activities is typically lower than the minimum capital requirement resulting from the supervised entity's business risks. However, if a supervised entity's business is limited, the calculated minimum capital requirement may be lower than the initial capital requirement. In this case, the *initial capital* de facto determines the statutory minimum level of own funds for the supervised entity.

(2) FIN-FSA approves as minimum requirement for credit, market and operational risk only an amount calculated in accordance with methods provided in legislation. For example, as the amount of own funds

[10] The height of bars in Chart 1 describe a hypothetical situation, however so that the order of size of the bars is correct.

for credit risk, the minimum requirement is the amount calculated by the standard approach or the internal ratings-based approach (IRBA).

(3) FIN-FSA requires that a supervised entity's own assesment of capital requirement is always higher than the minimum capital requirement for own funds. A supervised entity's own assessment may be calculated by several different methods, such as using the economic capital models, other calculations based on quantitative data or expert judgements. Due to the variety of the methods and related uncertainties, FIN-FSA takes a critical view to the results stated by the supervised entity and challenges the assessments stated by the supervised entity as part of its supervisory review process.

(4) FIN-FSA takes assessments based on economic capital calculation models (forecasts) fully into account only in case it is convinced of the reliability of the models. Furthermore, as stated above, FIN-FSA's starting point in assessing the adequacy of own funds is always the results generated by Pillar 1 calculation. Hence, FIN-FSA's assessment of own funds required e.g. for credit risk is always at least equal to the results of Pillar 1 calculation, although the supervised entity's economic capital model would generate a lower estimate of own funds for credit risk.

(5) A supervised entity's own funds in the balance sheet must always be higher than sum of the minimum capital requirement (Pillar 1) and the Pillar 2 assessment. Hence, the supervised entity needs a *capital buffer* in addition to the minimum capital requirement and the Pillar 2 assessment. The need for a buffer can be justified among other things by uncertainties related to the assessment and calculation methods.

(6) FIN-FSA takes the stress test results into account as separate information in assessing the adequacy of own funds. The outcomes of the tests depend, among other things, on the parameters chosen in the scenario, severity of the scenario, and the amount of the supervised entity's own funds at the time of testing. Therefore, the effects on supervised entities are assessed case by case in the SREP.

(7) FIN-FSA forms an overall assessment of the adequacy of own funds considering the risk profile of the supervised entity and changes in it. The review covers the current and two following years. The supervisory review is determined based on a comparison and assessment of various components, as described above and in chart 1. The basis for determining the adequacy of own funds is always the assessment of the supervised entity's risk profile as described in paragraph 5. FIN-FSA underscores that supervised entities differ from one another in terms of the nature and scope of business activities. Therefore, assessment of the capital adequacy of an individual supervised entity always involves case by case considerations and supervisory judgement.

FIN-FSA's supervisory review covers the current and two following years. As stated above in point (5), a supervised entity's own funds in the balance sheet must always be higher than the sum of minimum capital requirement and the Pillar 2 assessment. This means that the supervised entity should have adequate own funds *already at present* to cover also future expected risks (for example those estimated by a stress test).

If the outcome of the review reveals the supervised entity's own funds are insufficient to cover all of its present and/or future risks, the supervised entity is required to undertake corrective actions. The corrective actions may encompass an improvement of risk controls, reduction of risk positions and/or revision of the capital plan. If the adequacy of own funds cannot be otherwise ensured, the supervised entity may be assigned a capital add-on requirement as described in pararaph 7.7.

7.7 **Capital add-on**

In accordance with section 86 of the Credit Institutions Act, FIN-FSA may pose an additional capital requirement to a supervised entity whose overall risks exceed its total amount of own funds and the adequacy of its own funds cannot be otherwise ensured. An additional capital requirement may be posed subject to certain statutory conditions, if a supervised entity fails to meet the requirements provided in the Credit Institutions Act to risk management (section 49), capital adequacy assessment (section 54) or large exposures (section 68). An additional capital requirement will be set for a fixed term and may only be posed for three years at a time. A supervised entity must meet the additional capital requirement by increasing the level of its own funds. In addition, the supervised entity should undertake corrective actions already during the fixed term in order to rectify the mismatch of its risk position and amount of own funds. Such measures include a reduction of risks (positions), risk hedging, revisions of risk control systems or governance processes.

7.8 **Assessment of conglomerates**

A "conglomerate" is a supervised entity whose main business activities include both banking and insurance activities. The business of a conglomerate may also include other activities, such as investment services, management company activities and/or payment services.

Materially significant supervised entities belonging to conglomerates are reviewed separately. The risk management procedures of conglomerates is also reviewed as a whole, in which case the review of a single risk area also accounts for the whole business of the conglomerate.

Calculation of the requirement for own funds in the financial and insurance sector is different due to differences in sectoral legislation (for example the Credit Institutions Act, Insurance Companies Act and Payment Institutions Act have different calculation rules for the own funds requirement).

Therefore the following minimum conditions must be met in assessing the total capital requirement for a conglomerate.

- the own funds of any company belonging to the conglomerate may not fall below the regulatory capital provided in the relevant sectoral legislation (surplus in the parent company / another sector does not compensate for a deficit in another sector).
- the conglomerate's own funds may not fall below the minimum level provided in the Act on the supervision of financial and insurance conglomerates.

The conglomerate must ensure sufficient capital adequacy in view of risks resulting from all of its activities. Therefore, FIN-FSA assesses the amount of conglomerates' own funds also in excess of the regulatory minimum.

Annex 1. Key phases in the supervisory review and assessment process

FIN-FSA's supervisory review process has five main phases:

1. planning phase
2. conducting supervisory reviews according to the above plan
3. quality assurance of the reviews, ensuring their commensurate-nesss and equal treatment of supervised entities
4. submission of an individual review to the supervised entity including potential requirements for corrective actions
5. monitoring the implementation of these actions.

Monitoring of the risk position and adequacy of own funds (or solvency margin) is constant. In addition, FIN-FSA creates at least annually a more detailed plan for making the individual supervisory reviews and assessments.

Individual supervisory reviews are made according to an annual plan. The review may also be made more frequently if necessitated by the risk position of the supervised entity or change in its own funds.

FIN-FSA's assessment report covers the organisation of risk management, risk positions and the adequacy of own funds of the supervised entity or groups of supervised entities. The outcome of the individual supervisory review is submitted to the supervised entity in writing. The written report supports the development of capital adequacy assessment by supervised entities and therefore also FIN-FSA's general objectives. The sector level reviews covering several supervised entities are not submitted to the supervised entities.

All reviews are discussed in FIN-FSA's decision-making bodies. This seeks to ensure the quality of each report, the commensurateness of different reports and the equal treatment of supervised entities.

The corrective actions required of supervised entities are monitored as part of FIN-FSA's regular supervision activities. If required by the supervised entity's risk position or own funds position, progress with respect to the corrective actions may be monitored more intensely.

Annex 2. Scoring scale used by FIN-FSA and scoring descriptions

	Sub-area assessed				
Score	**Internal governance and strategy**	**Business activity**	**Risk positions**	**Risk management**	**Quality of ICAAP**
1	The supervised entity has a clear strategy / moderate risk-taking / well-organised governance.	Good profitability / no circumstances in view that would jeopardise the company's near-term profitability.	Low risk. The risk position has little impact on capital adequacy and liquidity management.	Good risk management and control. Risk management and control processes are clearly defined and at adequate levels relative to the nature and scope of the activities.	The models, methods and processes for calculating and assessing capital adequacy are of high quality. They enable to make an accurate estimate of the amount of (economic) capital for various risk areas and the whole entity.
2	The supervised entity has medium risk-taking / fairly well organised governance.	Fairly good profitability / the company's profitability is to some extent sensitive to future changes in the external operating environment.	Medium risk. The risk position has an impact on the development of capital adequacy and liquidity management.	Fairly good risk management and control. Risk management and control processes are defined fairly well relative to the nature and scope of the activities.	The models, methods and processes for calculating and assessing capital adequacy are of fairly good quality. They enable to make a sufficiently accurate estimate of the amount of (economic) capital.
3	The supervised entity has considerable risk-taking / clear shortcomings in organising governance.	Weak profitability / the company's profitability is sensitive to future changes in the external operating environment.	Considerable risk. The risk position has a material impact on the development of capital adequacy and liquidity management.	Shortcomings in risk management and control. Clear shortcomings in the definition of risk management and control relative to the nature and scope of the activities.	Shortcomings in the models, methods and processes for calculating and assessing capital adequacy. They may underestimate the amounts of (economic) capital.
4	The supervised entity's strategy is unclear / aggressive risk-taking / major shortcomings in organising governance.	Unprofitable operations / the company's profitability is highly sensitive to future changes in the operating environment.	High risk. The risk position may jeopardise capital adequacy and liquidity management.	Inadequate risk management and control. Organisation of risk management is not commensurate with the nature and scope of the activities.	Weaknesses in the models, methods and processes for calculating and assessing capital adequacy. They clearly underestimate the need of (economic) capital.

Overall assessment of capital adequacy		
Score	**Description**	**Impact on supervision**
1	Low risk level and good capital adequacy.	The supervised entity's activities are subject to low risk, and mainly normal periodic reporting is sufficient for the supervision of the activities.
2	Medium risk level that may impair the supervised entity's capital adequacy in the long term.	The supervised entity is required to take certain measures to remedy risk management and/or positions, but normal periodic reporting is sufficient for the supervision of the activities. FIN-FSA monitors the correction of shortcomings as part of its ongoing supervision.
3	Considerable risk level that may impair the supervised entity's capital adequacy in the medium term.	The supervised entity should take substantial measures to remedy risk management and/or positions. More frequent and/or more comprehensive reporting than normal periodic reporting may be required in respect of some risk areas. FIN-FSA will conduct a supervisory visit or follow-up inspection to monitor the remedial action taken.
4	High risk level that may impair the supervised entity's capital adequacy in the short term.	FIN-FSA requires rapid and structural remedial action from the supervised entity. The supervised entity will be subject to specific supervision, which means more frequent and more comprehensive reporting than normal and additional inspections.