MEMORANDUM

Supervision strategy

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The purpose of having a supervision strategy

One of the most important tools that Finansinspektionen (FI) has for executing its assignment is supervision. While part of supervisory work is indeed about managing incidents and urgent problems, the main purpose of supervision is preventing problems. In order for supervision to make the greatest difference and bring the most benefits, it must therefore, to the greatest possible extent, be both risk-based and forward-looking. The purpose of the supervision strategy is to interlink the overarching vision of risk-based supervision with the tangible, daily supervisory work.

Thorough external analysis and the ability to see where and how risks can build up, and their potential consequences, are needed for FI to perform this task. To start with, an accurate view of the present status and how it was reached is required. FI's ongoing monitoring of firms and markets provides this basis, and the investigations it initiates account for the main forward-looking element. Without a risk-based view, there is a clear risk of supervision losing both oversight and foresight.

The strategy for risk-based supervision stands on two legs – a risk assessment process and a risk classification. The risk assessment process identifies and ranks the biggest risks, while the risk classification ranks the firms based on where problems are considered to have the greatest potential to produce negative consequences for consumers or the national economy.

Actual risk-based supervision is difficult because it requires a genuinely forward-looking analysis and an ability at the organisation to constantly evaluate and re-evaluate risks, review prioritisation and, based on this, *actively choose* the focus of work and the initiatives required. Regulation-driven and event-driven supervisory work are necessary elements of supervision. However, without a clear risk-based strategy, there is a risk of losing focus and oversight, and of routine matters and reactions to incidents completely taking over the supervisory agenda.

A *common* supervision strategy also improves FI's possibilities of capitalising on the perspectives and angles of approach of the different supervisory areas. FI must also be able to have efficient collaboration in supervision across area boundaries. This has become all the more important on an increasingly integrated financial market.

The basis of the strategy consists of the objectives of financial supervision as defined by the Government and Parliament – promoting a stable financial system and sound consumer protection.

Financial supervision encompasses a substantial number of firms and FI's assignment is to conduct comprehensive supervision.[1] Hence, all firms under FI's supervision, even those with operations that cannot be

1 See the Governments proposal.2012/13:1, p. 107

considered to pose any material risks from a stability or consumer perspective, shall also be subject to specific supervisory actions. The principle aim is that each firm operating on the basis of authorisation from FI shall, over a three-year period, be subject to at least one supervisory activity. This is important in upholding the principle of rules for a certain type of financial operation applying equally to all, and that they must be respected by all. Even if a business is of limited scope or involves moderate risks for society for other reasons, this shall not mean that it is not required to follow the rules in practice. It can be added that it is important also to maintain equal conditions for competition between different participants.

Prioritising according to risk thus does not mean that supervisory resources shall be exclusively allocated to firms or factors which in each situation are deemed to pose the greatest risks. Financial supervision has a broader objective. Prioritising is about devising and distributing supervisory actions between all firms under our supervision in a balanced manner, and with risk being the most important governing factor.

We note that there are mainly three types of supervision: ongoing supervision, investigations and event-driven supervision. A material part of supervisory resources will always be needed for event-driven supervision. However, in order for supervision to prevent problems, a risk-based and forward-looking approach must have a constant presence in ongoing supervision and investigations.

The strategy is about creating a framework for ensuring that the prioritisation and focus of both ongoing supervision and investigations rest on a risk-based approach. There are two fundamental elements here: on the one hand, the **risk assessment** in which the most important risks at any given time are identified and ranked; and on the other hand, the **risk classification**, in which we, for each area of operation, define the firms at which problems might be expected to have the greatest negative impact from the point of view of society. When these two dimensions are merged, a clear basis is provided for where our focus should lie in both ongoing supervision and investigations.

Furthermore, FI has defined a number of overarching principles regarding working method, summarised into: working with a *forward-looking* approach, *clarity* in communication and *decisiveness* in action.

A supervisory authority such as FI covers many varying operations – issuing regulations, granting authorisations, supervision, dialogue, interventions and analysis. All of these elements are interlinked and have the same fundamental objective. However, the supervision strategy discussed in this governance document has a more defined perspective and only covers the monitoring operations, i.e. supervision in a somewhat narrower, operative sense. Hence, it does not constitute a strategy document for FI’s entire operations.

This document provides a more detailed presentation of the supervision strategy and the principles and trains of thought that led to it.

The document commences with a section that describes the overarching objectives of supervision. In section 3, different types of supervision are discussed. Based on this, in section 4 we describe our supervisory philosophy, i.e. the fundamental basis and principles for how we are to work to achieve the objectives. The fifth section describes the risk-based supervision, strategy and prioritisation, and in the sixth are discussed questions and aspects that are more specific to the individual areas of operation.

Financial supervision – in the public interest

The financial system fulfils several key functions in a modern economy – the conversion of savings to investments, payment mediation, insurance and risk management. Hence, major costs are associated with a financial system that is unstable and incapable of fulfilling these functions, or in which consumer protection is too weak.

A series of financial crises has, over the years, shown the tremendous damage to society that can be caused when the financial system suffers severe shocks. One example is the Swedish banking crisis at the outset of the 1990s, which led to Sweden's GDP falling for three consecutive years, which was unprecedented, and with substantial repercussions in unemployment and public finances. Another example is the global financial crisis of 2008–2009, which gave rise to a need to bail out a large number of banks worldwide with state funds in order to avoid a total collapse of the financial system.

Besides the risks to the economy, it can also be ascertained that many of the financial services offered on the financial market – payment services, savings products, loans and insurance solutions – are complex and difficult for consumers to judge, and to a higher degree than in most other areas. Consumers are often at a major disadvantage in terms of information – a factor that society must take into account and influence.

The ultimate objective of financial regulation and supervision is thus to contribute to the financial system working efficiently and securely, and to counteract the risks in the system which might affect the economy and consumers. All experience clearly shows that market participants alone cannot ensure the present and future stability of the system, and soundness of consumer protection – society must be actively involved. At the same time, however, this can also give rise to problems insofar that participants may rely on the government and hence take even greater risks.

Society's most tangible tools for influencing financial firms and the financial system are financial regulation and supervision. In its instruction, the Government has expressed Finansinspektionen's (FI's) responsibility as follows:

> *"The authority shall work to promote a stable financial system that is characterised by a high level of confidence and has well-functioning markets that meet the needs of households and corporations for financial services, and provide comprehensive protection for consumers."*

Because of sensitivity to shocks and the unevenness in knowledge between producers and consumers, the operations of financial firms must feature stability, competence and seriousness so that risk-taking is at a reasonable level and the interests of customers are taken into account, particularly since it is often a case of managing customers' money by investing it or lending it out.

The emphasis of the risks varies from area to area. In the banking and insurance areas, protective interests are strongly linked to the firms' financial stability. One reason is thus that the money of customers – deposits and insurance premiums – is in their balance sheets; the firm's financial risks thus become the customers' risks too. The other reason, which mainly affects the banks, is that one side of the balance sheet, which includes deposits, is highly liquid while the other side (mainly lending) is typically illiquid. Because of this, a bank can quite easily fall into financial difficulty. In particular, if the bank is large, problems can quickly spread to other banks. It is in such situations that the entire system's ability to function comes under threat. In turn, this poses risks of major shocks to the economy, and of taxpayers having to finance support measures.

In the market and consumer protection areas, focus is not on the financial circumstances of participants, but on their behaviour and information provision in relation to customers, counterparties and the market at large.

The difficulties for all participants – financial firms and their customers alike – lie in having sufficient information about counterparties and products at all times. Because of this, a firm foundation of trust is needed within and in the financial market. In order for the market to function efficiently, one must, despite having incomplete knowledge, be reasonably sure that the counterparty is willing and able to fulfil its obligations. Furthermore, the market must also maintain reliable and efficient infrastructure for managing payment and securities transactions. Where the latter is concerned, systems must also be secure and efficient in terms of information and pricing.

Because of all of this, financial operations cannot be conducted in any old way by whoever.

By creating rules and monitoring compliance therewith, by informing and educating consumers and by following, judging and acting on the market trend and risk build-up, public authorities can contribute to the stability of the system and sound consumer protection. The authorities set the framework and fundamentals for financial operations that support public interests, and the possibility and ability of participants to operate in accordance therewith. Hence, the public authorities are not solely responsible for the stability and smooth functioning of the financial market: financial firms are themselves responsible for how they conduct their operations and for compliance with rules, and consumers themselves are responsible for their decisions.

Supervision is largely about limiting and managing risks, but does not have the objective of minimising or eliminating all risks. A measure of risk-taking is a necessary feature of all business operations, even of the financial kind, if the business is to be run efficiently – which is naturally also an important objective for society. Instead, the task is about ensuring that financial firms – and the system as a whole – maintain a reasonable balance between risk-taking and business considerations on the one hand, and measures for identifying and managing different types of risk on the other.

Financial markets and financial firms are affected by many factors. Supervision must observe, judge and be able to react to:

- how firms devise their governance, risk management and control, and their financial resilience.
- how firms inform and behave towards their counterparties – both consumers and other firms
- how information, pricing and trading and clearing systems work on securities markets
- the interaction between general economic and financial trends with the actions of firms on the financial market, and how this affects the stability of the system as a whole.

FI's supervisory work is organised into four areas of operation: Banks, Insurance, Markets and Consumer. Finansinspektionen's tasks – working to promote stability in the system, consumer protection, efficient and smoothly functioning markets – have a varying emphasis and angle of approach within the different areas of operation. However, because of the substantial overlapping and interdependence of these objectives, all of them must be taken into account and kept alive in the work of all of the operational areas.

Different types of supervision

The fundamentals for FI's supervision are highly affected by how regulations are devised and by our own practices. There is a choice between devising regulations and supervision; more general rules require more analytical, principle-based supervision while more detailed rules correspond, in a certain sense, to simpler, more formal supervision that focuses on verifying compliance. Even with a clear emphasis on either, in reality there is always a mixture between detailed and more general rules, which then also involves different types of requirements for parallel supervisory approaches. A balance must also be struck between how strict the requirements should be for obtaining authorisation for certain operations, and follow-up in the form of supervision. More intense supervision could in principle compensate for less strict authorisation assessment.

FI also has a more general standard-setting role that affects the general public through e.g. reports, opinions and warnings. Active, clear communication from FI regarding risks, development trends, sanction decisions, etc. can affect firms and consumers and hence supplement and, to a certain extent, replace the more intervening effect brought about by supervision.

Supervision of firms can be described in different ways. Here, we have chosen to break down supervisory work into three types:

- Ongoing supervision
- Investigations
- Event-driven supervision

All firms and markets under our supervision are subject to ongoing supervision, which is conducted regularly and, to a certain extent, routinely. Ongoing supervision consists of constant monitoring of risk development, and of monitoring to verify that firms and market transactions meet set rules and requirements. The basis consists of both the regular reporting of financial and other data which participants are legally obliged to submit to FI, and of the analysis performed by FI based on this material. It can be a case of performing follow-up to ensure that firms comply with capital adequacy or solvency rules, have no prohibited large exposures etc. In this part of the ongoing supervision, the different reporting and analysis systems now being constructed by FI are key tools. The ongoing supervision also consists of all the contacts constantly maintained by FI with firms and other participants, through which FI obtains a volume of information regarding risk development and changes in firms, markets and products. FI can, at an early stage, detect risks and hence better prevent problems by systematically analysing and evaluating the information FI obtains on an ongoing basis.

More thorough supervision comes in the form of investigations, which form the tool used by FI to dig deeper into a firm, area or certain activity and find information that does not usually emerge in ongoing supervision or reporting. It can be a case of assessing the actual quality of a firm's internal governance and control or risk management. Through its investigations, FI obtains a solid basis for assessing risks with greater accuracy, which is fundamental to FI's ability to efficiently influence firms and behaviour on the financial market.

A third type of supervision is event-driven supervision, which is about risks that have already manifested themselves in different ways. In other words, it can be described as reactive supervision. It can be a case of a firm facing acute difficulty, consumers being affected by dubious advice, or the detection of some sort of market abuse. Other examples are that a firm changes the focus of its operations or is acquired by another firm, which can lead to a change in authorisation- and supervision-related fundamentals.

All of FI's objects of supervision are subject to, or can become subject to, all three types of supervisory actions, and all of these types of action are necessary features of supervisory operations. In the practical work, they also overlap; for example the analysis and knowledge built up in the ongoing supervision are fundamental to the ability to plan relevant investigations. And, in terms of which firm and transaction data is to be periodically reported to FI, this is ultimately driven by what is considered interesting and important from a risk perspective. Finally, an incident can often trigger an investigation and also turn focus to more general problems, and hence affect how various risks are assessed and which risk classification a firm should have.

Supervisory philosophy

The basis of FI's supervision work is that supervision shall be forward-looking, clear and decisive.

- **Forward-looking**

FI shall actively seek out tomorrow's problems and resolve them today, before a problem has turned into a major risk to society. This requires an approach which, in an analytical and forward-looking manner, looks to the entirety. This marks a shift away from the audit-like and more one-sided retrospective approach that has traditionally dominated the work of supervisory authorities.

A clear link is also required to the external conditions of financial firms, to the institutional and macroeconomic conditions and to changes therein. Analyses are required of the dependence and interaction between different parts of the financial sector, and between financial markets and the surrounding economy.

In order to obtain a relevant holistic view, FI's assessments must also not only rest on various financial and other measurable data. More qualitative factors must also be taken into consideration, such as analyses of business models, corporate cultures and incentive systems. This also incorporates a need for supervision to be principle-based and not formalistic. Supervision must not only be about "ticking off" fulfilment of the literal content of regulations, but also ensuring that the fundamental purpose of the regulations is met.

- **Clear**

FI shall be able to explain to financial participants, and to the media and general public, the rules and the requirements imposed, and why we impose them. Our priorities, methods and approach shall be well known, so as to create the right expectations and so that our actions are comprehensible and predictable. It is also important that we can take on board justified criticism; positions largely based on qualitative, forward-looking assessments can always and should also be discussed. However, a desire for openness and dialogue shall not mean that FI in any sense shall negotiate with the firms under supervision regarding the interpretation of regulations and which supervision decisions shall be made.

- **Decisive**

A substantial part of the work of a supervisory authority is about communication and dialogue with banks, insurance companies and other financial firms. However, FI also has the possibility – and obligation – to intervene against firms under supervision if and when necessary. We must have the capability and boldness to act when we identify something that gives cause for concern, even if it is a case of measures which, at least in the short-term perspective, are not popular among firms, the general public or politicians. However, the purpose of supervision is not to pursue sanctions, but rather to resolve situations and problems that could otherwise force costly intervention.

Strategy and prioritisation for supervision

The strategy shall provide as good an exchange as possible between the resources employed and the objectives of supervision. Supervision will never have the use of resources that are sufficient to constantly monitor all participants at every point – this would require FI employing thousands of financial inspectors. Prioritisation and sampling capabilities are not only a necessary evil; they are also fundamental to efficient supervision from an economic perspective. Because supervision aims to reduce the risk of problems for the stability of the system or for individual consumers, such risks are at the basis of prioritisation in FI's work. In other words, supervision shall be risk-based.

RISK-BASED SUPERVISION

The basis of risk-based supervision is that both our ongoing supervision and our investigations shall be imbued with a risk-based approach. All supervision – investigations, reporting follow-up, analysis and contacts with firms – ought to be conducted with varying focus, breadth, depth and frequency depending on the risk profile and significance of each firm, submarket, function or product area assessed according to the classification performed for each area, together with the current risk assessment at that particular time.

The risk-based approach thus constitutes a framework and sets the direction of overall supervisory work. Without this approach, there is a great risk that the operations will be overly governed by external events and ingrained procedures. Our approach and ambitions in relation to our externalities are also expressed through the measures and initiatives we choose to conduct within the framework of the risk-based supervision. In other words, this also sends a signal of our approach.

FI's prioritisation can be governed by conditions that are very stable over time. For example, the very largest firms having specific priority, or certain conditions and variables, such as the banks' credit risks, being subject to constant attention. However, it can also be a case of certain firms or aspects of their operations being subject to specific review over a period. It can be a case of risk factors associated with the current state of the economy, with various links between different financial submarkets or about new types of financial instruments that can pose major risks to consumers. Even broad thematic studies, which cover all firms within an area, can also be an expression of a risk-based work method in the sense that the choice of theme in each situation is governed by what is determined to pose a risk. In this context, it is also important to note that a smoothly functioning analysis of both incoming reporting and the trend in the market and externalities are in reality fundamental to the ability to conduct risk-based supervision in a meaningful manner.

Conducting specific, targeted investigations is an important way for FI to manage change in risk profile – changes that might be difficult or impossible to capture in ongoing supervision.

The difference between risk-based supervision (in the form of ongoing supervision and investigations) and event-driven supervision is that FI, most obviously in terms of investigations, actively selects which questions and conditions to bring into focus. Risk-based supervision can be described as proactive supervision, with the purpose of identifying and remedying potential problems early on. Through FI's ability to identify and analyse potential risks, supervision is explicitly forward-looking, in which case it can also be preventive. Hence, the need for urgent, event-driven intervention can also decrease. In other words, this is where there is greatest potential for supervision that makes a difference.

RISK ANALYSIS GOVERNS PRIORITISATION

Risk-based analysis must always rest on a thorough risk analysis as a basis for prioritisation. Focus shall be on the firms, markets and products that pose the greatest risks to the financial system or to consumers. In turn, the risk depends on the probability of something going wrong, and, in that case, on the extent of the consequences for customers and society. Based on this, work methods must be devised and developed within the different supervisory areas.

Even with clear prioritisation of actions – and even in order to be able to perform such prioritisation – supervision requires substantial resources, because it is crucial for FI to uphold quality in analysis and action that minimise the risk of erroneous conclusions and decisions, and which guarantee equal treatment according to due process. This is needed for FI to gain the respect of financial firms and the confidence of the general public. Efficient action requires such confidence to be in place and maintained.

The challenge in terms of tackling supervisory duties is largely about prioritising: which problems and matters are the most important in the given situation, based on the objectives for society that FI is charged with promoting? This is governed by circumstances and trends in individual financial firms, but also by market-wide and macroeconomic factors. The risk assessment process and risk classification systems are cornerstones for prioritising FI's supervision.

The risk assessment process

The purpose of the risk assessment process is to identify and rank risks as early on as possible. Briefly, the process involves each area of operation (bank, insurance, markets and consumer protection, as well as macroprudential analysis) annually conducting an in-depth review of the risks in their respective areas. The opinions of the area result in a ranking of the risks, which is then discussed in the senior management group and is subsequently adopted by the Executive Director. The ranking of risks is a cornerstone for prioritising the supervision of each area. For the highest ranking risks, there is an explicit requirement for these to be addressed, which is verified in the follow-up of FI's operations. Besides the more general risks that may be identified on the financial market in general or within one of its subsectors, certain firms, depending on the focus of their business, organisation, etc. may also bring to light more specific risks. Risks of this nature too must of course also be assessed and managed.

Risk classification
Risk classification is fundamentally a matter of ranking financial firms based on their importance to the system, markets and consumers. The risk classification governs the scope of the supervisory actions taken in relation to different firms.

It is fundamentally a matter of structural conditions such as the firms' size, complexity, scope of cross-border operations, etc. In other words, it is not about risk in the sense of the probability of negative events, but mainly about what the consequences would be for the system, markets and consumers if a certain firm or group of firms suffered severe problems. Problems sustained by a major banks have more serious consequences for the economy than problems at a small bank. Problems at a large fund management company with many customers lead to more serious consequences than problems at a small fund management company with few customers. Risk classification thus supplements the more thematic risk perspective of the risk assessment process by ensuring that the most important firms undergo sufficiently thorough supervision.

The risk *classification* performed by FI annually thus lays the foundation for how supervisory actions should be devised and prioritised between different firms and types of firms, and from a structural perspective. Different supervisory activities are linked to each risk-classified category within an area of operation. The risk *assessment* lays the foundation for the specific questions and problems to which supervision should attach particular importance at every stage. It can be a matter of broad thematic studies, surveys or more firm-specific investigations to study how the risks identified are manifested and managed at different types of firm.

Prioritisation and strategy
Supervision planning hence requires an ability for FI to systematically assess the firms, operations and product areas in which the risks identified through the risk assessment process have the greatest significance. At the same time, work relating to prioritisation must be flexible and incorporate preparedness for change. Certain risk assessment and prioritisation can prove misplaced after a while, because circumstances can quickly change. The ability to capture and assess both changes in externalities and in individual firms, operations and product areas and, if needed, quickly reprioritise based on the changes, is crucial to sound supervisory work.

CHALLENGES FACING RISK-BASED SUPERVISION

FI's ambition to conduct risk-based supervision must as far as possible in practice be balanced against the growing need for regulation-driven supervision. This need is partially linked to the increasing internationalisation of supervision. In reality, this involves a restriction on how far supervision can go as regards prioritising according to risk.

Even today, regulation-driven supervision (i.e. supervision that FI is legally obliged to conduct in accordance with a regulatory framework) requires substantial resources. Examples of resource-intensive regulation-driven supervision are the annual reviews of the capital and solvency assessments of banks and insurance undertakings. Another example is supervision of the internal models that may be used for banks, insurance undertakings and central counterparties.

The requirements and resources needed for regulation-driven supervision are sharply on the rise due to the new EU regulations, such as Solvency 2, CRD 4, EMIR and MiFID, which will give rise to broadened reporting for the firms under supervision. This data will be used in analyses of the firms' operations. Developing arrangements for efficient information retrieval, processing and analysis is important in terms of quality and for freeing up resources for the risk-based supervision.

An element fundamental to the operations of growing significance, and which brings both opportunities and difficulties, is the internationalisation of regulations and supervision in progress, particularly in the EU. The three European supervisory authorities are increasingly influencing how supervisory work is conducted. The preparation of EU-wide supervision manuals has recently commenced and will of course affect FI's supervisory work in future.

This is fundamentally a needed response to an increasingly internationalised financial market. One of the most important lessons learned from the latest financial crisis was the very necessity to create more harmonised regulations internationally and have greater cooperation in supervision. However, the process can also give rise to problems insofar that it forces "standardisation" of the operations – in a way that makes it difficult for FI to prioritise as it deems necessary based on the market conditions prevailing at the time in Sweden. For this reason and others, active work within the European supervisory authorities and within the supervisory colleges is of great importance.

Supervisory colleges

Tangible supervisory work at the European level primarily takes place in the framework of what is known as supervisory colleges. Such a college is formed for each cross-border financial firm of significance, consisting of the national supervisory authorities of the countries in which the firm has significant operations and with the domestic authority as chair. A number of Swedish financial firms have relatively comprehensive international operations, so FI is responsible for leading the work at 12 such colleges – five in the banking area, six in the insurance area and one in the market area. In addition, FI participates in more colleges without chairing them. There are special provisions regarding the exchange of information and information between the Member States in the framework of colleges. The work of the colleges is governed by a fairly detailed regulatory framework setting out how the authorities are to agree on risk and capital assessments, and supervision plans and cross-border/joint investigations within the framework of the existing supervisory colleges.

In the event of disunity between the supervisory authorities in a college, the European supervisory authority in question may, upon request, provide an opinion which the national authorities concerned are obliged to follow. EBA and EIOPA annually evaluate the work of the supervisory colleges in their respective areas. As of November 2014, the ECB will, within the framework of the Single Supervisory Mechanism (SSM) gain a central role in banking supervision in the EU. For Swedish cross-border banks, with ECB/SSM representatives in their supervisory colleges, the implications of this will be that a risk-based supervision model will, to a greater extent, need to allow for the risk assessments and working methods that will be applied by ECB/SSM. At least to start with, this will pose a challenge to FI because ECB/SSM, within the framework of EBA's guidelines, have in many respect already developed a methodological orientation that differs from that of FI on several points. In practice, this might limit FI's possibilities of itself determining priorities and choosing methods in supervision when it comes to the cross-border financial firms.

COMMUNICATION

Supervisory work is largely a matter of influencing the behaviour of firms under supervision. To achieve this, FI must clearly communicate its opinions to the firms. If FI has important views on a firm's operations, this shall be clearly conveyed to the firm's management.

The scope and frequency of communication with the firms mainly depends on the size, risk profile and complexity of the firm. FI basically has a continual dialogue with the largest firms, including regular meetings with senior executives. Regular communication with the board of the firms has also become increasingly important. FI endeavours to have as many management and board contacts as possible also with smaller players.

In a supervision matter, arrangements for communication with the firm are governed by FI's investigation procedure. However, proactive supervision does not only involve FI communicating when serious deficiencies are detected; it also provides clear feedback regarding lesser weaknesses in the firm's operations, even though they do not (yet) constitute a more serious deficiency.

Supervisory areas

BANKING

Banking supervision aims to secure a reasonable balance between credit institutions’ risks and capital so as not to jeopardise the stability of the system and the money of depositors.

Firms under supervision

The Banking area of operation currently has around 250 financial firms under supervision. Disregarding foreign-owned branches, for which the home country in question bears primary supervisory responsibility, there are around 135 firms remaining for which FI has main responsibility. Around two thirds are banks and the remainder are credit market companies.

Supervision within Banking has a clear emphasis on financial stability in general and the stability of the system in particular. The four major Swedish banks are clearly systemically important through their predominant position on the Swedish financial market, their complex business models and their extensive cross-border operations. They are therefore thoroughly supervised.

Supervisory priorities

The risk classification system of categorises the firms into four different groups. Category 1 consists of global and national systemically important firms and comprises around ten firms including the four major banks. Category 2 is made up of other large or medium-sized firms with more complex and/or more extensive cross-border operations, and comprises around a dozen firms. Category 3 comprises around 50 medium-sized and small firms without extensive cross-border operations and with limited complexity. The fourth category consists of around 50 small companies of little significance on the markets on which they operate.

Category 1 has a clear link to the firms’ systemic importance, which is a complex concept that also often depends on the situation. The basis for the assessment is the effect on other financial firms, and ultimately the national economy, that shocks sustained by a certain firm could have. Development work is currently in progress to devise clearer criteria for defining systemic importance.

For the large systemically important firms, FI is in close dialogue with the firms’ board and management. A specific supervision plan is usually prepared for these firms, engaging a high number of employees in different types of activities. Coordination, cooperation and uniform communication with the firms are key. For the most systemically important firms, a contact person for the firm bears responsibility for the cohesion and coordination of the work in the team of risk specialists participating in supervising the firm.

A key part of the supervision of such firms is the so called *annual supervisory review and evaluation process (SREP),* which includes an assessment of the firms’ internal capital and liquidity assessment. This is supplemented by regular risk reviews (which cover at a minimum credit risk, market risk, operational risk and liquidity risk), an investigation of the largest identified risks and an investigation of the firm's internal credit risk models.

An important part of the risk-based supervision in the banking area is developing analysis support for the largest risk areas. With better analysis, early warning signals can be captured and lead to more proactive supervision. First and foremost, all firms are reviewed on an ongoing basis with respect to reported data. The firms in category 1 and 2 are regularly analysed, with more thorough reviews of developments. Firms classified into categories 1 and 2 also have an FI-internal contact person for the firm, who spends much more time on each firm than is the case for firms in categories 3 and 4. An overall general assessment shall however be performed annually for all firms under supervision.

INSURANCE

The purpose of insurance supervision is to secure a reasonable balance between the risks and solvency of insurance undertakings so that they can fulfil their obligations towards policyholders.

Firms under supervision

Supervision of the Insurance area spans everything from very small to large firms. The total number of firms under supervision in the insurance area can roughly be broken down into:

- insurance companies, both life and non-life insurance (just shy of 300)
- mutual benefit societies (around 65)
- foundations (around 75).

Disregarding foreign-owned branches, pension funds (for which the county administrative boards have primary supervisory responsibility) and a number of small, local firms without a reporting obligation, there are around 200 firms remaining that are subject to ongoing supervision from FI.

Supervisory priorities

The risk classification system of the insurance area is, like for the banks area, divided into four categories. The first step is classification based on the outcome of the periodic reporting to FI. Final classification takes place through a qualitative assessment, in which FI's knowledge about the firms supplements the quantitative analysis. Different types of stress test are also performed. Category 1 includes around 20 insurance undertakings. The lowest level of regular supervisory activity refers to follow-up and analysis of reported data.

Companies which, after the qualitative assessment has been conducted, end up in risk category 1, are given a supervisory contact person appointed to follow the company on an ongoing basis. Category 1 firms will also be subject to an annual risk assessment. Many companies in the highest risk category have cross-border operations and will thus also subject to the work at supervisory colleges at EU level. Companies in other risk categories are mainly monitored through analyses of reported data, and being included in the risk-based thematic studies. Otherwise, there is an endeavour to have a high degree of flexibility in terms of measures, and to avoid a set “protocol” for important measures to be carried out for different categories. The statistical reporting is, for all companies, subject to quarterly reviews in the form of analysis meetings. The main purpose of the reviews is to see which companies, in different respects, show weak results. This can initiate in-depth investigations and supervisory activities, such as in the form of on-site inspections.

MARKETS

Supervision in the market area aims to secure efficient securities markets with a high degree of confidence, smoothly functioning price formation and a high level of transparency. Supervision shall also promote financially stable and operationally secure infrastructures, and that the financial sector undertakes the measures necessary for limiting opportunities for money laundering and terrorist financing.

Firms under supervision

The supervision of the Markets area covers in principle all financial firms under supervision, but also certain non-financial firms and private individuals operating on the financial market. The area also bears responsibility for the ongoing supervision of almost ten firms that are key to market infrastructure. These are stock exchanges, trading venues, central securities depositories (CSD) and clearing firms, some of which are central counterparties (CCP).

Supervisory priorities

The focus of infrastructure supervision is on stability. For the infrastructure firms, operational security is key to the entire financial market’s ability to function, and for CCPs capitalisation is also important, because such firms assume substantial financial risk. The infrastructure firms are divided into systemically important and non-systemically important firms. The failure of a systemically important firm would therefore have major negative contagion effects for the financial sector and hence the economy. A systemically important firms fulfils a function that is critical for the market and which cannot be replaced at short notice. FI has identified three systemically important infrastructure firms with which FI has continual contacts in the form of meetings at least once a quarter. For two firms, FI also participates in a supervisory college and in supervisory collaboration. Supervision of the other firms is included in risk-based supervision and comprehensive supervision, which in practice entails FI meeting these companies at least once a year.

Markets supervision focuses on how participants in the securities market act towards each other and consumers with the purpose of ensuring a highly transparent market with accurate and clear information so that consumers, investors and issuers can make well-founded decisions. Market supervision focuses on reducing the asymmetry of information between participants and warding off different types of market abuse in order to ensure sound price formation and fair conditions for participating in trading. This requires the availability of information about the firms, prices and volumes. In other words, sound transparency is key.

In market supervision, ongoing supervision takes place in the form of continual contacts with stock exchanges, trading venues, listed companies, banks and investment firms regarding what is happening in the market. A large part of ongoing supervision is based on different types of reported financial information and data that is quality-assured, analysed and used as a basis for risk-based supervision. It is a matter of e.g. prospectuses, financial reports, transaction reporting and insider trading. A certain part of market supervision can be characterised as event-driven in the form of tip-offs or media reports about attempts to manipulate a share or other financial instrument, or trade based on insider information.

As a basis for supervision prioritisation, there is a risk classification of participants in the securities markets, i.e. banks and investment firms. The risk classification is based on e.g. market share and customer groups in different parts of the securities market.

Although the risk classification affects the scope of the supervision a firm will undergo, the emphasis in the prioritisation of market supervision is on the risks identified in the risk assessment.

Money laundering supervision is based on a specific risk assessment in the prioritisation of supervisory focus and employs risk classification in which highest priority is given to participants representing a major risk, or where the consequences in the event of exploitation might be at their greatest, when selecting firms to be included in various investigations.

Other firms and private individuals comprise everybody who may be covered by the regulations and they are hence not predefined into groups. However, risk criteria have been developed for the group which shall be used in the same way when prioritising supervision.

CONSUMER PROTECTION

Consumer protection supervision has the purpose of safeguarding the interests of consumers in the direct relationship between firms and consumers on the financial market. This primarily involves evening out the disadvantage of consumers in terms of information by ensuring that they obtain accurate, clear information that enables them to make well-founded decisions.

Firms under supervision

The Consumer Protection area is responsible for consumer protection supervision of basically all firms under supervision. However, the area also has ongoing supervision responsibility for just over 1,000 insurance intermediaries, approximately 120 investment firms, around 70 management companies and around 80 payment services firms. A small but rapidly growing number of alternative investment fund managers are also included. In 2014, instant loan firms will also be included.

Supervisory priorities

The focus of consumer protection supervision is on the firms' compliance and internal governance and control as regards their behaviour – e.g. provision of information, advice and equal treatment – towards consumers. FI's operations in the consumer protection area have the purpose of preventing problems that can affect consumers. However, FI does not intervene in the dealings of individual customers and firms.

The emphasis in the prioritisation of consumer protection supervision is on the risk assessment. Consumer protection supervision focuses primarily on the products and services of the greatest importance to consumers, particularly in cases where they themselves have the least opportunity of assessing risks and protecting their interests.

In terms of devising risk classification systems, the picture varies between different groups of firms – management companies, investment firms, banks, insurance undertakings and insurance intermediaries – but market share is a recurring and key criterion. Other important factors are the experiences built up in the framework of granting authorisation and supervisory work. The classification is mainly governed by the consequences to which deficient compliance leads, in the form of the number of consumers affected, the size of the amounts at stake or the effect on the market in general.

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