Performance audit report

Practicalities of the liquidation of Asset Management Company Arsenal Ltd

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Practicalities of the liquidation of Asset Management Company Arsenal Ltd

Helsinki 2015

Performance audit report of the National Audit Office

Registry no. 170/54/2014

The National Audit Office has conducted an audit of the practicalities of the liquidation of Asset Management Company Arsenal Ltd, which was included in its audit plan. The audit has been carried out in accordance with the performance audit guidelines issued by the National Audit Office.

Based on the audit, the National Audit Office has issued an audit report, which will be submitted to the audited entity and the ministry steering the process. Copies of the report will also be sent to the Parliamentary Audit Committee, Ministry of Finance and the Government financial controller's function.

Before the issuing of the audit report, the parties submitting opinions were provided with an opportunity to ensure that there are no factual errors in the report and give their views of the opinions of the National Audit Office contained in the report.

In the audit follow-up, the National Audit Office will examine, which measures have been taken on the basis of the opinions presented in the audit report. The follow-up will take place in 2017.

Helsinki 5 May 2015

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Keywords:
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Opinions of the National Audit Office

Practicalities of the liquidation of Asset Management Company Arsenal Ltd

Asset Management Company Arsenal Ltd (Arsenal) was founded in connection with the 1990's bank crisis to manage bad loans and other credit and sell real estate and other assets. Public support measures to banks aimed to revitalise the Finnish banking system.

Arsenal is a company entirely owned by the State. The Ministry of Finance is in charge of Arsenal's ownership steering.

Arsenal's operations were intended to be temporary to begin with, and the company was put into liquidation in October 2003. The company has operated for a total of just over 21 years. During the liquidation, the company's main task has been to recover remaining outstanding accounts, manage trials, dismantle archives, realise assets and shut down subsidiaries of the group.

Two central principles have guided the company's operations – minimal burden on the public economy and a clarifying objective (or clarifying interest). The audit focused on whether Arsenal has considered minimising costs to the public economy and its clarifying objective and appropriately incorporated them into Arsenal's operations during the liquidation. In addition, the audit examined whether Arsenal has been able to produce results in the liquidation, considering its operating environment and changes therein over time. The audit also has a developmental aspect with a focus on the future. Based on the audit findings, operating principles have been developed that should be observed in such a company's operations.

The clarifying objective and public economic interest have not been reconciled in an inappropriate manner during Arsenal's liquidation

One of Arsenal's objectives has been minimising State losses. Another central principle that has steered its operations has been the clarifying objective, which may allow for the review of unclarities in a debtor's operations to be prioritised over economic objectives.

In examining the significance of the clarifying objective, one must also pay attention to factors whose evaluation from an economic standpoint may not be possible or may be difficult. Settling unclarities can be justified based on monitoring legality, for example. On the other hand, debt collection based on the clarifying objective has yielded results from an economic perspective during the liquidation. Therefore, Arsenal has not neglected economic objectives in its debt collection. It cannot be stated, based on the audit findings, that economic objectives and the clarifying objective have been inappropriately reconciled in Arsenal's operations.

Ownership steering should be active at the end of the operations of an asset management company

Before and at the beginning of the liquidation, the company's steering and supervision structure was appropriately stripped down. The Ministry of Finance has been the main steering body for the duration of the liquidation. Communication between the Ministry representative and company administration has been in line with ownership steering guidelines.

However, based on audit findings, some passivity was detected in the ownership steering of the asset management company, and the owner has not necessarily been aware of all facts concerning the company's operations and operating environment relevant from the perspective of ownership steering. One might indeed say that communication between the company's management and owner has not been altogether in balance. From the perspective of ownership steer-

ing, the company's operations have seemed so established that there has not been much discussion on operating principles. In terms of Arsenal's risk management and ownership steering, the company's internal personnel dependency and lack of documented information can be considered problematic.

Based on audit findings, Arsenal has had solid financial resources at its disposal in relation to the scope of its operations. As the liquidation has progressed, the company's functions have been mainly limited to trials and the management of bankruptcy estates for which Arsenal has assumed responsibility in terms of costs. The number of such estates in 2014 was only approximately one tenth of the number at the beginning of the liquidation. Similarly, the number of pending trials in 2014 was approximately one fifth, and the number of related economic interests approximately one tenth of the respective figures at the beginning of the liquidation. Based on audit findings, the Ministry of Finance should examine the possibility of stripping down the company's operative resources as its operations continue to wind down.

The audit also involved a risk review concerning the use of services of a company associated with a member of Arsenal's management (in this case the liquidator). Based on audit findings, one cannot regard the individual in question as disqualified. However, such risks related to conflicts of interest should be considered in advance in the future.

Lessons learned from Arsenal should be utilised in establishing a potential new asset management company

Certain operating principles were developed in the audit, which should be considered in the operations of an asset management company. Based on audit findings, the contents of the principle of clarification were established. The audit also examined how changes in the company's operating environment have affected the implementation of this principle. In addition, based on the audit findings, principles closely related to good governance requirements have been developed, which should be considered in the company administration. The audit also specified and clarified the concepts of the clarifying objective and good governance on a more general level.

Due to the application of the clarifying objective, Arsenal has committed to long-term, demanding trial and debt collection processes. The company has continued operating much longer than estimated in the early 1990's. The poor predictability of the lifespan of an asset management company's operations can be seen as a regulatory risk and, at the same time, as a risk related to the assessment of crisis management means. It is difficult to predict the operating lifespan and required resources of such a company.

If asset management companies are used as a crisis management instrument in the future, the audit findings indicate that public receivership should also be considered as an alternative to clarifications carried out by an asset management company.

In the new Act on Resolution of Credit Institutions and Investment Firms (1194/2014, hereinafter also referred to as the Resolution Act), asset management companies are mentioned as one resolution instrument. Therefore, asset management companies will continue to be a tool in managing extensive, systemic bank crises. The operating principles developed based on the audit findings can be utilised in future development of practices and administrative structures of asset management companies used in crisis management.

Recommendations of the National Audit Office

1. The Ministry of Finance should examine the possibility of stripping down the asset management company's operative resources as its operations continue to wind down.

2. If asset management companies are used as a crisis management instrument in the future, the following facts should also be considered:

   - The management of an asset management company should explore means to reduce the lifespan of the company. One such means could be transferring the investigation of unclarities in a debtor's operations to public receivership.
   - One should also further consider what kind of debtors' operations are intervened in based on the clarifying objective on a more general level.
   - Good governance requirements should already be considered in planning the operations of an asset management company, and drafting public corporate governance guidelines related to asset management companies should be discussed.

1 Background to the audit

Arsenal is an asset management company, which was established on 24 November 1993 to manage the problems arising from the bank crisis. The task of the company has been to manage bad loans and other credit and sell real estate and other assets. Arsenal's operations were intended to be temporary to begin with and it was put into liquidation in October 2003 when the preparation of the final report began.

Arsenal has played an important role in central government finances during its operations. However, the company has operated as an off-budget entity. Between 1994 and 1996 Arsenal was recapitalised with a total of 3.8 billion euros of which the company has repaid 700 million euros to its owners. Of this amount about 200 million euros (29 per cent) has been repaid during the liquidation.[1] During the audit, the company's equity totalled about 212 million euros and advance disbursements accounted for 200 million of this amount. Ownership steering of Arsenal is the responsibility of the Ministry of Finance.

Throughout its existence, the operations of Arsenal have been guided by two main principles. Firstly, the objective of the company has been to minimise the losses incurred by central government. The second objective has been to investigate the irregularities in debtors' activities (clarifying objective or clarifying interest). These two principles have continued to have a major effect on the company's operations and ownership steering during the liquidation.

The substantial impact of the crises in the financial markets on central government finances and the national economy and the role played by the instruments for managing them provided a background for the audit. The Act on Resolution of Credit Institutions and Investment Firms, which entered into force on 1 January 2015, also lays down provisions on using an asset management company as an instrument for resolving crises. This means that such a company may also be used for managing future crises in the financial markets.

The crisis that hit the Finnish banks and financial markets in the 1990s has taught us a great deal about serious bank crises, their impacts and ways of managing them. The information produced by this audit is of use if it again becomes necessary to deal with the issues concerning the establishment, operations or dissolution of an asset management company.

In addition to its role in central government finances, Arsenal has also played a significant role in Finnish society at large. The company's operations have directly touched a large number of people and criticism has been levelled against many aspects of its operations. The National Audit Office has also received complaints concerning Arsenal's activities and its operating practices. In many of these contacts, attention has been drawn to the fact that adherence to the clarifying objective has kept the asset management company operational longer than originally expected and resulted in inappropriate use of state funds. The aim of this external review of Arsenal's operations and practices by the National Audit Office is to promote openness and strengthen citizens' trust in central government finances.

The audit had two objectives. The first objective was to ensure that the Asset Management Company Arsenal Ltd has properly reconciled the need to safeguard central government interest with the clarifying objective. The second objective was to develop operating principles that should be taken into account in the operations of a company of this type. These principles are closely connected with the content-related dimensions of the clarifying objective and corporate

[1] *During the liquidation, Arsenal has recovered a total of about 41 million euros in bad debts (this figure includes disbursements of bankruptcy estates), about eight million in realisation revenue (net) and about 18 million in damages, rental income and other operating income. The company has also received about 25 million euros in investment income. The business operations carried out during the liquidation of Arsenal have generated a profit of about 115 million euros.*

governance. The aim has been to develop principles that are based on the lessons learned from Arsenal's operations and that should be taken into account in the operations of a similar company in the future. It can also be said that these operating principles are connected with the interpretation of the provisions on an asset management company laid down in the Resolution Act, which entered into force on 1 January 2015. If it is decided to use the asset management company referred to in the Resolution Act as a crisis management instrument (or a crisis resolution instrument) the audit observations made in this audit and the operating principles based on them can be applied in the company's operations.[2]

[2] *Under chapter 1, section 2, subsection 1 of the Act on the Financial Stability Authority (1195/2014), the financial stability authority referred to in the act shall serve as a national resolution authority with the purpose of ensuring the stability of the financial markets and restructuring the operations of credit institutions and investment firms in difficulty. Under subsection 3, the authority shall administer the off-budget financial stability fund, which consists of a resolution fund referred to in chapter 4 of the act, which shall be accumulated by means of stability fees, and the deposit guarantee fund referred to in chapter 5, which shall be accumulated by means of deposit guarantee fees. As laid down in chapter 6, section 4 of the act, the National Audit Office has, under section 2 of the Act on the National Audit Office (676/2000) the right to audit the financial stability fund.*

2 Basis for the audit

2.1 Description of the audited entity: Asset Management Company Arsenal Ltd

As Finland was hit by a record-deep recession in the early 1990s, which also involved a crisis in the financial markets, the state had to use considerable amounts of public funds to ensure the revitalisation of the bank system. Asset management companies were an important instrument for managing and resolving the crisis. It was possible to transfer to such companies assets of the banks receiving support from the state or the Government Guarantee Fund or other companies necessary for safeguarding the stability of banking operations and financial markets. The purpose was to separate healthy banking operations from bad assets and liabilities.

The Asset Management Company Arsenal Ltd was established by Government decision on 24 November 1993 and it was given the task of managing bad loans and other credit and sell real estate and other assets. The company became operational on 15 January 1994. Provisions on the asset management company are contained in the Act on Government Guarantee Fund (379/1992), which was repealed on 1 January 2015. Under section 19 a of the Act on Government Guarantee Fund, the Limited Liability Companies Act (624/2006) also applies to the operations of the asset management companies.

Arsenal was intended to be a temporary company to begin with, managing a special task. A limited liability company was selected as the form of organisation for Arsenal. This form of operations was considered to provide a flexible framework for ensuring that the asset management company could achieve its operational objectives.[3] During its operations Arsenal has also owned two other asset management companies, which made Arsenal into a group.

The preparation of the final report on Arsenal began in October 2003 as the company was put into liquidation. Arsenal has had the recovery of debts connected with the bank crisis of the 1990s and recovery of capital for the state as its special task during the liquidation.[4] Changeover to liquidation has not had any effect on the principles guiding Arsenal's operations. The principles and guidelines steering the company's operations have remained unchanged during the liquidation to the extent that they have concerned the company's current operations.

During the liquidation of Arsenal, the two liquidators elected by the annual general meeting have managed the duties normally carried out by the Board of Directors and the Managing Director. The persons appointed to the task have remained in their jobs throughout the liquidation.[5] During the liquidation, the company’s main tasks have been to recover remaining outstanding debts, manage trials, dismantle archives, realise assets and shut down the subsidiaries of the group.

It was laid out in the preparatory document for the Act on Government Guarantee Fund (HE 130/1993 vp) that Arsenal should promote a specific financial policy objective by realising assets transferred to it as effectively and productively as possible so that central government losses could be minimised. In addition to the task of minimising central government losses, Arsenal was also provided with a broader societal objective. During the bank crisis in the 1990s, Parliament called for more public scrutiny of the bank subsidies and for the investigation of irregulari-

[3] *VTV 1995, p. 105.*

[4] *Prime Minister's Office 26 June 2013.*

[5] *At the start of the liquidation, the owners also elected a third liquidator. However, on 8 June 2004, the annual general meeting decided, on cost grounds, to reduce the number of liquidators to two because the three liquidators were managing overlapping tasks.*

ties. In its report (VaVM 35/1993 vp), the Parliamentary Finance Committee stated that "*the bank subsidies should be subjected to more public scrutiny and all economically significant credit losses should be thoroughly investigated in connection with the granting of the bank subsidies and the granting of the subsidies should be made conditional on investigating the credit losses. Investigated cases involving suspected crimes and offences should be brought before a court, which would make them open to public scrutiny. In special audits, opinions should also be expressed on the irregularities in which liability for damages and criminal liability has expired.*"[6] Based on the report of the Parliamentary Finance Committee, the clarifying objective was set as the second principle guiding Arsenal's operations.

The State of Finland recapitalised Arsenal with a total of 3.8 billion euros between 1994 and 1996.[7] The company has returned a total of 0.7 billion of the capital to its owners. During the liquidation, the company has returned a total of 200 million euros to its owners. During the audit, the company's equity totalled about 212 million euros and advance disbursements accounted for 200 million of this amount.

Arsenal is a company entirely owned by the State of Finland. Until the beginning of 2015, the ownership of the company was divided between the State of Finland, which owned directly 78.95 per cent of the shares, and the Government Guarantee Fund, which owned the remaining 21.05 per cent. The Government Guarantee Fund was an off-budget entity established in April 1992 for the purpose of managing the bank crisis and bank subsidies. Its task was to ensure stable operations of deposit banks and to deal with the bank crisis.[8]

Ownership steering of Arsenal has been the responsibility of the Ministry of Finance but during the company's existence the Government Guarantee Fund has also taken part in the steering and supervision of the company. Within the last-mentioned organisation, there have also been organs (governing body of the Government Guarantee Fund, guidelines committee and auditing committee), each of which has had its own specialised tasks in the steering and supervision of Arsenal (Figure 1).

Figure 1. Organs playing a role in the steering and supervision of Arsenal.

The steering and supervision of Arsenal has been developed throughout the company's existence. Because of the reasons behind the establishment of Arsenal, the importance of the bank

[6] *VaVM 35/1993 vp – HE 125/1993 vp.*

[7] *Examining the ratio of central government expenditure to the capital supplied to Arsenal gives a better picture of the size of the capital. In 1996, central government expenditure totalled 33.5 billion euros. Thus, the ratio of the capital supplied to Arsenal to central government expenditure in 1996 was 11.3 per cent.*

[8] *Financing for the Government Guarantee Fund came from the state budget and the decisions on the granting of the financing were made by Parliament. The assets of the Government Guarantee Fund could only be used in exceptional cases and on special terms. Special-term support loans and guarantees could be provided from the Fund's assets and the Fund also had the right to own and administer asset management companies.*

subsidies for society at large and the clarifying objective, the Government Guarantee Fund was initially established as a body directly under parliamentary control. The governing body served as the parliamentary organ of the Government Guarantee Fund. The main purpose of the governing body was to supervise compliance with the terms and conditions of the bank subsidies imposed by Parliament and the other general terms and conditions applying to the bank subsidies. The governing body also monitored the operations of the asset management company and had the right to make proposals concerning the principles observed in the supervision of the bank subsidies and the operations of the asset management companies.[9] The governing body had nine members who were elected by Parliament.

The Government Guarantee Fund was transferred under the Ministry of Finance on 19 December 1996. In the same connection, an auditing committee was established so that the asset management companies could be more effectively supervised by Parliament.[10] All members of the auditing committee were Members of Parliament and the way in which the committee operated was different from ordinary bank supervision. The auditing committee was dissolved by the decision of an extraordinary general meeting of Arsenal on 27 March 2003 as the preparations for putting the company into liquidation were initiated.

On 17 August 1998, a five-member guidelines committee was also established under the Government Guarantee Fund. This was because the view was that the Ministry of Finance was not an appropriate body to issue guidelines concerning trials, recovery of debts and debt adjustment.[11] The guidelines committee issued, at Arsenal's request, separate guidelines for the adjustment of each debtor's debts. In 2009, the issuing of separate guidelines ended and the debt adjustment procedures were streamlined. This was by means of overall guidelines issued to Arsenal by the guidelines committee. The guidelines committee was dissolved on 19 August 2010.

The Government Guarantee Fund was dissolved on 1 January 2015 as Parliament adopted the legislation on the resolution mechanism. The Ministry of Finance will complete the unfinished obligations of the Government Guarantee Fund.[12] Already during the existence of the Government Guarantee Fund, the Ministry of Finance managed most of the Fund's tasks.[13]

2.2 Audit issues and audit criteria

The first objective of the audit was to ensure that the Asset Management Company Arsenal Ltd has properly reconciled the need to safeguard central government interest with the clarifying objective (or clarifying interest). The second objective was to develop operating principles that should be taken into account in the operations of a company of this type. Specific audit issues and audit criteria are detailed in Appendix 1.

The audit only covered the liquidation period of the asset management company, which started in 2003. Thus, only the events taking place during the final stages of the company's life cycle

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[9] *HE 6/1996 vp.*

[10] *Under the rules of procedure of the auditing committee, Members of Parliament and representatives appointed by the Ministry of Finance and the bodies auditing Arsenal's accounts served as members and deputy members of the auditing committee. The rules of procedure of the auditing committee were changed at the extraordinary general meeting of Arsenal on 16 June 1998 so that after the changes, the committee had five members and three deputy members all of whom were Members of Parliament.*

[11] *HE 51/1998 vp.*

[12] *HE 175/2014 vp, p. 80.*

[13] *Provisions on the Ministry of Finance's powers to decide on matters concerning the Government Guarantee Fund were laid down in the Ministry of Finance Decree on the Ministry of Finance Rules of Procedure (966/2005). In practice, the Second Minister of Finance was responsible for deciding on important and far-reaching matters of principle concerning the Government Guarantee Fund during its operations.*

have been audited. It is clear, however, that the operating history of Arsenal preceding the liquidation, which was also the period when the company's most important operating practices were developed, provides a context for the company's operations during the liquidation. Furthermore, most of the decisions concerning the covering of the costs in bankruptcy estates and the initiation of the legal proceedings took place before the liquidation. The aim of the audit was to take appropriate account of this context and the manner in which it relates to the company's operations during the liquidation. At the same time, the audit report also contains more general observations concerning the operations of an asset management company. For example, the conclusions concerning the corporate governance of an asset management company and the content of the clarifying objective and development proposals are of such nature that they can be applied to an asset management company irrespective of its life cycle.

The statutes laying down provisions on Arsenal, preparatory documents concerning them and other official publications were used as audit material. Of these, the Government proposals concerning the amending of the Act on Government Guarantee Fund (HE 130/1993 vp, HE 6/1996 vp, HE 51/1998 vp) and the parliamentary committee reports concerning them, especially the report of the Parliamentary Finance Committee (VaVM 35/1993 vp – HE 125/1993 vp) were important in terms of the audit objectives. The parliamentary opinions on the solution of the bank crisis and the recommendations on state ownership steering were important for the assessment of the issues concerning ownership steering.[14] The material listed above also served as the audit criteria.

The information on the company's finances and operations, such as operational planning documents, financial statements, reports on operations, minutes of meetings and information on the recovery of outstanding claims were also used as audit material. The information contained in the documents was supplemented on the basis of the discussions with representatives of the audited entities and with additional information requested from the audited entities. Reports and research concerning the topic was also used. Because the emphasis in the audit was on legal aspects, case law and legal literature were also used as audit material.

Six semi-structured thematic interviews were carried out as part of the audit. The interviews were conducted with persons responsible for the operations and steering of the asset management company and experts on the recovery of bankruptcy claims. A representative of the Finnish Tax Administration was also interviewed by telephone.

Both qualitative and quantitative methods were used in the analysis of the material.

[14] *Requirements for the supervision of an asset management company are also discussed in the Government proposals HE 130/1993 vp, HE 6/1996 vp and HE 51/1998 vp.*

3 Audit observations

3.1 Winding down of Arsenal

3.1.1 Reduction and adjustment of the company's operations before liquidation

Arsenal's operations were intended to be temporary to begin with and throughout its existence, the aim has been to wind down the company's operations in a controlled manner. The nature of Arsenal's operations has been reflected in the many organisational changes in the company. The company was originally established to administer the bad loans of the bank Suomen Säästöpankki-SSP Oy and sell other assets. Arsenal became a group in summer 1994 when it acquired 99 per cent of the shares of Suomen Säästöpankki. After that other subsidiaries, such as Siltapankki (originally STS-Pankki) and SKOP-Kiinteistöt Oy, were also incorporated into Arsenal.

The liquidation of Arsenal was preceded by substantial reductions in the company's operations. Firstly, Arsenal's real estate business was separated from the company and made part of the state-owned Kapiteeli Group in 1999. After the separation, the Arsenal Group continued its customer business, in which the focus was increasingly on the recovery of debts.

The second major step aimed at closing down Arsenal took place between 2000 and 2003 when most of the debts were sold to outsiders. After it had sold most of its debts, Arsenal was only in possession of the debts that, as a result of court processes, disputes or liabilities, were not sellable. Simultaneously with the sales of the debts, Arsenal also outsourced its information and archives management and most of its financial administration services. Already in 2002, the company had moved its operations into a single location in Helsinki.

Outsourcing of the remaining debts was not considered practicable. The view was that Arsenal possessed the best expertise in contested or otherwise bad debts. Furthermore, the weak market value of the remaining debts was also an argument against the outsourcing of the debt recovery. For this reason, the view was that Arsenal would be best placed to carry out the debt recovery.[15]

After the adjustment measures and substantial reductions in operating volumes, it was decided to propose that Arsenal should be put into voluntary liquidation. The objective of putting Arsenal into liquidation was to speed up the winding down of the company by conducting an early review of the claims that any unknown creditors would present. The second objective was to ensure that the owners of Arsenal (State of Finland and the Government Guarantee Fund) would get back as much as possible of the money that they had invested in Arsenal.[16]

The view was that it was not possible to close down the company before the end of the court cases in progress. For this reason it was decided to complete all asset management task through liquidation. The timing of the initiation of the liquidation was influenced by the adjustment measures already carried out. Furthermore, based on the lessons learned from the process of splitting up the group, it was estimated that the closing down of the company would result in claims that would take about five years to process by means of declaratory action. The aim was to process the claims before the closing down of the company.

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[15] *Asset Management Company Arsenal Ltd 16 September 2003: Completing the winding down of Arsenal. Memorandum.*

[16] *Asset Management Company Arsenal Ltd 16 September 2003: Completing the winding down of Arsenal. Memorandum.*

After the Government had issued a resolution on putting Arsenal and its subsidiary Arsenal-SSP Oy into liquidation, an extraordinary general meeting decided to put the companies into liquidation starting on 1 October 2003. Thus, at the start of the liquidation, the group consisted of two operational companies. SSP was the operational arm of the company, while the personnel were on Arsenal's payroll and Arsenal was also responsible for group administration.

When the companies were put into liquidation, it was decided that they would only continue their business to the extent required by the review of their operations. For example, new reviews based on the clarifying objective or other extensive action could only be launched on sufficiently weighty grounds. Putting Arsenal into liquidation also meant the start of the process of compiling the final report on the companies. The final reporting has involved the recovery of the outstanding debts, management of trials, dismantling of archives, realisation of assets and the closing down of the group's subsidiaries. Recovery of the outstanding debts has involved civil and criminal cases, lodgement of claims in bankruptcy estates, ordinary execution, voluntary and statutory debt adjustment and debt recovery related to them.

It would seem that when Arsenal was established it was difficult to predict how long the company would remain operational. It was originally estimated in the Government proposal HE 130/1993 vp that the asset management company would remain operational for between five and seven years after which the company would be closed down by means of liquidation or other similar arrangement. However, when Arsenal was put into liquidation, it had already been operational for ten years. The liquidation of the company, which started in 2003, has also continued for a substantial period of time.

Even though the company has remained operational longer than originally expected, Arsenal took a series of measures at the end of 1990s/start of 2000s, which allowed it to adjust its operations and cost structure in accordance with its operating volumes. After the completion of the adjustment measures, the company has primarily operated as a debt recovery agency and it is no longer extensively involved in asset management business. At the same time, however, there has been a substantial decrease in debt recovery volumes at the start of (and during) the liquidation process, compared with the situation in the 1990s.

At the start of its operations in 1994, Arsenal had about 12,600 customers.[17] Corporate customers accounted for 66 per cent of this total. About 8,500 of the customers (67 per cent of the total) were customers with outstanding debts. At the start of the liquidation, all remaining customers were transferred under the debt recovery function and there were no longer any customers subject to stimulus measures. At the end of 2004, there were 461 customers categorised as principal debtors and of this total, 260 were corporate customers and 201 private customers with outstanding debts.[18] Likewise, there were substantial changes in the structure of the company's balance sheet between 1994 and 2013 and the changes are a reflection of the substantial reductions in the company's operations (Figure 2).

[17] *There have been cases in which a large number of "associate debtors" (principal debtors, co-debtors, guarantors, pledgees, etc.) have joined an Arsenal debtor.*

[18] *Asset Management Company Arsenal Ltd 2004. Annual report 2004, p. 3.*

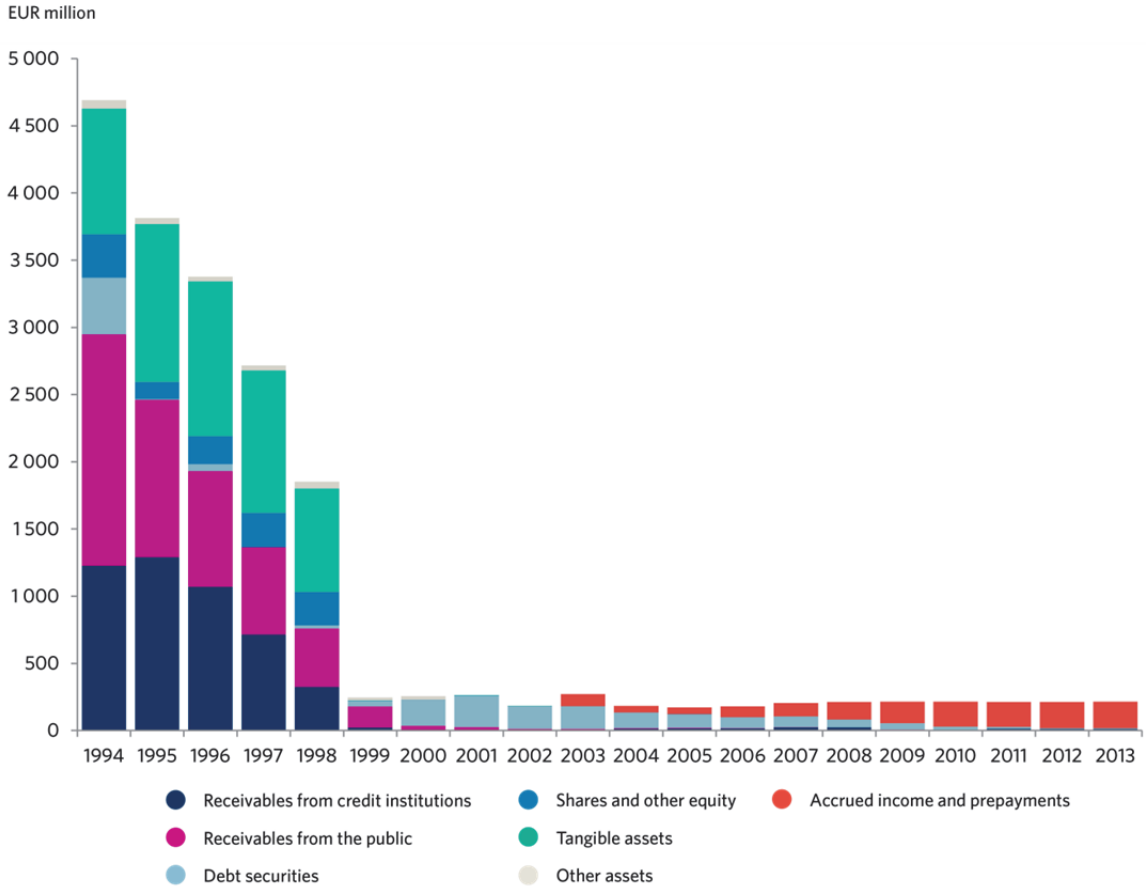

Figure 2. Assets in Arsenal's balance sheet between 1994 and 2013.

The figure shows the major operational restructurings carried out in the late 1990s/early 2000s. At the start of the liquidation, Arsenal's balance sheet total was about 182 million euros. Thus, the balance sheet total at the time was four per cent of the original balance sheet total of 1994.[19] The book value of customer receivables was 7.6 million euros, which was about 0.4 per cent of the balance sheet value of the customer business during the early stages of Arsenal's operations.

3.1.2 Uncertainties in the final reporting of the company and preparing for them

At the start of the liquidation, the aim was that Arsenal would have enough equity to cover the costs arising from final reporting and that no additional capital would have to be invested in the company during the liquidation. At the same time, however, only a limited amount of the Arsenal's equity could be returned to the state as the company was involved in court cases that would result in expenses (or expense risks). The company also had other liabilities that could have resulted in expenses. Thus, at the start of the liquidation, Arsenal had substantial cash reserves (168 million euros). The cash reserves were also the biggest single balance sheet item of the company. At the start of the liquidation, Arsenal's obligatory provisions totalled about 80 million euros, which was also a considerable amount. At the time, the company was also preparing for costs (such as legal expenses, claims concerning the division and other claims put to the

[19] *The process of determining the liabilities transferred to Arsenal was only completed in spring 1994 and for this reason, the company's balance sheet at the close of 1994 gives the best picture of the situation.*

company at the start of the liquidation) for which no separate provisions were made. The view was that the substantial cash reserves would allow Arsenal to prepare for the realisation of the provisions and other future cost items that were difficult to anticipate.

When Arsenal was put into liquidation, the company's management estimated that a total of 90.7 million markka (15.2 million euros) of the capital could be returned to the owners. By the end of 2014, Arsenal had returned a total of 200 million euros to the state. Thus, the amount of returned capital is much higher than originally anticipated. Even though this can be considered a positive development, it can also be seen as a sign that it has been difficult to anticipate expected revenue during the liquidation and that return expectations have probably been connected with substantial uncertainty factors. It would also seem that this was one reason why the amount of capital returned to the owners was cautiously estimated. No preliminary estimates of the trends in the company's cost structure were made at the start of the liquidation.

Tasks covered with provisions

The company's financial strategy was based on an assumption that no new capital investments would be needed. Thus, Arsenal prepared for the winding down of its business operations by means of a winding-down provision that had already been entered in the books before the liquidation. At the start of the liquidation, the winding-down provision of the Arsenal Group totalled 76.8 million euros and was allocated to a wide range of company operations.

Provisions were adjusted during the liquidation process, especially during its early stages (between 2003 and 2005). As the liquidation has continued, fewer changes have been made to the provisions, which also suggests that there are now fewer uncertainties concerning the company's operations. By the end of 2013, the provisions had shrunk to 5.6 million euros.

The increases in provisions have mainly concerned archiving provisions. Especially provisions concerning court cases and bad debts have been both increased and released during the liquidation. During the last few years, increases have been made to provisions concerning the winding down of operations and the support package.

At the start of the liquidation, more than 50 per cent of the provisions concerned court cases. This shows that the uncertainties concerning the court cases have had a substantial impact on Arsenal's operations and operational planning.[20]

The second biggest provision concerned the obligations connected with other debt transactions. The provisions in question were made in preparation of the demands that the prices of earlier debt transactions should be decreased as a result of the new debt recovery legislation. A total of 10 million euros of the provision was realised in 2005. During the early stages of the liquidation, the company was also involved in a number of investigations concerning bank guarantees.

Even though the real estate business had already been separated from Arsenal, the hidden liabilities arising from the real estate transactions made before the separation remained in the company accounts. For this reason, as the company was put into liquidation, a provisions of more than six million euros was made for possible real estate liabilities. Real estate provisions worth five million euros were released at the end of 2003. However, after this there was still a possibility that Arsenal would face claims concerning hidden defects or environmental damage in the properties previously owned by the company. Thus, we are talking about a liability item in which the realisation value was extremely difficult to estimate in advance.

During the liquidation, Arsenal has been presented with claims concerning real estate already sold and in almost 20 such cases the company has incurred costs. The real estate liabilities have included claims concerning polluted soil and building defects in the properties sold by Arsenal.

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[20] *Recovery of debts and the court cases connected with them and lodgement of Arsenal's claims in bankruptcy estates are discussed in more detail in chapter 3.1.3.*

During the liquidation Arsenal has also been responsible for a number of archives. The management of the archives of Suomen Säästöpankki-SSP Oy and the savings banks merged with it, which had become the responsibility of Arsenal, and Arsenal's own archives was outsourced as of 1 January 2003.

At the start of the liquidation, there were 80 shelf kilometres of archives and the archives of the savings banks accounted for most of this total. Initially, Arsenal was prohibited from destroying any of the archives of the savings banks. The archives were stored in 12 different locations in different parts of Finland. During the early stages of the liquidation, Arsenal's own archives accounted for about five per cent of the archived material.

At the start of the liquidation, Arsenal prepared for its archiving obligation by making a provision of 4.4 million euros. The size of the provision was based on an agreement on archiving services. However, as the liquidation has progressed, the archiving provision has proved inadequate and it has been necessary to increase the provision in nine financial years during the liquidation. Maximum annual archiving expenditure has amounted to about 2.4 million euros. The archiving expenses incurred by the company during the liquidation totalled about 11.5 million euros by the end of September 2014. The actual archiving expenditure has been almost three times as high as the archiving costs estimated at the beginning of the liquidation.

Destruction of the archived material has been postponed, which has pushed the archiving cost above what was originally estimated. The view has been that the archived information is important as evidence in court cases, and for this reason Arsenal has, at the owners' request, acted with caution when destroying information. On the basis of this, it was decided that the receipts and other similar material kept in the archives of Suomen Säästöpankki would be stored for ten years and not six years, which is the general retention period laid down in the Accounting Act (1336/1997). It was ordered that material that is relevant to court cases in progress or court cases that will probably become pending in the future may not be destroyed for the time being.[21]

Even though the ban on destroying the archives was officially repealed as early as 2003, the destruction of the savings banks' archives only began in March 2006. As a result, it was necessary to increase the archiving provision by about 4.5 million euros between 2004 and 2005. Start of the destruction of the savings banks' archives was delayed because there were court cases pending, while at the same time counterclaims in which the information contained in the savings banks' archives could be relevant were under review. Furthermore, the destruction of the archives had to be stopped in October 2008 and could only be resumed at the end of 2009. The stoppage was due to claims presented in a court case.

By the end of 2014, the amount of archived material had been reduced to about five shelf kilometres and it now mostly consists of Arsenal's own documents. Some of the archived information is in paper form and some of it is stored as electronic documents. Arsenal has not yet destroyed any of its own archives. It was already stated in the archiving plan of Arsenal-SSP in 2003 that a separate plan for storing the archives of Arsenal will be prepared.[22] Preparation of the archiving plan for Arsenal's own archives did not start until 2014.

Observations concerning the disclosure of provisions

Under chapter 3, section 2, subsection 1 of the Accounting Act, the information on the company's operating result and financial position contained in the financial statements must be true and fair (true and fair view). Based on the large number of different provisions and the substantial sums tied to them, it would be expected that in order to meet the trueness and fairness requirement, the company would provide fairly detailed information on the provisions and the

[21] *Asset Management Company Arsenal Ltd 21 May 2003. Archiving plan of Suomen Säästöpankki-SSP Oy, p. 5.*
[22] *Ibid.*

grounds for them in its financial statements. In Arsenal's financial statements, changes to the provisions are presented in a fairly general manner and the grounds for the changes are not detailed. It may not be easy for outside observers unfamiliar with the company's operations and accounting practices to get a detailed view of the company's provisions when reviewing the financial statements.

At the same time, however, it should be noted that the requirements concerning the disclosure of provisions laid down in the Accounting Decree (1339/1997) are of fairly general nature and the financial statements of Arsenal cannot be considered to be in violation of these requirements as far as the disclosure of provisions is concerned.[23] It could also be noted that a company in liquidation (such as Arsenal) does not in all respects observe the same accounting practices as going concern companies. For example in a company in liquidation it is often practicable to prepare for expected expenditure and losses by making provisions. Provisions made in such situations may be both numerous and substantial. Detailed itemisation of the provisions may also be limited by the need to protect business secrets. It should also be noted that Arsenal is wholly owned by the State of Finland, which as the owner of the company, is able to obtain the information on the provisions made by the company. In fact, based on the audit observations, the Ministry of Finance has been notified of substantial changes in provisions in monthly reports.

Administrative tasks during liquidation

During its operational history, Arsenal has been the subject of a broad range of different claims concerning operational adjustment, division and placing of the company into liquidation. Many of the claims have also led to court processes. The trials concerning the claims preceding the liquidation and the processing of the claims elsewhere have in many cases continued during the liquidation. For example, processing of the claims concerning the division of the company that took place in 1999 continued until 2008.

The court processes concerning the putting of the company into liquidation also continued until 2008. The Group received a total of 56 letters of lodgement by the deadline given in connection with the public summons issued for the liquidation. Letters of lodgement containing both contested and uncontested claims were submitted. Claimants withdrew their claims in 12 contested cases. It was necessary to file a negative declaration in 11 lodgings. All demands concerning the liquidation and the claims concerning them were found to be groundless.

Closing subsidiaries has been one instrument whereby the company has been scaling down and adjusting its operations during the liquidation. At the same time, for strategic reasons connected with debt recovery, Arsenal has also acquired new subsidiaries during the liquidation.

When Arsenal was put into liquidation, it had a total of 25 subsidiaries and affiliated companies. In 2003, three subsidiaries were incorporated into the Arsenal Group and one of these was the asset management company Arsenal-SSP Oy. Some of the subsidiaries and affiliated companies were in liquidation, some of them were engaged in business operations and some of them had been put up for sale. The Arsenal Group has owned companies in a broad range of different sectors, in whole or in part. The company has owned asset management companies, financing and credit companies, real estate companies, holding companies, a golf company, spa companies and housing companies.

At the start of the liquidation, the subsidiary Arsenal-SSP was responsible for the recovery of debts, while the personnel were on Arsenal's payroll, which was also responsible for group administration. There was a steady decline in the number of companies owned by Arsenal during the early stages of the liquidation as they were sold and dissolved. At the same time, however,

[23] *Chapter 2, section 3, paragraph 4 of the Accounting Decree only states that as a note to the profit and loss account, a company must provide details of the changes in obligatory provisions contained in revenue and expenditure unless they are of minor significance.*

Arsenal has also acquired companies during the liquidation so that it can put the recovery of debts on a more effective basis. For example, in 2013, Arsenal acquired Value Investments AG, a Swiss holding company, so that it could speed up the recovery of customers' debts. During the audit (in 2014) Arsenal had three subsidiaries.

With few exceptions, the subsidiaries have not involved substantial financial interests as the subsidiaries and affiliated companies have mainly played a strategic role in the boosting of the recovery of debts.[24] Based on the audit observations, the management of the companies' matters has continued to require a great deal of resources during the liquidation. The tasks concerning the subsidiaries have covered a broad range of issues and such matters as possible court cases involving the companies or ongoing realisation of the companies have been a factor in the workload.

The company structure was simplified by incorporating Arsenal into its subsidiary Arsenal-SSP in 2012. It was decided to carry out the merger as a reverse merger in which the parent company is incorporated into the subsidiary. Merging the two companies generated economies of scale. For example, it was no longer necessary to have two separate accounts, prepare consolidated financial statements, monitor the relationships between the companies or record internal revenue and expenditure charges after the merger. Arsenal was also able to make use of the loss of ten million euros incurred by Arsenal-SSP in its taxation.

The fact that the parent company Arsenal no longer had any such liabilities that would have caused debtors to oppose the merger was the main reason determining the timing and form of the merger.[25] Based on the audit observations, it would also seem that during the last stages of its operations the company has been able to make use of the experience-based information accumulated over its life cycle. For example, the company has been able to use the lessons learned from the arrangements applied in previous divisions when anticipating the reactions of the debtors.

Summary

During the liquidation, Arsenal has had a broad range of different liabilities that have been connected with debt transactions, sales of real estate and the keeping of archives as well as the bankruptcy estates in which Arsenal has covered the costs. The corporate structures of the Arsenal Group have been adjusted during the liquidation in accordance with the shrinking operations of the group. After 2008, Arsenal has had few tasks except for the lodgement of claims in bankruptcy estates as part of the recovery of debts and the management of court cases connected with them.

Putting Arsenal into liquidation has made it possible to start the final reporting process. Largely as a result of the special characteristics of the company's operations, the liquidation process has lasted for many years. The cost structure of the company's operations during the liquidation has involved uncertainties and the company has prepared for the expected expenditure and losses by making provisions. Based on the audit observations it would also seem that in general the content of the asset management company's operations and tasks during the liquidation as well as the duration of the liquidation have been difficult to anticipate.

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[24] *Kylpyläkasino Oy (3.9 million euros) and Meri-Teijo Golf Oy (0.7 million) have been the most important subsidiaries in terms of the financial interests involved. Because of high risks and substantial liabilities, both companies originally had a balance sheet value of 0 euros. However, in the end, Arsenal managed to sell the companies at the prices given in the brackets. The other subsidiaries and affiliated companies have involved financial interests of about two million euros. The liquidators also served as Board members in such companies as Kylpyläkasino Oy for a short period after the completion of the debt adjustment process.*

[25] *Asset Management Company Arsenal Ltd 15 May 2012: Merger plan*

One important feature connected with the liquidation period has been the cautious attitude shown by the company towards the destruction of archives. As a result, the company's archiving costs during the liquidation have been almost three times as high as the original archiving budget. The caution shown in the destruction of the archives has largely been due to the unwillingness to take the risk of losing material that could be used as evidence in court cases. Based on the audit observations, it would also seem in general that the company has put a great deal of emphasis on preparing for legal disputes and that in this it has been able to make use of the experience-based information that it has accumulated in its operations.

3.1.3 Lodgement of claims and managing court cases

The main purpose of Arsenal's debt recovery operations is to ensure direct recovery of debts and to manage the court cases connected with the recovery. The second purpose is to ensure that the company is able to secure its interests in bankruptcy estates in which it has debts to recover. By April 2014, the number of the cases involving debts claimed by Arsenal had dropped from 1,558 (at the start of the liquidation) to 475 (Figure 3).

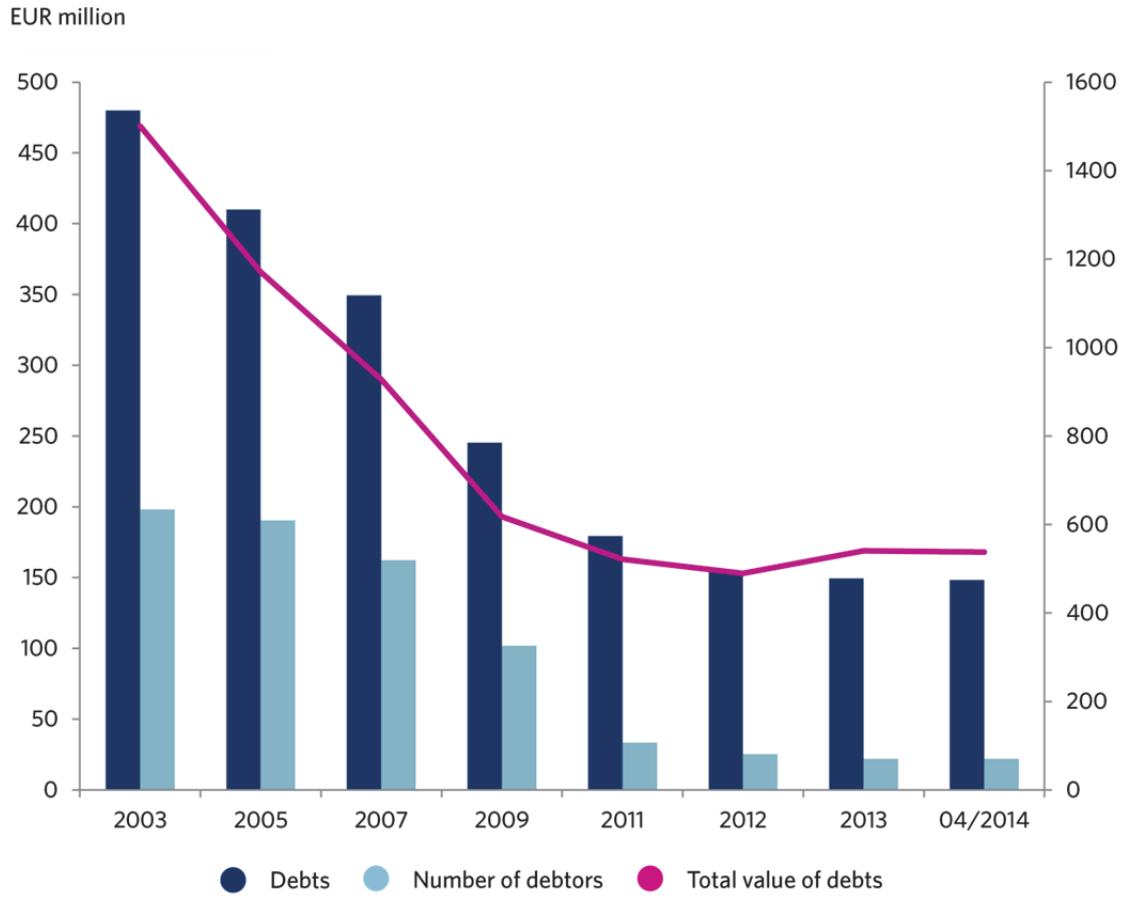

Figure 3. Trends in debts subject to recovery by Arsenal during liquidation.

As shown by the Figure, the total value of the debts subject to recovery has been reduced to about one third of what it was at the start of the liquidation. In April 2014, the capital value of the debts subject to recovery was 168 million euros or 36 per cent of the value at the start of the liquidation. With few exceptions, the debts subject to recovery do not have any book value. Claims for damages arising from criminal offences account for a large proportion of the Arse-

nal's claims portfolio. The Figure also shows the number of debtors involved in the claims. There have been cases in which Arsenal has been recovering more than one debt from a single debtor, while at the same time a debt may have involved more than one debtor. In 2003 (at the start of the liquidation) there were 654 debtors involved and by April 2014, the number had dropped to 70.

The company's claims based on claims judgements are recovered through enforcement. A large proportion of these claims collected by means of retrospective recovery has been subject to recovery through enforcement from the start of the liquidation. Arsenal has played a monitoring and steering role in the recovery of claims through enforcement. Within the framework provide by its guidelines, the company negotiates on voluntary debt adjustment on the basis of which changes are made to the amount of debts subject to recovery. As part of the monitoring, the company can also submit notifications of the changes in the customers' income levels that have an impact on the amount of the claims subject to recovery. Arsenal may also request that an enforcement inquiry on the debtor subject to enforcement should be carried out if the company considers such an inquiry necessary. Arsenal has requested the carrying out of an enforcement inquiry in cases where the claims have been substantial and there are reasons to believe that the debtor is actually not without means.

Arsenal keeps a register of its claims. The company is not linked with the systems of enforcement authorities as the account itemisations and notifications concerning the termination of enforcement are made manually.[26] Arsenal's yearly debt recovery performance between 2003 and 2013 based on the recovery of bad debts varied from less than 240,000 euros to more than ten million euros (Figure 4).

[26] *Actual and probable bad debts have been entered as bad debts. Probable bad debts have been entered in the accounts when it is clear that there is unlikely to be any payments of the principal sum owed. Such bad debts have been allocated on a customer and credit basis and deducted from the claims. The difference between the debtors' liabilities and security has been entered as bad debts and guarantee losses. When estimating the size of the probable bad debts, Arsenal has valued the assets used as security for the claim or contingent liability at fair value. It should be noted that the company's debt recovery performance based on the recovered bad debts does not include the damages received by the company or the penalty interest paid on them, as these have not been entered as bad debts. Revenue generated from the realisation of security acquired from bankruptcy estates or through enforced sales or rental income from re-renting are not included in recovered bad debts either. For example, in 2008, the company received more than ten million euros in damages. In other years during the liquidation, the above-mentioned revenue items have been considerably smaller. During the past five years (2010-2014), the total amount of these revenue items has varied between about 120,000 euros (in 2013) and about 200,000 euros (in 2010).*

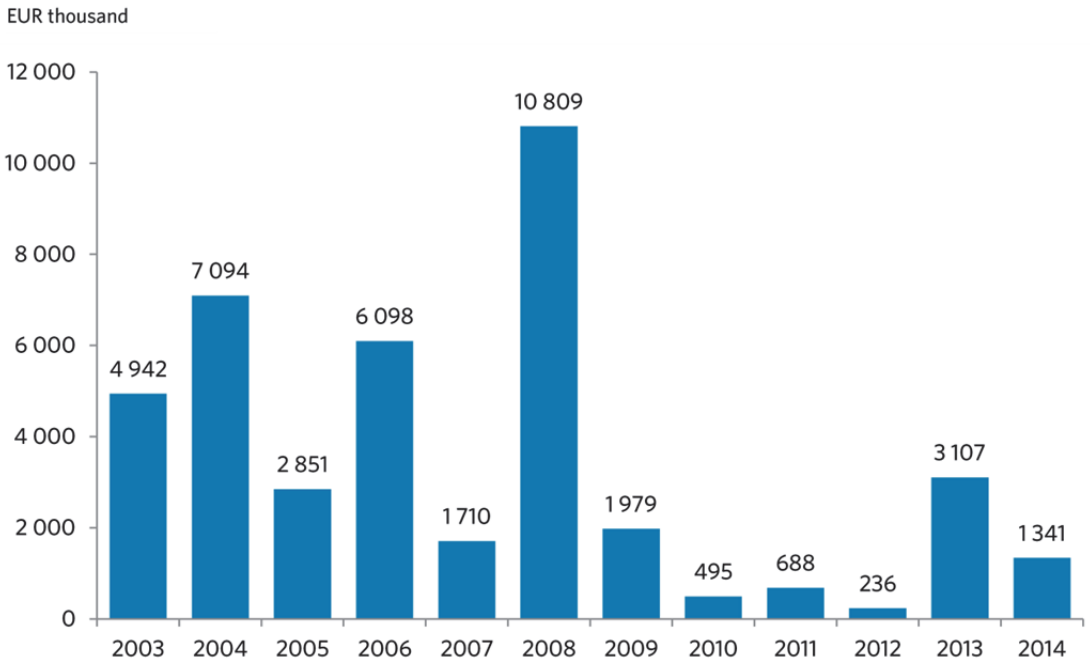

Figure 4. Arsenal's debt recovery performance based on recovered bad debts between 2003 and 2014.

Court cases and their end results have been the main reason for the fluctuations in the yearly debt recovery performance based on recovered bad debts. There has only been a small number of payments in the category of claims arising from criminal offences. During the last years of the period in review, debt recovery performance has been weaker than at the start of the period. During the past five years (2010-2014), yearly debt recovery performance has averaged about 1.2 million euros. This has mainly been due to reductions in debt recovery operations (and in the company's operations in general). During then liquidation, Arsenal has managed to recover about 41 million euros in probable bad debts.

In its debt recovery operations, Arsenal has been forced to take into account the legal reforms introduced over the years. One of the most important legal reforms affecting Arsenal's debt recovery operations has been the Enforcement Code (705/2007), which entered into force on 1 March 2008. Under the Enforcement Code, a ground for enforcement remains enforceable for 15 years from the decision. If the payment liability relates to a decision arising from a criminal offence, the time limit is 20 years. Arsenal's claims for damages arising from criminal offences will only become time-barred in the 2020s. Before the end of the liquidation, it will be decided how the recovery of debts arising from criminal offences will be continued after the closing down of the company.

After the expiry of the time limit on the grounds for enforcement the claims will also become time-barred. So far, a total of 41.5 million euros in debts have become time-barred and most this sum became time-barred at the entry into force of the new Enforcement Code. A total of about 15 million euros in debts have become time-barred after 2008. As a rule, Arsenal has not considered that there are financial grounds for seeking an extension of the time limit on grounds for enforcement in situations where receivables become time-barred. This is because from the outset the expectation has been that only a small percentage of the debts will be recovered.[27]

[27] *Issues concerning the time limit on grounds for enforcement are discussed in chapter 3.3.2 below.*

Trials and lodgement of claims in bankruptcy estates

In the recovery of debts during the liquidation, Arsenal has given priority to the management of court cases connected with the debts and to the lodgement of its claims in bankruptcy estates. As the liquidation has continued, these tasks have accounted for an increasing proportion of the company's remaining resources. Arsenal has been a creditor in 59 bankruptcy estates during the liquidation. In 33 bankruptcy estates, Arsenal has been the biggest creditor (with a claims share of at least 50 per cent). With two exceptions, the bankruptcies had been filed before Arsenal was put into liquidation. Six of the bankruptcies were still pending at the end of 2014. Arsenal has covered the costs in a total of 31 bankruptcy estates (52.5 per cent of all cases). As a rule, Arsenal has covered the costs in such bankruptcies where it has, in accordance with the clarifying objective, expected a thorough investigation because of possible irregularities. In these cases, the assets of the bankruptcy estates have been insufficient to cover the costs of the bankruptcy proceedings. In many cases, Arsenal has covered the costs in order to ensure that irregularities in debtors' activities can be investigated.

By September 2014, Arsenal had received a total of 23.4 million euros in disbursements from the bankruptcy estates. Arsenal has had a total of 401.7 million euros in lodged claims in bankruptcy estates during the liquidation. Thus, the average disbursement has been about six per cent.

The disbursements and tax revenue received by the Finnish Tax Administration from the bankruptcy estates in which Arsenal has covered the costs have also constituted substantial central government revenue items. In the biggest bankruptcy estates reviewed in the audit, the disbursements of the Finnish Tax Administration and the value-added taxes on estate administration fees and separate measures have totalled about 7.2 million euros.

Arsenal or Arsenal-financed bankruptcy estates have been a party in 203 court cases during the liquidation.[28] A total of 100 court cases were pending at the start of the liquidation. By September 2014, this total had dropped to one fifth of what it was at the start of the liquidation.[29]

The gross sums involved in the trials (excluding the overlaps in different cases) totalled 323.4 million euros in 2003. This total had been reduced to 38.5 million by September 2014. Cases with principal debtors involve both foreign and domestic processes, in which there are partially overlapping interests. In such cases, the recovery is directed, in full or in part, at the same debt in two separate debt recovery processes. According to an Arsenal estimate, the trials that took place in 2014 involved about 9.5 million euros in overlapping interests. This means that the net sums involved in pending court cases were about 29 million euros.

Managing court cases has been one of the most important tasks of Arsenal and the company has kept a centralised register of them since August 2001. Before that, regional offices kept local registers of the court cases that they managed. Originally it was intended to have a more extensive centralised register but it was decided to opt for a more limited register as the company was in the process of being put into liquidation. The aim has been to enter the most important details of the pending court cases in the register. The register shows the court cases involving Arsenal that are pending, Arsenal's role in them and at which court level the case is being pro-

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[28] *Situation at the end of September 2014. The court cases that are not connected with the recovery of debts are also listed in the statistics.*

[29] *At the start of the liquidation, some of the court cases involved matters other than debts subject to recovery. In all, court cases involving the recovery of debts have accounted for the largest number of the cases. Of the trials taking place between 2000 and 2014, Arsenal won in 169 and achieved partial victory in 23 cases. In 27 processes, there was an agreement with the opposing party, while in 55 cases, the asset management company (or the bankruptcy estate financed by it) lost. In addition, a total of 34 trials ended with the relinquishing or cancellation of claims. In seven of the trials, the party acquiring the debts assumed responsibility for the proceedings. There were still 19 court cases pending in April 2015.*

cessed. The register also gives the names of the lawyers acting as Arsenal's attorneys. The same information is also available on cases concluded during the existence of the register.

The aim has also been to enter the costs of the court cases and related risk assessments in the register. However, in this respect the register is incomplete. Moreover, the cost details are not updated as the liquidation progresses as there have been separate accounts for the largest expenditure items (bankruptcy estates) and if necessary the costs have been entered in separate business accounting. It is possible to obtain details of the duration of each legal process and the court level that the case has reached. However, it is not possible to obtain register-based reports providing an overall description of the processes. The register does not give the average duration of the trials or the court levels that the cases have reached or at whose initiative they have reached the court level in question. Moreover, Arsenal has not collected information on the sentences of the other parties in a centralised manner.

Observations on difficult debts

The number of prolonged legal processes is one indication of the number of difficult debts during the liquidation. The court processes involving Arsenal or Arsenal-financed bankruptcy estates have been of relatively long duration. An application for leave to appeal has been filed to the Supreme Court in 69 cases (which is about one third of the legal processes pending). In 49 cases, the opposing party has been the appellant (71 per cent of the cases).

The legal processes in which the opposing party has filed an application for leave to appeal to the Supreme Court have lasted for an average of 4 years and 11 months. However, the ten longest legal processes have lasted for an average of 9 years and 4 months. At the same time, the legal processes in which Arsenal has been the party filing the application for leave to appeal, have lasted for an average of 4 years 11 months. The legal processes involving Arsenal-financed bankruptcy estates, in which a party to the case has filed an application for leave to appeal, have, on average, been the longest (about 9 years and 2 months).[30] The parties opposing Arsenal have filed a large number of applications for leave to appeal in enforcement cases, while the Arsenal-financed bankruptcy estates have often been the appellants in large cases involving economic crime.

In many cases, parties opposing Arsenal or bankruptcy estates in which Arsenal has undertaken to cover the costs have filed an application for leave to appeal against the decision of the Court of Appeal to the Supreme Court. The Supreme Court has rejected the leave to appeal in about 90 per cent of the cases in which it has been sought. Furthermore, in cases where a leave to appeal has been granted and the Supreme Court has made a decision, the Supreme Court has not necessarily changed the decision of the Court of Appeal. In one case, the Supreme Court accepted the appellant's arguments concerning the protection against self-incrimination and in two other cases it went along with the appellant in the issue of legal expenses. Furthermore, in one case, the Supreme Court left the decision of the Court of Appeal unchanged. The appeals filed by Arsenal or the bankruptcy estates in which Arsenal has covered the costs have not been particularly successful either.[31]

Many of the debt recovery and court processes during the liquidation that have involved Arsenal have been complex and managing them has often required substantial resources. For example, one debtor has filed more than 20 enforcement appeals or recovery claims. On average, the

[30] *The duration of the legal processes has been calculated from the date on which the case became pending in the court of first instance to the decision of the Supreme Court or the rejection of the leave to appeal.*

[31] *Arsenal has been the defendant in all these cases.*

bankruptcies that have been pending during the liquidation have also lasted substantially longer (11.9 years) than average bankruptcies.[32]

The fact that the bankruptcy estates in which Arsenal has undertaken to cover the costs have been parties to protracted legal processes is largely the result of the clarifying objective (or clarifying interest), the main principle guiding Arsenal's operations. It follows from the clarifying objective that the asset management company assumes responsibility for investigations of the irregularities in debtors' activities.[33]

Summary

Because the court case register is of concise nature, the liquidation administration has made use of separate registers so that it can obtain more extensive monitoring information on the recovery of debts, lodgement of claims in bankruptcy estates and court cases. In the audit, the liquidators pointed out that as the liquidation administration has been familiar with the overall situation concerning the legal processes and the lodgement of claims, a comprehensive case management system has not been considered necessary.

The fact that the above-mentioned information, which is fairly central to the company's operations, has not been comprehensively documented can be considered a risk. Even though the information on the court cases and the documents in the possession of the company are added to the court case files and the most important events are entered in registers and monitoring tables, it may be difficult for the asset management company to access detailed information on the court cases if the liquidation administration is replaced with a new one or if some of its members are replaced. Systematic documentation of the information might also make it easier to verify this information in a reliable manner. With such register information, the company could also be in a position to develop the monitoring of its tasks and objectives, which are largely based on this documentation. For example assessing to what extent the clarifying objective has been applied is largely based on the information on court cases and bankruptcy estates. In an organisation carrying out a task like this, the "non-financial" information pertaining to the court cases may be relevant when the achievement of the company's objectives is assessed.

By the year 2014, Arsenal had reached a stage where its main task was to ensure that its interests are catered for in pending bankruptcy cases. As part of this task, it has financed court cases involving bankruptcy estates as a party. At the end of 2014, Arsenal had claims from six bankruptcy estates and a number of other debtors. At the time, there were a total of 21 legal processes pending. Judging from the amount of debts subject to recovery and the principal involved, the volume of the company's main operations has continued to shrink during the liquidation. During the liquidation, a substantial proportion of the Arsenal's claims have been classified as difficult debts.

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[32] According to a report prepared by the Bankruptcy Ombudsman in 2001, fewer than one per cent of the bankruptcies completed in 2000 (sample of 900 bankruptcy estates) lasted longer than ten years. The average duration of a bankruptcy was 43 months. A total of 43.7 per cent of the bankruptcies lasted less than two years and 77.6 per cent less than five years. In the light of these statistics, the bankruptcy proceedings involving estates under Arsenal's responsibility have been among the longest-lasting among the bankruptcies.

[33] The concept of the clarifying objective (or clarifying interest) is discussed in more detail in chapter 3.3.1 and the issues concerning protracted legal processes in chapter 3.3.2.

3.1.4 Adjusting Arsenal's operating expenses

Arsenal's yearly operating expenses have decreased as the liquidation has progressed (Figure 5).[34] The expenses peaked in 2004, when they totalled about 8.7 million euros. With a reduction in operations, yearly expenditure decreased to slightly more than two million euros between 2011 and 2013. Debt recovery expenses and expert fees have accounted for nearly 40 per cent of Arsenal's total operating expenses. Debt recovery expenses and expert fees have accounted for between 25 and 53 per cent of all operating costs. As recently as 2009, debt recovery expenses and expert fees totalled more than 1.8 million euros. Since then these expenses have decreased so that in 2013 they were slightly over 600,000 euros.

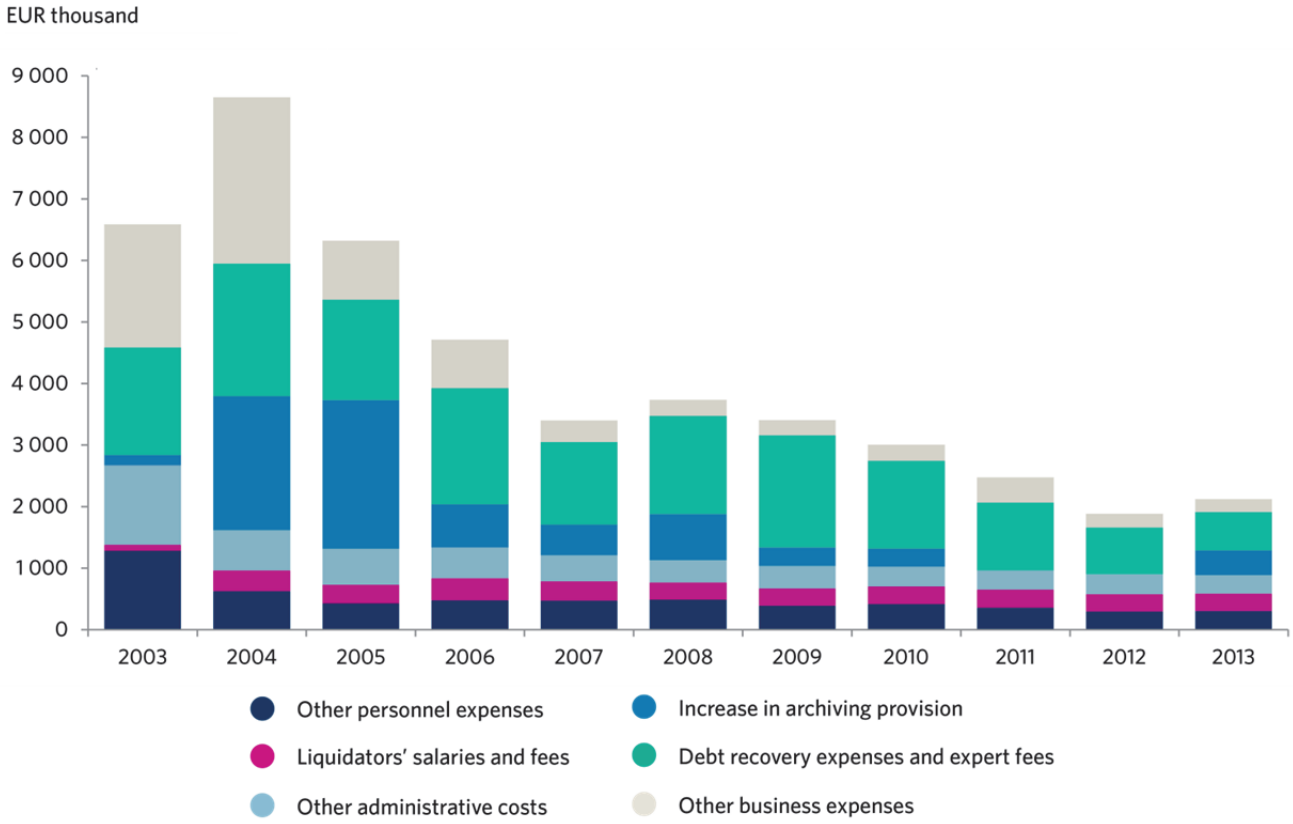

Figure 5. Arsenal's operating expenses during liquidation.

Personnel expenses have also decreased during the liquidation. At the start of the liquidation, the company employed a total of 13 salaried employees in addition to the liquidators. Personnel expenses, excluding liquidators' fees accounted for about 20 per cent of the company's expenditure. Already in 2004, the number of salaried employees decreased to seven and the proportion of personnel expenses was reduced to seven per cent of the overall expenses (to about 600,000 euros). In 2013, personnel expenses amounted to about 300,000 euros, which was 13 per cent of all expenditure.

One of the two liquidators is in employment relationship with Arsenal and receives a monthly salary. The other liquidator invoices Arsenal for the amount of the work done in the same man-

[34] *In addition to cash flows, operating expenses also include annual increases to provisions. The expenses paid by Arsenal on behalf of the bankruptcy estates have been entered under item "Other operating expenses". The expenses shown in Figure 5 are in this respect gross expenditure from which the payments transferred from the bankruptcy estates to Arsenal have not been deducted.*

ner as a lawyer. The total amount of the salaries and fees paid to the liquidators has remained largely unchanged.

As the company's overall operating expenses have decreased, the proportion of the liquidators' salaries and fees of the total costs of the company has increased throughout the liquidation, from about four per cent in the beginning to about 13 per cent by the year 2013. The salaries and fees of the liquidators have remained fairly stable since 2008 (total amount between 220,000 and 250,000 euros/year).[35] Some of the administrative and preparatory tasks have also been transferred to the liquidators as the number of personnel has been reduced.

The other operating expenditure items have played a varying role in Arsenal's cost structure.[36] In some years the increase in Arsenal's archiving provision has had a substantial impact on the company's cost structure. The increases in the archiving provision made in 2004 and 2005 accounted for an average of 30 per cent of all operating expenses. In other years, the archiving provision has accounted for a substantially smaller percentage of operating expenses. For example in 2007, the archiving provision accounted for about 15 per cent of the operating expenses.[37]

Arsenal outsourced its information management in 2003 as the company was put into liquidation. On average, yearly information management expenses have totalled 160,000 euros since 2010. Because of its operational history, Arsenal is using more than ten operating applications with partially overlapping functions. The applications are, however, well-established and their verifications have been carried out by means of backup copies of the network servers.[38]

Cost comparisons with Office of Bankruptcy Ombudsman

Since 2009, the main task of Arsenal has been the lodgement of claims in bankruptcy estates and the management of the court cases connected with them. In this respect, Arsenal could be compared with the Office of Bankruptcy Ombudsman. Most of the expenditure incurred by the Office of Bankruptcy Ombudsman and Arsenal results from similar bankruptcy-related matters. The main task of the Office of Bankruptcy Ombudsman is to supervise the administration of bankruptcy estates in addition to which it also conducts audits and administers bankruptcy estates under public receivership.

Between 2009 and 2013 the Office of Bankruptcy Ombudsman launched an average of 82 public receivership proceedings and carried out more than 100 special audits each year. In this period, the costs and debt recovery results of the public receivership proceedings launched by the Office of Bankruptcy Ombudsman and the disbursements secured were smaller than the expenditure and revenue generated by the bankruptcy estates in which Arsenal has been liable for the costs.

In 2009, Arsenal had two salaried employees and two liquidators on its payroll and at the time its operating expenses were about 2.5 times higher than those of the Office of Bankruptcy Ombudsman, which had ten employees on its payroll. By the year 2013, the operating expenses of the Office of Bankruptcy Ombudsman had exceeded those of Arsenal. At the time, there were still ten persons on the payroll of the Office of Bankruptcy Ombudsman, whereas Arsenal only employed three salaried employees and two liquidators.

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[35] *The invoicing by the liquidator who works as a lawyer, includes VAT. In 2014, the invoicing by the person in question was about 37,000 euros lower than in the previous year. The completion of proceedings in two bankruptcy estates in late 2014 has probably been the reason for the smaller invoices*

[36] *Before 2007, other operating expenses also included expense reimbursements. Starting in 2007, expense reimbursements have not been deducted from other operating expenses.*

[37] *Archiving expenses have been entered in the accounts by means of the archiving provision. Accumulated archiving expenses have been entered in the balance sheet as deductions in the archiving provision.*

[38] *Fujitsu 2014: Description of Arsenal's system v. 1.2. 12 December 2014.*

Based on these figures, the personnel resources of the Office of Bankruptcy Ombudsman have been substantially larger than the personnel resources of Arsenal. It can also be noted that in proportion to the number of employees, Arsenal has had substantially larger economic resources at its disposal than the Office of Bankruptcy Ombudsman. At the same time, when examining the above figures, one should not make far-reaching conclusions about such issues as the efficiency of the organisations in question. Even though the tasks of Arsenal and the Office of Bankruptcy Ombudsman are similar, the tasks and the nature of operations of these two organisations are not directly comparable. There are also differences between the cost structures of the two organisations. For example, during the liquidation Arsenal has incurred substantial archiving costs. Cost comparisons are also made more difficult by the fact that Arsenal has received revenue from the bankruptcy estates in which it has undertaken to cover the costs. However, even when consideration is given to the above, it can be concluded that Arsenal has had substantial financial resources at its disposal during the liquidation, which have allowed it to carry out its tasks.

Summary

During the liquidation process, Arsenal has managed to cut its operating expenses to about one third of what they were at the start of the liquidation and it has not required new capital investments from the state. At the same time, however, administrative expenses (especially personnel costs) have remained more or less unchanged during the last stages of the liquidation.

It can be assumed that there will be further reductions in Arsenal's tasks. As until now the biggest challenge in such a situation is to adjust the cost structure to the reduction in operations. In this respect, one can also draw attention to the fact that there has been no significant reduction in the salaries and fees of the liquidators during the final stages of the liquidation even though there has been a continuous reduction in the tasks of Arsenal during the liquidation and the company's operations have been reduced. In principle, the fact that one of the two liquidators charges for his work on a hourly basis would allow the expenditure arising from the liquidators' salaries and fees to be adjusted in accordance with the reductions in the company's operations. In fact it would seem that in the total invoicing of the person concerned there was already a reduction in 2014 compared with the preceding year. Attention can also be drawn to the fact that Arsenal has had substantial financial resources in relation to the scope of its operations compared with such agencies as the Office of Bankruptcy Ombudsman. On this basis, too, it would seem that the operating resources of the asset management company can be reduced in the future.

3.2 Arsenal's operating practices during liquidation

The objectives of an asset management company differ substantially from the objectives of conventional business operations. It is clear that the operations of a company established with the purpose of managing a far-reaching crisis in the financial markets involve the dimension of serving the public interest. The steering system of an asset management company also differs from the manner in which conventional business operations are managed. This gives rise to the following questions: What is the legal normative basis for the steering of an asset management company (subchapter 3.2.1) and, related to the above, what are the special considerations that should be taken into account in the ownership steering of such a company (subchapter 3.2.2). Concerning the second question, attention can also be drawn to the following special feature characteristic of Arsenal's liquidation administration: In its operations, Arsenal has used the services of a company partially owned by one of the persons responsible for the administration of

Arsenal (liquidator). This may raise the question of a possible conflict of interest (subchapter 3.3.3).

3.2.1 Arsenal and the requirements of corporate governance

The central question from the perspective of the operations and steering of an asset management company is what can be required of the operations of such a company and what are the content-related principles that the company should observe. These questions are closely connected with the legal basis of the company's operations and what can be required of the company's operations and management on this basis. As regards the issues that are closely connected with the above-mentioned "good" qualitative operating practices of the company, the following observations and clarifications can be made.

The assumption is that Arsenal serves the public interest. On the one hand, the aim of the establishment of the asset management company has been to ensure that the bank crisis, which has had far-reaching impacts, can be managed in a controlled fashion. On the other hand, the clarifying objective, which is connected with the company's operations, is in many ways linked with the requirement of public interest.[39] The fact that the asset management company is closely connected with the Government Guarantee Fund (which was originally an off-budget entity established for the purpose of managing the bank crisis) suggests that the operations of the asset management company are public in nature. Moreover, the fact that the operations of the Government Guarantee Fund and Arsenal are on a statutory basis and that at statute level, too, (in the system of the Act on Government Guarantee Fund, which was repealed on 1 January 2015) closely interlinked, suggests that the operations of the asset management company are public in nature.

Thus, on the basis of what is said above, one could ask whether, in addition to the Limited Liability Companies Act, the provisions of the Administrative Procedure Act could also apply to the operations of an asset management company. Under section 2, subsection 3 of the Administrative Procedure Act (434/2003), the act is also applicable to the relationship between operators under private law when these are performing public administrative tasks. A private body performing a public administrative task can be organised as a private corporation, such as a limited liability company. The Administrative Procedure Act can also be applied to state-owned companies provided that they are managing public administrative tasks.

It would seem that the decisions made by Arsenal may affect the interests and rights of a wide range of different parties. However, one can hardly claim that the operations of Arsenal involve the exercise of public authority referred to in the Administrative Procedure Act or the provision of a public service. Especially during the liquidation, Arsenal's main task has been to recover remaining debts, sell remaining assets, manage court cases and to ensure that the company can recover its debts from bankruptcy estates. Characterising such activities, which basically come under private law, as a "public administrative task" is problematic. At the same time, the fact that the operations and purpose of an asset management company are connected with the serving of public interest hardly makes the company a private body managing a public administrative task. For example, in state-owned special assignment companies (such as Arsenal), the state also has more general objectives pertaining to society at large. However, this does not mean that these companies would be considered as managers of public administrative tasks and that the Administrative Procedure Act would apply to them.

As a result of what is said above, the requirement/principle of good administration referred to in the Administrative Procedure Act can probably not be applied to an asset management company or to a review of its operations.

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[39] *For more details, see subchapter 3.3.1.*

At the same time, however, the provisions of the Limited Liability Companies Act are applied to an asset management company. Thus, in principle the administration of an asset management company could also be examined on the basis of the principles governing corporate law. Administration of a limited liability company is as such as multidimensional concept and can be examined from many different perspectives. If in this report, the focus is on the perspective of (corporate) law, governance can be understood as a steering system under which the company's operations are managed and controlled and which involves principles that the company must, in addition to laws and official guidelines, take into account. These thematics are often described using the concept of corporate governance. The concept mainly refers to the entity of good and smooth decision-making and supervision.[40]

The concept of corporate governance is connected with various background theories, in which the thematics are examined from different aspects. Such theory constructions include the agency theory, stakeholder theory and the enlightened stakeholder theory. In the first-mentioned theory, the focus is on the examination of the conflict of interest between the principal (shareholder) and the agency (management) and the asymmetric distribution of information between the two parties. In addition to a conflict of interest between the management and owners, agency theories may also examine the conflict of interest between other stakeholders of the company (such as those between creditors and owners).[41] At the same time, it is emphasised in the stakeholder theories that a company should consider the interests of all those actors that have concluded agreements with it. In the enlightened stakeholder theory, stakeholders are seen as instruments in the achievement of the principal objective - increasing of shareholders' wealth.

Under the Government Resolution on State Ownership Policy (3 November 2011), the ownership policy is based on transparent and consequent owner conduct, proposing responsible expert members to company boards, owner's inputs to management resources and management commitment and consideration of the interests of all owners and interested parties.[42] State-owned companies are also expected to be familiar with Finnish and international corporate governance recommendations and comply with the best practices that are in accordance with them. Where applicable, the Finnish Corporate Governance Code is used as a model for the governance of and reporting by unlisted state-owned companies.[43]

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[40] The concept of corporate governance has features that leave room for interpretation. The concept can also be given a broad meaning in which it can refer to all types of regulation of internal company matters. In such cases, corporate governance is understood as an entity consisting of the rules under which wealth, power and responsibilities are divided between the main stakeholders of a limited liability company (shareholders, company management and creditors). The examination of the responsibilities based on the Limited Liability Companies Act and the norms closely related to it is central to this process. Of the broad interpretation of the concept of corporate governance, see Mähönen and Villa 2010, especially pp. 1, 3 and 77. Corporate governance can also be structured as a set of supplementary regulations similar to "best practices", which helps to clarify regulation based on law. In this report, the concept (mainly) refers to the narrow definition, which is probably also the most common way to describe corporate governance.

[41] Of the agency theory, see e.g. Mähönen and Villa 2010, pp. 86-87. The authors specifically connect the (broadly defined) concept of corporate governance with the agency theory. In this case, corporate governance means the relationship between the shareholders and company management and (mainly) the instruments used for resolving the conflict of interest between the two. At the same time, the authors point out that in addition to the relationship between the shareholders and the management, there are also other types of agency relationships in a company. All these relationships involve the risk of opportunistic behaviour and all these relationships are relevant in terms of corporate law. The purpose of regulation is to alleviate conflicts between different parties.

[42] Government Resolution on State Ownership Policy 3 November 2011, p. 4.

[43] Ibid. p. 5.

Based on the Government resolution on ownership policy it would seem that unlisted state-owned companies have discretion in the application of the corporate governance codes and that they must comply with applicable parts of these codes.

Under the Government resolution, the asset management company Arsenal is a special assignment company in which ownership steering is, as a result of the liquidation, "clearly different from normal companies."[44] Thus, one could ask to what extent - regardless of whether the company has been put into liquidation - corporate governance codes intended for a different operating environment can be applied to a company in this category that has been established to manage a bank crisis and administer bad loans. Applying these codes to an asset management company in liquidation is probably even more problematic. Thus, it seems unclear to what extent the normal objectives and operating principles laid out for special assignment companies can be applied to a company in liquidation. On the other hand, the focus in Arsenal's operations during the liquidation has been on the recovery of the remaining debts, court cases and winding down of the group companies. The aims and operating practices of such a company, that focuses on the winding down of the operations and measures of legal nature (such as investigating irregularities), are significantly different from those of going concern companies. This is because the governance codes are intended to ensure compliance with the principles of corporate governance in such companies.

It is clear, however, that the operations of Arsenal have been steered with a broad range of different guidelines. The operations of the asset management company have been steered with the guidelines issued by a guidelines committee, which has also approved the credit management manual, the principal set of guidelines used by the company in its debt recovery operations. The clarifying objective, the main principle steering the company's operations, is also laid out in the credit management manual. Thus one could think that the guidelines and the company's ownership-steering structure are connected with corporate governance requirements. It might also be that certain principles used as a basis for corporate governance, such as ensuring openness and transparency, are applicable to an asset management company.

Governance in an asset management company can also be assessed on the basis of the theories behind the concept of corporate governance. First, one can ask whether the conflict of interest between the management and owners referred to in the agency theory or the information imbalance are relevant to the operations of an asset management company. In such cases, it should also be assessed how the above-mentioned problems could manifest themselves in an asset management company, which engages in operations that are substantially different from those in an ordinary business.

One could also ask what are the stakeholders whose needs an asset management company is expected to serve. In an asset management company intended to serve as a tool for managing a bank crisis, the circle of interested parties is wider than in a company engaged in ordinary business operations. The purpose of an asset management company that has assumed responsibility for the management of bad debts has been to balance the operations of the banking sector, which in turn may have more far-reaching impacts on the national economy. Investigating the irregularities in debtors' activities can also be justified with the requirement of public interest. It also follows from the clarifying objective that there may not be any reason to give priority to financial gains in the debt recovery operations performed by the company. Debt recovery operations connected with bankruptcies in which Arsenal has undertaken to cover the costs may also benefit other creditors (such as the tax authorities). It may also be necessary to assess how an asset management company acts in relation to debtors and how in this respect it takes into account the wider impacts of its action on the national economy, position of the debtors or the aspects connected with the activities of the debtors. In fact, it would seem that the stakeholder in-

[44] *Ibid. p. 17.*

terests that an asset management company must take into account in its operations are significantly different from the interests guiding ordinary business operations.

Based on what is stated above, it is safe to say that the operations of an asset management company are connected with the corporate governance requirements based on corporate law. It would, however, seem that there are special features characterising the operations of an asset management company and that, consequently, the operations of such a company are significantly different from ordinary business operations. These special features are also relevant to what kind of corporate governance requirements are set for an asset management company and what is the content of this corporate governance in day-to-day operations.

Summary

As described above, there are special features characterising the operations of an asset management company that make such companies different from ordinary businesses. Thus it can be asked what are the corporate governance principles that an asset management company must follow in its operations and what are the corporate governance requirements that can be laid out for such a company.

One option is to examine what kind of general requirements should be laid out for a successful asset management company. In international comparative research on asset management companies, the view is that such companies can only operate in a smoothly functioning legislative environment. An asset management company must also have an adequate capital base and it must be possible to convert the assets transferred to it into liquid form. Specific requirements can also be laid out for the organisation and administration of the asset management company. The company must have professionally competent management[45] and a smoothly functioning organisational infrastructure. The company's operations must also be open and transparent. Furthermore, the company must be sufficiently independent in relation to political decision-makers.[46]

Especially the two last-mentioned criteria referred to above (openness and independence) are closely connected with the requirement laid out for the content of corporate governance and ownership steering of an asset management company. This question is discussed in subchapter 3.2.2. Conceptual support for the examination of these themes can be derived from the above-mentioned theories behind corporate governance, in which the conflict of interest between the management and the owners and stakeholder interests are highlighted. The operations of an asset management company may, especially during liquidation, involve a conflict of interest between owners and the company management and risks of other conflicts of interest that are connected with the contractual arrangements between the asset management company and a company associated with a person in a managerial position in the company (liquidator). This question is discussed in subchapter 3.2.3 below.

If the concept of corporate governance is understood in a broad sense, it can be said with some certainty that it is also connected with the clarifying objective (or clafying interest), the principle guiding the operations of an asset management company. This question is also discussed in subchapter 3.3.1 below.

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[45] There are also references to the requirement concerning the professional competence of the management in the Resolution Act. Under chapter 11, section 2, subsection 1 of the act, the management and personnel of an asset management company must have adequate professional competence for managing the assets of the asset management company. There are no specific references in the preparatory document for the act to what is meant by the professional competence requirement laid down in the provision.

[46] See Klingebiel 2000, p. 5. It should be noted that these criteria are not necessarily mutually exclusive. For example, smoothly functioning infrastructure and professional management competence may coexist with openness and transparency. In fact in this report, these requirements should be understood as a basis for review (or a thinking tool) that makes it possible to structure the concept of corporate governance.

3.2.2 Ownership steering of Arsenal

As described above, one prerequisite for a successful asset management company could be independence in relation to the political decision-making process. Administrative independence of an asset management company can be important for a variety of reasons. First of all, it is possible that in a far-reaching crisis in the financial markets, public debate may get heated. In practice, this may mean that in the public debate, efforts are made to find parties responsible for the crisis.[47] In such a situation, there may be a danger that political decision-makers try to steer the operations of the asset management company in a manner that is not in accordance with the company's basic objectives.

The independence of the asset management company in relation to political decision-makers may also refer to a situation where the company can in general perform the business transactions that are in accordance with its strategy in an independent, consequent and long-term manner. As part of this process, it may also be expected that the persons appointed to the operative management of the company are in a position to perform the tasks concerning the operations of the asset management company, which are often demanding. Management members appointed to their posts on political grounds do not necessarily have such capabilities.

The administrative independence of an asset management company may also be important in situations where there is public criticism of specific measures taken by the company. In such cases it may not necessarily be appropriate if political decision-makers are in a position to influence the execution of specific transactions.

Even though the asset management company is basically a corporation under private law, it is clear that it must also consider public interest in its operations. One could think that as a result of the requirement of public interest, the asset management company should, at least in certain respects, be independent in relation to political decision-makers. For example, in its governance, the asset management company should perhaps take into account matters that are usually associated with general legal principles of governance or the principles of corporate governance in general. Direct influence of political decision-makers on the operations of an asset management company might in certain situations run counter to these principles. The principles of administrative law that may have natural *analogical* connections with the operations of an asset management company could include the requirement for objectivity, requirement for equal and non-discriminatory treatment and openness characteristic of the activities of the authorities.[48]

Since the establishment of the company, openness of operations and information provision has been the principle guiding Arsenal's operations. This has also included the principle of equal treatment of debtors. Thus it can also be assumed that in general the operations of an asset management company should not be based on objectives that are alien to the nature of its operations (such as favouring specific parties). An asset management company must, in the same way as the authorities, make its decisions in an impartial manner and be able to justify its decisions in an objective manner.

In terms of their content, the above-mentioned operating practices adopted by Arsenal resemble the general legal principles observed in public administration. For example, the most important non-discriminatory principle in administrative law is the requirement that customers are treated equally and in a consistent manner. At the same time, it could also be assumed that these

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[47] *During far-reaching crises in the financial markets, the issue of the lack of ethics (so called moral hazard) among market actors is often highlighted in the public debate. There may also be attempts to find parties responsible for the events.*

[48] *Section 6 of the Administrative Procedure Act (434/2003) lists five central legal principles of administration: equality, exercise of competence for acceptable purposes, impartiality, proportionality and protection of legitimate expectations. The requirement of openness can be considered to be included in the openness principle laid down in administrative law.*

principles are part of the observance of good banking and business practices, which are contained in the credit management manual, Arsenal's most important set of internal guidelines. Thus, the requirements of openness and non-discriminatory treatment could also be linked to the observance of the ban on improper conduct, which is the central principle in property law. It is also possible that the management's duty of care laid down in corporate law, which specifically obliges the management to pursue the company's interest, may in certain situations restrict the management's freedom of action in the same manner as the general principles referred to above. One could think that on the basis of the above-mentioned characteristics, which are relevant to both private and public law, an asset management company operates in the interface of private and public law.

In principle there is a risk that political decision-makers try to influence the operations of an asset management company in a manner that runs counter to the general principles referred to above. For example, political decision-makers might try to influence the operations of an asset management company by persuading it to enter into a voluntary debt adjustment arrangement with a party close to a specific political grouping. Such an arrangement might be considered to be in violation of the requirement of non-discriminatory treatment and it may not be possible to find objective justification for such conduct either.

As stated in subchapter 2.1, a broad range of different organs have taken part in the steering and supervision of Arsenal during the company's operations. The Ministry of Finance has been responsible for most aspects of the ownership steering of the company. The governing body, auditing committee and the guidelines committee of the Government Guarantee Fund have also taken part in the supervision of the company. The auditing committee was dissolved in 2003 and the guidelines committee in 2010.[49] When Arsenal was put into liquidation, the scope of steering and supervision of the company was reduced. Decision-making in the company has largely been on the basis of approved general operating guidelines. Reducing the scope of the ownership steering can be considered to have been appropriate in a situation where the operating volumes of the company were shrinking.

As a whole, Arsenal's operations have been supervised by a large number of different parties and the company has also been subject to ownership steering of the Ministry of Finance. Based on the audit observations, it would seem that at least during the liquidation, the company has operated in a fairly independent manner in relation to political decision-makers. Nothing in the audit results suggested that political decision-makers have influenced the operations of the company in a harmful manner during the liquidation.

The most important factor in the independence of the asset management company in relation to political decision-makers is the way in which the company is structured (adequate recapitalisation, legal structures of the company administration, composition of the top management, etc.). The actual independence of the company may, however, also be substantially affected by the type of interaction between the company and its operating environment.[50]

Such parties as debtors may be critical of the way in which the asset management company operates. This means that the company may not be able to operate successfully if it loses the trust of political decision-makers or the public at large. There has been criticism of Arsenal's operations for the whole duration of its life cycle and some of the criticism has been quite strong. However, nothing in the audit results indicates that Arsenal has been in danger of losing the trust of its operating environment during its operations in a manner that would have limited its actual freedom of operations.[51]

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[49] *For more details, see subchapter 2.1.*

[50] *Of the role of actual trust in the operating environment, see also Bergström et al. 2003, p.1.*

[51] *It is often believed that the openness (or transparency) of an organisation makes it easier to create trust in the operations of the organisation. On this basis, it would be natural to assume that structures and operating models promoting openness and transparency would help to strengthen trust in the opera-*

Even though the political supervision of the asset management company may involve certain risks, it should also be noted that open supervision can ensure the transparency of the company's operations. As described above, the last-mentioned factor has also been considered as one of the prerequisites of success of the asset management company. Openness is also connected with the general principles of administrative law. Furthermore, openness can be considered as the central principle of corporate governance in corporate law and efforts are made to strengthen it by such means as corporate governance guidelines.[52]

After the dissolution of the guidelines committee, the Ministry of Finance has been the only party directly steering Arsenal during the liquidation. The supervision by the governing body of the Government Guarantee Fund has been of more indirect nature. Its role has been largely limited to requesting reports from Arsenal on matters that are of interest to the governing body. The governing body has also received information on Arsenal's operations and finances as part of the financial statements of the Government Guarantee Fund and at meetings where an Arsenal representative has given a briefing of the company's situation.

As part of the ownership steering, the Ministry of Finance and Arsenal have maintained contacts by formal and informal means. After being put into liquidation, Arsenal has agreed on submitting regular reports to the Government Guarantee Fund and the ministry responsible for the company. At the start of the liquidation, reports were submitted twice a month but after that, at the ministry's request, reports have only been submitted on a monthly basis. The reports give the main key indicators, major decisions and events (such as the details of the most important court cases) and the events affecting the company's finances. The reports also follow trends in budgeted revenue and expenditure and in the most important balance sheet items. Arsenal has also submitted the minutes of the meetings of the liquidators (without appendices). On average, reporting meetings have been held on a twice-yearly basis. In addition, contacts have also been maintained by more informal means, mostly without documentation.

The contacts between the public servant representing the ministry and the liquidation administration have been in accordance with the guidelines laid down in the Government resolution on ownership steering. Under the resolution, the ministry responsible for ownership steering is expected to be in contact with the company's board and management and monitor the company between general meetings.

Based on the audit observations, it would seem that the steering of Arsenal by the Ministry of Finance has been of more passive nature during the liquidation than before it. In the owner's view, Arsenal's operations have been so well-established that the Ministry of Finance has not deemed it necessary to discuss the principles governing the company's operations. Moreover, the Ministry of Finance has not had any specific information on the remuneration arrangements of the asset management company. It would seem that there has not been any discussion at the general meetings of alternative ways of managing the final stages of protracted debt recovery

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tions of the asset management company. These factors would also make it easier for the company to succeed in the task given to it. At the same time, however, due to the nature of the asset management company, there are also factors limiting the openness and transparency of its operations. These factors include bank secrecy and the need to protect business secrets.

[52] *The requirement for openness (or transparency) may be relevant to the operations of an asset management company in many respects. First of all, transferring banks' bad balance sheet items to an asset management company may increase market trust in "healthy" banks. As a result, bank customers no longer need to suspect that banks have bad assets in their balance sheets and that the risks contained in the assets might be realised at some point. Thus, an asset management company also helps to make markets more open. At the same time, openness may also be connected with the valuation of the assets transferred to the asset management company. Assessment of the financial position of the banks (or the asset management company) may require that no attempts are made to hide the problems connected with the asset items in question. Openness may also refer to the transparency of the administrative structures of the asset management company.*

processes. However, there has been discussion in the Ministry of Finance recently on the fact that some of the legal processes connected with the recovery of debts will last so long that it is not practicable to maintain the existing company structure until the end of Arsenal's operations. At the time of the audit, the Ministry of Finance did not know when the company would be dissolved.

As described above, the asset management company should be sufficiently independent in relation to the political decision-making process. As has been stated above, this view can also be justified with the fact that the operations of such a company involve the public interest dimension. At the same time, one can also hold the view that the operations of a company involving the public interest dimension should be controlled by its owners. Special assignment companies (such as Arsenal), are often considered to be a combination of "state administration operating in company form" and business operations. Such companies are usually closely connected with the tasks of the steering authority. In such a situation, it is desirable that the owners have relatively tight control over the company.

The need for active ownership steering could also be justified with the fact that it is impossible to fully determine the profitability of an asset management company on the basis of market-oriented indicators.[53] In such a situation one can ask: How cost-effectively is the company performing the tasks laid out for it by the Ministry of Finance?[54]

Stronger ownership steering could perhaps be justified with the principles of corporate governance based on corporate law and the way in which they relate to the requirements of openness and transparency. A relative low level of owner control may in principle lead to a situation where, as laid out in the agency theory, information is unevenly distributed between the management and owners of the asset management company.[55]

When the questions concerning the distribution of information are examined attention should also be paid to the potential conflict of interest between the management and the owners. If there is a conflict of interest concerning the operations of the company between the owners and the management and if the information on the company is not conveyed to the owners in a manner that gives the owners an adequate overall picture of the company's operations, there may be a situation where the company's operations are directed in accordance with the management's interests even though these interests may not correspond with the owners' wishes. The fact that as a result of inadequate provision of information ownership control is more or less formal may make such a situation more likely.

In an asset management company, the conflict of interest between the management and the owners may be connected with the duration of the company's operational life cycle. Already in the preparatory document for the Act on Government Guarantee Fund (HE 130/1993 vp) it was emphasised that the assets transferred to the asset management company should be quickly realised. In its legislative proposal, the Government estimated that the asset management company would remain operational for between five and seven years. Likewise, a liquidation, in which Arsenal was put in 2003, is generally expected to lead to a rapid winding down of a company's operations.

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[53] *This specifically refers to the aims of the clarifying objective.*

[54] *Parliamentary Audit Committee 2010, p. 17.*

[55] *Because of the problem of information imbalance it may also be better to transfer bad assets to an asset management company instead of liquidating them in a crisis situation ("fire sales"). If in such a situation efforts are made to sell bad assets to an outsider, the seller often has a better idea of the content of the assets in question than the potential buyer. Information imbalance and the risk connected with it may in such situations drive down the price offered for the bad assets. In many cases, transferring bad assets to an asset management company makes it possible to realise the assets in a more long-term manner, in which case the effects of the information imbalance can often be limited. Of the last mentioned problems, see Bergström et al. 2003, pp. 2-3.*

In principle, it is possible that a rapid winding down of the company's operations is not necessarily in the interests of the management and/or the personnel of the asset management company. The winding down of the company also means the end of the employment relationships of the parties concerned and the loss of the financial benefits associated with them.[56] In principle the substantial cash reserves of the asset management company might allow the company to remain operational for many years. The passive approach of the owner, which may be based on inadequate information may allow the asset management company to continue its operations in a manner that is against the owner's interests.

Based on the audit observations, the ownership steering during the liquidation has been characterised by certain degree of passivity and the flow of information between the owner and the company management has not been entirely balanced. The owner's main role has been to receive information from Arsenal, which has been of fairly general nature, and the state owner may not have not been provided with all the concrete information connected with Arsenal's operations. At the same time, however, it seems that the state owner has accepted the operating principles of the asset management company and there have not been any clear motive-based disagreements between the state owner and the company management. Even though the relationship between the company and the owner has involved risks concerning information balance and ownership steering, it would seem that the realisation of these risks has not led to a situation where the company has been managed in a manner that has been against the owner's wishes.

Summary

In the chapter above, there has been discussion on a broad range of different questions that may be relevant when it is assessed whether the operations of an asset management company are in compliance with corporate governance requirements. When the questions are examined, the administrative independence of the asset management company may be one important factor. The second important factor that warrants consideration might be the openness and transparency of the company's operations. In the chapter above, we have also clarified the issues that are contained in the general principles guiding the operations of the asset management company and that should be taken into account when the importance of these principles is assessed. The conclusion is that the principles can mainly be characterised as flexible weighing norms the importance of which should be determined on a case-by-case basis. It has also been highlighted above that the operations of Arsenal have involved certain risks concerning the flow of information and ownership steering.

One might also ask whether openness and transparency should be emphasised in the operations of an asset management company. It might be worth examining whether it would be appropriate to draw up corporate governance guidelines specifically tailored for an asset management company in which consideration is given to the special characteristics of such a company. Such a set of corporate governance guidelines would be a public document unlike the Arsenal-internal guidelines, which are, as a rule, considered business secrets.[57] The corporate governance guidelines could, as applicable, be based on Arsenal's existing internal guidelines.

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[56] *Of the possibility of such a conflict of interest in the management of the asset management company, see Bergström et al. 2003, pp. 10-12. The authors are of the view that a passive approach of the owner increases the risk of a conflict of interest. It would seem that the management of Securum, the company established to manage the Swedish bank crisis, had wide powers to manage the company without the active supervision of the owners.*

[57] *For example, in agency theories, corporate governance is primarily understood as an instrument for alleviating the conflict of interest between different stakeholders in a company. In an asset management company, the conflict of interest is not limited to the relations between owners, management and creditors. In fact, one could think that in such a corporation operating under private law, which is clearly serving the public interest, there is a conflict between these roles (private and public role). One aim of*

3.2.3 Risk concerning lack of impartiality in the operations of an asset management company

In the above chapter, we have discussed the conflict of interest between the management and owners of an asset management company from the perspective of corporate governance requirements based on corporate law and the background theories connected with them. It has emerged during the liquidation, that there has also been a potential for conflicts of interest concerning one of the Arsenal liquidators and a company associated with him. These potential conflicts are clearly of legal nature and they are assessed on the basis of legal norms concerning lack of impartiality.

One character specific to Arsenal is that one of the two liquidators managing the liquidation process is a lawyer. The person in question invoices Arsenal for the work done in the same manner as a lawyer and he does not receive a fixed monthly salary from the company. Arsenal has also used the legal services of the law firm in which the liquidator in question is a shareholder. The liquidator in question has not approved any of the invoices submitted by the law firm that he partially owns or his own invoices on behalf of Arsenal. He has, however, taken part in decision-making concerning assignments in the asset management company. Such a situation may give rise to a question, which has also been asked in public, whether there is a conflict of interest between the asset management company and the liquidator in question.

Provisions in the Limited Liability Companies Act, under which it is also possible to assess the question of a conflict of interest, are applied to Arsenal. Under chapter 20, section 9, subsection 1 of the Limited Liability Companies Act, the provisions of the Limited Liability Companies Act applying to the members of the Board of Directors are applied to liquidators unless otherwise provided in the provisions of the chapter. Under subsection 2 of the section, the liquidators shall manage the affairs of the company during the liquidation.

Under chapter 6, section 4 of the Limited Liability Companies Act, a member of the Board of Directors may not take part in the consideration of a matter pertaining to an agreement between the member in question and the company. Likewise, the member in question may not take part in the consideration of a matter pertaining to an agreement between the company and a third party if the member in question can expect material benefits from the matter and the benefits may be contrary to the interests of the company. The provisions pertaining to the agreement referred to in the section are also applied to other legal acts and legal processes and the use of other right to be heard. As the provisions of the Limited Liability Companies Act pertaining to members of the Board also apply to liquidators, any lack of impartiality of the liquidators is assessed on the basis of this provision.

Under the above-mentioned provision, a liquidator may not take part in the consideration of a matter between the company and a third party (in this case a law firm) if the liquidator can expect material benefits as a result and the benefits may be contrary to the interests of the company.

It is not necessary to show that the arising of the lack of impartiality referred to in chapter 6, section 4 of the Limited Liability Companies Act has resulted from an actual conflict of interest. It is only required that, based on an objective assessment, such a conflict may exist. Likewise, lack of impartiality may also arise even if a liquidator is not personally a party to a contractual arrangement with the company. Lack of impartiality may also result from a sufficiently strong indirect interest that is based on a stake in a contractual partner of the company. In fact, compa-

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corporate governance in an asset management company could be to alleviate this conflict. The public corporate governance guidelines might allow an asset management company to emphasise openness, a typical feature of a public sector organisation. At the same time, however, such guidelines could also in other respects (as applicable) emphasise the requirements characteristic of the public sector, such as objectivity and fairness.

nies often act with certain care in situations where lack of impartiality may arise. In practice this means that a member of the Board (or the liquidator) should not take part in decision-making in situations that might involve lack of impartiality.

In the case concerned, the law firm partially owned by the person working as Arsenal liquidator has received 67 assignments after the start of the liquidation. The invoicing for these assignments has accounted for slightly more than four per cent of the law firm's turnover in recent years. The liquidator in question has owned about ten per cent of the law firm. The invoicing for the assignments has accounted for about 15 per cent of the total Arsenal invoicing for court cases.

Considering the fact that in case law there are no explicit principles concerning the interpretation of chapter 6, section 4 of the Limited Liability Companies Act, it is difficult to assess whether there has been any lack of impartiality. Based on audit observations, one can, however, say with some degree of certainty that the liquidator referred to above has not received any substantial direct financial benefits as a result of the assignments received by his law firm from Arsenal. Thus, this would suggest that there has not been any lack of impartiality, as referred to in the Limited Liability Companies Act, in the activities of the liquidator in question.

Originally (in 2003) two external liquidators were appointed for Arsenal. The two liquidators were selected on the basis of tenders requested from law firms. In their tenders, the law firms pointed out that the other legal resources of the law firms would also be available to the asset management company in matters pertaining to the liquidation. This could indicate that giving assignments to the liquidators' law firms has been the intention of the parties from the outset.[58] In other respects, too, the audit observations indicate that the state owners (State of Finland and the Government Guarantee Fund) have known that the law firm partially owned by the remaining liquidator would be given work assignments. The State of Finland and the Government Guarantee Fund have been the only shareholders in Arsenal. Thus, one can probably assume that any lack of impartiality of the liquidator referred to above would, on the basis of actual approval by the state owner, no longer be of any importance anyway.

In addition to the situation referred to above, the issue concerning the lack of impartiality has also come to the fore in a case where a business partner of the lawyer serving as Arsenal liquidator had worked as an estate administrator in a bankruptcy estate in which Arsenal had been a major creditor. In his reply dated 17 January 2014 to a request for information submitted by a debtor in the bankruptcy (39/31/2013), the Bankruptcy Ombudsman concluded that under the Bankruptcy Act (120/2004) the estate administrator in question should have been disqualified from working as an estate administrator. As none of the parties entitled to submitting an application had sought the replacement of the liquidator during a period of more than ten years, the Bankruptcy Ombudsman was of the view that the relieving of the estate administrator of his duties and the appointment of a new administrator would not have been appropriate.[59]

If in the future the administrative arrangements in a state-owned company involve potential lack of impartiality, adequate consideration should already be given to matters important in the consideration of the issue in the planning of the arrangements. For example, it would be appropriate if such a legal risk would already be assessed in a clear and documented manner in advance. Attention should also be drawn to the risks pertaining to the lack of impartiality of the estate administrator if it is decided to use the asset management company as a tool for resolving bank or financial crises in the future.

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[58] *Since 2004 there has only been one liquidator.*

[59] *The lack of impartiality issue referred to above was also mentioned in a decision on a complaint made by the National Audit Office on 1 October 2014 (39/34/2014).*

3.3 Clarifying objective as a principle guiding Arsenal's operations

3.3.1 Conceptual dimensions of the clarifying objective

If the concept of corporate governance is understood in a broad sense, it can be said with some certainty that it is also connected with the clarifying objective (or clarifying interest), the main principle guiding the operations of an asset management company. As described above, the conflict of interest between the management and the owners of an asset management company could concern the duration of the company's life cycle. The clarifying objective has been one of the main reasons why Arsenal has remained operational for considerably longer than was anticipated at the establishment of the company. There are reasons to believe that the implementation of the clarifying objective in particular has been a source of conflict between Arsenal and the debtors. On this basis, the clarifying objective could be considered to have connections with the agency theory. On the other hand, one could also, using stakeholder theories as a basis, assume that the purpose of the company is to serve a "wider" public interest. Furthermore, one has the right to expect that in the application of the clarifying objective, consideration is also given to the limitations concerning discretion and the rights of the debtor/defendant. This in turn would mean that when the principle is applied consideration should also be given to the last-mentioned parties as a stakeholder of the asset management company.

It should be noted, however, that the clarifying objective is, in addition to the requirements of corporate governance, also connected with many other legal concepts and principles. One could assume that in conceptual terms the principle is connected with the liquidation procedure referred to in the Limited Liability Companies Act, the material principles of bankruptcy proceedings, public receivership laid down in the Bankruptcy Act, protection against self-incrimination, clarifying objective concerning offences as laid out in criminal procedure and deterrence theories in criminal law. In fact, the clarifying objective could be characterised as a (cross-)legal hybrid principle, which guides the asset management company in the investigation of the irregularities in debtors' activities. As regards the setting of objectives for this audit, the concept of clarifying objective can be specified as follows.

The operations of the asset management company Arsenal are based on section 2, subsection 4 of the Act on Government Guarantee Fund (379/1992), which was repealed on 1 January 2015. Under the subsection the fund can own shares in the asset management company referred to in the subsection in question. The tasks and purpose of the asset management company have been specified in the preparatory document for the act.

In its report on amending the Act on Government Guarantee Fund (TaVM 29/1993 vp), the Parliamentary Commerce Committee expressed an opinion that the provisions on the asset management company should not provide the company with too detailed steering as it is difficult to predict the situations that the company will face in its day-to-day operations. According to the committee, too detailed provisions could interfere with the company's day-to-day operations in a manner that would be against its operating principle.[60]

Arsenal has built its operations around two main operating principles: minimising central government losses and clarifying objective. As regards the central government interest, the Government proposal HE 130/1993 vp stated the following: *"The main purpose of the company's operations is the realisation of the assets, credits, real estate, real estate and housing company shares or other assets as efficiently and productively as possible so that the losses incurred by central government as a result of its operations can be minimised."*

[60] *TaVM 29/1993 vp – HE 130/1993 vp.*

At the same time, the operating principle behind the clarifying objective is based on the parliamentary opinions concerning increased openness of bank subsidies and investigation of irregularities. In its report (VaVM 35/1993 vp), the Parliamentary Finance Committee stated that "*the bank subsidies should be subjected to more public scrutiny and all economically significant credit losses should be thoroughly investigated in connection with the granting of the bank subsidies and the granting of the subsidies should be made conditional on investigating the credit losses. Investigated cases involving suspected crimes and offences should be brought before a court, which would make them open to public scrutiny. In special audits, opinions should also be expressed on the irregularities in which liability for damages and criminal liability has expired.*"

Furthermore, in its report TaVM 29/1993 vp, the Parliamentary Commerce Committee stated: "The management of the assets transferred to the asset management company should be organised so that the company can maximise the benefits arising from the arrangements. In the manner described above, this also applies to the realisation of the company's assets. In the view of the Committee, the benefits generated by the asset management company also include the indirect benefits incurred by banks when, as a result of the recovery in other areas of their business operations, they are able to manage and monitor problem customers effectively."

It would seem that according to the preparatory document for the act referred to above, the main purpose of Arsenal is to manage and sell assets in its possession so that the financial results generated by the sales can be maximised. It would also seem that in the achievement of the last-mentioned objective, consideration should, in addition to monetary recovery performance, also be given to other factors, such as ensuring smooth functioning of the markets. At the same time, however, even though the emphasis in the preparatory document (especially in the Government proposal) was on the speed of the debt recovery operations, the Parliamentary Commerce Committee also stated in its report that in these operations consideration should also be given to other interests. Such factors could include revitalisation of customers' operations or controlled winding down of their business. Especially on the basis of the observations made by the Parliamentary Commerce Committee, one can reach the general conclusion that the committee has given priority to case-specific factors in the realisation of assets. It would also seem that the assessment of asset realisation should be based on a comprehensive evaluation of benefits and disadvantages.[61] Furthermore, it would seem that from the outset the intention has been that the principles guiding Arsenal's operations should be flexible so that the company can, within the framework of these principles, react to situations that are difficult to anticipate.

The clarifying objective has proved to be an important element in Arsenal's operations. In its report VaVM 15/1996 vp, the Parliamentary Finance Committee stated as follows: *"Even though the court processes involving banks are unlikely to bring any financial benefits to taxpayers, from the perspective of general sense of justice, it is important that the cases involving damages are thoroughly investigated. As action can only be brought for violations of legal provisions or the banks' own guidelines, the Committee is fairly certain that a large proportion of the failures resulting in substantial losses will remain uninvestigated. Some of the cases have expired, which means that it has not been possible to bring the perpetrators to justice. The Committee is of the view that the citizens' sense of justice requires that despite the expiry of the cases, the matters concerning liabilities in the bank crisis are investigated."*[62]

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[61] *Of the role of Arsenal's operating policies laid out as part of the preparatory document, see also Lehtiö 2004, p. 300. According to the author, the purpose of the policies has been to emphasise controlled management and, in addition to minimising losses incurred by the state, consideration has also been given to the impact of the operations on the markets.*

[62] *In his reply to Parliament on 14 September 1994 (KK 505/1994), the Minister of Finance also emphasised the importance of the clarifying objective: "In order to minimise the losses incurred by central government, it is important to investigate any harmful measures taken in connection with the financing and*

In its report VaVM 15/1996 vp, the Parliamentary Finance Committee emphasised the role of the special audits and bank trials coordinated by the Government Guarantee Fund and the transparency and openness of the procedures concerning the support received by banks. In its report, the committee also emphasised that the issue of damages arising from the banks' operations should be examined. However, the clarifying objective has not been limited to the investigation of liability for damages under civil law and the consideration of the resulting claims for damages in courts. In practice, the clarifying objective has become the general principle guiding Arsenal's operations and its application has led to the investigation of a broad range of objectionable activities carried out by debtors. In many cases, irregularities have been investigated as part of the bankruptcy procedure. Such cases have often involved a situation where Arsenal has undertaken to cover the costs of a specific party in a bankruptcy, which has allowed a debtor's activities to be investigated as part of the insolvency proceedings. Criminal justice matters connected with the debtor's activities and the investigation of these matters in a criminal procedure may also have arisen in such situations.

The clarifying objective, which has been adopted as the central principle guiding Arsenal's operations, is often understood, in the manner referred to above, to mean that possible irregularities in debtor's activities are investigated. At the same time, in accordance with the principle, the asset management company does not have any (business) cooperation with debtors whose operations involve legal irregularities.

Operating on the basis of the clarifying objective has also been justified by stating that such an approach can help to prevent possible abuses. If Arsenal's operations can be considered to prevent criminal or otherwise objectionable activities, the clarifying objective may also involve a preventive dimension.[63]

Even though an asset management company is an arrangement based on private law, its operations can be considered to serve the public interest. The purpose of such an arrangement is to ensure that a bank crisis that can affect all areas of the national economy can be managed in the desired manner. It can also be considered that the purpose of serving the public interest is connected with the concept of clarifying objective. Investigation of irregularities in debtors' activities can be deemed to serve the public interest.

Furthermore, it can also be considered that the requirement of public interest is connected with the assessment of the financial rationality of the debt recovery operations. Especially in situations where entities subject to debt recovery are associated with substantial credit losses Arsenal has often undertaken to cover the costs of the bankruptcy estates. This has made it possible to investigate irregularities in debtors' activities in situations where the bankruptcy would otherwise have expired as a result of insufficient funds. One can also assume that in such situations Arsenal has played the same role as the public receivership procedure which was introduced in 2004.

The existence of the clarifying objective is not directly based on the law and there is no legal definition for it. It would thus seem that the principle has "evolved" through opinions issued by parliamentary committees and parliamentary debate and become part of Arsenal's operating practices.

The concept of clarifying objective has also been incorporated in the internal guidelines of the asset management company. In the credit management manual, which was approved at the annual general meeting of the asset management company on 3 February 1995, the main content of the principle is defined as follows:

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to identify the persons responsible for the measures. This clarifying objective may actually be more important than the explicit objective of ensuring the most profitable course of action."

[63] *It has also been mentioned in the preparatory document for the Resolution Act that the clarifying objective may prevent abuses (see HE 175/2014 vp, p. 115).*

- If there are irregularities in the credit relationship investigating them may, on a case-by-case bases, be given priority over financial considerations.
- No assets kept as security shall be sold to a company/entrepreneur that has caused bad debts to be entered in the accounts or their close associates referred to in section 3 of the Act on the Recovery of Assets to a Bankruptcy Estate. In exceptional cases, the sale can be approved if a special audit or a statement issued by the estate administrator shows that the bankruptcy does not involve any irregularities and the sales serve Arsenal's interests.
- In situations where the abandonment of the investigation of the irregularities is set as a condition for receiving financial gains, priority is given to the clarifying objective.[64]

The credit management manual, which guides Arsenal's operations, was prepared after the establishment of the company and was frequently updated, especially during the early stages of Arsenal's operations.[65] The manual has also provided effective steering for Arsenal's debt recovery operations during the liquidation. By approving, as part of its tasks, the principles concerning the recovery of the debts of credit customers with large debts and their debt adjustment arrangements, the guidelines committee also made an important contribution to the steering of Arsenal's credit management. The committee adopted the principles by approving Arsenal's existing credit management manual on 17 December 1999. When approving the document, the committee also stated that it was no longer necessary to set out separate principles concerning the recovery of debts and debt adjustment. The guidelines committee also provided Arsenal with guidelines in the management of what were called savings bank trials and in the collection of the compensations that salaried employees and elected representatives of the savings banks had been ordered to pay and in the payment arrangements. Under the general guideline issued by the guidelines committee, Arsenal has, since 1 April 2009, been able to make independent decisions on contractual arrangements concerning compensations.

Summary

The operations of the asset management company can be considered to serve the public interest. The main purpose of such an arrangement is to ensure that a bank crisis affecting all aspects of the national economy can be managed in a controlled fashion. Investigation of irregularities in debtors' activities on the basis of the clarifying objective can also be deemed to serve the public interest.

During Arsenal's existence, the clarifying objective has evolved into a principle that has strongly steered the company's operations. For example, the clarifying objective has been one of the main reasons why the company has remained operational much longer than anticipated at its establishment. It was also observed in the audit that the regulation of the company's operations, which had intentionally been put on a flexible basis when Arsenal was established, has during the company's existence evolved into a fairly detailed set of credit management guidelines that is based on the principles laid out by the annual general meeting that steer the company's operations. The main content of the clarifying objective is also documented in the credit management manual.

[64] *Asset Management Company Arsenal Ltd Credit management manual.*

[65] *See also Lehtiö 2004, pp. 307-308. According to Lehtiö, an asset management company was a new concept in Finland and it was natural that the operating procedures of Arsenal only took shape after the establishment of the company when the executive management and the Board had to give their opinions on operational issues.*

3.3.2 Impact of the changes in Arsenal's operating practices and operating environment on the application of the clarifying objective

The clarifying objective (or clarifying interest) does not necessarily mean that the asset management company should investigate all irregularities in debtors' activities. Certain changes in the regulatory environment of the asset management company might also make it difficult to act in accordance with the principle. Moreover, the public receivership procedure provides an alternative to the investigation of the debtors' activities by the asset management company. The above-mention issues, which in practice might have an impact on the content and implementation of the clarifying objective, are discussed in more detail below.

Public receivership

Public receivership, which was introduced in 2004 and provisions on which are contained in chapter 11 of the Bankruptcy Act, is in most cases an alternative to a situation where a bankruptcy may otherwise expire. The most common reason for applying public receivership is the investigation of economic crime and in fact the procedure has often been accompanied by criminal procedural measures. Public receivership can be considered as one way of promoting the clarifying and supervision objective in bankruptcy proceedings. According to a widely held view, public receivership helps to prevent abuses and irregularities.[66]

Public receivership, which has similar features as the clarifying objective, the principle guiding Arsenal's operations, can be considered a change in Arsenal's legal operating environment. In principle, the new regulation and the procedure based on it could also have had an impact on the way in which the asset management company operates. One can think that the administration overseen by Arsenal and the public receivership procedure have often similar objectives and that they could serve as optional procedures.

However, based on audit observations, no consideration has been given to using public receivership as an alternative to the administration overseen by Arsenal. By assuming oversight of the administration, Arsenal has wanted to ensure that competent estate administrators are appointed to bankruptcy estates in which complex administrative tasks can be expected. Furthermore, public receivership has not been considered an appropriate solution from the perspective of the division of responsibilities concerning ownership steering. The view has been that Arsenal is responsible for the results of its operations to its owners and that transferring the responsibility for the bankruptcy estates outside the asset management company would be problematic. The view has also been that Arsenal knows the legal business and is thus capable of overseeing the administration of the bankruptcy estates in a cost-effective manner.

Based on the audit observations, it would seem that public receivership has only been relevant to Arsenal's operations in a small number of cases. It may be that the option of applying for public receivership has been mentioned to the estate administrator in situations where Arsenal considers the administrator too slow. In fact, in such situations, referring to public receivership has served as a "threat of sanctions".

The view of the National Audit Office is that if it is decided to use an asset management company as a crisis management instrument, it might be useful to examine the relationship between public receivership and administration overseen by the asset management company already at the establishment of the company. In such cases, one consideration could be whether public receivership could be used as an alternative to the administration overseen by the asset management company and whether the asset management company and the authority responsible for public receivership (Bankruptcy Ombudsman) should cooperate with the aim of examining and

[66] *Of the special features and purpose of public receivership in general, see for example Könkkölä and Linna 2013, pp. 324-327.*

formulating optional approaches. It could also be considered whether in situations where the asset management company is approaching the end of its life cycle and is only administering a limited number of bankruptcy estates, the remaining estates could be transferred to public receivership so that the winding down of the asset management company's operations could be speeded up.

Terminating debt recovery on the basis of appropriateness principle

As described above, public receivership could in principle be applied in *parallel with* the administration overseen by the asset management company. However, there have also been changes in the legal operating environment of Arsenal that in principle could *make it more difficult* for the company to recover debts or that may *restrict* the application of the clarifying objective as the principle guiding the company's operations. Similarly, the weight of the clarifying objective could be limited by the appropriateness considerations connected with Arsenal's own operating practices.

It should be noted that applying the clarifying objective does not mean that all types of irregularities in debtors' activities are investigated. Even though, as a result of the clarifying objective, the cost-benefit ratio does not play the same role in Arsenal's recovery operations as in recovery proceedings in general, applying the clarifying objective does not mean that the asset management company would attempt to recover its debts in all situations. Despite the clarifying objective, the likelihood of achieving the desired recovery results in the recovery proceedings has also been a consideration in the operations of the asset management company. Especially the recovery proceedings launched outside Finland may have proven so problematic and uncertain that in some cases it has been appropriate to terminate the process.

Voluntary debt adjustment

One factor that could limit the duration of trials and recovery processes is the conclusion of voluntary debt adjustment arrangements with debtors. In practice, this could also reduce the role of the clarifying objective as the principle guiding the company's operations. In a situation where a debt adjustment arrangement is concluded before a court has examined the debtor's activities the irregularities of the debtor might not necessarily be investigated at all and an impartial body would not be requested to investigate the debtor's activities either. If on the other hand there is an agreement on debt adjustment after the court has, in a criminal or civil case, examined the grounds for and amount of the claim, the agreement means a reduction in the debtor's payment liabilities.

One central feature of the clarifying objective is that in situations where the abandonment of the investigation of the irregularities is set as a condition for obtaining financial gains, priority is given to the clarifying objective. The concept of clarifying objective already means that the debt recovery proceedings have not been abandoned and that debt adjustment arrangements between Arsenal and debtors are only possible in a limited number of situations.

In 2002, the guidelines concerning Arsenal's debt recovery procedures were changed so that when specific conditions were met, Arsenal could enter into voluntary debt adjustment arrangements with parties guilty of economic crime. One condition was that the debtor had contributed to the investigation of the irregularities. Under the operating guidelines approved in 2009, voluntary debt adjustment is possible if the debtor has served its punishment or there are no criminal investigations or civil claims pending. It is also required that the debtor has made efforts to repay its debts and the amounts payable by the debtor correspond to the available funds laid down in the Act on the Adjustment of the Debts of a Private Individual (57/1993). Under the guidelines, debt adjustment may, however, be prevented by the fact that the origins of the assets used for paying the debts are not known.

There have been no debt adjustment arrangements in major cases of economic crime that in addition to serious charges also involve substantial claims for damages. In such situations, adjustment may also have been prevented by the fact that the debtors involved have not been prepared to contribute to the investigation of the matter in a manner laid out in the guidelines of the asset management company (for example help in the recovery of hidden assets). The issue of whether Arsenal can enter into debt adjustment arrangements with all those guilty of economic crime has also been discussed at every annual general meeting of the asset management company during the liquidation. None of the Ministers of Finance representing the state at the annual general meetings has been prepared to enter into agreement with parties guilty of economic crime that have not contributed to or taken part in the investigation of the irregularities.

It seems that in situations where a group of debtors is jointly and severally liable for the debts to the asset management company, agreeing on debt liabilities with one debtor is also problematic from the perspective of law of obligations. Exempting one debtor from debt liabilities (wholly or in part) would in such cases also affect the liabilities of the other debtors towards the asset management company. There is a risk that in such cases the remaining co-debtors' debt liabilities towards the asset management company would be determined in accordance with the number of debtors ("sharing of liability"). It would also seem that there may be some room for interpretation in the assessment of the issue and that the asset management company has examined the legal complexities concerning the issue.

However, there has been at least one extremely protracted bankruptcy process where an agreement was concluded with a debtor's associate subject to civil claims. The aim of the agreement was to speed up the procedure. One factor contributing to the agreement was probably that it would have been necessary to determine the amount of the damages in a separate civil process. In the case in question, the issue of the debtor's criminal responsibility had already been determined in a separate court decision.

Protection against self-incrimination in Arsenal's operations

In principle, the investigation of irregularities might be hampered by the debtor's rights under the criminal procedure and the protection against self-incrimination connected with them. The last-mentioned principle, under which the suspect does not need to contribute to the establishment of his/her guilt, has been adopted as part of the procedural norms used in Finland over the past 15 years, largely on the basis of the decisions made by the European Court of Human Rights and the Supreme Court. In recent years, the provision on complying with the principle has also been explicitly incorporated in the Enforcement Code (chapter 3(73)(1)) and the Bankruptcy Act (chapter 4(5 a)).

The decisions of the Supreme Court (KKO 2009:27, 2009:80 and 2010:41) have played an important role in the shaping of the principles concerning the protection against self-incrimination. The decisions have concerned bankruptcies in which the asset management company had undertaken to cover the costs. In another case, in which the activities of the defendant had a factual connection with the activities of the defendant in the case KKO 2009:80, the Supreme Court also rejected the charge of aggravated debtor's fraud. The decision (2 December 2010, registry no. 2398), which has not been published, was also made on the grounds of the protection against self-incrimination.

In certain criminal cases connected with Arsenal's operations, the decision not to press charges has been justified with the protection against self-incrimination. There have also been cases in which the bankruptcy estate (as the injured party) has decided to press charges in such situations. In such cases, the aim may have been to ensure that the court can determine, which of the assets belong to the bankruptcy estate. The purpose of the bankruptcy estate has been to have a court decision stating that the assets hidden by the debtor or the assets frozen outside Finland

belong to the bankruptcy estate. In such cases a declaratory judgement might make it easier to recover debts outside Finland.

One could also assume that the asset management company has contributed to the process in which the protection against self-incrimination has become part of Finland's legal system. Based on the Supreme Court decisions referred to above, it would seem that the decisions concerning the operations of Arsenal (KKO 2009:27, 2009:80 and 2010:41) have provided a basis on which the Supreme Court has started using protection against self-incrimination as a component in its decisions. The decisions of the Supreme Court in matters concerning the protection against self-incrimination apparently prompted the legislators to incorporate the principle into the Bankruptcy Act and the Enforcement Code. Furthermore, it would seem that the content of the protection against self-incrimination and its different dimensions are continuously evolving on the basis of Supreme Court decisions. In situations where the protection against self-incrimination has been incorporated into the legislation, the way in which it is applied may evolve with the case law. For example, the protection against self-incrimination laid down in the Bankruptcy Act may leave room for interpretation as regards the obligation of the debtor to give notification of his/her decision to remain silent, temporal and content-related dimension of the protection against self-incrimination, the scope of the protection concerning the duty of disclosure and transitional provisions.[67] Such regulation leaving room for interpretation often becomes more specific as case law evolves.

Even though the protection against self-incrimination has probably not significantly interfered with Arsenal's debt recovery operations or made it more difficult to apply the clarifying objective guiding its operations, the situation may become different if it is decided to use an asset management company as an instrument for managing bank or financial crises. Protection against self-incrimination might in the future limit the asset management company's chances to recover debts.

Protracted legal processes

Under Article 6, paragraph 1 of the European Convention on Human Rights, in the determination of his/her civil rights and obligations or of any criminal charge against him/her, everyone is entitled to a fair and public hearing. Likewise, under Article 14 of the International Covenant on Civil and Political Rights, in the determination of any criminal charge against him/her, everyone shall be entitled to be tried without undue delay. Furthermore, under section 21 of the Constitution of Finland (731/1999), everyone has the right to have his/her case dealt with appropriately and without undue delay by a legally competent court of law or other authority.

During the past 15 years, the European Court of Human Rights has on many occasions ruled that Finland is in breach of Article 6 of the European Convention on Human Rights because a trial has not been conducted without undue delay. Most of these rulings have concerned trials that took place in the 1990s and that have involved cases of economic crime.

The court cases involving the operations of Arsenal and issues concerning their duration have been examined by the European Court of Human Rights on many occasions. There have been many reasons for the long duration of these trials. The delays in the legal processes may have been the result of a backlog of cases in the courts and the fact that the cases have involved complex procedural issues. The conduct of the defendants may also have contributed to the long duration of the processes.

It would seem that a large proportion of the legal processes connected with the bank crisis of the 1990s concern processes initiated at the time by the Government Guarantee Fund. These processes have been transferred to Arsenal after Arsenal had acquired Suomen Säästöpankki-SSP. In practice these processes have been managed by the Government Guarantee Fund.

[67] *For more details, see Könkkölä and Linna 2013, pp. 541-549.*

Delays in the trials and the risks that the delays involve have apparently not affected Arsenal's debt recovery operations. The asset management company has, based on the clarifying objective guiding its operations, initiated claims, submitted requests for investigation and made bankruptcy applications when there have been sufficient grounds for doing so. In this respect, the fact that the European Court of Human Rights has imposed penalties for delays in legal processes on the State of Finland and not on the asset management company may also have been relevant.

Even though the delays in trials and the penalties connected with them have apparently not have any significant impact on Arsenal's debt recovery operations and even though the processes have only indirectly concerned Arsenal's operations one can ask whether the asset management company should also consider the risks concerning protracted trials when it plans and implements its debt recovery operations if it is decided to use the asset management company as a crisis management tool. Even though the penalties for the delays are imposed on the State of Finland and not on the asset management company, one might think, considering the special features concerning the operations of the asset management company, that the asset management company should also take such limitations into account in its debt recovery operations. The asset management company is a typical example of a company under state ownership steering that partially serves public interest. One can ask whether the asset management company can in its debt recovery operations ignore the penalties resulting from protracted trials and the disapproval resulting from them.

Another issue, which is connected with the above-mentioned problem, is how the asset management company should take the risk of delays into account and how it can take this risk into consideration when it plans its operations. When a legal process is being initiated, it may be difficult for the asset management company to predict the duration of the process. It follows from the clarifying objective that the asset management company assumes responsibility for investigating the irregularities in the operations of the debtors. At the same time, however, the principle does not, as a rule, have any effect on the duration of the legal processes that are already pending. A protracted court process may also be the result of factors that are beyond the plaintiff's control. If the excessive length of a trial is caused by the defendant's conduct, the question also arises to what extent the asset management company should in general take into account the risk of delays in its debt recovery operations. In this respect, one can draw attention to the fact that the defendant's own conduct may under section 4, subsection 1, paragraph 2 of the Act on Compensation for the Excessive Length of Judicial Proceedings (362/2009), which entered into force on 1 January 2010, be taken into account in the assessment of whether the length of the legal proceedings has been excessive.

Time limit on grounds for enforcement

During the first decade of the 2000s a large number of people that had accumulated large debts during the recession were still in serious economic difficulties. One legal instrument for dealing with the indebtedness problem that arouse during the recession of the 1990s has been the introduction of a time limit on the grounds for enforcement. The purpose of the reform was to prevent private persons from becoming subject to life-long enforcement or enforcement that is otherwise of excessive length. In practice, the time-barring of the claims on the basis of the enforcement legislation is the method of last resort in the dealing with the problem of excessive debts in relation to the debt adjustment of private individuals or voluntary debt adjustment.[68]

Provisions on the time limit on the grounds for enforcement and the time-barring of the claims are laid down in chapter 2, sections 24-28 of the Enforcement Code. In most cases, a payment liability remains enforceable for 15 years. It is also required that the liability has been imposed on a natural person (chapter 2(24)(1)). The longer time limit of 20 years becomes applicable if

[68] *For more details of the background to the regulation, see e.g. Linna and Leppänen 2014, pp. 183-189.*

the creditor is a natural person or the payment liability concerns damages arising from a criminal offence for which the debtor has been sentenced to imprisonment or community service. The time limit on the grounds for enforcement may also be extended if the debtor has essentially hampered the collection of the debts within the original time limit and the extension cannot be considered unreasonable to the debtor (chapter 2(26)). The creditor must request the extension of the time limit by bringing an action against the debtor (chapter 2(26(1)). Under the transitional provisions of the Enforcement Code (chapter 13(2)(7)), the provisions on the time limit of enforcement and the time-barring of the claims are also applied to the grounds for enforcement issued before the entry into force of the Enforcement Code on 1 January 2008.

The main aim of the provisions on the time-limit of enforcement has been to improve the position of individuals that accumulated debts during the recession of the 1990s. In this respect, the provisions are fairly closely connected with Arsenal's operations. As a rule, the debts transferred to the asset management company during the recession of the 1990s were those that where problematic and difficult to recover. One can take the view that the expiry of the time limit on the grounds for enforcement and the time-barring of the claims connected with it will, in the same manner as the agreements on debt liabilities, limit the role of the clarifying objective as the principle guiding the operations of the asset management company.

In practice, the provisions on the time limit on the grounds for enforcement have not significantly affected Arsenal's debt recovery operations or their results. Most of the claims managed by the asset management company had already been sold before the entry into force of the new act. The anticipated value of the claims that are still in the possession of Arsenal after this arrangement has been low, except for claims connected with a number of large bankruptcies. For this reason, it has rarely been necessary to bring an action to seek an extension to the time limit on the grounds for enforcement and it has been decided to allow the claims to become time-barred. If, however, the debtor has been sentenced for economic offences and if he/she has tried to avoid enforcement, an action has been brought with the aim of seeking an extension to the time limit on the grounds for enforcement in situations where substantial interests have been involved and the prerequisites for extending the time limit have otherwise been met.

As regards the provisions on the time limit on the grounds for enforcement, the question arises whether this provision could assume a greater importance if it is decided to use an asset management company as an instrument for managing a bank or financial crisis. One could think that for debtors that have not acted in an objectionable manner and in whose case the time limit on the grounds for enforcement cannot be extended the time limit could serve as a deadline for the operations of the asset management company. After this deadline, the operations of the asset management company would probably be limited to investigating the activities of the debtors that have acted in an objectionable manner. One could also ask whether the provisions on the time limit of enforcement would affect the value of the claims held by the asset management company if the asset management company decided to enter into major disposition arrangements concerning the claims when the provisions are in force.

Summary

During the liquidation, Arsenal has only entered into voluntary agreement-based debt adjustment arrangements with debtors that are guilty of economic crime in exceptional cases. Likewise, there are only a small number of cases involving such debtors where the company has terminated debt recovery proceedings. Thus, the asset management company has attached great weight to the clarifying objective as a principle guiding its operations.[69] Arsenal has only decided not to apply the clarifying objective in specific situations.

[69] *In fact, instead of the clarifying objective (or interest) references are often made to a strong clarifying objective.*

There have been a number of changes in Arsenal's regulatory environment during the liquidation. Based on the audit observations, it would seem that the regulatory reforms concerning the protection against self-incrimination, protracted legal processes or the time limit on grounds for enforcement have not had any major effect on Arsenal's debt recovery operations or on the way in which Arsenal applies the clarifying objective. This may partly be due to the fact that the regulatory reforms have been introduced or they have only become important in case law at the end of the life cycle of the asset management company. If in the future the asset management company will be used as an instrument for managing a bank crisis, such issues should already be taken into account at the establishment of the asset management company and in the planning of its operations. Likewise, it should also be considered whether in such a situation the investigation of irregularities should be transferred from the asset management company to public receivership carried out under the supervision of the authorities.

3.3.3 Relationship between clarifying objective and other objectives of the asset management company

During its existence, Arsenal has been recapitalised with about 3.8 billion euros and it has repaid capital to the amount of about 0.7 billion euros.[70] These rough indicators already show that the operations of the asset management company have not been profitable. On the contrary, recapitalisation of the company has required substantial amounts of state funds.

However, it should be noted that the performance of the asset management company cannot be examined from such a narrow perspective. An asset management company is one instrument for managing a bank crisis with far-reaching impacts. The purpose of such a company is not to generate "profits" but to limit the losses incurred by central government (and the national economy). Likewise, in the preparatory document for the Act on Government Guarantee Fund, references to central government interest meant specifically the minimising of central government losses.[71] Thus, when the clarifying objective (or clarifying interest) is weighed against central government interest, the main issue is whether the clarifying objective is appropriately in accordance with the above-mentioned minimising objective.

One characteristic of the clarifying objective is that the investigation of irregularities can be given priority over financial gain. The clarifying objective may have led to a situation where the company has not carried out its debt recovery operations on the basis of cost-benefit calculations in the same way as (private) creditors operating in a market-rational manner. As a rule, investigating debtors' activities generates costs. If the asset management company is unable to cover its costs with the proceeds of the debt recovery operations, a situation might arise where the clarifying objective as a principle guiding the company's operations is in conflict with the minimising of central government losses, the second objective set for the asset management company.

However, the issues cannot be assessed in such a simplistic manner. When the role of the clarifying objective is assessed, consideration should in addition to financial gain also be given to factors that cannot be assessed on the basis of financial gain or the assessment of which on this basis is difficult. For example, the investigation of irregularities can be justified from the perspective of legal control. Such issues that involve a clear ethical dimension are not necessary commensurate with objectives of economic nature (such as minimising of central government losses).

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[70] *For more details of the role of Arsenal in central government finances and recapitalisation of the company, see chapter 1.*

[71] *For more details of the opinions issued as part of the preparatory work for the Act on Government Guarantee Fund, see subchapter 3.3.1.*

At the same time, it should be noted that from the perspective of economic criteria, the debt recovery proceedings based on the clarifying objective have also produced results during the liquidation. First of all, the amount of capital returned to the owners during the liquidation has been higher than originally estimated.[72] The company has also been able to cover its operating expenses with its debt recovery revenue during the liquidation (between 2003 and 2013). At the same time, in recent years (2009-2013) the company's operating expenditure has been higher than the debt recovery result.[73] Judging from the above-mentioned indicators, the clarifying objective has in the last few years been given priority over financial considerations as a principle guiding the company's operations.

It should be noted, however, that assessing the company's operational performance in such a categorical manner is not unproblematic. There have been substantial fluctuations in the asset management company's debt recovery performance during the liquidation. It would therefore seem that the fluctuations in the debt recovery performance may have been the result of random factors, some of which are difficult to anticipate. For example, it is possible that a debt recovery process continuing for many years that has generated continuous expenditure has only produced revenue after several years. In such a situation the operating expenditure has been divided over several years. At the same time, the monetary recovery result has been realised within a period of one year.

There are a number of uncertainties in the assessment of the asset management company's debt recovery performance. Based on the examination above, it can, however, be said that the asset management company has not neglected financial gain in its debt recovery operations during the liquidation. When consideration is also given to the fact that the investigation of the debtors' activities on the basis of the clarifying objective can, in addition to considerations of financial gain, also be justified with other considerations that may involve ethical dimensions, it would be wrong to say that Arsenal has reconciled considerations of central government finances with the clarifying objective in an inappropriate manner.[74]

Even though central government interest has not been reconciled with the clarifying objective in an inappropriate manner during the liquidation, one can, however, ask whether the content of the clarifying objective and its weight should be assessed differently if a decision is made to use an asset management company as an instrument for managing a banking crisis. In such cases, attention should be drawn to how the role of the clarifying objective should be assessed during the early stages of the asset management company's life cycle when the irregularities concerning the debtors' activities may be of different nature than those at the final stages of the company's life cycle. At the same time, the question arises what the role of public receivership would be in the application of the clarifying objective.

In the first-mentioned issue, it is noteworthy that during the liquidation, emphasis in the operations of the asset management company has been on the investigation of difficult debts and any legal irregularities connected with them. This has also meant that there has been an emphasis on the role of the clarifying objective. In fact, one could think that the importance of the clarifying objective in relation to the "original objectives" mentioned in the preparatory document for the Act on Government Guarantee Fund has become more pronounced during the liquidation.

Even though the role of the clarifying objective has become more pronounced during the liquidation, it is clear that the principle has guided the operations of the asset management company (and the Government Guarantee Fund) from the earliest stages of its operations. It would al-

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[72] *For more details, see subchapter 3.1.2.*

[73] *For more details, see subchapter 3.1.3.*

[74] *This conclusion is based on the assessment of the asset management company's operations at general level. Thus, on the basis of this assessment one cannot make conclusions on the such issues as how the asset management company has weighed procedural options or expense risks in specific legal proceedings.*

so seem that there have been certain changes during the life cycle of the asset management company concerning the debtors whose business operations have been made subject to investigations on the basis of the clarifying objective. It has been noticed that during the liquidation, debt recovery and legal proceedings have usually targeted debtors that have been found to have committed criminal offences or that have been suspected of criminal offences. In the 1990s, on the other hand, the damages claims brought against bank directors were given a great deal of publicity.

When the content of the clarifying objective is assessed, consideration could be given to the fact that in the preparatory document for the legislation, the tasks of the asset management company have been defined in a fairly flexible manner and given a wide meaning. In addition to debt recovery performance, ensuring smooth operations of the market or revitalisation of customers' business may also be relevant to the operations of the asset management company. It would also seem that from the outset the intention was that the principles guiding Arsenal's operations should be flexible so that the company can, within the framework of these principles, react to situations that are difficult to anticipate. In fact, one could ask whether the clarifying objective should also be characterised by certain degree of flexibility. In practice, this could mean that, the principle would not necessarily oblige the asset management company to investigate all irregularities and that the principle should be proportioned to the other objectives set out for the asset management company.

If it is decided to use the asset management company as a crisis management instrument, it should be considered whether the scope of the debtor irregularities that are investigated on the basis of the clarifying objective should in some way be limited. For example, one could ask whether the investigation should mainly target the debtors suspected of criminal offences. If this approach is chosen, asset management company could apply a relatively high threshold when bringing civil action against bank directors responsible for loan decisions.[75] The fact that the judicial assessment of the care shown by the parties responsible for the loan decisions would not necessarily be without problems and the assessment process may involve a great deal of interpretation would be an argument in favour of this view. As a rule, under the principle concerning business decisions based on corporate law (so called business judgment rule), the management of a limited liability company would only be liable for errors in business operations in specific situations. One can also ask whether the general reasonability principle (or consideration of equity) should be taken into account when the importance of the clarifying objective is considered. In most cases, compensation claims against individual persons usually subject these persons to lengthy court processes, as a result of which they become liable for compensation that puts an excessive financial burden on them. At the same time, however, from the perspective of the operational performance of the asset management company, such legal processes and the compensations ordered to be paid as a result may only be of minor importance.

One can also ask whether in the future, the asset management company should in general give priority to development-oriented objectives, such as ensuring smooth market operations, revitalisation of the customers' business or relatively rapid winding down of the asset management company's operations in relation to the investigation of irregularities in debtors' activities.[76] In

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[75] *For example, in Sweden it was decided not to bring any action against bank directors in the 1990s.*

[76] *Under chapter 11, section 2, subsection 2, of the Resolution Act, "the Board of Directors and the Managing Director of the asset management company must manage the asset management company in accordance with healthy and cautious business principles and in accordance with the operating plan approved by the agency and the risk-taking principles contained in the plan." The provision lays down "healthy and cautious business principles" as the general principles guiding the company's operations. As regards the principles guiding the operations of the asset management company, the provisions of the act are fairly open and leave room for interpretation. For example, the "cautious business principles" can be understood in many different ways. One could think that the concept refers to general caution in the taking of business risks. At the same time, caution could refer to caution in terms of accounting or corporate*

such a situation, the question may also arise whether the asset management company should relinquish responsibility for the investigation of the irregularities in debtors' activities. As described above, public receivership might in such cases be used as an alternative. The fact that the clarifying objective may make the life cycle of the asset management company very long would also be an argument in favour of this alternative. The poor predictability of the life span of the company operations can also be seen as a regulatory risk and, at the same time, as a risk related to the assessment of crisis management instruments. If it is decided to use the asset management company as a crisis management instrument, it might be difficult to anticipate the operational time span and the resources required by such a company.

3.4 Asset management company as an instrument for managing bank crisis - perspectives for the future

As referred to in this report, the asset management company has been primarily an instrument for managing bank and financial crises. A typical feature of such crises is that they can spread rapidly to all parts of the world. Where and when financial markets are hit by a crisis may not necessarily be easy to predict. A bank or a financial crisis can also be examined from the perspective of leadership. One will notice that managing crises often involves certain paradoxes. On the one hand crises require leadership. At the same time, in crisis situations, the parties are often at the mercy of "counterforces" in which only a limited number of management tools are available. Furthermore, one can also notice that in a serious crisis, major changes are often needed. However, in such situations there is not necessarily time to introduce changes.[77] These problems were also characteristic of the bank crisis affecting Finland in the 1990s. The asset management company Arsenal to which the bad loans and assets were transferred was a central instrument in the management of the bank crisis.

If there is a prospect of a bank or a financial markets crisis in the future, the fact that Finland has accumulated experience in how to manage it can in a way be considered a positive feature. It would also seem that an asset management company is currently and probably also in the future one way of managing systemic bank crises with far-reaching impacts. One indication of this is the fact that in the Resolution Act, which entered into force on 1 January 2015, asset management company is considered as a possible crisis management instrument and that there is a separate set of provisions on asset management company in chapter 11 of the act.

Concerning chapter 11, section 1, it is stated in the Government proposal that "the asset management company referred to in the proposal is not essentially different from the Asset Management Company Arsenal Ltd that was established as a result of the bank crisis of the 1990s

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law. In the first-mentioned situation, caution would probably be a "measuring principle" and would mean caution in the valuation of assets and debts (so called prudence or conservatism principle). In principle, caution could also refer to the caution in the distribution of assets carried out in accordance with corporate law. For example, chapter 17, section 3, subsection 2 of the Swedish limited liability companies act (Aktiebolagslag 2005:551) contains an explicit obligation to act with caution in such situations (försiktighetsregeln). Furthermore, caution might refer to factors that are also mentioned in the preparatory document for the regulation concerning Arsenal. In such situations, the concept could be understood so that the asset management company should in certain respects also give consideration to the customers' interest or the ensuring of smooth functioning of the market. Furthermore, one could also ask what is the relationship between caution and the clarifying objective referred to in the preparatory document for the act (see HE 175/2014 vp, p. 115). For example, one could think that the commitment to the investigation of irregularities in debtors' activities that have continued for many years and the funding of investigations that may not produce any results is not necessarily a sign of cautious approach. Provisions on the clarifying objective laid down in the Resolution Act are also discussed in chapter 3.4 below.

[77] *Of the paradoxes in crisis management, see more generally Tainio 2011, pp. 141-147.*

and that is still operational, albeit in liquidation".[78] Furthermore, as regards chapter 11, section 2 of the Resolution Act, it is stated in the preparatory document for the act that "concerning the assets transferred to it, the asset management company would also often have special tasks, such as recovery of debts and the related clarifying objective". Under the Government proposal, from the perspective of crisis resolution objectives, it may be justified to have a situation where the asset management company could undertake to cover costs in bankruptcies that would otherwise expire as the estates in question do not have any assets so that it can investigate any objectionable or criminal activities that may be connected with the assets or debts transferred to it. Investigation would allow assets moved beyond the reach of creditors to be returned to the bankruptcy estate. According to the Government proposal, the clarifying objective would also help to prevent abuses.[79]

In the preparatory document for the act, it is also stated that the asset management company should be wound down "as soon as it can be done without any significant losses and without any significant disturbance in the financial markets". At the same time, however, it is also stated in the Government proposal that the asset management company can continue its operations for a long period of time as the duration of its operations is tied to the objectives set for the winding down of the company and its impacts.[80]

The fact that there are legal provisions on crisis management principles and mechanisms can be considered a clear solution from the perspective of the legal state. In this respect, consideration can also be given to the special characteristics of the management of the crisis in the financial markets. In a situation where the financial markets are already in a crisis, finding a solution to a bank crisis is, in a situation characterised by the paradoxes referred to above, often difficult. Solving crises is probably easiest when there is not yet a deep crisis. This underlines the role of pre-emptive action as a crisis resolution tool. One could think that the statutory regulation of crisis management mechanisms is a form of anticipatory preparation for crises. On the other hand, with reference to what was stated above, in a situation where the financial markets have already reached a crisis point, statutory regulation provides a clear framework for crisis management.

Based on the preparatory work for the Resolution Act, it would also seem that the asset management company should observe principles similar to those that have guided Arsenal's operations. Apparently there has not been any intention to introduce major changes in this respect. At the same time, it should be noted that in the preparatory document for the act, these principles have not been specifically defined and in this respect regulation can be interpreted in a flexible manner, giving consideration to situational special characteristics.

It would thus seem that in the structuring and specifying of the operating principles of the asset management company referred to in the Resolution Act, consideration should be given to factors that are similar to those discussed in this audit report. In this respect, attention should at least be drawn to the following:

Concerning the objectives of the asset management company, it is stated in the preparatory document for the Resolution Act that the aim is to rapidly wind down the company. At the same time, in deviation from what is said above, it is stated in the Government proposal that the company may have to continue its operations for a long period of time. Apparently, the main reason for the long duration of the company's operations would be (in the same way as in the case of Arsenal) the clarifying objective, which would serve as the principle guiding the company's operations.

The fact that in the preparatory document for the Resolution Act, the objectives for the expected life cycle of the asset management company have been set in a manner that leaves room

[78] *See HE 175/2014 vp, p. 115.*
[79] *See HE 175/2014 vp, p. 115.*
[80] *See HE 175/2014 vp, p. 115.*

for interpretation or conflicting conclusions may be considered as a regulatory problem. It is also problematic that the operations of the asset management company referred to in the Resolution Act could probably (in the same way as the operations of Arsenal) continue for a long period of time. This may lead to a situation where the asset management company will become, quoting the title of a book discussing the thematics of the bank crisis, "the long shadow of the bank crisis".

One feature characteristic of this audit is a future-oriented approach. This audit report and its background material have outlined and structured different dimensions of the clarifying objective. In this report we have also drawn attention to the question whether, in order to shorten the life cycle of an asset management company, the scope of application of the clarifying objective should be narrowed and whether the investigation of debtors' irregularities should be transferred to public receivership if an asset management company is used in the future. [81] We have also examined the requirements of good governance and the special characteristics that an asset management company should take into consideration in this respect. If an asset management company will be used as an instrument for managing a future bank crisis the operating principles based on the observations of this audit can be utilised in the development of operating practices and administrative structures of asset management companies used in crisis management.

If it is decided to establish an asset management company again, it should also be considered whether more emphasis should be given to the public interest nature of such a company in the development of its administrative practices. Even though an asset management company is basically an entity under private law, the operations of such a company are so closely connected with public interest that the company could well be considered as an entity existing on the "interface" between private and public law. In fact one could ask whether openness and transparency, which are typical features of public administration, should be emphasised in the operations of the asset management company. It might be worth examining whether it would be appropriate to draw up corporate governance guidelines specifically tailored for an asset management company in which consideration is given to the special characteristics of such a company. Such a set of corporate governance guidelines would be a public document unlike the Arsenal's internal guidelines, which are, as a rule, considered business secrets. The corporate governance guidelines could, as applicable, be based on Arsenal's existing internal guidelines. Furthermore, such guidelines could also take into account the changes emphasising the rights of the debtor/defendant (see section 3.3.2) that have taken place in Arsenal's operating environment during its life cycle. One could also think that the corporate governance guidelines provide a soft law code supplementing the general regulation applying to the asset management company that is laid down in the Resolution Act.[82]

Even though the Resolution Act contains provisions on an asset management company and even though these provisions would, in terms of their content, seem to correspond to the operating practices applied by Arsenal, the proposed regulation also contains reforms at principal level. It should be noted that the new crisis resolution legislation is part of EU law, which is also reflected in the functioning of the crisis management mechanisms referred to in the act. In the future, the administration of the asset management company would be the responsibility of the Financial Stability Authority. In a situation where the crisis resolution fund of the EU would be used for resolving a crisis, the decision-making powers would be transferred to a supranational

[81] *For more details, see subchapter 3.3.3.*

[82] *As regards chapter 11, section 2, subsection 2 of the Resolution Act, it is stated in the preparatory document for the act that the principles governing the operations of an asset management company should lay out the objectives and practices concerning the management of the assets and the powers of the management. There should also be guidelines concerning the operations of the asset management company in the markets (see HE 175/2014 vp, p. 115). A separate corporate governance code could supplement the principles laid down in the provision or these principles could be developed into a public corporate governance code.*

crisis resolution council. One can assume that in the last-mentioned situation, the management of the asset management company, as the management of financial crises in general, might involve challenges.

Appendices

Appendix 1. Audit issues and audit criteria

Audit issues	Audit criteria
Have the minimising of central government losses and the clarifying objective been appropriately considered in the liquidation of the Asset Management Company Arsenal Ltd?	
1. Has the ownership steering of Arsenal been adequate? 1.1. Parliament has called for a balance between the clarifying objective and central government interest. Has this been clearly laid out in ownership steering? 1.2.Has the liquidation process been adequately monitored and supervised as part of ownership steering?	– The owners have clearly expressed how they define the balance between the clarifying objective and central government interest. – The owners have provided the company with adequate steering. – The owners have worked to ensure that the liquidation administration acts in accordance with agreed operating principles in an appropriate manner.
2. Has Arsenal given proper and balanced consideration to the clarifying objective and central government interest during the liquidation? 2.1. Has Arsenal Ltd operated in accordance with the clarifying objective in a systematic manner and in accordance with the owners' wishes? 2.2. Has Arsenal recovered its debts and realised its assets in a effective and productive manner, taking into consideration the clarifying objective?	– The clarifying objective has been applied in a systematic manner from the owners' perspective. – The clarifying objective has been applied in a systematic manner from the customers' perspective. – The company has reported on the application of the clarifying objective in sufficient detail. – The company has worked to recover its debts and realise assets it has acquired in an effective and productive manner as soon as practicable. – The winding down of the company's operations has not been unnecessarily delayed.
3. Has the liquidation of Arsenal been managed in accordance with the plans and guidelines approved by the owners? 3.1. Has Arsenal operated in an open and transparent manner? 3.2. Has Arsenal solved the liability issues concerning its operations in an appropriate manner and reported on them to its owners?	– From the perspective of its owners, the company has operated in an open and transparent manner. – The company is reporting on liability issues in adequate detail.
4. Has Arsenal operated in an economically efficient manner? 4.1. Is the scope of the company's operations appropriately measured? 4.2. Is the company's expenditure at appropriate levels?	– The company has been able to adjust its equity structure as the liquidation has progressed, while at the same time it has also maintained an equity structure that allows the company to meet its profit responsibility targets. – The company has been able to reduce its operations in a cost-effective manner. – The company has been able to cover most of its running costs with its operating revenue. – The company's expenditure is at appropriate levels and similar to the expenditure incurred by other businesses in the sector.

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3. Interviews in chronological order

Ministry of Finance 28 May 2014, one person.

Asset Management Company Arsenal Ltd, in liquidation 12 June 2014, one person.

Office of Bankruptcy Ombudsman 26 August 2014, two persons.

Asset Management Company Arsenal Ltd, in liquidation 3 September 2014, two persons.

Ministry of Finance 11 September 2014, three persons.

Finnish Tax Administration 7 October 2014, one person.

Finnish Tax Administration (telephone interview) 15 October 2014, one person.

4. Opinions on the audit report

Ministry of Finance, 14 April 2015. VM/637/00.05.00/2015.

Arsenal Ltd, 17 April 2015.

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