

Annual Report 2002

The Period July 1st 2001 to June 30th 2002

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INTRODUCTION

The Financial Supervisory Authority (FME) is now issuing its third annual report. The report gives an account of the FME's activities from 1 July 2001 to 30 June 2002. It discusses developments and the outlook on financial markets, supplementing reports compiled on the basis of annual accounts and other information on the activities of financial undertakings which are published on the FME website. It also highlights the priorities in FME's work for the next year or two. A list of the parties subject to supervision as of 30 June 2002 is published in the report. FME also publishes on its website a variety of materials concerning supervision and the financial market. The URL of the FME website is www.fme.is.

The annual report is published in both Icelandic and English.

FME Board of Directors:

Mr. Stefán Svavarsson, certified public accountant, associate professor at the University of Iceland, chairman

Mr. Lárus Finnbogason, certified public accountant, vice-chairman

Mr. Finnur Ingólfsson, governor of the Central Bank of Iceland *)

**) Ingimundur Friðriksson, governor of the Central Bank of Iceland, was appointed to the Board as of 25 October 2002.*

Alternates:

Mr. Benedikt Árnason, head of department, Ministry of Industry and Commerce

Ms. Þuríður I. Jónsdóttir, district court attorney

Mr. Ingimundur Friðriksson, assistant governor of the Central Bank of Iceland

Director General: Mr. Páll Gunnar Pálsson

Deputy Director General Mr. Ragnar Hafliðason

FME operates in accordance with Act No. 87/1998 on Official Supervision of Financial Activities. FME is a public authority directed by a special Board of Directors, but under the administrative jurisdiction of the Minister of Industry and Commerce. The Minister appoints the Board for a four-year term. Its role is to specify the emphases in FME's work and follow its activities and operations. It appoints the Director General, who directs day-to-day activities.

FME operates in accordance with an approved policy outline, which is regularly adapted to changed conditions. It is published on the FME website, which also has a description of the organisation of the FME.

1. SURVEY OF ACTIVITIES FROM 1 JULY 2001 TO 30 JUNE 2002

The Financial Supervisory Authority, FME, carries out various types of supervision of financial enterprises and financial activities, supervision of which is prescribed by law. This supervision takes the form of a variety of specific investigations, for instance on-site examinations, together with regular gathering of financial information. Handling written inquiries and communications from financial enterprises and their customers is also a major aspect of the Authority's activities. FME publishes formal guidelines on general activities on the financial market, arranges various sorts of presentations and meetings with management and staff of companies on the financial market, and endeavours to initiate discussion on questions concerning the security and competitiveness of the financial market, e.g. by publishing discussion documents on its website.

This section is intended to provide general information on the activity of the Authority during this period, without specifically discussing individual cases. It deals with FME's tasks in individual areas of the financial market, as well as looking especially at supervision of qualifying holdings, proposed amendments to legislation, foreign co-operation, FME operations, etc.

1.1 Supervision of individual areas of the financial market

Emphases during the period: Monitoring of capital adequacy. Internal controls and risk management. Transparency and market discipline. Development of a risk assessment system.

1.1.1 The credit market

As previously, FME has emphasised monitoring developments in the capital adequacy ratio (CAR) of credit institutions and urged the setting of clear operating objectives with regard to capital adequacy. The substantial expansion of credit in recent years gave cause for special concern with regard to the capital adequacy of credit institutions, which could in individual cases be insufficient to meet unavoidable setbacks in the form of loan losses.

Expansion of credit slowed significantly during the second half of 2001 and the first half of 2002 and has now practically come to a standstill. Credit institutions have, on the whole, managed to meet their increased loan-loss provisions without substantially weakening their capital adequacy. Further increases in provisions to loan-loss accounts can be expected, since experience of repayment of the loans of recent years is still limited. Information on default trends, which FME collects and publishes quarterly on its website, gives an indication of this. For this reason, FME has emphasised investigating the lending processes of credit institutions, internal controls on loans, risk management and assessment of the need for loan-loss provisions.

In various instances investigations of banks' loan portfolios have resulted in increased provisions to credit institutions' loan-loss accounts and the CAR of several smaller credit institutions proved to be less than the legal statutory limits. In such

cases, measures were taken so that the CAR would comply with law.

By issuing rules and formal guidelines, FME has sought to strengthen the framework necessary for solid operations of credit institutions and to encourage transparency and market discipline. At the beginning of 2002 FME issued changes to an Annex to the Rules on the annual accounts of credit institutions concerning assessment of the need for loan-loss provisions. This change tightens these provisions of the rules. Further review of the rules on loan assessment is planned with an eye to changes to international standards and core principles which are now in preparation. The FME also published formal guidelines on internal controls and risk management by financial companies, placing special emphasis on the responsibility and obligations of the board of directors and the management of financial companies. Furthermore, at the beginning of 2002, formal guidelines were published on additional information concerning financial instruments in the annual accounts of credit institutions.

FME has taken part in the review of the international capital adequacy rules for credit institutions (Basel II), which are currently planned to take effect at the end of 2006. With this in mind, FME has worked at strengthening the information system in assessing risk of credit institutions. These new rules on capital adequacy will take into consideration risk in the operations of credit institutions in assessing satisfactory CAR, in addition to placing special emphasis on having the credit institutions themselves independently assess their necessary CAR having regard to risks in their activities. The rules also assume that supervisory author-

Increase of loan-loss provisions.

Review of capital adequacy rules.

ities will have increased authorisation to specify a higher CAR for individual credit institutions.

FME has formulated a first draft of its own risk assessment system, which is intended to facilitate assessment of the necessary CAR of individual credit institutions, based on information on equity, quality of assets, profitability, liquidity, sensitivity to market exposure and management. The risk assessment system will be used to prioritise supervision of credit institutions from next year onward.

During this period the FME began regular information gathering on financial services extended to so-called connected parties, i.e. parties who have a significant effect on decision-making by management of credit institutions, because of the danger of conflicts of interest. Such parties could include, for instance, members of the boards of banks, management, key personnel, major shareholders and enterprises with holding or management connections to a credit institution.

1.1.2 The securities market

Emphases during the period: Market surveillance. Supervision of conduct of business. Equal treatment of investors. Actions due to operating difficulties.

The changed situation in the securities market during this period has been evident in various ways in FME's activities. Following major expansion, trading has decreased substantially, which has affected the operating basis of enterprises offering securities services. The operating licence of one securities firm was revoked in November 2001, in the wake of which the firm went into bankruptcy. FME has in one other instance had to take measures due to the poor CAR of a securities company.

During the period only two prospectuses for public offers were sent to FME for review and approval, as during the past year the Authority was assigned the task of reviewing prospectuses for public offers which do not involve listing on a regulated securities market. In one of these cases nothing came of the public offer because of a decision to list on the stock exchange.

Supervision of conduct of business on the securities market has been strengthened substantially, with the introduction of special market surveillance, improving FME's overview of the securities market and enabling it to intervene at an earlier stage if needed.

A variety of cases have come up during the period concerning conduct of business of financial companies on the securities market. To mention one example, at the end of 2001, FME saw cause to raise objections to the investment recommendation of certain financial companies, as a result of the interests of the companies in question in the securities concerned. FME drew attention to this publicly. Formal guidelines on analysts and research departments are being prepared. Similar objections were raised as a result of insufficient discussion in listing prospectuses of the interests between the co-ordinator and the issuer.

FME formally examined eight cases where there were indications of a violation of provisions on insider trading. The investigation has been concluded in half of these cases. One of them was referred to the Financial Crime division of the National Commissioner of the Icelandic Police, while two cases were concluded with reprimands. In one case no reason was seen to take action. Indications of market manipulation were also followed up, with five cases formally investigated for such reasons. None of these cases has been concluded. FME's market surveillance has also examined a number of cases in this area without initiating a formal investigation.

A judgement has been handed down in the first case in Iceland involving prosecution of insider fraud. The case involved a primary insider trading in the shares of the company in which he was an insider while possessing confidential information. The District Court returned a verdict of not guilty, saying that it had not been demonstrated that the insider had taken advantage of confidential information in his trading. The Director of Public Prosecutions decided not to appeal the verdict. Following this verdict the Financial Crime division of the National Commissioner of Icelandic Police terminated an investigation of one case of presumed insider trading, since the case did not appear likely to lead to a conviction in view of this recent judgement. Following the Court's verdict, the provisions of the Act on Securities Trading prohibiting fraudulent insider trading were amended by Act No. 39/2002. The amendment has removed all ambiguity concerning the requirements for a conviction in insider trading cases, i.e. that negligence is sufficient cause for conviction.

In several other cases FME has informed the Financial Crime division of the National Commissioner of the Icelandic Police of cases on the

Insider trading and market manipulation.

Objections raised to investment advice.

securities market. These cases concern e.g. presumed violations of rules concerning public offers violations of the Criminal Code and other cases.

During this period FME has approved the rules of most financial companies on separation of interests (Chinese walls), companies' trading on own account, employee trading, and the participation of management and staff in business activities. In its formal guidelines No. 1/2001, FME laid down requirements for the principal content of such rules, which are intended to encourage better conduct of business practices on the securities market.

FME has, furthermore, been approving rules which securities issuers are to set themselves concerning the handling of inside information and trading of insiders. The rules of several issuers have been approved and others are awaiting approval. These rules, however, have been slow in coming in and reviewing them is time-consuming. FME has stressed that securities issuers follow the basic principles laid down in formal guidelines No. 2/2001, although there was some delay in the adoption of rules by boards and their approval by FME.

FME has, during this period, emphasised strengthening supervision of mutual funds, for instance, by demanding the submission of regular reports with a breakdown of the funds' investment. A draft of the report form was presented in a discussion paper in the middle of the summer of 2002, and the parties subject to supervision given an opportunity to submit their comments. Mutual funds currently submit two quarterly reports, one a quarterly economic summary and the other a breakdown of investments. Additional supervision in this area is aimed at making FME better prepared to meet changes in the working environment of mutual funds which can be expected with a new Act on such funds and implementation of a new EU Directive.

1.1.3 The pension savings market

Emphases during the period: Importance of internal controls reiterated. Increased market discipline. Conduct of business practices in the sale of supplementary pension savings plans. Transparency in actuarial assessment.

The most extensive task in supervising pension funds during the period were the detailed investigations into pension funds' investments. In connection with these investigations, special examinations were made of documentation on internal

controls, annual accounts and reports by the funds' auditors. The principal objective of these investigations is to review the investments of individual pension funds with regard to the provisions of Chapter VII of Act No. 129/1997, on Mandatory Insurance of Pension Rights and Activities of Pension Funds.

Examinations of the investments revealed that the investments of quite a number of pension funds are not within the limits provided for by law, especially with regard to investments in unlisted securities and securities issued by a single party. FME has had to raise repeated objections with several pension funds. Furthermore, several pension funds have been instructed to make improvements in accordance with the conclusions of the examinations. In several cases these investigations have revealed a need for a considerably more detailed examination of the pension funds' activities and it is a common characteristic of these funds that they have not devoted sufficient attention to internal controls. In addition, it could be generally said that documentation on internal controls by pension funds which was requested has in many cases been defective or has not been submitted satisfactorily. FME has repeatedly reminded the board members of several pension funds of their responsibility for internal controls.

FME has also expressed detailed comments and objections concerning the filling out of quarterly reports giving a breakdown of investments, in connection with its investigations of investments. At the beginning of this past summer, FME arranged a special presentation for the pension funds on how to complete these reports, which was well attended. The above-mentioned actions have led to improved completion of reports, which FME emphasises should be done with care, since the reports serve an important purpose in supervision of pension funds' investments. The reports are at least as useful to the pension funds themselves in making sure their investments are within the framework provided by law.

There are a number of instances where annual accounts of pension funds do not comply with the rules concerning them. FME has made a variety of remarks in this connection and in one instance the pension fund was made to re-publish its annual report.

Serious cases have arisen during the period connected with pension fund activities which have

Better reporting.

Faults in internal control.

Supervision of pension funds' liabilities increased.

Market discipline and transparency.

been the subject of investigation by the Financial Crime section of the National Commissioner for the Icelandic Police and FME. Some of these cases could have been prevented or exposed earlier had these pension funds had effective internal controls.

FME intends to strengthen its supervision of pension funds' obligations and actuarial assessments substantially. Measures are being prepared to increase reporting to FME in connection with actuarial assessments of pension funds.

Concurrent with the significant growth and development of the market for supplementary insurance coverage and personal pension savings in the past year or two, FME has received a considerable number of queries, suggestions and comments concerning pension savings from depositaries, right-holders and wage payers. The principal task of FME in connection with supplementary pension savings is, however, to provide opinions to the Minister of Finance on rules for pension savings and amendments to them, as depositaries of pension savings must seek approval from the Minister on these rules and amendments to them. FME intends to follow up on important points, which have been raised in supervisory projects concerning the implementation of supplementary pension savings and the interpretation of the Acts and rules concerning these savings, by issuing formal guidelines.

Financial difficulties of brokers.

In accordance with recent amendments to the Act on Pension Funds, each fund must now adopt procedures on securities transactions by the fund, its management and staff, which are to be approved by the FME. FME has been considerably involved with pension funds concerning the setting of rules during this period and practically all the pension funds now have approved rules.

During the period 19 pension funds had amendments to their Articles of Association approved, with FME delivering an opinion on the amendments in each case.

Formal guidelines on conduct of business.

1.1.4 The Insurance Market

Emphases during the period: Actions due to the operating difficulties of certain insurance brokers. Market discipline and transparency in determining motor vehicle insurance premiums. Formal guidelines on conduct of business. Obligation to provide information to customers.

There have been several changes in the insurance market during this period. Two small boat insur-

ance companies ceased their activities during the latter half of the previous year with the transfer of their insurance portfolios to the company Sjóvá-Almennar tryggingar hf. The operating licence of one of them was cancelled, while the other will no longer write new policies. In addition, the insurance portfolio of Samábyrgðin hf. was transferred to Sjóvá-Almennar tryggingar hf. and the activities of the two merged. In July of this year a new non-life insurance company, Íslandstrygging hf., was granted an operating licence and has now commenced operation. FME is currently processing an application from a life insurance company for an operating licence.

There were also some changes among insurance brokers; during the period six parties relinquished their operating licences, either on their own initiative, in consultation with FME or at its demand. Several brokers have experienced operating difficulties and FME has had to take measures as a result, although its supervision is constrained to their services and is not financial supervision.

Premiums for compulsory motor vehicle insurance have long been the subject of public discussion and FME has continued to follow the development of insurance liability in this sector. FME is of the opinion that it is very urgent for insurance companies to review the premises for determining their motor vehicle insurance premiums as soon as experience shows cause to do so. FME has emphasised market discipline and to this end has sought to ensure increased transparency. A committee appointed in the year 2000 was assigned the task of reviewing the Regulation on annual accounts of non-life insurance companies. A number of changes were made aimed in this direction. Furthermore, FME issued formal guidelines No. 4/2002 on insurance companies accounting practices, concerning the interpretation and implementation of the aforementioned Regulation.

FME has issued formal guidelines No. 1/2002 on internal control and risk management by financial enterprises. They lay down the minimum requirements made by FME concerning internal control and risk management, including the overview of management and their supervisory practices, analysis and assessment of risk, separation of responsibilities, etc.

FME has issued formal guidelines No. 5/2002 on the bonus rules of insurance companies in compulsory motor vehicle insurance. The guidelines

apply to the determination of premiums on the basis of individual damage histories. Policyholders should be able to rely on the bonus rules remaining unchanged throughout each insurance period in the same manner as insurance terms. Awareness of the rules, and of changes to them, is conducive to increasing transparency in the business and is a factor in making the bonus rules more effective.

In addition, FME has issued formal guidelines No. 3/2002, on the rights of injured parties to provisional compensation. Their objective is to have insurers carry out their damage settlements in accordance with the mandatory provisions of the Act on Insurance Contracts (Article 24 of this Act) and develop working practices aimed at providing injured parties with comprehensive information on their legal situation and damage compensation without unnecessary delay.

During the period FME has investigated the insurers obligation to provide information and general practices in the sale of insurance by insurance companies and brokers. In some instances there was felt to be cause to make objections and demand improvements. To mention one example, there have been a fair number of cases where customers of both domestic and foreign insurance companies have transferred their life insurance to another company, i.e. terminated their insurance contracts and changed companies. It is important that consumers are informed of the expense which this leads to in the case of life assurance with saving part, so that any termination is made after careful consideration. There is cause to assume that this has not always been the case.

Various difficulties have arisen in insurance brokering during the period. Several cases can be attributed to insurance brokers in some instances hiring the services of a number of consultants without ensuring a sufficient overview of their activities. FME has, in the light of experience, recommended that those parties who intend on brokering insurance limit the number of their consultants/sales agents, so that it will be certain that the party in question has an overview of their activities.

FME has, on the basis of the Insurance Act, pointed out to insurance companies that they should adopt working guidelines on the securities trading of the company itself, its employees and management. FME has issued formal guidelines on the substance of such rules.

1.2 Supervision of qualifying holdings

Supervision of qualifying holdings is becoming a more extensive part of FME's activities. There are two reasons for this in particular. On the one hand, in recent months there has been considerable change in ownership of financial enterprises. On the other hand, statutory provisions on supervision of qualifying holdings were strengthened with Act No. 69/2001, amending provisions on supervision of owners of qualifying holdings in financial enterprises.

FME's enforcement powers has been put to the test in several cases. In one instance FME deemed it necessary to decide that the shares of owner of a qualifying holding would not entail voting rights. In another case, voting rights became invalid since the change of ownership was not effected as prescribed by law. FME has also refused authorisation to acquire a qualifying holding.

It is important that purchasers of a qualifying holding bear in mind the legal obligations which rest upon them to seek prior approval from FME for such purchase. In practice this has not been carried out in several instances.

1.3 Proposed statutory amendments on the financial market

In most cases, FME is involved in the preparation of parliamentary bills concerning activities on the financial market. Thus FME has representatives on committees appointed to review legislation and draw up bills. Here FME is in a key position, with regard to having an overview of how legislation proves in practice, and it is on this premise that it participates in preparation of new legislation.

During the period, legislation regarding most areas of the financial market has been undergoing review. Work has been underway at an overall review of credit market legislation and a bill on financial enterprises has been submitted to the Icelandic parliament, Althingi. In the securities sector, work is underway on a review of the Act on Securities Transactions, on Activities of Stock Exchanges and Regulated OTC Markets and of the Act on UCITS. In the insurance sector, the Act on Insurance Contracts, Rules on insurance brokering and Rules on the winding-up of insurance companies are under review.

1.4 International co-operation

FME is involved in foreign co-operation in all areas of the financial market. By so doing, FME can communicate to the Icelandic financial market knowledge and experience gained in supervision of larger and, as the case may be, more developed markets. Such co-operation also contributes to the competitiveness of the Icelandic financial market.

On its website, FME has published a summary of its participation in foreign co-operation. This provides information on the organisations and institutions to which FME is a party and the committees and expert groups where it has a representative or observer. The principal tasks of this co-operation are explained, the FME personnel who participate or observe the work in question are listed, and their attendance at meetings accounted for.

Co-operation of European financial supervisory authorities in individual sectors of the financial market is currently undergoing radical review in connection with changes to the EU decision-making process. FME is a party to the new Committee of European Securities Regulators, CESR. The Committee was established in connection with the above-mentioned changes and has the task of providing advice to the European Commission and co-ordinating regulation and implementation of EU legislation in the European Economic Area (EEA). FME has taken an active part in this co-operation during the past year. CESR's first advisory task for the European Commission was connected with proposed Directives on market abuse, on the one hand, and on prospectuses, on the other. These working groups received a formal statement of duties from the European Commission, but other working groups exist discussing, for instance, the different arrangements of securities markets, price formation and trading practices. FME hosted a standing committee of this co-operation this autumn.

Co-operation of European financial supervisory authorities in the loan and insurance market is now under review, having regard to the above-mentioned changes in co-operation between securities regulators.

FME was during the period invited to participate in an EU evaluation of the insurance market in Malta; evaluations of this sort are part of the accession negotiations between the EU and individual states. A FME representative took part in this work and the evaluation report is now being finalised.

The project was highly instructive and will without doubt provide FME staff with increased insight.

1.5 FME operations

Scope of operations and supervision fee

According to the FME's annual accounts for the year 2001, expenses including purchase of assets amounted to a total of ISK 210.8 million. Income for the year 2001, including interest income, amounted to a total of ISK 206.3 million, of which income from the supervision fee was ISK 198.2 million. Expenses in excess of income thus amounted to ISK 4.5 million in 2001. In the year 2000 similar figures were ISK 179.1 million for expenses, including purchase of assets, and ISK 192.9 million for income, with the supervision fee amounting to ISK 192.5 million. The above figures do not include expenses and income arising from the Rulings Committees, which are hosted by FME.

According to FME's reviewed operating plan for 2002, operating costs for the year are expected to total ISK 263.5 million compared to ISK 259.4 million in the original budget. Income, including interest income, is expected to be ISK 219 million, of which income from the supervision fee should be ISK 211.7 million. Expenses in excess of income amounting to ISK 44.5 million will be covered by accumulated surpluses from former years.

FME's operating budget for 2003 has now been presented to the Minister of Commerce as provided for by law. The budget estimates that the scope of operations in 2003 will be similar to that in 2002, with an increase over the previous year in operating expenses amounting to about 2%. Expenses are expected to amount to ISK 268.4 million and income, including financial income, to be ISK 265 million, of which the levied supervision fees for 2003 should be around ISK 260 million.

According to Act No. 87/1998, on Official Supervision of Financial Activities, parties subject to supervision are to bear the cost of FME's operations. Act No. 99/1999, on Payment of Cost Due to Official Supervision of Financial Activities, as subsequently amended, applies to the levying of the supervision fee. The supervision fee is calculated as a percentage of total assets, operating expenses or insurance premiums of parties subject to supervision, in accordance with the nature of their activities. In all cases, however, there is a specific

minimum amount. Since its establishment in 1999, there has been a significant increase in the activities of many parties subject to supervision, which has resulted in a relative reduction in the levy percentage. As an example, the base figure used for calculation in the levying of the supervision fee, in the main classes of parties subject to supervision, has increased by 139-216%, while the levy percentage has decreased by 22-48% from 1999-2002.

Number of employees

The number of employees determines FME's main operating expense items, such as salaries and wage-related expenses, the size of premises and extent of computer equipment required. In 2001 FME compiled an assessment of its personnel needs and an explanatory statement of this accompanies the budget compiled at that time. The statement gave a detailed assessment of FME's short-term personnel needs and an indication of requirements in the longer term. It is now clear that the projection of short-term personnel needs, i.e. until year-end 2002, has been borne out in principal aspects. In its premises for the 2003 budget, FME is not proposing to increase the number of personnel.

At the beginning of 2002 FME had 31 staff positions, which are expected to be 33 at year-end. At mid-year 2001, positions numbered 27. From mid-2001 until mid-2002, a total of 10 employees commenced work at FME, and three ceased their employment. The majority of FME's staff are specialists, in particular, in commerce, economics, law or computer science.

In-house rules and work processes

Efforts are continually underway to reinforce the internal structure of FME's activities. This past year the Minister of Commerce issued rules on dealings of FME's board members, Director General and employees with parties subject to supervision. Rules have been adopted in accordance with Article 6 of Act No. 87/1998, on Official Supervision of Financial Activities, intended to ensure objectivity in carrying out the Authority's duties and preventing conflicts of interest or the formation of possible interest connections. FME's Board has, furthermore, adopted rules on treatment of confidential information and securities trading by FME's board members, Director General and employees. The rules have been adopted in accordance with Article 37 of Act No. 13/1996, on Securities Transactions. The above rules are published on FME's website. Special consideration has

also been given to handling of cases and processing of matters at FME, aimed at co-ordinating handling of cases in different areas of the financial market and speeding up their conclusion. An overall supervision manual for FME's tasks is being compiled.

Improvements to premises

In February 2002, FME acquired additional premises on the fifth floor of the building at Suðurlandsbraut 32, which had been in construction since mid-2001. This addition increased FME's premises, and improved considerably all facilities for meetings and promotional work. The Authority's premises are leased until 2011.

Various statistics for the period from 1 July 2001 to 30 June 2002

During the period from 1 July 2001 to 30 June 2002 FME sent some 3000 letters and received about 1800 letters. During this same period parties subject to supervision submitted about 1500 reports to FME as part of the Authority's regular data and information gathering. Parties subject to supervision now obtain all the forms and report templates for making their reports to FME from the Authority's website. This arrangement makes things much easier for everyone involved.

FME keeps track of all its projects using a special customer relations management (CRM) system. All queries received by the FME and individual projects arising from its activities are registered in the CRM system and then dealt with in accordance with the instructions to employees which were mentioned previously. During the 12-month period under discussion here, some 860 cases were opened by FME, with the comparable number for the preceding similar period 760.

FME continually receives many types of formal queries concerning activities on financial markets in Iceland. Thus some queries are received from abroad in connection with international co-operation on supervision of financial markets and also from various parties distributing information on financial markets and parties involved in financial activities. Domestic queries, on the other hand, are received primarily from parties subject to supervision, their customers or various public bodies. During the period under consideration here, FME received a total of 152 formal queries, of which 62 were from foreign parties.

Increase in number of staff.

Enlargement of premises.

Complaints and consumer issues are another class of queries which FME continually receives. These involve queries concerning business dealings with financial enterprises which FME sees cause to investigate. A total of 55 such cases were received during the period mentioned.

A variety of information in addition to the above can be obtained from FME's CRM system on the tasks dealt with by the Authority. To mention an example, during the period under discussion here, a total of 45 cases concerning on-site examinations of parties subject to supervision were registered, 29 cases were registered concerning applications for operating licences, 15 cases concerning insider trading and six concerning money laundering.

Fines

In July 2001 Regulation No. 560/2001, on the application of fines and financial penalties in official supervision of financial activities, was issued. The Regulation authorises The Board of FME to apply fines, for instance, because of failure to fulfil regular reporting obligations to FME. The provisions of the Regulation were enforced for the first time in three instances during the first half of 2002 as a result of end of year 2001 reports which parties subject to supervision failed to submit before certain deadline.

2. THE FINANCIAL MARKET – TRENDS AND OUTLOOK

2.1 The credit market

Unchanged overall performance

Although the operating conditions of credit institutions have undergone a series of changes in recent months, this has not affected their overall profitability. The cumulative profits of commercial and savings banks before taxes for the year 2001 amounted to ISK 7.4 billion, as compared with profits of ISK 7.5 billion in 2000.¹ Return on equity rose from around 11% to 13.5% between 2000 and 2001, cf. **Figure 1**. A sizeable increase in gross income is, however, not reflected in increased profits. This is partly due to increased provisions for bad loans, which rose by ISK 3.8 billion, or from ISK 4.3 billion in 2000 to ISK 8.1 billion in 2001.

During the first half of 2002 the cumulative profits before taxes of commercial and savings banks amounted to ISK 5.5 billion, which corresponds to an annual ROE of 13.2%. Principal changes from the year 2001 include, on the one hand, lower spread – for instance on account of a slow-down in inflation – and, on the other hand, a favourable turn in trading rate gains which causes an upswing in other income. Apart from trading rate gains, there has been little change in other operating income of credit institutions during the first half of 2002 compared with numbers for the year 2001.

The above-mentioned figures on ROE and cost ratios vary between individual credit institutions. Thus, the ROE of the four largest banks ranged from 13% to 21% for the first half of 2002 and from –8.7% to 10.8% in the case of Sparisjóðabanki and the largest savings banks.

Decreasing cost/income ratios

The cost/income ratio, i.e. operating costs as a percentage of gross income, was lower during the first half of 2002, or 62.8%, as compared with 66.7% in 2001, cf. **Figure 1**. During the period 1995–1998 the ratio was 66–68%, but dropped to 62% in 1999 due, in part, to unusually high trading rate gains that year. As indicated by the above

1) All mention of commercial banks and savings banks in this analysis relates to the consolidated accounts of the country's five commercial banks and the six largest savings banks unless specified otherwise. Where comparisons are made between accounting periods, allowance is made for Kaupthing Bank hf. which was granted a licence to operate as a commercial bank at the beginning of 2002. Comparative figures are adjusted accordingly unless specified otherwise.

2) These are Jyske Bank in Denmark, SEB in Sweden, DnB in Norway, Sampo in Finland, HVB in Germany, and Bank of Ireland.

figures, the decrease in this ratio has been rather slow for the past 5 to 6 years. In comparison, the median of comparable cost/income ratios at selected foreign banks was 54% in the year 2001.² The cost/income ratio of the four major banks was between 54% and 71% for the first half of 2002 and ranged from 47 to 99% at Sparisjóðabanki and the largest savings banks.

Figure 2 shows principal operating items as a percentage of the total assets of commercial and savings banks. If the situation from 1998 onwards is reviewed, operating costs as a percentage of total assets have decreased steadily, or from 3.7% in 1998 to 3.0% in the first half of 2002. Net interest income dropped from 3.1% in 1998 to 2.6% in the first half of 2002. Other operating income as a percentage of total assets reached a peak of 2.6% in 1999, then dropped over the next two years until 2002 when there was an upswing towards 2.1%. Provisions to loan-loss accounts were 0.66% in 1998, 0.60% in 1999, 0.54% in 2000, then rose to 0.80% in 2001 and reached 0.77% during the first half of 2002.

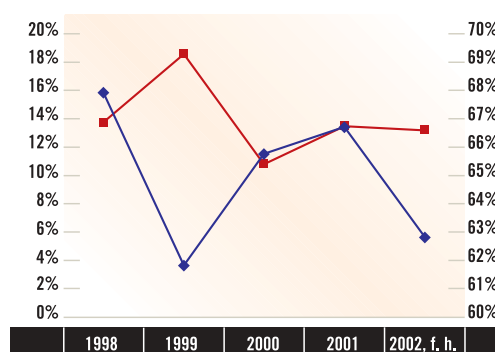


Figure 1.
Return on equity (ROE) and cost as a percentage of gross income of commercial and savings banks.

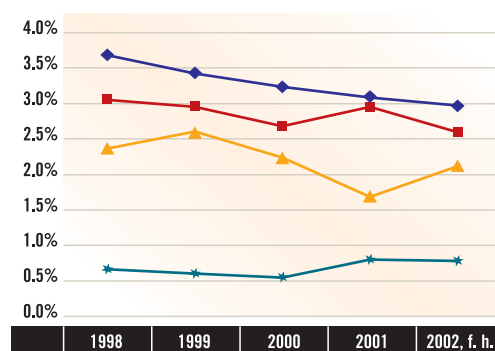


Figure 2.
Main operating items as a percentage of total assets of commercial and savings banks.

Increased credit risk

As shown in **Figure 3**, total defaults³ by households and industries amounted to ISK 25.6 billion at the end of June 2002, or 3.5% of lending, as compared with 13.3 billion, or 2.1% of all lending, at year-end 2000.

Defaults by households has been proportionally greater than that of industries. Defaults by households at the end of June 2002 thus amounted to ISK 10.5 billion, or 5.8% of loans to households, whereas defaults by industries at the same time stood at ISK 15.1 billion, or 2.7% of industrial lending. At year-end 2000, defaults by households reached ISK 5.8 billion, or 3.3% of loans to households, while defaults by industries amounted to ISK 7.5 billion, or 1.7% of loans to industries.

Households defaults are a particular case for concern owing to the high proportion of households debt as a percentage of their disposable income.

Recent months have witnessed an increase in non-performing loans⁴ as a proportion of total lending by commercial and savings banks, cf.

Figure 4. The proportion of non-performing loans thus amounted to 2.8% of all lending by commercial and savings banks at the end of June 2002, 1.9% at year-end 2001, and 1.6% at year-end 2000. Appropriated assets have not increased in line with the growth in non-performing loans. The growth in these types of loans is a clear indicator of increased lending risk for credit institutions which is likely, in turn, to result in an increase in loan-loss provisions.

Provisions to loan-loss accounts by commercial and savings banks totalled ISK 4.2 billion during the first six months of 2002, compared with ISK 3.2 billion for the same period in 2001. This corresponds to an increase of ISK 1 billion or 31% between accounting periods. This increase goes hand in hand with growing defaults and an upsurge in non-performing loans.

An increase in defaults, a growing number of non-performing loans, and an increase in loan-loss provisions are indicators of a deteriorating lending environment for credit institutions, which is likely to result in escalating loan losses over the months to come.

Figure 5 shows the twelve-month real increase in average lending (average lending adjusted to price level changes) and annual loan-loss provisions as a proportion of average lending. A closer look at developments over the past five years reveals a twelve-month real increase in average lending of 10-20% in the period 1997-2001. Recent months have witnessed a decrease in lending by credit institutions and the twelve-month real decrease in average lending is estimated to be around 4% in the year 2002. Annual loan-loss provisions as a proportion of average lending reached a peak of 4.2% in 1992. Annual loan-loss provisions kept dropping between 1992 and 2000 when it reached the lowest point of 0.85% of average lending. This

Figure 3.
Default to deposit institutions
(payments over one month past due).

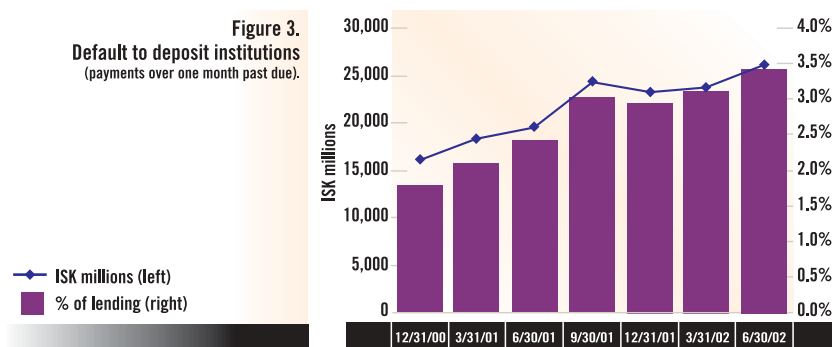


Figure 4.
Non-performing loans and
appropriated assets as a
percentage of total loans.

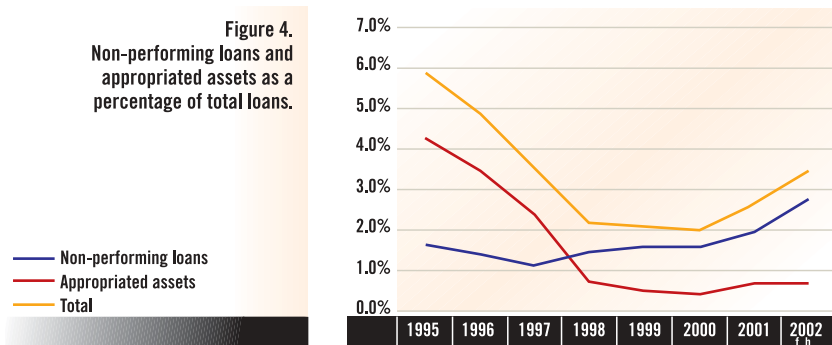
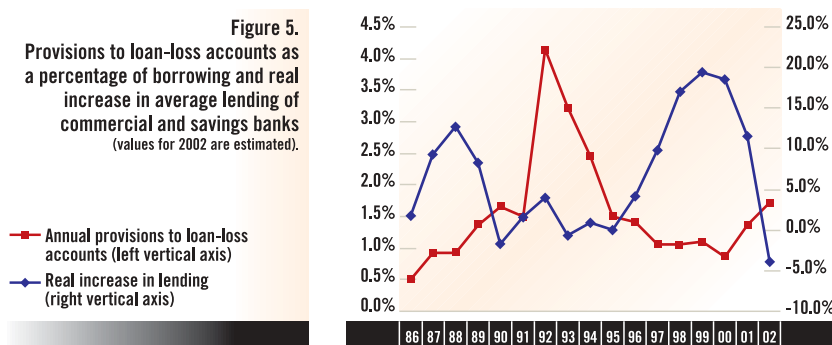


Figure 5.
Provisions to loan-loss accounts as
a percentage of borrowing and real
increase in average lending of
commercial and savings banks
(values for 2002 are estimated).



3) The definition of defaults in this analysis is having amortisation and interest payments in arrears more than one month past due. Kaupthing Bank hf. is included in statistics prior to the end of March and after.

4) Non-performing loans less specific loan-loss provisions. Appropriated assets are not included in the amount for non-performing loans.

ratio has been rising again in recent months and the loan-loss provisions as a proportion of average lending is expected to reach 1.7% in 2002.

Economic developments will, to a large degree, determine the need for loan-loss provisions in coming months.

The growth in lending up to 2001 was mostly financed through foreign borrowing and only to a relatively small extent through deposits or domestic securities issues. **Figure 6** shows the trend in net liabilities owed by major credit institutions to foreign parties in recent years. Net liabilities reached a peak at mid-year 2001 but since then the trend has been reversing steadily due, in part, to a revaluation of the Icelandic króna. These foreign loans are usually balanced against exchange rate-linked loans to domestic parties who receive, to a varying extent, income in the currencies involved, which imposes an indirect credit risk for the banks.

Increased stock of market securities

Part of the assets of credit institutions is tied up in market securities which are subject to market rate fluctuations. As shown in **Figure 7**, the net bond assets⁵ of commercial and savings banks at the end of June this year were ISK 73 billion, compared with ISK 62.1 billion at the same time in 2001. Net bond assets of commercial and savings banks thus increased by ISK 10.9 billion, or 17.6%. Net share assets⁶ at the end of June amounted to ISK 53.8 billion, compared with ISK 44.4 billion at the same time in 2001, which constitutes an increase of ISK 9.4 billion, or 21.2%. During this period, the total assets of commercial and savings banks increased by 6% and the required capital by 8.8%.

Bond and share ownership as a proportion of required capital increased between accounting periods. Net bond ownership as a percentage of required capital, thus, amounted to 81% at then end of June this year, required with 75% at the same time in 2001. Net share ownership as a percentage of required capital stood at 60% at the end of June, compared with 54% at the end of June 2001. These figures are a clear indicator of an increased market risk for credit institutions.

5) Bonds less forward contracts and swaps entered into against bonds.

6) Shares less forward contracts and swaps entered into against shares.

7) Íslandsbanki, Landsbanki, Búnaðarbanki, Kaupthing Bank and the six largest savings banks.

Present equity position must be maintained

The equity position of commercial and savings banks⁷ as defined by law amounted to ISK 102.1 billion at the end of June 2002, ISK 94 billion at year-end 2001 and 84.6 billion at the end of June 2001 and had thus increased by ISK 17.5 billion, or 21%, between June 2001 and June 2002.

By the end of June this year, commercial and savings banks had issued subordinated notes, which are classified under Own Funds Tier 2 and 3 in calculating capital adequacy ratios (CAR), amounting to a total of ISK 25.2 billion. At year-end 2001 subordinated Tier 2 and 3 notes amounted to ISK 27.1 billion and ISK 28.1 billion at the end of June 2001.

Towards the end of the year 2000, the FME authorised credit institutions to issue subordinated notes included under Own Funds Tier 1 in calculating CAR on the basis of a new regulation issued by the Ministry of Commerce. At the end of June 2002, subordinated Tier 1 notes amounted to ISK 6.1 billion, but stood at ISK 6.3 billion at year-end 2001 and ISK 5.5 billion at the end of June 2001.

According to the rules that apply to subordinated loans there are certain limits as to the degree to which they may be included in the calculation of capital adequacy ratios. By the end of June 2002 a number of credit institutions had made nearly full

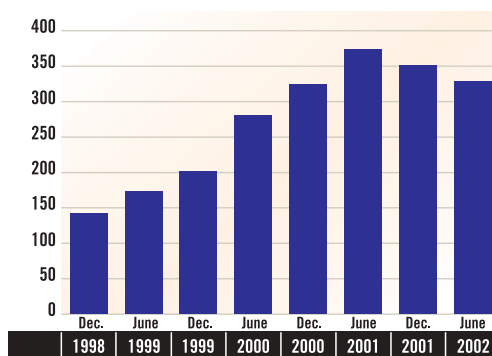


Figure 6.
Net liabilities of credit institutions to foreign parties (ISK billions).

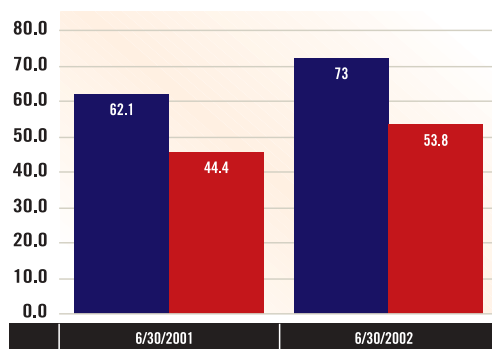


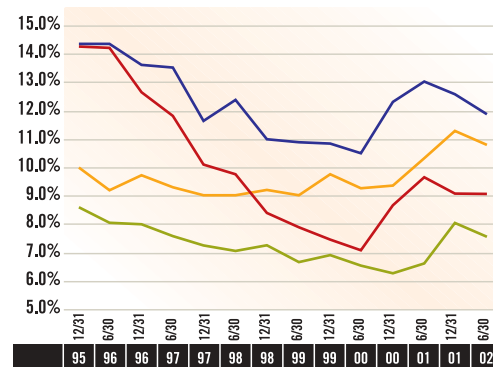
Figure 7.
Market value of securities, net, owned by commercial and savings banks (ISK billions).

use of their authorisation to borrow subordinated capital as indicated by Own Funds Tier 1. The leeway for subordinated Tier 2 and 3 borrowing was slightly greater.

The combined risk-weighted base of commercial and savings banks amounted to ISK 825.7 billion at the end of June 2002, as compared with ISK 826.5 billion at year-end 2001 and ISK 766.1 billion at the end of June 2001. The increase between June 2001 and June 2002 amounted to ISK 59.6 billion, or 7.8%, with a slight shrinkage during the first half of 2002.

Figure 8.
CAR with and without
subordinated loans included
under Own Funds Parts B and C.

— CAR commercial banks
— CAR savings banks
— CAR commercial banks, without
Tier 2 and 3 sub. loans
— CAR savings banks, without Tier
2 and 3 sub. loans



As shown in **Figure 8**, the CARs of commercial banks remained at a level of between 9 and 10% during the period 1995-2000, whereas CARs excluding subordinated loans Tier 2 and 3 declined steadily. During 2001 the CARs of commercial banks kept rising, but in the first half of 2002 they have dropped by 0.5 percentage points to 10.8% and 7.6% excluding subordinated loans Tier 2 and 3. Since 1995, the CARs of savings banks have dropped from just over 14% to 10.5% and 7.1% excluding subordinated loans Tier 2 and 3 compared with June 2000. From mid-2000 to mid-2001 the ratios rose to 13% and 9.7% excluding subordinated loans Tier 2 and 3. During the last two half years periods the CARs of savings banks have swung downwards again, thus reaching 11.9% and 9.1% excluding subordinated loans Tier 2 and 3 at the end of June 2002.

In recent years, the FME has warned against the possible effects of low CARs. In the case of commercial and savings banks it is clear that these ratios have been increasing in recent years. It is imperative that the commercial and savings banks at least maintain their current equity positions since there are signs that loan-losses will become more evident in future months.

2.2 The securities market

Increased securities market turnover

The total turnover of shares and bonds on the Iceland Stock Exchange has been growing steadily since the second quarter of the year 2000 when it reached ISK 91 billion. The growth in turnover was relatively slow until the last quarter of 2001 but then it soared to ISK 228 billion. This trend continued into the year 2002. This growth is largely due to trading in bonds, which has been progressively increasing since the second quarter of 2000, cf. **Figure 9**, with the exception of the last quarter of 2000 and the first quarter of 2002 where there was a slight decline. Share trading has, on the other hand, been increasing since the third quarter of 2001.

Higher amounts in individual transactions

Securities markets worldwide have been experiencing a period of downswing, which has been deepened further by the events of 11 September 2001 and recent accounting scandals. This trend has also been felt in the Icelandic securities market, although it seems to have been somewhat less

Figure 9.
Bonds and equities, total turnover. Turnover (ISK millions) on each year's price level and number of trades (thousands).

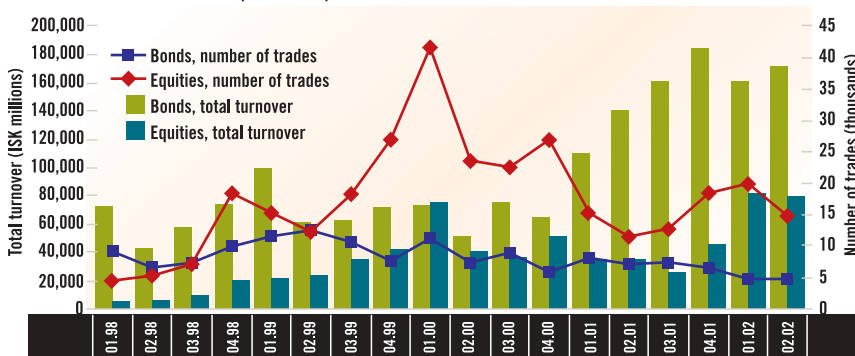
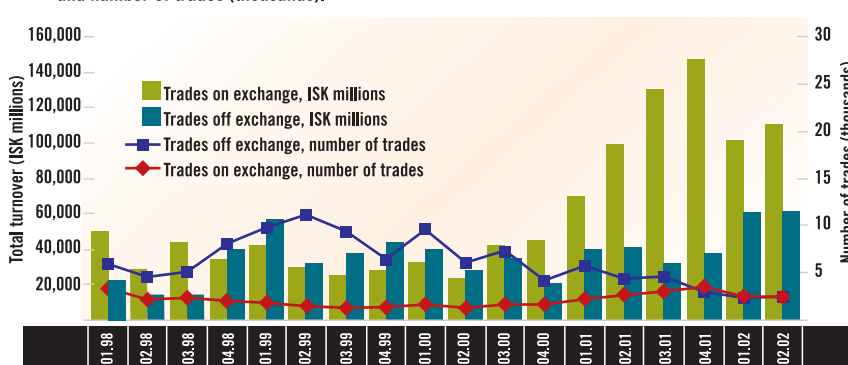


Figure 10.
Bonds, total turnover. Turnover (ISK millions) on each year's price level and number of trades (thousands).



severe and not as prolonged as in the largest foreign markets. In fact, there has been a steady recovery in the Icelandic market since the third quarter of 2001. Since the beginning of 2001 there has been considerable activity in the bonds market which appears, however, to have slightly slowed down in 2002, cf. **Figure 9**. A notable feature is the fact that the average amounts of each bonds transaction have been showing a steady increase each quarter. Generally speaking, growth in the share market means decline in the bonds market and vice versa. This correlation does, however, not seem to apply to conditions in the Icelandic market.

Figure 10 shows that the total turnover of trading in bonds outside the stock exchange has been increasing during this period whereas the total turnover of stock exchange transactions has dropped during 2002. A comparison of turnover and the actual number of transactions outside the stock exchange reveals a certain trend towards larger individual transactions.

Following a relatively steady downswing, share trading also flourished during this period, i.e. as of the last quarter of 2001, cf. **Figure 11**. The increase in turnover of share trading outside the stock exchange has been proportionally greater than the turnover of trade on the stock exchange and the amounts of individual transactions have also become higher. This is partly due to a number of business mergers and takeovers where payments are generally made by shares in the takeover firm. Such transactions take place outside the stock exchange.

Rising share indices

For some time, Icelandic share indices showed a steady rise and peaked during the first quarter of 2000, cf. **Figure 12**, when the overall index of the Main List reached 1800 points and the ICEX-15 index reached 1900 points. From then on the indices underwent a period of steady decline towards an all-time low during the third quarter of 2001 when the overall index of the Main List stood at 1000 points and the ICEX-15 index went below the 1000 point barrier. These indices have, however, been gradually recovering and have now reached 1300 points as of the third quarter of 2002. The overall index of the Main List has risen somewhat faster this year than the ICEX-15, or by 15.93% as opposed to 12.33%. The recovery of the Icelandic share indices is interesting when com-

pared with the situation in major overseas markets, where there is no evidence of a comparable upswing and share indices have been dropping during the year.

Fewer listed companies on the stock exchange

Between 1992 and 1999 the number of companies listed on the Icelandic Stock Exchange increased from 11 to 75, cf. **Figure 13**. This figure remained unchanged during the year 2000 but dropped after that to a total of 71 listed companies in 2001. By the end of September 2002 the number of listed companies had gone down to 66. Only one new listing has taken place this year (Vátryggingafélag

Figure 11.
Equities, total turnover. Turnover (ISK millions) on each year's price level and number of trades (thousands).

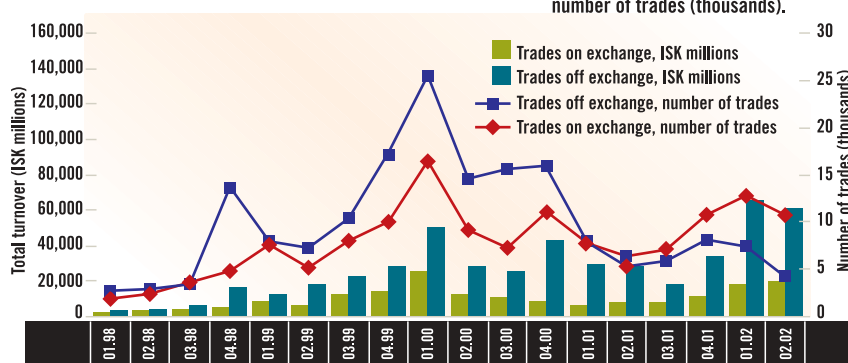
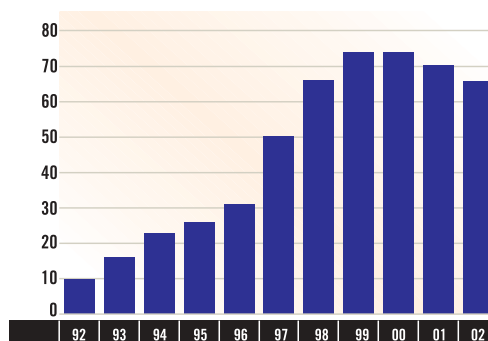


Figure 12.
The ICEX-Main index and the ICEX-15 index.



Figure 13.
Number of listed companies at Iceland Stock Exchange.



Íslands hf.) but six companies (Húsasmiðjan hf., Keflavíkurverktakar hf., Loðnuvinnslan hf., Skagstrendingur hf., Talenta Hátækni hf., Útgerðarfélag Akureyringa hf.) had been delisted as of the third quarter of 2002. Two more companies were delisted at the beginning of October (Delta hf., and Þróunarfélag Íslands hf.). There has been some concentration in the pharmaceutical and fisheries sectors and further restructuring is forecast in the fisheries sector. Equity funds have also announced operational changes and two funds are at present discussing mergers with other companies. Only one company has announced publicly its intention to apply for a listing on the Icelandic Stock Exchange before the end of the year. The remainder of the year is thus likely to witness a further reduction in listed companies as notification has already been made of the prospective delisting of a num-

ber of companies during the fourth quarter of this year. The reasons for the above-mentioned delistings are twofold: on the one hand, companies have been delisted following mergers with companies that are also listed on the Stock Exchange and, on the other, because they no longer met the requirements for distributed ownership. A closer look at the delisted companies reveals that trading in their shares has been negligible. This can, therefore, only be regarded as a positive trend for the securities market as the remaining companies grow stronger and the marketability of their shares increases, which in turn reduces the risk to investors.

2.3 The pension savings market

Negative real rate of return for 2001

Net assets for pension payments at year-end 2001 amounted to ISK 644.8 billion. The real increase of net assets in 2001 was 5%, which is exactly the same result as in the previous year. Premiums rose from ISK 49.7 billion in the year 2000 to ISK 62.7 billion in 2001 and pension payments from ISK 18.9 billion to ISK 22.2 billion, thus giving a net increase in deposits by ISK 9.7 billion. The net real rate of return of pension funds for the year 2001 was negative by 1.9%. **Figure 15**, which illustrates the real rate of return for the years 1991-2001, also shows the atypical results for the years 2000 and 2001 as the average rate of return over the past 10 years has been 5.9%. Changes in the asset portfolios of pension funds, i.e. increases in the ownership of shares and units in mutual funds, will cause enhanced fluctuations in rates of return in the future.

Compared to other economic figures, pension fund assets have increased from 39% of gross domestic product (GDP) in 1990 to over 86% at year-end 2001. Pension fund assets as a proportion of the credit system's total liabilities have risen from 26% in 1991 to 34% in the year 2001, cf. **Figure 14**.

Pension fund investment limits

The Pension Fund Act contains quantitative provisions regarding investments, which aim to diversify assets over a range of selected securities categories. The provisions furthermore stipulate that investment decisions shall take into consideration risk factors as well as expected rate of return. Pension fund investments and categorisation of assets have been subject to special examination by the FME since year-end 2000. Most investments are now in

Figure 14.
Pension fund assets.

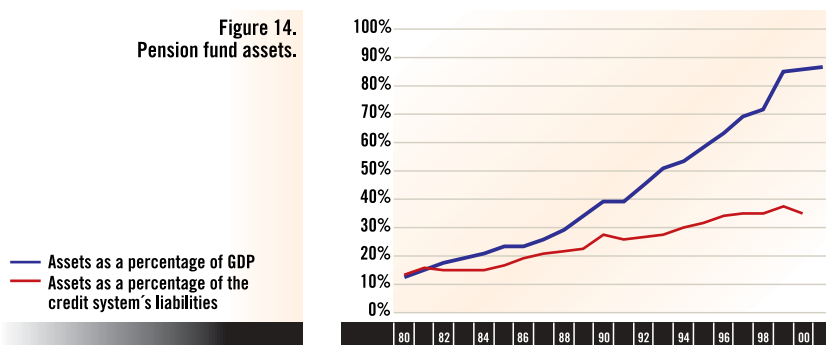


Figure 15.
Net real rate of return of pension funds.

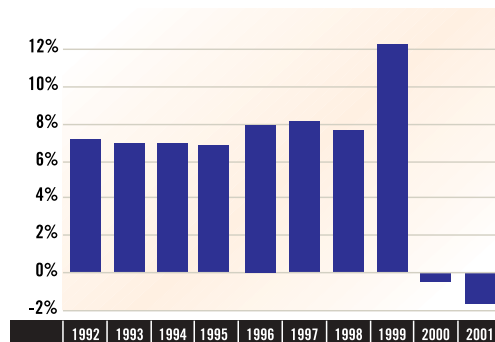
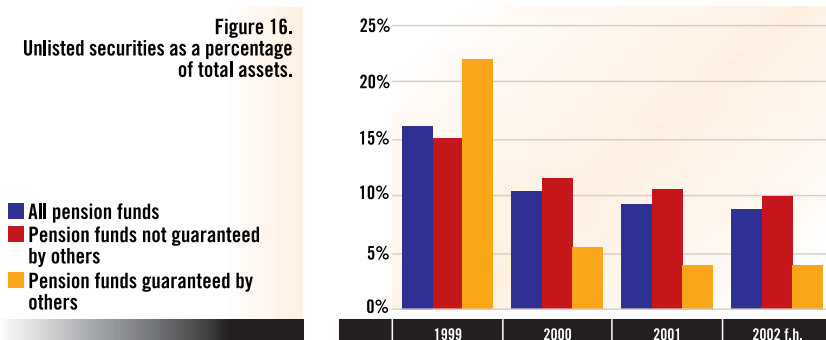


Figure 16.
Unlisted securities as a percentage of total assets.



keeping with the Pension Fund Act. The FME has primarily made observations concerning investments in excess of the legal limits in unlisted securities after the entry into effect of the Pension Fund Act.

Small changes in asset structure/allocation

The proportion of unlisted securities at year-end 2001 amounted to 9% of the net assets of pension funds, compared with 10% in the previous year, cf. **Figure 16**. Although the overall proportion of unlisted securities was below the stipulated maximum, 23 of 54 pension funds had more than 10% of their net assets for pension payments in unlisted securities. By 30 June this year, however, the number had dropped to 21.

Share ownership by Icelandic pension funds as a whole at year-end 2001, both direct ownership and through mutual funds, amounted to ISK 192 billion, or 30% of net assets for pension payments, compared with ISK 181 billion, or 32% of net assets, at year-end 2000, cf. **Figure 17**. At year-end 2001 the percentage of shares as a proportion of the net assets of pension funds/divisions ranged from 0-49%, but the highest permitted ratio is 50%. By 30 June this year, share ownership by the pension funds as a whole had reached at 27.7%.

Figure 17 shows that there is little difference now in share ownership between guaranteed and non-guaranteed pension funds, whereas it was striking in 1999 and 2000.

Foreign currency assets of pension funds dropped from 23% at year-end 2000 to 22% at year-end 2001, but the limit stipulated by the Pension Fund Act is 50% of total assets. No fund was close to the maximum, but seven funds/divisions had more than 30% of their assets in foreign currencies with the highest ratio being 39%. By 30 June this year the ratio of foreign currency assets of pension funds had dropped to 18%. As shown in **Figure 18**, there is a negligible difference between the foreign currency assets of guaranteed and non-guaranteed pension funds, which is a big change from the year 1999.

Financial position of pension funds

According to the Pension Fund Act, a pension fund is regarded as showing a balance if the difference between net assets for pension payments plus future premiums at their present value, on the one hand, and total pension obligations, on the other hand, does not exceed 10%, or 5% over a period of five consecutive years.

At year-end 2001, 27 of 45 non-guaranteed mutual insurance divisions were operated at a loss. Of these, two showed a deficit in excess of 10% and 9 divisions had a deficit ranging from 5-10%. Eighteen divisions showed an operating surplus and one had a surplus of over 10%. If an annual actuarial survey reveals an imbalance in the funding of a pension fund, its articles of association must be amended in order to correct the balance. By the end of 2002, five years will have passed since the entry into effect of the Pension Fund Act. At that time its provisions concerning pension funds which have shown an imbalance of 5-10% for five consecutive years and are, consequently, required to amend their articles of association will be put to the test.

The mutual insurance divisions of pension funds guaranteed by the National Treasury, municipal authorities or banks are exempt from the provisions regarding full funding. None of these funds accept new members, apart from two funds that have availed themselves of the option permitted by law to establish new divisions based on the principle of full funding. The financial position of guaranteed pension funds is generally poor on account of their closures, which entail a faster depletion of assets even though the increase in long-term commitments has been reduced. This applies to a total of 17 mutual insurance divisions, of which 15 show a deficit ranging from 4-96% whereas the remaining two show a balance.

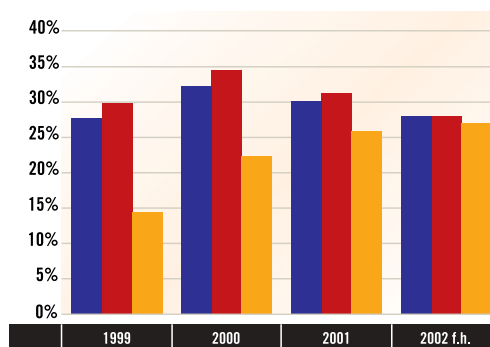


Figure 17.
Share ownership as a percentage of total assets.

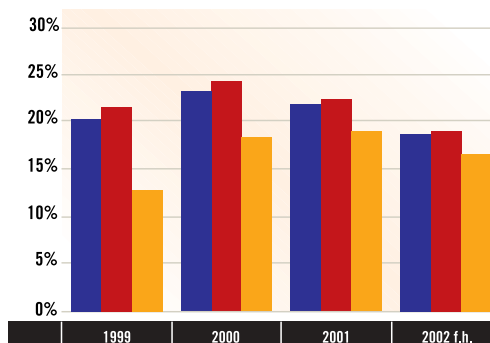


Figure 18.
Assets in foreign currencies as a percentage of total assets.

The pension burden of pension funds, i.e. pension payments as a ratio of premiums, is a useful gauge for predicting the position and future prospects of pension funds. The pension burden increases with the age of the fund and a heavy burden means a speedier depletion of the fund's assets. The pension burden of non-guaranteed pension funds is 0-180% and the pension burden of guaranteed pension funds ranges from 0.3-170%. The overall pension burden of Icelandic pension funds is 35.4%.

Increased pension system diversity

On 1 July 2001 the number of pension funds was 52, but 11 of these no longer receive premiums, which leaves a total of 41 fully active funds. Of the 52 (41) pension funds, 38 (28) are pension funds without employer guarantee, while 14 (13) funds are guaranteed by other parties.

A number of pension funds operate more than one mutual insurance division, providing for varying pension rights and 21 pension funds also operate personal pension schemes. All in all, the mutual insurance divisions and personal pension schemes total 103.

The division of the total assets of pension funds at year-end 2001 by pension schemes is as follows: pension units schemes ISK 443.6 billion (68.8%), final salary schemes ISK 127.7 billion (19.8%), age-based units schemes ISK 30.6 billion (4.7%), and personal pension schemes ISK 42.8 billion (6.6%). **Figure 19** shows that this asset division has remained relatively unchanged since year-end 1999, the only major change being an increase of nearly 5% in assets in the age-based and final salary schemes at the expense of assets in the more traditional pension units schemes. The increase in the final salary schemes is largely on account of pre-

mium payments in the B-division of the Civil Servants' Pension Fund. Personal pension savings still form only a very small part of the overall assets of the pension funds.

Supplementary pension cover and personal pension savings

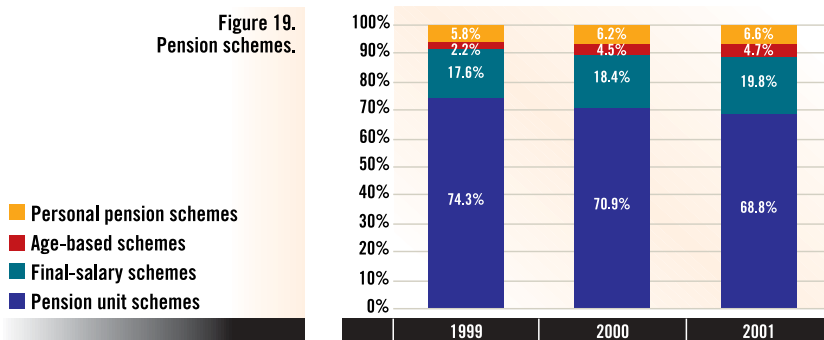
At present, there are 50 depositories for pension savings, i.e. 22 pension funds, 4 banks, 20 savings banks, 3 life insurance companies and 1 securities firm.

According to information obtained by the FME from pension savings depositories, this type of savings has been increasing in recent years. The assets of the personal pension divisions, excluding the 7 funds operating purely as personal pension savings funds prior to the entry into effect of Act 129/1997 on 1 July 1998, amounted to ISK 1.0 billion at year-end 1999, ISK 1.9 billion at year-end 2000, and ISK 3.4 billion at year-end 2001. Pension savings with depositories other than pension funds amounted to ISK 0.6 billion at year-end 1999, ISK 2.0 billion at year-end 2000, and ISK 5.5 billion at year-end 2001. Pension savings with other depositories than funds operating purely as personal pension savings funds prior to the entry into effect of Act 129/1997 thus amounted to ISK 8.9 billion at year-end 2001. **Figure 20** shows a more detailed breakdown of pension savings by depositories and the developments over the past three years.

Total personal pension savings deposited with pension funds and other depositories amounted to ISK 30.6 billion at year-end 1999, ISK 37 billion at year-end 2000, and ISK 48.3 billion at year-end 2001. The biggest part of personal pension cover is thus tied up with the seven pension funds operating purely as personal pension savings funds prior to the entry into effect of Act 129/1997.

Personal pension cover can stem from a supplementary premium in excess of the mandatory 10% premium on the one hand, or from the mandatory 10% minimum premium on the other hand. Personal savings from the mandatory 10% premium are divided between a minimum pension guarantee and a private account for supplementary cover. Seven pension funds make use of the legal authorisation to define minimum pension cover as lower than 10% and offer a minimum pension cover which is an integration of personal and mutual savings. A fund member may, at no extra cost,

Figure 19.
Pension schemes.



divert his/her premium payments that are defined as personal savings to a different depository.

Net assets of pension funds amounted to ISK 644.8 billion at year-end 2001 and pension savings with depositories other than pension funds amounted to ISK 5.5 billion. Personal and mutual pension savings thus came to ISK 650.3 billion at year-end 2001. Pension savings with depositories other than pension funds operating purely as personal pension savings funds prior to the entry into effect of Act 129/1997 was thus 1.4% of the total assets of pension funds and other depositories, whereas total personal pension savings with pension funds and other depositories was 7.5%.

2.4 The insurance market

Increased profit of insurance companies

The year 2001 was characterised by an improved performance of insurance companies compared with previous years. This is, in part, the result of a relatively small increase in claims incurred for own account against premiums earned for own account, but claims incurred for own account had escalated during 1999 and 2000.

The following section provides details of the activities of Icelandic insurance companies as they are presented in their annual accounts for the year 2001. All amounts have been adjusted to price levels in 2001. Changes in amounts from one year to the next are thus changes in excess of price level changes. Iceland's natural catastrophe insurer (Viðlagatrygging Íslands), which operates under special legislation, has a clearly defined role and is omitted from the following account of the activities of insurance companies. Premiums for natural catastrophe insurance in 2001 amounted to ISK 721 million while claims were ISK 161 million, compared with claims to the amount of ISK 2.6 billion in the year 2000.

Total profit of insurance companies⁸ was ISK 2.7 billion in 2001, which corresponds to a 71% increase. **Figure 21** illustrates profit developments since 1997.

In the profit and loss accounts, income from investments is divided between insurance opera-

tions and financial activities. The profit of each part is then calculated separately. This division affects neither total investment income nor the results of the profit and loss account. Profit from insurance operations had shown a steady annual decline since the introduction of this accounting method for the year 1996, whereas profit from financial activities had increased. The year 2001 was, however, a watershed when profits from insurance operations reached their highest level since 1996 but profits from financial activities decreased. Nevertheless, all areas can be regarded as having shown considerable profit.

Figure 22 illustrates the division of total profit from the principal activities of insurance companies since 1997.

Drop in claims – increased premiums

Earned premiums of non-life insurance companies kept rising throughout 2001. The premium increase was 9% in excess of price level changes over the previous year, or ISK 1.6 billion, with earned premiums amounting to ISK 19.9 billion. In the case of motor vehicle insurance alone, the increase was ISK 1.9 billion. There was also a slight increase in premiums for other types of direct insurance, but this was offset by a considerable reduction in

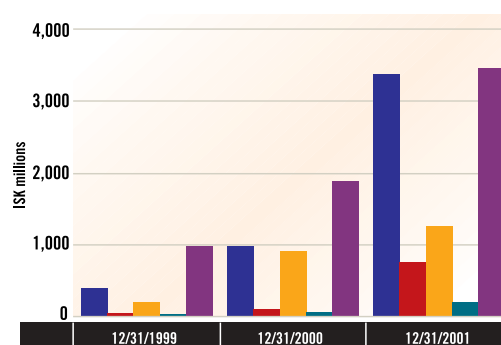


Figure 20. Pension savings by depositories other than pension funds operating purely as personal pension savings funds prior to the entry into effect of Act 129/1997.

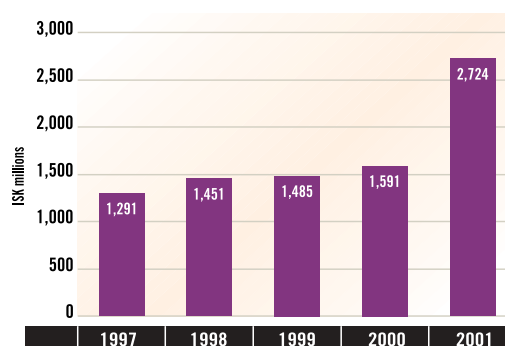


Figure 21. Total profit of insurance companies at 2001 prices.

⁸ These figures are the aggregated results of all the insurance companies. No consideration is made for insurance companies owning holdings in other insurance companies, so a part of the profit is reported twice.

reinsurance premiums. Premiums in domestic reinsurance dropped by ISK 800 million, or 71%.

On the other hand, there was a decrease in claims between years by ISK 1.6 billion, or around 8%. The largest contributing factor here is property insurance, where the figure for claims fell by ISK 800 million. Similarly, claims in compulsory motor vehicle insurance decreased by ISK 460 million although they still remain higher than premiums. Claims in domestic reinsurance decreased by ISK 600 million. After deducting the share of the reinsurers from premiums and claims, own premiums amounted to ISK 16.7 billion and own claims to ISK 16.2 billion.

Figure 23 shows trends in premiums and claims for non-life insurance since 1997, both gross

amounts and premiums and claims for own account. Despite an overall decrease in claims during 2001, claims incurred for own account have increased due to some heavy claims in the previous year that were to a larger extent met by reinsurers.

In addition to premiums and claims, operating costs, investment income and changes to equalisation provisions have a substantial effect on the profitability of insurance activities. Operating costs were ISK 3.5 billion and have increased steadily in recent years. Equalisation provisions for the year totalled ISK 269 million. During the year, insurance companies were required to adopt specific rules to determine changes in the equalisation provisions. Only those companies that have adopted such rules and had them ratified by the Financial Supervisory Authority are authorised to make equalisation provisions.

Figure 22.
Total profit from principal activities of insurance companies at 2001 prices.

■ 1997
■ 1998
■ 1999
■ 2000
■ 2001

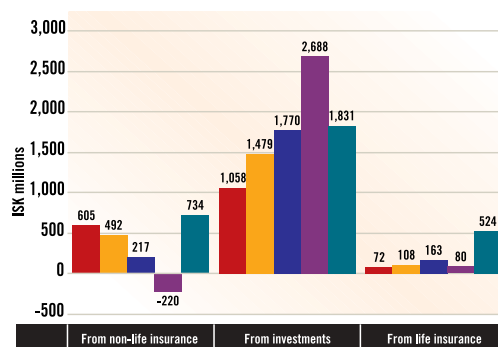


Figure 23.
Trends in premiums and claims for non-life insurance, with gross and net amounts at 2001 prices.

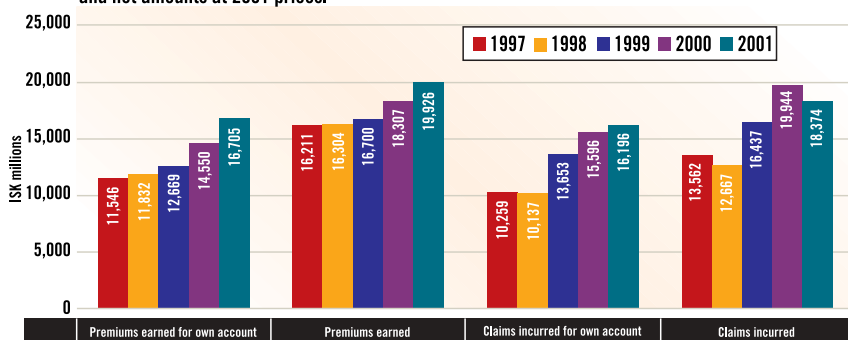
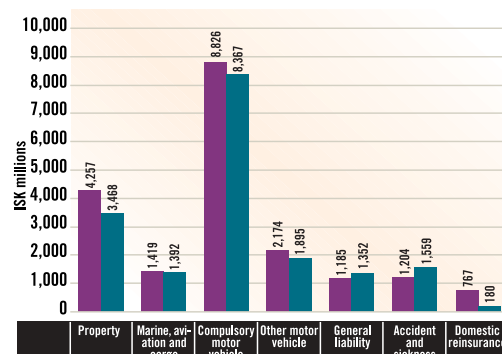


Figure 24.
Claims incurred at 2001 prices.



Individual classes of non-life insurance

Figure 24 illustrates the breakdown of claims by insurance classes with comparison with the previous year. Claims in property insurance dropped by ISK 800 million, or around 19%. There has been a decrease in reinsurance operations by Icelandic insurance companies since the largest reinsurer, Íslensk endurtrygging hf., has ceased taking on new insurance. There has, on the other hand, been a steady growth in general liability and accident and sickness insurance over the years, both as regards premiums and claims.

Claims incurred in compulsory motor vehicle insurance decreased by ISK 500 million, or 5%, and amounted to ISK 8.4 billion, which corresponds to 46% of all direct insurance claims in the country. Provisions for claims outstanding increased by ISK 2.9 billion, whereas paid claims amounted to ISK 5.9 billion. Claims in the year 2000, at that year's prices, amounted to ISK 8.3 billion, with the increase in claims outstanding being ISK 2.7 billion and paid claims amounting to ISK 5.6 billion. Claims in compulsory motor vehicle insurance were ISK 513 million, or 7%, in excess of premiums. In all insurance activities as a whole, however, premiums above claims amounted to ISK 1.56 billion, of which premiums in excess of claims in optional motor vehicle insurance were ISK 1 billion, or 51%.

Figure 25 illustrates the trend in premiums by major non-life insurance classes during the year as well as the weight of each class in premiums earned.

Premiums earned for direct insurance in 2001 totalled ISK 19.6 billion, while the corresponding claims were ISK 18.0 billion. Premiums for reinsurance written by Icelandic insurers were just over ISK 320 million, while claims were ISK 356 million.

Premiums earned in compulsory motor vehicle insurance increased by ISK 1.6 billion from the previous year, or around 25%. Premiums for motor vehicle insurance were raised in mid-year 2000 and part of this rise was thus being realised in 2001. The share of compulsory motor vehicle insurance in gross direct insurance premiums was 40% compared with 37% in the previous year. Motor vehicle insurance of all types has increased steadily in recent years and accounted for 55% of gross direct insurance premiums in 2001.

Expansion in life insurance

Recent years have seen a sure and steady growth in written life insurance premiums. Premiums increased by ISK 353 billion at fixed prices, or 23%. Written life insurance premiums were ISK 1.9 billion in 2001. Life insurance involving policyholder investment risk continues to grow and nearly doubled in scope during the year.

Figure 26 illustrates the trend in written life insurance premiums over the period 1997-2001. In addition to premiums paid to domestic life insurance companies, premiums to the amount of ISK 516 million were paid to foreign life insurance companies through domestic insurance brokers.

Assets increase

The cumulative assets of insurance companies totalled ISK 71.0 billion at year-end 2001, an increase of ISK 7.7 billion over the previous year. In accordance with the nature of insurance activities, investments were the largest asset item of the companies, amounting to ISK 50.9 billion at the end of 2001. Technical provisions are the largest liabilities item, or ISK 48.0 billion. Roughly speaking, investments and technical provisions comprise close to 70% of the balance sheet.

Figure 27 shows developments in main investment items since 1997. Growth in investment was particularly in variable-yield securities, but investment in fixed-yield securities also increased. Automobile loans decreased during 2001.

The assets of a number of insurance companies abroad have been considerably depleted as a result of the recent slump in the share market. This trend has not affected the Icelandic insurance market to the same extent. Domestic shares have not taken as deep a plunge as foreign ones, and the share ownership of the insurance companies is mostly domestic. Icelandic insurance companies enter their shares at acquisition cost or market value, whichever is lower at the end of the accounting year. At year-end 2001 the book value of the listed shares held by the three largest insurance companies in Iceland amounted to ISK 13.1 billion and their market value was ISK 16.2 billion.

Figure 25.
Premiums earned in the main non-life classes at 2001 prices.

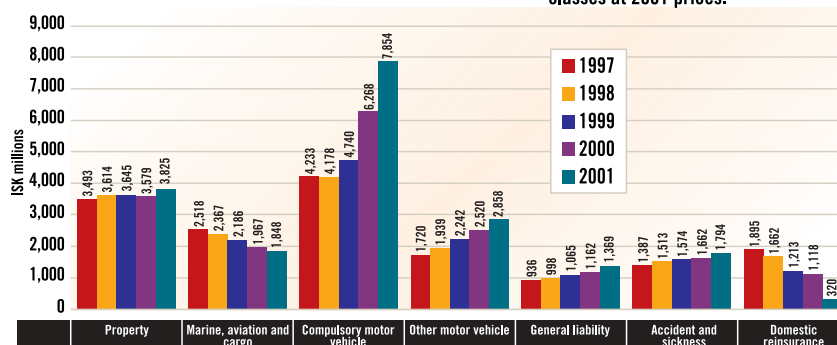


Figure 26.
Premiums written in life insurance at 2001 prices.

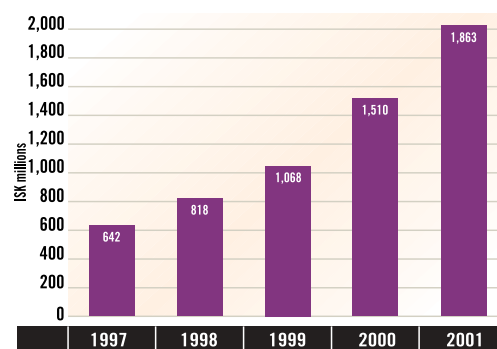


Figure 27.
Principal classes of investments at 2001 prices.

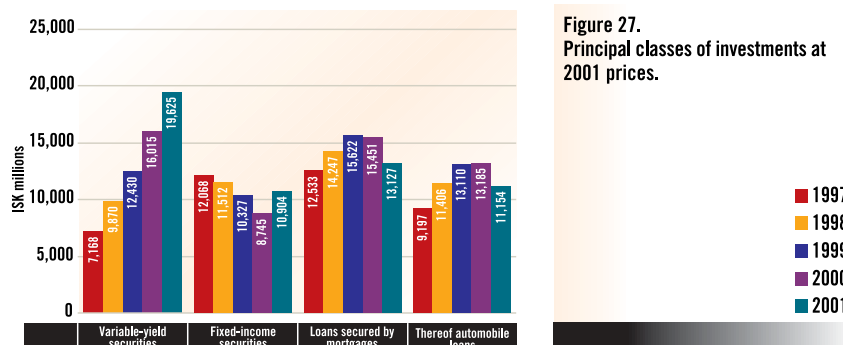


Figure 28.
Own capital and reserves,
and technical provisions at
2001 prices.

■ 1997
■ 1998
■ 1999
■ 2000
■ 2001

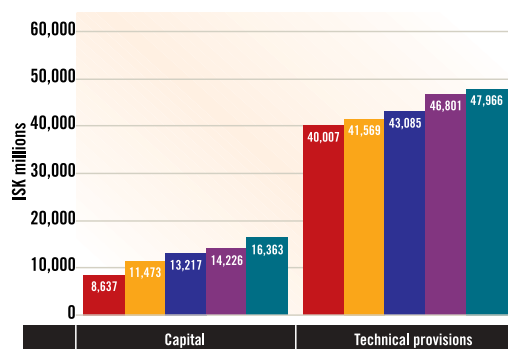


Figure 29.
Main components of
technical provisions at
2001 prices.

■ 1997
■ 1998
■ 1999
■ 2000
■ 2001

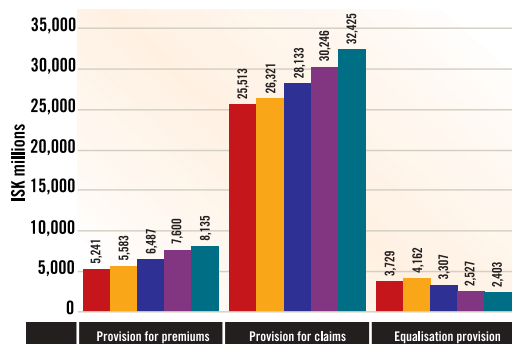


Figure 28 shows own capital and total technical provisions. Both items have grown steadily. Some capital is, however, reported twice on account of holdings which insurance companies have in other insurance companies.

Gross provisions for claims for all insurance classes were ISK 35.5 billion, or three-quarters of the technical provisions. Thus, the claims provision is a good half of the balance sheet total. Claims provision in compulsory motor vehicle insurance was ISK 22.6 billion, or around two-thirds of the claims provision.

Figure 29 shows the development of the principal components of own technical provisions. The reinsurers' share in the technical provisions, which amounted to ISK 4.5 billion at year-end 2001, is entered as an asset item in the annual accounts. Own technical provisions totalled ISK 43.5 billion, which is an increase by ISK 5.2 billion from the year 2000.

Provision for unearned premiums rises in line with increased activities and higher cost of automobile insurance. Similarly, there is an increase in claims provisions since unsettled claims are valued at a higher price than the settlement of older claims during the year. As in previous years, the increase in claims provisions is largely on account of compulsory motor vehicle insurance. Included in that figure are accident claims, which normally have a prolonged settlement phase. Technical provisions in this class amount to ISK 2.6 billion. Equalisation provisions, as measured at a fixed price level, appear to have shrunk slightly.

3. EMPHASES IN FME'S WORK IN THE COMING YEAR

FME has based its activities on clear emphases formulated with regard to the financial market's strengths and vulnerabilities. These emphases do not change in principal respects from one year to the next, but form the cornerstone of FME's long-term activities. A summary of the activities in Chapter 1 describes most of the tasks placed on the working agenda and carried out in accordance with these main points of emphasis.

3.1 Role of boards of directors in risk management and internal controls

To encourage every financial company to have management capable of providing the company with a strong structure, clear policy, effective internal rules and work procedures, a suitable information system and internal auditing. Enabling the managers themselves and other employees to correctly evaluate the risk involved in activities and to manage it in accordance with the strengths of the enterprise.

Major shocks in the activities of financial companies can almost without exception be traced to weaknesses in their direction, risk management and internal controls. In its activities FME has gathered broad experience and knowledge of the activities of boards of financial companies and the ways which are open to them to carry out their role.

Until now, FME has emphasised relations with the boards of companies in difficulties or where serious objections have been raised as part of the supervision. In the next year or so FME will seek to increase information provision and its relations with the boards of financial companies in general. Thus FME intends to invite members of the boards of financial companies in each sector of the financial market to information sessions, where the role of the boards will be discussed, together with the means they have to perform their function. Emphasis will be placed on discussing those aspects where problems have recently occurred.

There is good reason to pay special attention to how internal controls are applied by financial companies. Internal controls are frequently in the hands of external auditors, in accordance with a specific agreement. The general experience of this arrangement indicates a need to consider further separation of external and internal auditing, and FME intends to raise this issue with the interested parties. FME has, furthermore, raised the issue of

necessary legislation to require insurance companies and undertakings engaged in securities services to have internal auditing which is directly responsible to the board of the company in question.

3.2 Conduct of business practices on the financial market

FME monitors the activities on the financial market to make sure they are in accordance with proper and sound business practices. Accordingly, FME emphasises keeping track of conduct of business practices on the financial market.

FME has recently placed emphasis on strengthening its market surveillance and creating the premises for effective supervision of the securities market. Furthermore, FME has given special consideration to conduct of business practices in the insurance market and pension funds market.

In the opinion of FME, special attention needs to be given to conduct of business practices on the financial market in connection with supervision of owners of qualifying holdings in financial companies. The major changes in the ownership of financial companies in recent months, and past experience, gives FME reason to examine especially how acquisition of qualifying holdings is carried out, the participation of owners of qualifying holdings on boards of financial companies, and their impact on the activities of the company in question. Under current legislation FME is intended to play an important role in this area, since approval must be sought for purchase of qualifying holdings and the law provides means for continuing supervision after the purchase has taken place.

In this connection FME will place increased emphasis on keeping track of business connections between financial companies and parties related to them, e.g. members of the boards of financial companies, their largest shareholders, and companies with connections through their holdings or management with financial companies. This applies not least to credit institutions.

Risk management and internal control.

Examples of general actions during the last period:

- Formal guidelines on internal controls and risk management of financial companies (1/2002).
- Strengthening rules on assessment of loan-loss provisions (5/2002).
- Strengthening supervision of CAR and quality of loan portfolios.

Conduct of business practices on the financial market.

Examples of general actions during the last period:

- Building up market surveillance in the securities market.
- Discussion paper on guidelines for analysis/research departments.
- Discussion paper on guidelines for conduct of business practices in insurance brokering.

3.3 Market discipline

FME emphasises encouraging increased transparency in the activities of financial companies. Doing so leads to increased discipline exerted by the market, accompanied by the restraint of internal control and official supervision of financial activities.

Market discipline.

Examples of general actions during the last period:

- Review of regulation on annual accounts of insurance companies other than life assurance companies (No. 951/2001) and formal guidelines on financial accounts of insurance companies (4/2002).
- Formal guidelines on supplementary information concerning financial instruments in annual accounts of credit institutions.
- Discussion paper on new reporting obligations for pension funds on actuarial assessments.

Competitiveness of the financial market.

Examples of general actions during the last period:

- Complying with IMF comments and suggestions made during the Fund's investigation of the stability of the Icelandic financial system.
- Concerted structuring of FME's participation in foreign co-operation.

FME will continue to examine the question of auditing and harmonisation of accounting on the financial market. Developments in legislation abroad have been followed, as improvement and harmonisation of accounting is the subject of considerable discussion both within the EU and elsewhere.

In the next year or so FME will examine the issue of increased transparency in the financial market. FME is to show confidentiality towards the parties involved when dealing with individual cases, and will continue to do so. On the other hand, because of the principle of transparency on the securities market and equal treatment of investors, FME is obliged to seek all means of disseminating information on its activities, the situation of financial markets and financial stability. By so doing FME can, for its part, encourage increased market discipline. FME will continue to make use of its website and other publications to this end.

FME places increased emphasis on its function to promote discussions on issues relevant for the financial market. This is currently directed primarily at employees of financial companies, but is also useful in increasing knowledge on the financial market in general. Enlargement of its premises means that FME now has the facilities to perform this function to an increased extent, by inviting groups of interested parties to seminars and discussions.

3.4 Competitiveness of the financial market

FME has a role to play in creating a competitive financial market in Iceland. Furthermore, FME should take part in shaping that financial market and safeguarding perspectives of customer interests and security in financial services.

The competitiveness of the Icelandic financial market is both a premise and reason for effective connections between the market and foreign financial markets. The steadily increasing activities of Icelandic financial companies abroad is an important aspect of building up the competitiveness of the financial market as a whole. At the same time, this foreign participation would hardly be conceivable unless domestic financial companies could meet competitive requirements.

Increased foreign participation by domestic financial companies calls for changes in FME's surveillance of their activities and reinforcement of supervision on a consolidated basis. For this reason FME places emphasis on strengthening still further its co-operation with supervisory bodies in the countries where these activities are underway.

4. PARTIES SUBJECT TO SUPERVISION

4.1 Number of parties subject to supervision

As of 30 June 2002, the number of parties subject to FME's supervision was as follows:

Parties subject to supervision	Number	Operate in accordance with Act No.:
Commercial banks	5	113/1996, as subsequently amended
Savings banks	24	113/1996, as subsequently amended
Other credit institutions		123/1993, as subsequently amended
Investment banks	4	123/1993, as subsequently amended
Investment funds	4	123/1993, as subsequently amended
Leasing companies	3	123/1993, as subsequently amended
Deposit departments of co-operative societies	9	22/1991, as subsequently amended
Securities companies	5	13/1996, as subsequently amended
Securities brokers	3	13/1996, as subsequently amended
Mutual Funds (UCITS)	10	10/1993, as subsequently amended
Management companies of mutual funds (UCITS)	6	10/1993, as subsequently amended
Stock exchanges and regulated alternative markets	1	34/1998, as subsequently amended
Central securities depositories	1	131/1997, as subsequently amended
Pension funds	52	129/1997, as subsequently amended
Insurance companies	13	60/1994, as subsequently amended
Insurance brokerages	18	60/1994, as subsequently amended
Other parties subject to supervision	5	Various Acts
Total	163	

4.2 Changes in the operating licences, names and number of parties subject to supervision during the period 1 July 2001 to 30 June 2002

The credit market

In September of 2001, the name of the savings bank Sparisjóður Önundarfjarðar was changed to Kaupthing Savings Bank and the name of the savings bank Sparisjóður Súðavíkur to nb.is-savings bank, after new guarantee capital owners entered the operations of these funds and their establishments were moved to Reykjavík. The principal activities of the savings banks in their former locations had previously been merged with the savings bank Sparisjóður Vestfirðinga with the Minister's approval of 15 June 2001. Both savings banks formally re-commenced their operations at the end of December 2001. The Minister of Commerce approved the merger of Lýsing hf. with Búnaðarbanki Íslands hf. on 16 November 2001. On 24 April 2002, a new company, Lýsing hf., received an operating licence as a credit institution on the basis of Act No. 123/1993. The company took over the operations of the former company of the same name. On 11 January 2002 Kaupthing bank hf. was granted an operating licence as a commercial bank on the basis of the Commercial Banks and Savings Banks Act, No. 113/1996. The company formerly operated as a credit institution on the basis of Act No. 123/1993, when it was called Kaupthing hf. In March 2002 the name of Íslandsbanki-FBA hf. was changed to Íslandsbanki hf.

The securities market

Undertakings engaged in securities services

On 7 November 2001 Verðbréfafyrirtæki Lifiðnar og Sameinaða lifeyrissjóðsins was granted a licence to operate as a securities company on the basis of Act No. 13/1996, on Securities Transactions; the company formerly operated as a securities broker under the name of Verðbréfamiðlun Lifiðnar og Sameinaða lifeyrissjóðsins. On 14 January 2002 the Minister of Commerce then confirmed the licence of Virðing hf. to operate as a securities company, after the name of the aforementioned company had been changed. On 27 November 2001 the Minister of Commerce revoked the operating licence of the securities company Burnham International á Íslandi hf., making reference to Point 2 of the first paragraph of Article 60 of Act No. 13/1996, on Securities Transactions. Following this the company's estate went into receivership. On 11 January 2002 the Minister of Commerce approved the merger of Landsbréf hf. and Landsbanki Íslands hf. The licence of Landsbréf to operate as a securities company was cancelled as of that same day.

Mutual funds and management companies of mutual funds

On 26 November 2001 a shareholders' meeting of Verðbréfasjóðurinn hf. and Hávöxtunarfélagið hf. approved merger of the two companies. The merger of their financial accounts is based on 30 July 2001, as on that day Hávöxtunarfélagið hf. assumed all rights and obligations of the other company. On 17 December 2001, Vísitölusjóður BÍ hf. was granted an operating licence as a mutual fund which may only be marketed in Iceland, in accordance with Article 2 of Act No. 10/1993, on UCITS. The company has concluded an operating agreement with the management company Rekstrarfélag verðbréfasjóðs Búnaðarbankans hf., which will handle its day-to-day operations. On 8 April 2002, ÍV hf. was granted an operating licence as a mutual fund which may only be marketed in Iceland, in accordance with Article 2 of Act No. 10/1993, on UCITS. The company has concluded an operating agreement with the management company Íslensk Verðbréf-Eignastýring ehf. to handle its daily operations. On 26 April 2002 FME approved changes to the Articles of Association of the mutual fund Verðbréfasjóðir Íslandsbanka hf., which had previously been called Verðbréfasjóðir Verðbréfamarkaðar Íslandsbanka hf. That same day changes were also approved to the Articles of Association for the mutual fund Heimasjóðir Íslandsbanka hf., the name of which was previously Verðbréfasjóðir VÍB hf. Concurrent to these changes, the name of the management company for these funds was changed from Rekstrarfélag VÍB ehf. to Rekstrarfélag ÍSB ehf.

The pension savings market

On 31 May 2002 the Ministry of Finance approved changes to the Articles of Association of Sameinaði lífeyrissjóðurinn after the board of the pension fund and the board of the pension fund Lífeyrissjóðurinn Hlíf had previously approved the latter's merger with the former as of 1 January 2002. In addition, on 19 September 2002 the Ministry of Finance approved changes to the Articles of Association of the pension fund Frjálsi lífeyrissjóðurinn after the board of the pension fund and the board of the pension fund Lífeyrissjóðurinn Eining had previously approved the latter's merger with the former as of 1 January 2002.

The Insurance Market

Insurance companies

On 8 October 2001, FME authorised the transfer of the insurance portfolio of a small boat insurer Bátatrygging Breiðafjarðar to Sjóvá-Almennar tryggingar hf. The transfer date is 1 October 2001. The Minister of Commerce subsequently revoked the operating licence of Bátatrygging Breiðafjarðar on 26 March 2002, in accordance with the company's request. On 16 October 2001 FME authorised the transfer of the insurance portfolio of Samábyrgðin hf. to Sjóvá-Almennar tryggingar hf. The transfer date is 1 December 2001. Samábyrgðin hf. was subsequently merged with Sjóvá-Almennar tryggingar hf. as of 31 December 2001. The Minister of Commerce issued an operating licence as an insurance company to Íslandstrygging hf. on 30 July 2002.

Insurance brokerages

On 27 June 2001, the Minister of Commerce granted Trausti Sigurðsson a licence for insurance brokering and granted Sigþór Hákonarson the same on 22 October 2001. On 10 January 2002 Danish brokers Den Danske Forsikringsmægler ApS was listed on the insurance brokers' register in accordance with the Act on Insurance Activities, No. 60/1994, and the Regulation on Brokering of Insurances, No. 853/1999. The company is Danish but has an establishment in Iceland. On 14 January 2002, the Minister of Commerce granted Hákon Hákonarson, Olaf Forberg and Torfi Karl Karlsson a licence for insurance brokering. On 29 January 2002 Guðjón Styrkársson relinquished his operating licence for insurance brokering to the Ministry of Commerce. On 28 February 2002 the Minister of Commerce granted Nor Finans á Íslandi ehf. a licence for insurance brokering. On 22 March 2002 the Swedish company Willis AB was listed on the insurance brokers' register in accordance with the Act on Insurance Activities, No. 60/1994, and the Regulation on Brokering of Insurances, No. 853/1999. On 27 May 2002 Tryggingastofan ehf. received an operating licence for insurance brokering from the Ministry of Commerce. On 3 June 2002 the Ministry of Commerce confirmed the return of the licence of Renta ehf. for insurance brokering. On 5 June 2002 Valdemar Johnsen relinquished his operating licence for insurance brokering to the Ministry of Commerce.

On 20 December 2001 the Minister of Commerce confirmed the Articles of Association for the savings banks' insurance fund, Tryggingasjóður sparisjóða, in accordance with Article 19 of Act No. 98/1999, on Deposit Guarantees and an Investor-Compensation Scheme.

(ICEX) and the Icelandic Securities Depository. The company was established by financial companies, listed companies, pension funds, the Central Bank of Iceland, investors' associations and the National Treasury. Following the establishment the name Verðbréfaþing Íslands hf. was changed to Kauphöll Íslands hf. as of 1 July 2002.

Head Office		Head Office	
COMMERCIAL BANKS			
Búnaðarbanki Íslands hf.	Reykjavík	Frjálsi Fjárfestingarbankinn hf.	Reykjavík
Íslandsbanki-FBA hf.	Reykjavík	Greiðslumiðlun hf. - VISA Ísland	Reykjavík
Kaupþing banki hf.	Reykjavík	Kreditkort hf. - EUROPAY Ísland	Reykjavík
Landsbanki Íslands hf.	Reykjavík		
Sparisjóðabanki Íslands hf.	Reykjavík		
SAVINGS BANKS			
nb.is-sparisjóður	Reykjavík	Investment Funds	
Sparisjóður Bolungarvíkur	Bolungarvík	Byggðastofnun	Reykjavík
Sparisjóður Hafnarfjarðar	Hafnarfjörður	Ferðamálasjóður	Reykjavík
Sparisjóður Hornafjarðar og nágrennis	Höfn	Hafnabótasjóður	Kópavogur
Sparisjóður Hólahrepps	Sauðárkrókur	Lánasjóður landbúnaðarins	Selfoss
Sparisjóður Húnaþings og Stranda	Hvammstangi		
Sparisjóður Höfðhverfinga	Grenivík		
Sparisjóður Kaupþings	Reykjavík	Leasing Companies	
Sparisjóður Kópavogs	Kópavogur	Glitnir hf.	Reykjavík
Sparisjóður Mýrasyslu	Borgarnes	Lýsing hf.	Reykjavík
Sparisjóður Norðfjarðar	Neskaupstaður	SP-Fjármögnun hf.	Reykjavík
Sparisjóður Norðlendinga	Akureyri		
Sparisjóður Ólafsfjarðar	Ólafsfjörður	DEPOSITARY DEPARTMENTS OF CO-OPERATIVE SOCIETIES	
Sparisjóður Ólafsvíkur	Ólafsvík	Kaupfélag Árnesinga	Selfoss
Sparisjóður Reykjavíkur og nágrennis	Reykjavík	Kaupfélag Austur-Skaftfellinga	Höfn
Sparisjóður Siglufjarðar	Siglufjörður	Kaupfélag Eyfirðinga	Akureyri
Sparisjóður Strandamanna	Hólmavík	(The depositary department merged with Íslandsbanki hf. as of 20 September 2002)	
Sparisjóður Suður-Þingeyinga	Laugar	Kaupfélag Fáskrúðsfirðinga	Fáskrúðsfjörður
Sparisjóður Svarfdæla	Dalvík	Kaupfélag Héraðsbúa	Egilsstaðir
Sparisjóður Vestfirðinga	Þingeyri	Kaupfélag Skagfirðinga	Skagafjörður
Sparisjóður Vestmannaeyja	Vestmannaeyjar	Kaupfélag Suðurnesja	Reykjanesbær
Sparisjóður vélstjóra	Reykjavík	Kaupfélag V-Húnvetninga	Hvammstangi
Sparisjóður Þórshafnar	Þórshöfn	Samvinnufélagið Hreyfill	Reykjavík
Sparisjóðurinn í Keflavík	Keflavík		
OTHER CREDIT INSTITUTIONS			
Investment Banks			
Eignarhaldsfélagið Alþýðubankinn hf.	Reykjavík	SECURITIES FIRMS	
(As of 8 October 2002 the name of the company is Próunarfélag Íslands hf.)		Arion verðbréfavarsla hf.	Reykjavík
		(Received an operating license as of 30 October 2002)	
		Fjárvernd - Verðbréf hf.	Reykjavík
		Íslensk verðbréf hf.	Akureyri
		Jöklar - Verðbréf hf.	Reykjavík
		MP Verðbréf hf.	Reykjavík
		Verðbréfastofan hf.	Reykjavík
		Virðing hf.	Reykjavík

SECURITIES BROKERAGES

	Head Office
Annar hf. - verðbréfamiðlun	Reykjavík
Íslenskir fjárfestar hf.	Reykjavík
Vaxta ehf. - verðbréfamiðlun	Kópavogur

MUTUAL FUNDS (UCITS)

Hávöxtunarfélagið hf.	Reykjavík
Heimasjóðir Íslandsbanka hf. *)	Reykjavík
Landssjóður hf.	Reykjavík
Landssjóður2 hf. *)	Reykjavík
SPH Verðbréfasjóðurinn hf. *)	Reykjavík
Verðbréfasjóðir Íslandsbanka hf.	Reykjavík
Verðbréfasjóður Búnaðarbankans hf.	Reykjavík
Vísitölusjóður BÍ hf. *)	Reykjavík
Verðbréfasjóður ÍV hf. *)	Akureyri
Ævisjóðurinn hf. *)	Reykjavík

*) National funds only marketed in Iceland.

MUTUAL FUNDS (UCITS) MANAGEMENT COMPANIES

Íslensk Verðbréf-Eignastýring ehf.	Akureyri
Kaupþing-eignastýring ehf.	Reykjavík
Landsvaki ehf.	Reykjavík
Rekstrarfélag Verðbréfasjóðs Búnaðarbankans hf.	Reykjavík
Rekstrarfélag ÍSB hf.	Reykjavík
SPH Rekstrarfélag ehf.	Reykjavík

STOCK EXCHANGES AND REGULATED MARKETS

Kauphöll Íslands hf.	Reykjavík
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CENTRAL SECURITIES DEPOSITORIES

Verðbréfastráning Íslands hf.	Reykjavík
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PENSION FUNDS

Almennur lífeyrissjóður VÍB hf.	Reykjavík
Eftirlaunasjóður F.Í.A.	Reykjavík
Eftirlaunasjóður Reykjanesbæjar	Keflavík
Eftirlaunasjóður Sláturfélags Suðurlands	Reykjavík
Eftirlaunasjóður slökkviliðsmanna á Keflavíkurflugvelli	Keflavík
Eftirlaunasjóður starfsmanna Hafnarfjarðarkaupst.	Hafnarfjörður
Eftirlaunasjóður starfsmanna Íslandsbanka hf.	Reykjavík
Eftirlaunasjóður starfsm. Oliuverslunar Íslands	Reykjavík
Eftirlaunasjóður starfsmanna Útvegsbanka Íslands	Reykjavík
Frjálsi lífeyrissjóðurinn	Reykjavík
Íslenski lífeyrissjóðurinn	Reykjavík
Lífeyrissjóður Akraneskaupstaðar	Akranes
Lífeyrissjóður arkitekta og tæknifræðinga	Reykjavík
Lífeyrissjóður Austurlands	Neskaupstaður
Lífeyrissjóður bankamanna	Reykjavík
Lífeyrissjóður Bolungarvíkur	Bolungarvík
Lífeyrissjóður bænda	Reykjavík

Head Office

Lífeyrissjóður Hf. Eimskipafélags Íslands	Reykjavík
Lífeyrissjóður Flugvirkjafélags Íslands	Reykjavík
Lífeyrissjóður hjúkrunarfræðinga	Reykjavík
Lífeyrissjóður lækna	Reykjavík
Lífeyrissjóður Mjólkursamsölnunar	Reykjavík
Lífeyrissjóður Neskaupstaðar	Reykjavík
Lífeyrissjóður Norðurlands	Akureyri
Lífeyrissjóður Rangæinga	Hella
Lífeyrissjóður sjómanna	Reykjavík
Lífeyrissjóður starfsmanna Akureyrarbæjar	Akureyri
Lífeyrissjóður starfsmanna Áburðarverksmiðju ríkisins	Reykjavík
Lífeyrissjóður starfsmanna Búnaðarbanka Íslands hf.	Reykjavík
Lífeyrissjóður starfsmanna Húsavíkurkaupstaðar	Reykjavík
Lífeyrissjóður starfsmanna Kópavogsbæjar	Kópavogur
Lífeyrissjóður starfsmanna Reykjavíkrapóteks	Reykjavík
Lífeyrissjóður starfsmanna Reykjavíkurborgar	Reykjavík
Lífeyrissjóður starfsmanna ríkisins	Reykjavík
Lífeyrissjóður starfsmanna sveitarfélaga	Reykjavík
Lífeyrissjóður starfsmanna Vestmannaeyjabæjar	Vestmannaeyjar
Lífeyrissjóður Suðurlands	Selfoss
Lífeyrissjóður Suðurnesja	Keflavík
Lífeyrissjóður Tannlæknafélags Íslands	Reykjavík
Lífeyrissjóður verkfræðinga	Reykjavík
Lífeyrissjóður verslunarmanna	Reykjavík
Lífeyrissjóður Vestfirðinga	Ísafjörður
Lífeyrissjóður Vestmannaeyja	Vestmannaeyjar
Lífeyrissjóður Vesturlands	Akranes
Lífeyrissjóðurinn Framsýn	Reykjavík
Lífeyrissjóðurinn Lífiðn	Reykjavík
Lífeyrissjóðurinn Skjöldur	Reykjavík
Sameinaði lífeyrissjóðurinn	Reykjavík
Samvinnulífeyrissjóðurinn	Reykjavík
Séreignalífeyrissjóðurinn	Reykjavík
Söfnunarsjóður lífeyrisréttinda	Reykjavík
Tryggingasjóður lækna	Reykjavík

INSURANCE COMPANIES

Alþjóða líftryggingarfélagið hf.	Reykjavík
Íslensk endurtrygging hf.	Reykjavík
Íslandstrygging hf.	Reykjavík
(Received an operating license as of 30 July 2002)	
Líftryggingafélag Íslands hf.	Reykjavík
Sameinaða líftryggingarfélagið hf.	Reykjavík
Sjóvá-Almennar tryggingar hf.	Reykjavík
Trygging hf.	Reykjavík
Tryggingamiðstöðin hf.	Reykjavík
Vátryggingafélag Íslands hf.	Reykjavík
Vélbátaábyrgðarfélagið Grótta	Reykjavík
Vélbátaábyrgðarfélag Ísfirðinga	Ísafjörður
Viðlagatrygging Íslands	Reykjavík
Vörður vátryggingafélag	Akureyri

INSURANCE BROKERAGES**Head Office**

Alþjóða fjárfestinga- og váttryggingamiðlunin ehf.	Kópavogur
Alþjóðleg miðlun ehf.	Reykjavík
Árni Reynisson ehf.	Reykjavík
Den Danske Forsikringsmægler ApS	Hafnarfjörður
Fjárfestingarmiðlun Íslands ehf.	Kópavogur
Heath Lambert Norway AS	Oslo
Howden Insurance Brokers Ltd.	London
Ísvá ehf.	Reykjavík
(The operating license relinquished 9 October 2002)	
Marsh Ltd.	London
Nor Finans á Íslandi ehf.	Reykjavík
Nýja váttryggingaþjónustan hf.	Reykjavík
Provins Insurance AB	Sweden
Tryggingastofan ehf.	Reykjavík
Trygg miðlun ehf.	Reykjavík
Tryggingamiðlun Íslands ehf.	Reykjavík
Tryggingamiðlunin Gildi ehf.	Reykjavík
(The operating license relinquished 29 August 2002)	
Tryggingar og ráðgjöf ehf.	Reykjavík
(Received an operating license as of 26 September 2002)	
Váttryggingamiðlunin ehf.	Reykjavík
(The operating license revoked 18 October 2002)	
Willis AB	Stockholm

4.4 Insurance brokers which are covered by professional liability insurance of insurance brokerages

Árni Reynisson	Árni Reynisson ehf.
Eiríkur Hans Sigurðsson	Nýja váttryggingaþjónustan ehf.
Halldór Sigurðsson	Alþjóðleg miðlun ehf.
Hákon Hákonarson	Tryggingar og ráðgjöf ehf.
(As of 26 September 2002)	

Ingi Eldjárn Sigurðsson	Váttryggingamiðlunin ehf.
Karl Jónsson	Tryggingamiðlun Íslands ehf.
Kristinn Sigurðsson	Nor Finans á Íslandi ehf.
Leó Árnason	Tryggingastofan ehf.
Valur Arnórsson	(The operating license relinquished 31 July 2002)
Olaf Forberg	Alþjóða fjárfestinga- og váttryggingamiðlunin ehf.
Ómar Einarsson	Nýja váttryggingaþjónustan ehf.
Sighór Hákonarson	Den Danske Forsikringsmægler ApS
Sigurður Rúnar Ástvaldsson	Trygg miðlun ehf.
Torfi Karl Karlsson	Den Danske Forsikringsmægler ApS
Trausti Sigurðsson	Nor Finans á Íslandi ehf.
Örn Gústafsson	(The operating license relinquished 4 September 2002)
Þorlákur Pétursson	Fjárfestingarmiðlun Íslands ehf.

4.5 Financial companies originating from EEA Member States

In concordance with European legislation, financial companies licensed in countries within the European Economic Area are permitted to conduct business in Iceland. Categories of these firms include, credit institutions, mutual funds, various types of funds, investment firms, and insurance companies. The following roster presents the number of these firms by category:

Banks, 85
 Mutual funds, 39
 Various funds, 8
 Investment firms, 640
 Insurance companies with local branches, 2
 Insurance companies without local branches, 174