



GUIDELINES

ON ON-SITE INSPECTIONS



Framework for On-Site Inspections

On-site inspections support periodic monitoring of regulated entities and are carried out with reference to the first paragraph of Article 8 of Act No. 87/1998 on Official Supervision of Financial Activities and the first paragraph of Article 9 of the same Act. The first paragraph of Article 8 states that the Financial Supervisory Authority of the Central Bank of Iceland (the Financial Supervisory Authority) shall monitor the activities of regulated entities to ensure compliance with laws, regulations, rules, or agreements governing the activities, and that the activities are otherwise in accordance with sound and normal business practices. The first paragraph of Article 9 states that the Financial Supervisory Authority shall examine the operations of regulated entities as often as deemed necessary and may, for this purpose, conduct on-site inspections or request information on the activities in such a manner and as often as it deems necessary.

These guidelines are intended to inform regulated entities about the execution of on-site inspections. The process is described from the decision to initiate an on-site inspection until its completion. In addition, the main methods used by the Financial Supervisory Authority in conducting on-site inspections are covered.

The Financial Supervisory Authority prepares an annual plan for the supervision of regulated entities, which includes, among other things, the on-site inspections to be carried out during the coming operational year. Decisions on on-site inspections are based on impact categorisation, risk assessment results, and the priorities of supervision at any given time.

Objectives of On-Site Inspections

The objective of an on-site inspection is to identify specific risks in the activities of a regulated entity in detail, assess its internal control system, business models, and governance practices. The scope and timeframe of an on-site inspection are defined in advance, but

the timeframe may change during the inspection if circumstances require. On-site inspections generally take place at the premises of the regulated entity.

The objectives of an on-site inspection may include, among others, to:

- Examine and analyse underlying risk factors in the activities of the regulated entity.
- Examine and assess governance practices and the framework of internal control of the regulated entity, taking into account the nature of its activities and associated risks.
- Assess processes related to the control system and risk management of the regulated entity.
- Evaluate the quality of assets and financing of the regulated entity.

On-site inspections are:

- Risk-based: Decisions on on-site inspections are based on the impact of regulated entities and the results of risk assessments. This means that the Financial Supervisory Authority conducts inspections that it deems most necessary, taking into account the risk assessment and the impact of the relevant regulated entity on the market.
- Proportional: Consideration is given to the size, activities, and risk profile of the regulated entity.
- Assertive: The development of supervisory methods has increasingly led to more assertive supervision, with supervisory inspectors applying their expertise more extensively than before and gaining a better understanding of the risk profile and activities of regulated

entities. On-site inspections play a key role in this regard, as they provide the Financial Supervisory Authority with deeper knowledge of the activities of regulated entities.

- Forward-looking: Focus on the future, among other things, analyse historical data to try to anticipate undesirable trends.
- Action-oriented: Lead to the regulated entity taking corrective measures within a timeframe set by the Financial Supervisory Authority.

Independence of On-Site Inspections

The on-site inspection team works independently but in cooperation with the responsible person of the relevant regulated entity within the Financial Supervisory Authority and other experts of the Authority as needed. Once a decision on an on-site inspection has been made, the project manager of the on-site inspection team is responsible for its execution and for delivering a report with the findings to the regulated entity and its responsible person within the Financial Supervisory Authority or the relevant expert.

On-Site Inspection Team

The project manager is the point of contact for the regulated entity regarding the on-site inspection. At the

beginning of an on-site inspection, the regulated entity is informed of who the project manager is. Project managers are always staff members in the Department of On-Site Inspections of the Financial Supervisory Authority. Other team members may include, in addition to on-site inspection staff, the responsible person of the relevant regulated entity within the Financial Supervisory Authority or other experts of the Authority. Furthermore, the Financial Supervisory Authority may engage external parties to participate in an on-site inspection. The regulated entity is informed if there is a change in the appointment of the project manager.

Preparation Phase

The first step in the preparation phase is to appoint a project manager for the inspection.

The Financial Supervisory Authority notifies the regulated entity by letter to the executive director that a decision has been made to initiate an on-site inspection. The letter is sent at least five working days before the initial meeting, although a longer notice period is generally provided. Under certain circumstances, the Financial Supervisory Authority may carry out an on-site inspection without prior notice.

The letter to the regulated entity includes the following information:

- Objectives and scope of the inspection.
- Acts and regulations on which the on-site inspection is based.
- Name of the project manager and other on-site inspection team members.
- Request for a contact person for the on-site inspection.
- Specification of the necessary facilities and material resources for the on-site inspection, such as office space and access to information technology systems.



Investigation Phase

Initial Meeting

Once the Financial Supervisory Authority has notified the regulated entity of the planned on-site inspection and the entity has informed about its contact person, the project manager convenes an initial meeting.

The initial meeting is the first formal meeting between the regulated entity and the on-site inspection team. The project manager organises and directs the meeting, which takes place at the premises of the regulated entity, no earlier than five days after the inspection has been announced. In general, all meet-

ings held during the on-site inspection take place at the premises of the regulated entity. At the meeting, the project manager introduces the on-site inspection team, explains the objectives and scope of the on-site inspection, and provides a timeline for the inspection.

Execution of the On-Site Inspection

Following the initial meeting, the on-site inspection begins at the premises of the regulated entity. The on-site inspection team may use a wide variety of methods during the inspection, such as:

- **Examination, analysis, and verification of information:** This method aims to verify the information provided by the regulated entity to the Financial Supervisory Authority and examine the process of disclosure. It is essential that the on-site inspection team has access to all requested documents and relevant information systems of the regulated entity.
- **Interviews:** By interviewing the staff of regulated entities, the on-site inspection team collects information on the aspects being investigated.
- **Step by step:** This method is intended to ensure that the execution is carried out in accordance with the documented procedure. For example, by reviewing each task and checking whether it is carried out as specified in the procedural rules.
- **Sampling Method:** Samples are taken, among other things, to verify the findings of the examination and assess the quality of internal control at the regulated entity. Furthermore, the sampling method is an essential tool for identifying problems and risks in the activities and can also shed light on their severity.
- **Verification of Data Quality:** The accuracy and consistency of numerical information from the regulated entity are verified through recalculations.

The investigation phase generally takes place at the premises of the regulated entity.

Reporting Phase

Preliminary findings of the on-site inspection are presented in a draft report, where the on-site inspection team draws conclusions based on data, information, and interviews. In the draft, any deficiencies that appear to the inspection team in the aspects examined are specified, and recommendations are provided.

Deficiencies are identified in cases that do not meet the requirements set out in laws and/or regulations. Recommendations are made in instances where the aforementioned circumstances do not apply, but the Financial Supervisory Authority still considers it desirable for the regulated entity to further examine

the issue and, depending on the circumstances, make improvements. Recommendations often rely on comparisons with best practices.

The project manager sends the draft report to the regulated entity. The regulated entity has a few days to familiarise itself with the draft findings of the on-site inspection. After this period, the project manager convenes a meeting to present the report's content. The meeting is chaired by the on-site inspection project manager, and the responsible person of the regulated entity within the Financial Supervisory Authority is invited to attend, along with other experts from the Financial Supervisory Authority if necessary. The meeting's objective is to ensure that both parties have the same understanding of the findings and prevent the report's conclusions from being based on incorrect information.

The regulated entity has at least two weeks after receiving the draft report to present its views on the report's content¹. The regulated entity is expected to focus its review on the summary and main findings of the inspection and, furthermore, to use the three-column format accompanying the draft report when making comments. The first column should state the text or deficiency specified in the report that the entity wishes to comment on, and the second column should present the entity's viewpoint.

The project manager is responsible for finalising the report and reviewing the regulated entity's written views.

The project manager clarifies the inspection team's position on the regulated entity's views in the third column of the template. In cases where the regulated entity's views are taken into account, the report is amended accordingly.

The report is sent to the regulated entity after the review, along with the completed template. When no deficiencies are specified in the on-site inspection report, the Financial Supervisory Authority does not impose remediation requirements, and the inspection is concluded with the on-site inspection team's report.

Remediation Phase

Where deficiencies are identified in the regulated entity's operations in the on-site inspection report, the report is subject to further review by other divisions of the Financial Supervisory Authority. Based on the deficiencies specified in the report, the Financial Supervisory Authority may, as appropriate, make binding decisions

1. Article 13 of Act No. 37/1993 on Administrative Procedures.

towards the regulated entity, impose remediation requirements, and formally notify the entity of the decision².

If the remediation requirements cannot be directly linked to the deficiencies specified in the report, or if penalties are to be applied, the regulated entity is given an opportunity to raise new objections before the aforementioned decision and remediation requirements are presented. The deadline for remediation depends on the nature of the remediation requirements. The Financial Supervisory Authority may request that an internal auditor or independent party verify whether the regulated entity has fully complied with the supervisory requirements for remediation within the set timeframe.

The responsible person of the regulated entity within the Financial Supervisory Authority, or another expert from the Financial Supervisory Authority, monitors the remediation. The Financial Supervisory Authority may impose daily fines on the regulated entity to expedite remediation if milder measures have not been successful.

The publication of transparency notifications due to the inspection's findings is in accordance with the Financial Supervisory Authority's transparency policy, available in Icelandic on the Financial Supervisory Authority's website.

2. Article 20 of Act No. 37/1993 on Administrative Procedures and the first and second paragraphs of Article 10 of Act No. 87/1998 on Official Supervision of Financial Activities.

Access to Premises and Information

The Financial Supervisory Authority and regulated entities share a common interest in ensuring that on-site inspections are professional and efficient. To achieve this, communication between the parties must be open and honest, and the on-site inspection team must have access to the necessary information and documents.

To conduct an on-site inspection, the inspection team has the right to access the regulated entity's premises subject to the inspection.¹

Access to Information and Documents

The on-site inspection team also has the right to access such information and documents as it deems necessary in connection with on-site inspections.² The Financial Supervisory Authority's powers to access information and documents are extensive, and confidentiality provisions in financial market laws do not preclude the provision of information to the Authority. On-site inspection team members are bound by confidentiality regarding what they discover during the inspection and may not, subject to liability under the provisions of the General Penal Code on public officials, disclose to unauthorised parties what they learn in their work and what should be kept confidential, including the business and operations of regulated entities, related parties, or others, unless a judge orders that information must be provided in court or to the police or there is a legal obligation to provide information.³

The Financial Supervisory Authority's powers to access information include, among other things, the right to:

- Request information, explanations, and justifications.
- Receive any documents related to the regulated entity's operations, such as accounting records, meeting minutes, contracts, documents, files, declarations, and other data.
- Copy or extract from the aforementioned documents if they are not provided electronically.
- Verify information by accessing computer systems, databases, electronic files, and data used by the regulated entity.

Interviews

The on-site inspection team conducts interviews with the regulated entity's staff to obtain information and documents related to the on-site inspection.⁴ Interviews can be held with both managers and specialists.

The on-site inspection team may also interview parties who perform specific tasks for the regulated entity based on an outsourcing agreement, such as internal audit and information system operations.

On-site Inspection Team's Working Environment

To ensure a smooth on-site inspection, it is essential that the regulated entity provides the on-site inspection team with access to the necessary documents and information, as well as access to staff who can provide the required information. The Financial Supervisory Authority considers that its authorisation for on-site inspections includes the right to demand a suitable working environment for supervisory inspectors at the regulated entity's premises during the inspection. In this way, an environment is created that is conducive to the best possible inspection, benefiting both parties.

1. The first paragraph of Article 9 of Act No. 87/1998 on the Official Supervision of Financial Activities.

2. The first paragraph of Article 9 of Act No. 87/1998 on the Official Supervision of Financial Activities.

3. Article 13 of Act No. 87/1998 on the Official Supervision of Financial Activities.

4. The first and third paragraph of Article 9 of Act No. 87/1998 on the Official Supervision of Financial Activities.

