



# FRAMEWORK

OF ON-SITE INSPECTIONS



# Framework of on-site inspections

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On-site inspections support the regular monitoring of supervised entities and are carried out with reference to the first paragraph of Article 8 of Act No. 87/1998 on the 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 shall monitor the activities of supervised entities to ensure compliance with laws, regulations, rules or agreements governing their 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 supervised 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 supervised 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. Among other things, they stipulate which on-site inspections will 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 supervised entity in detail, and 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 supervised entity.

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

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

On-site inspections are:

- Risk-based: Decisions regarding on-site inspections are based on the impact of supervised 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 supervised entity on the market.
- Proportional: Consideration is given to the size, activities, and risk profile of the supervised 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 supervised 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 supervised parties.
- Forward-looking: Focus on the future, among other things, analyse historical data in an endeavour to anticipate undesirable trends.
- Action-oriented: Lead to the supervised 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 collaboration with other experts from the Financial Supervisory Authority as needed. Once a decision regarding an on-site inspection has been made, the project manager of the on-site inspection team is responsible for its execution and delivering a report with the findings to the supervised entity and the person responsible for it within the Financial Supervisory Authority or the relevant expert.

## On-Site Inspection Team

The project manager is the point of contact for the supervised entity regarding the on-site inspection. At the beginning of an on-site inspection, the supervised entity is informed of who the project manager is. Project managers are always members of the staff of the On-Site Inspections department of the Financial Supervisory Authority. Other team members may include, in addition to on-site inspection staff, the person responsible for the relevant supervised 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 supervised entity shall be informed if there is a change in the appointment of the project manager.

## On-site Inspection Process



## Preparatory Phase

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

The Financial Supervisory Authority notifies the supervised entity by letter to the managing 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 supervised entity includes the following information:

- Objectives and scope of the inspection.
- Acts and regulations on which the on-site inspection is founded.
- 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 IT systems.
- Request for data, if applicable.

## Investigation phase

### Initial Meeting

Once the Financial Supervisory Authority has notified the supervised 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 supervised entity and the on-site inspection team. The project manager organises and chairs the meeting, which takes place at the premises of the supervised entity, no earlier than five days after the inspection has been announced. In general, all meetings held during the on-site inspection take place at the premises of the supervised 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 supervised 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 supervised entity to the Financial Supervisory Authority and examine the process of disclosure. It is essential that the on-site inspection team be given access to all requested documents and relevant information systems of the supervised entities.
- **Interviews:** By interviewing the staff of supervised 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 by, for example, reviewing each task and ensuring it is carried out as specified in the rules of procedure.
- **Sampling method:** Samples are taken in order to, among other things, verify the findings of the examination and assess the quality of internal control at the supervised entity. The sampling method is also an essential tool for identifying problems and risks in the activities and can shed light on their severity.
- **Verification of Data Quality:** The accuracy and consistency of numerical data from the supervised entity are verified through recalculations.

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

### Reporting Phase

The preliminary findings of the on-site inspection are presented in a draft report in which 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 supervised entity to further examine the issue and, depending on the circumstances, make improvements. Recommendations are often founded on comparisons with best practices.

The project manager sends the draft report to the supervised entity. The supervised entity has a few days to acquaint 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 expert, who is also the person responsible for the supervised entity within the Financial Supervisory Authority, is invited to attend, along with other experts from the Financial Supervisory Authority if necessary. The objective of the meeting is to ensure that both parties have the same understanding of the findings and ensure that the report's conclusions are not based on incorrect information.

The supervised entity has at least two weeks after receiving the draft report to present its views on the report's content<sup>1</sup>. The supervised 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, which 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 supervised entity's written views.

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

### Remediation Phase

Where deficiencies are identified in the supervised entity's operations in the on-site inspection report, the Financial Supervisory Authority may, as appropriate, make binding decisions towards the supervised entity, impose remediation requirements, and formally notify the entity of its decision<sup>2</sup>. Letters stating remediation requirements are usually included with the final reports of on-site inspections to the supervised entities.

The deadline for remediation depends on the nature of the remediation requirements in question. The Financial Supervisory Authority may request that an internal auditor or independent party verify whether the

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

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 the Official Supervision of Financial Activities.

supervised entity has fully complied with the supervisory requirements for remediation within the set timeframe.

Remediations are monitored by the relevant expert within the Financial Supervisory Authority. The Financial Supervisory Authority may impose daily fines on the supervised entity to expedite remediation if milder measures have not been successful.

The publication of transparency notifications related to the inspection's findings is in accordance with the Financial Supervisory Authority's transparency policy, which is accessible on its website.

# Access to premises and information

The Financial Supervisory Authority and supervised 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 supervised entity's premises subject to the inspection.<sup>1</sup>

## Access to information and data

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.<sup>2</sup> 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 supervised 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.<sup>3</sup>

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 supervised 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 supervised entity.

## Interviews

The on-site inspection team conducts interviews with the supervised entity's staff to obtain information and documents related to the on-site inspection.<sup>4</sup> Interviews can be held with both managers and experts.

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

## On-site Inspection Team's Working Environment

To ensure a smooth on-site inspection, it is essential that the supervised entity provide 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 supervised entity's premises during the inspection. This creates an environment 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.

