Trust earned

THE ICELANDIC FINANCIAL SUPERVISORY AUTHORITY´S EMPHASES AND VISION FOR THE FINANCIAL MARKET TO 2020

FJÁRMÁLAEFTIRLITIÐ
THE FINANCIAL SUPERVISORY AUTHORITY, ICELAND

Contents

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Foreword

The impact of the financial crisis which struck the Icelandic financial system in 2008 is still fresh in the minds of most people. There are therefore few Icelanders who doubt the importance of having solid financial supervision with oversight of the risks inherent to the operation of financial undertakings and which can apply risk mitigation measures as necessary. The financial crisis was not limited to Iceland, and the international community has undertaken a comprehensive review and tightening of financial market regulations. Both the regulatory framework in Iceland and FME's working practices reflect these changes.

The circumstances in 2016 are in many aspects highly favourable. GDP growth is strong, inflation and unemployment are low, the purchasing power of wages has grown and both household and corporate indebtedness has declined. The Icelandic financial market can therefore be considered quite sound from several standpoints although various challenges must be addressed in coming years.

The Icelandic financial market is in many aspects quite sound. However, various challenges must be addressed in the coming years.

This publication contains a summary of the supervisory emphases which FME will apply over the next four years. It also addresses the challenges and FME's future vision for financial activities in Iceland, as well as the desired state for the year 2020. Furthermore, consideration is given to the role of other participants on the financial market, in promoting a sound and reliable financial system and maintaining financial stability.

Unnur Gunnarsdóttir,
Director General

HIGHLIGHTS OF FME'S STRATEGY

The objectives of financial regulation in Iceland are:

- *to promote financial stability and an efficient financial market which can be relied upon to perform its role in the economy;*
- *to ensure compliance with law and the sound, secure and effective operation of financial undertakings;*
- *to safeguard the interests of customers of financial undertakings and the public in general.*

1. Framework for financial services in Iceland

Reforms inspire trust

The global financial crisis had a severe impact on the financial sector and the real economy, particularly in Iceland. Among the most important lessons learned, was the fact that the financial system is by nature complex and volatile and crisis in the financial sector can have much more damaging effect on the interests of the general public, than was previously assumed.

Major changes have since been made to the rules governing financial markets and supervision of financial activities. Rules on corporate governance have been revised, clarifying the responsibility of Board members and setting stricter requirements for the independence and eligibility of managing directors. Methods of proactive supervision have been redefined resulting in added prudential requirements. These can include additional capital requirements and restrictions on authorised activities based on the risk involved. Supervision compliance with law and regulation has also been reinforced and added emphasis has been put on transparency. Last but not least, a new financial stability strategy has been put in place, by forming a Systemic Risk Committee and a Financial Stability Council and new macroprudential tools aiming at reducing risks threatening the financial system as a whole, rather than individual undertakings.

To build trust, it must be earned. Aforementioned changes all aim at raising customers confidence with regard to financial undertakings. FME plays a key role in building confidence through active supervision and a clear transparency policy. All participants must pull their weight. Financial undertakings by fulfilling regulatory requirements, following proper and sound business practices and responding promptly and effectively to any mistakes; and customers by accepting responsibility for their own finances, acquainting themselves thoroughly with financial services offered and taking informed decisions. The overall environment needs to be sound and everyone has to follow the same rule book.

Despite extensive improvements, there are still steps to be taken on the road to a sufficiently resilient financial system and reinforcement of the recovery and resolution framework is needed to manage financial setbacks in the future. To this end FME has defined several principal emphases for its activities until 2020.

Confidence must be earned. FME plays a key role in building confidence through active supervision and a clear transparency policy. However, all participants need to pull their weight.

The principal subjects are the following:

Oligopoly, concentration and international competition

Most areas of financial services in Iceland are characterised by oligopoly and concentration. The most striking examples are the three large commercial banks and three large insurance companies, which jointly hold an overwhelming market share. The largest pension funds also have a major presence in the securities market and as direct or indirect lenders. This situation can be expected to remain relatively unchanged for the foreseeable future. It has to be considered unlikely that the basic principles of economics of scale will change in the near term and the continuing expansion of the pension system is foreseeable. In that light, it´s important to emphasize requirements regarding corporate governance, especially to reduce the negative impact of market concentration. Appropriately defining the role of pension funds within the financial system is another challenge that needs addressing. Currently, pension funds are such dominant investors on the Icelandic financial market that a complex network of interests has developed. For an example, pension funds provide funding for banks and funds, compete with banks in commercial lending activities and own qualifying holdings in many of the country's leading enterprises, which at the same time are also customers of the banks. If the pension funds would acquire qualifying holdings in the banks, it would make the network of interests even more complicated.

As in other sectors, competition provides certain constraints to the market and it's therefore important that supervisory measures in response to financial market innovation, does not overly restrict market entry. Opening the domestic financial market towards foreign markets is most important, in particular with result to the EEA which is governed by the same regulatory framework. Increased activities by foreign undertakings in Iceland together with operations of Icelandic undertakings abroad, is likely to have a positive impact on both consumers and the market, e.g. through risk diversification. It is important however, to guard against risky behaviour, as exemplified by the expansion of the large banks prior to the financial collapse. FME has prepared itself for the anticipated increase in international supervisory collaboration and increased competition in the coming years.

Greater protection for consumers and investors

Financial services are often complicated; comparing price and quality can prove difficult and resolution of disputes can be time-consuming. Adding to the complexity, three public bodies and several non-governmental organisations are involved or signed with the task of consumer protection in the financial market, leaving the division of responsibilities and scope of authority often unclear. Lack of trust and uncertainty can impair the financial market. Increased protection for consumers and investors is therefore an important aspect of improving the efficacy of the financial system to the benefit of society as a whole.

The Icelandic judicial system has unhesitatingly held those responsible for market abuse and insider trading to account, with both positive and negative effects. In the short term the increased public discussion of unlawful conduct can have a deterrent effect on retail investors. However, the judicial system holding participants on the market accountable should in the long term increase confidence. Building trust and confidence is a gradual process and will require continuing supervision of conduct in the securities market, aiming to prevent undesirable behaviour and hold market participants accountable for legal violations.

Technical advances in financial markets

Information technology plays an ever expanding role in the services offered on the financial market and new FinTech products outside the scope of traditional financial services are increasing their presence on the market. This involves more extensive collection and utilisation of data than ever before; making the financial sector more vulnerable to cyberattacks and cybercrime. Optimally, a suitable balance needs to be achieved between insuring security and taking advantage of technical advances. The continuous unveiling of new FinTech products underlines the importance of appropriate supervision being allocated to those activities.

Final details remain to complete

Although the regulatory framework of the financial system has gone through drastic changes since the collapse, a number of urgent tasks remain to be completed in the next few years. Leading among these is the implementation of EU directives on recovery and resolution of financial undertakings and deposit guarantee schemes. A number of directives concerning the securities market also await implementation; all of them intended to reinforce the position of consumers and investors. A comprehensive review of the regulatory framework applicable to the Icelandic pension funds is also long overdue. Last but not least, a review of the Act on Official Supervision of Financial Activities, which provides the legal framework for FME's operations, is needed.

2. FME's emphases to 2020

The following sections give an account of the principal emphases in FME's operations to 2020.

Forward-looking prudential supervision

Prudential supervision entails the FME monitoring the legal compliance of supervised entities' as well as their adherence to proper and sound business practices and limit excessive risk taking in their operations. Forward-looking prudential supervision focuses not only on the current risks but also those risks supervised entities could encounter in the future. Emphasis is placed on proficient strategic planning by supervised entities and insuring its correlation with risk based decisions. Forward-looking supervision is furthermore considered to reduce the probability of supervised entities entering serious operating difficulties.

- *Application of forward-looking prudential supervision entails high requirements for supervised entities to include a strategic aspect in their business plans, risk management and overall standards for professional work practices.*
- *The Boards of Directors and management of supervised entities are responsible for keeping the risk in their activities within the pre-determined risk appetite adopted by the Board. The FME stresses that supervised entities must be able and willing to recognise unfavourable trends, respond in a timely manner and apply preventive measures wherever possible. Stricter requirements are made with regard to Boards of Directors, management and internal and external auditors than before.*
- *Emphasis will be placed on theme based on-site inspections.*

Increased focus on consumer issues

FME's consumer protection efforts consist of applying available measures to those aspects of supervised activities which directly concern consumer interests. To this end, the FME conducts inquires, often following consumer complaints, on whether activities of individual undertakings or markets are consistent with proper and sound business practices.

- *FME emphasises increasing supervision of proper and sound business practices with an emphasis on consumer protection.*
- *FME promotes improved information disclosure to consumers.*
- *FME underlines that undertakings providing financial services need to safeguard consumer interests.*
- *FME also focuses on investor protection because of how important such protection is to maintain a sound and efficient securities market. It is important for customers of financial undertakings to be properly classified as retail or professional clients and to enjoy suitable protection.*

Key participant in co-operation on financial stability

Risk factors concerning the operations of individual financial undertakings, the financial system as a whole and the economy, are closely connected. The FME considers a macroprudential policy to be an integral aspect of its supervisory strategy. To that point, the FME conducts macroprudential analysis in collaboration with the Central Bank of Iceland and by participation in the Systemic Risk Committee, aiming to ensure that micro- and macroprudential requirements[1] made in regard to supervised entities are as internally consistent as possible. Systemically important banks rank highest in significance in this context but other major financial market participants, such as pension funds, insurance companies and systemically important payment and settlement systems, also need to be given attention. International collaboration in this area is important and in fact necessary in order to achieve the objective of opening the Icelandic financial market to foreign competition once more.

- *The FME puts emphasises on the application of realistic stress tests, both by the undertakings themselves and by supervisory authorities.*
- *The FME underlines the importance of applying macroprudential management tools to limit systemic risk, in particular through capital buffers, rules on maximum loan-to-value (LTV) ratios, debt-to-income ratios and similar requirements, as well as special prudential requirements for lending to sectors which are considered systemically risky.*
- *The FME will promote mutual recognition of macroprudential requirements in Iceland and within Europe, to level the playing field for competition between domestic and foreign parties.*

Risk-based supervision

The implementation of risk-based supervision is the largest reform project carried out by FME in recent years. Supervised entities are ranked by impact category reflecting the possible impact of interruptions in their operations on financial stability and consumer interests. FME has at the same time introduced a new risk-assessment system, through which the principal risks in the operations of supervised entities are assessed and monitored.

- *FME's supervision is prioritised according to the entities' risk assessment and assessed impact weight. Pro-active and preventive supervision is directed primarily at systemically important entities', while reactive supervision is applied when an entries risk level exceeds reference limits.*
- *Furthermore, the FME monitors closely any future risks´ potentially affecting the financial market and adapts its supervision accordingly.*

[1] *Microprudential supervision:* Prudential supervision of individual supervised entities. Macroprudential: Comprehensive or systemic supervision which is not limited to each individual supervised entity, cf. microprudential supervision, but rather consists of supervising the system as a whole, the interplay of the units of which it is comprised and its connections with the real economy.

Supervision conforming to best international practice

In 2014 the International Monetary Fund (IMF) assessed FME's compliance with the 29 core principles of the Basel Committee on Banking Supervision (Basel Core Principles, BCP). The IMF concluded that the FME was compliant with 7 core principles and largely compliant with 9 others, while it was materially non-compliant with 13 of the core principles. Where materially non-compliant the comments made by the IMF concerned either deficiencies in the Icelandic legal framework or supervisory practices, with emphasis put on reforming supervision of risk factors in banking operations. Recent reforms within the FME are in accordance with the IMF's recommendations.

- *FME has put emphasis on achieving compliance with the all the relative core principles concerning banking, the securities market, insurance and pension fund supervision by 2020 and subsequently undergo a compliance assessment by the IMF, i.e. Financial Sector Assessment Program (FSAP). Before such an assessment is carried out FME will perform a self-assessment of compliance with the principles of best supervisory practice.*

Intervention by FME

One of the FME´s main tasks is to monitor the financial markets compliance with the relevant legislation rules, and recognized guidelines applicable to the activities. In cases where supervised entities are found non-compliant with the relevant legislation or accepted criteria, the FME requires corrective action to be carried out within a reasonable time limit, subjectable to corrective measures by the FME.

FME can impose administrative fines on individuals or legal entities which have violated specific statutory provisions. In the case of minor violations, cases can be concluded with a settlement between the parties. In the case of major violations, punishable by fines or imprisonment, the FME refers cases to the police following investigation by the authority.

Legislation provides FME with various risk mitigation tools that can be used to intervene in the activities of supervised entities. These tools are either intended to increase the resilience of individual undertakings, such as higher capital requirements, liquidity requirements and various demands for improvements, or that of the financial system as a whole, such as capital buffers and decisions on maximum LTV or debt-to-income ratios.

- *Major advances have been made in recent years with regard to the legal compliance of the financial market and its relationship with the FME. Nonetheless the FME maintains strict compliance supervision and applies sanctions when warranted as part of its efforts to build well-earned confidence.*

More transparency

Since 2012 FME has published the electronic journal Fjármál (e. Financial Affairs) featuring articles written by FME employees as well as holding regular meetings and conferences on industry related subjects. The objective is to inform supervised entities, other authorities and the general public of changes and novelties in financial supervision and financial market affairs.

- *The FME puts emphasis on publishing the results of its inquiries and the application of sanctions, and by so doing encourage both market restraint and greater confidence in the financial market. Making the outcome of examinations public also raises the visibility of FME in the eyes of the public and other financial market stakeholders.*

- *The FME emphasises on quality of information given to supervised entities in order to ensure awareness and anticipation of expectations made by the FME. In order to achieve this objective, the FME issues rules, guidelines and other relevant criteria for supervised entities concerning both supervision in general and assessment of individual risk factors. These rules, guidelines and criteria serve as the basis for FME's risk assessment as well as decisions regarding supervisory measures and requirements of corrective action to mitigate risk in the operations of supervised entities.*

- *The FME emphasises on holding regular meetings with supervised entities, to present novelties and changes in the regulatory environment and allow for direct communications and exchange of information.*

Active participant in creating financial market rules

Iceland's membership to the European Economic Area (EEA) comes with the obligation to implement all single market legislation, including legislation concerning financial services. This creates both opportunities and challenges. Icelandic undertakings are small in comparison to the typical undertakings for which EU legislation is drafted. Although it's the stated policy of the EU to take both size and level of complexity of undertakings into consideration in the implementation and execution of legislation (Proportionality principle); regulatory burden will unavoidable weigh higher when it comes to Icelandic undertakings on the account of their size. On the other hand, there are major advantages to a harmonized regulatory framework relating to financial activities within the EEA. It creates both business opportunities for domestic undertakings abroad and facilitates the participation of foreign undertakings in the domestic market. The rules of the single market therefore provide the discipline of competition. FME also benefits from joint work between the EEA member states in developing and co-ordinating financial supervision. It would be almost unthinkable for the Icelandic financial regulator to meet all the criteria's provided for in international standards without its participation in the EU supervisory institutions EBA, ESMA and EIOPA.[2] Nonetheless, the EU regulatory framework does not provide for complete harmonization, thus making it necessary to consider appropriate rules specific for the Icelandic financial market in certain areas. The most significant of example of such rules is the special legislation which applies to the Icelandic pension fund system.

- *The FME implements technical standards which further detail the application of EU directives and regulations, and follows guidelines issued by the EU supervisory institutions in its work.*[3]

- *The FME is furthermore attentive to developments on the Icelandic market, encourages discussion and when warranted the FME makes proposals to the relevant authorities with regard to amendments to the regulatory framework.*

[2] Information on EU supervisory institutions is provided at the end of Chapter 4.
[3] he annex provides an account of the main regulations and directives concerning the European financial market which are in the process of being or will be transposed into Icelandic law within the next few years.

Strong infrastructure

The FME places emphasis on well-conceived planning. The objective of new legislation on public finances (Act No. 123/2015) is, among other things, to encourage responsible public financial management and ensure comprehensive policy formulation in both the long and short term. The FME pursues the above-mentioned objectives by prioritising its tasks by importance and measuring its performance wherever possible. Emphasis has been placed on increased efficiency in both supervisory work and communications with supervised entities. Major projects have been undertaken aimed at simplifying the required data reporting to FME from supervised entities aimed at benefiting all involved. Furthermore, the FME has begun introducing electronic delivery of all data.

In recent years' emphasis has been put on project-oriented work methods, applying the methods of traditional project management. Such methodology includes defining benchmarks upon the commencement of a project which then enables measurement of the benefit upon its conclusion.

FME's tasks are perpetually evolving and new challenges arising. This makes it important for the FME to have highly capable and ambitious personnel, possessing the relevant educational qualifications and expertise to enable it to fulfil its role. FME aims at retaining capable personnel by offering competitive salaries, a clear path for career advancement and a continuous education programme. Emphasis is placed on strong team spirit, where personnel in various departments work together to promote financial market health while sharing expertise across the FME.

- *FME prepares a longer-term supervisory strategy, based on the relative significance of supervised entities. The strategy defines basic tasks and their frequency. A co-ordinated supervisory plan for each year, based on the supervisory strategy and current risk assessment, includes all aspects of FME´s activities. This lays the foundation for the preparation of FME´s operating budgets, which include on the one hand, a long-term five-year budget and on the other, an annual budget.*

- *In the coming years, FME will continue the implementation of automatic reception and processing of regular data reporting from supervised entities, with the aim of better utilising human resources, increasing the quality of data used for supervision and reducing the cost for supervised entities. The aim is to have all data submission fully electronic by 2020.*

- *To increase the efficacy of its activities, FME applies project-oriented work methods, where projects are well-defined and carried out in a harmonised manner following project management methodology. Furthermore, the FME requires clear objectives and benchmarks which are used as a basis for further developing the authorities operations.*

- *The FME will continue to document its procedures and processes with the aim of increasing security, efficacy and harmonised practices in supervision.*

- *The FME will continue its focus on creating and maintaining consumer-friendly, reliable and effective IT systems which can be adapted to the ever-changing needs of supervision and thus contribute to its efficiency. In this context suitable technological expertise and equipment needs to be secured in order to produce quality analyses which give an incisive overview of the situation and development of individual entities and of the market as a whole.*

- *The FME emphasises the importance of having reliable and professional personnel that possess the relevant expertise, experience and capabilities to provide effective and productive supervision. To this end the FME makes a point of providing an attractive working environment, efficacious continuing education, a clear path for career advancement and competitive salaries.*

3. The state of the financial markets and FME's vision

Extensive progress has been made during the eight years which have passed since the financial crisis in the autumn of 2008, and the final stages of the reconstruction of the financial system are now in sight. Restructuring of private sector debt has for the most part been completed and the lifting of capital controls are underway. This makes it a good time to cast a backward glance and reflect on how the reconstruction of the financial system should be completed, in order to ensure sufficient resilience to minimise the damage resulting from future financial setbacks. To this point, it is important to have rules that limit the risk arising from the operation of the three systemically important banks, each of which having critical functions.[4] It can furthermore be appropriate for a small, open economy with proportionally large banks to set stricter requirements regarding financial activities than generally apply in larger economies where there is diversification of risks stemming from financial activities. Uncertainty prevails as to the future ownership of the banks, as the government's stated objective is to sell its shares within the next few years. It is important to ensure the sale takes place in a well-conceived and transparent manner, to ensure that the banks are acquired by capable and financially sound owners. Furthermore, it's of importance to eliminate the uncertainty regarding the future of the Housing Financing Fund (HFF, Íbúðalánasjóður) and minimise Treasury losses resulting from its guarantee of the Fund's obligations.

The following section discusses the challenges facing the financial market as they relate to what the FME considers to be the desirable state in 2020. The discussion begins with challenges facing the financial market as a whole and its desirable state in 2020, and then proceeds to examine individual sectors. Although FME can only respond to a limited extent to some of these challenges, it is important to present its vision of them clearly.

[4] Critical functions: Activities or services which are so crucial for the real economy or financial stability that there is a significant risk of disruption to economic activities or stability if they were to cease because of their extent, market share, external and internal interconnectedness, level of complexity or cross-border activities, given that comparable activities, services or operations are not available.

Challenges for the financial market as a whole

Both the FME and participants on the financial market need to continue the rebuilding of confidence that was lost following the financial crisis in 2008. Otherwise, the financial system will not be able to fulfil its role adequately and support economic development. Building trust requires strengthening consumer protection, improving corporate governance and promoting increased transparency.

CHALLENGES AND FUTURE VISION

Confidence in the financial market

The legal framework of the financial market has been reinforced. Improvements have also been made with regard to FME´s organisational structure and working practices. Supervised entities have also improved their procedures for risk management, internal controls, and other aspects of their activities, as well as their corporate governance. Despite the aforementioned as well as various other actions taken by the legislator, supervisory authorities and financial market participants; a considerable lack of confidence in the financial market as a whole still prevails[5].

Desirable state in 2020

- Participants on the financial market prioritise transparency and clarity in their offerings of goods and services.
- Information disclosure regarding the financial soundness and risk profile of financial market participants and other matters of significance for both consumers and investors has been increased.
- Management of financial market participants have succeeded in improving both their risk and corporate culture, in part through more active risk management and internal controls, by considering consumer interests and by applying more effective prevention against excessive risk-taking as well as harmful or even unlawful activities.
- The public awareness regarding the above-mentioned improvements and confidence in the financial sector is growing, with the result that financial intermediation and risk diversification are more effective.

[5] Gallup – Traust til stofnana (Trust in Institutions), March 2016.

Consumer protection

The FME provides guidance for consumers as well as options available to them in order to enforce their rights and resolve disputes, but does not issue rulings in individual disputes. These include the Complaints Committee on Transactions with Financial Undertakings and the Insurance Complaints Committee. These forums offer consumers and financial market participants an opportunity to effectively resolve disputes.

The tariffs when it comes to financial market services are complex and extensive, making it difficult for consumers to compare terms and fully understand their rights. Such a lack of transparency can inhibit competition. The large variety of financial products available has resulted in the potential risk of mis-selling products or services to consumers. One such example is the increase in available insurance products, with extensive and complex terms and conditions, potentially exposing consumers to be double-insured or have insurance coverage that they do not fully understand.

Desirable state in 2020

- Corporate culture in the financial market is characterised by awareness of the undertakings' role as service providers and contributes to the credibility and public confidence in the financial market.
- Customers' rights and obligations are well defined and known to consumers.
- Supervision of proper and sound business practices has been increased, with a focus on consumer protection.
- Supervised entities provide clear and comparable information to consumers, e.g. on commissions and service charges, insurance terms and conditions, the cost of investment in funds and pension funds' management costs.
- With consumer interest in mind, customers are not deceived or deluded through mis-selling of financial services, as undertakings do not offer undesirable incentives to their employees which could create a temptation for such practises.
- A specific website has been established providing information disclosure and comparison of the services and charges of supervised entities.
- Financial literacy among the general public has improved

Corporate governance

Good corporate governance is crucial for the efficiency of the financial market and financial system as a whole. Prior to the financial crisis of 2008 corporate governance in the financial sector was materially flawed. Major improvements were made in subsequent years, in part through implementation of new legislation on financial undertakings and insurance companies.

Recent amendments to the Act on Financial Undertakings require consideration to be given not only to the qualifications of individual Board members but also to the collective experience and expertise possessed by the Board as a whole. In view of the responsibility of Board members, it is extremely important that Boards of Directors of financial market participants possess the collective experience and expertise to determine their strategy and risk-taking, and to monitor that the operations are within those limits.

Desirable state in 2020

- Participants on the financial market comply with legal provisions, rules and other recognised guidelines on corporate governance.
- Boards of Directors are aware that their main role and responsibility is to create a sound foundation for their activities and to lead the way in creating an environment encouraging compliance together with a sound risk and corporate culture. Harmful conduct is not accepted and actions are taken to prevent the undertakings being a venue for illegal activities, e.g. money laundering or tax evasion. Undertakings make every effort to promote positive corporate culture in the financial market.
- Undertakings have adopted moderate and appropriate remuneration policies.
- Shareholders and Boards of Directors are aware of the importance of an appropriate combination of board members with regard to qualifications, expertise and experience. Nomination committees follow clear protocols intended to ensure the qualifications and capabilities of individual Board members and of the Board as a whole.

Information technology

Participants on the financial market face a variety of challenges in the field of information technology (IT). IT is an ever-expanding aspect of their services and customers choose to avail themselves to a growing extent of self-service solutions. Cyber-crimes are becoming increasingly organised. Technological advances furthermore open the door to new service providers in direct competition with the traditional financial service providers. In order to maintain their competitive position, it's therefore vital for them to keep up with the latest developments; which unavoidably leads to increased operational risk in certain areas.

Desirable state in 2020

- Supervised entities offer technologically advanced solutions enabling simple and secure online financial services.
- Supervised entities have adopted the necessary procedures to ensure information and operational security.
- Boards of Directors of supervised entities are aware of the responsibility involved in operating IT systems and that responsibility for risk management always remains with the undertakings even when operations are outsourced.

Financial undertakings

The role of financial undertakings includes transferring of savings to individuals and corporates in the form of loans, handling of customer assets, payment services and providing services in issuing securities.

Financial intermediation of capital contributes to effective use of capital and risk diversification, to the benefit of society as a whole, and is a premise for economic growth. On the other hand, these activities involve a variety of risks, such as the risk of maturity mismatch between long-term credit, on the one hand, and its funding through short-term obligations (e.g. demand deposits), on the other. Banks can also suffer credit losses which depletes their equity. There is a strong correlation between credit risk and liquidity risk. As a result, the advantages to the society of financial intermediation to borrowers need to be weighed against the risks of funding lending activities with short-term financing.

Iceland's three largest banks, together with the Housing Financing Fund (HFF), are regarded as systemically important entities and FME organises its supervision accordingly. Supervised entities are considered systemically important if, due to their size and the nature of their activities, they can have a major negative impact on financial system stability and the real economy if financial difficulties occur. Increased concentration and limited sensitivity of revenues to changes in cost[6], suggest that competition in the banking market is limited.

[6] According to the Panzar-Rosse model (Bikker, Shaffer and Spierdijk 2009, Assessing Competition with the Panzar-Rosse Model: The Role of Scale, Costs, and Equilibrium. DNB Working Paper No. 225).

CHALLENGES AND FUTURE VISION

Strengthening resilience by introducing new provisions on capital and liquidity requirements

The principal objective of new statutory provisions on prudential requirements, including capital and liquidity requirements, for financial undertakings based on Basel III and the EU CRD IV directive and the CRR regulation,[7] is to strengthen resilience and increase the probability of withstanding unexpected upsets, whether these are the result of internal activities or changes in their external environment. As before, the capital requirement will be in accordance with the risk-taking of the respective undertaking and as assessed by FME's Supervisory Review and Evaluation Process (SREP).[8] The new provisions provide a stronger statutory foundation for FME's decisions and set higher requirements concerning the quality of equity and for additional capital (capital buffers) for macroprudential purposes. Furthermore, they set stricter requirements regarding liquidity management and liquidity position. The commercial banks currently have high capital adequacy ratios and liquidity, in accordance with current rules and FME's requirements. The challenge will be to maintain this strong position in coming years. It will take some time to conclude the implementation and harmonise FME's rules with the new EU regulatory framework.

The HFF has struggled with financial difficulties in recent years due to loan losses, early paybacks of loans and persistent interest-rate and indexation risk. HFF's current business model can only be regarded as unsustainable.

Desirable state in 2020

- New rules on prudential requirements, including provisions on variable remuneration, supervision on a group basis, cross-border supervision, cross-border notifications, protection for whistle blowers and sanctions, have been implemented and taken effect.
- Financial operations are sustainable, i.e. the liquidity position and capitalisation of financial undertakings is fully adequate to address the risks in their operations and their activities give an acceptable return.[9]
- Sorting out the past difficulties of HFF and on-going social housing facilitation have been fully separated.

[7] See further Point 1 in the Annex.
[8] Through the Supervisory Review and Evaluation Process (SREP) FME assesses the risks involved in a financial undertaking's activities. SREP provides a conclusion on how sufficient the measures which the respective financial undertaking has undertaken are, whether its management is sound and whether its capital base is adequate given the risks involved in its activities.
[9] See further "General criteria and methodology of SREP for financial undertakings", version 1.0, published on FME's website 31 May 2016.

Strengthening the measures available to authorities in response to the failure of financial undertakings

The main objective of the new EU directives on recovery and resolution of financial undertakings and deposit guarantee schemes, is to ensure that the authorities can intervene in a timely manner when financial undertakings face serious difficulties. The aim is to maintain critical functions while at the same time limiting the impact of the undertakings' collapse on the financial system and the economy. Furthermore, the goal is to ensure that the financial undertakings can respond to financial setbacks without needing taxpayer support. This is achieved in part by ensuring the losses are borne by shareholders, subordinated debt holders and unsecured depositors.

Desirable state in 2020

- The legal framework regarding the resolution of financial undertakings and a deposit guarantee scheme, has been implemented. A resolution authority has been established and systemically important banks have in place comprehensive recovery plans. The resolution authority has completed preparation of resolution plans for each financial undertaking and minimum requirements set for own funds and eligible liabilities (MREL).[10]
- The implementation of the 2014 Directive on deposit guarantee schemes, providing increased protection for retail depositors, has been concluded.

[10] MREL refers to the minimum requirement set for the undertaking's capital base (own funds) and liabilities deemed eligible. The minimum requirement is calculated as the sum of its capital base and these liabilities as a ratio of the sum of its capital base and total on- and off-balance-sheet liabilities.

Changes in the structure and ownership of the commercial banks

Although Iceland's commercial banks are considered large on a domestic scale, they would be seen as small and cost-inefficient units on an international scale. Policy making in this field must find a balance between concerns regarding economies of scale and the potential macroeconomic risks arising from setbacks in the activities of systemically important undertakings. The collapse of a large financial undertaking can accrue for enormous cost to taxpayers. One possible preventive mean is considering ring-fencing investment banking activities by commercial banks.

Since 2009, when one of the commercial banks became State-owned and the State acquired holdings in two other commercial banks, a major portion of the banking system has been state-owned. Changes to the ownership of Íslandsbanki in 2016 further increased the states holdings in the banking system. Considering that the sale of Arion banki is underway and the state's declared policy of disposing of its holdings in the banks system; the ownership structure can be expected to change substantially in the coming years.

Desirable state in 2020

- Stricter macroprudential requirements have been set for systemically important financial undertakings and measures taken to ensure that risks arising from investment banking activities exceeding normal limits is addressed with additional macroprudential requirements or separation of activities.
- Qualifying holdings in the commercial banks are held by parties who promote their sound operation. In view of the small size and concentration of the Icelandic financial market it would be desirable for experienced and respected foreign parties to be to some extent participants in the ownership and funding of the Icelandic banks.

Pension funds

The Icelandic pension system is comprised of three pillars: social security (Pillar 1), mandatory pension savings (Pillar 2) and personal pension savings (Pillar 3). Pension savings under Pillar 2 are exclusively in the hands of pension funds while pension funds, deposit institutions, life insurance companies and securities firms are authorised to receive personal pension savings. Upon retirement, the pension system is intended particularly to ensure elderly and disabled persons a pension in accordance with the contributions paid to the pension fund in question and the return which has been obtained on the fund's assets. In recent years the size of the pension system relative to GDP has steadily increased. As of year-end 2015, the total assets of pension funds were equivalent to 157% of GDP, which is among the highest in international comparison.

CHALLENGES AND FUTURE VISION

Increased pension fund obligations

Pension funds face challenges resulting from the longer life expectancy of pensioners. Pensions have been and will be paid for a considerably longer period than was anticipated when the pension system was set up. With other factors remaining unchanged, this will cause the funds' actuarial position to deteriorate. It is therefore important that pension funds monitor demographic aspects closely as well as assessing probable occurrence rate of disability. If the funds' actuarial position deteriorates as a result of the abovementioned factors, the response must be to increase premiums, raising the pension eligibility age, reduce entitlements or a combination of these measures.

Pension funds with fixed entitlements guaranteed by public funds, are generally in a difficult situation, i.e. their actuarial obligations substantially exceed their assets. Actuarial assessments have demonstrated that many of these pension funds will be exhausted within the next 15-20 years if actions are not taken. Preferably, the parties responsible for these pension funds will resort to measures to increase contributions in a timely manner, in order to spread the financial burden resulting from the guarantee over a longer period.

Desirable state in 2020

- Measures have been taken to meet the increase in pension liabilities resulting from higher life expectancy and increased occurrence rate of disability.
- Actions have been taken to distribute the financial burden of obligations of pension funds with fixed entitlements guaranteed by public bodies.

[11] The most significant demographic factors are changes in the age structure and mortality and disability rates of members.

Risk diversification of pension funds' investments

Restrictions which have applied to pension funds' investments outside of Iceland have increased their participation and share in the domestic securities market. This has contributed to an undesirable risk concentration in their portfolios. It has also resulted in the pension funds holding considerable stakes in most publicly listed companies as well as many unlisted companies. As pension funds are long-term investors, these holdings can have undesirable effects on price formation in the securities market. It is foreseeable that the pressure caused by this on the Icelandic securities market will increase following the rise in contributions to private sector pension funds which entered into effect in mid-2016. It is therefore extremely important that pension funds are always able to spread their investments in accordance with acceptable risk diversification requirements.

Desirable state in 2020

- Pension funds invest to an increasing extent abroad, thereby diversifying risk.
- All pension funds have adopted an ownership strategy taking into consideration requirements for good corporate governance and the undesirable effects of ownership concentration on competition.

Good corporate governance – appointment of pension funds' boards of directors

The procedure for appointing members to the Boards of Directors of pension funds generally focuses on the qualifications of individuals rather than on what each person can add to the overall capacity of the Board. In view of the responsibility of Board Members, it is extremely important that Boards of pension funds possess the collective experience and expertise to determine their strategy and risk-taking, and to ensure that the funds' activities are within the limits they have set. Considering the size of the pension fund system and mandatory membership; the procedure for appointing Board members needs to be adapted to recognised guidelines retaining to good corporate governance. It would be desirable to harmonise the legal framework regarding pension fund governance to correspond with the framework of other participants on the financial market.

Desirable state in 2020

- Amendments have been made to the legal framework on pension funds as it relates to harmonising requirements to corporate governance on the financial market. In appointing members to the Board of Directors, consideration is not only made to the individual eligibility of members but the collective eligibility of the Board, as it relates to the Board possessing sufficient expertise and experience to perform its role. Pension fund stakeholders have set up nomination committees to ensure these perspectives are respected.
- Pension funds lead by example regarding transparency and good corporate governance.

Insurance companies

The role of insurance undertakings is to prevent the general public and businesses from encountering losses by providing insurance products. Insurance is classified in two categories: non-life insurance, such as motor vehicle, household and accident insurance, and life insurance, including some categories of health insurance. Four non-life and five life insurance undertakings operate in Iceland, in addition to Natural Catastrophe Insurance of Iceland, which operates under special legislation. The market share of each insurer is quite high, as the three largest non-life undertakings hold approximately 90% of the market. It should however be mentioned, that a large number of foreign insurance undertakings are licensed to provide services in Iceland. Due to the strong pension system, the scope of life insurance undertakings has been relatively limited compared to most European countries, with the result that the activities of non-life insurers are more prominent.

CHALLENGES AND FUTURE VISION

Strengthening the resilience of insurance companies and professional risk management

The operations of Icelandic insurance undertakings consist to a large extent of investment operations intended to maximise funds covering technical provisions. Previous legislation did not sufficiently address the risk inherent on the asset side of the balance sheets of insurance companies'.

New legislation on insurance activities, implementing the EU Solvency II directive, is intended to strengthen the resilience of insurance undertakings and increase their capacity to withstand unexpected setbacks, whether these arise from their internal activities or changes in the external environment. Insurers' will be authorised to invest in any type of financial instrument provided they hold equivalent own funds. This means they will have to apply the prudent person principle in their investments.

Desirable state in 2020

- Solvency II and rules derived from the directive are part of the Icelandic legal system and insurance undertakings have fully adapted to the regulatory framework. Insurers´ are fully conscious of risks facing their operations and have introduced risk management procedures.

Recovery plans and resolution measures

There is not in place a necessary resolution framework for insurance undertakings. Subsequently, if an insurance undertaking does not have sufficient assets to cover its technical provisions, it is unrealistic to expect a portfolio transfer to another insurer without contribution from public funds. There is furthermore no guarantee scheme in place to finance actions in case of an insurance undertaking´s failure.

Desirable state in 2020

- Uncertainty regarding the recovery and resolution process for insurance undertakings has been eliminated through the adoption of a suitable recovery and resolution framework.
- An insurance guarantee scheme has been established to finance responses to failings on the insurance market.

Securities market

An active securities market is important to ensure efficient flow of capital, especially in Iceland where competition on the banking market is relatively limited. Following the financial collapse in the autumn of 2008, average daily turnover on the Icelandic market fell by over 95%. Since then the stock market has grown substantially. In November 2016, 20 companies were listed on NASDAQ Iceland, 17 of them on a regulated securities market and 3 on a multilateral trading facility. This is somewhat fewer than at year-end 2007, when 30 companies were listed.

Although the Icelandic bond market was not hit as hard as the stock market by the 2008 collapse, it has gone through considerable changes. The issuing of corporate bonds contracted sharply, but at the same time the issuing of Treasury bonds increased in parallel with growing Treasury indebtedness. A better economic outlook and the government's policy of a balanced budget, have resulted in a change in this trend. Corporate bond issuance has picked up somewhat while the issuance of new Treasury bonds has mostly ceased. There has furthermore been a rise in covered bond issuance by the banks.

CHALLENGES AND FUTURE VISION

Building confidence in the securities market

Participation of the general public in the securities market contracted markedly during the years following the collapse, as investors had suffered high losses. The lack of confidence has therefore impeded the growth of the market in recent years. This makes it of great importance to ensure market discipline with effective information disclosure, secure securities settlement and a strong response to insider trading violations.

Desirable state in 2020

- Companies on the securities market are conscious of the importance of transparency for their credibility.
- Investors and market participants provide discipline for securities market companies.
- The Icelandic regulatory framework for the securities market corresponds with the European framework.
- Price formation on the market is efficient and liquidity of securities is high.
- Investor protection has been increased and retail investors' access to the market facilitated.

Other financial market participants

The following section looks at financial market participants, other than those mentioned before and the challenges they face. It also discusses technological innovations and growing financial market competition from new types of undertakings beginning to offer their services

CHALLENGES AND FUTURE VISION

New framework for alternative funds

The alternative investment (AIFMD) Directive 2011/61/EU applies to the activities of alternative fund managers, i.e. of funds other than UCITS. The objective of the directive is to harmonise the regulatory framework in member states, ensure consistency in the single market within the European Economic Area (EEA), reinforce supervision, increase transparency on the market and boost confidence in the activities of alternative funds and their managers. It´s main aim is to harmonise the supervisory obligations of regulators within the EEA in order to prevent instability and systemic risk of the financial system. The AIFMD directive applies to fund managers within the EEA and those outside the area marketing funds within it. Prior to AIFMD, no comprehensive EU legislation had applied to the activities of alternative investment funds and the national legislation of EEA states was not harmonised. The implementation of the directive into Icelandic law will create a new category of supervised entities which will need to be licensed by or registered with the FME, followed with regular supervision of the entity. As no comprehensive Icelandic regulatory framework has until now applied to alternative fund managers, the implementation will result in increaded number of new supervisory tasks for the FME.

Desirable state in 2020

- Legislation in Iceland on the activities of alternative funds has been harmonised with that of the EU single market, effectively reinforcing customer confidence.

New technologies in financial services – FinTech

Competition to provide financial services from new parties operating outside the traditional financial system will foreseeably increase. Such activities, often referred to as "FinTech", can for example consist of payment mediation services, advice, or peer and crowd funding of projects. Developments in this area are rapid and the outcome unknown. Existing rules do not fully address activities of this sort, creating a risk that such undertakings will be subject to unnecessarily strict regulation or that innovative financial services companies will seek to circumvent the rules, with the resulting insecurity for consumers.

Desirable state in 2020

- FinTech innovations have had a positive impact on financial services, on the one hand by providing value-added services to financial undertakings and, on the other hand, by competing with traditional financial undertakings by providing innovative services to the public.
- Supervision of such activities is appropriate to their nature and risk level and covers all financial activities of concern to public interests without overly burdening such activities.

Lending by parties other than credit institutions

In recent years, securities firms, institutional investor funds, limited partnerships and other parties have provided additional competition for the banks as intermediaries with the issuance of bonds. To some extent this can be regarded as "shadow banking" activities. The main buyers of such bonds are pension funds, UCITS and investment funds, institutional investor funds and other institutional investors. This increase results principally from a high supply of liquid funds seeking a good return, more favourable lending terms than are offered by the banks and limited investment options for pension funds

Increased diversity in financial intermediation is generally considered as positive. However, certain aspects of shadow banking activities can result in an unforeseen accumulation of risk and create the possibility of regulatory arbitrage. Therefore, careful consideration must be given as to whether risk has been transferred from the traditional banking system to other areas of the financial system, in part as a result of tighter regulation of the former.

Housing mortgage lending by pension funds has grown rapidly in recent years. Banks and pension funds are not on equal footing in competing in this regard, as pension funds neither have to satisfy minimum capital requirements nor liquidity requirements which apply to credit institutions and can therefore offer borrowers better credit terms.

Desirable state in 2020

- The basis for competition among various financial market participants has been equalised as circumstances warrant and information gathering on shadow banking activities together with analysis of risks related to them is satisfactory.

4. Role of stakeholders and partners

The objectives of promoting healthy and sound financial markets and maintaining financial stability will not be achieved without the involvement of various parties in addition to those previously mentioned. The following sections describe in more detail the role of the main stakeholders and other affiliates connected to the financial market.

Parliament (Althingi) and ministries

The Icelandic parliament, Althingi, and government ministries are responsible for ensuring the existence of a suitable legal and regulatory framework to support supervision of financial market activities. FME's role in this connection is to inform the relevant authorities if it sees a necessity for improvements to the regulatory framework. In 2017 efforts to implement extensive improvements to the EU regulatory framework will continue, involving both the Althingi and ministries.

Central Bank of Iceland

The Central Bank of Iceland plays a crucial role in supervision of credit institutions as it monitors and regulates their liquidity position. Furthermore, the Central Bank has an important function in connection with payment and settlement systems. Extensive co-operation is between FME and the Central Bank. A collaboration agreement from 2014 provides for the co-operative efforts of these institutions; aiming to increase joint efforts and information exchange, as well as co-ordinating responses to systemic risk or setbacks trough the forum of the Financial Stability Council. Additionally, the institutions consult one another on various issues and projects.

NASDAQ Iceland

The sound and reliable operation of a regulated securities market in Iceland is the responsibility of NASDAQ Iceland. This is achieved in part by analysing and responding to conflicts of interest, managing risk, ensuring that transactions are concluded in an honest and fair manner and taking measures to ensure that secure settlement of transactions on the market are executed. A co-operation agreement signed in 2016 provides for the collaboration between NASDAQ Iceland and the FME. The parties meet regularly and co-operate on various issues concerning the securities market.

Consumer Agency

The role of the Consumer Agency is to protect the safety of consumers and assuring consumers legal protection in various transactions with business operators, supervise business practices, and the implementation of legislation on consumer protection and retail lending. The Consumer Agency furthermore supervises the execution of the Act on Real Estate Mortgage to a large extent. FME, on the other hand, issues rules and supervises proper and sound business practice on the financial market, as it relates to both individuals and legal entities

Competition Authority

The Competition Authority has the task of enforcing the main objectives of the Competition Act; to promote effective competition, in part by opposing unreasonable barriers and restrictions on freedom in economic activities, by opposing harmful oligopoly and restriction to competition, while facilitating the entry of new competitors to the market. The Competition Authority also has the role of monitoring the development of competition and trade practices in individual market sectors, including the financial market, and investigate the management and ownership relations between undertakings. In certain instances, such as financial market mergers, both the Competition Authority and FME have a specific role.

District Prosecutor

The District Prosecutor functions both as prosecutor and a law-enforcement agency in its field of jurisdiction, and thus holds the general authorisations of a police commissioner. Among the tasks of the District Prosecutor are to investigate various serious violations of the General penal code, in particular violations of chapter XXVI on enrichment offences. The District Prosecutor also investigates violations of statutory provisions on foreign currency, competition, securities, lending activities and other financial activities.

Violations of Acts supervised by the FME are only subject to criminal investigation after being referred by the FME to the Prosecutor's office. FME also lodges complaints to the District Prosecutor cases where there is suspicion of serious violations of other Acts, such as the General penal code. When necessary, exchange of information between these institutions can be extensive.

The District Prosecutor's office also includes a Financial intelligence unit (FIU) which receives notifications arising from the Act on actions to combat money laundering and terrorist financing. There information is analysed and communicated to the respective authorities for further action, such as investigation and prosecution. FME co-operates with the District Prosecutor in connection with referrals where there is suspicion of major violations or money laundering.

Stakeholders´ groups

These include, for instance, the Icelandic Financial Services Association, Icelandic Pension Funds Association, Icelandic Chamber of Commerce, Institute of State Authorised Public Accountants and the Consumers' Association of Iceland. The abovementioned parties play a role in drafting rules for the financial markets as they safeguard the interests of businesses and the general public. The FME puts emphasise on maintaining good relations with these parties.

Other participants

Supervised entities themselves play a key role in contributing to a sound and stable financial market. It is up to them to maintain the confidence of customers, other stakeholders and the general public, thereby promoting a sound financial market. In this connection the various supervisors within the undertakings have an important role. These internal supervisors are in particular: The Board of Directors, which is responsible for general oversight of activities, compliance, the audit committee, the risk committee and internal audit. All of these parties have important responsibilities in their respective undertakings. In the case of pension funds and insurance companies, actuaries perform a key supervisory function. Other parties directly involved with a supervised entity in a specific supervisory capacity include, for example, external auditors and credit rating agencies.

EU supervisory authorities in the financial market

The European Union operates three supervisory agencies in the financial market,

- European Banking Authority (EBA),
- European Securities and Markets Authority (ESMA), and
- European Insurance and Occupational Pensions Authority (EIOPA).

The supervisory authorities draft technical standards, for instance, which are subsequently adopted by the EU Commission and apply to all EU member states without having to be implemented into national law. The agencies also issue guidelines directed at both supervised entities and national supervisory authorities. To his effect, the authorities have set up various committees in which FME's employees participate. In certain cases, the supervisory authorities have been entrusted with supranational powers within the EU, which can be directed at member states' supervisory authorities or financial market participants. In the case of the EEA EFTA states (Iceland, Norway and Liechtenstein) such powers will be in the hands of the EFTA Surveillance Authority (ESA). The EU supervisory authorities are also entrusted with drafting new rules for the financial market in cooperation with other EU institutions, which are likely to be included in the EEA Agreement and implemented in Iceland. This collaboration means, inter alia, that the FME, the Central Bank and participants in the market have to deliver a variety of data regarding their activities to EU institutions. Furthermore, FME's Director General or another executive officer attends meetings of the Board of Supervisors of the three supervisory authorities.

Annex – EU directives and regulatory framework in the process of transposition

Below is a list of the principal directives and other rules governing the European financial market which are being implemented into Icelandic legislation or will be implemented in near future. Experts within the FME are involved in the implementation in various ways, such as participation in ministry committees and by issuing rules and guidelines.

1. CRD IV/CRR banking directives and regulation

The CRD IV Directive is the backbone of the Single Rule Book for financial undertakings operating in the EU single market. CRD IV provides a single, comprehensive framework of EU legislation comprised of the Directive 2013/36/EU itself and derived CRR Regulation (EU) No. 575/2013. The main substance of CRD IV is in the form of greater requirements concerning financial undertakings' liquidity and capital requirements in accordance with Basel III. The provisions of CRR are expected to fully implemented into Icelandic legislation in 2016. The implementation of this new European regulatory framework sets a variety of increased prudential requirements for financial undertakings, in particular with regard to their capital requirements, liquidity and risk management.

2. Recovery and resolution of financial undertakings and Deposit Guarantee Scheme (DGS)

The European Recovery and Resolution Directive (BRRD), Directive 2014/59/EU primarily focuses on recovery plans, which financial undertakings are required to draft and implement in case of financial setbacks in their operations, early intervention by supervisory authorities in the activities of financial undertakings and their resolution when considered necessary for a supervisory or resolution authority to take over or intervene in the activities of financial undertakings.

Parallel to the implementation of BRRD, Directive 2014/49/EU on Deposit Guarantee Schemes will be implemented into Icelandic law. According to the DGS Directive, deposit guarantee schemes in member states must ensure eligible deposits of individual parties in their respective deposit institutions up to a maximum of EUR 100,000; eligible deposits exceeding this amount will not be covered under the respective insurance scheme.

3. Regulatory framework in the insurance market – Solvency II

Solvency II is a new regulatory framework for the insurance market, entered into effect within the EU January 1st 2016. It is comprised of the Solvency II Directive, from November 2009 as amended by Directive 2014/51/EU, referred to as the Omnibus II Directive, and a Delegated Regulation (EU) No. 2015/35, adopted by the EU Commission in October 2014. The regulation provides details and further explanations of various aspects of the Solvency II framework. In essence, Solvency II sets higher requirements for insurance companies concerning solvency and risk management with the aim of increasing the protection of policy holders' and reducing the likelihood of consumer losses or market disruption.

4. Investor protection in securities transactions – MiFID II / MiFIR

The MiFID II Directive, 2014/65/EU, and MiFIR Regulation (EU) No. 600/2014, replace the previous MiFID Directive which was implemented into Icelandic legislation on November 1st 2007. Like MiFID, MiFID II /MiFIR are concerned with investor protection in securities transactions, the arrangements and requirements for trading venues,[12] transparency etc. However, the requirements set by MiFID II will be considerably greater than in the earlier MiFID. Financial undertakings licensed to trade in securities will have to satisfy stricter and more detailed organisational requirements than are currently in effect, increased demands will be made of parties operating trading venues, as well as rules on transparency in transactions are more extensive etc.

5. Rules on derivatives transactions – EMIR

The objective of Regulation (EU) No. 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) is to increase transparency and reduce risk on derivative markets. The scope of the regulation is fairly broad, affecting all parties trading in derivatives whether they are financial undertakings or other parties. EMIR sets the requirement that all parties concluding derivative contracts i) send notification thereof to a trade repository, ii) satisfy requirements concerning risk management for all derivative contracts which are not cleared and iii) clear those OTC derivatives which are covered by clearing obligations with central counterparties.

6. Short-selling regulation

The purpose of the Short-selling regulation (EU) No. 36/2012, is to establish a general framework for short selling. The Regulation obliges legal entities and individuals with net short positions in a class of listed equities to notify their position to the FME if their short position amounts to at least 0.2% of the company's listed share capital. If the short position exceeds 0.5%, notification thereof must be made publicly. Similar rules apply to short positions in Treasury bonds.

7. Regulation on market abuse – MAR

The Market Abuse Regulation (EU) No. 596/2014, contains new provisions on insiders, insider lists, treatment of inside information, obligation of insiders to give notice, market abuse etc. The regulation is somewhat more detailed than current legal provisions, regulations and rules. It also has a broader scope and applies to a wider variety of financial instruments.

8. Regulation on central securities depositories and settlement (CSDR)

Regulation (EU) No. 909/2014, on Central Securities Depositories and settlement of Securities transactions (CSDR), is intended to harmonise rules in this area throughout Europe, to provide greater security and efficiency in settling securities transactions. The increased requirements arising from CSDR will include stricter prudential requirements for securities depositories, greater demands for supervision, and a requirement for deterrent measures and for harmonised settlement periods in securities trading.

[12] A trading venue is a collective term for various types of markets where financial instruments are traded. Trading venues include regulated securities markets, multilateral trading facilities (MTFs) and organised trading facilities (OTFs).

9. Managers of alternative funds – AIFMD

The Alternative Investment Fund Managers Directive (AIFMD) 2011/61/EU applies to the activities of alternative fund managers, i.e. of funds other than UCITS. The objective of the directive is to harmonise the member states' regulatory framework, ensure homogeneity within the EEA single market, increase supervision and transparency in the fund market and boost confidence in the activities of alternative funds and their managers.

10. UCITS V

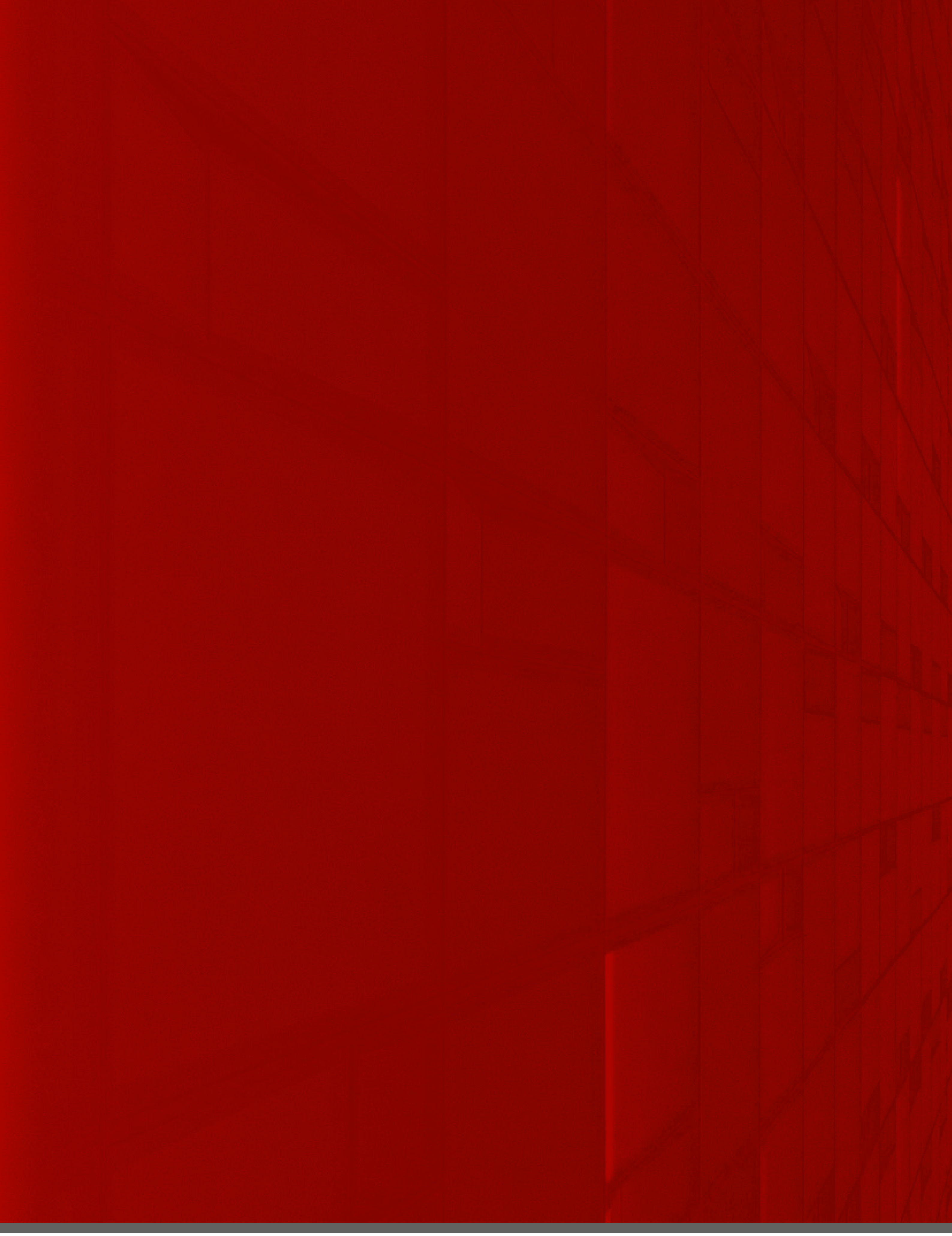
Directive 2014/91/EU is intended to update Directive 2009/65/EC on UCITS funds to meet increased requirements made of non-UCITS funds with the advent of the AIFMD Directive. The principal changes arise from detailed provisions on the role and responsibility of custodians, the obligation of having in place a remuneration policy in UCITS management companies and harmonisation of the powers entrusted to supervisory authorities.

11. Payment Services Directive – PSD II

Directive 2015/2366/EU on payment services expands the scope of the previous PSD considerably. The directive now covers payments in currencies other than those of the member states when payment service providers, both payers and recipients, operate within the European Economic Area, as well as payments in any currency where only one payment service provider operates within the EEA.

12. Payment Accounts Directive – PAD

Directive 2014/92/EU concerns the comparability of fees related to payment accounts, switching of payment accounts and access to payment accounts with basic features. The objective of the directive is to promote transparency and competition, facilitate comparison of fees and switching of payment accounts, as well as encouraging effective and problem-free financial mobility for consumers.



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