FJÁRMÁLAEFTIRLITIÐ
THE FINANCIAL SUPERVISORY AUTHORITY, ICELAND

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The Director General's Address to the FME's 2019 AGM

Unnur Gunnarsdóttir

Minister of Finance and Economic Affairs, managers of regulated entities, board of directors and employees of the Authority, and other distinguished guests.

I would like to start by thanking everyone interviewed for our videos. This winter, we also celebrated the 20th anniversary by holding brief breakfast meetings on various pressing issues, and we plan to continue holding such meetings in the fall.

These twenty years have been marked by historical events in the Icelandic financial markets, and for the Authority. I do not intend to spend time reminiscing, however, it is important, here and now, to remember that following the collapse of 2008, the Authority was entrusted with great responsibility in leading the restructuring of the financial system as well as carrying out the initial investigations of possible criminal activity concerning the collapse of the banks. After their conclusion, the success of these assignments became apparent, but the outcome was not certain in the fall of 2008. At this juncture, I would like to express my admiration and respect for the Authority's management and staff at that time for their tenacity at a critical moment.

The brunt of the work in projects resulting from the collapse took four or five years but for the last decade the Authority has been concerned with building up the infrastructure for risk-based supervision, establishing constancy in the Authority's activities, and investing in human capital. During this period, various new tasks have been assigned to the Authority by law, requiring dynamic and rapid development of day-to-day operations. Examples of new tasks include the analysis and decision-making for the application of macro-prudential tools, assessments of the fitness and propriety of board members and managing directors of supervised entities, comprehensive assessments of the various risk in their operations and, finally, their governance. The scope continues growing and last year financial institutions and UCITS were, for the first time, required to make recovery plans that set out the measures they would take following a significant deterioration that could threaten their financial position or operations. More changes are ahead with the establishment of a resolution authority and a resolution fund to strengthen the framework for insolvent financial undertakings.

The last decade has been characterized by extensive legislative changes in the financial market. The changes in the regulatory frameworks for banking and insurance have already been significant and substantial changes are on the horizon for the operational environment of funds and in the securities market. Among other things, I would like to mention the introduction of EU acts on market abuse and the treatment of inside information, on securities settlement and the activities of central securities depositories, on trading in financial instruments, and on prospectuses, and this is not everything we have faced in recent years.

The Authority hopes that, following the implementation of the Alternative Investment Fund Managers Directive (AIFMD), investors will be better protected and oversight will be clearer for the activities of such funds. This applies in particular to what is now called professional investment funds that are subject to limited requirements and supervision under the current body of legislation.

The introduction of these European acts is, furthermore, expected to change the emphases for the public disclosure of issues that the Authority concludes with administrative sanctions. Thus, supervisory authorities are increasingly required to publish their conclusions. In addition, their provisions stipulate disclosing names of the parties concerned, unless there are special reasons for not doing so. One such legislative provision has already entered into force through the Act on Measures against Money Laundering and Terrorist Financing.

Since 2009 the Authority has, in fact, been authorised by statutory provisions to make the results of its inquiries public, subject to certain conditions. Such formal press releases on the results of inquiries have always been referred to as Transparency Notifications, and they have always been contentious. Nevertheless, the experience gained from their publication has generally been positive. This legal authority was clearly ahead of its time compared to Europe as a whole, but the tide is changing, and supervisory authorities are, in general practice, gradually being required to disclose violations.

It is safe to say that the extensive legislative changes in the last decade have not only magnified the Authority's role, but also increased its powers. With great power comes great responsibility and the Authority places great emphasis on proper and lawful procedures carrying out its administrative duties.

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Ladies and gentlemen

The economy has been in an upswing for the last few years; characterized by strong economic growth, low unemployment, and favourable external conditions. The situation turned around this winter with a downswing in the tourism industry, which has driven the massive surge in recent years. The position of the financial system to deal with the challenges that may arise, however, is very favourable. The capital position of the banking system is strong at present, capital buffers have been bolstered, and the banks' resilience is great. Default ratios for bank lending to households and businesses have continued to decline and are now at historic lows. And, it should be noted, that the general economic situation of households and businesses to deal with headwinds is probably better than ever.

In the upswing of recent years, the financial system has not grown at the same rate as the economy and total assets of credit institutions as a percentage of GDP have been declining. Since the end of 2008, the ratio has dropped from 334% to 165% at year-end 2018, but at the end of 2007 this ratio was 900%. In particular, the explanation for this trend since 2008, is that GDP has grown substantially, while the total assets of credit institutions have remained virtually unchanged.

Recently, the profits of the three systemically important banks have been somewhat below expectations. The banks have, however, all undertaken considerable rationalization measures in recent quarters, such as reducing the number of service points and staff. It is clear that considerable emphasis will continue to be on the introduction of digital solutions and infrastructure optimization. The banks' lending to households increased by 11% in 2018, mainly due to mortgage lending, despite the high level of competition from the direct lending by pension funds to their members.

At year-end 2018, pension savings in Iceland had reached about 160% of GDP. There has been a large increase in personal pension savings, partly because of the so-called specified personal private pension savings, since part of the premium in excess of the minimum insurance coverage can be allocated to a private pension. The pension funds are the largest institutional investors in Iceland and, after the release of the capital controls, they have largely directed their new investments into foreign assets. However, as I mentioned earlier, they are also heavily involved in mortgage lending to households, with about 12% of their assets currently allocated to such lending.

Insurance companies performed worse in 2018 than in 2017. The loss ratio in non-life insurance (as a percentage of gross premiums) was 78% overall and increased by almost 5% between years. And, insurance companies' investment income decreased by almost one-third from the previous year. In consumer business, it is mainly the insurance companies that find significant competition from abroad.

Last year, for the first time since the collapse, an Icelandic bank was listed on the general stock market, and now two banks are listed on the market. The last few years have been characterized by small increases in the stock market, but the increases have been considerable so far this year despite the turbulence in the travel industry and uncertainty in the economy.

It should be noted that in the coming weeks, the Authority is putting a new securities control system into service, which automatically identifies suspicious transactions in the market and assists in analysing transaction data. The system will make it easier for the Authority to identify any market abuse and insider dealing on the Icelandic securities market.

European cooperation is vital to the activities of the Financial Supervisory Authority. And, cooperation with our counterparts and other Nordic and Baltic governments is also very useful, in particular concerning financial stability. Earlier this year, a major two-day crisis exercise was held in all eight countries of the region, where the governments' response to financial shock was practiced. The eight countries are now also aiming for further cooperation in combating money laundering and terrorist financing; but there is more work to be done.

Recent revelations have shown large and respected banks in Denmark and Sweden being complicit in money-laundering. Their reputations have been heavily tarnished and so have, to some extent, the respective State Governments. Iceland is a part of an international organisation, the Financial Action Task Force (FATF), set up to combat money laundering and terrorist financing. In 2018, FATF assessed Iceland's performance in measures against money laundering. The results were, in short, a condemnation of both the domestic legislation and supervisory implementation, although the Authority, as such, was assessed favourably. FATF required numerous improvements and the relevant Icelandic authorities have united in a targeted effort to strengthen these activities.

These efforts include the enactment of a new comprehensive legislation on measures against money laundering and terrorist financing, a risk assessment for Iceland issued by the National Commissioner of Police, and the Internal Revenue Directorate has been tasked with overseeing the actions of parties not under the supervision of the Financial Supervisory Authority, such as auditors, lawyers, real estate agents, and art dealers.

The Authority has done its part and markedly enhanced supervision and education. FATF strictly follows up on its remediation requirements. By year-end, we expect FATF's results on how effective the undertaken remediation measures have been in raising the country's overall evaluation. Supervisory authorities and governments are becoming more aware of the importance of prioritizing this issue and this risk will continue to be a priority for the Authority in the coming years. I would, therefore, like to take this opportunity and urge financial market participants to take the risk of money laundering seriously and to strengthen their defence.

Another risk, to be considered by the Authority in the coming years, concerns network security. The transformation that has taken place in the use of technology to provide financial services does not only bring opportunities but also various threats. The European Banking Authority, EBA, conducted a risk assessment survey of many European banks last year. The result showed that nearly 90% of them now find that network and data security risk is the main source of operational risk in their operations. In a comparable survey from 2017, however, only 55% of the banks considered that this risk was their largest operational risk factor. The risk is, therefore, becoming considerably clearer. The International Monetary Fund has also published studies showing that financial companies already suffer significant losses due to online attacks around the world.

It is of the utmost importance that financial market participants develop their defences and security in line with the rapid development of existing risks. It should also be noted that potential operational disruptions, data theft, and online attacks do not only have a direct impact on the performance and reputation of the companies involved, but the consequences can be devastating for customers, causing disturbances and losses in the real economy and jeopardizing financial stability. It can be assumed that this risk will grow gradually in the Authority's risk assessment and that the Authority's supervision and decisions will be increasingly affected.

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On-site inspections are one of the methods used by the Authority to perform its role. Their goal is analysing specific risks in detail, assessing internal control systems, business models, and corporate governance, and examining general compliance with laws and regulations. At year-end 2018, the Authority introduced procedural changes to on-site inspections. The main change from the perspective of regulated entities is that the Authority's employees now remain longer on-site. According to the procedure, the employees must have good working facilities and access to the necessary data. Another change concerns the presentation of preliminary results that are currently presented in a meeting with the regulated entity before the final results are available. The Authority hopes that this will facilitate communication with regulated entities, that better access to the underlying data for the inspection will increase efficiency, and that it will be able to give more timely feedback on the results of its inspections.

The culture of continuous reform is necessary for institutions such as the Financial Supervisory Authority. We are tasked with overseeing sectors with rapid technological evolution that changes our environment from year to year. These technological changes can also benefit our administration. For example, the improvements regarding electronic submission of data and the automatic calculation of key metrics and risk indicators.

The Authority is a knowledge-based company that depends on the professional conduct of its staff. Last year there were 118 full-time equivalent positions at the Authority. The number of employees increased rapidly in the years from 2009 to 2011, with a peak of 126, but since 2012 the number of employees has remained relatively stable. The average length of service is now seven and a half years and is rising. The gender ratios are almost equal.

In January 2018, a new organizational chart was implemented. The main objective of the organizational changes was to create a clearer division of tasks and mandate for management, while also adapting the Authority's organization to the organization of the European Supervisory Authorities. These changes were very successful and I would like to thank employees for their positive attitude and participation in these changes.

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It is apt to say that the Authority has, in its 21st year, grown up and reached maturity. Merging the Authority and the Central Bank has been suggested in recent years. Central to the argument for the merger is the belief that it will consequently strengthen and align the diagnostic efforts and decision-making concerning financial stability. In October 2018, the Ministerial Committee on Economic Affairs decided on the merger and assigned a project management task force with preparing bills to present to Althingi in the 2019 Spring Assembly. The preparations were successful and Althingi is currently discussing a new comprehensive legislation on the Central Bank of Iceland and a bill amending numerous other associated acts. If the bills are enacted in the current assembly, the merger should take effect on 1 January 2020. In that case, the Central Bank will become a very large organisation entrusted with extensive power. This does not diminish the importance of safeguarding its independence. Therefore, the bill on the Central Bank assumes three organisational pillars, monetary policy, financial stability and financial supervision and three committees, each associated with one of the organisational pillars, take major decisions in their domain. In part, the same officials will be appointed to all three committees and they will be responsible for integrating different organisational objectives. In an effort to protect the progress and oversight achieved in recent years, the Authority has stressed the importance of continued comprehensive and integrated supervision, as we believe that to be key in the future identification of systemic risk in the financial market.

The Authority's roles in consumer affairs, on the one hand, and the supervision of business conduct, on the other hand, are often addressed in connection with the proposed merger of the Financial Supervisory Authority and the Central Bank of Iceland. Discussions on these matters are often mired in misunderstanding whereby business conduct supervision and prudential supervision are posed as if they are clearly distinguishable.

The Act on Financial Undertakings and the Act on Insurance Activities stipulate that these regulated companies shall operate in accordance with normal and sound business practices and procedures. There are almost no other legal provisions that directly address the conduct of business and consumer affairs. On the other hand, when it comes to prudential supervision, business conduct supervision primarily concerns operational risk and governance and is tightly linked with other comprehensive prudential supervision of risks in the operations of banks, insurance companies, and other regulated entities. Business conduct supervision, therefore, does not only concern supervision of the securities market, as many seem to believe, but also the prudential supervision of other markets, including capital decisions.

The Authority's role concerning consumer affairs is limited, although it is important. We handle complaints from customers of the regulated entities and use these complaints to gauge their business conduct. However, the Authority does not arbitrate in disputes between the companies and their customers. These limitations are appropriate for the role of the Authority and in accordance with other supervisory authorities. However, I would like to take this opportunity to call on the government to promote consumer protection in the financial markets specifically and also in general, and refer to the White Paper discussing the future vision for the financial system.

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Distinguished guests.

Designing the framework for the Government's role in the financial markets is no simple task. The implementation varies greatly, and each implementation has its own strengths and weaknesses. The Authority has been successful for many years as an independent institution, and we are concerned that the success that has been achieved will not be lost. Therefore, we approve the implementation proposed in the abovementioned Central Bank Bill on three pillars, each of which has a well-defined responsibility. The utmost importance is to achieve the greatest possible results for Icelandic society.

Should the bill be enacted, this anniversary annual meeting may be the last annual meeting of the Financial Supervisory Authority as an independent institution. This will, however, in no way signify the end of supervisory activities as we know them. The merged institution includes all the prerequisites for the Financial Supervisory Authority to be a strong pillar within the Central Bank with a robust role in safeguarding a sound and proper financial system.

I would like to conclude with my heartfelt thanks to my colleagues in the Authority, the Board of Directors of the Authority, the Ministry of Finance and Economic Affairs, the Prime Minister's Office, and the Central Bank of Iceland.