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Annual Report – Financial Supervisory Authority 2012

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Contents

Contents of the Annual Report

The substantial discussion in the Annual Report of the Financial Supervisory Authority (FME) for 2012 covers primarily the period from1 July 2011 to 30 June 2012. The Report describes FME's principal projects and tasks during these months. It also discusses the situation and outlook on the credit market, securities market, pensions and funds market, and insurance market. An account is given of FME's reorganisation and court cases which are connected with its activities. The Annual Report contains a table showing the number of regulated entities as of mid-2012 and the key figures from FME's annual financial statements for 2011. The Annual Report will be published in English and Icelandic on FME's website, www.fme.is. A variety of information is also available there concerning the Icelandic financial market and the arrangements for official supervision of financial activities.

FME's Board of Directors and management

A three-person Board of Directors is ultimately responsible for FME's administration. Its role is to specify the priorities in FME's work and to follow its activities and operations. All major decisions are to be referred to the Board for approval or rejection. The Board engages the Director General, who is responsible for FME's day-to-day administration. As of October 2012 the Board of Directors was comprised of Aðalsteinn Leifsson, assistant professor, Chairman; Valgerður Rún Benediktsdóttir, acting office director, Vice-chairman (appointed temporarily from 1 July to 1 November 2012); and Arnór Sighvatsson, Deputy Governor of the Central Bank of Iceland, nominated by the Central Bank. Alternate directors are Halldór S. Magnússon, former managing director; Harpa Jónsdóttir, Deputy Director of Financial Stability at the Central Bank of Iceland (appointed as of 3 February 2012); and Margrét Einarsdóttir, assistant professor, appointed temporarily (as of 1 July 2012).

During the period from 1 June 2011 to October 2012, in addition to the above-mentioned, the following persons have served on the Board of Directors of FME: Ingibjörg Þorsteinsdóttir, who is temporarily on leave and was Vice-chairman of the Board from 27 May 2011 to 1 July 2012, and Sigurður Þórðarson, who was an alternate director from 1 September 2010 to 1 July 2012.

Director General
Unnur Gunnarsdóttir

Heads of supervisory divisions

Oversight
Lúðvík Þorgeirsson

Off site
Halldóra Elín Ólafsdóttir

On site
Sigurveig Guðmundsdóttir

Acting Chief Legal Counsel
Guðrún Finnborg Þórðardóttir

Operations and Finance
Ingibjörg Sigrún Stefánsdóttir

IT division
Jón Andri Sigurðarson

Human Resources
Jakobína Hólmfríður Árnadóttir

1. Activities of the Financial Supervisory Authority

1.1 Summary by the Director General

Financial market undertakings perform an important public service function. They are entrusted with the monetary assets of the general public for investment and repayment. They are required to have sound and effective payment systems, so that trade and commerce can proceed smoothly, and they provide loans and other forms of credit to individuals and undertakings for important projects. Financial market undertakings also ensure individuals and undertakings against major setbacks. All of these functions promote effective and reliable financial activities and financial stability. While the undertakings themselves bear the primary responsibility for the soundness of their operations and compliance with existing rules and regulations, organised supervision of their activities is undeniably important.

FME is the Icelandic authority entrusted with ensuring that regulated entities comply with the Acts, Regulations and Rules which apply to their activities.

It has been granted authorisations for detailed data gathering to analyse and assess whether undertakings are following good and sound business practices in their activities. FME assesses the eligibility of directors and managing directors, as well as the eligibility of parties to own qualifying holdings in a financial undertaking. The Authority also monitors pension funds' investments, ensuring they are within statutory limits, and sees to it that the securities market operates in compliance with the law, to mention some examples.

FME also looks after the initial investigation of economic crime, levies administrative fines, grants operating licenses, revokes them or demands improvements to activities, as appropriate. Most of these authorisations for intervention can have onerous effects in the short term on the activities of the undertakings concerned.

FME currently supervises 121 regulated entities, 108 of them undertakings operating in the financial market and 13 Winding-up Boards of failed financial undertakings. These regulated entities include commercial banks, savings banks, credit institutions, securities dealers, insurance companies, insurance brokers, pension funds, UCITS and fund management companies.

The size of FME has been the subject of some discussion; its employees are currently almost twice as many as they were in the autumn of 2008. As has often been pointed out, Iceland's financial system has shrunk considerably and is far simpler than it was during the upswing in the early years of this century. At the same time, however, major demands have been made to drastically improve the work of FME, so that it can stand up to comparison with leading regulators. In this connection, reference can be made to the discussion of the Authority and its work in the Report of the parliamentary Special Investigation Commission and that of the Finnish banking expert Kaarlo Jännäri.

FME functions as part of the international environment in its field, and the European environment in particular. The Authority operates as provided for by statutes, rules, standards and guidelines adopted based on Iceland's membership of the European Economic Area (EEA). As a result, its activities are scrutinised by both domestic and foreign authorities.

As a recent example of regulating the regulator, it could be mentioned that since Iceland's Standby Arrangement with the IMF has only recently concluded, the Fund's representatives still follow the activities of FME. In 2011 an assessment was also made of how well FME satisfied the Basel Committee's Core Principles for Effective Banking Supervision. Such an assessment will be repeated by the IMF during the latter part of 2013. Both the regulatory framework for financial services in Iceland and FME's authority have been examined in connection with Iceland's application to join the European Union.

FME is a thirteen-year-old institution, which was created by merging the Banking Supervision section of the Central Bank of Iceland with the Insurance Supervision Agency. FME has therefore had time to mature, and has not escaped various growing pains and struggles in the process. As previously mentioned, the demands made of the Authority are considerable and steadily increasing. It is very important for the Icelandic financial market that FME fulfil these demands with distinction.

The period covered by this Annual Report has seen plenty of activity at FME. A radical reorganisation of the Authority was undertaken at the end of 2011 and the new organisational chart took effect in mid-January 2012, in tandem with the opening of FME's new website with its new logo. Only a few months earlier the Authority had moved to new premises.

The restructuring, which included all of FME's supervisory divisions and is discussed in more detail later in this report, resulted in considerable rearranging within FME. Five positions of managing directors were abolished and replaced by three new managing director positions. The restructuring also made changes to the positions and tasks of most employees working on traditional surveillance. This undeniably resulted temporarily in extra pressure on employees and activities.

The market situation is discussed in this Annual Report. It points out, among other things, that despite the banks' strong equity and liquidity, there are certain aspects which could cause uncertainty and have a negative impact on their performance in coming quarters. These include primarily uncertainty concerning the quality of loan portfolios, legal uncertainty concerning loans linked to foreign currencies, longer-term funding issues, uneasiness in foreign markets and uncertainty in connection with the proposed removal of currency controls.

Securities market turnover has increased with the advent of new investment options, as both new companies and new bonds have been listed on the market. Equity turnover, for instance, more than doubled in 2011 over that of 2010, increasing from ISK 2 billion to over ISK 5 billion, and has continued to increase year-to-date in 2012. Bond market turnover has also been brisk. Average monthly turnover in 2011 decreased slightly from that of the previous year, then increased substantially during the first 6M of 2012, and has not been higher since 2008.

The assets of Icelandic pension funds relative to GDP were around 137% at year-end 2011, or the same percentage as prior to the banks' collapse. Their assets amount to around one-third of total assets of all entities regulated by FME. Pension funds' net real return was 2.54% in 2011, compared to 2.65% in 2010. In the last five years pension funds' returns have been below the funds' target of a real return of 3.5% annually.

Four companies dominate the insurance market with a combined market share of around 95%. Two are in a sales process. The profits of non-life insurance companies amounted to ISK 4.9 billion in 2011, which is an increase of ISK 2.9 billion over the previous year. All life insurance companies operated at a profit, while their total profit of ISK 1.3 billion was slightly lower than in 2010.

Year-end 2012 will mark the conclusion of FME's formal investigations into alleged economic crimes during the period preceding the financial collapse in the autumn of 2008. As many as 15 experts have worked on these investigations within FME in recent years. As of October 2012, FME has concluded investigations into 167 cases. Complaints concerning a total of 49 cases in connection with the events preceding the financial collapse have been lodged with the economic crime division of the National Commissioner of Police or the Office of the Special Prosecutor. Furthermore, 34 cases of alleged violations of the General Penal Code have been referred to the Office of the Special Prosecutor. In three instances cases have concluded with the levying of administrative fines and 81 cases concluded without any action. FME remains responsible by law for preliminary investigation of economic crime. As a result, the number of employees in the investigation team will decrease and from the beginning of next year its tasks will only include investigation of contemporary cases.

Recently FME has placed strong and increasing emphasis on information dissemination to regulated entities, the media and the general public. These efforts are based on FME's overall strategy and in part on its information policy published at the end of November last year. FME's Annual Report is definitely

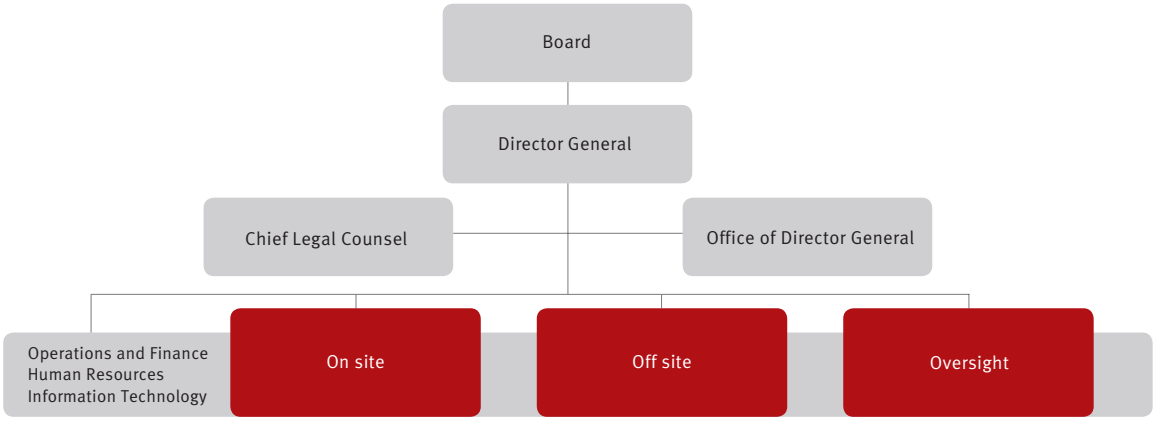
part of this information dissemination and I hope it will provide a clear and informative picture of its activities. As our intention is to hold FME's AGM hereafter in the spring, the interval until the next meeting will be shorter than usual.

1.2 Organisational changes

Since the collapse of the financial system in the autumn of 2008 both domestic and foreign parties have made assessments of FME's activities. Concerted efforts have been directed at acting on their comments and recommendations, a number of which were directed at changes to the Authority's internal organisation.

Major changes were made to FME's structure in the autumn of 2011. They were based on the work of a large group of FME employees, having regard for the above-mentioned comments and proposals of domestic and foreign parties. This work focused on the Authority's role and strategy, and the objectives the new organisation was aimed at achieving. The outcome was to introduce a task-oriented structure instead of divisions by markets. Emphasis was placed on actively involving all FME employees by one means or another in the implementation of the new arrangements.

Under the new structure, FME's activities are divided into three core divisions, On site, Off site and Oversight. Its support divisions are Operations and Finance, Human Resources and Information Technology. In addition, there are the offices of the Chief Legal Counsel and the Director General.



1.3 Human Resources

The organisational changes had a major impact on FME's management and employees. The positions of five managing directors were abolished and in their stead three new managing directors' positions were created, i.e. the managing directors of On site, Off site and Oversight. Sigurveig Guðmundsdóttir was appointed managing director of On site. She previously served as a department head at FME. Halldóra E. Ólafsdóttir, who had previously headed FME's Pensions and funds division, was appointed managing director of Off site. Lúðvík Þorgeirsson was appointed managing director of Oversight. He previously worked for Actavis and prior to that for TM Insurance hf.

Changes were made to the tasks and scope of work of most employees working on traditional supervision with the introduction of the new structure. Efforts were made to enable employees to take as active as possible a role and select positions suited to their individual qualifications and interests.

The method used to locate employees in the new organisational chart was based on a threefold process. Firstly, regard was had for employees' expertise and experience, then their strengths were assessed using Occupation Personality Questionnaires and finally their wishes as to where they would be placed in the new organisational chart were considered. This methodology was successful and most employees were

assigned to positions aligned to their first or second choice and strengths. The following table shows the distribution of employees by division and educational classification as of May 2012. Filling the positions in the new organisation concluded on 16 January 2012.

Division	Total	Lawyers	Commerce graduates, economists and engineers	Other university graduates	No university degree
Off site	38	19	18	1	
On site	24	5	16	2	1
Oversight	20		17	2	1
IT division	11		1	7	3
Human Resources	2			2	
Operations and Finance	14		4	4	6
Office of the Chief Legal Counsel	5	5			
Director General's Office	5	1	1	3	
Total	119	30	57	21	11

Staff development in Human Resources

The Human Resources Division is working on improving the Authority's human resources having regard to five main aspects:

- Training in supervision
- Knowledge management
- Corporate culture
- Wages and incentive systems
- Optimal utilisation of human resources

The objective of this development project, which is to cover a two-year period, is to strengthen these aspects of FME's infrastructure. Part of the development project is to visit regulatory agencies abroad and learn from their methods.

Internal instruction has already been reinforced. During the winter of 2011-2012 a fairly varied supply of useful courses was offered. Employee participation was high and satisfaction was expressed with the offerings. There are high expectations of further development of educational issues through participation in the development project and with additional staff in Human Resources; currently the division has two employees.

Staff turnover and growth

Employees increased somewhat in number in 2012. The number of FME's employees will reach a peak this year as planned and no further expansion is anticipated in coming years. In recent years staff turnover has been close to 13%. To date in 2012 (as of September) staff turnover has been 4%. FME has managed successfully to hire employees with varied backgrounds and education, and few employees ceased their employment this year, which is encouraging in view of the pressure on the Authority's staff resulting from such extensive changes.

1.4 FME's supervisory divisions

FME has three supervisory divisions, On site, Off site and Oversight.

On site

On site consists of two sections, investigations and on-site supervision. Up until now, the investigations section has primarily worked on investigation of alleged violations in connection with the banking collapse; these are to conclude for the most part at the end of this year. After that, a smaller group of employees will, among other things, handle investigation of contemporary issues requiring preliminary investigation by FME. The scope of the section will likely decrease considerably, with emphasis on utilising investigators' expertise and experience in examining similar cases in the future, enabling FME to respond rapidly in suitable manner. On-site supervision carries out supervision in regulated entities. Each on-site team is generally comprised of two to five employees. Each assessment demands strong co-operation among team members, and the team determines to a large extent the progress and quality of each examination, making it important that they consist of capable employees with relevant experience, expertise and ability.

Investigation and on-site examinations require extensive knowledge on the part of FME employees of the activities of the regulated entities and the laws and rules which apply to them. Several employees of the investigations section will join the on-site teams at the beginning of next year, ensuring that the knowledge they have acquired in recent years will be utilised. The division emphasises verifying data and providing follow-up.

Off site

The main task of the Off site division is to supervise entities on the Icelandic financial market, financial undertakings, insurance companies, pension funds and other financial market actors. Off site ensures that regulated entities operate in accordance with the Acts and rules which apply to their activities, as well as the Act on Official Supervision, No. 87/1998. The division is also to make sure that FME adopts appropriate rules and guidelines, as well as monitoring developments and communicating to the authorities proposals for necessary amendments to financial market legislation. Consumer affairs are also part of the mandate of Off site, for instance, in connection with supervising sound and healthy business practices.

The principal emphases in Off site's work are:

1. to oversee the activities of each individual regulated entity, monitor that they satisfy the conditions for their license and take suitable measures, if warranted, to ensure ongoing supervision;
2. to see to it that financial market activities comply with the current regulatory framework, including rules on sound and healthy business practices. This applies, for instance, to securities market transactions.

Off site reviews regular reporting, as well as other financial data from regulated entities. The division also assists On site in carrying out on-site investigations, as well as providing follow-up after investigations to ensure demands for improvements are implemented by regulated entities. Off site is also responsible for assessing the eligibility of directors and managing directors of regulated companies and issuing licenses and assessing fitness of owners of qualifying holdings etc. when these tasks arise. In the near term extensive work will be required on introducing new rules and guidelines in close consultation with the Ministries.

Oversight

The main focus of the Oversight division is to assess risk in individual financial market sectors and the market as a whole; to monitor the development of risk; make proposals for emphases in supervision; and assess the need for possible intervention by FME. Oversight directs the implementation of Risk-based Supervision (RBS), and lays the foundation for drafting a risk-based and preventive supervision

programme, which is then developed jointly with On site and Off site.

Oversight handles the publication of statistical data, as well as assessing the need for amendments to Acts, rules and guidelines. The division actively co-operates with parties abroad, in particular sister institutions, and receives a large number of foreign visitors, acquainting them with individual financial market sectors and/or the market as a whole.

The principal tasks of Oversight in 2012 have involved assessment of the equity requirements of commercial banks and savings banks; Supervisory Review and Evaluation Process (SREP); the introduction of RBS for FME; co-operation with the Central Bank of Iceland on financial stability; the development and introduction of a Credit Registry, a supervision of the NASDAQ OMX Exchange in Iceland and price formation on the securities market; maintaining registers of regulated entities and cross-border activities; communication of statistical data within the EEA on cross-border activities; and publication of statistics.

A variety of statistical material has been published and made available on the FME website, including annual account tables for credit institutions, securities dealers, fund management companies, pension funds, insurance companies and insurance intermediaries.

It is proposed that a working group of FME and the Central Bank of Iceland review current contingency plans and make proposals for future arrangements in this regard. Work is also underway on a Retirement Savings Adequacy (RSA) project concerning the pension fund system. This is an OECD project, supported by the EU. Its objective is, among other things, to evaluate overall pension savings and their role in providing satisfactory pension entitlement. FME serves mainly as co-ordinator of the project.

1.5 Operations and Finance

Regulated entities and other fee-paying entities, as defined by Act No. 99/1999, on Payment of Cost due to Official Supervision of Financial Activities, are to bear the cost of FME's operations. In its operating budgets, FME is by law required to estimate the relative breakdown of cost between the classes of regulated entities during each previous three-year period. This breakdown of activities, which is prepared each year from the FME's employee time sheet records, also provides general information on activities. The following table shows a breakdown of FME's working hours devoted to each main category of regulated entity in 2010 and 2011.

Relative distribution of FME working hours by category of regulated entity*)	2010 %	2011 %
Credit institutions	57.7	52.7
Insurance companies and insurance intermediaries	11.9	13.5
Pension funds	14.0	13.9
Fund management companies	7.6	8.9
Securities dealers and securities brokers	2.6	3.1
Equity and bond issuers	4.2	5.4
Other parties	2.0	2.5
	100.0	100.0

*) Work on investigations of failed financial undertakings is not included in any of these categories.

FME's time sheet records also enable analysis of activities by type of task or subject. Such analysis of hours spent in 2010 and 2011 is as follows:

Relative distribution of FME working hours between main tasks	2010 %	2011 %
Supervision	70.2	66.9
Off site	24.3	17.5
On site	3.0	3.2
Other supervisory activities	42.9	46.2
Regulatory framework	3.0	2.7
General operations	22.9	27.3
Foreign co-operation	3.9	3.0
	100.0	100.0

Off site supervision refers to examinations, monitoring and market vigilance of various types, based for the most part on regular information gathering by or reporting to FME. It also includes various specific inspections of the activities, business practices and operating rules of regulated entities. On site supervision refers to supervision tasks which commence with special on-site visits. The heading Other supervisory activities includes work in connection with granting of licenses, assessment of eligibility, sanctions, information dissemination, queries etc. This also includes most of the investigative work in connection with the banking collapse. General operations refers to work on FME's document management and archiving, IT, Human resources, education matters and other aspects of regular operations and office administration.

Operations in 2011 and estimates for 2012 operations

In 2011, FME's expenses, including purchases of assets, totalled ISK 1,613.0 million, while its income, including financial income, totalled ISK 1,704.3 million. Of this amount, supervisory fees totalled ISK 1,642.7 million. In 2011, therefore, there was a surplus of ISK 91.4 million on FME's operations. Included in the above-mentioned are expenses and income of ISK 11.7 million from Complaints Committees hosted by FME. As of year-end 2011, equity was ISK 334.2 million, while at the beginning of that year it was ISK 242.9 m. Equity at year-end reduces supervisory fees the following year, as according to Act No. 99/1999, on Payment of Cost due to Official Supervision of Financial Activities, regard is to be had to any estimated budget surplus or deficit in determining the supervisory fees for the following year when FME's budget is drafted. FME may, however, create a reserve within certain limits prescribed by law. The reserve as a proportion of equity allowed by this authorisation is ISK 38.3 million at year-end 2011. Key figures from FME's annual financial statements are shown in Chapter 5 of the report, while the annual financial statements in their entirety are published on the FME website.

No provision was made for the above-mentioned equity creation in the Authority's 2011 budget. The carry over of equity from 2010 proved to be somewhat greater than anticipated in the budget and income in 2011 was also higher than expected. The greatest difference, however, is that salary expense in 2011 was below budget since hirings had to be postponed, in part due to limited premises, as the availability of new rental premises was delayed somewhat from the assumptions in the year's budget. According to FME's 2012 budget, expenses are expected to total ISK 1,917.1 million, ISK 14 million of this for Complaints Committees. Estimated income including interest income for the year will be ISK 1,864.1 million, with income from supervisory fees totalling ISK 1,859.1 million. The estimated operating deficit for 2012 is therefore ISK 53.1 million, which will be covered by equity carried forward from the preceding year.

FME's operating budgets, including more detailed explanations of the Authority's operating cost

and outcome, are supporting documents with the annual Bills submitted to the Icelandic parliament Althingi by the Minister of Industries and Innovation, amending Act No. 99/1999 concerning the levying of supervision fees.

1.6 Just over a year in new location

In September 2011, FME moved to new premises at Höfðatún 2 in Reykjavík, in the Höfðatorg Tower, as it is commonly referred to. The new premises suit the Authority's needs extremely well with regard to space, location, internal facilities and building security, as strict demands are set by FME regarding secure handling of data and information and restrictions on access by unauthorised parties. FME's activities are mostly located on the third floor of the building and in part on the fourth floor as well. Activities are carried out mainly in open area workspaces, most of them intended to accommodate six to twelve employees. There is easy access between floors in the building. The new premises have greatly improved all reception and meeting facilities for dealing with regulated entities, other parties and customers.

1.7 New website proves useful

FME opened a new website in January 2012 after considerable preparation. The new website is both simpler and more accessible than its forerunner. It is not separated into markets, as was the previous website, but instead is intended to be a general source of data and information for regulated entities, the media and the general public.

1.8 Emphasis on information disclosure

In recent years FME has placed increasing emphasis on communication of information to regulated entities, the media and the general public. Press conferences have been held with success. Publication of an electronic periodical, *Fjármál*, has commenced, with three issues published to date. FME's increased emphasis on information dissemination can be attributed in part to the FME Information Strategy, which was issued at the end of November 2011.

The twofold strategy is aimed, on the one hand, at those parties supervised by FME and, on the other hand, at the media. With regard to regulated entities, emphasis is placed among other things on publishing material on the FME website for information purposes and to increase understanding of the application of legislation and what is considered sound and healthy business practices. Consultation papers are published on the website and stakeholders offered the opportunity to express their comments and suggestion before FME adopts and publishes rules and guidelines. Furthermore, public conclusions of cases and examinations are made available on the website.

With regard to the media and the general public, FME emphasises making its role visible to consumers, regulated entities and other interest parties. Accounts are given of actions by FME to protect consumers of financial services, provide information and explain the reasons why if information cannot be provided. FME also seeks to disseminate information on the financial market and the outcome of analyses on major aspects of it, as well as providing information on its international collaboration.

FME's Information Strategy is available here:
http://en.fme.is/media/um-fme/Strategy.pdf

2. Market trends

2.1 Credit market

The performance of the three largest commercial banks last year was very good, despite court decisions on exchange rate linked loans unfavourable to them. Their equity position is strong, at 23% on average based on their 6M results in 2012. The principal events in the banking system during the past 12 months are the takeover of BYR hf. by Íslandsbanki hf. at year-end 2011 and the Supreme Court's judgement in February 2012, declaring a certain type of exchange rate indexed loans to be illegal. While this outcome will have a substantial negative impact on the banks' operations, all of them will satisfy FME's current minimum equity requirements of 16%.

Improvement in the Icelandic economy continued this past year. GDP growth was around 3% and growth of 2.5-3% is forecast for 2012. Other statistics also showed a positive development. Unemployment has decreased and purchasing power of wages has increased. Domestic investment has also grown in tandem with a lower interest rate level.

The household and corporate debt situation has improved, as is reflected in a decline in default ratios, which have not been lower since the establishment of the new banks in 2008. Much work remains to be done, however, in restructuring the debts of these parties.

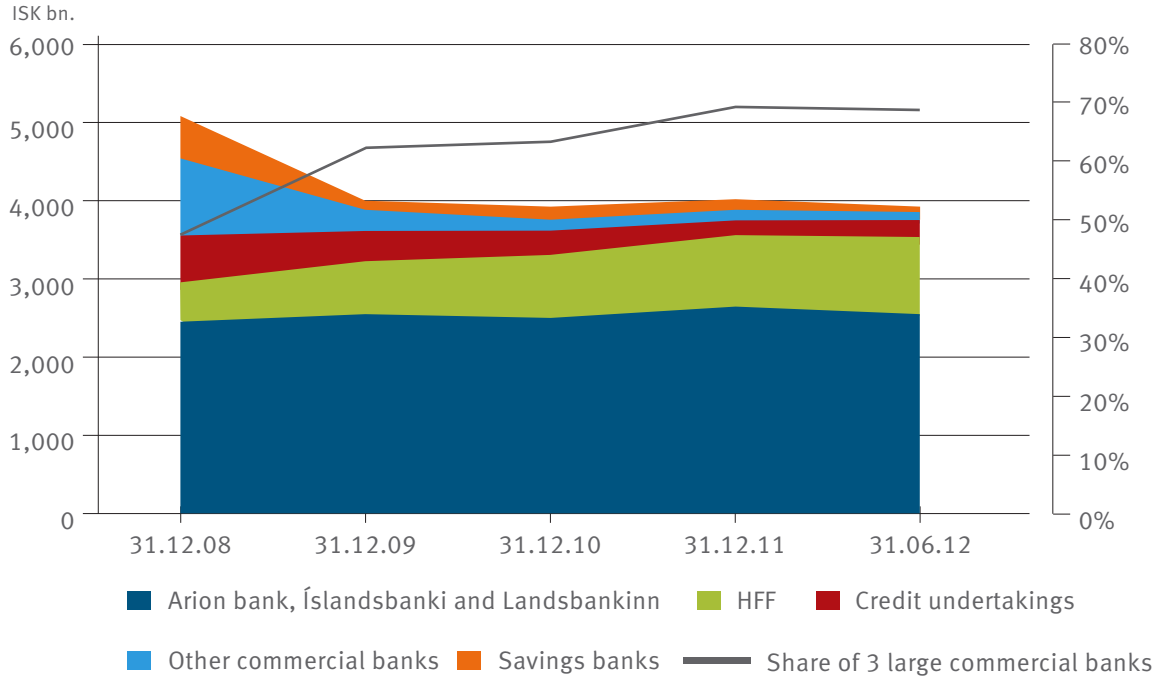
Despite their strong equity and liquidity, there are certain aspects which could cause uncertainty and have a negative impact on the banks' performance in coming quarters. These include primarily uncertainty concerning the quality of loan portfolios, legal uncertainty concerning loans linked to foreign currencies, longer-term funding issues, uneasiness in foreign markets and uncertainty in connection with the proposed removal of currency controls.

Another cause for concern is the banks' high cost-income ratios by international comparison, which indicate that there is considerable scope for increasing cost efficiency in their activities.

The total assets of the four commercial banks are equivalent to over 90% of total assets of credit institutions other than the Housing Financing Fund (HFF). If HFF is included the banks' share is over 70%. The commercial banks' total assets currently amount to approximately ISK 2,800 billion, or almost double Iceland's GDP.

Figure 1

Size of the banks and other credit institutions - total assets



HFF's situation is definitely worrisome, as the Fund's equity ratio has been dropping in recent quarters and its prepayment risk is considerable. The savings banks' situation remains sensitive.

2.2 Securities market

Securities market trends

Developments on securities markets have been noteworthy in the past year. Turnover has increased with the advent of new investment options, as both new companies and new bonds have been listed. It should be borne in mind, however, that while currency controls are in force investment options are limited and there is danger of asset bubbles developing.

Equity market trends

Equity turnover more than doubled in 2011 over that of 2010, increasing from ISK 2 billion to over ISK 5 billion, and has continued to increase year-to-date in 2012. This increased turnover can be attributed to some extent to the listing of new parties on the market: shares of the retailer Hagar hf. were listed at the end of 2011 and those of the real estate company Reginn hf. in July 2012. Despite an upturn in equity turnover in 2011 and 2012, this must still be considered fairly low and limited liquidity has more often than not resulted in sharp fluctuations in share prices.

The OMXI6 selected shares index dropped fairly sharply after mid-2011, reaching a temporary nadir at 860 points around mid-October that year. After that share prices began to pick up once more and the index closed at year-end at 910, compared to a level of 934 at the beginning of the year, or a decrease of 2.6%. The index continued to rise in the early months of 2012 and peaked at 1,092 at the beginning of May, its highest level since it was introduced. During the first six months of this year the OMXI6 index rose from 934 to 1,057 points, an increase of 16.2%. The market capitalisation of companies listed on the exchange as of the end of June 2012 was around ISK 326 billion, compared to ISK 280 billion at the beginning of this year.

At mid-2012, there were 13 companies listed, 9 on the main list and 4 on First North. Two companies plan to list their shares before the end of this year, Eimskip hf. and Vodafone hf. Interest in new investment options appears fairly strong, as shares of both Hagar hf. and Reginn hf. were oversubscribed, so the addition of these companies to the equity market should be welcomed by investors faced with limited investment options due to currency controls.

Figure 2

NASDAQ OMXI6 Selected shares index

Bond market trends

Turnover on the fixed-income market has been brisk. Average monthly turnover in 2011 decreased slightly from that of the previous year, then increased substantially during the first 6M of 2012, and has not been higher since 2008. As previously, turnover in both 2011 and 2012 was highest in non-indexed Treasury bonds, accounting for around 60% of total turnover of all listed market bonds. The total market value of registered bonds on the exchange was ISK 1,858 billion at mid-2012, an increase of ISK 139 billion from the same time in 2011.

In 2011 the indices for non-indexed yields rose by 79-155 points, while to date in 2012 yields on the shortest bonds have dropped once more, by 106 points and have remained at this level for quite some time. Yields on indexed securities continued to drop, especially during the latter half of 2011; at year-end yields according to the OMXI5YI and OMXI10YI indices dropped by 79 and 175 points. The OMXI5YI index has risen by 88 points during the first 6M of 2012, while OMXI10YI has remained practically unchanged.

Figure 3

Yields on NASDAQ OMX non-indexed bond indices

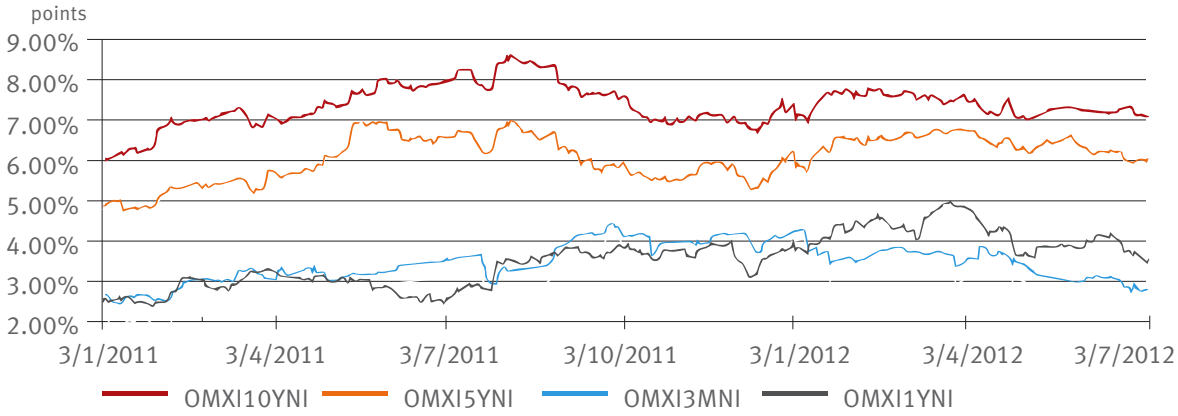
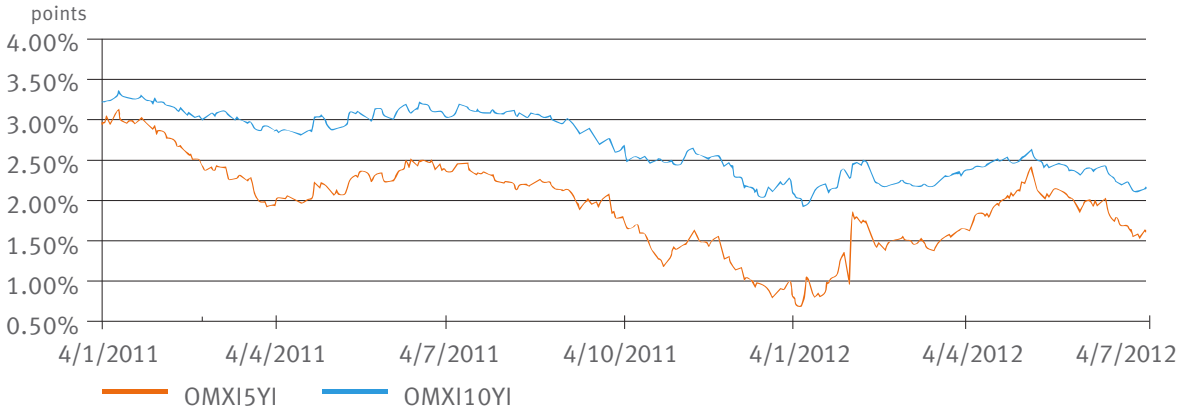


Figure 4

Yields on NASDAQ OMX indexed bond indices



The impact of currency controls and non-residents on market price formation was clearly visible in March this year, in the tumult on the bond market following an announcement by the Central Bank of Iceland tightening rules on foreign currency. The price of the bond series HF 14 0915 dropped by 13% immediately following the announcement, as non-resident investors had purchased these securities in large quantities, resulting in negative yields for a time. Non-residents owned around 23% of all Treasury bonds and around 73% of all Treasury bills at mid-2012.

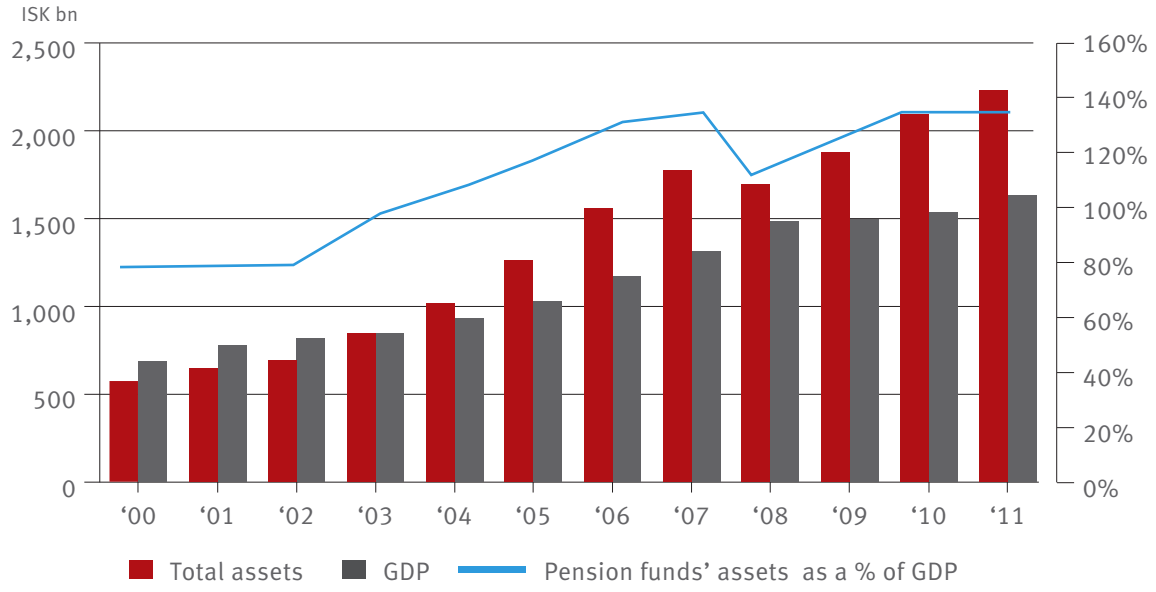
During the period Arion Bank hf. and Íslandsbanki hf. sought funding on the market by issuing covered bonds. Investors' interest was high, and both issues were substantially oversubscribed.

2.3 Pension funds and UCITS

As of year-end 2011, assets of Icelandic pension funds were equivalent to around 137% of GDP, or the same level as prior to the banks' collapse. The total assets of all the parties monitored by FME amount to close to ISK 6,700 billion; assets of pension funds and custodians are around one-third of this amount, or 33.4%. Pension funds' assets are comprised of assets owned by mutual insurance divisions, which amount to ISK 1,889 billion or around 90% of the total, while assets of the funds' private pension schemes amount to ISK 209 billion and those held by other pension custodians to ISK 132 billion.

Figure 5

Assets of pension funds and private pension custodians / GDP



Pension funds' returns have fluctuated strongly, especially in 2008, when their returns were negative by 22% following good returns from 2003 to 2006. The net real return of both mutual insurance and private pension divisions of pension funds, measured against the CPI, was 2.47% in 2011 and 2.65% in 2010. In the past five years pension funds' returns have been below the funds' target of a real return of 3.5% annually. If the breakdown of investments by pension funds' mutual insurance divisions as of year-end 2008 and year-end 2011 is compared it is striking how great the increase has been in securities issued by the Treasury and municipalities, as they have risen from 23% to 48% of total investments in the space of three years. In tandem with this exchange rate linked assets have decreased from 29% to just over 23%.

Since 2008 the pension funds have placed increased emphasis on risk management. FME has issued guidelines on risk management of mutual insurance divisions and comparable guidelines for custodians of private pension savings are awaiting comments from interest parties. New and improved rules on audit departments and independent pension fund supervisors were issued recently.

Actuarial status

The actuarial status of funds which do not enjoy wage payer guarantees was negative by ISK 180 billion at year-end or equivalent to 7% of their total obligations. The situation has improved gradually since 2008, primarily due to reductions to pension entitlements. The actuarial status of funds guaranteed by the wage payer, i.e. the state and municipalities, was negative by ISK 488 billion or 63% of the funds' total obligations; the deficit will have to be made up by the respective guarantors. These latter funds, which are largely of the "pay-as-you-go" type, were closed to new members quite a number of years ago.

International comparison

Icelandic pension funds are large by international comparison. In Europe, only the Dutch pension fund system is larger. Iceland is followed by Switzerland, the UK, Finland, Denmark and Ireland. Pension fund coverage is also high in Iceland, as 85.5% of persons of working age are included in compulsory occupational pension schemes and 42% have personal pension savings. This is among the highest in Europe.

In 2011, ISK 78.4 billion or 50% of pension payments came from pension funds while ISK 56.3 billion or 36% came from the State Social Security Institute. Disbursements of personal pension savings in accordance with Temporary Provision VIII of Act No. 129/1997 amounted to ISK 20.9 billion or 14%. Public pension payments as a percentage of GDP are lower in Iceland than in other European countries. In 2010 this was only 4%. The next lowest proportion was in Switzerland, 6%.

Management companies of UCITS and investment funds

There were nine management companies regulated by FME at the end of June 2012, an increase of one company over the previous year.

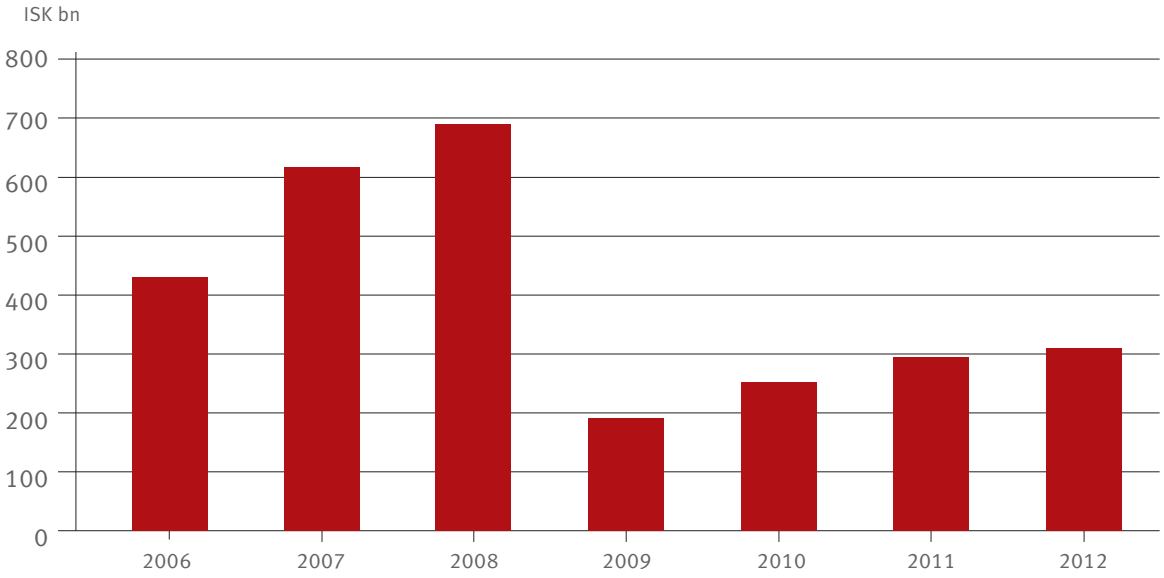
The companies operate a total of 54 UCITS funds and fund divisions and 28 investment funds and fund divisions. The total assets of UCITS and investment funds amounted to ISK 311 billion as of the end of June 2012. Of this, assets of UCITS were close to ISK 251 billion and assets of investment funds almost ISK 60 billion.

Assets of UCITS and investment funds

Assets of UCITS and investment funds increased by 5.5% between 2011 and 2012. In line with general trends in recent years, the decrease in their assets in 2008 and 2009 has been reversed to some extent. The great majority of total assets of UCITS and investment funds (around 80%) are invested in bonds issued by or guaranteed by the Icelandic state. This investment has grown greatly over the past four years, at the cost mainly of other bond assets and deposits. Investment in unit share certificates (units) has also increased somewhat. Figure 6 shows the total assets of UCITS and investment funds in 2006-2011.

Figure 6

Total assets of UCITS and investment funds (ISKbn) as of the end of June each year.



2.4 Insurance market

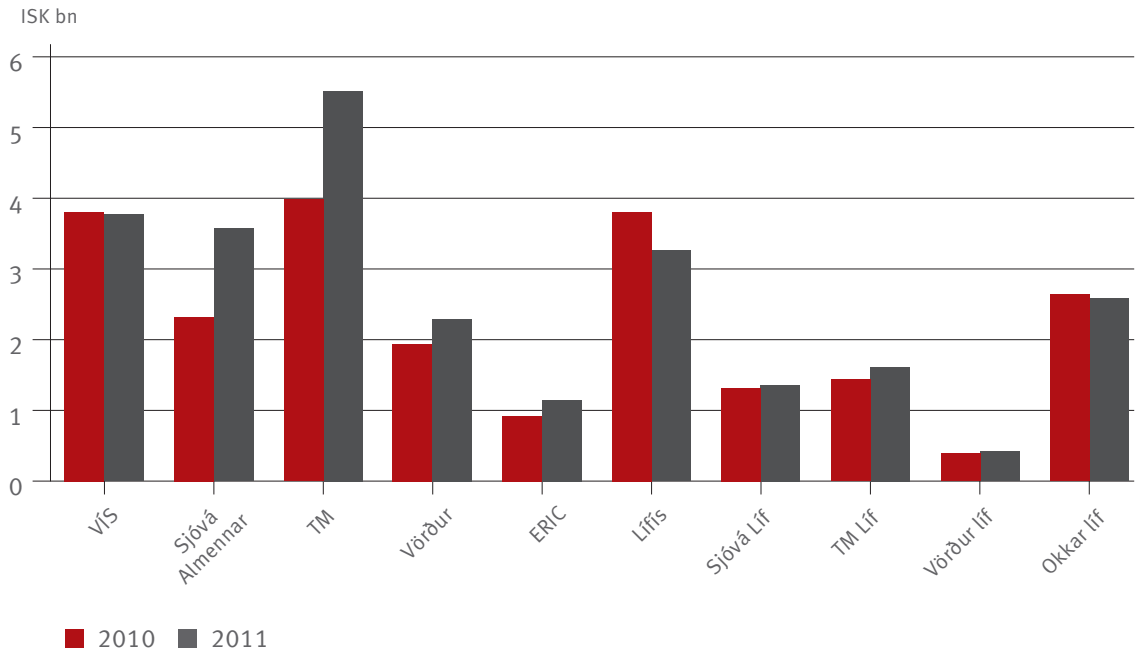
The banking collapse, together with the changes to Acts and Regulations following in its wake, has had a major impact on insurance companies. Instead of developing new insurance products the companies have focused on adapting their operations to the altered environment and on reviewing their strategy. Their income has increased and key ratios have improved. FME has taken an active part in preparation of introducing the Solvency II Directive, chairing the preparatory committee appointed by the Ministry of Economic Affairs (now the Ministry of Industries and Innovation). A bill transposing the Directive is to be submitted to the Althingi in 2012-13.

There has been no change in the number of non-life insurance companies; four companies dominate the market with a combined market share of 95%. Two of these companies, TM Insurance and VÍS, are in a sales process and Sjóvá was sold last year. The profits of non-life insurance companies amounted to ISK 4.9 billion in 2011, which is an increase of ISK 2.9 billion over the previous year. These companies' total assets amounted to ISK 131 billion as of year-end 2011, increasing by ISK 7 billion year-over-year.

Five companies operate in the Icelandic life insurance market, of which four are subsidiaries of non-life insurance companies and one is owned by Arion Bank. All life insurance companies operated at a profit, although their total profit of ISK 1.3 billion was ISK 0.1 billion less than in 2010. At year-end, total assets of life insurance companies amounted to ISK 14.4 billion.

Figure 7

Solvency of insurance companies



3. Events of the year

3. 1 Significant events of the past year

Rules on remuneration policy

Rules on financial undertakings' remuneration policy were adopted by the Board of Directors of FME on 30 June 2011. Amendments to the Act on Financial Undertakings, No. 161/2002, resulting from Act No. 75/2010, entrusted FME with setting such rules. They entered into force upon publication in the Official Journal of Iceland (Icel. *Stjórnartíðindi*) on 8 July 2011.

Rules on assessment of eligibility of managing directors and directors of financial undertakings

In the latter part of July 2011, FME issued rules on assessing the eligibility of managing directors and directors of financial undertakings. The rules accorded for the most part with altered practices for eligibility assessment adopted by FME at the beginning of 2010.

Financial undertakings must inform FME, in advance if possible, of the composition of and subsequent changes to their Board of Directors and managing director. The undertakings are also to deliver specific data and documentation to FME within four weeks of the election of directors or hiring of managing directors.

EIOPA stress tests

At the end of August this year, FME issued a news release on stress tests performed by the European Insurance and Occupational Pensions Authority (EIOPA) on all insurance markets in the European Economic Area. The largest life and non-life insurance companies in each market were selected, so that participants included insurance companies with a total of over 50% market share in each individual market.

The largest Icelandic life and non-life insurance companies were included in the stress test and all withstood the setbacks applied in the test.

Revised guidelines on actions to combat money laundering and terrorist financing

At the end of September 2011, FME issued revised guidelines on actions to combat money laundering and terrorist financing. Their objective was, among other things, to provide instructions for carrying out risk assessment by regulated entities.

Approval of the merger of BYR hf. and Íslandsbanki hf.

In October 2011, FME granted approval for the merger of BYR hf. and Íslandsbanki hf., based on Art. 106 of Act No. 161/2002, on Financial Undertakings. FME had been examining the case and accompanying documentation since July 2011.

Presentation of commercial banks' 6M results

On 20 October 2011, FME held a press conference reviewing the commercial banks' 6M results. Holding a meeting of this sort was to some extent an innovation in FME's activities, in line with its policy of increasing informed debate and transparency.

Revocation of the licence of Saga Investment Bank hf.

On 24 October 2011, FME announced it had revoked the licence of Saga Investment Bank hf. to operate as a credit institution, as the undertaking did not fulfil the provisions of Act No. 161/2002, on Financial Undertakings, regarding minimum equity. The revocation was effective as of 3 October 2011.

Judgement by the Reykjavík District Court of 5 January 2012 (decision on the eligibility of the managing director of a pension fund)

In this case the former managing director of the Engineers' Pension Fund demanded that a decision by FME of 31 August 2010, to the effect that he did not fulfil the requirements made of managing directors, be invalidated. FME's examination of his eligibility had revealed that his career and background did not ensure that he could justifiably serve as managing director of a pension fund, cf. the sixth paragraph of Art. 31 of the Act on Mandatory Guarantee of Pension Rights and Operation of Pension Funds. The District Court invalidated FME's decision, as there was not deemed to be sufficient grounds on which to base as onerous a decision on a discretionary legal authorisation, in addition to which it was concluded that FME's processing of the case did not comply with Art. 15 of the Public Administration Act and the managing director had as a result not been accorded full right to object, cf. Art. 13 of the same Act.

The judgement was not appealed by FME to the Supreme Court as permission for the appeal was not granted by the Supreme Court.

Judgement by the Reykjavík District Court of 5 March 2012 (decision on revocation of the operating license of a credit undertaking)

In this case Saga Capital hf. demanded that FME's decision of 28 September 2011 to revoke the company's operating license be invalidated. FME had taken the decision to revoke the license on the basis that Saga Capital hf. did not satisfy provisions of the Act on Financial Undertakings on equity, cf. Point 2 of the first paragraph of Art. 9 of the same Act. The District Court concluded that FME's decision should be upheld, as the statutory requirements for the license were not satisfied and the company's claims, that the decision violated procedural rules of the Act on Financial Undertakings or the principles of the Public Administration Act or that it was substantially flawed, were not accepted. The judgement was not appealed to the Supreme Court.

A Ruling from the District Court in Northeast Iceland on 16 May 2012 placed Saga Capital hf. in winding-up proceedings, as provided for in Point 1 of the second paragraph of Article 101 of the Act on Financial Undertakings. The Ruling was subsequently confirmed by a judgement of the Supreme Court on 14 June 2012.

Judgement of the Supreme Court on 16 May 2012 (decision on an administrative fine)

In this case the investment company EA fjárfestingarfélag hf. demanded that FME's decision of 31 May 2011, levying an administrative fine of ISK 15 million on the company, be cancelled. FME had taken the decision following an on-site examination of the company which revealed, in the Authority's estimation, that the company's risk arising from its internally connected customers exceeded what was authorised by the then applicable Art. 30 of the Act on Financial Undertakings, cf. subparagraph a of Art. 2 of the Rules on Large Exposures. The Supreme Court cancelled the decision, concluding that FME had not demonstrated sufficiently that the connections between the said customers were covered by the definition of financially connected parties upon which the administrative fine was based.

Earlier in the year FME began a revision of the Rules on Large Exposures of Financial Undertakings in connection with the transposition of Directive 2009/111/EC, including those points which were disputed in the above-mentioned judgement.

FME entrusted with supervision of institutional investor funds

On 1 November 2011, it was announced that FME had been entrusted with specific limited supervision of institutional investor funds upon the entry into force of Act No. 128/2011, on UCITS, Investment Funds and Institutional Investor Funds, that same day. This was a new step, as previously institutional investor funds had not been subject to regular supervision by FME.

Summary of provisional activities of credit institutions

On 17 November 2011, FME published a summary of provisional activities of credit institutions. This reviewed the ownership status of credit institutions in companies with unrelated activities and how their activities were being concluded or reorganised.

State prosecutor upholds complaint from FME

It was reported on FME's website on 1 December 2011 that the State Prosecutor had accepted FME's complaint in connection with a decision by the Office of the Special Prosecutor to cease investigation of alleged violations of investment authorisations by five pension funds managed by Landsbanki Íslands hf. prior to the bank's collapse. FME had referred its charges against the pension funds to the Office of the Special Prosecutor.

The conclusion by the State Prosecutor was to cancel the decision by the Office of the Special Prosecutor to cease its investigation of the case and instruct it to continue investigation of the case.

Guidelines on risk management for pension funds' mutual insurance divisions

On 12 December 2011, FME issued guidelines on risk management for the mutual insurance divisions of pension funds, a draft of which had been issued as a discussion paper earlier that year.

Guidelines on the status and responsibilities of financial undertakings' compliance function

FME issued Guidelines No. 5/2011, on the on the status and responsibilities of the compliance function of financial undertakings on 12 December 2011.

Following the issuance of the Guidelines, FME held special information meetings with financial undertakings' executives and compliance officers.

FME's Information Policy

FME published an Information Policy on 15 December 2011. It discussed dissemination of information, on the one hand, to parties regulated by FME and, on the other and, to the media and the general public. The information policy is based, among other things, on FME's overall strategy.

FME takes over the scrutiny and approval of prospectuses

In December 2011 it was announced on FME's website that the Authority would, as provided for by law, take over the scrutiny and approval of prospectuses as of 1 January 2012.

Organisational changes and hiring of managing directors for three new supervisory divisions

At the beginning of 2012, FME appointed managing directors for its three new supervisory divisions, following work on re-organisation within FME which had been in progress since October 2011 with active employee participation. The work resulted in changes to FME's structure, including the disbanding of five divisions and the creation of three new ones. The three new supervisory divisions are On site, Off site and Oversight. Under the new task-oriented structure, the new supervisory divisions took over all the tasks of the five previous divisions which were disbanded. Their organisation was based to a large extent on sectors of the financial market. The objective of

the organisational changes was to increase the efficacy and co-ordination of FME's work.

Halldóra E. Ólafsdóttir, who had been the managing director of FME's pensions and securities division since April 2008, was appointed managing director of Off site. Lúðvík Þorgeirsson, who had previously worked for Actavis and before that for TM Insurance hf., was made managing director of Oversight. Sigurveig Guðmundsdóttir, an economist in FME's pensions and funds division, was appointed managing director of On site. A total of 72 applications were received for the managing director positions.

Conclusion of the Supreme Court's judgement not considered a threat to financial stability

On 16 February 2012, FME published a news announcement on the occasion of a landmark judgement by the Icelandic Supreme Court regarding recalculation of an exchange rate indexed loan. The announcement stated that, while in FME's estimation the Court's conclusion would have a negative impact on the system, it would not do so to the extent of threatening financial stability. The extent of the impact could vary depending on the financial undertaking involved, and in some cases it could even be insignificant. It was pointed out in the announcement that FME would begin immediately the work of assessing the impact of the judgement on the financial position of individual financial undertakings, emphasising the importance of resolving any uncertainty regarding the precedent set by the judgement and its effect on recalculation of exchange rate indexed loans.

Director General dismissed

On 1 March 2012, the Board of Directors of FME issued a statement that it had informed Gunnar Þ. Andersen, Director General of FME, of its decision to terminate his contract of employment. The reason for this action was the failure, in the estimation of FME's Board of Directors, of the premises for Gunnar Andersen to be able to serve in his position due to lack of eligibility. This was attributable to his past actions as one of the managing directors of Landsbanki Íslands hf. In addition, FME's Board of Directors had received information indicating that Gunnar Andersen may have committed a violation of his duties by unlawfully obtaining confidential information from the banking system. Furthermore, it was stated that Unnur Gunnarsdóttir, FME's Chief Legal Counsel, had taken over as Director General provisionally.

FME's Guidelines to credit institutions administered by a Winding-up Board and subsidiaries of credit institutions in winding-up proceedings

On 1 March 2012, FME published a news announcement, with reference to the legal uncertainty which had arisen concerning recalculation of exchange rate indexed loans and asset leasing agreements, cf. the Supreme Court's judgement of 15 February 2012 in case no. 600/2011, that it had instructed credit institutions administered by a Winding-up Board and subsidiaries of credit institutions in winding-up proceedings (hereafter credit institutions) that they were to assess what the possible impact of the judgement and consequent recalculations would be on their equity.

If there was a probability that new recalculation in accordance with the judgement would result in certain debtors possibly having overpaid, and these overpayments could not be netted, as provided for in Art. 18 of Act No. 38/2001, on Interest and Indexation, the credit institutions were to:

1. assess whether it was appropriate to send further payment coupons to such debtors;
2. ensure that debtors who were found to have overpaid, based on new recalculations, received full repayments.

In addition, FME reminded credit institutions of the option to offer debtors, who were considered to have possibly overpaid, the remedy of depositing payment in accordance with payment coupons received into a special escrow account until the new recalculation and settlement could be

completed. Furthermore, FME pointed out to credit institutions that onerous collection actions should not be taken against debtors, such as actions based on Act No. 90/1989, on Enforcement Proceedings and Act No. 90/1991, on Forced Auction and Deprivation of Assets, based on contractual terms and conditions in cases where there could be doubt as to the alleged defaults.

FME's electronic publication *Fjármál*

The first issue of FME's electronic publication, which has been named *Fjármál* (Financial Affairs) appeared on 21 March 2012. The initial issue of *Fjármál* contained an introduction by Unnar Gunnarsdóttir, acting Director General, and three articles. It discussed investigations by FME of the events preceding the banking collapse, credit institutions' exchange rate indexed loans and asset leasing contracts and an assessment of risk management and corporate governance in the three large commercial banks.

Memorandum concerning Supreme Court's judgement

Around mid-March 2012, FME published a memorandum compiled by the Authority in response to the Supreme Court judgement of 15 February 2012. It summarised FME's conclusions as to the impact of the judgement on the book value of exchange rate indexed loans in credit institutions' loan portfolios. The credit institutions were asked to assess the impact of the judgement based on four scenarios, where scenario one assumed the most wide-reaching negative interpretation of the judgement with regard to credit institutions and scenario four the most limited impact. FME's memorandum was based on the two scenarios which the Authority regarded to be most closely aligned with the Supreme Court's premises in its judgement. The difference between the most wide-reaching scenario and the most limited is only 10%. FME's assessment was that the impact of the Supreme Court's judgement did not threaten financial stability. However, FME repeated that all uncertainty concerning the settlement of exchange rate linked loans was detrimental to the financial system and it was important that it be resolved. Since then FME has followed the development of this matter closely.

New Director General engaged

The hiring procedure for a new Director General of FME was announced on the Authority's website on 20 April 2012 and the position advertised shortly afterwards. The announcement of the hiring of Unnur Gunnarsdóttir was made on 5 July.

Commercial banks - status and outlook

On 10 May 2012, FME held a media presentation meeting under the heading "Commercial banks - Status and outlook". Among other things, the meeting presented a review of the commercial banks' operations during the preceding year, provisional banking activities and legal uncertainty concerning the recalculation of exchange rate linked loans. The future outlook for the banks' operations was also considered.

Second issue of *Fjármál* published

On 19 June 2012, the second issue of FME's electronic publication *Fjármál* appeared, with a variety of material. In her introduction, Unnur Gunnarsdóttir, acting Director General of FME, discussed what factors FME took into consideration in its decisions and actuary Sigurður Freyr Jónatansson provided an account of non-life insurance companies' performance in 2011. Analyst Guðmundur Örn Jónsson wrote on the separation of commercial and investment banking activities. Finally, another analyst, Evgenía K. Mikaelsdóttir, discussed FME's supervisory procedure in connection with assessment of financial undertakings' capital adequacy, in accordance with Pillar 2 of the Basel rules.

Complaints Committees hosted by FME

FME hosts the Insurance Complaints Committee, which deals with disputes on liability for compensation, including responsibility and division of responsibility between consumers and insurers. The major increase in referrals in recent years can be attributed in part to parties' increased knowledge of the Act on Insurance Contracts, No. 30/2004, and an authorisation to refer cases. Changes made to the Articles of the Insurance Companies' Damages Committee in 2008 also resulted in an increase in the number of referrals. Until 2009, the Committee issued on average 270 rulings annually, but last year they were 523 in number.

FME also hosts the Complaints Committee on Transactions with Financial Undertakings, which handles disputes with credit institutions (e.g. commercial banks or savings banks), securities dealers or subsidiaries of these financial undertakings. Until 2009, referrals to the Committee averaged around 20 annually, but they have increased greatly in number in the years following the financial shocks in the autumn of 2008, with no end to the increase in sight. In 2011, for instance, a total of 115 cases were received by the Committee and Rulings were issued in 106 cases. During the first eight months of 2012, 148 cases were referred to the Committee.

FME's investigations

FME's investigations into the events preceding the banking collapse in the autumn of 2008 began immediately following the failure of the three large commercial banks. The investigations have been directed at securities market transactions as well as the activities of financial institutions and other regulated entities. When it became clear that the extent of the investigations would be very considerable, FME requested additional budget allocations to ensure it would be possible to handle this large and important project professionally and reliably. In recent years as many as 15 experts have been working concurrently on investigations within FME. In October 2012, FME had completed investigations into 167 cases. A total of 49 cases have been referred for prosecution to the Economic Crime Division of the National Commissioner of Police or the Office of the Special Prosecutor. Furthermore, 34 cases which concern alleged criminal violations have been referred to the Office of the Special Prosecutor. In three instances cases have been concluded with the levying of administrative fines and 81 cases concluded without any action.

The above-mentioned investigations by FME have revealed alleged violations involving practically every type of economic crime. Furthermore, it is established that in many instances the conduct of regulated entities during the period preceding the banking collapse did not comply with the specific legislation enforced by FME.

At year-end 2012, FME's formal investigations into the banking collapse will conclude. Substantial expertise and experience in investigating economic crime and methodology in this connection has been accumulated by FME in the past few years, making the Authority well prepared to deal with demanding tasks in this area in the future. After the conclusion of investigations into the banking collapse, this experience and expertise will be preserved within FME, in part in the form of an investigative team within On site, which will handle contemporary investigations of alleged violations of the specific legislation enforced by FME.

4. Regulated entities

4.1 Number of regulated entities as of 30/06/2012

The following is a breakdown of those entities regulated by FME as of 30 June 2012:

	Number 30/06/2012*)	Operate under Act No.:
Commercial banks	4	Act No. 161/2002, on Financial Undertakings
Savings banks	10	Act No. 161/2002, on Financial Undertakings
Credit undertakings	6	Act No. 161/2002, on Financial Undertakings
Deposit departments of co-operative societies	1	Act No. 22/1991, on Co-operative Societies
Securities dealers	12	Act No. 161/2002, on Financial Undertakings
Securities brokers	3	Act No. 161/2002, on Financial Undertakings
Fund management companies	8	Act No. 161/2002, on Financial Undertakings
UCITS - 53		Act No. 128/2011, on UCITS, Investment Funds and Institutional Investor Funds
Investment funds - 23		Act No. 128/2011, on UCITS, Investment Funds and Institutional Investor Funds
Institutional investor funds - 33		Act No. 128/2011, on UCITS, Investment Funds and Institutional Investor Funds
Institutional investor funds	4	Act No. 128/2011, on UCITS, Investment Funds and Institutional Investor Funds
Stock exchanges and regulated OTC markets	1	Act No. 110/2007, on Stock Exchanges
Securities depositories	1	Act No. 131/1997, on Electronic Registration of Title to Securities
Pension funds	32	Act No. 129/1997, on Mandatory Guarantee of Pension Rights and Operation of Pension Funds
Insurance companies	13	Act No. 56/2010, on Insurance Activities
Insurance intermediaries	6	Act No. 32/2005, on Intermediation of Insurance
Parties with debt collection licenses	4	Act No. 95/2008, on Debt Collection
Other regulated entities	3	Various Acts
Total	**108**	
Winding-up Boards	13	Act No. 161/2002, on Financial Undertakings
Total	**121**	

*)The changes which have taken place since the last Annual Report include the revocation of the operating license of Saga Capital hf. and the approval of the relinquishing of its operating license by EA fjárfestingarfélag ehf. These companies have now been placed in winding-up proceedings. In addition, mergers of the following financial undertakings have taken place: a merger of BYR hf. with Íslandsbanki hf., of Alfa verðbréf hf. with MP Bank hf., of Tindar verðbréf hf. with Auður Capital hf. and of Verdis hf. with Arion Bank hf. UCITS, investment funds and institutional investor funds operated by fund management companies are not included in the total number of regulated entities. Several of the funds are divided into divisions.

4.2 Activities by foreign parties in Iceland

The following summary shows the number of parties/companies authorised as of mid-2012 to provide services in Iceland based on rules which apply in the European Economic Area:

Foreign banks without establishments	220
UCITS	49
Securities dealers/brokers (Investment firms)	1,913
Insurance companies with establishments	2
Insurance companies without establishments	350
Insurance brokers and insurance agents	4,962

5. Highlights of FME's annual financial statements for 2011

The following are the key figures from FME's annual financial statements for 2011. The statements were endorsed by FME's Board of Directors on 27 June 2012 and endorsed by the National Audit Bureau the same day. The annual financial statements are published in their entirety on FME's website, www.fme.is

Income statement 2011

Income	2011	2010
Income from supervision fee	1,642,716,557	1,143,217,311
Other income	37,360,169	124,788,106
	1,680,076,726	1,268,005,417
Expenses		
Salaries and related expense	1,074,475,956	822,521,261
Complaints Committees	11,659,789	12,723,784
Office and administrative expense	93,870,613	63,061,119
Travel and work-related expenses	34,985,192	31,303,791
Expert services purchased	169,867,329	162,872,402
Operation of tools and equipment	26,880,183	26,723,935
Other operating expenses	49,158,557	36,902,693
Cost of premises	79,714,665	66,437,068
Transfers	130,975	147,275
	1,540,743,259	1,222,693,328
Assets purchased	72,211,644	10,582,375
	1,612,954,903	1,233,275,703
Operating surplus	67,121,823	34,729,714
Financial income	24,253,126	19,383,860
Income surplus	91,374,949	54,113,574

Balance sheet as of 31 December 2011

Assets	2011	2010
Current assets		
Receivables	174,052,920	91,903,206
Other short-term monetary assets	7,416,898	8,414,554
Cash and cash equivalents	203,502,982	184,401,897
	384,972,800	284,719,657
Total assets	384,972,800	284,719,657
Liabilities and equity		
Equity		
Principal at beginning of the year	242,852,961	188,739,387
Surplus/(Deficit) for the year	91,374,949	54,113,574
Equity	334,227,910	242,852,961
Short-term liabilities		
Treasury	3,570,457	5,418,748
Short-term liabilities	44,979,507	35,488,877
Other short-term liabilities	2,194,926	959,071
Liabilities	50,744,890	41,866,696
Liabilities and equity	384,972,800	284,719,657

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