

# Annual Report of the Financial Supervisory Authority

2018



**FJÁRMÁLAEFTIRLITIÐ**  
THE FINANCIAL SUPERVISORY AUTHORITY, ICELAND

## Annual Report of the Financial Supervisory Authority 2018

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The Financial Supervisory Authority  
Katrínartún 2  
IS-105 Reykjavík  
Telephone: +354 520 3700 / Fax: +354 520 3727  
E-mail: [fme@fme.is](mailto:fme@fme.is)

Editorial Board: Jón Þór Sturluson, Bjarki Vigfússon, Sigurður G. Valgeirsson, and Sigurður Freyr Jónatansson

Design and layout: ENNEMM

Photos: Birgir Ísleifur Gunnarsson

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# Contents of the Annual Report

The 2018 Annual Report of the Financial Supervisory Authority (FME) primarily addresses the period between 1 May 2017 and 30 April 2018. The report describes the main tasks of FME. It also addresses the 2017 situation and development in the banking market, the pension and insurance markets, and the securities and mutual funds market. The report also contains various information on the financial market and the arrangement of official supervision of financial activities. The report is published on FME's website in Icelandic and English.

## **FME's Board of Directors and management**

A three-person Board of Directors is ultimately responsible for FME's administration. Its role is to define the priorities in FME's work and to monitor its activities and operations. Major decisions shall be referred to the Board for approval or rejection. The Board appoints a Director General responsible for FME's day-to-day

administration. As of May 2018, the Board comprises of Ásta Þórarinsdóttir, economist and Chairman of the Board, Guðrún Þorleifsdóttir, Office Manager and Vice-Chairman of the Board, and Arnór Sighvatsson, Deputy Governor of the Central Bank who is appointed by the Central Bank of Iceland.

Alternate members are: Friðrik Ársælsson lawyer, Guðrún Ögmundsdóttir, Director at the Central Bank of Iceland, and Andri Fannar Bergþórsson, Assistant Professor at the Reykjavik University School of Law. Harpa Jónsdóttir served on FME's Board as an alternate until mid-2017 when Guðrún Ögmundsdóttir replaced her. Ástríður Jóhannesdóttir served on FME's Board as an alternate until year-end 2017 when Andri Fannar Bergþórsson replaced her.

## **FME Management**

### **Director General \***

Unnur Gunnarsdóttir

### **Deputy Director General \***

Jón Þór Sturluson

### **Chief Legal Counsel**

Anna Mjöll Karlsdóttir

### **Supervisory Units**

Björk Sigurgísladóttir

Director, Compliance and Inspections

Finnur Sveinbjörnsson

Director, Banking

Páll Friðriksson

Director, Markets and Business Conduct

Rúnar Guðmundsson

Director, Insurance and Pensions

## **Support Functions**

Ingibjörg Sigrún Stefánsdóttir

Director, Administration

Árni Ragnar Stefánsson

Director, Human Resources

Bjarni Þór Gíslason

Chief IT Officer

*\* Unnur Gunnarsdóttir is on educational leave until June 2018. Jón Þór Sturluson therefore wrote the Director General's Address to this annual report.*



# From the Director General

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The financial crisis that led the collapse of the Icelandic financial system, and began more than a decade ago, is still vivid in our minds and its impact is still present. Even though the economy has recovered and the financial sector is relatively stable, the crisis of 2008 and its aftermath still affects many of the sector's foundations.

Major financial crises cause massive harm across the economy. Reducing the probability of and negative consequences of future crises is therefore of the utmost importance. The greatest challenges of recent years have been securing the foundations of the financial market through regulatory reforms and the strengthening of supervision. Most important are the new international standards on the assessment and mitigation of risk as well as best practices for supervision.

Iceland forms a part of the European Economic Area (EEA) and is therefore obliged to adopt EU directives and regulations concerning financial institutions and the markets for insurance and securities. The post-crisis comprehensive reforms of the European regulatory framework is coming to completion. However a substantial domestic transposition deficit results in further development of laws and regulations in the financial market in the coming years. Directives and regulations awaiting introduction to Icelandic law concern, among others, mutual funds, securities depositories, the deposit guarantee scheme, payment service providers and financial institutions, particularly with respect to restructuring and resolution. The fourth Capital Requirements Directive (CRD IV) from 2013 has still not been completely adopted even though the fifth version has already been drafted. Without further action, and increased resources, Iceland's transposition deficit concerning the financial market will not decrease any time soon.

Icelandic legislation was amended substantially in many ways following the financial crisis of 2008 due to local initiatives. As an example, the Act on Financial Undertakings (No. 161/2002) has been amended 22 times since 2008. Examples of special Icelandic provisions include: A substantially limited scope for financial undertakings to make loans to board members,

directors, and key employees; lower bonus ceilings and a wider scope for the applicable bonus rules than in other countries; limitations to the holdings of banks in unrelated businesses, and a prohibition of own equity backed lending.

For decades, the general policy of the Government of Iceland has been to harmonise financial market regulations as much as possible with the applicable rules in the European Economic Area. There is a broad consensus about this policy in the financial sector. Some are even of the opinion that it would be best not to have any specific or individual Icelandic regulations for the market. Generally, however, European directives are not harmonised perfectly across countries and the regulations usually contain optional provisions and leeway for national discretion. This idea of perfect harmonisation and no country-specific regulations is, therefore, simply infeasible. Additionally, it would simply be unwise if the rules did not take the special circumstances in each locale into consideration, at least to some extent. Every EU/EEA State has in fact imposed specific rules to some extent.

Some of the Iceland-specific rules established following the financial crisis of 2008 undoubtedly require review, both in light of local practice, international developments and regulatory convergence. Areas not covered by European legislation must also be considered. The most pertinent question perhaps being whether to separate investment banking and commercial banking. The European States have not acted uniformly in that matter, some maintaining a complete lack of intervention while others have chosen to require a strict operational and financial separation in the case of systemically important banks.

The FME regularly assesses the market risk, both in the banking book and the trading book. In recent years, exposure to market risk has been fairly moderate, at

least for systemically important banks. Drastic measure may therefore be unwarranted at present. However, circumstances may change rapidly making predefined limits to commercial bank's market risk exposure worth considering. Future concerns may be alleviated if FME is authorized to require structural separation of banks if market risk exceeds predefined limits and other prudential requirements are insufficient for risk mitigation.

Some commentators worry that the updated financial market regulatory regime is too focused on the problems and risks of the last financial crisis. That it is too concentrated on preventing the last financial crisis when the next financial crisis is likely to be of a different nature. It is correct that attempts to learn from the last crisis have been made, to improve resilience, where it has been proven to be insufficient, and limit undesirable incentives for excessive risk taking. It is incorrect, however, that the rear-view mirror is the only visual aide in this exercise. The new framework and approach to prudential supervision is much more forward looking than before. For example, the supervision of financial undertakings and insurance companies is much more focused on governance and business models. Analysing new risk factors and the viability of business models is a major priority. The stipulations for the eligibility and competence of the board members and the directors of supervised enterprises has been transformed and their responsibilities have been increased.

The aim of financial supervision is threefold. Preserving financial stability, protecting the rights and interests of consumers and investors, and promoting trust in and the credibility of the financial market in general. In recent years substantial improvements have been made on all three fronts, even though the trust in the financial market is suffering from the financial crisis. According to FME's priorities and vision for the financial market in 2020 (see the publication *Earned trust*), a targeted effort is required to reclaim the public trust in financial undertakings in Iceland. FME has set itself ambitious objectives of forward-looking and risk-based prudential supervision, increased emphasis on issues concerning consumer protection, and further transparency and disclosure.

Important steps have been taken to achieve these objectives. The risk assessment of individual supervised entities and the market as a whole has become a key element in the activities of the FME. Conclusions of risk assessments now impact both prudential requirements and prioritisation in the supervisory engagement. Last year saw an increase in the number of inspections where customer rights were in focus, triggered by information from consumers and internal assessments. The visibility

of the public service aspects of the FME's activities has become a greater priority. For several years, the FME has exercised a transparency and disclosure policy requiring it to publish the conclusions of all inspections. The number of transparency notifications reveals that financial supervision in Iceland is both active and effective. This must, however, be better publicised and the FME's social media engagement, and the increased number of conferences and open meetings, is an effort to do better. These efforts may already be paying off in increased trust towards the FME as Maskína's survey in February showed that 30% of participants held a favourable view towards the FME whilst 25.8% held a negative view (others were impartial). This is a significant improvement from the preceding year when 19.3% held a favourable view. In Gallup's last measurement of public confidence towards institutions, the FME also improved its standing more than any other public body. The trust towards the FME is, of course, not the primary goal. Trust in financial institutions is more important and that they are deserving of that trust. According to Gallup's survey mentioned above, around 20% of participants trust banks, a significant improvement from the previous year (14%). This is an indication of success in this respect. Other indications point in the same direction. For instance, the public has increasingly begun to entrust banks with their savings and the number of disputes between financial institutions and their clients is ever decreasing. The number of cases before the Complaints Committee on Transactions with Financial Undertakings reached its peak of 202 cases in 2012. There were 53 cases last year. Enterprises in the financial market should continue to build trust with their customers by engaging in sound and proper business practices and by quickly and securely responding to any irregularities or mistakes that may occur. This is the sustainable strategy for the financial sector to build customer confidence in the long-term. With this strategy implemented and exercised, and through interaction with effective and transparent financial supervision, the sector will become more effective in its role to strengthen Icelandic households and businesses.



## FME's Board of Directors and Management

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In the bottom row, seated from left to right: Guðrún Þorleifsdóttir, Vice-Chairman, Ásta Þórarinsdóttir, Chair, and Arnór Sighvatsson, Board Member. Standing from the left: Jón Þór Sturluson, Deputy Director General, Anna Mjöll Karlsdóttir, Chief Legal Counsel and the alternate Board members: Andri Fannar Bergþórsson, Guðrún Ögmundsdóttir, and Friðrik Ársælsson.

The Act on Official Supervision of Financial Activities defines the role of FME's Board stating: 'The Board of the Financial Supervisory Authority is composed of three members, appointed by the Minister for a term of four years at a time. One member of the Board shall be nominated by the Central Bank of Iceland. Alternates shall be appointed in the same manner. The Minister appoints the Chairman of the Board and decides on the remuneration of the members of the Board. The role of the Board is to specify the points of emphasis in the work of the Financial Supervisory Authority and oversee its activities and operations.'

Major decisions shall be referred to the Board for approval or rejection.' The rules adopted in early 2018 on the activities of FME's Board address the Board's role in more detail. They detail, among other things, the division of duties between the Board and Director General, the Board's role, the Board's decisions in major cases, Board members' competence and confidentiality. Furthermore, they address Board meetings, how often they are should be held and how they are organised.



# 1. Activities of the Financial Supervisory Authority

## 1.1 Supervisory activities

### **FME's new organisation chart**

The Authority's new organisation chart describes four supervisory units: banking, insurance and pension, markets and business conduct, and compliance and inspections. In addition to the offices of the Chief Legal Counsel and the Director General, the three previous support functions remain. The new organisation merges financial supervision and risk analysis under the units for banking and insurance and pension. Fund supervision, supervision of business practises, and consumer affairs have been combined with securities inspections under the new name of market and business conduct. These three supervisory units, having been separated by market, therefore correlate to the European financial supervisory authorities, EBA, EIOPA, and ESMA.

Finally, common cross-sectoral supervisory tasks were merged under the name of compliance and inspections comprising two groups, a group of specialists in legal supervision and a group of specialists on on-site inspections.

### **Supervision of financial undertakings**

With the entry into force of the CRD IV, the Authority adopted the common reporting framework of the European Banking Authority (EBA). In light of the variety of new data being collected, work has been conducted on improving the reliability of data submitted to the Authority. For the first time, data from the three large commercial banks will be submitted this year to the EBA and published in its transparency exercise.

In conjunction with these efforts, FME has been working on increasing automation for the review of quarterly reporting by, among other things, implementing key risk factors which form part of the Authority's risk assessment of the largest risk factors in the activities of financial undertakings.

Conversations with management and the financial undertakings' supervisory units have increasingly been emphasised in recent years

The directors, director generals, managing directors, and internal auditors of these companies are interviewed regularly. FME also meets biannually with the external auditors for larger financial undertakings, at the beginning of an audit and at its completion.

In addition, meetings are held with the largest market participants when they have prepared their financial statements.

The annual statutory Supervisory Review and Evaluation Process (SREP) was undertaken in a continuous process for the three large commercial banks with the conclusions being presented to the banks' boards in the second half of 2017. Kviká banki hf. also underwent the SREP resulting in a reassessment of the bank's capital adequacy.

SREP includes a review of the banks' own assessment of capital adequacy due to risk endured from their activities (ICAAP for banking). The purpose of the Internal Capital Adequacy Assessment Process (ICAAP) is to ensure that the bank concerned analyses, assesses,

and monitors risks inherent in its activities, that it has sufficient own funds in accordance with the bank's risk policy and that it implements sound risk management. Among other things, SREP is used to assess the reliability of the methodology and results of the financial undertakings' ICAAP.

In January 2018, FME published updated Common Procedures and Methodologies for the Supervisory Review and Evaluation Process for Financial Undertakings. The purpose of these Guidelines is to introduce the methodology and implementation of FME's SREP. The methodology conforms to EBA's Guidelines from 2016. Various examinations were conducted in connection with SREP, using specific data enquiries, to assess the banks' risk factors. A simplified version of the ICAAP report was requested from smaller financial institutions in line with European practices. The process is promising and FME will continue to develop its procedure for the risk assessment of smaller financial institutions.

The commercial banks had a few applications for increasing their covered bond issues processed during the year, as they have in recent years.

### **Inspections concerning the circumvention of bonus rules**

FME conducted a review of payments of ISK 900,000 that Borgun hf. made to its employees in a single payment in addition to their fixed remuneration. The case was

### **FME launches a help desk for financial technology companies**

Recent years have seen substantial growth in the development and scope of financial services based on optimisation of information technology, in particular over the internet and using smart devices. This has been referred to as financial technology or FinTech. FinTech development opens up multiple opportunities for companies and consumers alike.

It is, however, not void of risk and FME's mission is to monitor these developments in order to ensure the safety of the Icelandic financial market as well as compliance to law. FME must also be careful of not hindering reasonable progress in new solutions and product offerings in the financial market.

The activities of FinTech companies can involve all aspects of regulated activities and it is therefore imperative to determine the applicable legislation on a case-by-case basis and whether the entity offering a new FinTech solution should be regulated or not.

FME therefore encourages conversations with FinTech companies and small entities considering entering the market.

In September 2017, FME launched a help desk for FinTech for the purpose of promoting communications with entities considering or already supplying such services and helping these entities to determine how their activities fit the regulatory framework.

The help desk contains check lists for entities to fill out when they seek the involvement of FME or communications with the Authority.

The Authority uses the check list to define what it should be aware of before engaging in the conversations. Advice can be sought from the Authority after submitting the list, either over the phone or after meetings with experts. FinTech questions can also always be submitted to [fintech@fme.is](mailto:fintech@fme.is). FME foresees considerable developments in the sector and is prepared to engage in conversations with anyone looking to enter the market.

settled amicably with the payment of a fine and Borgun hf. acknowledged that it had made the payments in breach of the provisions of Article 57(a) of the Act on Financial Undertakings concerning bonus payments.

In early 2017, FME considered whether dividends to holders of Class B, C, and D shares in Arctica Finance hf., who were also employed by the company, constituted a bonus payment. FME found it to be so. The bonus was not paid out on the basis of a bonus plan, in most cases the purchase amounted to more than 25% of the employees' salary, rules concerning deferring a portion of the bonus were not complied with, and finally the compliance officer received a bonus. The Board of FME decided to levy an administrative fine on the company due to these infringements. In December, the company initiated legal proceedings to annul FME's decision.

FME also reviewed whether dividends to holders of Class B shares in Kvika banki hf., who were employed by the company, companies owned by the employees, or their spouses, constituted a bonus payment. The case was settled amicably with the payment of a fine and the bank acknowledged having paid a bonus in the form of B shares without basing the payment on a bonus plan, without complying with provisions of laws and regulations concerning maximum bonus payments, and without having deferred a portion of the payments.

### **Self-assessments for the composition of the boards of regulated entities**

In 2017, FME required the boards of certain banks, savings banks, insurance companies, pension funds, and the Housing Financing Fund to conduct a self-assessment of the composition of their boards to confirm that they had sufficient knowledge, competence, and experience to understand the activities of their respective companies, including their principal risk factors. It is worth noting that acts, regulations, and guidelines on sound governance stipulate that boards of regulated entities must have sufficient knowledge, competence, and experience.

The main purpose of the self-assessment was for the boards of these regulated entities to review the composition of their boards critically with regard to the knowledge, competence, and experience of individual board members. On the one hand, the boards could use the self-assessment to map the comprehensive knowledge and competence criteria desirable for the board of the regulated entity as a whole and on the other hand to identify potential opportunities for improvement. The Act on Financial Undertakings and the Regulation on Insurance Activities require companies to allocate sufficient funds and personnel to acquaint board members with the activities of the company in question and ensure that such members receive the appropriate

training to serve on the board. The self-assessment finally served the purpose of giving FME the necessary overview of the comprehensive knowledge, competence, and experience of the boards of the regulated entities.

The process itself demonstrated the varying attitudes of the boards in question to filling out the self-assessment and that was apparent from the assessment as submitted to FME. Most entities, however, used the self-assessments appropriately and filled them out acceptably.

### **Supervision of UCITS management companies**

FME reviewed whether the disclosure and presentation of UCITS management companies' marketing material complied with Article 28 of Regulation No 995/2007 on Investor Protection and the Business Conduct of Financial Undertakings, cf. Article 14(4) of Act No 108/2007 on Securities Transactions. FME required corrections to published marketing material from IS Funds hf. and Gamma Capital Management hf. The comments concerned, among other things, the presentation of accrued returns as well as noting that warnings for the risks involved in mutual funds' units were not conspicuous. Both management companies changed their advertisements as a result of FME's comments to comply with Article 28 of the Regulation and the cases were settled by publishing transparency notifications.

FME also concluded an amicable settlement with Kvika banki hf. resulting from breaches of Article 19(1) of Act No 161/2002 on Financial Undertakings and Article 14(4) of Act No 108/2007. The bank was found to have committed a serious breach of Article 14(4) of Act No 108, 2007, cf. Regulation No 995/2007, as the bank's advertising referred to an investment fund as Kvika's Asset Line (I. Eignaleið Kviku) without noting that Jupiter Capital Management hf. managed the fund in question. The advertising was furthermore published without Jupiter Capital Management hf. having authorised it. In addition, comments were made regarding the presentation of information in the advertisement as it did not comply with Article 28 of the Regulation.

Investments made by funds under the management of Gamma Capital Management hf. were also reviewed as a result of unauthorised investments in the company's funds and that case ended with an amicable settlement whereby the company paid a fine.

Furthermore, FME began a special inspection of whether Gamma Capital Management hf., Jupiter Capital Management hf., Landsbréf hf., and Stefnir hf. comply with statutory investment authorisations. The cases against Gamma Capital Management hf., Jupiter Capital Management hf., Landsbréf hf., and Stefnir hf. were concluded with comments, request for corrective actions, and by publishing transparency notifications.

### Supervision of pension funds

In 2016, Althingi adopted amendment to the investment authorisations of pension funds that subsequently entered into force in July 2017. The amendments had an impact on FME's activities, for example, the legislative changes led to projects concerning revising the pension funds' reporting to the Authority and the development of supervision concerning the pension funds' risk management.

For the first time, the pension funds are tasked with conducting their own risk assessments in 2018 and FME has prepared guidelines on how the pension funds should implement these risk assessments.

FME has furthermore assessed individual risk factors in the pension funds' activities such as market risk, governance, credit risk, operational risk, liquidity risk, and longevity risk. Further reviews were conducted during the year into registers of possible conflicts of interest and asset management. Furthermore, information systems of the pension funds were audited. Internal methodologies and procedures were developed, including the implementation of risk indicators for pension funds as well as developing the supervision of the funds.

A number of pension funds outsource all of their activities where every single employee managing the fund is employed by the outsourcing company, including the managing director of the fund. Recently, FME found reason to inform the Ministry of Finance and Economic Affairs of the Authority's view on the need for legislative amendments to circumscribe the potential conflicts of interest resulting from the complete outsourcing of the management of pension funds. During the year, FME began examinations of pension fund investments in the silicon factory of United Silicon in Helguvík.

FME's conclusions concerning the process of Frjálsi Pension Fund's investment in the factory were published in April 2018.

In 2017, FME delivered its opinion on changes to the Articles of Association of pension funds whereby the pension funds requested authorisation to offer so-called specified personal pension savings (I. tilgreind séreign). The changes resulted from provisions of collective agreements that FME did not consider complying fully with the consumer protection guaranteed by Act No 129/1997.

This resulted in official correspondence with social partners where FME sought to correct misstatements in the public debate pursuing the best interests of fund members.

### Supervision of insurance activities

Following the transposition of the Solvency II Directive

in 2016, FME has been engaged in the projects entailed by its implementation. FME has completely adopted the reporting language issued by the European Insurance and Occupational Pensions Authority (EIOPA) and reports specific to Iceland are no longer used for insurance companies. The first-time adoption of a new reporting framework will inevitably contain some data errors. Extensive work has therefore been undertaken to ensure quality of data submitted to the Authority, that is to ensure that the data is both accurate and sufficient. Data from every insurance company covered by Solvency II is submitted to EIOPA which publishes select information on its website and uses it for its risk dashboard, among other things.

As with the pension funds, FME assessed individual operational risk factors for the insurance companies during the year, such as operational risk, the business model, and market risk while also emphasising the review of the companies' governance. FME has, in connection with the above-mentioned risk assessments, reviewed the own risk and solvency assessment of insurance companies (ORSA), the composition and functioning of boards, the key functions of the insurance companies, and their investment policies.

The transposition of Solvency II resulted in the repeal of legal provisions subjecting all decisions to reduce capital in an insurance company to FME's approval replacing the provision with a provision to notify FME of any such decreases in capital. The Commission Delegated Regulation (EU) 2015/35 does, however, require insurance companies to seek prior approval for any repurchases of own shares if the purchase is for the purpose of deflating issued capital. FME contacted the insurance companies for this reason and advised them to seek authorisation for repurchasing should they wish to use the boards authorisation to repurchase their own shares. The Ministry of Finance and Economic Affairs was subsequently asked to clarify the legal provisions and harmonise them with the provisions of the Regulation.

### On-site inspections

Inspections in 2017 included examinations of the banks' valuation procedures concerning lending to their largest borrowers and the underlying valuation techniques. FME collected information on each bank's 50 largest borrowers at the beginning of the examination and in the final sample five companies and related entities were subject to more detailed inspection. The results of the inspections were used for the annual Supervisory Review and Evaluation Process of the large commercial banks, Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf.

The procedures for filling out specific parts of the FINREP were also reviewed at the three large commercial

banks. The review concerned whether the banks had implemented the procedures laid down in EBA's Guidelines and whether the banks were sufficiently forward-looking when assessing defaults. The review also concerned the record keeping for cases where the banks made concessions to lending terms due to financial difficulties of customers

Arion Bank hf., Íslandsbanki hf., Landsbankinn hf., and Lykill fjármögnun hf., were also subject to an inspection concerning the valuation of seized movable assets. The objective of the inspections was to assess whether the companies' valuation of seized movable assets conformed to sound and proper business practices and procedures in the financial market.

In particular, the inspection reviewed whether customers benefited when financial undertakings sold movable assets over the assessed value given in the settlement with the customer.

Management companies for UCITS and investment funds offer a variety of services for investment options and portfolio management. In 2017, FME reviewed the active management practises the investment funds employ for the funds' investments, and as is noted in the market information from many of them. FME examined the management of investment funds at Gamma Capital Management hf., IS Funds hf., Jupiter Capital Management hf., and Landsbréf hf. An article based on the above-mentioned presentations of the management of the investment funds was published in the first issue of *Fjármál*, FME's web publication, in 2018.

An examination concerning the internal auditing of Kvika banki hf. concluded in 2017. The objective was to identify the auditing activities with a special emphasis on their assessment and review through interviewing the bank's internal auditor and the chair of the risk, audit, and

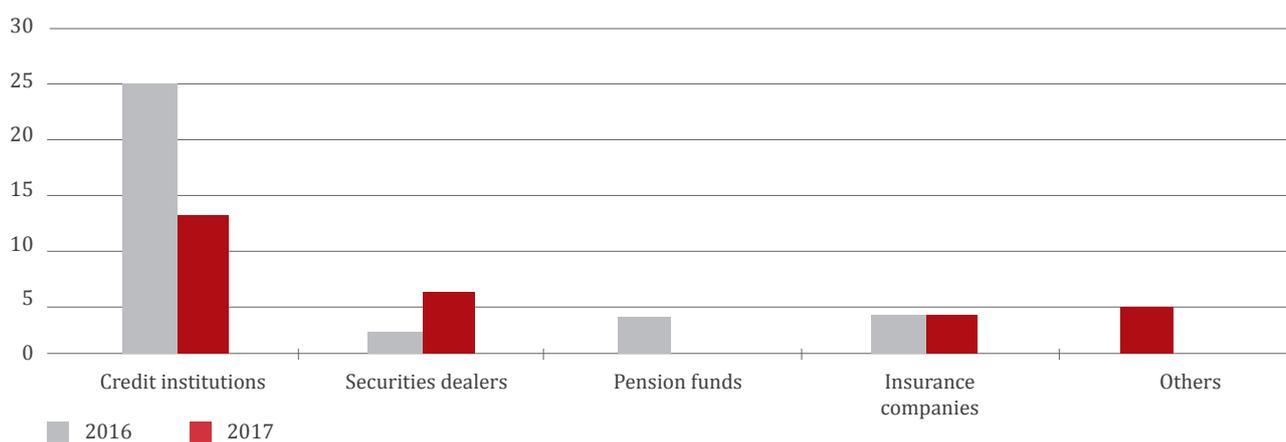
remuneration committee.

Borgun hf. and Valitor hf. were inspected during the year. On the one hand, the inspection reviewed the companies' enforcement of laws on measures against money laundering and terrorist financing concerning their foreign acquiring services. The objective was to determine whether the companies had adequate procedures in place for customer information due diligence measures, periodic monitoring, notification requirements, and internal control. On the other hand, the inspection focused on the implementing arrangements for risk management pursuant to the Act on Financial Undertakings and how the companies' boards carried out their related functions. And finally, the inspections reviewed specific matters concerning the companies' boards.

A number of financial undertakings invest on behalf of their customers and FME conducted on-site inspections to review whether these undertakings' investments for their asset management customers were consistent with the investment policies as defined in their asset management contracts. The inspected financial undertakings presented their procedures for making investment decisions on behalf of asset management customers to FME. In addition, the investments of a sample of customers were reviewed for compliance with their agreements. The inspection focused on the financial undertakings Íslandsbanki hf., Kvika banki hf., and Virðing hf.

Financial undertakings are required to notify FME of transactions with financial instruments admitted to trading on a regulated securities market pursuant to the Act on Securities Transactions. FME reviewed the coordination and processes at the financial undertakings Fossar Markets hf., Íslandsbanki hf., and Landsbankinn hf. for compliance with the companies' statutory notification

Figure 1 The number of concluded on-site inspections in 2016 and 2017



obligation concerning for trading in financial instruments. FME also took samples from each company and verified the submitted data.

FME reviewed the quality of submitted data during the year from Vörður Insurance hf., Sjova-Almennar Insurance hf., VIS Insurance hf., and TM Insurance hf. As part of the inspection, the insurance companies presented their systems and organisation for ensuring satisfactory data being submitted to FME cf. Article 31(2) of Act No 100/2016, on Insurance Activities.

Figure 1 shows the number of concluded on-site inspections in 2017 by type of regulated entity.

In comparison, it also shows the number of examinations concluded in 2016. A summary of FME's decisions and notifications on transparency from 1 May 2017 to 30 April 2018 can be found on page 53.

### **Applications for competence assessment, qualifying holdings, and licensing**

In 2017, FME received numerous notices of new directors and managing directors and assessed their eligibility. Regulated entities currently employ between 600 and 700 directors and each year the eligibility is assessed for between 100 and 200 new directors.

FME assesses the eligibility of entities that intend to acquire qualifying holdings in financial undertakings and insurance companies. A qualifying holding means a direct or indirect participating interest in a company that amounts to 10% or more of equity capital, establishment funds, or voting rights or allows the entity to assert considerable influence on the management of the company in question. The ownership interests in financial and insurance undertakings changed significantly during the year and, among other things, FME processed notifications from Kvika banki hf. and VIS Insurance hf. to own qualifying holdings in Virðing hf. and Rekstrarfélag Virðingar hf., Kortabjónustan hf. (KORTA PAY), and Alda Asset Management hf.

The purchase of four foreign parties of a 29% share in Arion Bank hf. from Kaupskil ehf., a subsidiary of Kaupthing ehf., was announced in March 2017. The announcement also noted that the new owners had the option to purchase up to 22% in the bank. Taconic Capital Advisors LP and related entities, Attestor Capital LLP and related entities, as well as Kaupthing ehf. subsequently announced to FME that they intended to hold qualifying holdings in the bank in accordance with Chapter VI of Act No 161/2002. FME comprehensively assessed the eligibility of these parties and in mid-September the same year the Authority found that, on the one hand, Attestor Capital LLP and related entities were eligible to own a qualifying holding of up to 20% and, on the

other hand, that Taconic Capital Advisors LP and related entities and Kaupthing ehf. were eligible to jointly own a qualifying holding of up to 33% as they are considered to collaborate. FME's assessment specifically reviewed the parties' ability to support the bank financially under exceptional circumstances as the bank is considered a systemically important financial undertaking pursuant to the definition of the Financial Stability Council. FME's decisions concerning Taconic Capital Advisors LP and related entities and Kaupthing ehf. enter into force when the shares of Arion Bank hf. have been admitted to trading on a regulated securities market which is intended in 2018. FME's terms from 8 January 2010 on the ownership of Kaupthing ehf. in the bank through Kaupskil ehf. will remain unchanged until that time.

At the end of the same month, it was announced that Attestor Capital LLP and related entities had exercised a small part of the above-mentioned purchase option to add a 0.44% interest.

It was announced at the end of February 2018, that Kaupskil ehf. had sold a 2.54% share in Arion Bank hf. to 24 funds managed by four domestic UCITS management companies, a 2% share to Attestor Capital LLP and related entities, and a 0.8% share to ELQ Investors II Ltd. Kaupskil ehf. also exercised its purchase option for the State's 13% share in the bank in accordance with the shareholders' agreement made in September 2009 during the initial funding of Arion Bank hf. At the same time, Arion Bank hf. purchased 9.5% of its own shares from Kaupskil ehf. with FME's prior approval.

FME also processed a notification from RedRiverRoad ehf. on owning a qualifying holding in Icelandic Investors Ltd. and a notification from Adix ehf. on owning a qualifying holding in Centra Corporate Finance Ltd. In the last case, FME did not receive the notification of a qualifying holding until after it had been assembled and the case ended with an amicable agreement where Adix ehf. paid a financial penalty.

During the year, FME authorised the merger of Virðing hf. and Kvika banki hf.

In the beginning of 2018, FME granted Inkasso ehf. (previously known as Mynta ehf.) a collection license as the company acquired the operations of Innheimturáðgjöf (previously known as Inkasso ehf.). The collection license covers primary and secondary collection measures of pecuniary claims fallen due on behalf others and the collection of any pecuniary claims purchased for the purpose of professional debt collection. At the end of March 2018, Iceland Tax Free ehf. was registered as a money exchange service, pursuant to Article 25(a) of Act No 64/2006 on Measures against Money Laundering and Terrorist Financing.

In mid-year 2017, FME revoked the collection license of T-9 ehf. on application by the company. At the beginning of April 2018, Iceland Travel Assistance ehf. was delisted as a money exchange service as insolvency proceedings had been opened for the company and it was, therefore, no longer eligible for registration, cf Article 25(b)(2) of Act No 64/2006.

The operations of Klettur Capital ehf. were also subject to a special inspection during the year which concluded with FME imposing an administrative fine on the company for having received and transmitted instructions concerning one or more financial instruments without the proper operating license.

Fossar Markets hf. were granted an extended operated license for corporate consulting at the end of April.

### Securities market regulation

In 2017, 47 cases were investigated for violations of securities market legislation. In comparison, 48 cases were investigated in 2016. Comments from Nasdaq Iceland (Kauphöllin) resulted in examinations in 11 cases compared to 24 cases in 2016. Other cases were examined at the initiative of FME or resulting from other tips. The cases can be categorised as follows:

- 20 cases involved disclosure which includes the disclosure of insider information (Article 122 of the Securities Transactions Act), notification of the acquisition or disposal of major proportions of voting rights (Chapter IX of the Securities Transactions Act), and the publication of annual reports (Article 57 of the Securities Transactions Act)
- 17 cases involved market abuse (Articles 117 and 123 of the Securities Transactions Act)
- 4 cases involved the duty of insiders to give notification (Articles 125, 126, and 127 of the Securities Transactions Act)
- 1 case involved the contents of prospectuses (Article 45 of the Securities Transactions Act)
- 2 cases involved issuers' buy-back programmes (Annex to Regulation No 630/2005)
- 1 case involved mandatory reporting on short positions (Act No 55/2017)
- 2 cases – other

Most of these examinations were concluded without any action, i.e. no infringement was found or it could not be established that an infringement had been committed. One of the cases was referred to the Danish Financial Supervisory Authority. Two of the cases were referred to the District Prosecutor. The imposition of penalties is discussed specifically in Chapter 1.2.

FME implemented a new system on 1 January 2018

for receiving reports on transactions with financial instruments, the so-called TRS II system. The system is part of the implementation of a new securities market framework, that is Directive 2014/65/EU of the European Parliament and of the Council (MiFID II) and Regulation (EU) No 600/2014 of the European Parliament and of the Council (MiFIR). Preparation for the implementation of the system lasted a large part of the year 2017. FME held two presentations for financial undertakings concerning the implementation. Among updates to the system is the use of Legal Entity Identifiers (LEI) for all entities other than individuals. LEI is a global 20-character identifier for legal entities. The TRS II system provides FME with much more detailed information than previously on transactions with financial instruments admitted to trading on trading platforms and related financial instruments. The data is important for monitoring securities market trading and FME has campaigned for some time to ensure data quality. That campaign will continue.

On 1 July 2017, Act No 55/2017 on Short Selling and Credit Default Swaps entered into force. The Act transposed Regulation (EU) No 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps (the Short Selling Regulation).

The Act provides for the first time in Iceland a comprehensive regulatory framework for short selling financial instruments, short positions, and certain aspects of credit default swaps. The transposition introduces new supervisory tasks for FME. According to the Act, entities holding significant net short positions in shares admitted to trading on trading platforms and government debt instruments are required to notify FME of their positions. Short positions in equities are disclosed publicly on FME's website when they reach certain thresholds. FME received 30 notices concerning short positions in equities in the period 1 July 2017 through 31 March 2018, two of which were disclosed publicly. During the period, there were 12 net short positions in seven companies where ongoing relationships existed between one entity and one share issuer from the time of the first notice of the short position. In the winter of 2017–2018, FME examined the potential reporting requirements concerning short positions in certain equities from 1 August to 31 October 2017. The conclusions are expected in early summer 2018.

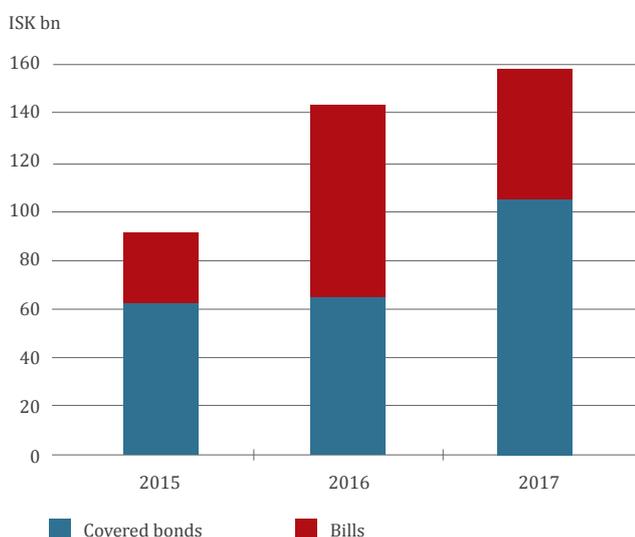
FME also made a number of smaller inspections concerning the securities market.

FME has one representative participating in a Nordic college of supervisors tasked with harmonising the supervision of the Nasdaq Nordic exchanges. The college's key role, in addition to conducting ad-hoc examinations, is to assess and supervise the principal risk factors in

the operations of the Nasdaq Nordic exchanges. The college has conducted extensive work in the past year supervising the implementation of the new financial market regulatory framework. The Nasdaq exchanges jointly operate all of their major infrastructure and Nasdaq Iceland has, therefore, in collaboration with the other Nordic exchanges, mostly implemented MiFID II and MiFIR for its operations even though the transposition into Icelandic law is not expected until 2019.

On 20 October 2017, the Ministry of Finance and Economic Affairs granted an operating license to

**Figure 2** The domestic security issues of the banks in billions of ISK



Source: Financial Supervisory Authority

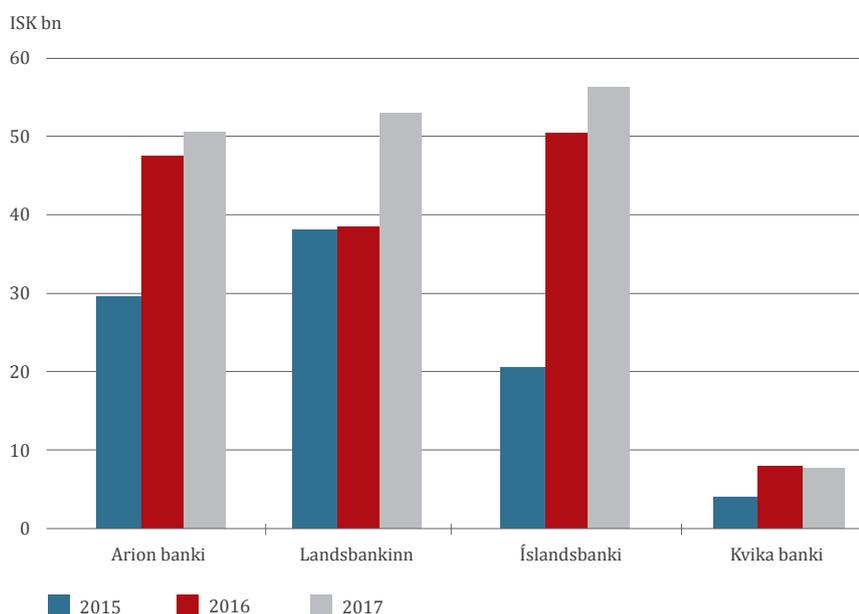
Verðbréfamiðstöð Íslands hf. as a central securities depository pursuant to Act No 131/1997 on Electronic Registration of Rights of Title to Securities. At that time, FME had concluded an on-site inspection of the facilities of Verðbréfamiðstöð Íslands hf. and had reviewed the application pursuant to the above-mentioned law requiring the Authority to advise the Ministry on whether a given company fulfils the provisions of the Act before an operating license is granted. Verðbréfamiðstöð Íslands will operate a securities settlement system and settle transactions where electronically registered securities are traded. That entails, among other things, that the company will conduct trade pairing, execute settlement instructions, confirm trading, and manage other matters relevant to the settlement of securities.

A total of 19 offering circulars were confirmed in 2017. No equity offerings were confirmed during the year so the only offerings were for bonds. The confirmed appendices to the offerings totalled 14. During the year, nine base prospectuses and 183 final terms were published on FME's website. The number of final terms is slightly lower with the fewer bills and covered bonds issued by the commercial banks even though the total amount was higher than the year before. Other entities increased the number of their issues.

They include Reykjavik Energy, Municipality Credit Iceland Plc., Lykill fjármögnun hf., Regin hf., and Reitir fastignafélag hf.

As shown in Figure 2, the growth in the banks issuance of securities admitted to trading on the main market of Nasdaq Iceland has slowed down. There was significant growth from 2015 to 2016, or 56.5%. The increase was

**Figure 3** The total issuance of the banks in billions of ISK



Source: Financial Supervisory Authority

10.4% between 2016 and 2017, the issue increased from over ISK 144 billion to over ISK 159 billion. The majority of the issuance was in the form of covered bonds and covered proportion of the issuance was 66.1% of the total issuance in 2017. The percentage of covered bonds was 45.1% in 2016.

In 2017, Landsbankinn hf. issued 33.5% of the issuance, Íslandsbanki hf. 31.8%, Arion Bank hf. 30.2%, and Kvika banki hf. 4.5%.

## 1.2 Sanctions and changes to the legal framework of the financial market

### Coercive means and sanctions

#### Amended implementation for imposing daily penalties concerning periodic reporting

On 1 January 2018, FME amended the implementation for imposing daily penalties on regulated entities concerning delays in periodic reporting in order to ensure more equality when imposing periodic penalty payments pursuant to Article 11 of Act No 87/1998, so that the penalties have equal weight for all regulated entities. Periodic penalty payments now take the financial strength of regulated entities into account and amount to ISK 25,000–1,000,000 per day but until 1 January 2018 the lowest possible amount had been levied, i.e. ISK 10,000 per day.

#### Infringement notifications in the financial market

FME receives and follows up on notifications of infringements, suspected infringements, and attempted infringements of law and regulatory acts governing entities subject to official supervision of financial activities. A special interface, entitled “uppljóstrun” or disclosure, has been prepared to receive such notifications on FME’s website. The interface ensures that the notification cannot be traced to the submitter unless the individual wishes to be known. FME is obliged to ensure the confidentiality of any information that could be traced directly or indirectly to the individual making the infringement notification, regardless of whether it is submitted anonymously or not, unless it must be disclosed to the police or on the basis of judicial decisions. FME encourages people to submit infringement notifications by name to instil confidence in the notifications and allowing for possible follow-up.

#### Administrative fines and settlements

For the purposes of equality and deterrence, FME has generally taken the total turnover of legal entities

into account when determining financial penalties for infringements committed after Act No 58/2015 entered into effect on 16 July 2015. Among other things, the Act significantly raised the maximum amounts for administrative fines imposed on legal entities and individuals as well as allowing for administrative fines of up to 10% of the total turnover of legal entities.

Amicable settlements and decisions to impose administrative fines are generally published on FME’s website in accordance with the Authority’s transparency policy from 16 April 2014. In the period of 1 May 2017 to 30 April 2018, FME published two notifications of having concluded cases by imposing administrative fines and eight notifications of having concluded cases with an amicable settlement. The notifications concerned the following parties:

#### *Klettur Capital ehf.*

An administrative fine was imposed on Klettur Capital ehf. for infringement of Article 3(1)(6)(a) of Act No 161/2002. The infringement entailed receiving and transmitting instructions concerning one or more financial instruments without the proper operating license. The Board of FME decided to impose an administrative fine, amounting to ISK 2,500,000, on the company.

#### *Arctica Finance hf.*

An administrative fine was imposed on Arctica Finance hf. for breach of Article 57(a) of Act No 161/2002 and Rules No 700/2011 and No 388/2016 on Bonus Schemes. The infringement concerned bonus payments to employees in the form of dividends from Class B, C, and D shares in the company from 2012 and through 2017. FME required Arctica Finance hf. to forthwith seize any bonus payments in the form of dividends to holders of Class B, C, and D shares. The Board of FME decided to impose an administrative fine, amounting to ISK 72,000,000 on the company.

#### *Landsbankinn hf.*

A settlement was reached with Landsbankinn hf. for breach of Article 86(1) of Act No 108/2007.

The infringement involved the bank not having given notice of major changes in the bank’s right to vote in N1 hf. within the statutory time limit. The settlement provided for the payment of a fine in the amount of ISK 11,800,000.

#### *Borgun hf.*

A settlement was reached with Borgun hf. for breach of Article 57(a) of Act No 161/2002, cf. Rules No 388/2016 on Bonus Schemes. The infringement involved Borgun hf.

paying employees a guaranteed bonus. The settlement provided for the payment of a fine in the amount of ISK 11,500,000.

*Kvika banki hf.*

A settlement was reached with Kvika banki hf. On the one hand for an infringement of Article 19(1) of Act No 161/2002 for making public an advertisement concerning a certain investment fund without the approval of the fund's management company.

On the other hand, due to a serious infringement of Article 14(4) of Act No 108/2007, cf. Regulation No 995/2007 on Investor Protection and the Business Conduct of Financial Undertakings, as the information in the above-mentioned advertising did not confirm to paragraph 2 (a), (b), and (d) and Article 28(4)(a), (b), (d), and (f). The settlement provided for the payment of a fine in the amount of ISK 2,300,000 for infringing Article 14(4) of Act No 108/2007 while not providing for a specific fine for the infringement of Article 19 of Act No 161/2002.

*Gamma Capital Management hf.*

A settlement was reached with Gamma Capital Management hf. for five infringements of Article 59(1), cf. Articles 30 and 43 of Act No 128/2011.

The infringements involved Gamma purchasing ownership interests in private limited companies on behalf of investment funds without notifying FME of the investments. The settlement provided for the payment of a fine in the amount of ISK 23,000,000.

*Adix ehf.*

A settlement was reached with Adix ehf. for breach of Article 40(1) of Act No 161/2002. The infringement entailed the company acquiring a qualifying holding in Centra Corporate Finance Ltd. without notifying FME prior to the purchase.

The settlement provided for the payment of a fine in the amount of ISK 250,000.

*Kvika banki hf.*

A settlement was reached with Kvika banki hf. for an infringement of Article 57(a) of Act No 161/2002 and Articles 3, 6(1) and 7 of Rules No 388/2016 on Bonus Schemes. The infringement entailed having in March 2017 paid specific employees, companies belonging to them, or their spouses a bonus in the form of B shares in the company itself. The settlement provided for the payment of a fine in the amount of ISK 37,500,000.

*Hagar hf.*

A settlement was reached with Hagi hf. for breach of Article 87(1) of Act No 108/2007. The infringement

entailed not having published a notification of major changes in the right to vote in the company within the given time limit. The settlement provided for the payment of a fine in the amount of ISK 6,750,000.

*Origo hf.*

A settlement was reached with Origo hf. for breach of Article 122(1) of Act No 108/2007. The infringement involved the company not disclosing inside information on having engaged an international investment bank to begin a formal sales process for the company's shares in Tempo ehf. The information was available at 4:15 PM on 2 October 2017 but not made public until 09:03:24 AM on 3 October 2017. The settlement provided for the payment of a fine in the amount of ISK 2,200,000.

It is worth noting that fifteen breaches committed after Act No 58/2015 entered into force were concluded with amicable settlements or administrative fines. Twelve cases were concluded with amicable settlements where the parties admitted their infringements and agreed to pay fines.

Three cases were concluded by imposing administrative fines on the parties. Two of the three parties, Eimskipafélag Íslands hf. and Arctica Finance hf., brought action before the courts to annul the decision of the Board of FME to impose administrative fines. The District Court has rejected the claims of Eimskipafélag Íslands hf. to annul the decision and lower the financial penalty.

### **Changes to the legal framework of the financial market**

FME is actively involved in developing the domestic regulatory framework of the financial market, both through issuing rules and guidelines and by participating in drafting laws and regulations concerning financial services. FME participates in committees and working groups under the ministries responsible for preparing bills concerning the activities of regulated entities. The role of FME in the work of these committees and working groups mainly involves oversight over the legal acts applicable to Icelandic financial markets, knowing their content and being apprised of impending changes within the EEA. FME holds a key position in the financial market concerning the monitoring of technical standards, guidelines, and recommendations issued by the ESAs (EBA, ESMA, and EIOPA). Technical standards are either adopted through rules or regulation where applicable. The ESAs issue policies and guidelines with the aim to establish a harmonised, effective, and efficient supervisory procedure for the EEA. FME publishes implemented guidelines on its website.

Althingi enacted a number of laws on financial

services last year including Act No 23/2017 on Notifications Concerning Infringements in the Financial Market, Act No 24/2017 on the European System of Financial Supervision, Act No 50/2017 on Credit Rating Agencies, Act No 55/2017 on Short Selling and Credit Default Swaps, Act No 60/2017 on Insurance Groups, Act No 61/2017 on Supplementary Supervision of Financial Conglomerates. This year Althingi enacted laws on derivatives trading, central counterparties, and trade repositories in order to transpose the European Market Infrastructure Regulation (EMIR). The Regulation was implemented using a so-called reference method whereby EMIR is given legal status in Iceland by reference to its publication in the EEA Supplement to the Official Journal of the European Union. The main feature of EMIR is the requirement to report derivatives to a trade repository, having to clear over-the-counter (OTC derivatives traded outside regulated markets) derivatives through central clearing counterparties (CCPs) when required, new requirements for risk management resulting from OTC derivatives that are not cleared centrally, and the preparation of a framework for the activities of CCPs and trade repositories. An Act transposing the Omnibus II Directive was adopted recently. The Act amends Act No 100/2016 on Insurance Activities, mostly due to the powers of EIOPA that entered into effect with Act No 24/2017 on the European System of Financial Supervision.

A number of acts is still awaiting enactment and a summary of the main acts to be transposed in the coming years follows:

#### *BRRD*

A Bill for the transposition of the first part of BRRD has been submitted to Althing, as amendments to Act No 161/2002 on Financial Undertakings. This part of the transposition contains provisions on recovery plans, early intervention, and intra-group financial support. These powers are all subject to the supervision and decision-making of FME and therefore fall under FME's scope of activities. The same Bill also contains legislative amendments based on the CRD IV Directive concerning the supervision of groups.

#### *AIFMD*

A committee is working on transposing directives concerning the activities of alternative investment funds. AIFMD covers the activities of non-UCITS funds and aims to harmonise the regulatory framework of member states, ensure uniformity in the EEA Internal Market, ensure financial stability, increase investor protection, and promote trust and supervision of the activities of AIFs and AIFMs.

#### *MiFID II/MiFIR*

In 2018, FME participates in a committee drafting the transposition of the Markets in Financial Instruments Directive (MiFID II) and Regulation (MiFIR) which address, among other things, investor protection, the organisation of trading platforms and UCITS, and trading transparency. The scope of MiFID II/ MiFIR is broader than MiFID I and takes the technological innovation of recent years into account. The new framework is also supplemented by a large number of Directives and Regulations issued by the European Commission. MiFID II/ MiFIR is intended to increase transparency and improve the functioning of the market for financial instruments within the European Economic Area.

#### *PSD II*

FME participates in a committee working on a bill to transpose second EU Directive on payment services in the internal market. This Directive may have a broad impact on domestic payment service providers as certain financial market participants are granted access to data on payment services previously only available to banks. Furthermore, the activities of FinTech companies offering new options and new technological solutions for payment transactions will be subject to authorisation, or where applicable subject to registration. Payment service providers will be subject to stringent requirements concerning the safety of these new technological solutions with particular emphasis on consumer protection.

#### *IDD*

The Ministry of Finance and Economic Affairs is preparing a bill for transposing the Insurance Distribution Directive with the participation of FME.

Among other things, this Directive requires the registration of insurance intermediaries and the Directive covers more entities than the present legislation. Furthermore, the Directive assumes an independent complaints committee and requires sellers of insurance policies to undergo continuing education and training.

#### *MAR*

The Ministry of Finance and Economic Affairs has begun preparing amendments to Act No 108/2007 on Securities Transactions to transpose the EU Regulation on Market Abuse into Icelandic legislation. FME participates in the committee.

#### *The Statutory Audit Directive*

The Ministry of Industries and Innovation has begun preparing a bill to implement the EU Statutory Audit Directive and Regulation on Statutory Audit of Public-Interest Entities (Audit Regulation) with FME's participation.

*AML IV*

FME participates in a committee tasked with preparing a bill to transpose the Directive on the Prevention of the Use of the Financial System for the Purposes of Money Laundering or Terrorist Financing. Among other things, the Directive addresses required risk assessments for Member States, competent authorities, and reporting entities. Reporting entities are also required to disclose information to a central database which collects beneficial ownership information.

Finally, the definition of individuals at risk is expanded to cover both domestic and foreign parties.

### Review of the regulation on the ESAs and ESRB

In 2016, the EU Regulations establishing three supervisory authorities for the financial market (EBA, EIOPA, and ESMA, collectively known as ESAs) were incorporated into the EEA Agreement along with the EU Regulation establishing the European Systemic Risk Board, that entered into force in the European Union in 2010. When the acts were being adapted to the EEA Agreement, the EFTA Surveillance Authority was assigned the powers of the other ESAs to make decisions against the authorities, regulated entities, and market participants in the EFTA States. The regulations were transposed into Icelandic law by Act No 24/2017 on the European System of Financial Supervision.

A EU level review of the ESAs and ESRB regulatory framework began in 2017. A consultation paper was issued calling for stakeholder comments. A large number of comments were received and the EEA-EFTA States, for instance, submitted a joint comment. The European Commission subsequently submitted recommendations to amend the ESA Regulations along with amendments to a number of acts.

The general aim of the recommended amendments is to strengthen the ESAs and extend their powers. They will increasingly be tasked with the direct supervision of financial undertakings and market participants, granting operating licenses, approving offering circulars, requesting information, conducting on-site inspections, and levying fines and periodic penalty payments.

The Commission has also submitted a proposal to amend the ESRB Regulation, most importantly to open the option for the EEA-EFTA States to negotiate comparable access to ESRB as they have with the ESAs.

EU institutions are currently reviewing the

recommendations. The EFTA States have submitted joint comments. It is essential for the EFTA States to protect the two-pillar solution agreed to with the EU on 14 October 2014 and which was further elaborated on in adaptation texts to the ESA regulations and related acts.

### Regulation and the publication of guidelines in 2017

In 2017, FME issued a number of rules for implementing the ESAs' technical standards for the financial market.

Those rules were Rules 505/2017 on Technical Standards for the Reporting of Financial Undertakings, Rules No 506/2017 on Technical Standards for the Disclosure Requirements of Financial Undertakings, Rules No 507/2017 on Technical Standards Concerning own Funds Requirement, Rules No 508/2017 on Technical Standards Concerning Credit Risk, Rules No 509/2017 on Technical Standards for Large Exposures, Rules No 960/2017 on Technical Standards Concerning Transferred Credit Risk from Securitisation, Rules No 961/2017 on Technical Standards for Market Risk, Rules No 962/2017 on Technical Standards for Internal Methods for Calculating Capital Requirements for Financial Undertakings, Rules No 963/2017 on Technical Standards Concerning the Mapping of Credit Assessments for Calculating Capital Requirements on the basis of the Standard Method and for Securitisation.

Rules No 150/2017 on the Fit and Proper Assessment of Managing Directors and Directors of Financial Undertakings, Rules No 247/2017 on Credit Facilitation from Financial Undertakings to Parties with Close Links, Rules No 666/2017 on Maximum Loan-to-value Ratios for Consumer Mortgages, Rules No 672/2017 on the Proper and Sound Business Practices of Financial Undertakings, Rules No 673/2017 on the Proper and Sound Business Practices of Insurance Undertakings, Rules No 959/2017 on the Calculation of Leverage Ratios for Financial Undertakings, and Rules No 285/2018 on the Fit and Proper Assessment of Managing Directors, Board Members, and Employees Tasked with the Key Functions of the Insurance Companies.

FME publishes a schedule on its website concerning regulation and the publication of guidelines. The publication is a factor in preparing regulated entities for impending changes. FME's website also contains a summary of all legal acts applicable to the financial market.

### 1.3 Commercial practices and consumer affairs

FME has for many years monitored regulated entities' commercial practices. One of the methods for carrying out the above-mentioned supervisory function is to receive public comments on the operating activities of regulated entities. FME also discloses information and provides guidance in accordance with the provisions of the Public Administration Act and clients of regulated entities can submit enquiries to the Authority. In recent years, FME has strengthened this role and has now assigned a special team within the Authority to carry it out.

FME's website contains further information on this service and its implementation. Comments may be submitted through the website, by email, or by phone. All comments are forwarded to the team in charge of business conduct supervision and responded to as soon as possible. Since comments relate to most aspects of financial supervision, there is strong and effective cross-sectoral collaboration within FME for processing these comments.

In 2017, FME received 173 comments and inquiries from the clients of regulated entities.

FME is also an active participant in the activities of the ESAs which are now increasingly focused on supervision of commercial practices. FME has been focused on strengthening forward-looking prudential supervision and examinations of its own initiative in this area. These have been further promoted by FME's participation in international cooperation and the increased weight of this policy area.

Tasks for the supervision of commercial practices varied during the year and this report contains information on a few of them while FME's website contains further information and transparency notifications where applicable:

- Revision of the Rules on the Proper and Sound Business Practices of Financial Undertakings.
- Imposition of Rules on the Proper and Sound Business Practices of Insurance Companies.
- An examination into the collection process concerning primary and secondary collection measures of selected regulated entities.
- An examination of the valuation of seized movable assets at Arion Bank hf., Íslandsbanki hf., Landsbankinn hf., and Lykill fjármögnun hf.
- An examination of unsolicited claims created on-line at the commercial banks.

- An examination of whether changes in policy interest rates have affected the lending rates of Arion Bank hf., Íslandsbanki hf., Landsbankinn hf., Sparisjóður Austurlands hf. (Austurland Savings Bank), and Sparisjóður Strandamanna ses. (Strandamenn Savings Bank).
- An examination of credit companies' information disclosure to clients.

FME's strategic priorities include increasingly emphasising consumer affairs and to that point the Authority's website is currently undergoing updates whereby consumers will have access to significantly more educational material and guidelines. FME will also remain active on Facebook, around one-half of the content on FME's Facebook Page constitutes information intended for consumers.

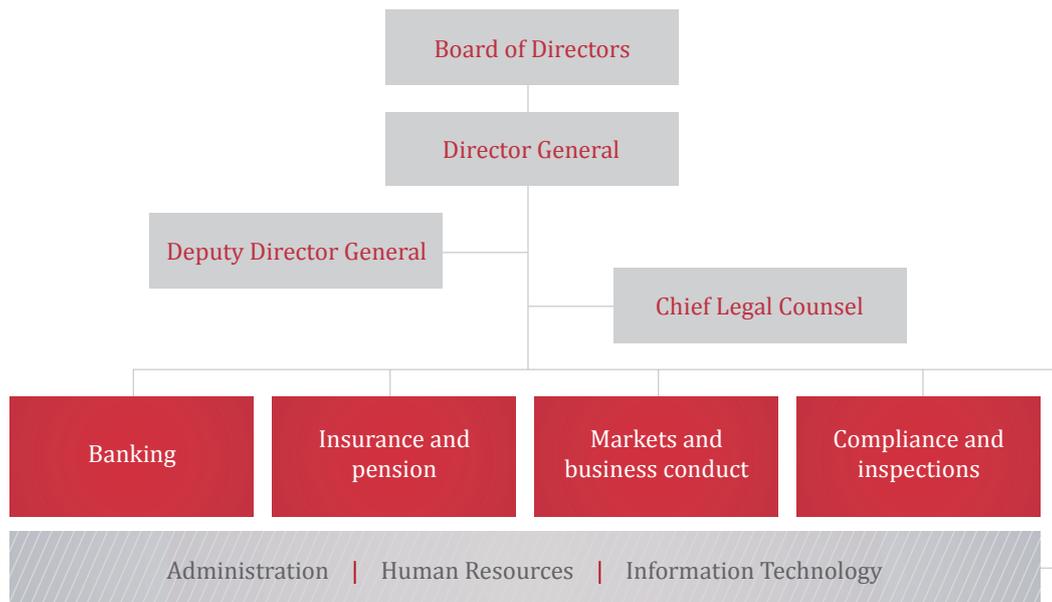
### 1.4 Infrastructure

The Authority's infrastructure has been improved extensively in recent years. The emphasis has been on attracting and keeping competent staff, which has been successful. Targeted procedures have been established and the Authority's IT infrastructure has been upgraded substantially facilitating processing of data and monitoring of risk indicators. The primary purpose has been to strengthen procedures, increase efficiency and improve operational performance. In addition, the policy, strategic priorities, and goals of the Authority have been elaborated in accordance with its role.

The results from the Authority's first comprehensive risk assessment indicate that the infrastructure is solid but at the same time it shows opportunities for improvement and how to prioritise operational improvement projects.

Special attention was given to reviewing and improving a few key factors in our activities. One of those tasks was reviewing the Supervisory Review and Evaluation Process of financial undertakings (SREP). The purpose of this task was to align the process with a new focus. Work continued on increasing the efficiency of reporting data to the Authority in order to better deploy the Authority's specialist to the benefit of the regulated entities. Furthermore, work has commenced on an electronic service portal in light of the Authority's intent to receive all submitted data electronically by 2020.

## FME's Organisation Chart



### Organisational changes

The administrative organisation of the Authority was analysed at the end of 2017. The analysis identified potential improvements and the first phase of the organisational change began immediately at the beginning of 2018. The major objectives of the changes are to strengthen the interplay between the Authority's activities and its strategy and priorities, clarify work allocation and improving the effectiveness of governance by distributing responsibility and decision-making authorities, as well as aligning the Authority's organisation to the organisation of the ESAs.

The new organisation chart has four supervisory units: banking, insurance and pension, market and business conduct, and compliance and inspections. The banking unit supervises banks and other financial undertakings, the insurance and pension unit supervises the pension and insurance markets, the market and business conduct unit supervises the securities market, UCITS, and business practices, and the compliance and inspections unit is responsible for cross-sectoral legal issues (such as cases involving operational licenses, eligibility assessments, etc.) and inspections. In addition to these changes, the Office of the Chief Legal Counsel assumed responsibility for regulation and the Office of the Director General assumed responsibility for macro-prudential matters.

### 1.5 Operations and Finance

According to FME's draft annual account for 2017, operating expenses totalled ISK 2,079.1 million having

increased by 2.2% from ISK 2,035.1 million in 2016. Labour costs are the largest individual item of FME's operating expenses and amounted to ISK 1,696.1 million in 2016 compared with ISK 1,643.4 million in the preceding year, having increased by 3.2% year-on-year. Salary increases in the year are substantially lower than the general salary increases in the market which reflects the effects of streamlining personnel during the year. The number of employees calculated into full-time units was 116.2 in 2017 compared to 117.5 in 2016. Expenses from two complaints committees hosted by the Authority are included in operating expenses and their labour cost amounted to ISK 15.2 million in 2017, which is reclaimed.

FME's total operating revenues amounted to ISK 2,228.9 million in 2017. Thereof, the revenue from the supervision fee amounted to ISK 2,166.6 million compared with ISK 1,710.1 million in 2016. Other operating revenues totalled ISK 62.3 million, including ISK 21.9 million in finance income, ISK 10.5 million in special revenue from providing food, ISK 13.2 million in reclaimed costs for the complaints committees, and ISK 16.7 million in various other tariff-based revenues.

The 2017 surplus therefore amounted to ISK 149.8 million, mostly due to delays in the transposition of new directives and the related supervisory tasks. FME's equity at year-end 2017 was ISK 286.5 million, as compared to ISK 136.6 million at the beginning of the year. Equity at year-end, less reserves amounting to no more than 5% of next year's supervision fees, reduces supervision fees the following year, pursuant to Act No 99/1999 on Payment of Cost due to Official Supervision of Financial Activities. Thus, the reserves amounted to ISK 113.4 million at year-end 2017.

### 2018 operational schedule

In a report on the 2018 operational schedule, submitted to the Minister of Finance and Economic Affairs pursuant to law in June 2017, the Authority's expected expenses total ISK 2,392.4 million for 2018. In addition, the Authority's revenues were expected to total ISK 2,370.2 million. It was proposed to transfer a loss of ISK 17.2 million from own funds making the reserves close to 5% of next years estimated supervision fee. In accordance with the 2018 general budget adopted by Althing in December 2017, the total revenue amounts to ISK 2,369.7 million, of which the imposed supervisory fee according to Act No 99/1999 amounts to ISK 2,305.7 million.

### Distribution of working hours

Pursuant to Act No 99/1999 on Payment of Cost due to Official Supervision of Financial Activities, regulated entities shall cover the operational expenses of FME through a special supervision fee. The Authority's operational schedule should therefore assess the development of its activities with regard to the time allocated to the supervision of each class of regulated entity. The assessment is based on the Authority's time sheet records. Table 1 shows a breakdown of FME's working hours devoted to each main category of regulated entity from 2015 through 2017:

**Table 1** Relative distribution of FME working hours by category of regulated entity

|                                   | 2017   | 2016   | 2015   |
|-----------------------------------|--------|--------|--------|
| Credit institutions               | 59.1%  | 56.5%  | 61.3%  |
| Insurance companies and insurance | 12.0%  | 13.0%  | 12.2%  |
| Pension funds                     | 12.4%  | 12.9%  | 12.3%  |
| Fund management companies         | 8.3%   | 8.3%   | 4.8%   |
| Securities dealers                | 4.2%   | 4.8%   | 2.8%   |
| Equity and bond issuers           | 1.9%   | 2.1%   | 4.7%   |
| Others                            | 2.1%   | 3.0%   | 1.8%   |
|                                   | 100.0% | 100.0% | 100.0% |



## 2. Financial market

### 2.1 Economic outlook

Global economic growth has been recovering slowly in recent years and according to the International Monetary Fund the outlook looks favourable in the near term. Many of the stock market indices in Europe and the United States have reached all-time highs. At the same time, measures for market risk expectations remain rather low, even though there has been some uncertainty in regards to the economic policies of larger countries. International financial markets have enjoyed relatively easy access to credit due to low interest rates in recent years, especially in Europe and the United States. Even so increased economic growth and inflationary pressure may lead to further interest rate hikes. The Federal Reserve has been raising US interest rates in steps for two years and last year the Bank of England raised its base rate for the first time since 2008. However, the European Central Bank has yet to indicate any intention to raise interest rates in the

near future.

Domestic economic growth in Iceland during last year was slower than the previous year, with preliminary numbers indicating a 3.7% growth in 2017, compared to 7.5% in 2016. A major factor in the slowdown was the slower growth in tourism during 2017. The high growth of 2016 was mostly due to increased tourism activities while the growth in 2017 was driven by increased consumption. This development is most likely a result of the significant appreciation of the króna during the last couple of years, which has led to an increase in imports and lowered the trade surplus.

The lifting of the capital controls in March of 2017 increased the volatility of the króna but in recent months the volatility has diminished again significantly. The ongoing appreciation of the króna also slowed considerably in the second half of last year and currently the exchange

rate seems to have reached a point of some stability. This has resulted in increased domestic inflation, as the prices of imported products have not continued to fall as rapidly as they did previously.

Inflation was measured at 2.8% last March, the first time since the beginning of 2014 that the 12 month increase in the consumer price index was over the Central Bank's 2.5% inflation target.

Slower economic growth has led to a decrease in the output gap, but it remains positive. Nominal credit growth was 3.9% in 2017, outpacing GDP growth during the year. Household credit growth has picked up slightly, but corporate liabilities are still the main driver of credit growth. However the considerable increases in the price of residential real estate in the first half of last year has led to significantly higher collateral capacity amongst house owners.

The major uncertainties facing the Icelandic financial market today is the potential impact slower growth in tourism activities may have on returns and investments. There are also potential risks associated with the increased collateral capacity of households which might stimulate unsustainable credit growth

### **Rules limiting loan-to-value ratios of residential mortgages**

During 2016 and the first half of 2017 there was a growing tension in the Icelandic residential housing market. With favourable developments in the economy leading to a considerable growth in purchasing power the House Price Index in the capital area increased by 16.26% in 2016 and by 12.26% in 2017. At its high during the second quarter of 2017, the annual growth of housing prices exceeded 20% in real terms.

On 20 July 2017, FME established rules limiting the maximum loan-to-value ratio of new residential mortgages in accordance with Article 25(1) of Act No. 118/2016 on Consumer Mortgages. The maximum loan-to-value ratio according to the rules shall be 85% of the market price of the residence and, in the case of first time buyers, up to 90% of the market price in accordance with paragraph 2 of the same Article.

The rules entered immediately into force and apply to all real estate creditors in Iceland. The purpose of the rules is to maintain and increase the resilience of lenders and borrowers with respect to the possibility of downturns in the housing market.

Significant increases in house prices often precede financial crises and when real estate growth is driven by credit growth financial market

downturns tend to be more severe. The maximum loan-to-value ratio imposes stricter requirements on borrowers and, therefore, directly affects the demand for residential mortgages. Research has also shown that defaults among borrowers are increased when initial loans are granted at high loan-to-value ratios. Lower loan-to-value ratios, therefore, increase household resilience with respect to real estate crises and, at the same time, mitigate future credit losses of financial undertakings.

There is also some evidence that such restrictions lower the expectations of market participants concerning future house price increases and can, therefore, curb further price increases in the market.

Even though the format and implementation may differ, many countries outside of Iceland have considered statutory maximums for loan-to-value ratios on real estate loans in order to limit risk build up in real estate markets.

The Bank of England has, for instance, the power to impose such rules and the central bank of Ireland has, for a number of years, prohibited credit institutions from granting housing loans for more than 80% of the value of the residence in question, or 90% in the case of first-time buyers. Supervisory authorities in Cyprus, the Netherlands, Estonia, the Czech Republic, Lithuania, Romania, Poland, and Slovakia are also authorised to impose rules on maximum loan-to-value ratios for residential mortgages, and in some cases already have.

Loan to Value limits have also been imposed in other Nordic countries. Denmark has implemented a guiding maximum loan-to-value ratio of 95% and the statutory maximum in Finland is 95% for first-time buyers and 90% for others. Some of the Nordic countries have, also, imposed more stringent requirements on loans with higher loan-to-value ratios, for instance by requiring higher amortisation of such loans than other loans. The statutory maximum in Norway has been 85% but, in addition, the principal of loans where the loan-to-value ratio is higher than 70% must be amortised by a minimum of 2.5% annually. The statutory maximum loan-to-value ratio in Sweden is also 85% but the borrower must additionally amortise 1% of the principal when the loan-to-value ratio is over 50% and 2% of the principal when the loan-to-value ratio is higher than 70%. Other macroprudential tools have also been applied in addition to loan-to-value limits for residential mortgages and both Denmark's Central Bank and the Swedish Financial Supervisory Authority have considered increasing the integration between maximum loan-to-value ratios and other

macroprudential tools.

FME's analyses have demonstrated that in respect to the current situation on the Icelandic real estate market, an 85% maximum loan-to-value ratio on new residential mortgages is adequate to sufficiently increase the resilience of both borrowers and lenders to potential real estate crises. Pursuant to Article 25(2) of the Act on Consumer Mortgages, the loan-to-value ratio for first-time buyers shall be higher and in those cases the maximum loan-to-value ratio should be 90%.

FME will continue monitoring developments in the residential mortgage and housing markets and will review the rules on maximum loan-to-value ratios for consumer mortgages. FME will also regularly assess whether there is cause to implement other macroprudential tools for the real estate market with the objective of maintaining financial stability.

## 2.2 Securities Market

### Equity market trends

After a few years upswing in the equity market the Nasdaq all-share index declined in 2016 with heavy volatility in the market. The market rose substantially in 2017 up until the mid-year when it began declining again.

The index did, however, increase overall in 2017, by about 4.8%, and has increased by 9.7% as of 20 April 2018.

The market capitalisation of companies listed on Nasdaq Iceland's main market declined in December 2017 when the shares of Össur hf. were delisted from the Icelandic market. The shares of Bank Nordik P/F were delisted in February 2017.

No new companies were listed in the main market so the total number of listed companies decreased by two and ending the year at 16. Nasdaq Iceland also operates a multilateral trading facility for financial instruments under the name of First North Iceland.

Two new companies were admitted to trading there during the period, Klappir Inc and Kvikabanki hf.

Figure 4 Turnover velocity in the Nasdaq Iceland main market (XICE)

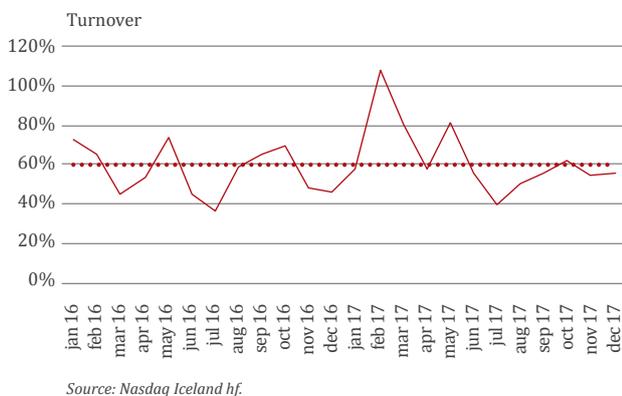


Figure 5 Turnover in the Nasdaq Iceland main market (XICE)

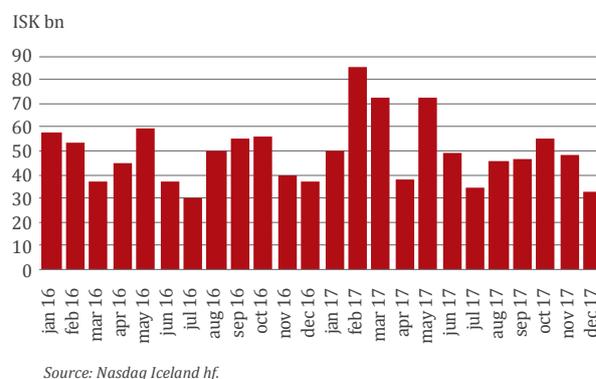
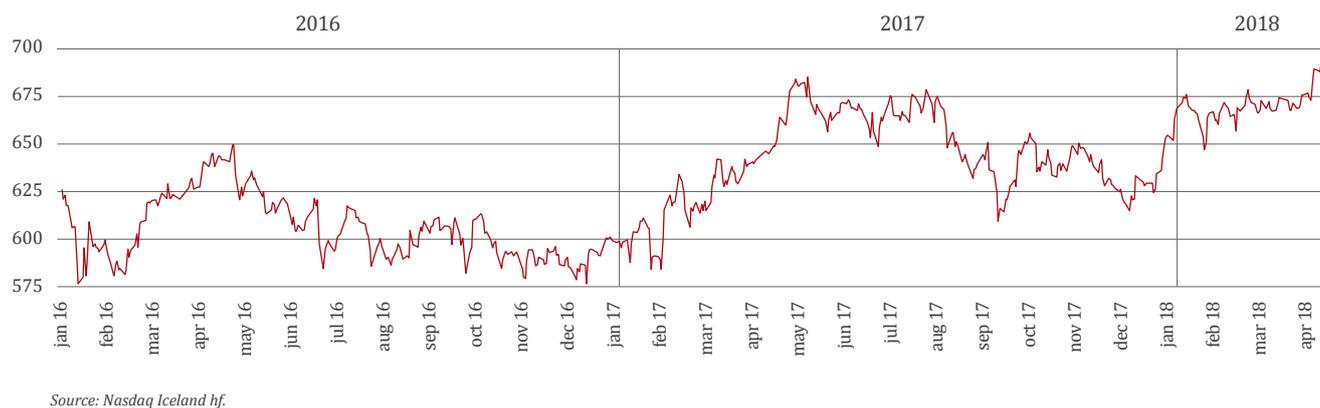
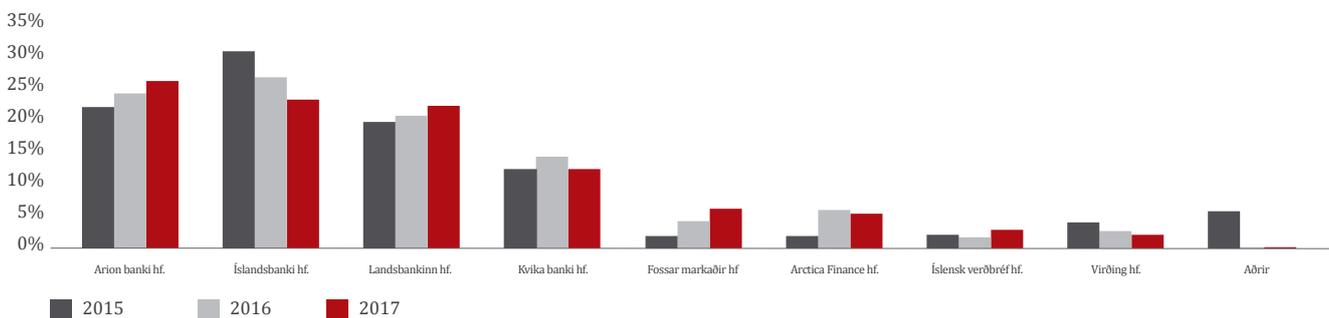


Figure 6 Trend of the NASDAQ OMXIGI Index



**Figure 7** Market participant ratio of total turnover of securities in the Nasdaq Iceland main market (XICE)

Source: Monthly Reporting of Nasdaq Iceland hf.

The turnover and turnover velocity of listed shares did not vary significantly in 2016 and 2017. The turnover velocity, the measure for turnover as a ratio of market value, has oscillated around 60% during the period with a conspicuous increase in February 2017, most likely due to massive trading resulting from a profit announcement from Icelandair Group hf.

As Figure 7 shows, the three large commercial banks, Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf., play a large role in the market with equities admitted to the Nasdaq Iceland main market, representing 71.4% of the total market turnover.

Arion Bank hf. and Landsbankinn hf. have increased their ratio in the last three years while the ratio of Íslandsbanki hf. has decreased significantly. The proportions between market participants seem to be equalising but the above-mentioned participants clearly stand out with over 20% of total turnover each.

### Bond market trends

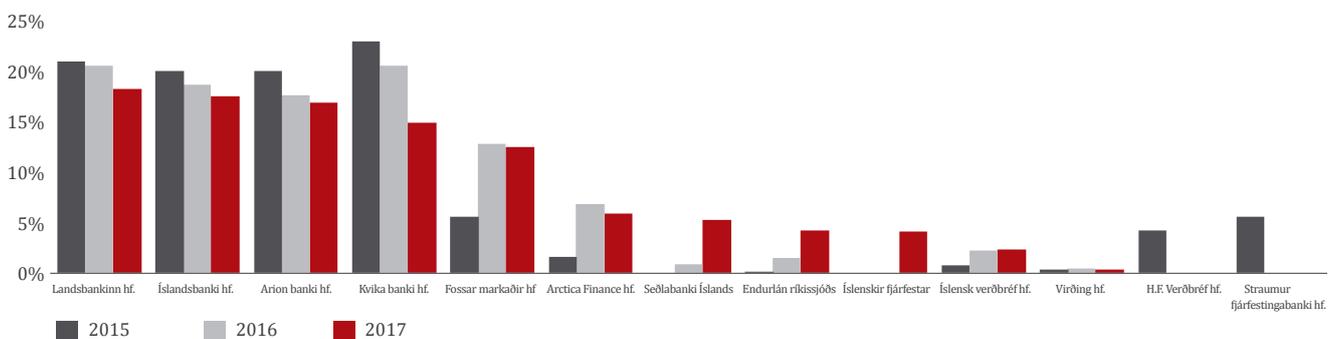
Bond market turnover has decreased for the last two years. The total bond market turnover in Nasdaq Iceland amounted to ISK 1,240 billion in 2017.

For comparison, the turnover was ISK 1,476 billion in 2016 and ISK 1,996 billion in 2015.

As in previous years, non-indexed government bonds were traded most. The total turnover of non-inflation linked government bonds on Nasdaq Iceland in 2017 amounted to ISK 847 billion, and this class includes the seven bonds with the highest turnover.

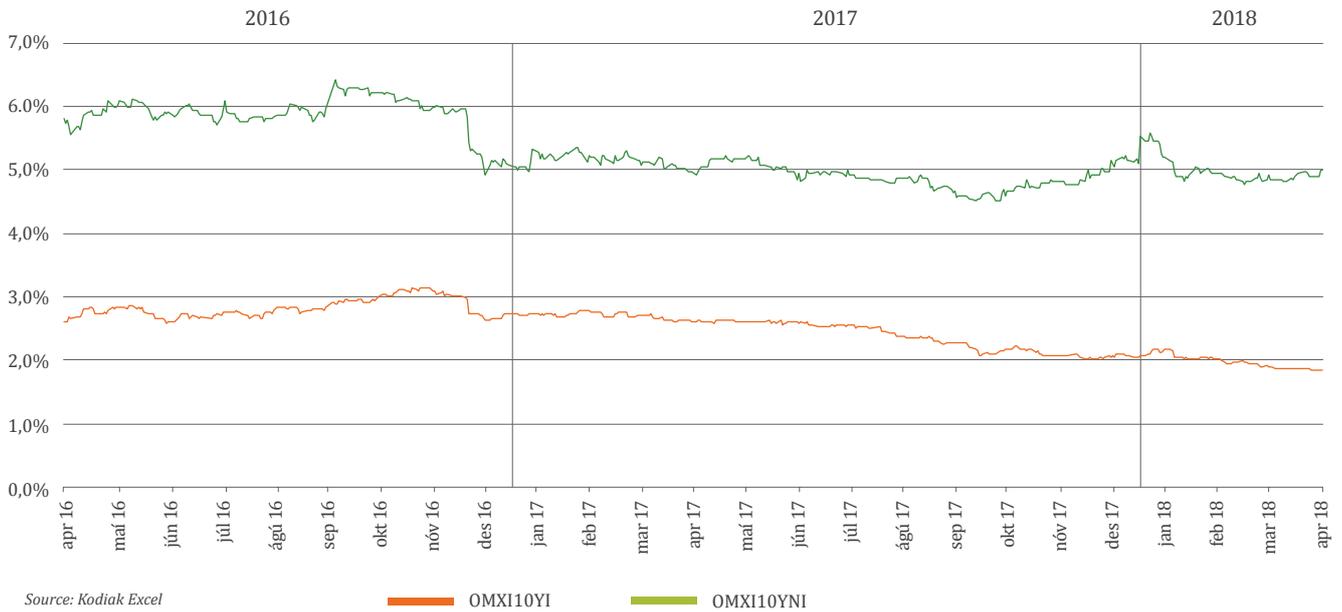
The turnover of bonds issued by banks increased significantly in 2017 compared to the previous year or from ISK 109 billion to ISK 164 billion, amounting to 7% of the total bond turnover on Nasdaq Iceland.

The four commercial banks are the largest market participants engaged in trading with listed bonds on Nasdaq Iceland. Since 2015, they have, however, lost a substan-

**Figure 8** Market participant share in the bond market

Source: Monthly Reporting of Nasdaq Iceland hf.

**Figure 9** Imputed rate of interest for indexed (OMXI10YI) and non-indexed (OMXI10YNI) bond indices on Nasdaq Iceland.



tial part of their market while smaller participants have increased theirs, such as Fossar Markets hf. and Arctica Finance hf., cf. Figure 8.

The development of the imputed rate of return of listed bonds has been twofold.

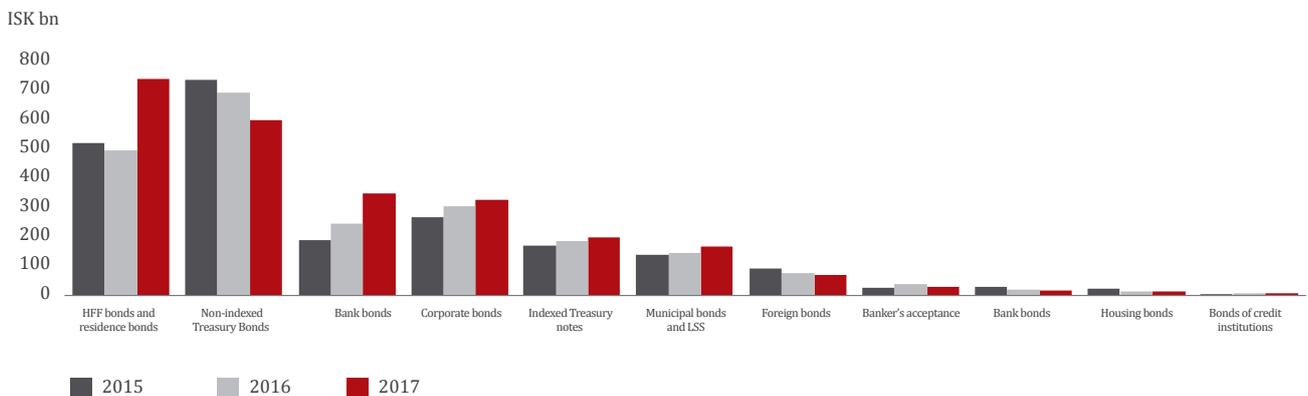
The imputed rate of return for indexed bonds has decreased substantially while the imputed rate of return for non-inflation linked bonds has been stable from 2016 to 2017, even though the period saw significant volatility. The above-mentioned development is clear from Figure 9 that shows the development of the OMXI10YI (infla-

tion linked bonds with a 10-year average maturity) and OMXI10NI (non-indexed bonds with a 10-year average maturity) indices on Nasdaq Iceland during 2017.

The inflation premium rose substantially after mid-2017 and, likely, the government breakup with the resulting uncertainty concerning the General Budget going forward, uncertainty related to collective agreements in 2018, and the reasoning addresses by the Monetary Policy Committee concerning decreasing tension in the economy had an effect.

Figure 10 shows the development of marketvalue on

**Figure 10** Market value of listed bonds at year-end



Nasdaq Iceland for issued bonds in the last three years. The total value of listed bonds amounted to ISK 2,418 billion in 2017, compared with ISK 2,136 billion in 2016.

In 2017, two new bond issuers were authorised and in total 60 new bonds were admitted to trading while the year-end total number of bonds on Nasdaq Iceland was 188.

## 2.3 Credit market

At year-end 2017, 4 commercial banks, 4 savings banks and 5 credit institutions were operating in Iceland, in addition to the state-owned Housing Financing Fund, which is under FME's supervision pursuant to the Housing Act, No. 44/1998. At year-end 2017, the total assets of credit institutions amounted to ISK 4,434 billion, thereof the total assets of the commercial banks amounted to ISK 3,452 billion, having increased by 6.1% from the end of 2016. The ownership interests of the Treasury and public bodies are still a large part of the credit market but the public ownership interest decreased when the State sold its 13% share in Arion Bank hf. in February 2018. The total ownership interest held by the Treasury and public bodies in credit company equity in the first quarter of 2018 was 65% compared to 71% at the end of 2016. Arion Bank hf. is aiming to be admitted to trading in 2018.

### Balance sheet structure

The ratio of credit companies' total assets to GDP decreased from the end of 2009 until 2016. The ratio during the period decreased from 277% to 173%. At year-end 2017 the ratio had, however, risen to 174% which is a small increase from the previous year. This ratio was approximately 900% at year-end 2007. The developments since 2009 are mostly a result of the gross domestic product having risen proportionately faster than the credit institutions' total assets, which have increased by 7% since year-end 2009.

### Equity position

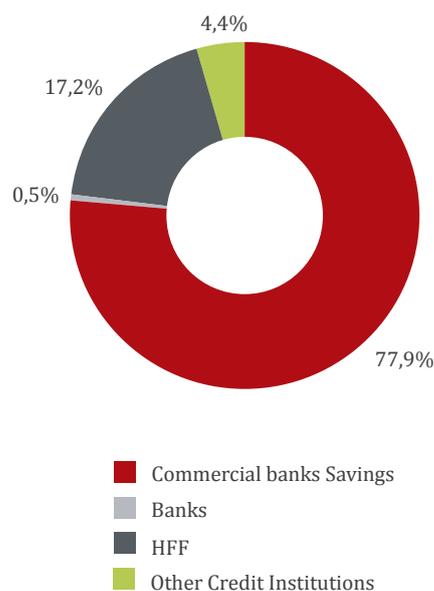
At year-end 2017, the capital base of the three large commercial banks amounted to ISK 618 billion, compared with ISK 635 billion at year-end 2016, a decrease of almost 3% year-on-year. Their capital adequacy ratio was 25% at year-end 2017 as compared to 27.5% at year-end 2016. The main reason for the decrease are increasing risk weighted assets as well as dividend payments, both general and specific. The banks' capital ratios, however, remain significantly higher than specified by FME criteria. The majority of the capital base of the three large commercial banks constitutes Common Equity Tier 1, or approximately 96%.

The weighted ratio of Tier 1 Capital for the large commercial banks was on average 24.3% at year-end 2017, which is substantially higher than is common in Europe where the average ratio is 16%. The comparison shows that the Icelandic banks have a strong equity position although it bears mentioning that the capital adequacy ratios of foreign banks have been increasing in recent years as a result of increased international requirements for capital adequacy while the capital adequacy ratios of the Icelandic banks have been decreasing.

### Operating results

The overall operating results of the banks were comparable in 2017 and the previous year. In 2017, the profit of the three largest commercial banks amounted to over ISK 47 billion compared with over ISK 50 billion in 2016. The return on equity after tax decreased year-on-year and was 7.3% in 2017 compared with 8.9% in 2016. The banks' return on core operations before tax, however, improved slightly year-on-year and amounted to 9% in 2017 compared with 8.7% in 2016. The banks' net interest income remained unchanged year-on-year but their net commission income increased by ISK 2 billion. The interest rate margin was 2.9% in 2017 compared with 3% in 2016. Operating expenses as a percentage of net operating income were 54.8% in 2017 compared with 53% in 2016. Operating expenses as a percentage of assets decreases to 2.5% from 2.6% the previous year.

Figure 11 Total assets of the credit companies on a consolidated basis as of 31 December 2017.



Source: Financial Supervisory Authority

### Liquidity position and funding

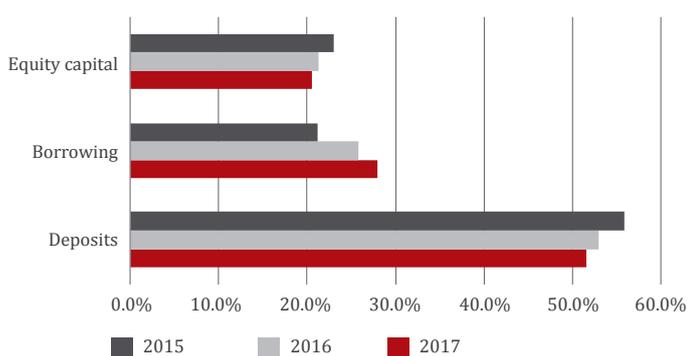
The liquidity position of the banks is strong and they have approximately ISK 160 billion in excess of the applicable minimum liquidity coverage ratio (LCR) for credit companies as of year-end 2017, compared to approximately ISK 200 billion at year-end 2016. The minimum LCR according to the rules is 100% in total and also for the foreign currency LCR.

The banks' weighted LCR was 169% at year-end 2017 and 491% for foreign currencies, compared to 153% and 404% respectively at year-end 2016.

At year-end 2017, the funding comprised ISK 1,634 billion in customer deposits (48%), ISK 885 billion in market funding (26%), ISK 653 billion in capital (19%), and ISK 204 billion in other items (7%). The banks have increased funding diversification in the past three years. The proportion of customer deposits has declined by 2.7%, the proportion of market funding has increased by 6.8%, and the proportion of own funds has declined by 1.7%. The banks are aiming to increase their funding diversification further by issuing equity instruments as Additional Tier 1 Capital or Tier 2 Capital. As part of the issuance they will consider the forthcoming MREL<sup>1</sup> demand which is part of the EU adoption of the Bank Recovery and Resolution Directive (BRRD) which is to be transposed into Icelandic law this year and next year.

Figure 12 shows the developments of select factors in the banks funding from 2015 and through 2017.<sup>2</sup>

**Figure 12** Development of the commercial banks' funding composition



Source: Financial Supervisory Authority

The ISK 885 billion of the banks' market funding consists of 56% in foreign currencies and 44% in Icelandic króna. The largest portion of Icelandic króna comes from covered bonds, or approximately 39% of the total market funding. The banks' issuance of foreign denominated bonds, considering refinancing, amounted to ISK 37 billion in 2017 while the comparable net position in 2016

amounted to ISK 98 billion.

Foreign currency funding consists of 82% in euro, 11% in Swedish kroner, and 7% in Norwegian kroner.

The increase in covered bonds issues amounted to ISK 84 billion in 2017 and at year-end the banks had issued a total of ISK 348 billion in covered bonds, an increase of 32% year-on-year.

The banks' borrowing rates in foreign credit markets have not been better since in the fall of 2008, and maturities are getting longer. The major reasons for that are more favourable conditions in foreign credit markets, the banks' higher-quality balance sheets each year, improved credit rating, and increased trust towards the banking industry and the Icelandic economy.

Foreign denominated funding maturing this year and in the next two years amounts to ISK 148 billion or approximately 59% of the outstanding foreign denominated market funding. The banks' recent foreign denominated bond issues amounting to ISK 90 billion have, however, lowered the refinancing ratio, raised the average maturity, and, thereby, reduced the refinancing risk.

The lengthening maturity has had a positive impact on the foreign denominated funding ratio and the ratios are substantially higher than the 100% minimum stipulated by rules on the foreign denominated funding ratio. The ratio at year-end 2017 was 162% and therefore still substantially higher than required.

A large portion of the banks' market funding in Icelandic króna is in residential mortgage backed covered bonds. This portion is therefore weighted in the ratio of encumbered assets but the ratio has been decreasing in recent years, among other things due to repayments of the banks initial funding. The weighted ratio for all banks amounted to 14% at year-end 2017 compared to 16% in 2016.

### Credit risk and asset quality

The book value of the large commercial banks' customer lending amounted to ISK 2,446 billion at year-end 2017, which is an 8.5% increase from year-end 2016 when lending amounted to ISK 2,254 billion. The measured inflation was 1.9% in 2017 showing that the banks' loan portfolios increased by 6.6% in real terms, which is faster than the 3.6% economic growth in 2017. Corporate and individual debt as a ratio of domestic product had been decreasing since 2008, but the decrease has stopped.

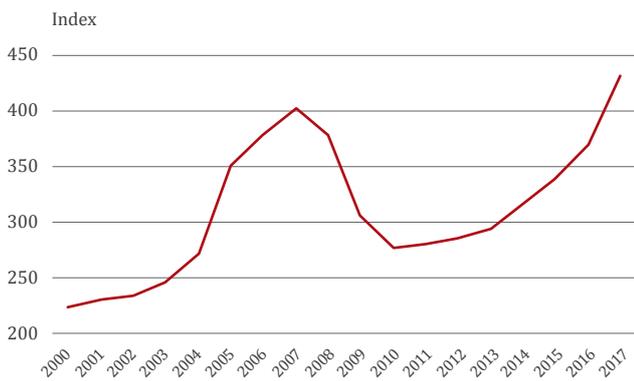
The large commercial banks have completed credit restructuring for companies that encountered financial difficulties following the collapse in 2008 and the ratio of default loans has most likely reached its lowest point in this economic cycle. In the assessment of FME, the major risk factor in the large commercial banks' credit portfolios are mortgage backed loans for industrial property and

<sup>1</sup> Own funds requirement and bail-in-able liabilities.

<sup>2</sup> These factors account for a total of 93% on the funding side.

such loans amounted to ISK 574 billion at year-end 2017. The banks suffered substantial losses from such loans following the collapse in 2008. The real value of commercial and office real estate in the capital area is now higher than it was at the top of the last economic cycle as Figure 13 shows.

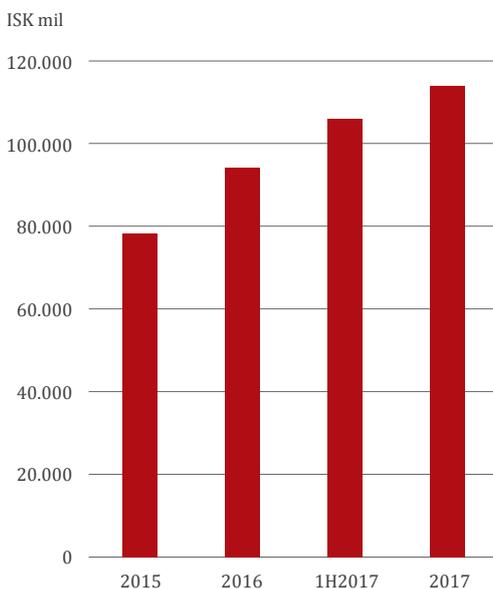
**Figure 13** Real value of commercial and office real estate in the capital area for the period 2000–2017



Source: Registers Iceland

The book value of the large commercial banks' lending to tourism companies amounted to ISK 212 billion at year-end 2017, which is an increase of 20% from the previous year. However, the credit growth has slowed significantly since mid-year 2017 as the growth of the sector has slowed. The lending of the commercial banks to

**Figure 14** Trend in the hotel property lending of the large commercial banks from year-end 2015.

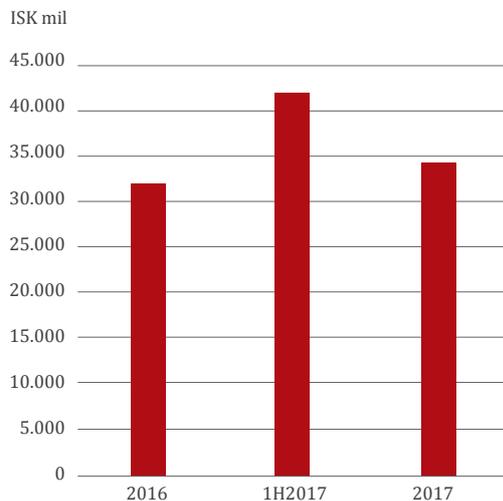


Source: Financial Supervisory Authority

tourism companies amounts to 15.2% of their total corporate lending. Lending backed by hotel mortgages amounted to ISK 78.2 billion at year-end 2015 but had risen to ISK 114 billion at year-end 2017, which constitutes a 46% increase as Figure 14 shows.

The credit the large commercial banks extended to car rental agencies amounted to ISK 42.1 billion in mid-year 2017 but they decreased in the second half of 2017 and ended at ISK 34.5 billion at year-end 2017. Figure 15 shows the credit trend for the three large banks' lending to car rental agencies.

**Figure 15** The credit trend for the three large banks' lending to car rental agencies in 2017.



Source: Financial Supervisory Authority

**International working group on measures against money laundering and terrorist financing**

Task Force (FATF) on Iceland's measures to fight money laundering and the financing of terrorism was published in early April 2018. The audit concludes, with respect to the function of FME, that the framework for operating licenses and registration is sufficient to prevent criminals and their associates from becoming beneficial owners of participating interests in entities regulated by the Authority. However, even though FME has begun identifying risks, the conclusion notes that the Authority has an insufficient understanding of the risks related to money laundering and terrorist financing. The supervision is, therefore, not carried out with regard to risk assessments. The audit committee finally criticised the fact that FME is not empowered to impose administrative fines for infringement of Act No 64/2006 on Measures Against Money Laundering and Terrorist Financing.

FME is working on implementing risk-based

supervision at the Authority in accordance with the Joint Guidelines of the ESAs No 2016/17 and the first risk assessment for entities subject to reporting requirements will be completed in the fall of 2018.

The Ministry of Justice is preparing a bill for a new comprehensive legislation on actions to combat money laundering and terrorist financing. The bill will propose granting FME extensive sanctioning powers for infringements of law.

## 2.4 Insurance market

At year-end 2017, 11 insurance companies had an operating licence from FME, with the number decreasing by one during the year when Vörður líftryggingar hf. and Okkar líftryggingar hf. merged. Of the 11 companies, four companies operate in the non-life insurance market and four operate in the life insurance market. In addition, the reinsurance companies Íslensk endurtrygging hf. and Trygging hf. only settle older obligations and Iceland's Natural Catastrophe Insurance operates in accordance with special legislation.

### Financial position

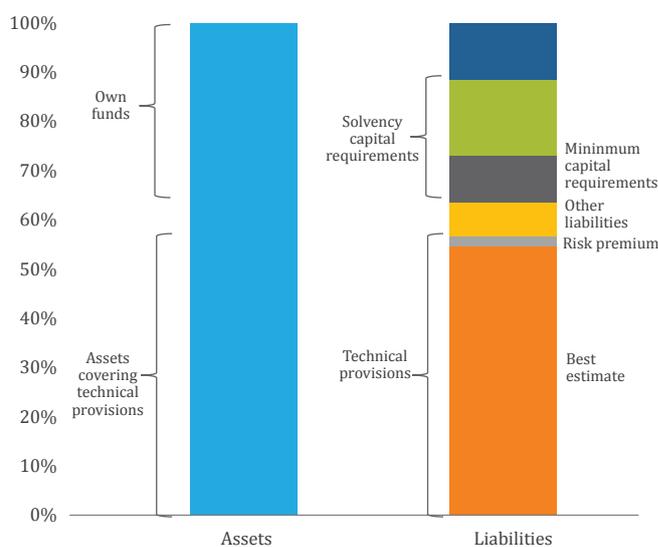
At year-end 2017, the total assets of all insurance companies in Iceland amounted to approximately ISK 144 billion, increasing by more than 4% from the previous year.

Figure 16 shows a breakdown of balance sheet liabilities for life and non-life insurance companies at year-end 2017. Their equity position decreased somewhat from the previous year. The technical provision has increased by almost ISK 4 billion, or 5% as accounted for in accordance with methods of the Solvency II framework.

As before, market risk is the largest contribution to the solvency capital ratio (SCR) as in recent years, the insurance companies have increased their exposure to riskier asset classes, such as equity securities and funds for collective investment. The second largest contribution arises from non-life underwriting risk as the companies are more involved in non-life insurance than life and health insurance. Every company applies the Solvency II standard formula for calculating SCR which is intended to assess the impact of a 1 in 200-year loss event on the companies' balance sheet.

The SCR ratios of all insurance undertakings have decreased slightly from the previous year and the combined ratio was 1.49 at year-end 2017 for all companies on a consolidated basis. The reduction in SCR is, in part, due to the increasing investments in equities and other asset classes with higher risk charge. Another factor is

Figure 16 Insurance company balance sheets



Source: Financial Supervisory Authority

that Vátryggingafélag Íslands reduces its participation in Kvika banki hf. from own funds and the share is not included in calculation of the SCR. Figure 17 shows the composition of SCR and own funds.

### Insurance company investments

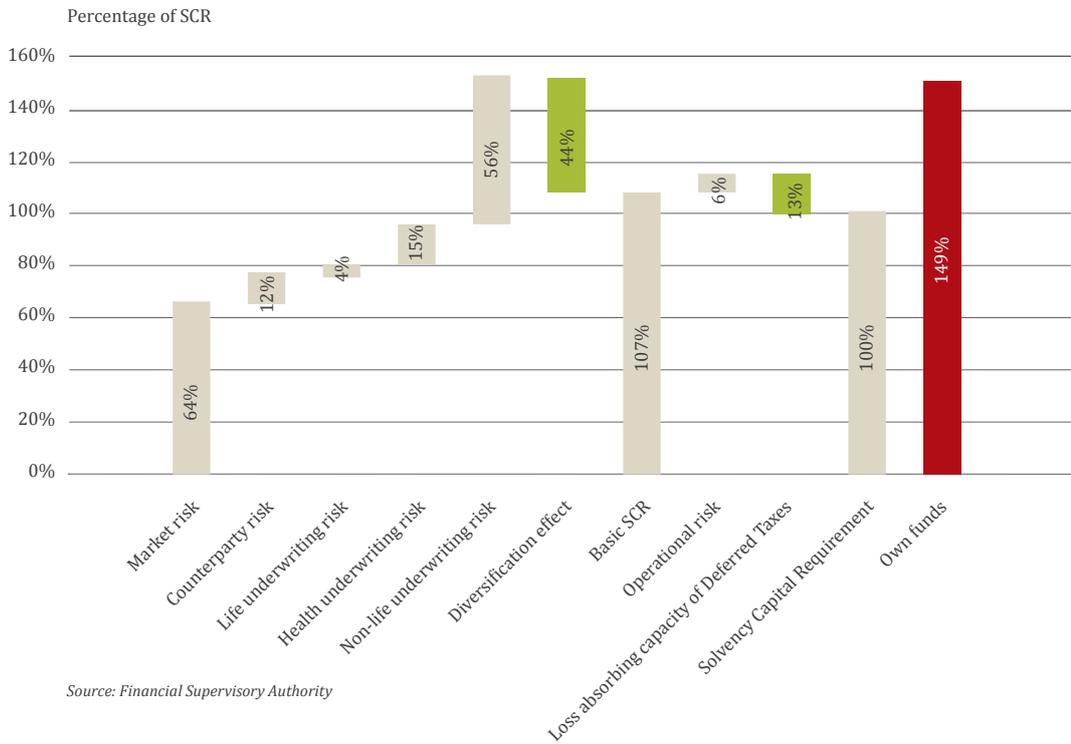
Figure 18 shows the breakdown of investment assets at insurance companies at year-end 2017. Equities shares accounted for 18% at year-end 2017, which is a similar ratio as the year before. The share of bonds was 31% at year-end 2017, having decreased from the prior year. Some insurance companies seek more risk than others but their overall share in riskier asset classes has increased substantially in recent years and equity risk constitutes the largest part of their solvency capital requirement from market risk.

### Operations of insurance companies

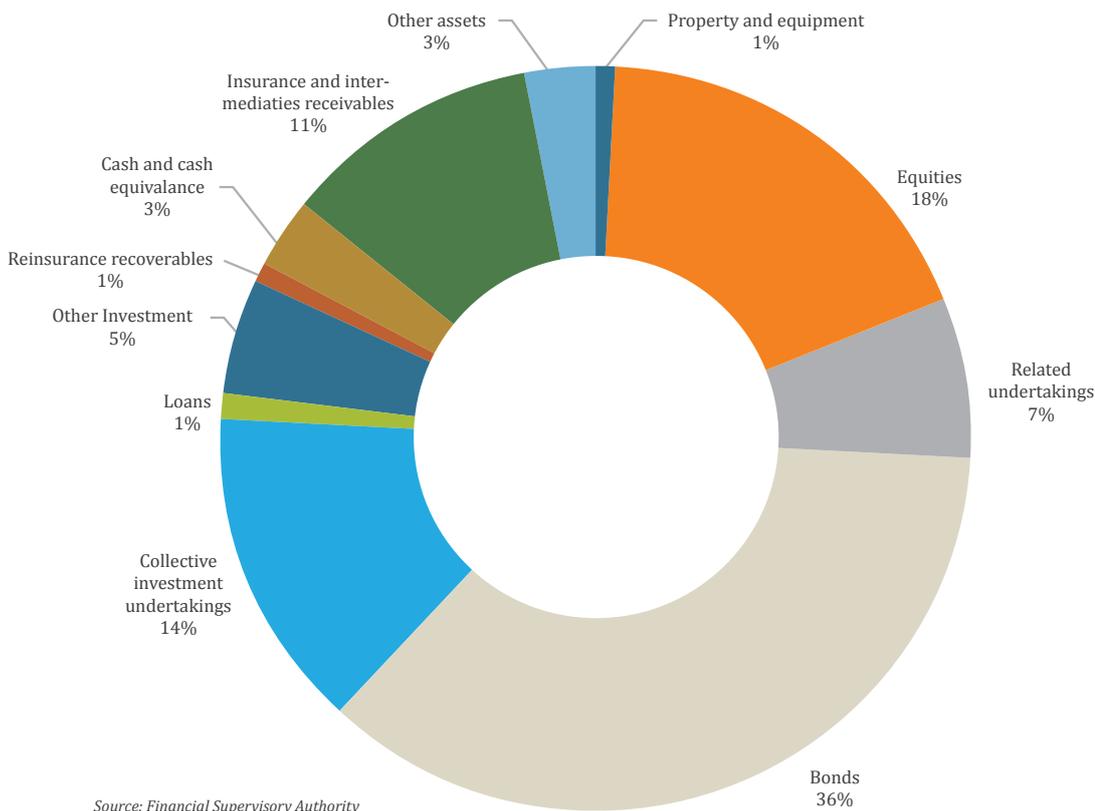
The overall performance of the non-life insurance companies declined somewhat in 2017 compared to the preceding year. There is variation across insurance undertakings with regards to underwriting performance on the one hand and return on investment on the other hand. Profits from investment activities were generally lower than in previous year but the non-life and life underwriting activities were more profitable and compensated in part for decrease in income from investment activities.

The premiums increased by 9% in 2017 while operating costs increased less, or approximately 5% compared to the previous year. The combined ratio is the most common measure for the underwriting performance and

**Figure 17** The breakdown of non-life and life insurance companies by risk factors and deductions



**Figure 18** Composition of insurance companies' assets as of 31 December 2017



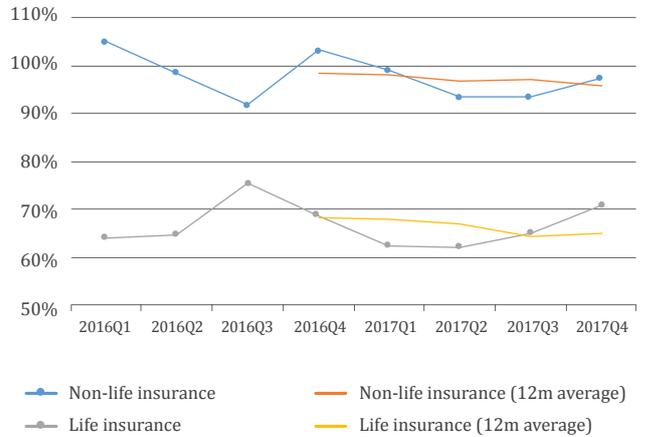
it is expressed as the total of incurred claims losses plus operational expenses divided by earned premiums. For the fiscal year 2017, combined ratio for undertakings was 96% and 65% for non-life and life insurance undertakings, respectively. The life-insurance activities are a small portion of the total and have little impact on the average when all lines of business are considered. The overall combined ratio of insurance undertakings across all lines of business was 96% in 2017 compared to 99% in 2016.

## 2.5 Pension funds and custodians of private pension savings

The total number of pension funds reduced by three in 2017 when three pension funds merged with other pension divisions or were decommissioned. The Reykjanesbær Municipality Pension Plan merged with Division B of Brú Municipality Alliance of Pension Fund in the first half of the year, the Nurse Pension Fund merged with Division B of the Pension Fund for State Employees (LSR) at the beginning of 2018. Retirement Benefit Plan for Employees of Útvegsbanki Íslands was dissolved at the same time when current liabilities were transferred to the accounts of the Treasury.

Currently there are 22 pension funds operating collecting premiums from members to cover minimum pension savings. These pension fund operate 26 divisions for mandatory personal pension and 42 plans for voluntary private pension savings. In addition, five other

Figure 19 The combined ratio of insurance companies by quarter



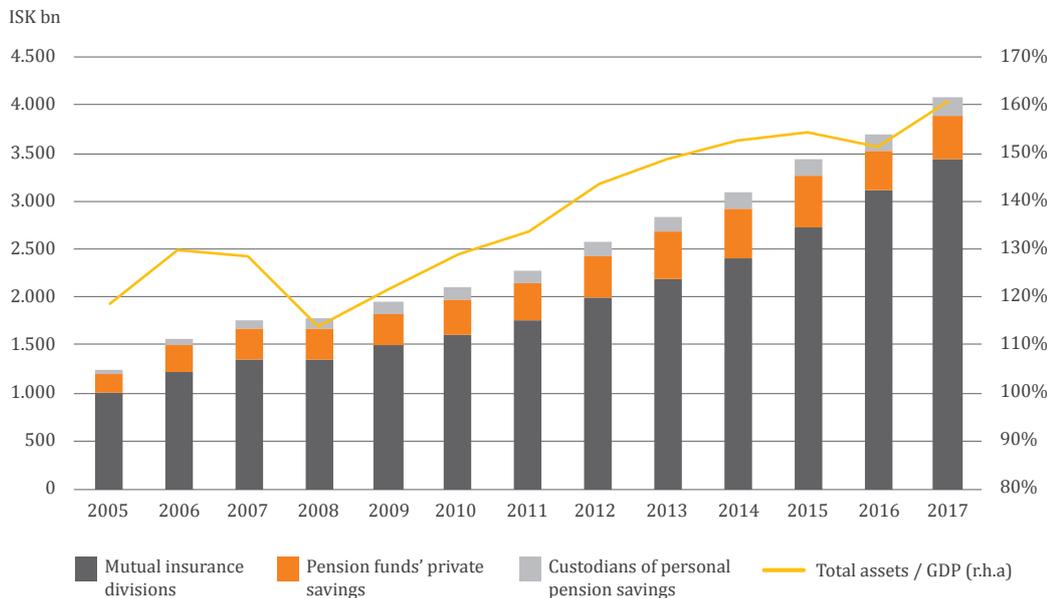
Source: Financial Supervisory Authority

domestic custodians of private pension savings with a total of 31 private pension plans as well as two foreign custodians operate providing voluntary pension savings.

### Financial position

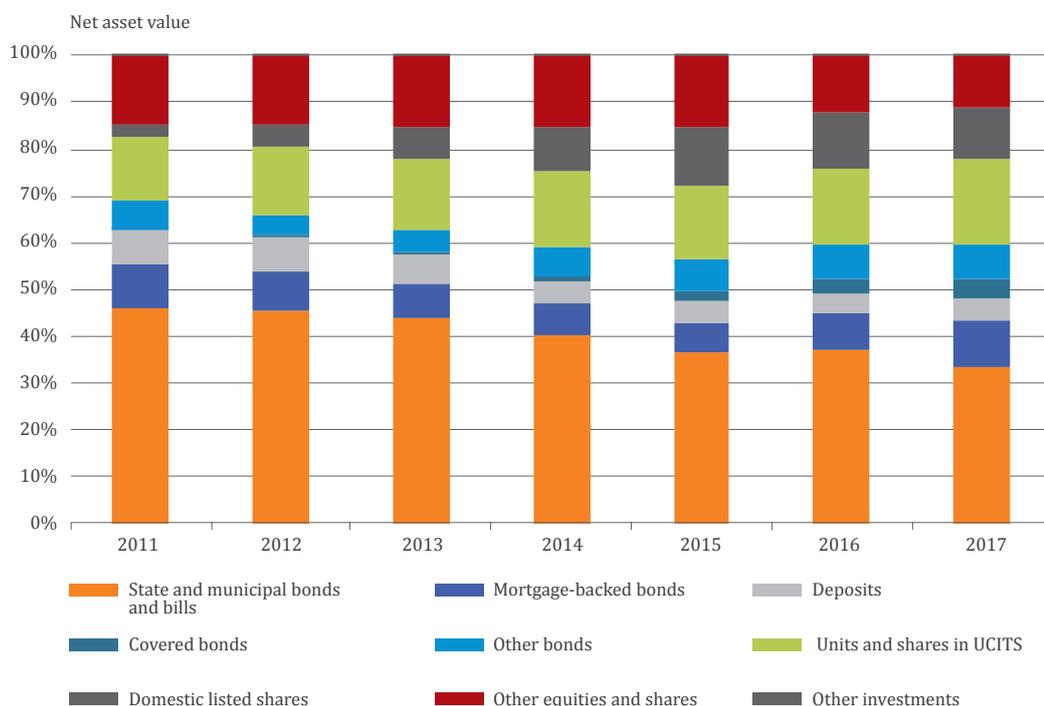
The total assets of the pension funds and other domestic custodians of private pension savings amounted for ISK 4,062 billion at year-end 2017. That is equivalent to 160% of the estimated GDP in 2017 and the ratio is still increasing year by year. Thereof the ratio of the pension

Figure 20 Assets of mutual insurance divisions, private pension divisions, and private pension custodians



Source: Financial Supervisory Authority

**Figure 21** Breakdown of the investments of mutual insurance divisions, private pension divisions, and personal pension custodians



Source: Financial Supervisory Authority

funds' mutual insurance divisions amounted to 135% of gross domestic product (GDP). The ratio of pension funds' private pension divisions and other custodians amounted to 25% of GDP.

The total assets of the pension funds' mutual insurance divisions amounted to ISK 3,498 billion at year-end 2017, increasing by 7% from the previous year. The total assets of the pension funds' private pension divisions increased by 14.2% during the same period and amounted to ISK 382 billion at year-end. And finally, the assets of other domestic custodians of private pensions amounted to ISK 182 billion having increased by 12% in 2017.

### Investment

At the end of last year, the pension funds directly held 48% of shares in companies listed in the OMX Iceland Stock Exchange. In addition, the estimated indirect pension funds' share through their investment UCITS fund is equivalent to 3% of the total value of companies on the exchange. The pension funds' direct and indirect holding in shares listed in Iceland amounts to approximately 12% of the pension funds' total assets. In addition, the pension funds have invested 2% of their total assets in bonds from the same issuers. Exposures to issuers of listed equity shares in the domestic market therefore amounts to 14% of the funds' total assets. At year-end 2017, the pension funds' holdings in listed and unlisted limited liability

companies amounted to ISK 380 billion and ISK 70 billion respectively. The pension funds' extensive ownership in the domestic economy stands out in comparison with other countries.

Almost a third of the pension funds' asset are invested in State-guaranteed bonds and bills with the ratio decreasing continuously in recent years. The ratio of bonds issued by municipalities has, however, remained steady as a proportion of the pension funds' total assets.

The pension funds mortgage backed lending increased significantly in 2017, mostly by direct lending to members. Historically, the pension funds have been the major providers of funds into the mortgage market, primarily through investing in mortgage backed bonds from the Housing Financing Fund and its predecessor and through investments in the covered bonds of financial undertakings. Denominated in króna, the pension funds' investment in the financial undertakings' covered bonds has increased significantly but their ratio of the funds' total assets remained unchanged between years last year.

Most recently, the pension funds have increasingly entered the financial market without intermediaries by lending members directly and competing with banks and other financial institutions. The ratio of mortgage backed bonds to the total assets of mutual insurance divisions is now 10% and the ratio has not been higher since 2009. Figure 21 shows a breakdown of the investments of mutu-

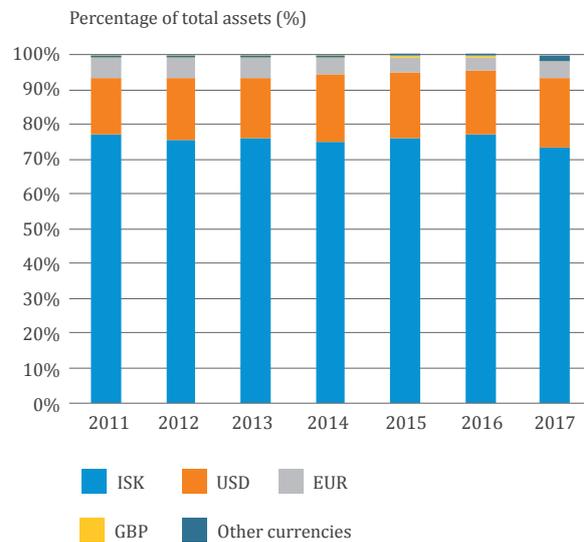
al insurance private pension divisions, their personal pension divisions, and personal pension held by custodians.

The pension funds are authorised to invest up to 50% of their assets in foreign denominated financial instruments. There has been an observable increase in new foreign denominated investments since the capital controls were lifted in March 2017 and it is estimated that the pension funds invested ISK 90 billion abroad in 2017, an increase of more than ISK 20 billion from the previous year. The pension funds' foreign assets are mostly in the form of units in equity funds. The ratio of the pension funds' foreign assets amounted to approximately 27% of their total assets at year-end 2017, an increase of three percentage points from the previous year, and Figure 22 shows the trend for the ratio. The increase is largely attributable to new investments and high returns on foreign assets during the year. About one third of the increase in foreign currency denominated asset can be linked with discontinued listing of Össur hf. in the domestic stock exchange. Now, the company is only being listed in the Copenhagen stock exchange so the domestic pension fund ownership is accounted for as Danish krone denominated investment.

**Performance**

The real return of the pension funds' mutual insurance divisions is forecasted to be 5% in 2017 as the pension funds' annual accounts were not available when this was written. The real return for the pension funds has aver-

**Figure 22** Breakdown of the pension funds' investments by currency

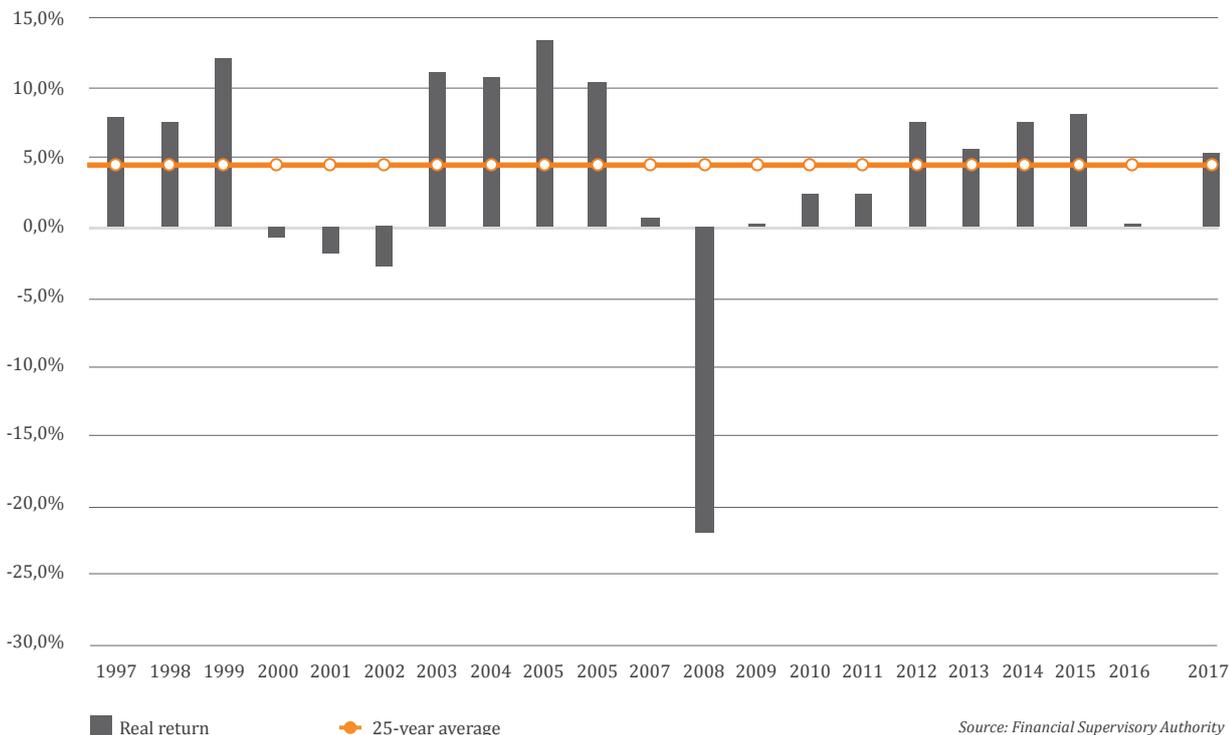


Source: Financial Supervisory Authority

aged to 4.2% over the last 25 years. Their real return has been fairly volatile in the short term. In the last 10 years the real return is on averaged 1.2% and in the last 5 years it has averaged to 5.1%.

Foreign currency denominated equities and mutual funds' units increased by almost 20% in value during the year due to strengthening of the ISK, the net return

**Figure 23** Pension fund returns 1997-2017



Source: Financial Supervisory Authority

was lower. The real return of foreign equities and mutual funds' units was around 11% during the year. Domestic equities rose on average by 3–4% during the year.

Lower interest rates in Iceland pose a new challenge for the pension funds. Since the weighted average maturity of pension fund liabilities is substantially longer than the weighted averaging period for their assets, young pension fund members are most sensitive to further decreases in interest rates and if they stay low in the long-term. About half of pension funds government bonds and bills is accounted for at market value and the lower yield therefore substantially increased their return during the year. This will require higher returns from other asset classes to maintain adequate returns going forward.

## 2.6 Management companies and funds

Management companies are financial undertakings that have been granted operating licenses pursuant to the Act on Financial Undertakings and manage collective investment undertakings pursuant to Act No 128/2011 on UCITS, Investment Funds and Professional Investment Funds. UCITS and investment funds are approved by FME and are subject to stringent requirements for the organisation, activities and management of their management companies. Professional investment funds are only open to professional investors and are pursuant to applicable legislation only required to be notified to FME. They are subject to restricted supervision, mostly related to information disclosure. Furthermore, investments of professional investment funds are not subject to any of the restrictions that apply to the investments of UCITS and investment funds. However, the supervision of management companies of professional investment funds (AIFMs) will increase with the adoption of Alternative Investment Fund Managers Directive (AIFMD) that has been in force in Europe for a few years even though it has not been transposed in Iceland. The transposition of said Directive in Iceland is expected in 2018.

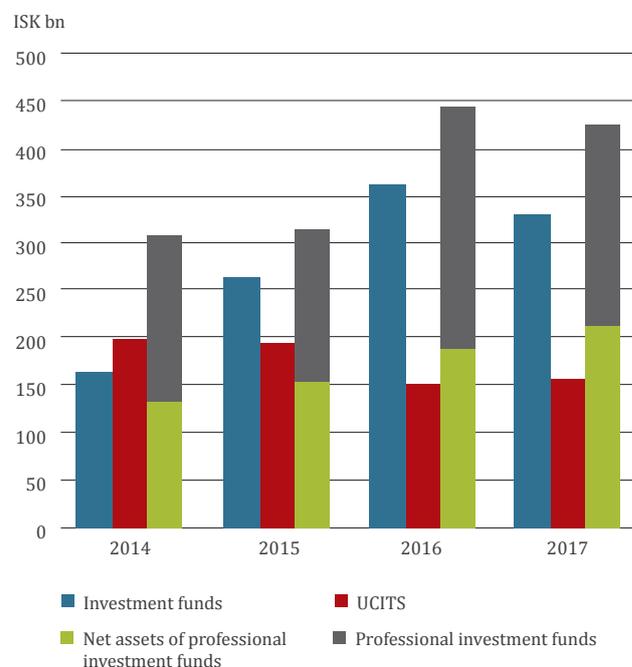
There were ten management companies regulated by FME at year-end 2017 and the number of companies has not changed since 2014. The principal activities of fund management companies involve managing UCITS and investment funds but also professional investment funds even though management companies are not the only companies authorised to manage these funds. The adoption of the above-mentioned AIFMD will require management companies for professional investment funds to apply for operating licenses as management companies of alternative investment funds (AIFMs).

The number of UCITS has decreased in recent years and 3 funds ceased operations last year. At year-end 2017,

a total of 42 UCITS were in operation compared to 57 in 2013. The increase in recent years in the number of investment funds seems to have halted and the number decreased by one in the last year. At year-end 2017, a total of 60 investment funds were in operation. The total assets of UCITS and investment funds amounted to ISK 488 billion at the end of 2017. Of these, assets of UCITS totalled ISK 156 billion and assets of investment funds totalled ISK 332 billion.

The assets of UCITS and investment funds grew substantially after the financial shock of 2008 with the greatest increase in 2015–2016, or a total of ISK 150 billion. The increase for both years is due to the investment funds as their assets increased by ISK 196 billion, or 118% during those two years. The UCITS' assets decreased continuously 2013–2016, after having initially grown significantly after 2008. The decrease was largest in 2014 and 2016, at approximately ISK 40–45 billion or about 20% each year

Figure 24 Assets trend for UCITS, investment funds and professional investment funds



Source: Financial Supervisory Authority

The trend from UCITS to investment funds seems to have stemmed somewhat in the past year with UCITS

assets appreciating by ISK two billion while investment fund assets depreciated by ISK 31 billion.

However, the number of regulated professional investment funds has increased significantly in recent years, in particular in 2016 and 2017, with the number going up by a total of 26 funds. At year-end 2017, 14 entities managed 111 professional investment funds. The total assets of the professional investment funds still depreciated by ISK 19 billion in the past year, about 4%, after having appreciated by around ISK 129 billion, or 41%, the year before. Net assets amounted to approximately ISK 212 billion with leverage staying similar in recent years, at around 50%.

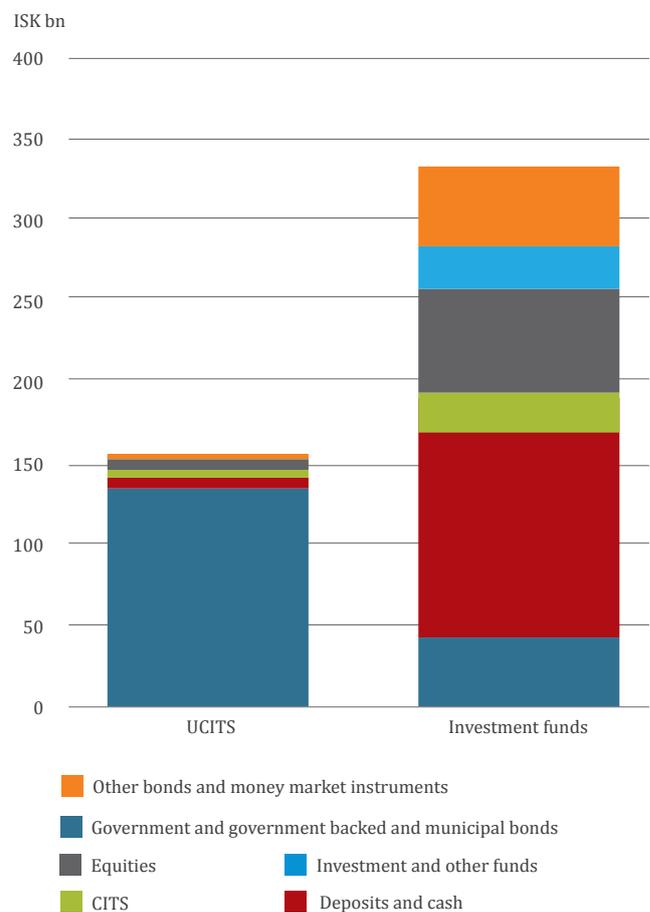
### UCITS and investment funds' asset breakdown

The investments of investment funds are less restricted than UCITS, i.e. investing in individual issuers, asset classes, percentages in listed and unlisted financial instruments and leverage is also authorised. Therefore, they are inherently riskier than UCITS.

The asset breakdown of UCITS is substantially different from the asset breakdown of investment funds and approximately 86% of UCITS holdings are securities which are issued by government or government backed and municipal bonds. Investment funds' holdings are substantially more varied. Approximately 38% is held in deposits and cash, approximately 19% is in equities, and approximately 28% is in bonds, of which 13% are government and government backed and municipal bonds and 15% are other bonds and money market instruments.

Professional investment funds mainly hold their assets in mortgage-backed bonds, equities, loan contracts, and bonds.

Figure 25 Asset breakdown of UCITS and investment funds as of year-end 2017



Source: Financial Supervisory Authority

### FME on Facebook

FME decided to open its own Facebook Page in early 2017. Among other things, the objective was to better inform the general public and thereby contributing to financial literacy and improving accessibility and visibility of FME in public debate. The goal was to publish between two and four status updates weekly with a variety of content. The page would be used to report on the Authority's activities to the public as well as introducing the Authority as an institution and a place of work. FME's Facebook Page was launched on 15 March 2017. The first post concerned the work Earned Trust published by FME at year-end 2016 wherein the Authority's increased emphasis on consumer affairs is addressed.

In just over a year, most of the approximately 170 published posts concern legislative amendments,

discussions on the complaints committees in the financial market, discussions addressing various articles and reports, and various other information which is of clear educational interest to the public. Other posts are very different and for example the "other side", where individual employees and their hobbies are introduced, has been very popular.

The page has gained around 1.000 likes in a little over a year from launch and each post reaches more than 1.000 users. In some cases the page has inspired debate that has in all cases been objective and factual. Some users have also used the page to message questions to the Authority. The page has been successful. FME's presence on Facebook has created a new way to inform the public and the project will be continued.



# 3. Events of the past years

## 3.1 Highlights from May 2017 to end of April 2018

### Predicate offences concerning money laundering

On 19 May 2017, FME pointed out a summary of predicate offences concerning money laundering from the District Prosecutor's Financial Intelligence Unit. At the same time, the Authority made note of related discussions on its own website.

### Abrogated rules concerning the activities of financial undertakings and insurance companies

FME noted on 29 May 2017 that the Authority had published several notices relating to the abrogation of rules concerning the activities of financial undertakings and insurance companies. The notices showed every rule repealed as a result of amendments to the Act on Financial Undertakings and the entry into force of the Regulation Concerning the Prudential Requirements of Financial Undertakings as well as the new comprehensive

legislation on insurance activities. These changes to the banking and insurance markets relate to the transposition of the European CRD IV and Solvency II legislation.

### Prior notification of a life insurance portfolio transfer

The proposed partial transfer of a life insurance portfolio from Scottish Equitable Plc to Legal and General Assurance Society Ltd was announced at the end of May 2017.

### FME issues rules concerning technical standards for the CRD IV framework

On 13 June 2017, FME's website announced that the Authority had issued five rules on technical standards in relation to the CRD IV framework. The rules are based on provisions of CRR, i.e. Regulation (EU) No 575/2013, that were transposed into Icelandic law with the

implementation of Regulation No 233/2017 Concerning the Prudential Requirements of Financial Undertakings.

#### Temporary prohibition on making contracts for short selling shares in Liberbank, S.A.

On 13 June 2017, FME's website announced that the European Securities and Markets Authority (ESMA) had issued an official opinion agreeing to a temporary short selling prohibition by the Spanish securities market commission, Comisión Nacional del Mercado de Valores (CNMV), on net short positions in Liberbank, S.A. shares under Regulation (EU) No 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps (the Short Selling Regulation). This prohibition entered into force before the trading session began on 12 June 2017 for a period of one month.

#### Prior notification of an insurance portfolio transfer

The proposed transfer on an insurance portfolio from Ridgwell Fox & Partners, owned by Allianz IARD, to Bothnia International Insurance Ltd was announced on 14 June 2017.

#### Revocation of the collection license of T-9 ehf.

On 16 June 2017, FME announced it had revoked the collection license of T-9 ehf. with reference to the company's request.

**The position of the pension funds at year-end 2016** On 16 June 2017, FME published a summary of the position of pension savings, mutual insurance and private pensions at year-end 2016.

#### Amendments to the Pensions Act - questions and answers

On 21 June 2017, FME published questions and answers on its website concerning proposed amendments to be entered into force on 1 July with Act No 113/2016 amending Act No 129/1997 on Mandatory Pension Insurance and on the Activities of Pension Funds, as subsequently amended (investment authorisations). FME had invited pension funds and custodians of supplementary pension cover to submit questions concerning the legislative amendments.

#### FME deems Adix ehf. eligible to own a qualifying holding in Centra Corporate Finance Ltd.

On 21 June 2017, FME announced on its website that the Authority had concluded that Adix ehf. was eligible to own a qualifying holding up to 20% in Centra Corporate Finance Ltd., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.

#### Overall results of financial undertakings' annual accounts etc. 2016

On 23 June 2017, FME published a report on the overall results of financial undertakings' annual accounts for 2016, commercial banks, savings banks and credit undertakings (collectively referred to as credit institutions), securities dealers, and fund management companies, as well as information on the total assets of UCITS and investment funds operated by individual management companies and total assets of professional investment funds operated by management companies and other operators. In addition, the report contains information on the Housing Financing Fund, payment institutions and co-operative deposit departments.

#### Second meeting of the Financial Stability Council in 2017

On 26 June, FME announced in a news update on its website that the second meeting of the Financial Stability Council had been held on 20 June at the Ministry of Finance and Economic Affairs. It stated inter alia: "The overall risk to the financial system remains fairly low. However, as expected, the risk has been increasing in several fields since the last meeting of the Council. Household and corporate resilience has mostly strengthened with the improving economic circumstances. The commercial banks' resilience is also strong regardless of whether it is based on asset quality, capital or liquidity. There are indications of an upswing in debt even though the growth of lending remains moderate."

#### EIOPA's press release on the progress of implementing the own risk and solvency assessment of insurance companies (ORSA)

On 27 June 2017, FME mentioned a press release from the European Insurance and Occupational Pensions Authority (EIOPA) on the progress of implementing the own risk and solvency assessment of insurance companies (ORSA) and encouraged the insurance companies to review EIOPA's conclusions.

#### Regulation on short selling enters into force on 1 July 2017

On 28 June 2017, FME noted the transposition of Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps (the Short Selling Regulation) into Icelandic law. The Act would enter into force on 1 July 2017.

#### Notification of an unchanged countercyclical capital buffer

On 28 June 2017, FME announced that the countercyclical buffer would remain unchanged in accordance with recommendations from the Financial Stability Council dated 20 June.

### Consolidated versions of several EEA acts concerning financial services

On 6 July 2017, FME announced on its website that the EFTA Secretariat in Brussels had now made available on EFTA's website consolidated versions of several EEA acts concerning financial services in English. The adaptation text from the decisions of the EEA Joint Committee was consolidated with the text of the acts for the convenience of users.

The following acts were included:

- The regulations establishing the European Surveillance Authorities (EBA, ESMA, EIOPA)
- The regulation establishing the European Systemic Risk Board (ESRB)
- The legislation on credit rating agencies (CRA)
- The European Market Infrastructure Regulation (EMIR)
- The regulation on Short-Selling and Credit Default Swaps, and on Alternative Investment Fund Managers (AIMFD)

### FME reiterates that pension fund participants contributing to private plans decide for themselves to which plan they contribute

On 7 July 2017, FME published a news update pointing out changes to the resolutions of a large number of pension funds authorising them to receive specified personal pension savings in line with the collective agreements between member trade unions of the Icelandic Confederation of Labour (ASI) and the SA Confederation of Icelandic Enterprise (SA). FME's news update stated: "Due to misleading news and information on pension fund websites, FME decided to send a circular to the pension funds reiterating that participants contributing to private plans decide for themselves to which plan they contribute." The circular was included with the news update.

### FME issues draft rules concerning the calculation of leverage ratios and for the technical standards supplementing CRR

On 10 July 2017, FME announced on its website that the Authority had issued seven Consultation Papers, No 9–15/2016, containing draft rules for calculating leverage ratios and draft rules transposing the technical standards supplementing Regulation (EU) No 575/2013 (the CRR Regulation), in accordance with Regulation No 233/2017 Concerning the Prudential Requirements of Financial Undertakings

### FME establishes rules on maximum loan-to-value ratios for consumer mortgages

On 20 July 2017, FME announced on its website that the

Authority had established rules limiting the maximum loan-to-value ratio of new residential mortgages in accordance with Article 25(1) of Act No. 118/2016 on Consumer Mortgages. The news update stated: "In accordance with the rules entering into force, the maximum loan-to-value ratio shall be 85% of the property's market price. First-time home buyers, however, may be granted loans of up to 90% of the market price as Article 25 of the Consumer Mortgage Act allows for higher mortgages to fund first-time real estate purchases. The news update also stated: "The purpose of the Rules is to maintain financial stability and to increase the resilience of lenders and borrowers with respect to the possibility of retreating property prices, in light of the growing stress in the housing market. FME uses other measures to mitigate risk resulting from professional lending such as implementing appropriate capital requirements for financial undertakings.

### Response to a joint letter from ASI and SA concerning specified personal pension savings

On 21 July 2017, FME announced that the Authority had responded to a joint letter from ASI and SA from 19 July, concerning specified personal pension savings at a number of pension funds, that media had reported on earlier that week. FME noted that the Authority had reviewed the perspective posed in the letter from ASI and SA and that it did not warrant a review of the Authority's circular from 7 July.

### FME issues rules on the proper and sound business practices of financial undertakings and insurance companies

On 27 July 2017, FME announced on its website that the Authority had issued rules on the proper and sound business practices of financial undertakings concerning what constitutes proper and sound business practices pursuant to Article 19 of Act No 161/2002 on Financial Undertakings and rules on the proper and sound business practices of insurance companies concerning what constitutes proper and sound business practices pursuant to Articles 9 and 10 of Act No 100/2016, on Insurance Activities.

### Updated schedule for regulation and the publication of guidelines for 2017–2018

On 9 August 2017, FME announced the Authority's updated schedule for establishing rules and publishing guidelines for 2017–2018 and published the revised schedule on its website. The changes were significant to the older schedule, mostly due to FME's revised procedures concerning guidelines.

**Notification of an insurance portfolio transfer**

On 11 August 2017, FME announced the proposed transfer of an insurance portfolio from Congregational and General Insurance Company Plc to International Insurance Company of Hannover SE.

**Notification of a life insurance portfolio transfer**

On 11 August 2017, FME announced the proposed transfer of a life insurance portfolio from Friends Life Limited and Friends Life and Pensions Limited and the partial transfer of a life insurance portfolio from Aviva Investors Pensions Limited to Aviva Life and Pensions UK Limited and Aviva Pension Trustees UK Limited.

**Prior notification of an insurance portfolio transfer**

On 14 August 2017, FME announced the proposed transfer of an insurance portfolio from ERV Försäkringsaktiebolag (publ) to Europæiske Rejseforsikring A/S.

**Prior notification of a life insurance portfolio transfer**

On 16 August 2017, FME announced the proposed transfer of a life insurance portfolio from AXA Wealth Limited to Phoenix Life Limited.

**Prior notification of an insurance portfolio transfer**

On 17 August 2017, FME announced the intended transfer from KX Reinsurance Company Limited and OX Reinsurance Company Limited to Catalina London Limited.

**Information on high-risk jurisdictions**

On 1 September 2017, FME published a news update on its website noting a public statement that the Financial Action Task Force (FATF) adopted after its meeting on 23 June 2017. It stated that jurisdictions subject to FATF should apply special counter-measures against the Democratic People's Republic of Korea due to the ongoing risk to the international financial system emanating from the DPRK's lack of action against money laundering and terrorist financing.

**FME deems Attestor Capital LLP and related entities eligible to own a qualifying holding in Arion Bank hf.**

On 15 September 2017, FME announced that the previous day the Authority had notified Attestor Capital LLP and related entities that they were deemed eligible to own a qualifying holding of up to 20% in Arion Bank hf., including the subsidiaries Stefnir hf., Valitor hf., Vörður tryggingar hf., and Vörður líftryggingar hf., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings and Chapter X of Act No 100/2016, on Insurance Activities.

**FME deems Kvika banki hf. and VIS Insurance hf. eligible to own a qualifying holding in Virðing hf. and the management company Rekstrarfélag Virðingar hf.**

On 19 September 2017, FME announced it had concluded that Kvika banki hf. was eligible to own a qualifying holding of up to 100% in Virðing hf., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings. The announcement further stated that FME had also deemed Kvika banki hf. eligible to own a qualifying holding of up to 100% in Rekstrarfélag Virðingar hf., by its indirect interest through holding Virðing hf.

**FME deems Kaupthing ehf. eligible to own a qualifying holding in Arion Bank hf.**

On 22 September 2017, FME announced that the Authority had notified Kaupthing ehf. the same day that it was deemed eligible to own a qualifying holding of up to 33% in Arion Bank hf., including the subsidiaries Stefnir hf., Valitor hf., Vörður tryggingar hf., and Vörður líftryggingar hf., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings and Chapter X of Act No 100/2016, on Insurance Activities.

**FME deems Taconic Capital Advisors LP and related entities eligible to own a qualifying holding in Arion Bank hf.**

On 22 September 2017, FME reported that the Authority had notified Taconic Capital Advisors LP and related entities the same day that they were deemed eligible to own a qualifying holding of up to 33% in Arion Bank hf., including the subsidiaries Stefnir hf., Valitor hf., Vörður tryggingar hf., and Vörður líftryggingar hf., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings and Chapter X of Act No 100/2016, on Insurance Activities.

**Legal Entity Identifier (LEI) for securities transactions**

On 26 September 2017, FME announced that as of January 2018, financial undertakings authorised to trade in securities pursuant to Act No. 108/2007 on Securities Transactions, shall verify that legal entities which are clients and which must be identified by LEI, such as UCITS, pension funds, insurance companies, municipalities, institutions, and companies, have such codes before carrying out transactions with financial instruments listed on a regulated securities market on their behalf.

**FME launches a help desk for financial technology (FinTech)**

On 27 September 2017, FME reported the Authority had launched a FinTech help desk. The purpose of launching the help desk is to promote communications with entities that provide (or intend to provide) such services in order

to identify whether said services comply with law and whether the activities should be licensed.

#### Third meeting of the Financial Stability Council

FME reported on the third meeting of the Financial Stability Council on its website on 12 October. The news update stated among other things: “The overall risk to the financial system is fairly low. There is tension in the real estate market, real estate prices are close to an all-time high, and there is a growing disequilibrium from the underlying economic factors. However, evidence shows that the price increases in the real estate market are slowing.”

#### Notification of an unchanged countercyclical capital buffer

On 17 October 2017, FME issued a notification of an unchanged countercyclical capital buffer. The notification was in line with the recommendations of the Financial Stability Council from 9 October 2017.

#### Undirbúningsfélag Verðbréfamiðstöðvarinnar hf. is granted an operating license as a central securities depository

On 26 October 2017, FME reported on its website that the Ministry of Finance and Economic Affairs had granted an operating license to Undirbúningsfélag Verðbréfamiðstöðvarinnar hf. as a central securities depository pursuant to Act No 131/1997 on Electronic Registration of Rights of Title to Securities.

#### FME deems Kvika banki hf. and VIS Insurance hf. eligible to own a qualifying holding in Alda Asset Management hf.

On 3 November 2017, FME announced on its website that on 15 October the Authority had concluded that Kvika banki hf. was eligible to hold a 100% qualifying holding in Alda Asset Management hf., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.

#### FME's new list of tariffs

On 6 November 2017, FME announced the entry into force of its new list of tariffs No 924/2017. The list of tariffs had been published in the electronic issue of the Official Journal of Iceland on 3 November 2017. FME's older list of tariffs No 161/2017 was repealed at the same time.

#### FME deems Kvika banki hf. and VIS Insurance hf. eligible to own a qualifying holding in KORTA PAY.

On 8 November 2017, FME reported that on 1 November the Authority had concluded that Kvika banki hf. and VIS Insurance hf. were eligible to own a qualifying holding in KORTA PAY, pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings, cf. Act No 120/2011 on Payment Services.

#### FME has concluded the Supervisory Review and Evaluation Process at Arion Bank hf., Íslandsbanki hf. and Landsbankinn hf.

On 8 November 2017, FME announced the conclusion of the Supervisory Review and Evaluation Process at Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf. on its website. The report noted, among other things, that in March and April of 2017 Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf. had submitted ICAAP/ILAAP reports to FME based on their 2016 annual accounts. FME sent the banks draft conclusions for SREP in June 2017 where the banks had an opportunity to raise objections, pursuant to Chapter IV of Act No 37/1993 on Administrative Procedures. The objections of the banks were received in August and September of 2017. At this time FME had concluded the three banks' SREP and had reported the conclusions to them in September and October of 2017.

The main conclusion of the process was to stipulate a capital base of more than 8% of the three banks' risk-weighted asset base. The decision would form the basis for a new minimum capital requirement for the banks concerned in addition to them being required to satisfy their combined buffer requirement. FME also directed a number of comments and suggestions to the banks and required appropriate improvements for any comments made.

The news update concluded: “FME does not publish information on the Authority's minimum capital requirement but encourages the banks to disclose the requirement publicly in conjunction with their regular reporting of financial information.”

**The merger of Kvika banki hf. and Virðing hf.** On 13 November 2017, FME reported that it had authorised the merger of Kvika banki hf. and Virðing hf. on 10 November pursuant to Article 106(1) of Act No 161/2002 on Financial Undertakings.

#### Is FME growing too large?

On 16 November 2017, FME published a news update on its website commenting on discussions concerning increased supervisory costs in the annual publication of the Icelandic Financial Services Association (SFF) and the subsequent reporting of the newspaper Fréttablaðið. The news update pointed out and maintained that the comparison of SFF was both incorrect and misleading.

#### FME publishes operating budgets for 2014–2018

On 17 November 2017, FME noted in a news update that the Authority had made its operating budgets for

2014 through 2018 available on its website. The report noted that FME's operating budgets had been published on the website of Althing until 2014 in connection with amendments to Act No. 99/1999 on Payment of Cost due to Official Supervision of Financial Activities. Their publication on the website of Althing was discontinued with a new process implemented by the Ministry of Finance and Economic Affairs for preparing the general budget. FME will, therefore, publish its operating budget as from 2014 and until next year on the Authority's website.

#### Discussion document on updated guidelines and methodologies for the Supervisory Review and Evaluation Process for Financial Undertakings

On 20 November 2017, FME reported that the Authority had issued and published a discussion document containing updated guidelines and methodologies for the Supervisory Review and Evaluation Process for Financial Undertakings (SREP).

#### Information from FATF on high-risk jurisdictions

On 22 November 2017, FME published a news update on its website noting a public statement that the Financial Action Task Force (FATF) adopted after its meeting on 3 November. The report included: "The public statement notes that jurisdictions subject to FATF should apply special counter-measures against the Democratic People's Republic of Korea due to the on-going risk to the international financial system emanating from the DPRK's lack of action against money laundering and terrorist financing. It continues that the States should advise financial institutions to enforce extended due diligence concerning individuals and legal entities from Iran due to the risk of money laundering and terrorist financing."

#### New arrangements for imposing daily penalties concerning periodic reporting

On 22 November 2017, FME reported a change entering into force on 1 January 2018 on the Authority's arrangement for imposing daily penalties on regulated entities concerning periodic reporting. From that time on the amount would take the size and financial strength of the entity in question into account and amount to ISK 25,000–1,000,000 per day.

#### Prior notification of a life insurance portfolio transfer

On 28 November 2017, FME announced in a news update the proposed transfer of a life insurance portfolio from Reliance Mutual Insurance Society Limited to LCCG New Lifeco Limited.

#### FME issues new technical standard rules and rules for the calculation of leverage ratios for financial undertakings

On 29 November 2017, FME reported that the Authority had issued seven new rules for the calculation of leverage ratios for financial undertakings and technical standards concerning market risk, the use of internal models, the mapping of credit assessments for calculating capital requirements for credit risk, transferred credit risk from securitisation, financial undertaking reporting (amendment rules), and reporting rules for financial undertakings (amendment rules).

#### Notifications of infringements in the financial market

On 8 December 2017, FME reported that the Authority had launched a website where to submit notifications of infringements, suspected infringements, and attempted infringements of law and regulatory acts governing entities subject to official supervision of financial activities. This was done in compliance with Article 13(a) of Act No 87/1998 on Official Supervision of Financial Activities.

#### The endorsement of reforms to the Basel III framework

On 8 December 2017, FME reported that the Basel Committee's oversight body, the Group of Central Bank Governors and Heads of Supervision (GHOS), had endorsed the regulatory reform of the global Basel III framework adopted on 7 December last year. Work began on the reforms following the onset of the financial crisis in 2008. The endorsement of the reform was considered an important milestone in promoting financial stability, increasing transparency, and to strengthening and increasing public confidence in the international banking system. The report noted that the reform, entering into force from 2022 to 2027, would mainly affect the activities of larger international banks and would therefore only have a limited effect on Icelandic banks. The report continued that the proposed regulatory changes would neither enter into force nor have any effect in Iceland until they were adopted on the European level and that amendments might be made.

#### Presentation of marketing material and disclosure to clients

On 11 December 2017, FME reported that the Authority had sent circulars to UCITS management companies specifying legal and regulatory requirements concerning the presentation of marketing material and disclosure to clients. The purpose of the circular was to emphasise the importance of management companies taking the applicable regulations and legal provisions into account while preparing marketing material and disclosing information to their clients.

### Real-world reporting with TRS II

On 20 December 2017, FME reported that real-world reporting would be tested for TRS II until the end of the year. Reporting entities were encouraged to test submitting data through the real-world environment before the end of the year. The real-world environment was to be shut down at the end of the testing period on 2 January 2018 and the test data would be cleared.

### ESMA's statement concerning CFDs and binary options offered to retail investors

On 21 December 2017, FME announced on its website that ESMA had issued a statement on preparatory work in relation to the marketing of contracts for difference (CFDs) and binary options offered to retail investors. ESMA had been reviewing the marketing of these financial instruments for a while and a few Member States had decided to restrict them. Irrespective of these restrictions, ESMA was of the opinion that investor safety was not sufficiently guaranteed and intended to apply Article 40 of MiFIR to remedy the situation.

More precisely, ESMA intended to examine options to: Prohibit the marketing, distribution, or sale of binary options to retail investors and restrict the marketing, distribution, or sale of CFDs.

### Recalculation of euro amounts in Act No 100/2016

On 28 December 2017, FME reported that the Authority had recalculated the euro amounts in Act No 100/2016 on Insurance Activities as stipulated in the Act. FME also published the recalculated euro amounts in the Act.

### Notification of an unchanged countercyclical capital buffer

On 5 January 2018, FME announced that the countercyclical buffer would remain unchanged in accordance with recommendations from the Financial Stability Council dated 22 December 2017.

### FME's new organisation chart

On 12 January 2018, it was reported on the Authority's website that the Board had adopted a new organisation chart earlier that week. The aim of the changes is, among other things, to clarify lines of responsibility at FME and improve visibility of the organisation for entities engaged in communications with the Authority. Furthermore, the new organisation chart is better aligned with FME's policy and with the European System of Financial Supervisors that FME is part of than the older organisation chart.

### Consultation for ESMA's planned intervention concerning CFDs and binary options offered to retail investors

In a report on 18 January, FME announced consultations for ESMA's planned intervention concerning CFDs and binary options offered to retail investors. FME referenced its report from 21 December concerning ESMA's

statement regarding the marketing of CFDs and binary options offered to retail investors. The report noted that ESMA had published a call for evidence where parties could submit comments to a consultation paper published on ESMA's website.

UCITS engaged in the sale, distribution, or marketing of the financial instruments in question, consumer groups, and investors were specifically encouraged to read the consultation paper.

### Updated Guidelines and Methodologies for the Supervisory Review and Evaluation Process for Financial Undertakings

On 29 January 2018, FME announced on its website that the Authority had issued and published updated Guidelines and Methodologies for the Supervisory Review and Evaluation Process for Financial Undertakings (SREP). The Guidelines are based on Discussion Document No 16/2017.

### First meeting of the Financial Stability Council in 2018

At the end of January, FME reported on its website that the second meeting of the Financial Stability Council had been held on 18 June at the Ministry of Finance and Economic Affairs.

The report stated among other things: "The overall risk to the financial system is fairly low. There is tension in the real estate market, real estate prices have reached an all-time high, and there is a growing disequilibrium from the underlying economic factors.

However, evidence shows that the price increases in the real estate market are slowing."

### Public warning on virtual currencies

On 31 January 2018, FME issued a public warning on the great risk inherent in virtual currency trading. The price volatility for virtual currencies such as Bitcoin had been extreme in the past year with massive declines following the massive increases. The warning stated, among other things: "Virtual currencies, in particular Bitcoin, follow the rules of speculative investments and are extremely risky. Those who purchase virtual currency risk losing large portions of their investments."

### FME deems RedRiverRoad ehf. eligible to own a qualifying holding in Icelandic Investors Ltd.

On 2 February 2018, FME reported that the Authority had concluded that RedRiverRoad ehf. was eligible to own a qualifying holding up to 50% in the UCITS Icelandic Investors Ltd., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.

**FME grants Inkasso ehf. a collection license**

On 5 February 2018, FME reported that on 1 January the Authority had granted Inkasso ehf. a collection license pursuant to Act No 95/2008 on Debt Collection.

**Memorandum on financial stability in the Nordic and Baltic countries**

On 9 February 2018, FME announced on its website that a joint memorandum of understanding had been signed by the appropriate Nordic and Baltic ministries, central banks, financial supervisory authorities, and resolution authorities on collaboration between the countries and harmonisation for financial stability.

**FinTech – The future of financial services and supervision**

On 9 February 2018, FME held a popular breakfast meeting at Hilton Nordica in Reykjavik entitled FinTech – The Future of Financial Services and Supervision. The meeting addressed, among other things, the development and future of financial services, forthcoming amendments to the regulatory framework for the financial market and the interaction between supervision and FinTech. The speakers were Jón Þór Sturluson, Deputy Director General of FME, who spoke about FME's vision for FinTech, Friðrik Þór Snorrason, CEO of Reiknistofa bankanna (RB) who addressed new laws on payment services, "open banking", and payment service provider security and Fríða Jónsdóttir, consultant with Deloitte London, who presented a lecture entitled: FinTech and Market Collaboration – Nordic and British Experience. After the lectures, Helena Pálsdóttir, risk analysis specialist with FME, organised a panel discussion that included Katrín Júlíusdóttir, Managing Director of SFF, and the speakers.

**European Surveillance Authorities' warning on virtual currencies**

On 12 February 2018, FME's website noted that the ESAs, (i.e. EBA, EIOPA, and ESMA) had jointly issued a warning due to the risk inherent in virtual currency transactions. The warning of the ESAs was included in its entirety.

**Presentation of EBA's Guidelines on Internet Payments**

On 19 February 2018, FME noted that the Authority had sent a circular to payment service providers introducing EBA's Guidelines on the Security of Internet Payments. The circular emphasised, among other things, that EBA had issued a number of guidelines concerning the activities of financial undertakings and other payment service providers, including the Guidelines on the Security of Internet Payments published on FME's website.

**Presentation of EBA's Guidelines on Information and Communication Technology (ICT) Risk Assessment**

On 21 February, FME noted in a news update that at 10 PM on 6 March the Authority would host a presentation to introduce EBA's Guidelines on ICT Risk Assessment.

**EIOPA publishes data on the activities of insurance companies in the EEA**

On 23 February, FME reported on its website that EIOPA had collected data from the supervisory authorities of the EEA States since the Solvency II Directive (2009/138/EU transposed in Iceland by Act No 100/2016) entered into force. A portion of the data had been published on EIOPA's website in quarterly summaries for individual states since the third quarter of 2016. When Act No 24/2017 on the European System of Financial Supervision entered into force FME was authorised to submit data on the Icelandic insurance market to EIOPA.

EIOPA's recent publication for the second quarter of 2017, referenced on the page, contained, for the first time, information on the Icelandic insurance market. The data could be used to compare the Icelandic insurance market to other markets in the EEA.

**Prior notification of an insurance portfolio transfer**

On 27 February, the proposed transfer of an insurance portfolio from AXA Belgium SA to Portman Insurance SE was announced in a news update on FME's website.

**Three directors engaged for new supervisory units**

On 1 March 2018, FME reported on its website that three directors had been engaged for new FME supervisory units, after calls for applications were published on 13 January. Björk Sigurgísladóttir was engaged as Director of Compliance and Inspections, Finnur Sveinbjörnsson as Director of Banking, and Páll Friðriksson as Director of Market and Business Conduct.

**Self-assessment for boards**

On 5 March 2018, FME reported on its website that in the preceding year the Authority had required the boards of certain banks, savings banks, insurance companies, pension funds, and the Housing Financing Fund to conduct a self-assessment of the composition of their boards to confirm that they had sufficient knowledge, competence, and experience to understand the activities of the regulated entities, including their principal risk factors. In order to facilitate the self-assessment of the boards, FME had prepared a form for the self-assessment based on a form from EBA. The above-mentioned forms are published on the Authority's website.

### Árni Reynisson ehf.

On 20 March 2018, FME's website noted that Árni Reynisson and Árni Reynisson ehf., which had an insurance intermediary operating license pursuant to Act No 32/2005 on Insurance Intermediation, had surrendered their operating license pursuant to Article 36 of that Act. Accordingly, FME removed the entities from the insurance brokers' register and published a notice to that effect in the Icelandic Legal Gazette.

### Insurance market consumers reminded of the importance of making informed judgements when changing life and/or sickness insurance

On 20 March 2018, FME published a reminder of the importance of making informed judgements when changing life and/or sickness insurance between insurance companies.

It stated among other things: "Even though such transfers may be beneficial, both to individual consumers and for market competition in general, FME exhorts the importance of consumers first reviewing their current insurance cover extensively and comparing that carefully to the cover they are considering buying. To that effect they should for instance review their aims by purchasing insurance, premiums on offer, insurance amounts, the insurance cover, and the general terms."

### The European Insurance and Occupational Pensions Authority (EIOPA) calls for interested parties from the pension and insurance markets who wish to join their stakeholder groups

On 23 March 2018, FME's website noted that EIOPA had called for interested parties from the pension and insurance markets who wished to join the Insurance and Reinsurance Stakeholder Group (IRSG) and Occupational Pensions Stakeholder Group (OPSG). The report specified where to download the application form on EIOPA's website.

### ESMA prohibits binary options and restricts CFDs to protect retail investors

On 27 March 2018, FME announced on its website that ESMA had agreed to prohibit the marketing, distribution, or sale of binary options to retail investors. ESMA had also restricted the marketing, distribution, or sale of CFDs. The announcement referred to FME's news update from 21 December and it was noted that as previously stated these measures had been prepared for some time.

### FME's Decision concerning the designation of a financial conglomerate due to the participating interest of VIS Insurance hf. (VIS) in Kvika banki hf.

On 28 March 2018, FME addressed the designation of a financial conglomerate due to the participating interest of VIS Insurance hf. (VIS) in Kvika banki hf.

(Kvika). It stated: "VIS acquired a participating interest in Kvika in 2017 and the bank is currently an associate of VIS. Articles 3 through 5 of Act No 61/2017 on Supplementary Supervision of Financial Conglomerates task FME with assessing whether to designate a financial conglomerate. FME is of the opinion that the designation of a financial conglomerate would not, in this case, provide supplementary information to FME in accordance with the aim of supplementary supervision and that the benefits of supplementary supervision would be insignificant from said designation. Based on the above considerations, FME has decided to exercise the option of Article 5(2) of the Act to decide that the group does not constitute a financial conglomerate within the meaning of the law."

### FME registers Iceland Tax Free ehf. as a money exchange service

On 4 March, FME announced it had registered Iceland Tax Free ehf. as a money exchange service on 27 March 2018, cf. Article 25(a) of Act No 64/2006 on Measures against Money Laundering and Terrorist Financing and Rules No 917/2009 on Currency Exchange Offices and Money and Value Transfer Services.

### Iceland Travel Assistance ehf. delisted as a money exchange service

On 5 April 2018, FME announced on its website that the Authority had delisted Iceland Travel Assistance ehf. as a money exchange service on the basis of Article 25(b)(2) of Act No 64/2006. The company was no longer eligible for registration as the Reykjavik District Court had ruled on opening insolvency proceedings for the company on 7 March this year.

### An international working group on measures against money laundering and terrorist financing publishes report based on the groups audit of the situation in Iceland

On 6 April 2018, FME announced that the Financial Action Task Force (FATF), an international working group on measures against money laundering and terrorist financing, had published a report based on the groups audit of the situation in Iceland. The major conclusions of the report were published on the website of the Ministry of Justice.

### Second meeting of the Financial Stability Council in 2018

FME announced the second meeting of the Financial Stability Council on its website on 16 April. The report stated among other things: "The Council meeting addressed risks in the financial system which are, still, within reasonable limits and there are indications for relaxing tension in the national economy. However, there are indications of increasing risk in the financial system."

Credit started growing over a year ago and is currently growing faster than nominal GDP. Increased risk-taking is apparent in the banking industry and other sectors.”

#### **The District Court rejects claims in the case of Eimskipafélagið v. FME**

On 23 April 2018, FME reported that the District Court had ruled in the case of Eimskipafélag Íslands hf. v. the Financial Supervisory Authority concerning the Authority’s decision from March 2017 to impose an administrative fine of ISK 50.000.000 on the company for infringements of Article 122(1) of Act No 108/2007, on Securities Transactions. All claims by the plaintiff were rejected, both for the annulment of the decision and also for lowering the financial penalty.

#### **FME grants Fossar Markets hf. an extended operating license**

On 25 April, FME reported on its website that on 24 April 2018 the Authority had granted Fossar Markets hf. an extended operating license on the basis of Act No 161/2002 on Financial Undertakings. The operating license for Fossar Markets hf. was extended to cover corporate consulting on the structure of own funds, strategy, and related matters as well as consulting and services concerning corporate mergers and acquisitions.

#### **Prior notification of a partial transfer of an insurance portfolio**

On 30 April, FME reported that the proposed partial transfer from AXA Insurance UK Plc to Riverstone Insurance UK Limited was in line with the British Prudential Regulation Authority’s announcement from 25 April 2018.

### 3.2 Summary of decisions and transparency notifications from 1 May 2017 to end of April 2018

- 4 May 2017: Conclusion of an examination of the risk management implementation and Board activities of Borgun hf.
- 10 May 2017: Conclusion of an examination of the risk management implementation and Board activities of Valitor hf.
- 7 July 2017: Amicable settlement for the infringement of Landsbankinn hf. of Article 86(1) of Act No 108/2007 on Securities Transactions
- 8 August 2017: Amicable settlement for the infringement of Borgun hf. of Article 57(a) of Act No 161/2002 on Financial Undertakings
- 8 September 2017: Conclusion of an examination of the marketing material of IS Funds hf.
- 8 September 2017: Conclusion of an examination of the marketing material of GAMMA hf.
- 8 September 2017: Amicable settlement for the infringement of Kvika banki hf. of Article 19(1) of Act No 161/2002, on Financial Undertakings and Article 14(4) of Act No 108/2007 on Securities Transactions
- 14 September 2017: Conclusion of an examination of the valuation of seized movable assets at Landsbankinn hf.
- 14 September 2017: Conclusion of an examination of the valuation of seized movable assets at Íslandsbanki hf.
- 14 September 2017: Conclusion of an examination of the valuation of seized movable assets at Arion Bank hf.
- 21 September 2017: Amicable settlement for the infringement of GAMMA Capital Management hf. of Article 59(1), cf. Articles 30 and 43 of Act No 128/2011
- 28 September 2017: Conclusion of an examination into the collection process concerning primary and secondary collection measures at Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf.
- 29 September 2017: Conclusion of an examination of HFF's lending for rental housing, cf. Chapter VIII of the Housing Act, No. 44/1998
- 4 October 2017: Administrative fine for the infringement of Klettur Capital ehf. of Article 3(1)(6) of Act No 161/2002, on Financial Undertakings
- 5 October 2017: Administrative fine and request for corrective actions resulting from bonus payments by Arctica Finance hf.
- 16 October 2017: Amicable settlement for the infringement of Adix ehf. of Article 40 of Act No 161/2002 on Financial Undertakings
- 19 October 2017: Conclusion of an examination of unsolicited claims created on-line at Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf.
- 17 November 2017: Conclusion of an examination of the valuation of seized movable assets at Lykill fjármögnun hf. (previously known as Lýsing hf.)
- 27 November 2017: Amicable settlement for the infringement Article 57(a) of Act No 161/2002 on Financial Undertakings
- 29 November 2017: Conclusion of an examination of whether changes in policy interest rates have affected the lending rates for three banks and two savings banks
- 1 December 2017: Conclusion of an examination into the compliance to specific statutory investment authorisations by an investment fund managed by Jupiter Capital Management hf.
- 1 December 2017: Conclusion of an examination into the compliance to specific statutory investment authorisations by two funds managed by GAMMA Capital Management hf.
- 1 December 2017: Conclusion of an examination into compliance to specific investment authorisations by a mutual fund managed by Landsbréf hf.
- 1 December 2017: Conclusion of an examination into compliance to specific statutory investment authorisations by two investment funds managed by Stefnir hf.

- 8 February 2018:** Conclusion of an examination of investments on behalf of the asset management clients of Kvikabanki hf. and Virðing hf.
- 22 February 2018:** Amicable settlement for the infringement of Article 87(1) of Act No 108/2007 on Securities Transactions
- 5 April 2018:** Conclusion of an examination of bonus payments Landsbréf hf. made to employees
- 5 April 2018:** Conclusion of an examination of bonus payments Landsbankinn hf. made to employees
- 06 April 2018:** Amicable settlement for the infringement of Origo hf. of Article 122(1) of Act No 108/2007 on Securities Transactions
- 10 April 2018:** Conclusion of an examination into the process of Frjálsi Pension Fund's investment in United Silicon hf.

## Summary of issues of **Fjármál** and articles from 1 May 2017 to end of April 2018

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### **Technology, the Internet, and Financial Services – Limitations on FinTech Players and the FME’s Role**

*Helena Pálsdóttir, risk analysis specialist*

### **Infrastructure Investment of Insurance Companies**

*Katrín Gunnarsdóttir, former risk analysis specialist with FME*

### **In Banking Crises the Question is Always: Where was the Financial Supervisory Authority?**

*Ragnar Hafliðason, reflections of former Deputy Director General of FME and Special Adviser to the Director General*

**Fjármál, Vol. 6, Iss. 3 (December 2017)**

### **Bonus Payments and Their Maximum Amounts**

*Andrés Þorleifsson and Gísli Örn Kjartansson, lawyers with Off-Site Supervision*

### **The Importance of Prioritising Network Security**

*Stella Thors, risk analysis specialist*

### **Richard H. Thaler and Behavioural Economics: Are Our Personal Finance Decisions Always Sound**

*Hallsteinn Arnarson, risk analysis specialist*

**Fjármál, Vol. 7, Iss. 1 (March 2018)**

### **Active Management of Equity Funds**

*Finnur Tryggvi Sigurjónsson and Úrsúla Ingvarsdóttir, specialists with On-Site Inspections*

### **Combined Risk Indicator for the Icelandic Financial System**

*Loftur Hreinsson, risk analysis specialist*

### **Public Disclosure of Information Concerning Insurance Activities**

*Jón Ævar Pálmason, risk analysis specialist*

### **When Will PSD2 Enter into Force in Iceland?**

*Hjálmar Stefán Brynjólfsson, lawyer with the Office of the Chief Legal Counsel*



## 4. Entities regulated by FME

## 4.1 Number of entities regulated by FME

| Categories of regulated entities at year-end                       | Note | 2013       | 2014       | 2015       | 2016       | 2017       |
|--|------|------------|------------|------------|------------|------------|
| <i>Subject to licence or operating under specific legislation:</i> |      |            |            |            |            |            |
| Commercial banks   |      | 4          | 4          | 4          | 4          | 4          |
| Savings banks  |      | 8          | 7          | 4          | 4          | 4          |
| Credit undertakings  |      | 6          | 6          | 5          | 5          | 5          |
| Housing Financing Fund (HFF)                                       |      | 1          | 1          | 1          | 1          | 1          |
| Deposit departments of co-operative societies                      |      | 1          | 1          | 1          | 1          | 1          |
| Securities dealers   |      | 10         | 9          | 10         | 10         | 9          |
| Securities brokers   |      | 2          | 2          | 1          | 0          | 0          |
| Fund management companies  | 1)   | 9          | 10         | 10         | 10         | 10         |
| Professional investment funds - legal entities                     |      | 7          | 9          | 14         | 22         | 20         |
| Stock exchanges  |      | 1          | 1          | 1          | 1          | 1          |
| Securities depositories  |      | 1          | 1          | 1          | 1          | 2          |
| Pension funds  | 2)   | 27         | 26         | 26         | 25         | 22         |
| Insurance companies  |      | 13         | 12         | 12         | 12         | 11         |
| Insurance brokers  |      | 11         | 9          | 9          | 9          | 9          |
| Entities with debt collection licenses                             |      | 5          | 6          | 8          | 8          | 7          |
| Payment institutions   |      | 1          | 1          | 1          | 1          | 1          |
| Money exchange services  |      |            | 1          | 1          | 1          | 1          |
| Guarantee funds  |      | 2          | 2          | 2          | 2          | 2          |
| Registered creditors   |      | 0          | 0          | 0          | 0          | 1          |
| <b>Total</b>   |      | <b>109</b> | <b>108</b> | <b>111</b> | <b>117</b> | <b>110</b> |
| <i>Other regulated entities:</i>                                   |      |            |            |            |            |            |
| UCITS (not legal entities)   | 3)   | 57         | 53         | 50         | 47         | 42         |
| Investment funds (not legal entities)                              | 3)   | 44         | 48         | 53         | 60         | 60         |
| Professional investment funds (not legal entities)                 | 3)   | 63         | 65         | 71         | 84         | 91         |
| Custodians of private pension savings                              | 4)   | 14         | 13         | 8          | 8          | 8          |
| Issuers of listed shares   |      | 18         | 17         | 20         | 21         | 20         |
| Issuers of listed bonds  |      | 57         | 60         | 60         | 57         | 65         |
| Agent of foreign payment institution                               |      | 1          | 1          | 1          | 1          | 2          |
| Holding companies  | 5)   | 12         | 10         | 11         | 9          | 6          |
| Financial undertakings in winding-up proceedings                   |      | 15         | 11         | 2          | 2          | 1          |
| <b>Total</b>   |      | <b>390</b> | <b>386</b> | <b>387</b> | <b>406</b> | <b>405</b> |

1) Furthermore, see the number of UCITS and investment funds and professional investment funds lower in the table.

2) Many pension funds have more than one division. By including the divisions, the number of pension funds would increase by approximately 50 for each year shown in the table.

3) Funds that are not legal entities but operated by fund management companies. Refer to the above table for the number of management companies. Several UCITS and investment funds have more than one division. The number of divisions is reflected in the figures in the table.

4) Commercial banks and savings banks. Excluding the two foreign custodians of pension savings, all included in the above totals.

5) Holding companies in the financial sector and insurance sector and mixed holding companies, see more details in the definition in Acts No 161/2002 and No 56/2010. These are active shareholders that hold more than 50% in the regulated entities. Active shareholders with stakes of 10-50% are not included in the table.

## 4.2 Activities by foreign parties in Iceland

The number of parties/companies authorised to provide services in Iceland based on rules which apply in the European Economic Area.

| Number at year-end   | 2014     | 2015     | 2016    | 2017    |
|--|----------|----------|---------|---------|
| Foreign banks (credit and financial institutions) without establishments | 254      | 263      | 274     | 337     |
| Foreign payment institutions without establishments                      | 193      | 266      | 299     | 343     |
| Foreign payment institutions with agents                                 | 2        | 2        | 2       | 2       |
| Foreign electronic money institutions without establishments             | 38       | 49       | 84      | 147     |
| Foreign electronic money undertakings with distributors                  | 1        | 1        | 1       | 1       |
| UCITS (no. of divisions in parentheses)                                  | 65 (410) | 70 (518) | 75(596) | 93(807) |
| Securities dealers/brokers (Investment firms)                            | 2280     | 2461     | 2512    | 2566    |
| Insurance companies with establishments                                  | 2        | 2        | 2       | 2       |
| Insurance companies without establishments                               | 352      | 389      | 408     | 411     |
| Insurance brokers and insurance agents                                   | 5223     | 5055     | 5008    | 5960    |
| Credit intermediary  |          |          |         | 9       |



FJÁRMÁLAEFTIRLITIÐ

THE FINANCIAL SUPERVISORY AUTHORITY, ICELAND