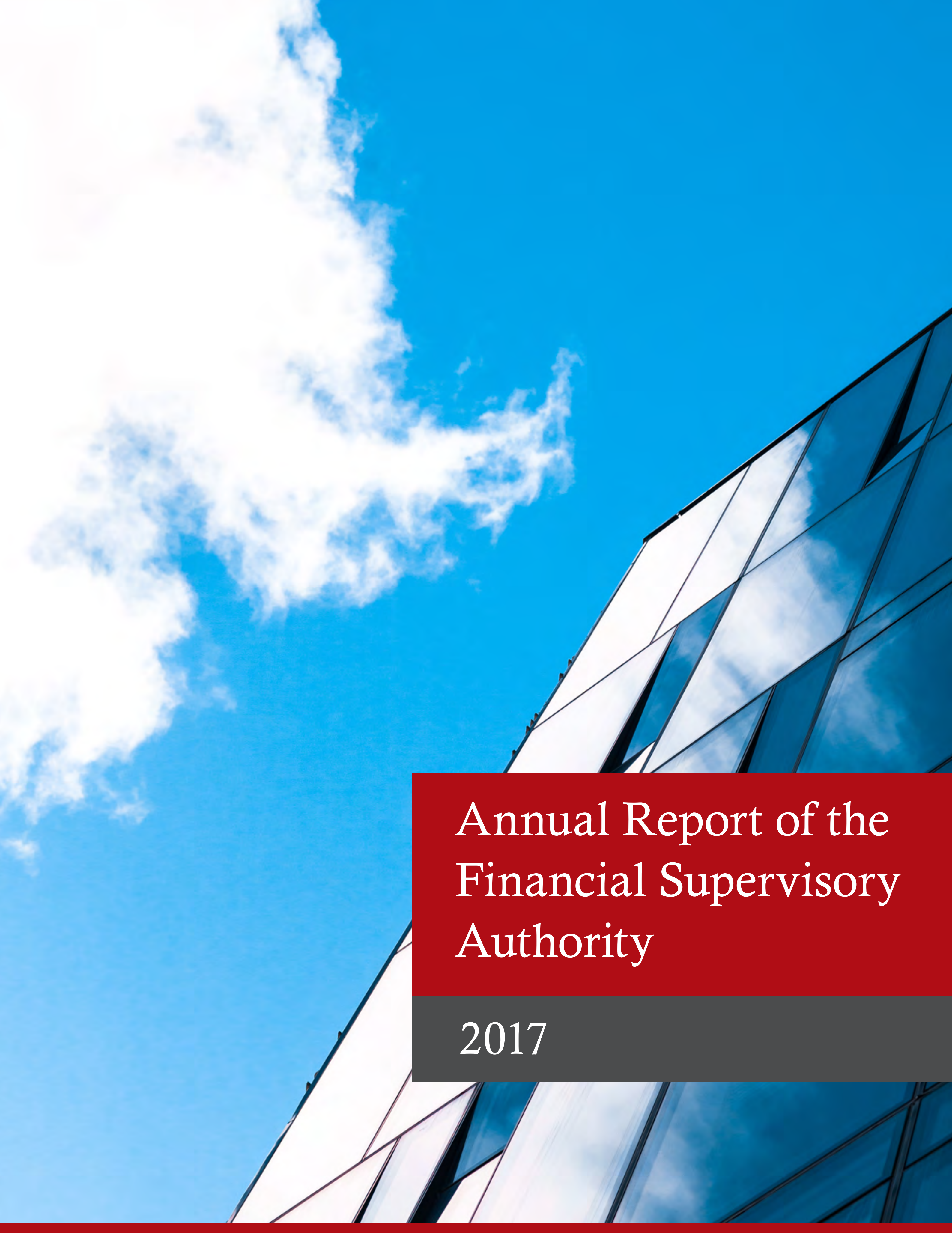

Annual Report of the Financial Supervisory Authority

2017

FJÁRMÁLAEFTIRLITIÐ
THE FINANCIAL SUPERVISORY AUTHORITY, ICELAND

Annual Report – Financial Supervisory Authority 2017

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Contents of the Annual Report

The 2017 Annual Report of the Financial Supervisory Authority (FME) primarily addresses the period between 1 May 2016 and 30 April 2017. The report describes the main tasks of FME. Furthermore, it discusses the 2016 situation and developments on the credit market, securities market, pensions and funds market, and insurance market. The report will be published on FME's website in Icelandic and English. The website also contains various information on the financial market and the arrangement of official supervision of financial activities.

FME's Board of Directors and Management

A three-person Board of Directors is ultimately responsible for FME's administration. Its role is to define the priorities in FME's work and to monitor its activities and operations. All major decisions are to 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 2017, the Board comprises 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, solicitor, Ástríður Jóhannesdóttir, Manager, and Harpa Jónsdóttir, Director at the Central Bank of Iceland.

FME Board of Directors

Director General
Unnur Gunnarsdóttir

Deputy Director General
Jón Þór Sturluson

Chief Legal Officer
Anna Mjöll Karlsdóttir

Off-Site Supervision
Halldóra Elín Ólafsdóttir,
Director

Rúnar Guðmundsson,
Deputy Director

Oversight
Sigurður Freyr Jónatansson,
Acting Director

On-Site Inspections and Securities
Sigurveig Guðmundsdóttir,
Director

Support Functions
Ingibjörg Sigrún Stefánsdóttir,
Director of Administration

Árni Ragnar Stefánsson,
Human Resources Director

Bjarni Þór Gíslason,
Chief IT Officer

From the Director General

The recent national discourse arising when almost a third of Arion Bank changed hands, was unusually intense. It is a clear concern of the Icelandic people to prevent the recurrence of the prevailing governance leading up to the 2008 financial crises. Foreign investment funds purchased the shares from Kaupthing and now FME is tasked with assessing their eligibility to acquire a qualified holding. The estates of Kaupthing and Glitnir were considered ineligible to own qualified holdings and yet they maintained the largest share of the banks in accordance with a settlement agreement between the authorities and creditors. That case was settled based on the applicable law by forming holding companies responsible for keeping the governance at an arms-length from their owners.

Even though it has been a year and a half since the conclusion of the composition agreements, where the estates committed to paying a stability contribution to the Treasury, the conditions still apply to the participation of Kaupthing and Arion Bank's new owners in the bank's management. It is urgent to unwind this arrangement so that the only owners of qualified holdings in the bank are persons considered fit and proper by law and at the assessment of FME. A part of that is assessing the eligibility of Kaupthing and seeing through the direct and indirect ownership interest of the investment funds that recently purchased direct ownership in Arion Bank.

The Treasury received Íslandsbanki as payment for Glitnir's stability contribution. The State is considered to be a fit and proper owner of a qualifying interest in a bank and the conditions regarding the independence of owners in the activities of the bank therefore no longer apply. At this time, almost two-thirds of all credit institutions are directly or indirectly owned by the State. The authorities, therefore, face a considerable task in defining a policy on the future arrangement of these activities and the sale to fit and proper owners.

The banking sector cannot be considered large as of now. The percentage of the total assets of banks and other credit institutions has been decreasing for the last few years and amounted to 175% of gross domestic product at year-end 2016. The pension system on the other hand is considered large compared to other countries. The total assets of the pension funds, i.e. both mutual and private pensions, at year-end 2016 amounted to almost 152% of the gross domestic product.

There were significant changes made to the legal framework for financial services in the past year. New comprehensive legislation on insurance activities was adopted with enhanced requirements regarding the solvency and risk management of insurance companies and establishing the so-called prudent person principle concerning investments.

The investment provisions of the act on mandatory insurance of pension rights were also amended with the enactment of the prudent person principle and the enhanced requirements. Legislation was adopted eliminating guarantees by national and local authorities on pension payments for some of their employees and the employers' premium in the open labour market increased from 8% to 11.5%. The act on financial undertakings was amended making enhanced requirements on the quality of the bank's capital and laying down detailed provisions on FME's supervisory review and evaluation process. The new act on consumer mortgages implemented new macroprudential tools by giving FME the authority to regulate loan-to-value ratios and consumer debt-to-income ratios. Such rules have not been decided as of now but they will be based on the analysis and collaboration of FME and CBI with the input of the Financial Stability Council.

A bill has been submitted to the spring session of Althing concerning a European system of financial supervision. The bill recommends adopting the legislative acts establishing the three European supervisory authorities and The European Systemic Risk Board and giving the EFTA Surveillance Authority supranational powers over specific decisions on the Icelandic financial market. This solution is based on the two-pillar structure of the EEA Agreement. If the bill becomes law, data from Icelandic companies participating in the financial market will be submitted to the ESAs in a uniform format. This will call for increased collaboration between FME and European counterparts.

FME's participation in a cooperation agreement between Nordic supervisory authorities and ECB concerning the supervision of important branches forms a part of the Authority's preparation for increased international competition in the financial market.

Our neighbours in the United Kingdom had a momentous change of course when they voted to leave the EU in a referendum. Financial services are one of their most important industries and companies with operating licenses from the British authorities lose the entitlement to establish branches in EU/EEA countries or offer cross-border services. Authorities in Europe are therefore generally concerned that British companies will seek operating licenses that are likely to be used as a shell for outsourcing their actual activities to the United Kingdom.

At the same time as Icelandic and European legislators are working diligently on developing and improving the playing field of the financial market others have been working on developing and implementing various new electronic financial services. These new services are generally called fintech which is short for financial technology. Fintech gives rise to new challenges for supervisors that are tasked with ensuring legal compliance concerning the provision of financial services and that customers do not bear excessive risk. FME has therefore been working on an action plan to respond to these developments. The objective is for FME to offer organised guidance to any parties planning to offer fintech solutions.

Suggestions about restructuring the bodies that can regulate the financial market are broached from time to time, especially with regard to FME and CBI.

Most recently a delegation from the International Monetary Fund made comments on the topic. The criticism from the delegation must be viewed in light of the unusual supervisory arrangements of regulating the liquidity of financial undertakings in Iceland. The supervision of the banks' liquidity is divided between institutions. Admittedly this may not be completely suitable. However, the general suggestions of the Fund do not fit the size of Icelandic society. Furthermore, few nations have adopted such separation of functions as suggested by the Fund and there is therefore little experience with such a system. FME considers it useful to analyse in-depth the advantages and drawbacks of the current organisational infrastructure and other potential solutions. The principal aim must be to utilise the greatest strengths and create efficiency and synergies.

In October 2016, FME published its strategic priorities for a four-year period for the first time. The document contains the Authority's nine greatest priorities with the primary objective of maintaining a healthy financial market and that the market is deserving of trust. Consumer affairs and commercial practices are notable as increased priorities. As part of that is the monitoring of undesirable incentives in the activities of regulated entities and that these entities ensure they are not exploited for illegal transactions such as money-laundering. FME has also reached important milestones in the development of a risk-measurement system and for the supervisory architecture. The Authority has achieved this by building up a knowledge society favouring daring, professionalism, and team assertiveness.

FME's Board of Directors and Management

In the bottom row, seated from left to right: Guðrún Þorleifsdóttir Deputy Chairperson, Ásta Þórarinsdóttir Chairman of the Board, Arnór Sighvatsson Director, and Ástríður Jóhannesdóttir who is an alternate member of FME's Board of Directors. Standing behind them: Jón Þór Sturluson, Deputy Director General, Unnur Gunnarsdóttir, Director General, and Anna Mjöll Karlsdóttir, Chief Legal Counsel. The photo is missing Friðrik Ársælsson and Harpa Jónsdóttir, alternate board members.

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. The Central Bank of Iceland (CBI) shall nominate one member of the Board. 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 2012 rules on the activities of the 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.

Bjarni Þór Gíslason,
Chief IT Officer

‘A few of my friends bought beginner sets and introduced me to Disc Golf three years ago. I invested in my own set a few months later and continued playing with them.
Disc Golf is a fun hobby that connects competition and concentration to the outdoors and walks in beautiful parks or nature. The sport is easy to learn but there are many things to consider if you want to become a real pro, such as the distinct characteristics of the discs, various throwing techniques, the impact of the wind, and other aspects. I enjoy the constant improvement. I also enjoy finding new courses abroad when I travel and I have already tried courses in Helsinki, Copenhagen, and Prague.’

1. FME Activities

1.1 Supervisory activities

Supervision of financial undertakings

When the reporting scheme for financial undertakings was changed with the implementation of a new reporting language (XBRL), which the ESAs have implemented, the undertakings were required to also submit reports in the older format until mid-year 2016 to ensure conformity. The reporting from the financial undertakings has been in the new reporting language since that time. These changes have resulted in fewer reports being submitted to FME, reports specific to Iceland are no longer used, and reporting has been simplified. Work is continuing, in collaboration with the financial undertakings, on improving the reliability of the submitted data.

Conversations with management and the financial undertakings' supervisory units are increasingly important due to the implementation of risk-based supervision. Members of the board of directors, and internal auditors have been interviewed.

FME also meets biannually with the external auditors for larger financial undertakings.

The annual Supervisory Review and Evaluation Process (SREP) was undertaken as usual in a continuous process for the three large commercial banks and the conclusions were presented to the banks' boards at year-end 2016. As part of the SREP, FME assesses risk factors inherent in banking activities and how the banks treat those risk factors. The process further involves FME assessing and deciding the amount and composition of the necessary additional own funds due to the risks the bank in question faces, or could face, as well as the minimum capital requirement.

SREP includes a review of the banks' own assessment of capital adequacy due to risk endured from their activities (the bank's ICAAP). 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. Various examinations were conducted in connection with SREP, using specific data enquiries, to assess the banks' risk factors. In addition to the assessment of the commercial banks, the four savings banks went through a simplified supervisory review and evaluation process and their capital requirements were reassessed. A few applications have been processed concerning increased authorisation for covered bonds issues.

For the first time, FME called for recovery plans from systemically important commercial banks. It is expected that provisions to this effect will be transposed into Icelandic legislation in 2017 in line with Directive 2014/59/EU of the European Parliament and of the Council concerning the recovery and resolution of financial undertakings (Bank Recovery and Resolution Directive) that entered into force in the European Union at the beginning of the year 2015.

An examination on Housing Financing Fund's lending to legal entities was conducted in 2016 as HFF is considered a systemically important entity.

At the beginning of the year 2017, a few management companies of UCITS advertised quotes from 2016 for funds they manage. Thereafter, an ad-hoc examination was conducted of advertising material and the management companies' presentation of information as well as whether the material complied with Article 28 of Regulation No 995/2007 on investor protection and the business conduct of financial undertakings. FME called for the management companies' views regarding the compliance of advertising to the provision of the regulation concerned.

Supervision of insurance companies and pension funds

The Solvency II Directive was transposed into Icelandic law in 2016. New legislation has resulted in several tasks, e.g. changes to insurance companies' reporting and an increased emphasis on the supervision of the compliance with the prudent person principle in investments. FME has as of now completely adopted the reporting language (XBRL) the ESAs adopted and reports specific to Iceland are no longer used for insurance companies. FME has also implemented risk-based supervision of insurance companies, which entails, among other things, conducting an efficient and regular assessment of the risk factors in their activities. FME has assessed individual risk factors in the activities of insurance companies such as governance, operational risk, insurance risk, and market risk.

In connection with the above-mentioned risk assessments, FME has for instance reviewed the Own Risk and Solvency Assessment (ORSA) for the insurance companies, inspected the composition and functioning of management, examined whether the key functions of the insurance companies (i.e. risk management, compliance, internal audit, and actuarial functions) are in accordance with the requirements of Solvency II, inspected the process for the securities trading of board members and employees of the insurance companies, reviewed the risks facing insurance companies from their foreign activities, and examined whether the companies' investment processes are in compliance with the above-mentioned prudent person principle.

In 2016, Althing adopted a change in the investment authorisations of pension funds that will enter into force on 1 July 2017. As a result of the legislative changes, FME began work on mapping the effects of the changes on the supervision of pension funds. The changes require, among other things, updated reporting to the Authority and an increased emphasis on the supervision of the pension funds' risk management and FME has conducted work on the architecture of the supervision concerned. FME has furthermore assessed individual risk factors in the pension funds' activities such as governance, market risk, credit risk, and operational risk. In connection with the above-mentioned risk assessments, FME has, for instance, inspected the composition and functioning of management, reviewed the investment strategies of pension funds and examined the functioning of their investment processes, and the Authority has also examined the monitoring of the securities trading of board members and employees of the pension funds. With respect to the implementation of risk-based supervision, FME held an information meeting for the pension funds introducing the risk-based supervision, what it entails, what aspects FME considers for the decision of regulated entities' impact assessment, and what the assessment of the major risk factors in the pension funds' activities entails.

FME has increased its communication with external auditors of the insurance companies and pension funds and has held meetings with these parties, both at the beginning and at the end of the audit. FME has furthermore met with internal auditors, directors of risk management, managing directors, and board members of the insurance companies and pension funds.

On-site inspections

The aim of on-site inspections is to review whether the activities of regulated entities comply with applicable law, regulations and rules. FME's policy concerning risk-based supervision was instrumental to the prioritisation of the on-site inspections the Authority completed in 2016. Most of FME's on-site inspections were naturally conducted at the three commercial banks that are considered systemically important financial undertakings.

One of FME's largest projects is the supervisory review and evaluation process of financial undertakings. A few on-site inspections were conducted during the year as part of the supervisory review and evaluation process of the large commercial banks. FME specifically inspected the banks' monitoring process for lending, mostly through interviews with employees of risk management.

Another inspection concerned the banks' contingency plan for liquidity risk related to the lifting of the capital controls. The project was conducted in collaboration with CBI with an emphasis on the framework for liquidity management and the effectiveness of the banks' contingency plans for said liquidity risk. The object of the inspection was to review the banks' responses to liquidity and funding risk and ensuring that the banks had a documented process for working in case of emergency with illiquidity. In addition, the inspection reviewed whether the banks' contingency plans complied with requirements for such plans. Under the arrangement, FME and CBI presented a prepared scenario describing certain circumstances. The scenario was sent to the banks at the beginning of the working day and the banks had to respond to the situation presented in the scenario within the day. Representatives from FME and CBI attended the meetings the banks held after receiving the scenario and where the banks' employees reviewed the situation presented in the scenario and what measures should be taken in response to the situation. Among other things, the inspection entailed reviewing whether the banks' responses were in accordance with their applicable contingency plans.

In the past year, FME concluded an examination into the loan portfolios of Sparisjóður Austurlands hf. (Austurland Savings Bank), Sparisjóður Höfðhverfinga ses. (Höfðhverfingar Savings Bank), Sparisjóður Strandamanna ses. (Strandamenn Savings Bank). The examination focused on reviewing the savings banks' loan portfolio quality, in particular, whether the savings banks had enough collateral for their lending. In addition, the savings banks' rules on lending and loan monitoring were reviewed thoroughly.

FME has conducted on-site inspections in recent quarters concerning the separation of functions at the financial undertakings with the objective of reviewing whether that separation of functions complies with the Act on Securities Transactions and the Regulation on investor protection and the business conduct of financial undertakings. The examinations in question mostly focused on the separation of functions on the financial undertakings' premises, separation in management, and separation of data. Such an examination was concluded at the end of 2015 at Landsbankinn hf., last year at Arion Bank hf. and Íslandsbanki hf., and at the beginning of this year at Kvika banki hf.

Lending for share purchases and forward contracts were examined at the large commercial banks. The objective of those examinations was to review the enforcement and compliance to the internal rules and processes as well as the framework and monitoring of lending for share purchases and listed equity forward contracts. In addition, the scope and development of share-backed lending and lending for equity forward contracts were reviewed.

The large commercial banks' execution of stress testing was also reviewed. The examination focused on whether the banks' execution was in compliance with Article 17(2) of the Act on Financial Undertakings where it is stated that financial undertakings should conduct regular stress testing and document their assumptions and conclusions.

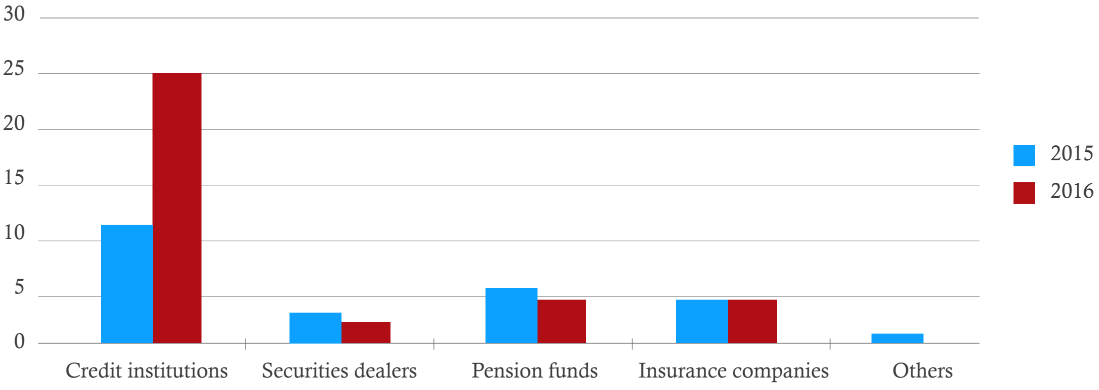
In the past year, an examination was completed concerning the audit of compliance for financial undertakings authorised to conduct securities transactions. The examination included a review of the independence of the compliance function, the expertise of the compliance officer and their deputy, the compliance officer's terms of reference and job security. The examination was conducted at GAMMA Capital Management hf., Kvika banki hf., and Virðing hf.

An examination was conducted on the basis of the Securities Transaction Act focusing on reviewing certain aspects of the activities of financial undertakings regarding the implementation, procedures, and monitoring of the company concerning the assessment of eligibility and compliance when offering investment advice. Particular attention was paid to the implementation of information acquisition for assessing the eligibility of the companies' customers concerning asset management and investment advice as well as the classification of financial instruments. The examinations were conducted at Arctica Finance hf., Arion Bank, and Kvika banki hf.

Last year, examinations were concluded into the asset-liability matching of pension funds, in particular with regard to the maturity of the assets and liabilities. The objective was to review the volatility in the funds' average maturity based on FME's stress-tests for the years 2012–2014 and obtain insight into how the pension funds monitor the average maturity of assets and liabilities. Such examinations were conducted and Stafir lífeyrissjóður (Stafir Pension Fund) and Stapi lífeyrissjóður (Stapi Pension Fund).

In 2015, examinations were concluded into the

Figure 1 The number of concluded on-site inspections in 2015 and 2016, by type



Source: Financial Supervisory Authority

risk management of five pension funds and those examinations continued last year with FME concluding examinations at the Almenni Pension Fund and the General Pension Fund. The examinations there involved the funds' implementation of risk-management and compliance with guidelines on risk management (monitoring mechanism) for mutual insurance divisions of pension funds.

FME publishes the conclusions of examinations on its website in accordance with the Authority's transparency policy. Independent transparency notifications for examinations that are part of the supervisory review and evaluation process are not published but those examinations are noted on the Authority's website.

A summary of FME's transparency notifications during the period covered by the annual report can be seen in Chapter 3.2. The summary shows, among other things, that examinations into measures against money laundering and terrorist financing were recently concluded at both Borgun hf. and Valitor hf.

Figure 1 shows the number of concluded examinations in 2016 by type of regulated entity. In comparison, it also shows the number of examinations concluded in 2015.

Eligibility assessment, qualifying holdings, and licensing

In 2016, FME received numerous notices of new board members and managing directors and assessed their eligibility. For comparison, there are between 600 and 700 board members for the regulated entities and each year between 100 and 200 new board members are generally assessed for eligibility.

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. There were substantial changes to the ownership structure of financial undertakings and insurance companies in the year and FME processed, among other things, a notification from BLM Investments and related entities on supplementing their qualifying holding in Lýsing hf., a notification from Solo Invest ehf. and Arnar Þorsteinsson on a qualifying holding in Akta sjóðir hf. (Akta Capital Management), a notification from Stálskip ehf. on a qualifying holding in Borgun hf., and a notification from Dittó ehf., Kristján Arason, and Karl Þorsteins on a qualifying holding in Centra Corporate Finance Ltd.

FME furthermore processed a notification from Birta Pension Fund on a qualifying holding in Virðing hf. as a qualifying holding had been established with the merger of the United Pension Fund and Stafir Pension Fund. In addition, FME processed a notification from Megind ehf. on supplementing its qualifying holding in Summa rekstrarfélag hf.

In the last two cases, FME did not receive the notification of qualifying holdings or supplemental qualifying holdings until after it had been assembled and the cases ended with an amicable agreement with the parties that entailed paying a financial penalty.

The ownership of Vörður tryggingar hf. and Vörður líftryggingar hf. was transferred. Arion Bank hf. was deemed eligible to own a 100% qualifying holding in those insurance companies at around mid-year 2016, the ownership of the companies had previously been held by the Faroese bank Bank Nordic. In addition, FME deemed Vörður tryggingar hf. eligible to own a qualifying holding in Okkar líftryggingar hf. The Authority also authorised the transfer of the portfolio of Vörður líftryggingar hf. to Okkar líftryggingar hf. at the beginning of 2017. Following the above, at the end of February 2017, FME authorised the merger of these two life insurance companies and they now operate under the name Vörður líftrygging hf.

In the middle of 2016, FME authorised the transfer of three professional investor funds, i.e. Burðarás HL1, Burðarás HS1, and Burðarás SK1 from ÍV sjóðir hf. (IV Funds) to Straumur sjóðir hf. (Straumur Funds), now called Akta Capital Management hf.

During the year, FME granted Íslandssjóðir hf. (IS Funds) an extended operating license to provide investment advice and at the beginning of 2017 Hákon Hákonarson was granted an operating license as an insurance broker.

A special examination was also conducted into the activities of Aktiva lausnir ehf. After a thorough examination, FME concluded that the company's activities had entailed facilitation of lending between customers, including the provision of payment services according to the Act on Payment Services.

In the latter half of the year, FME collaborated with the Financial Market Authority Liechtenstein concerning the latter's decision to revoke the operating license of Gable Insurance AG, which had sold insurance in Iceland through an Icelandic insurance broker, and later concerning the appointment of a Special Administrator for the company.

FME sought to fulfil its guidance duty to the insurance broker concerned as well as providing information and guidance to the Icelandic policyholders.

An examination was conducted into measures against money laundering and terrorist financing at Kvika banki hf. and the Authority published a transparency notification to that effect on its website in March 2017.

On 1 April 2017, FME listed Framtíðin lánasjóður hf. as a lender according to the act on consumer mortgages.

The analysis of individual risk factors and the assessment of systemic risk

One of FME's main tasks is assessing individual operational risk factors in the activities of regulated entities. The risk is graded on a scale of 1-4 and the grade forms the basis of the overall risk profile for the entity. Specialists in individual risk factors are involved in the risk assessment and it has now become a regular part of FME's activities. In 2016, FME worked on increasing and improving the analysis of the data regulated entities submit to the Authority as well as defining the risk indicators regularly monitored by the Authority based on the submitted data. A discussion follows of projects related to some of the risk factors in the period.

Business model

The analysis of a business model involved an assessment of factors that were considered to constitute a threat to the viability of the current business model and the sustainability of the business strategy. The business strategy was analysed and reviewed in terms of the risk appetite and the operational results of the preceding years. The operational and economic fundamentals were assessed to ascertain whether they were sufficiently clear and viable. Specifically examined aspects included the large commercial banks' plans for core operations and dividend payments in terms of liquidity and capital buffers.

Governance

One of the tasks is gathering data on the composition of the board. The acts on financial undertakings and insurance activities stipulate that the board be composed, as a whole, in such a way to have an acceptable overview of the companies' activities. FME considers it reasonable to take that criterion into account for all public-interest entities.

FME has requested that the boards of certain regulated entities conduct a self-assessment to give the board in question, and FME, a better view of the composition of the board as a whole and whether it is lacking in knowledge in any subjects that need to be improved, e.g. by seeking education or expert advice.

Market risk

In 2016, extensive work was conducted into developing the models FME applies to assess market and interest rate risk in the banking book (IRRBB) and into analysing the models the banks use for their assessments. This is only the beginning of a protracted process since significant changes are being contemplated for the European framework for market and fixed interest rate risks.

At the end of November 2016, the European Commission (EC) issued CRR II draft regulation, which contains among other things substantial changes to the treatment of market risk. The changes are in line with the amendments from the Basel Committee on Banking Supervision (BCBS), presented in the document[1] 'Minimum capital requirements for market risk', issued in January 2016. BCBS is assuming the supervisory authorities will have adopted the amendments before year-end 2018. EBA has submitted a draft technical standard[2] to the European Commission in support of the amendments to CRR II and several guidelines.

[1] http://www.bis.org/bcbs/publ/d352.pdf
[2] https://www.eba.europa.eu/documents/10180/1669525/Final+draft+RTS+on+the+IMA+assessment+methodology+%26+significant+shares+%28EBA-RTS-2016-07%29.pdf/f75ab291-838d-42fb-871e-3b2011728dfb

In addition, EBA has established a working group to update EBA's policy concerning the treatment of IRRBB as a result of BCBS IRBB new standards[3], due to enter into force before year-end 2017. This will result in the incorporation of new models, reporting in Iceland, and harmonisation in the treatment of IRBB in Europe.
Changes to Article 36 of Act No 129/1997, on Mandatory Guarantee of Pension Rights and Operation of Pension Funds, will take effect on 1 July 2017. Pension funds will have wider authority to invest as a result of the changes, based on the so-called prudent person principle which involves the pension funds having a judicious investment strategy and considering the risk from the investments rather than their form. This change affects how FME monitors the pension funds' market risk.

Credit, counterparty and concentration risk
Credit risk is the most important risk factor in banking activities and FME gathers detailed data on that risk factor. In 2018, a new financial reporting standard enters into force concerning the recognition and measurement of financial instruments (IFRS 9) and it will have a significant impact on the measurement of default amortisation.
FME is currently analysing the impact of this new standard. The above-mentioned CRR II Regulation replaces the Mark-to-Market standard method with the Counterparty Credit Risk Standard Approach (SA-CCR).
Finally, several pension funds have increased their lending which affects their risk profile.

Operational risk
In 2017, FME is focusing on information and communication technology (ICT) risk and reputational risk, which are risk factors that fall under operational risk, see Chapter 6.4.1 in the Guidelines on SREP. Examples of projects concerning the regulated entities' information technology are supervision of outsourcing, a review of contingency plans for network security threats, and an examination of processes related to anomaly notifications.
These examinations are based on the ICT Risk Assessment Guidelines from EBA and FME's Guidelines No 6/2014 on outsourcing by supervised entities. Also planned is the transposition of the NIS Directive from the EC concerning attacks against information systems and the Directive will provide an international platform for regulated entities combating network security threats. FME considers it essential to review how regulated entities respond to reputational risk and during its assessment the Authority will take into account Chapter 6.4.3, Assessment of Reputational Risk, in the Guidelines on SREP.
The operational risk of pension funds and insurance companies will also be in focus in addition to these tasks.

Pension risk
It is likely that new actuarial life tables will be published in the foreseeable future that reflect the increased life expectancy from the current reference, which will result in increased pension obligations. The pension funds will have to take countervailing measures due to the impending changes in life expectancy and raising the age for receiving benefits has been discussed in particular as a way to prevent impairing benefits. FME has monitored this development and the potential impact of such changes on the position of the pension funds.

Systemic risk
A special macroprudential team operates within FME on analysing systemic risk and preparing stress testing for the commercial banks. The macroprudential team also prepares the four annual meetings of the Systemic Risk Committee in collaboration with CBI. On 1 March 2016, a decision was taken on countercyclical buffers for financial undertakings, that entails a 1% increase in capital adequacy.

The decision is based on the Financial Stability Council's recommendation from January 2016 discussed in last year's annual report. The countercyclical buffer was levied 12 months after the decision was taken, i.e. on 1 March 2017. The countercyclical buffer was increased to 1.25% by FME's decision on 1 November 2016, in accordance with recommendations from the Financial Stability Council dated 30 September 2016, and the increase will enter into force on 1 November 2017. On 1 April 2017, Act No 118/2016 on Consumer Mortgages entered into force. The Act authorises FME, having received an opinion from the Financial Stability Council, to determine the maximum loan-to-value ratios for mortgages as well as determining the maximum overall amount of mortgages or the consumer's debt-to-income ratio. FME currently collects more extensive data on the regulated entities' lending than before as a result of the wider role, as these rules cannot be laid down without thorough pre-assessment.

[3] http://www.bis.org/bcbs/publ/d368.pdf

Securities Market Regulation

In 2016, 48 cases were investigated for violations of securities market legislation. In comparison, 44 cases were investigated in 2015. The examinations of half the cases resulted from comments made by Nasdaq Iceland while FME commenced examinations of the other cases on its own initiative or as a result of comments made by other entities. The cases can be categorised as follows:

- 30 cases involved disclosure which includes the publication of insider information (Article 122 of the Securities Transactions Act), flagging notifications (Chapter IX of the Securities Transactions Act), and the publication of annual accounts (Article 57 of the Securities Transactions Act)
- 2 cases involved the contents of prospectuses (Article 45 of the Securities Transactions Act)
- 8 cases involved possible market abuse (Articles 117 and 123 of the Securities Transactions Act)
- 1 case involved best execution in securities transactions (Article 18 of the Securities Transactions Act)
- 1 case involved the submission of lists of insiders (Article 128 of the Securities Transactions Act)
- 1 case involved the submission of information for central storage (Article 63 of the Securities Transactions Act)
- 3 cases involved the duty of insiders to give notification (Articles 125, 126, and 127 of the Securities Transactions Act)
- 2 cases – other

Most of the cases were concluded without any action, i.e. no infringement was found or it was not ascertained that infringement had occurred. The imposition of penalties is discussed specifically in Chapter 1.2.

In December 2016, FME met with the commercial banks concerning the impending implementation of the MiFID 2 Directive (2014/65/EU) and MiFIR Regulation (EU) (No 600/2014).

They concern investor protection in securities transactions, organisational requirements on investment firms and trading venues, transparency, reporting, and many other issues. The purpose of the meetings was to examine the status of the bank's preparatory work for the above-mentioned acts.

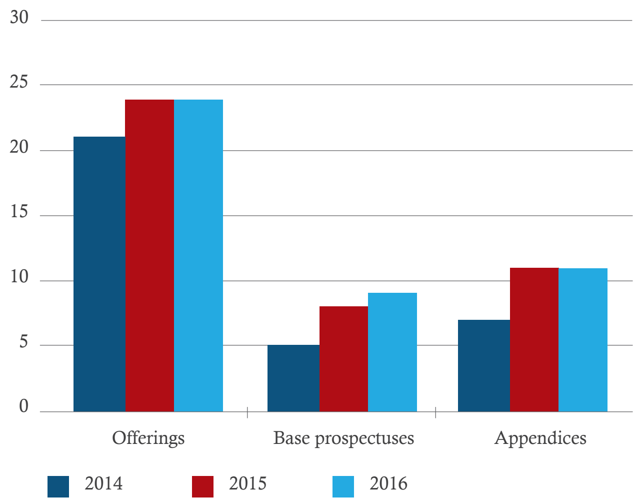
It is clearly necessary for financial undertakings, trading venues, and FME to prepare extensively for this. As an example, computer systems must be updated for the reporting from financial undertakings that will be required to submit more extensive information than before. FME has also been in communication with smaller financial undertakings for this reason.

Lately, FME has been examining how financial undertakings implement reporting on transactions they execute concerning financial instruments admitted to trading on a regulated securities market and the related derivatives (TRS Data). The project has special emphasis and has been under way for a while. The data is important for FME's supervision and it is essential to secure their good quality. Part of the project has been conducted in the form of on-site inspections.

FME has also conducted less extensive examinations concerning various aspects of the securities market. An example of note is the examination of whether certain financial undertakings have exercised their exemption from notification requirements concerning the trading book subject to the condition that the voting rights are not exercised to intervene in the management of the issuer. An examination into cyber security was also completed recently at the Nasdaq Nordic exchanges in collaboration with Nordic FSAs. These Authorities operate a specific supervisory college to harmonise the supervision of the Nasdaq Nordic exchanges. The college's key roles are to conduct ad-hoc examinations and assessing and supervising the principal risk factors in the operations of the exchanges.

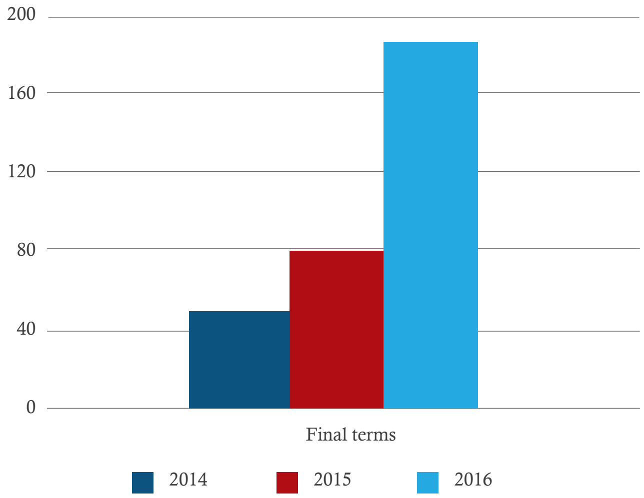
In 2016, a total of 24 offering circulars were confirmed, 1 equity offering and 23 bond offerings. There were 11 appendices and 9 base prospectuses confirmed in the year, see Figure 2. 187 final terms were also published on FME's website, see Figure 3. The substantial number of final terms reflects, among other things, the increased issuance of bills and covered bonds by the three commercial banks.

Figure 2 Number of offerings and appendices



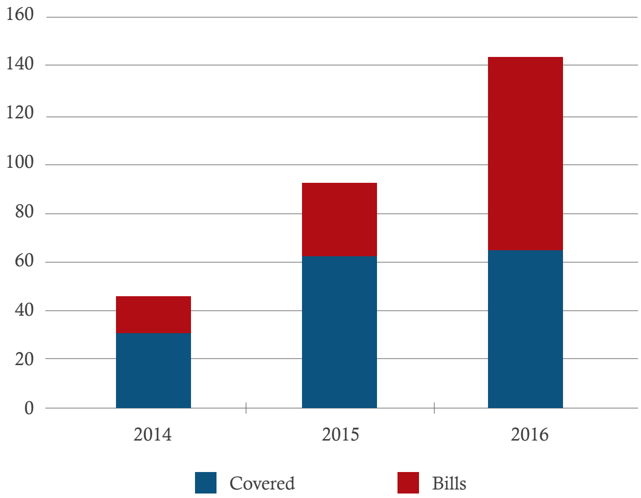
Source: Financial Supervisory Authority

Figure 3 Number of final terms



Source: Financial Supervisory Authority

Figure 4 The domestic security issues of the banks in billions of ISK



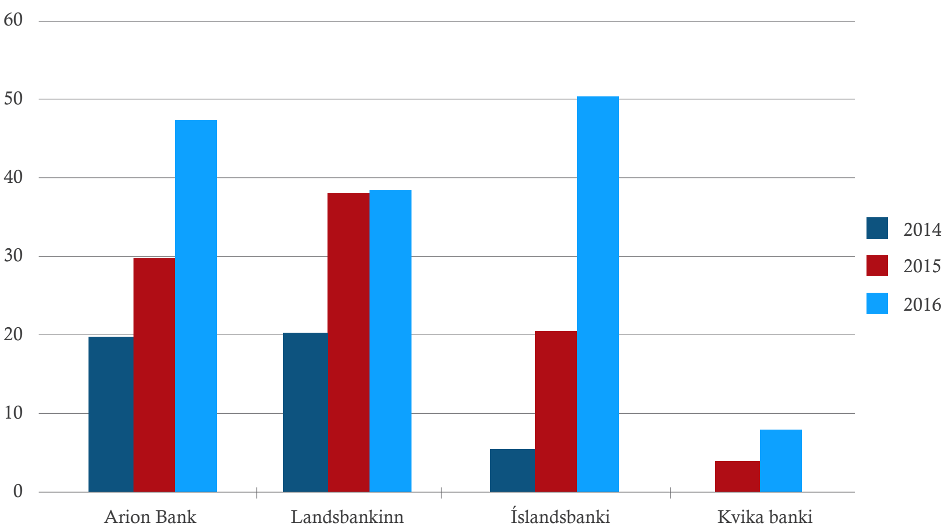
Source: Financial Supervisory Authority

Regulation No 836/2013 on public securities offerings[1] were amended in the year. The purpose of the amendment was to extend the rules on preparing prospectuses for public offerings and thereby making it easier for small and medium-sized enterprises to seek funding in the market. The Regulation only applies to public offerings amounting to between 2,500,000 and 5,000,000 euro and does not apply to the admitting of securities to trading on a regulated securities market.

The amendment removes the obligations of issuers to publish a prospectus if the amount of the public offering is lower than 2,500,000 euro, the prior limit was 100,000 euro.

The monetary amount of the banks' exchange traded issues has increased from year to year as can be seen in Figure 4. There was significant growth from 2014 to 2015, or 101.5%. There was some growth from 2015 to 2016 although it was not as great as from 2014 to 2015. The issuance grew from more than ISK 92 billion to more than ISK 144 billion, or a growth of 56.5%. As the figure shows, the majority of the issuance has been in the form of covered bonds, the percentage of the covered issuance was 67.6% of the total issuance in 2015. There was a turnaround in 2016 when bills comprised the majority of the issuance, or 54.9%. The issuance of Kvika banki hf. is included in the figures for 2015 and 2016, 4.5 billion ISK

Figure 5 The domestic issuance of the banks in billions of ISK



Source: Financial Supervisory Authority

[1] Regulation No 727/2016

and 8 billion ISK respectively.

Figure 5 shows the breakdown of securities issues between the banks. In 2016, Landsbankinn issued approximately 35% followed by Arion Bank that issued approximately 33%.

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

Sanctions

> *'FME imposes sanctions for infringement of law, rules and the Authority's decisions provided the legitimate objective cannot be achieved by other remedies. Sanctions are intended to have a deterrent effect aimed at minimising or averting further infringement. FME's sanctioning powers are administrative fines, periodic penalty payments, and revocation of operating licence for infringements. In addition, FME can close cases for infringement that is subject to an administrative fine by reaching a settlement with the party concerned to pay a financial penalty.'*

The text above is contained in FME's policy on the application of measures for enforcement and sanctions from 1 October 2015. It further states that FME concludes cases due to infringement that is subject to an administrative fine by settlement at the request of the party concerned provided said party has ceased the infringing activities or made the appropriate improvements. However, settlement is not an option if the requisite deterrent effect is not achieved, e.g. if the party concerned has consistently infringed the same legal provision or if the alleged infringement is considered serious enough to bring charges to the police. The party concerned must admit the infringement to reach an amicable settlement and agree to pay a financial penalty that can be up to half of the potential monetary amount of an administrative fine. 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 2016 to 30 April 2017, FME published two notifications of having concluded cases with administrative fines and eight notifications of having concluded cases with an amicable settlement. The notifications concerned the following parties:

Marel hf.
An administrative fine was imposed on Marel hf. for an infringement of Article 87(1) of Act No 108/2007, on Securities Transactions. The infringement concerned Marel failing to publish a notification on changes to voting rights, that were submitted to the company on 29 October 2014, within the statutory deadline. The Board of FME decided to impose an administrative fine, amounting to ISK 1,500,000, on Marel for the infringement.

Eimskipafélag Íslands hf.
An administrative fine was imposed on Eimskipafélag Íslands hf. for infringement of Article 122(1) of the Securities Transactions Act. The infringement concerned the company not publishing inside information, available on 20 May 2016, on its significantly improved financial performance in Q1 2016, as early as possible and on equivalent terms, or having deferred publishing the inside information. The Board of FME decided to impose an administrative fine, amounting to ISK 50,000,000, on Eimskip for the infringement.

Fjarskipti hf.
A settlement was reached with Fjarskipti hf. for breach of Article 126 of the Securities Transactions Act. The infringement concerned Fjarskipti hf. notifying FME too late of trading between a primary insider in the company and an entity financially related to a primary insider. The amicable settlement provided for the payment of a fine in the amount of ISK 350,000.

Greiðslumiðlunin Hringur ehf.
A settlement was reached with Greiðslumiðlunin Hringur ehf. for breach of Article 58(1) of the Securities Transactions Act. The infringement concerned the company publishing late the official interim report for the first half of the 2015 fiscal year. The amicable settlement provided for the payment of a fine in the amount of ISK 250,000.

Drómi hf.
A settlement was reached with Drómi hf. for breach of Article 78(1) of the Securities Transactions Act. The infringement consisted of neglecting to send flagging notifications to Nýherji hf. and FME concerning changes to voting rights at Nýherji. The amicable settlement provided for the payment of a fine in the amount of ISK 1,400,000.

Central Bank of Iceland Holding Company ehf. (ESÍ)
A settlement was reached with the Central Bank of Iceland Holding Company ehf. (ESÍ) for breach of Article 78(1) of the Securities Transactions Act. The infringement consisted of neglecting to send flagging notifications to Nýherji hf. and FME concerning changes to voting rights at Nýherji. The amicable settlement provided for the payment of a fine in the amount of ISK 1,400,000.

Íslandsbanki hf.
A settlement was reached with Íslandsbanki hf. for breach of Article 18(1) of the Securities Transactions Act. The infringement concerned the bank not following a customer's instructions and not taking into account criteria applicable to said customer. The amicable settlement provided for the payment of a fine in the amount of ISK 7,000,000.

Megind ehf.
A settlement was reached with Megind ehf. for breach of Article 40 of Act No on Financial Undertakings as the company raised its qualifying holding over 50% without notifying FME in advance of the purchase. The amicable settlement provided for the payment of a fine in the amount of ISK 250,000.

Stefnir hf.
A settlement was reached with Stefnir hf. for breach of Article 59(1), see Article 30 of Act No 128 on Undertakings for Collective Investment in Transferable Securities (UCITS), Investment Funds and Professional Investment Funds. The breach involved Stefnir purchasing an ownership interest in a private limited company on behalf of an investment fund managed by Stefnir. The amicable settlement provided for the payment of a fine in the amount of ISK 5,700,000.

Birta Pension Fund
A settlement was reached with Birta Pension Fund for breach of Article 40 of Act No 161/2002, on Financial Undertakings. The breach consisted of the pension fund not notifying FME of a qualifying holding in a financial undertaking within the time limit specified in the provision. The amicable settlement provided for the payment of a fine in the amount of ISK 1,000,000.
It is worth noting that the breaches of Eimskipafélag Íslands, Íslandsbanki, Megind, Stefnir, and Birta occurred after the entry into force of Act No 58/2015 amending legal provisions concerning penalties applicable to infringements in the financial market etc. whereby financial penalties were increased significantly and permission is given to base the amount on up to 10% of the legal entity's total turnover.

Changes to the legal framework of the financial market

FME is actively involved in changes to the rules that apply to domestic financial services. The Authority works on such changes either through the committees or working groups of the responsible ministry that is working to amend the act applicable to the activities of regulated entities, or by preparing regulatory acts, i.e. laying down rules or publishing guidelines. The role of FME in the work of the ministries' committees and working groups mainly involves summarising the legal acts applicable to Icelandic financial markets, researching their content, being aware of impending changes in the EEA as well as providing expert advice to the Ministry of Finance and Economy for preparing bills or, where applicable, preparing regulations.

FME is in a key position in the financial market concerning the monitoring of technical standards and guidelines from the ESAs (EBA/ESMA/EIOPA). Technical acts are either adopted through rules or regulation where applicable. The process of adopting the Authorities guidelines is being formed and is based on the bill concerning ESAs in the financial market.

In recent years, extensive projects have followed the revision of the legislation concerning financial services in the EEA. In the past year, there has been a watershed moment in this policy area with the transposition of the regulations on the ESAs, AIFMD, the CRA regulation, EMIR, and SSR into the EEA Agreement. Three important acts on financial services were adopted by Althing last year: new comprehensive legislation on insurance activities, No 100/2016, Act No 118/2016 on Consumer Mortgages, and Act No 96/2016 amending Act No 161/2002 on Financial Undertakings. The adoption of the laws in question is a crucial step in transposing the most important EEA acts on financial services in Iceland. Several of acts are still awaiting enactment in the coming years.

Progress of principal projects relating to legislation

Act on European supervisory authorities in the financial market. In 2016, the EU and the EEA States completed their negotiations on the incorporation of regulations concerning supervisory authorities in the financial market (the ESA Regulations on EBA, ESMA, and EIOPA). The incorporation of the regulations opens the way for other financial acts into the EEA Agreement, as of now there are more than one hundred acts, which were pending the solution to the ESA Regulations, awaiting incorporation into the Agreement. The incorporation of the Regulations into the EEA Agreement empowers the European Surveillance Authority to make a decision concerning the EEA States with regard to the European System of Financial Supervision. The solution, therefore, retains the two-pillar foundation of the EEA Agreement with the corresponding separate Supervisory Authority and separate courts for Iceland, Norway, and

Liechtenstein. The transposition of the regulations into Icelandic legislation is ongoing and a bill for a European system of financial supervision was submitted to Althing in the first half of 2017.

CRD IV / CRR. Important steps were taken during the year concerning the transposition of the CRD IV/ CRR legislation. Act No 96/2016, amending Act No 161/2002 on Financial Undertakings, made changes to the provisions on the capital base to conform with CRR and the Basel III international regulations. The amendments enhance requirements concerning the quality of the banks' capital. The same amending Act brought extensive reform to the statutory provisions addressing FME's supervisory review and evaluation process, and the new provisions include, among other things, a more detailed description of which aspects should be reviewed during the process as well as granting more extensive powers than had been stipulated in the Act before. The last step in the transposition of the CRR Regulation was taken in March 2017 when the minister issued a regulation on the prudential requirements for the activities of financial undertakings, transposing the European regulation on the same subject. When the Icelandic regulation enters into force in Iceland the regulatory framework for Icelandic banks will be completely consistent with the regulatory framework in the other EEA States.

BRRD / DGS. In 2017, FME will participate in drafting legislation concerning the resolution and winding-up proceedings for financial undertakings, with the submission of the bill being expected in the second half of 2017. The bill includes stipulations on financial undertakings concerning their eligible liabilities as well as requiring financial undertakings to prepare recovery plans in case of operational shocks. It is planned to amend Act No 98/1999 on Deposit Guarantees and the Investor-Compensation Scheme, in accordance with the new DGS III Directive on deposit guarantee schemes, to complement the drafting of the bill on the resolution and winding-up proceedings for financial undertakings.

Solvency II / Omnibus II. With the entry into force of the new comprehensive legislation on insurance activities, No 100/2016, the Solvency II Directive, as amended by the Omnibus II Directive, has entered into force in Iceland. The Solvency II/Omnibus II Directives contain enhanced requirements for the solvency and risk management of insurance companies with a view to increasing the protection of policyholders. The last step in the transposition of the Solvency II/Omnibus II framework will be taken in 2017 with the enactment of legislation concerning insurance groups. Work will also be conducted during the year to lay down a regulation on behalf of a minister to transpose Commission Delegated Regulation (EU) 2015/35 to supplement and further clarify certain aspects of the Solvency II Directive. FME will furthermore lay down rules for the adoption of the technical standards from EIOPA, which include provisions concerning the insurance companies' reporting. At the beginning of 2017, FME published 4 consultation papers concerning the rules in question.

MCD. The mortgage credit directive (MCD) was transposed into Icelandic law with the enactment of Act No 118/2016. The Act entered into effect on 1 April 2017, and it empowers FME, among other things, to determine the maximum loan-to-value ratios for mortgages and the maximum loan amount or the consumer's debt-to-income ratio for the loan, by regulation. The Act also stipulates that FME should register lenders and credit intermediaries that fall within the scope of the Act. Furthermore, the Act requires FME and the Consumer Agency to share tasks among themselves concerning the supervision of mortgages granted to consumers in Iceland. Work will continue in 2017 on the transposition of the MCD Directive and on proposals to amend Act No 118/2016 as regards the collaboration between EEA supervisory authorities concerning mortgages.

Acts concerning the securities market. Since 2016 when the European Markets Infrastructure Regulation (EMIR) on OTC derivatives, central counterparties, and trade repositories, the short selling regulation (SSR), and the CRA Regulation were incorporated into the EEA Agreement, work has been ongoing on drafting bills to enact the regulations concerned into Icelandic law. Drafts are currently being prepared on a bill concerning the supervision of credit rating agencies and a bill concerning notifications for short selling and credit default swaps. The bills are not equally far along but at least two bills are expected to be ready in the first half of 2017. The enactment of other acts concerning the securities market are ongoing at the same time, namely MiFID II/MiFIR on investor protection, organisation of trading platforms and financial undertakings, transparency etc., CSDR on securities settlement and the operation of central securities depositories, and the MAR Regulation on the treatment of inside information, management's insider dealing, and banning market abuse. This work is expected to conclude in the next two years with the enactment of the appropriate legislation. All the above-mentioned acts come with several technical standards that will be implemented appropriately.

AIFMD. Work was concluded in 2016 on transposing the Alternative Investment Fund Managers Directive (AIFMD) into the EEA Agreement. In 2017, a bill will be drafted to transpose the Directive in question on the basis of work done by a committee preparing the enactment of said Directive.
This work is expected to conclude in 2017 with the enactment of special law on the activities of alternative investment funds.

PSD II / IFR. FME has begun preparation for the transposition of the PSD II Directive on payment services and the EU regulation limiting interchange fees (IFR). The Authority is, therefore, monitoring the EBA's preparation of technical standards and guidelines as well as mapping the changes involved in the PSD II Directive compared to the prior directive on the same matter. The EU adopted both PSD II and IFR in 2015.

All of the above-mentioned EEA acts entail ongoing supervisory tasks that require extensive preparation within FME, including updating computer systems for the new reporting scheme, and some of the acts also require updates and changes to supervisory practices.

Regulation and the publication of guidelines in 2016

In 2016, FME adopted Rules No 388 on Bonus Schemes under the Act on Financial Undertakings and Rules No 981/2016 on the Supervision of Collection Activities under the Debt Collection Act. In addition, two rules were laid down in early 2017, Rules No 150/2017 on the fit and proper assessment of managing directors and directors of financial undertakings and Rules No 247/2017 on credit facilitation from financial undertakings to parties with close links. The regulations concerned required updates due to changes to the respective Acts the rules are based on.

Additionally, in 2016, FME published the Authority's Common procedures and methodology for the supervisory review and evaluation process for financial undertakings. The document concerned contains clarifications of FME's methodology for conducting the Supervisory Review and Evaluation Process (SREP) for financial undertakings as well as an explanation of the assessment of the largest risk factors involved with their activities. FME published Guidelines No 1/2016 on the Internal Governance of Financial Undertakings at the same time. The Guidelines further clarify FME's requirements for the governance of financial undertakings and are based on EBA's guidelines on the same subject.

FME also published several consultation papers in 2016. There were 6 consultation papers published at mid-year 2016 to introduce the methodologies for implementing the technical standards attached to the CRD IV/CRR framework in Iceland. No substantive commentary was received concerning the consultation papers in question and its publication is expected before mid-year 2017.

In addition, FME published a consultation paper containing draft rules on credit facilitation to parties with close links. The draft is, among other things, based on amendments to the Act on Financial Undertakings in recent years. The Board of FME has adopted the Rules and they have entered into force.

FME published a consultation paper at the beginning of 2017 concerning draft rules on the disclosure of investment costs in pension funds' annual accounts, and the rules are meant to harmonise the presentation of disclosed investment costs. Work on drafting the rules is expected to conclude in the first half of 2017.

Release of a schedule for regulation and the publication of guidelines for 2017–2018

FME newly began releasing a schedule for all new regulation and the publication of guidelines on the Authority's website. The release of the schedule is a factor in preparing regulated entities for impending changes and it covers two years at a time. The schedule will be reviewed regularly to ensure optimal disclosure to the market. FME is hopeful that this increased disclosure will be well received and will result in regulated entities being more aware of upcoming regulation in the years ahead. FME also notes that many projects in 2017 and 2018 relate to the implementation of technical standards and guidelines from the ESAs (EBA/ESMA/EIOPA).
In addition to the above-mentioned schedule, FME's website contains a summary of all legal acts applicable to the financial market. All rules and all guidelines from the Authority are available there, sorted by year and type of regulated entity, as well as consultation papers published leading up to their release.

1.3 Commercial practices and consumer affairs

FME has for many years monitored regulated entities' commercial practices, in addition to disclosing information and providing guidance in accordance with the provisions of the Public Administration Act. Provisions concerning the commercial practices of regulated entities are a part of financial market sectorial laws as well as being part of the Act on Official Supervision of Financial Activities.

In 2016, FME received 237 suggestions and inquiries from the customers of regulated entities. 7 of the written comments concerned the pension market, 38 concerned the insurance market, 108 concerned the credit market, and 32 concerned other matters, a total of 185 comments. 52 comments were received by phone of which 29 concerned the financial market, 7 concerned the pension market, and 10 concerned other matters.

The service FME provides consumers by phone was changed in the first half of 2016 in that the hours are no longer specified. In lieu thereof, the Authority's website now contains detailed information on the process for consumers to have their issues resolved. Consumers are still able to call FME by phone if they feel the instructions on the website are unclear or if they wish to submit comments.

Projects concerning commercial practices are generally very diverse. Examples of projects during the year:

- A warning concerning security features of payment software and potential misuse of debit card information, see news update on the website dated 29 February 2016.
- An examination of risk factors in financial instrument trading relating to foreign currencies and being offered to the public, see news update on the website dated 19 September 2016.
- Disclosure concerning so-called peer-to-peer lending involving lending between individuals rather than from a bank to a customer, see news update on the website dated 5 October 2016.
- Examination of the notice period for insurance contracts and the related notifications, see news update on the website dated 14 November 2016.
- Disclosure concerning the position of consumer ombudsman at Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf., see news update on the website dated 30 November 2016.
- Examination of paid services concerning payment accounts. The task is a part of EBA level collaboration. The task is still ongoing with the aim of establishing a comparative website that contains information on the service costs of certain financial undertakings.

FME's commercial practices supervision has mostly involved responding to information received on issues concerning the business activities of regulated entities. FME has strengthened supervision of commercial practices in a targeted way by increasing proactive supervision.

FME takes part in the work of the consumer protection committees of the EU supervisory authorities in the credit and financial markets. The EBA's Standing Committee on Consumer Protection and Financial Innovation (SCConFin) has the principal role of improving consumer protection in the credit markets and monitoring innovation in the financial market.

SCConFin is furthermore tasked with promoting secure, simple, and efficient payment service practices across the European Union. The role of EIOPA's Committee on Consumer Protection and Financial Innovation (CCPFI) in the pension and insurance markets is comparable to SCConFin's role in the banking market. CCPFI is tasked with improving consumer protection in the pension and insurance markets, seeking the best interests of policyholders, the insured, and pension beneficiaries, in particular through monitoring services offered in the market and responding to market innovation, offering advice when applicable.

FME's participation in international cooperation and the increased relevance of the category within the Authority has resulted in commercial practices supervision becoming more forward-looking, i.e. attempting to respond to foreseeable issues in the market. Thematic examinations conducted by ESAs are an example, e.g. EBA's examination of paid services concerning payment accounts.

In December 2016, FME published the work Trust Earned that includes the Authority's strategic focus until 2020. It states, among other things, regarding the matter of consumer practices and consumer issues, that FME will focus on strengthening the supervision of sound and proper commercial practices, improve disclosure to consumers, and that financial service companies will take consumer interests into account. To bolster these efforts, FME will aim to finish the following tasks in 2017:

- Reviewing rules on proper and sound business practices of financial undertakings. The rules were originally laid down in 2013 and have not been reviewed since.
- Preparing rules on proper and sound business practices of insurance companies, see Article 10(4) of Act No 100/2016, on Insurance Activities.
- Examining the treatment of complaints at financial undertakings and insurance companies.
- Updating the FME website. The website will increasingly be focused on giving information in the form of educational material and guidelines for consumers.

Increased collaboration is planned with other bodies and, where applicable, representative associations concerning consumer affairs. FME has also been reviewing how the Authority can utilise social media for its activities and has now opened a Facebook page.

1.4 Internal functioning

The Authority's growth in recent years, its new projects, and enhanced requirements necessitate reviewing the supervisory policy and future strategy. During the year, the Authority structured its global strategy and revised its long-term strategic priorities and objectives in connection with the implementation of the new act on public finances, No 123/2015. The Act's objective is to promote sound economic management and robust and accountable management of public finances by, among other things, ensuring comprehensive long and short-term policy making for public finances. The Act furthermore stipulates that public entities should develop a policy for their activities for at least three years at a time based on the strategy of each field.

FME's global strategy was expanded into so-called key policies concerning governance, supervision, and support services. The Authority's objectives and benchmarks were also expanded in more detail in accordance with the above-mentioned Act and the Board's priorities. The objectives cover both the Authority's core business and general operations. Changes to the budgetary process are also ongoing in line with the priorities of the new act on public finances. In addition, the Authority published the work Earned Trust, as stated above, containing the Authority's strategic focus for the years to come. The document shows nine strategic priorities until 2020 as well as the measures the Authority will apply to achieve its objectives.

All the Authority's employees were asked to participate in the above-mentioned work with an aim to conceive of a single vision of success and facilitate implementation and enforcement.

Many tasks were conducted at the same time to support the Authority's strategy and priorities. An example is the completion of a risk-assessment system, which has been under construction for the last few quarters and is based on the Authority's risk-based priority. The risk-assessment system, named Vaki, gives employees oversight of regulated entities and systemic financial risk. Vaki contains baseline information on entities regulated by the Authority, risk indicators, and conclusions of risk assessments, and it also contains information on submitted data and ongoing supervisory tasks.

A so-called own-risk assessment was also prepared based on the standards the Authority has selected for comparison, i.e. ISO/IEC 9001:2008 and ISO/IEC 27001:2013. The major groups of the risk assessment were delimited and defined for the Authority's supervisory activities, operations, and operating conditions, and risk criteria were defined as well.

Documented processes were used as a baseline for delimiting the risk factors and the risk factors identified by the assessment teams were evaluated for probabilities, impact, and quality of management. Several improvement projects have already been listed, commenced and concluded and that applies, in particular, to those projects that are subject to or support the Authority's ongoing quality and security activities.

1.5 Operations and Financing

According to FME's draft annual account for 2016, operating expenses totalled ISK 2,035.1 million having increased by 6.2% from ISK 1,915.6 million in 2014. Labour costs are the largest item of operating expenses and amounted to ISK 1,643.4 million in 2015 compared with ISK 1,547.6 million in the preceding year. The labour costs increased by almost 6.2%, which reflects contractual salary increases, as the number of paid positions remained unchanged between years. Expenses from two complaints committees hosted by the Authority are included in operating expenses and their labour cost amounted to ISK 13.7 million in 2016. Most of these costs are reclaimed.

FME's total operating revenues amounted to ISK 1,766.2 million in 2016. Thereof, the revenue from the supervision fee amounted to ISK 1,710 million compared with ISK 1,641.5 million in 2015, an increase of almost 4.2% year-on-year. Other operating revenues totalled ISK 56.2 million, including ISK 15.6 million in finance income, ISK 8.6 million in special revenue from providing food, ISK 12.6 million in reclaimed costs for the complaints committees, and ISK 19.4 million in various other tariff-based revenues.

The shortage was therefore ISK 268.9 million in 2016. Using the Authority's own funds to cover the shortage was planned according to the 2016 operational schedule to decrease the Authority's reserves to the authorised level under Act No 99/1999 on Payment of Cost due to Official Supervision of Financial Activities.

FME's equity at year-end 2016 was ISK 136.6 million, as compared to ISK 405.5 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, in accordance with the provisions Act No 99/1999. Thus, the reserves amounted to ISK 108.1 million at year-end 2016. The 2016 annual accounts are provided on FME's website.

2017 operational schedule

In a report on the 2017 operational schedule, submitted to the Minister of Finance and Economic Affairs pursuant to law in June 2016, the Authority's expected expenses total ISK 2,272.5 million for 2017. In addition, the Authority's revenues were expected to total ISK 2,316.1 million. It was proposed to transfer ISK 43.5 million of profit to own funds making the reserves close to 5% of next years estimated supervision fee. In accordance with the 2017 general budget adopted by Althing in December 2016, the total revenue amounts to ISK 2,220.8 million, of which the imposed supervisory fee according to Act No 99/1999 amounts to ISK 2,161.8 million.

Distribution of working hours

Pursuant to Act No 99/1999 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. The following table shows a breakdown of FME's working hours devoted to each main category of regulated entity in 2016 and 2015:

Relative distribution of FME working hours by category of regulated entity	2016	2015
Credit institutions	56.5	61.3
Insurance companies and insurance brokers	13.0	12.2
Pension funds	12.9	12.3
Fund management companies	8.3	4.8
Securities dealers and securities brokerages	4.8	2.8
Equity and bond issuers	2.1	4.7
Others	3.0	1.8
	100.0	100.0

FME's time sheet records also enable analysis of activities by type of task or subject. Such analysis of hours spent in 2014 and 2015 is as follows:

Relative distribution of FME working hours among its main tasks	2016	2015
Supervisory tasks	64.1	58.2
Off-site supervision	30.4	29.2
On-site examinations	17.5	9.0
Oversight	16.2	20.0
Regulation	5.8	6.2
General operations	24.4	28.9
Foreign cooperation/communications	5.7	6.6
	100.0	100.0

Hildigunnur Hafsteinsdóttir
lawyer with off-site supervision

'Earlier this year, my husband and I decided with our friends to read one book from each country of the world. It has been going well and I have already finished about sixty countries although it is certainly more difficult to find books from some countries than others. It is incredibly enjoyable to broaden the horizon in this way and I have picked up many interesting books, that I would never have thought to read under other circumstances, through the process.'

2. Financial market

2.1 Financial market outlook

Significant political instability still exists in the international economy although the latest figures indicate increasing economic growth in the countries that are Iceland's largest trading partners. The International Monetary Fund estimates that economic growth will increase slightly in the next two years in the United States and decrease in the euro area and the United Kingdom. Prices for commodities and oil have increased again and it is expected that the increase in economic activity will be followed by an increase in inflation. These expectations are, among other things, reflected in an increase of the imputed rate of interest for government bonds. The economic growth is reaching new heights in Iceland at the same time irrespective of disciplined monetary policy and it is estimated to have been 7.2% in 2016, compared to an average of 3.5% in 2013–2015. The majority of the economic growth stems from investments in the tourism industry and increased personal consumption. Personal consumption is expected to grow further since the debt burden and disposable household income have improved. Furthermore, real estate inventory is lacking and there will most likely be large investments in housing in the coming years. Most estimates indicate that economic growth will be moderate in the next two years but it is likely to remain high with regard to the states we use for comparison.

Export income has increased substantially and tourism activities are expected to have increased by 37% in real terms in the past year. The capital inflow resulting from exported services is further strengthening the Icelandic króna, which gained 12% in the past year. A large step to mitigate risk in the market for ISK was taken by giving CBI a capital flow management policy instrument. Carry trade, which has historically had a pro-cyclical effect on the value of ISK, has diminished since the decision was taken to implement the policy instrument. Advantage has been taken of these favourable conditions to lift the capital controls step-by-step and currently they mostly do not affect homes and individuals.

Inflation has remained beneath CBI's 2.5% target and the strengthening króna and decreasing commodity prices in the international markets have counteracted the domestic inflationary pressure resulting from higher pricing levels and salary increases in recent quarters. Consumer prices without the effects of housing deflated from January 2016 to January 2017. Foreign conditions are not expected to be as favourable to the development of inflation in Iceland for the foreseeable future and inflation will most likely reach CBI's inflation target in 2018. The domestic economic tension is significant and that has historically resulted in increased inflation and financial instability. However, it cannot be ruled out that inflation remains moderate as market participants have continued to decrease their inflationary expectations and the year-on-year increases in domestic pricing are getting smaller.

One of the largest factor of uncertainty in the financial market today is the rise of real estate prices which rose by 16.3% from January 2016 to 2017. It is important for supervisors to monitor the developments as recent examples have shown how adverse changes in the real estate market impact financial and economic stability.

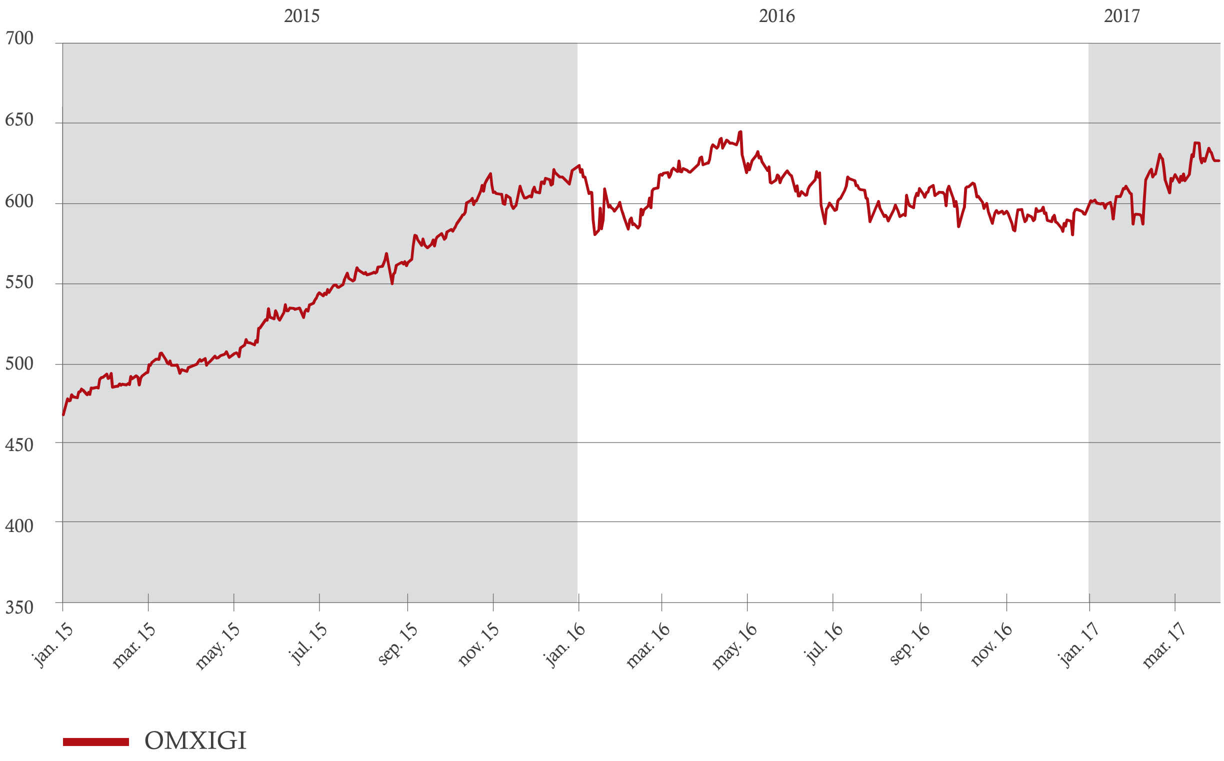
2.2 The securities market

The upswing in the securities market was a little slower than in recent years. One new company, Skeljungur, was admitted to the all-share index of Nasdaq Iceland and equity turnover increased significantly with returns being negative in the same period. Bond market turnover decreased year-on-year and it is now similar to 2014 levels.

Equity market trends

After extensive increases in the equity market in 2015, 2016 began with a significant drop. After the market had recovered and improved in the spring the decrease continued slowly for the rest of the year. Skeljungur was the only new company admitted to trading on the stock exchange during the year and the all-share index now comprises 17 Icelandic companies. Equity turnover continued growing and it amounted to more than ISK 550 billion. That is an increase in turnover of ISK 158 billion year-on-year, an increase of 40%.

Figure 1 Trend of the NASDAQ OMXIGI Index



Source: Nasdaq Iceland hf.

Every single company in the all-share index of Nasdaq Iceland had increased in 2015 but in 2016 they had varied returns. N1 hf. gained the most, about 93%, while Icelandair hf. lost about 35%.

The OMXIGI stock index, which measures the average return of every listed company on the main market with regard to dividends, lost 4.73% in the preceding year.

Even though a new company was admitted to trading the total market capitalisation of companies in the all-share index on the stock exchange decreased by 5.8% and at year-end 2016 the total market capitalisation was ISK 969 billion. The total value of domestic equity as a percentage of gross domestic product has therefore decreased and now amounts to almost 40%, in comparison to 47% in the preceding year. The proportion is still substantially lower in Iceland in comparison to the other Nordic countries. In the first quarter of 2017, the market has regained the loss from 2016 and gained almost 6.2% even though one of the largest listed companies, Icelandair hf., lost almost 40%.

Bond market trends

The annual bond turnover decreased in 2016, continuing the trend starting in 2012, except for 2015. The largest issues in the year were government Treasury notes and covered securities, even though the both classes were smaller than in 2015.

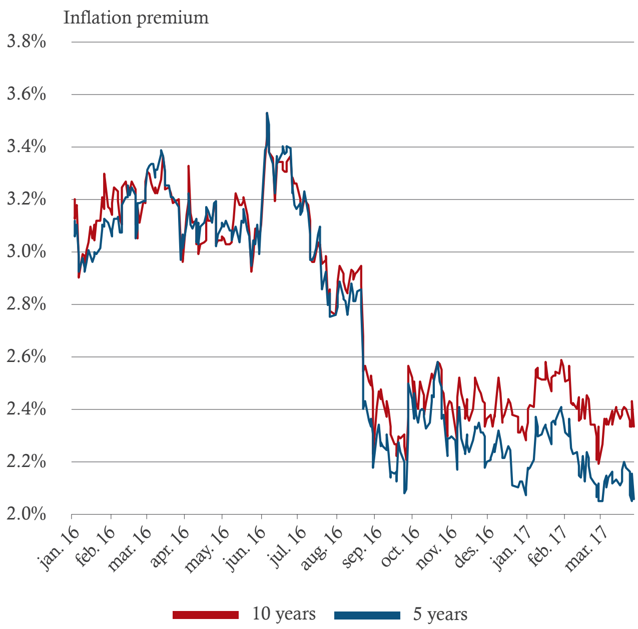
Figure 2 Yields of bond indices on Nasdaq Iceland.

Source: Kodiak Excel

In June 2016, CBI introduced a new policy instrument to temper potential carry trade as part of the plan to lift the capital controls that may have diminished the interest of foreign investors. The authorisations of pension funds to invest abroad and more extensive lending to members are likely factors in making the pension funds less interested in investing in the bond market.

When the bond market yield is considered its clear from figure 2 that the indices of unindexed bonds decreased significantly in 2016 and especially when the policy rate was decreased twice during the years for a total of 75 basis points. The indices of indexed bonds show that the yields of indexed bonds rose at the beginning of the year and then decreased sharply when the policy rate was decreased, in addition to Moody's increasing the Treasury's credit rating at about the same time. Favourable developments in the market conditions resulted in the yields decreasing near the end of the year and the indices of indexed bonds at year-end 2016 were similar to the beginning of the year.

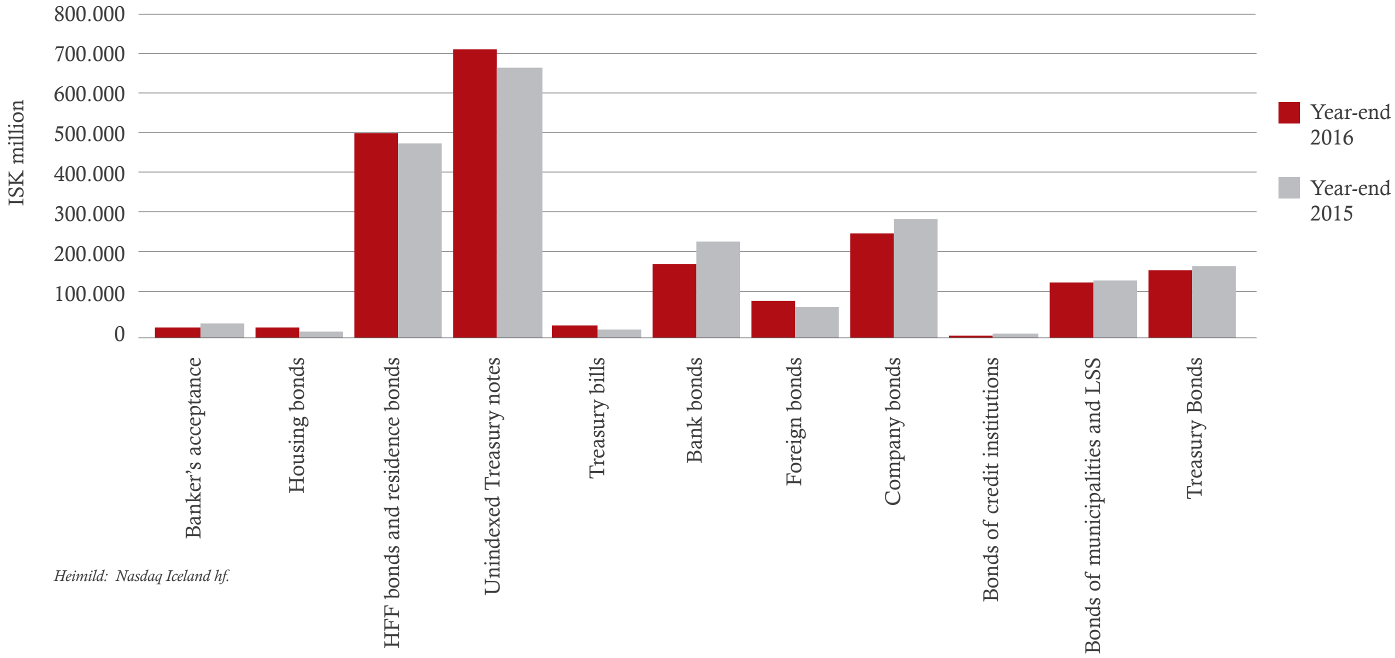
Figure 3 Inflation premium



Source: Kodiak Excel

The inflation premium has been comparatively low in recent years. Many professions fought for improved wages and conditions in 2015 and there was some apprehension that large improvements would result in increasing inflation. The inflation premium topped at 4.83% (for 10 years) at the beginning of June 2015 but at year-end 2016 it was 2.37%. The diminishing uncertainty in relation to collective agreements in addition to the stronger króna and

Figure 4 Market value of listed bonds by class of assets



Heimild: Nasdaq Iceland hf.

the elimination of various fees on imported products have had an impact.

The total value of exchange traded, listed bonds on the stock exchange amounted to ISK 2,136 billion at year-end 2016, compared with ISK 2,119 billion at year-end 2015.

The turnover changed to ISK 5,005 billion in 2016 from ISK 5,350 million in 2015.[4] A more detailed division of market prices for listed securities by asset class can be seen in Figure 6.

At year-end 2016, the market value of issued debt instruments was divided with 70% having been issued by public entities and 30% by private parties. In 2015, the same ratios were 74% and 26% respectively; meaning the percentage of instruments issued by private parties continued increasing year-on-year.

2.3 The Credit Market

At year-end 2016, 4 commercial banks, 4 savings banks and 5 credit institutions were operating in Iceland, in addition to the state-owned Housing Financing Fund, or a total of 14 credit institutions. At year-end 2016, the total assets of credit institutions amounted to ISK 4,250 billion, thereof the total assets of the commercial banks amounted to ISK 3,254 billion, and they have increased by 0.5% from the preceding year. The ownership interest of the Treasury and public bodies dominates the credit market, as their interest in the equity of all credit institutions was 71% at year-end 2016. Significant changes are planned for the ownership structure of the large commercial banks and the Government has announced, in its policy statement, that it is not desirable for the State to hold a majority interest in the commercial banks for the long-term. The State will carefully decrease its ownership interest pursuant to this policy direction and with broad support with the objective of keeping the process open and transparent and striving to distribute ownership as much as possible. Arion Bank may be listed on the equity market in the coming quarters. The new Government has announced that the 30% interest of the State in Landsbankinn will remain under its ownership for the future.

FME is of the opinion that due care must be taken during the sale of State-owned credit institutions and that it must be ensured that qualified entities will own and operate the banks in the future.

In recent years, the total assets of credit institutions, as a percentage of GDP, have been decreasing, from 277% at year-end 2009 to 175% at year-end 2016. 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 26% since year-end 2009.

Equity position

At year-end 2016, the capital base of the three large commercial banks amounted to ISK 635 billion, compared with ISK 670 billion at year-end 2015. Their capital base

[4] The numerical data comes from reports issued by Nasdaq Iceland. http://www.nasdaqomx.com/transactions/markets/nordic/statistics/icelandbondtradingomxi

is therefore 5% lower than the year before as a result of dividend payments and repayments of subordinated loans. Their capital adequacy ratio was 27.7% at year-end 2016 as compared to 28.2% at year-end 2015. The Act on Financial Undertakings was amended in 2016 in such a way as to divide the capital base into Common Equity Tier 1 (CET1), Additional Tier 1 (AT1), and Tier 2. The capital base previously comprised Tiers 1, 2, and 3.

The majority of the capital base of the three large commercial banks constitutes Common Equity Tier 1, or approximately 98%. Risk assessments of banks generally take Common Equity Tier 1 (CET1) into account.

Figure 2 shows a comparison of Tier 1 Capital as a ratio of the risk-weighted asset base on one hand at the large Icelandic commercial banks and on the other hand for a sample of EU banks collected by the European Banking Authority (EBA). The weighted ratio of Tier 1 Capital for the large commercial banks was 27.2% at year-end 2016 compared with 15.3% at the EU banks in the third quarter of 2016 (for a total of 198 banks). In addition, it shows a comparison of the Common Equity Tier 1 for the preceding two years when the difference was even greater. 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.

Operating results

In 2016, the profit of the three largest commercial banks amounted to almost ISK 59 billion compared with more than ISK 106 billion in 2015, a decrease of 45% year-on-year. The decrease is mostly due to lower revenues outside of the banks' core operations[5]. The return on equity after tax decreased significantly year-on-year and was 8.9% in 2016 compared with 16.6% in 2015. The banks' return on core operations before tax however improved year-on-year and amounted to 8.7% in 2016 compared with 8.1% in 2015. The banks' net interest income increased by almost ISK 8 billion but their net commission income decreased by ISK 1.6 billion.

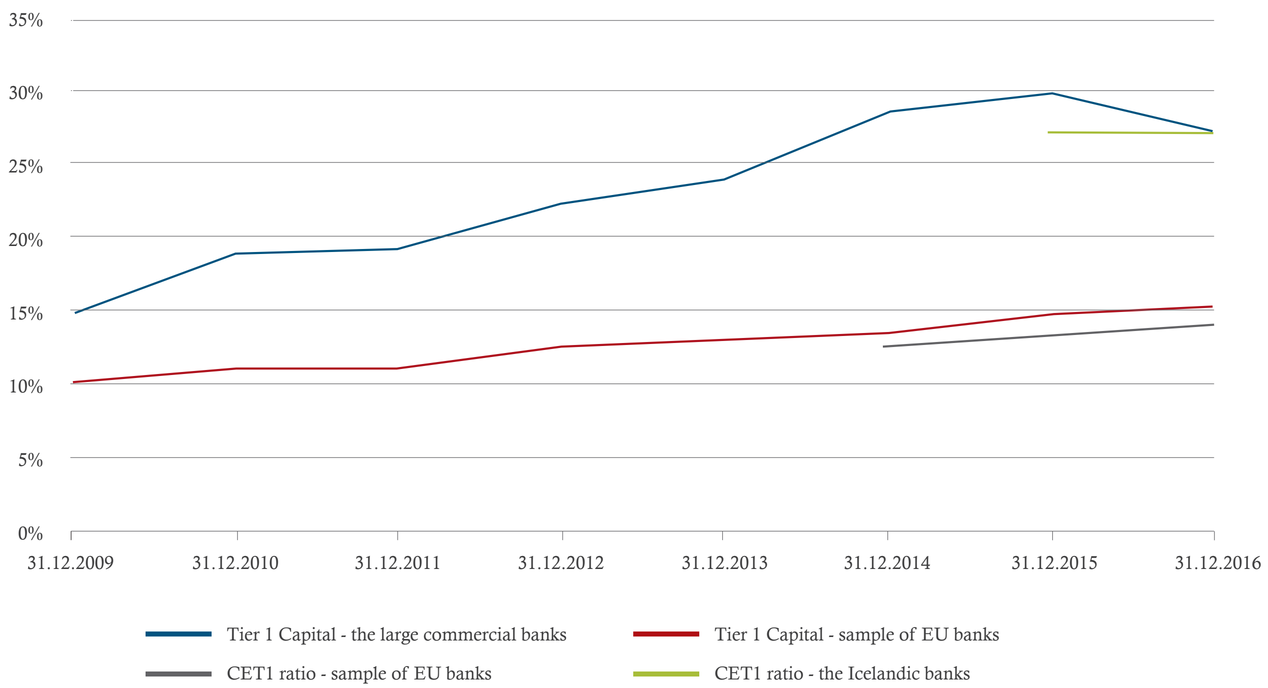
The interest rate margin was 3.0% in 2016 compared with 2.9% in 2015. Operating expenses as a percentage of net operating income were 53.0% in 2016 compared with 42.5% in 2015. Operating expenses as a percentage of assets were 2.6% and remained unchanged between years.

Funding and liquidity

At year-end 2016, the three large commercial banks' funding comprised 1,596 billion ISK in customer deposits (50%), 776 billion ISK in market funding (24%), 642 billion ISK in capital (20%), 181 billion ISK in other items (6%).

The banks' funding composition has changed since last year. The percentage of market funding rose by 5% while debts to credit institutions and central banks have

Figure 2 Capital adequacy ratio trend



Source: Financial Supervisory Authority and EBA

[5] Income from core operations: Net interest income, net fee and commission income Core operating costs: Compensation of employees, administrative expenses, and depreciation and amortisation expenses.

decreased by 2%, customer deposits by 1%, subordinated loans by 1%, and capital by 1%.

Market funding is mostly in foreign currencies with 66% denominated in Euro, 19% in US dollars, 9% in Swedish kroner, and the remainder in other currencies. The banks issued foreign denominated bonds for 265 billion ISK in 2016. The banks' borrowing rates have been improving and maturities are getting longer. The reasons for that include more favourable conditions in foreign credit markets, the banks' higher-quality balance sheets each year, improved credit ratings as a result of the credit rating of the Treasury improving, and increased trust towards the banking industry.

Issues of covered bonds have also been increasing and they amounted to ISK 163 billion at year-end 2016 compared to ISK 107 billion at year-end 2015, an increase of 52% year-on-year.

Foreign denominated funding maturing in 2017, 2018, and 2019 amounts to 154 billion ISK or approximately 34% of the outstanding foreign denominated market funding. The banks' recent issues have resulted in the average residual maturity getting longer which mitigates refinancing risk. The longer average residual maturity has had a positive impact on the ratio of stable financing and according to CBI rules, the foreign denominated Net Stable Funding Ratio (NSFR) shall be in excess of 100% and the banks' ratios averaged 163% at year-end 2016 compared to 138% at year-end 2015.

The residual maturity time of the Icelandic banks is comparable to a sample[6] of foreign banks. See Figure 3.

The figure shows that 27% of all the Icelandic banks' listed securities are due in the next three years compared to 36% for the foreign banks. Covering the period up to 2022, 68% of the Icelandic banks' issues will come due compared to 65% for the foreign banks. The ratios are similar covering the period up to 2026, or approximately 80%.

The liquidity position of the banks is strong and they have approximately 200 billion ISK in excess of the applicable minimum liquidity requirements.

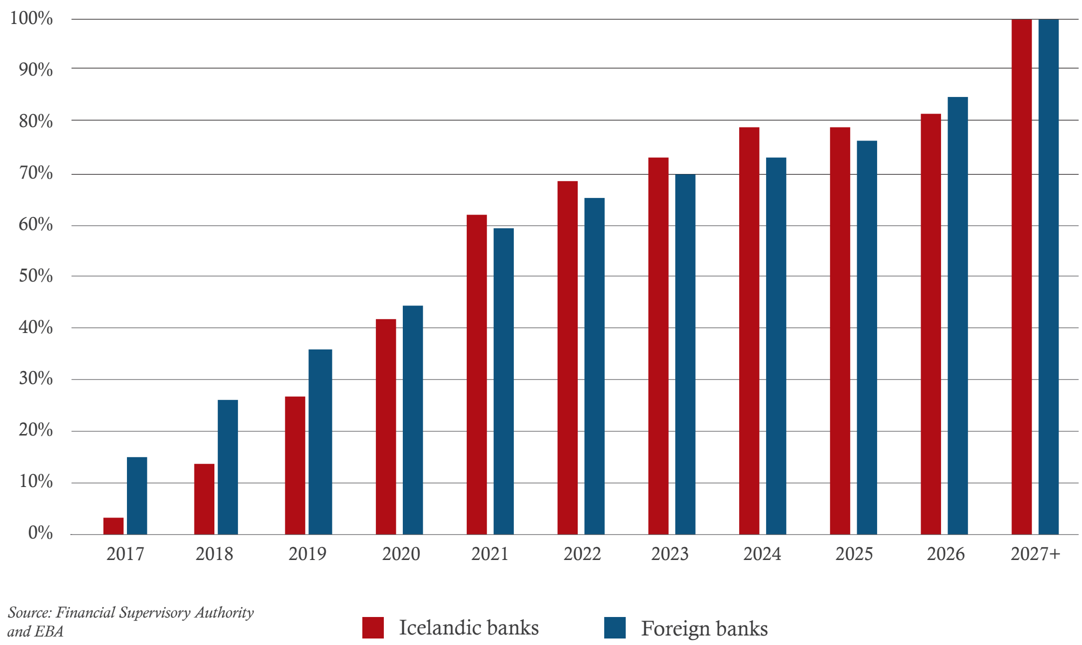
The minimum liquidity ratio provided for by the rules increased from 90% to 100% on 1 January 2017 and the banks' aggregate ratio at year-end 2016 averaged 153% compared to 124% at year-end 2015. According to the same rules, the minimum liquidity ratio in foreign currencies is 100%. The banks all had high foreign currency liquidity ratios at year-end 2016, and their ratios averaged 396% compared to 326% at year-end 2015.

The ratio of encumbered assets decreased during 2016 from 17.8% to an average of 15.7%. A sizeable portion of that decrease stems from Landsbankinn hf. refinancing indexed funding from the old bank's estate with new unindexed market funding. To compare, the average ratio was 26.5% for a sample of 156 EU banks according to information from EBA.[7]

Credit risk and asset quality

The book value three large commercial banks' customer lending amounted to ISK 2,254 billion at year-end 2016, which is a 4.5% increase from year-end 2015 when lending

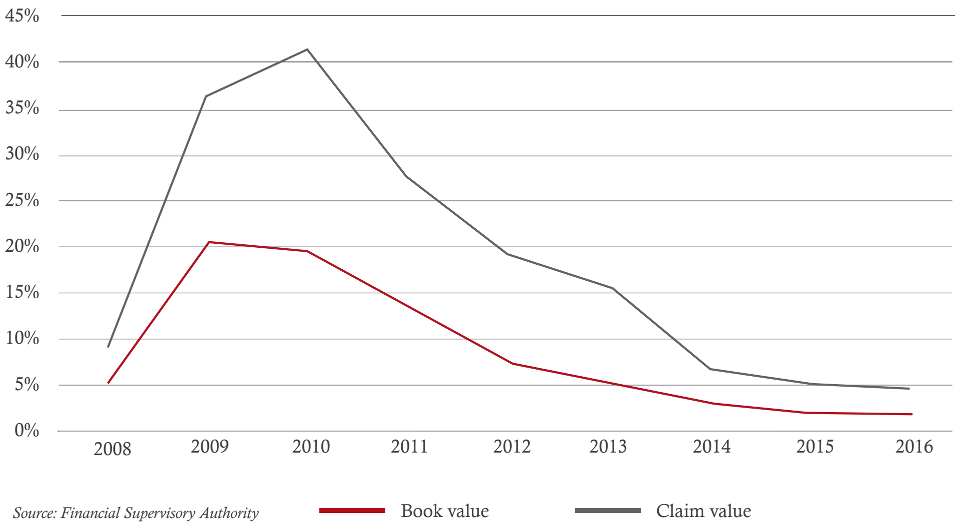
Figure 3 Aggregate ratios for listed debt securities in issue by maturity



Source: Financial Supervisory Authority and EBA

[6] Using an EBA sample (based on data from SNL as of 12 January 2017) of 43 euro area banks and in all cases concerning listed securities.
[7] The LCR and NSFR ratios are on a parent-company basis. The ratios of encumbered assets are on a group basis.

Figure 4 Ratio of 90-day defaults at the large commercial banks during the period using the facility-based approach.



Source: Financial Supervisory Authority

amounted to ISK 2,158 billion. Inflation measured 1.7% in 2016 showing that the banks' loan portfolios increased by 2.8% in real terms, which is significantly lower than the 7.2% economic growth in 2016, and meaning there are no signs of overextension in the large commercial banks' lending.

The large commercial banks have completed restructuring lending to corporations which had financial difficulties following the collapse. Since that time, individuals and corporations have been paying down debts and improving their capital position. The banks' lending portfolios have therefore been improving since 2008. The ratio of 90-day defaults has been decreasing but in the latter half of 2016, the ratio increased for the first time since the collapse in comparison to book value as can be seen in Figure 4; the 90-day defaults may therefore have reached the bottom of the economic cycle.

Summary

The equity position of the three large commercial banks is still sound and significantly in excess of counterparts internationally.

The banks therefore have leeway for further dividend payments based on their equity positions but they will have to take into account, among other things, the fact that the Icelandic authorities have not transposed the EU Bank Recovery and Resolution Directive (BRRD). According to the Directive, financial undertakings will have to fulfil special requirements concerning capital and bail-in-able liabilities with the purpose of such requirements to significantly reduce the potential for taxpayers having to pay for the financial recovery of systemically important financial undertakings.

In recent years there has been great uncertainty concerning the lifting of capital controls and now the authorities have significantly extended the exchange authorisations of individuals and corporations. Irrespective of the increased authorisations, the outflow of deposits from the banks' customers has been insignificant. However, the strong improvement of the Icelandic króna and unfavourable conditions in foreign markets have affected investors willingness to exchange króna for foreign currencies.

The profit of the banks decreased substantially year-on-year.

The 2016 results should reflect the banks' future performance clearer than the 2015 results as the profit decrease in 2016 is mostly due to lower non-core operating income.

The future ownership and structure of financial undertakings in the credit market remain uncertain. Due care is important during the sale of State-owned credit institutions and concerning the possible structural adjustments to the credit market.

2.4 Insurance Market

Insurance market

At year-end 2016, 12 insurance companies had FME's authorisation to operate in the non-life insurance market and five operate in the life insurance market. In addition, Íslensk endurtrygging hf. and Trygging hf. are reinsurance companies in run-off state and Iceland's Natural Catastrophe Insurance operate in accordance with special legislation. At the end of last year, the merger of Vörður líftryggingar hf. and Okkar líftryggingar hf was completed. FME authorised the transfer of the portfolio and the merger of the companies at the beginning of this year and currently there are therefore 11 companies in operation.

A new act on insurance market, No 100/2016, entered into effect on 1 October 2016 superseding the older act from 2010. The Act covers the domestic activities of Icelandic and foreign insurance companies and they apply to the direct insurance business concerning non-life and life insurance and all types of reinsurance.

The new act is based on Solvency II directive, a new insurance market framework that in general term stipulates more stringent requirements for solvency and risk management with a view to increasing the protection of policyholders and mitigating potential consumer losses or market interruptions. As a result of the transposition, FME has begun working on the adoption of the technical standards that come with EU's Solvency II acts by publishing a new regulation. FME has followed up with the Solvency II transposition by holding presentations, including concerning reporting, on-site inspections, and ad hoc meetings with regulated entities, as well as ongoing supervisory activities.

The Solvency II framework changed the assessment methods for items in the balance sheets of insurance companies, which now take greater account of economic principles much like international financial reporting standards. Technical provisions are now the probability-weighted average of future cash flow in addition to the credit spread and the solvency capital requirements are risk-based.

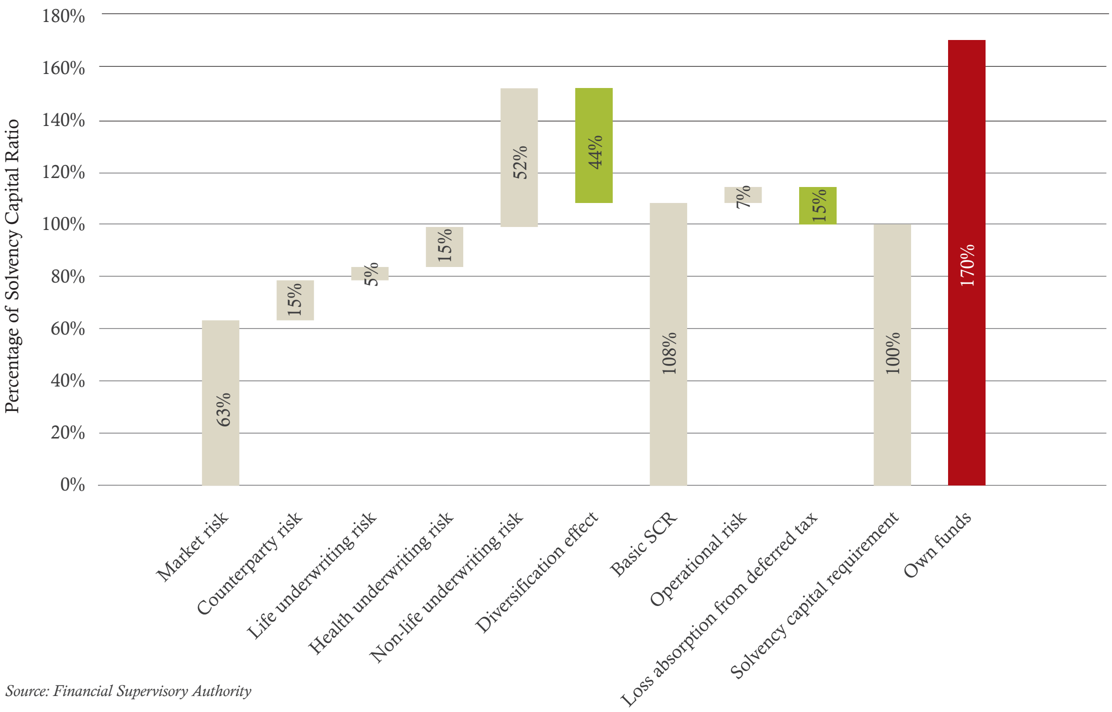
The solvency capital requirement is determined by assessing a 200-year loss event for each and every risk factor. Market risk has the largest contribution to total SCR, followed by non-life insurance risk. There is less risk stemming from counterparty risk, life and health insurance risk, and operational risk.

Insurance companies are required to meet their solvency capital requirement with eligible own funds.

Figure 1 shows the composition of solvency capital requirement of Solvency II according to the combined balance sheet for Icelandic insurance companies. The composite solvency ratio for all insurance undetakings was 1.70 at the beginning of 2016. The solvency ratio for non-life and life insurance undertakings was 1.66, and 2.09 respectively.

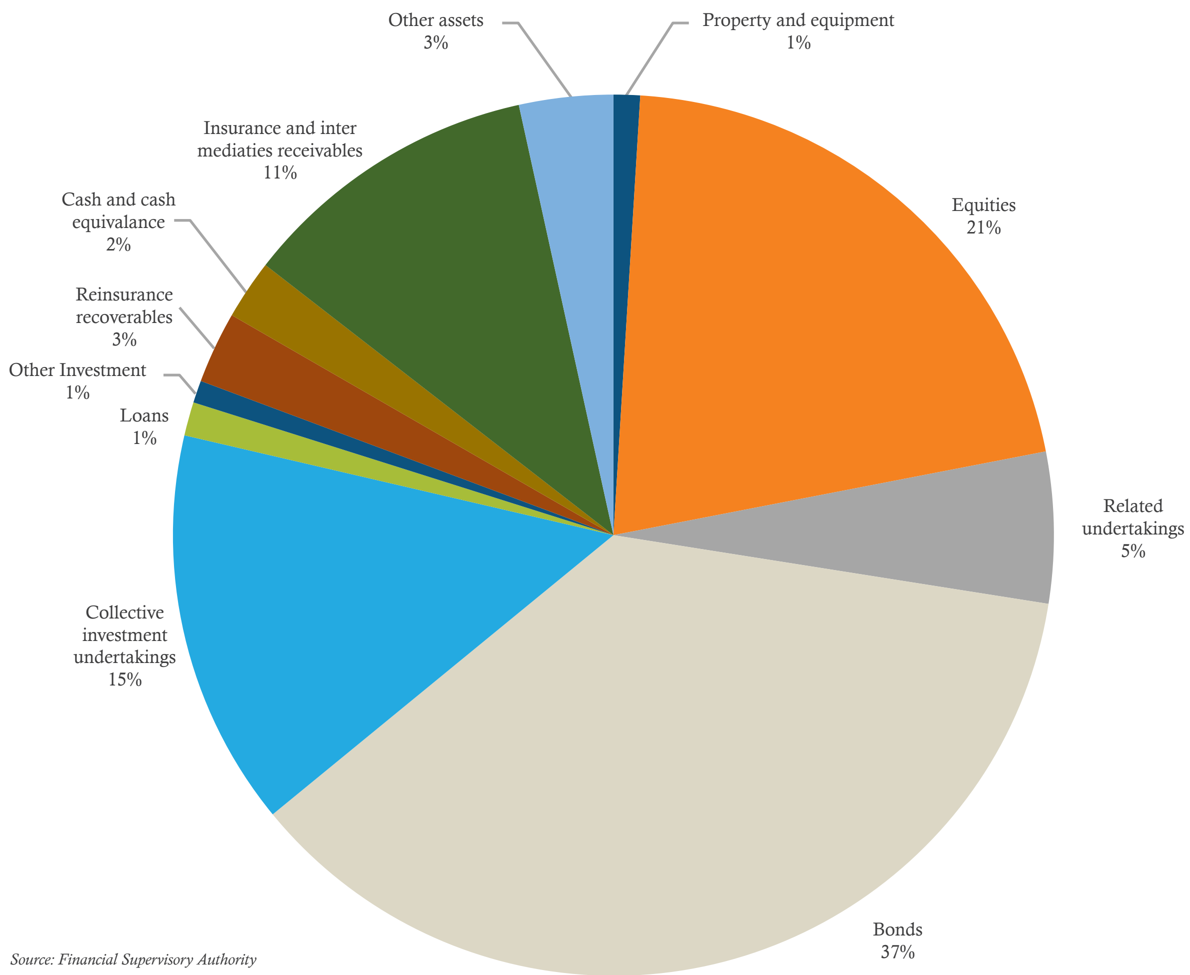
The capital dividend from listed insurance companies last year ended up being lower than had originally been proposed. The dividend payments were reduced due to pressure from stakeholders and individual owners but the companies continued their share repurchasement programs. The insurance companies are well funded and the increased

Figure 1 Composition of the solvency ratio for life and non-life insurance companies



Source: Financial Supervisory Authority

Figure 2 Breakdown of insurance companies' assets as of 31 December 2016



Source: Financial Supervisory Authority

capital has allowed them to take on riskier investments.

At year-end 2016, the total assets of all insurance companies in Iceland amounted to approximately ISK 139 billion, increasing by more than 3.6% from the previous year. Figure 2 shows the asset breakdown of insurance companies at year-end 2016. Equity shares accounted for 21% of total investment at year-end 2016, increasing from the preceding year as was to be expected. The share of debt securities was 37% at year-end 2016, having decreased a little from the preceding year.

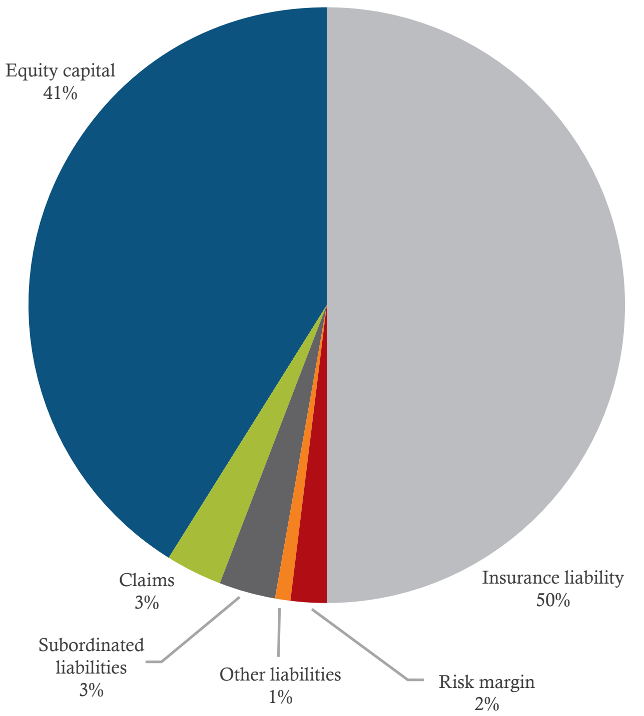
Figure 3 shows a breakdown of balance sheet liabilities for life and non-life insurance companies at year-end 2016. The equity position has improved consistently in recent quarters. The insurance technical provision has increased by almost ISK 4 billion, or 6%, and this is the second annual statement prepared in accordance with the assessment methods of the Solvency II framework.

Operations of insurance companies

The insurance companies' performance was better in 2016 than the preceding year. The income from investment activities was the companies' main source of profit. Profits from financial activities decreased but the non-life insurance operations were more profitable compensating

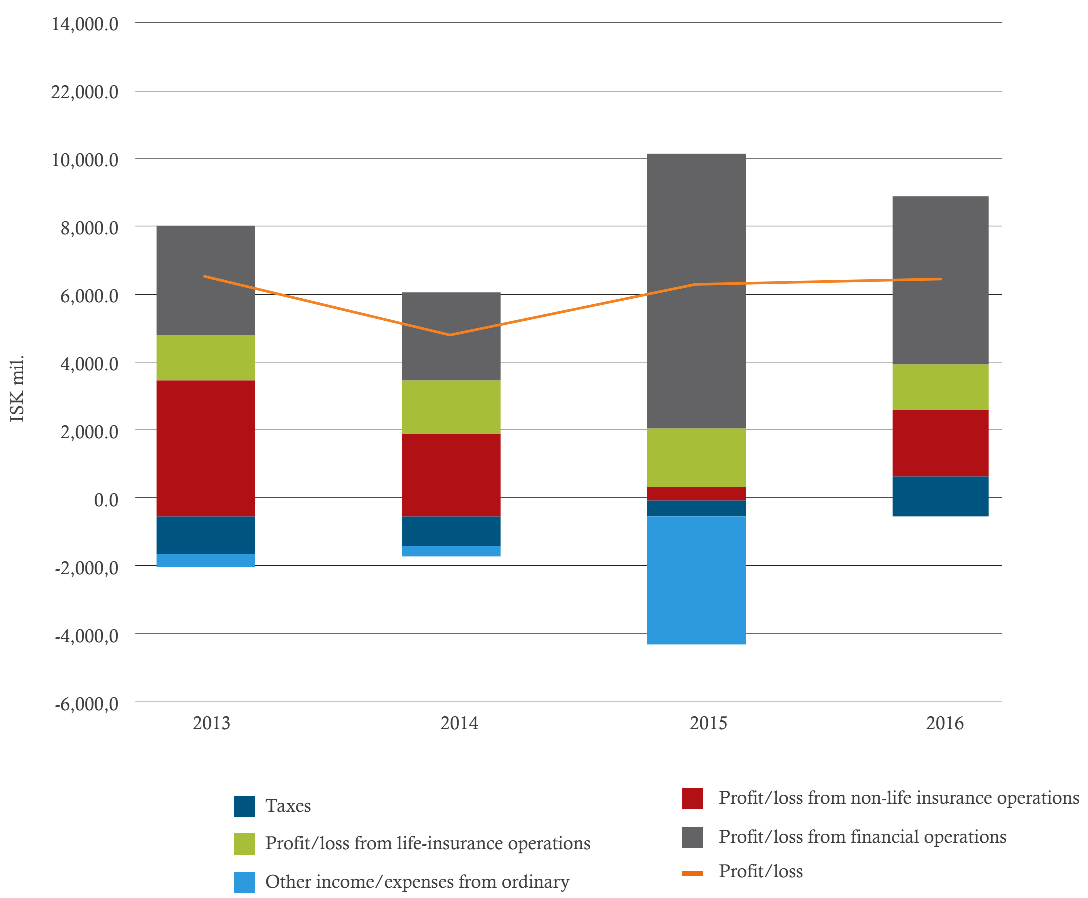
in part for the decrease. The performance of the life-insurance operations was similar year-on-year. The 2015 fiscal year was unusual since most insurance companies changed their assessment methods that year to conform with the methods of the Solvency II framework.
The insurance companies' premiums increased by 11% in 2016 and operating costs increased somewhat less, or approximately 9% year-on-year. Figure 4 shows the performance and breakdown of the companies' profit by function for 2013-2016.

Figure 3 Breakdown of insurance companies' assets and liabilities as of 31/12/2016



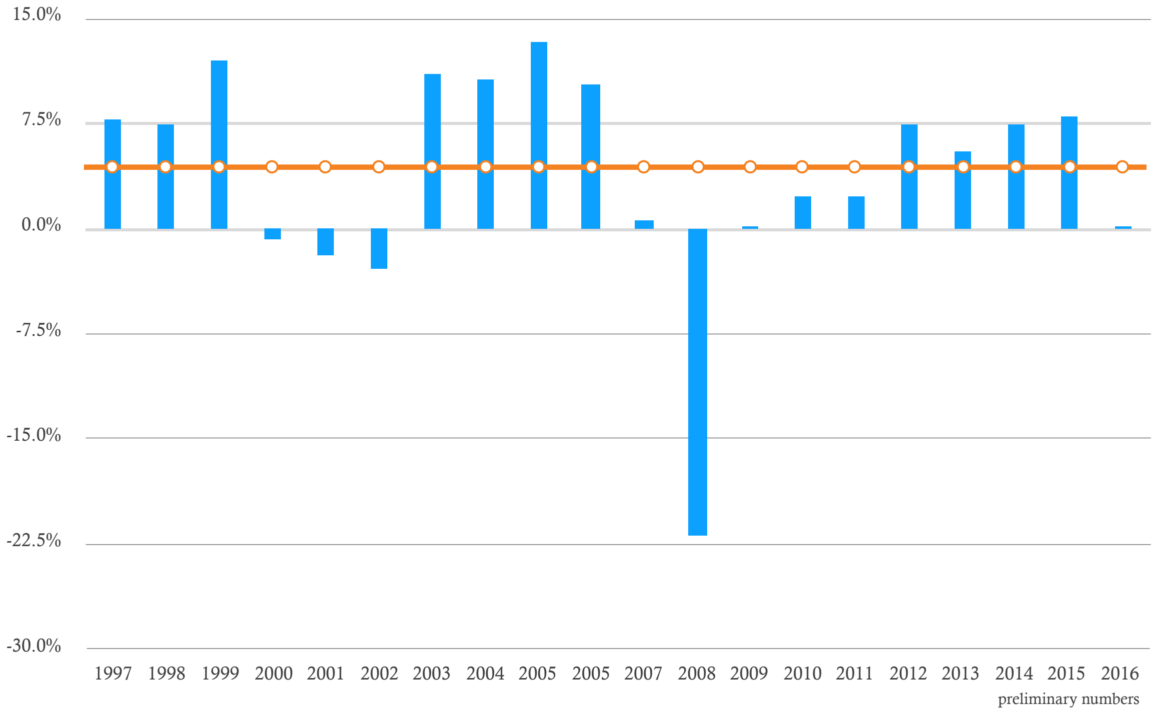
Source: Financial Supervisory Authority

Figure 4 Performance of insurance companies 2013-2016



Source: Insurance companies' annual accounts

Figure 1 Real return for pension funds' mutual insurance divisions



Source: Financial Supervisory Authority

2.5 Pension Funds

At year-end 2016, 25 operational pension funds were accepting mandatory savings in their mutual insurance divisions[8] and 13 of the funds accepted optional savings for private pensions. During the year the number of pension funds decreased by one when Stafir Pension Fund merged with the Sameinaði lífeyrissjóðurinn Pension Fund. The new fund is called Birta Pension Fund. At year-end seven non-pension fund custodians offered private pension savings.

Even with the increased economic growth and strong Icelandic economy last year the weighted average real return of the pension funds mutual insurance divisions only amounted to 0%. The main cause of lower returns are losses in the domestic equity market and the strengthening of the currency. The pension funds are by their nature long-term investors and that needs to be taken into account when assessing the investment returns. The average return of the mutual insurance divisions, based on the real return for the preceding 25 years, was 4.3%, which is well above the 3.5% target long-term real return.

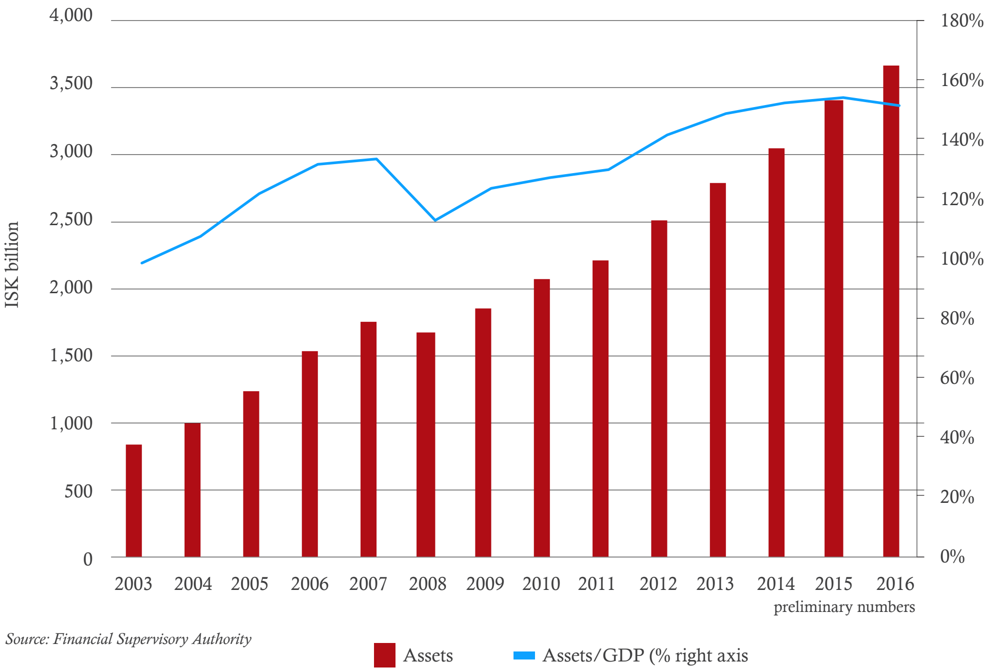
The total assets held by pension funds and other custodians of private pension custodians at year-end amounted to ISK 3,169 billion and ISK 502 billion respectively. The total assets held by these entities amount to ISK 3,671 billion. The increase year on year amounts to ISK 218 billion, almost 6%. Pension savings held by foreign parties, estimated at more than ISK 30 billion, are not included. As of 1 June 2017, the structure of Divisions A of the pension funds for State and municipal employees will be changed, in accordance with Act No 127/2016, whereby employers will no longer guarantee members' benefits. As a result of these changes, the State and municipalities will settle their liabilities and pay ISK 140–150 to the funds in 2017.

Total pension savings in mutual and private pensions at year-end 2016 amount to almost 152% of the estimated gross domestic product (GDP). The percentage decreased by 2% from the preceding year due to the funds lower yields and increased domestic product year-on-year. Pension savings have increased continuously since the financial crisis of 2008 and the pension funds' assets have become a larger part of the domestic financial market, amounting to around 75% of assets in the market.
The Icelandic pension funds are therefore very large participants in the domestic markets for debt and equity securities bearing great responsibility to the economy and domestic financial market stability.

Premiums including additional contributions totalled

[8] However, one pension fund, Eftirlaunasjóður starfsmanna Útvegsbanka Íslands, does not accept premiums.

Figure 2 Assets of mutual insurance and private pension divisions

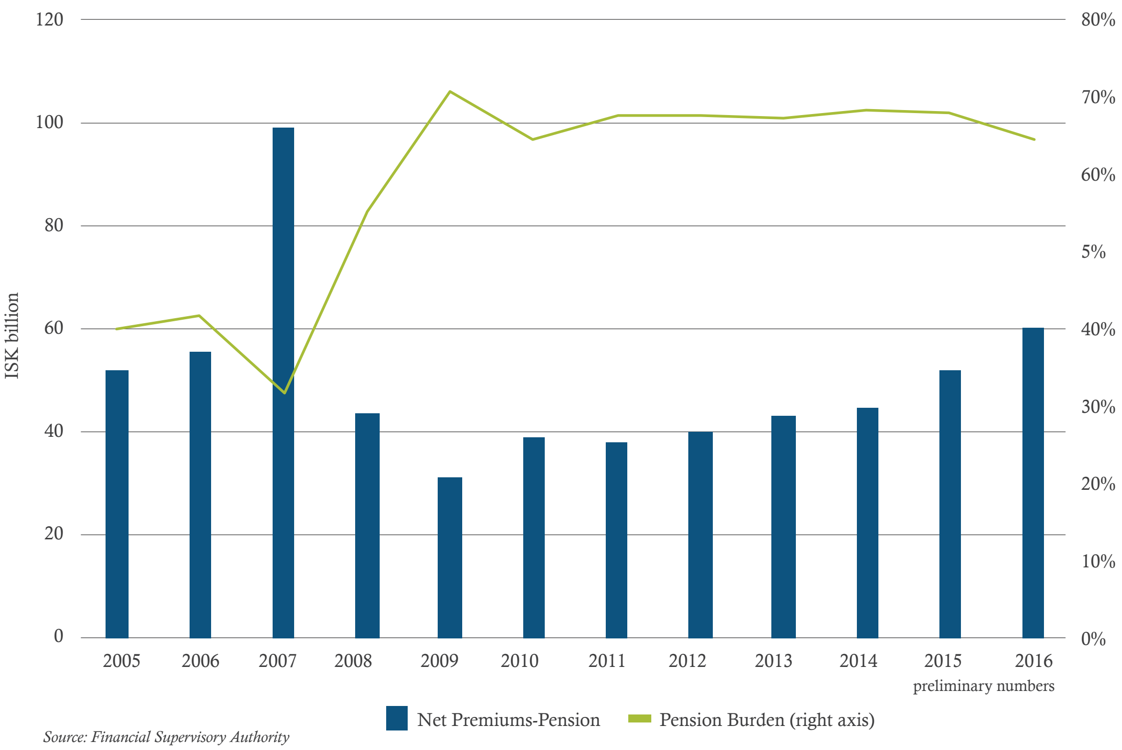


Source: Financial Supervisory Authority

approximately 170 billion ISK in 2016. Paid out pensions for the same period were 110 billion ISK. Meaning the annual net inflow amounts to 60 billion ISK.

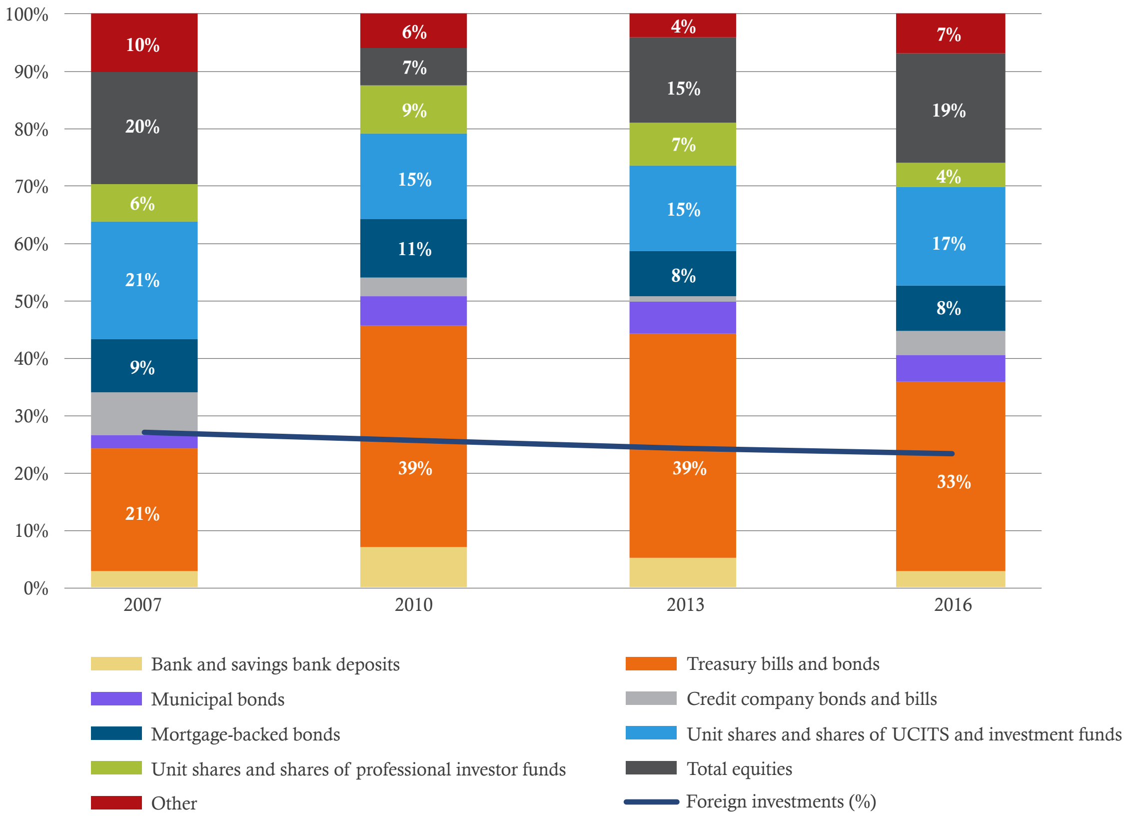
Figure 3 shows the development of net inflow to the pension funds, i.e. members' contributions, including additional contributions, minus paid out pensions, since 2015. There were significant supplementary contributions to the pension funds for State and municipal employees in 2007. The development is shown for the pension burden in the same period, i.e. the pension-to-premium ratio. Paid

Figure 3 Net inflow



Source: Financial Supervisory Authority

Figure 4 Pension fund asset composition and interests in foreign investments



Source: Financial Supervisory Authority

in premiums decreased following the financial crisis while paid out pensions increased.

Premiums are expected to grow by 15–20% until 2018 due to increase in employers contribution from 8%-11% in the open labour market. The net inflow will therefore increase significantly in the coming years, or by ISK 20–30 billion.

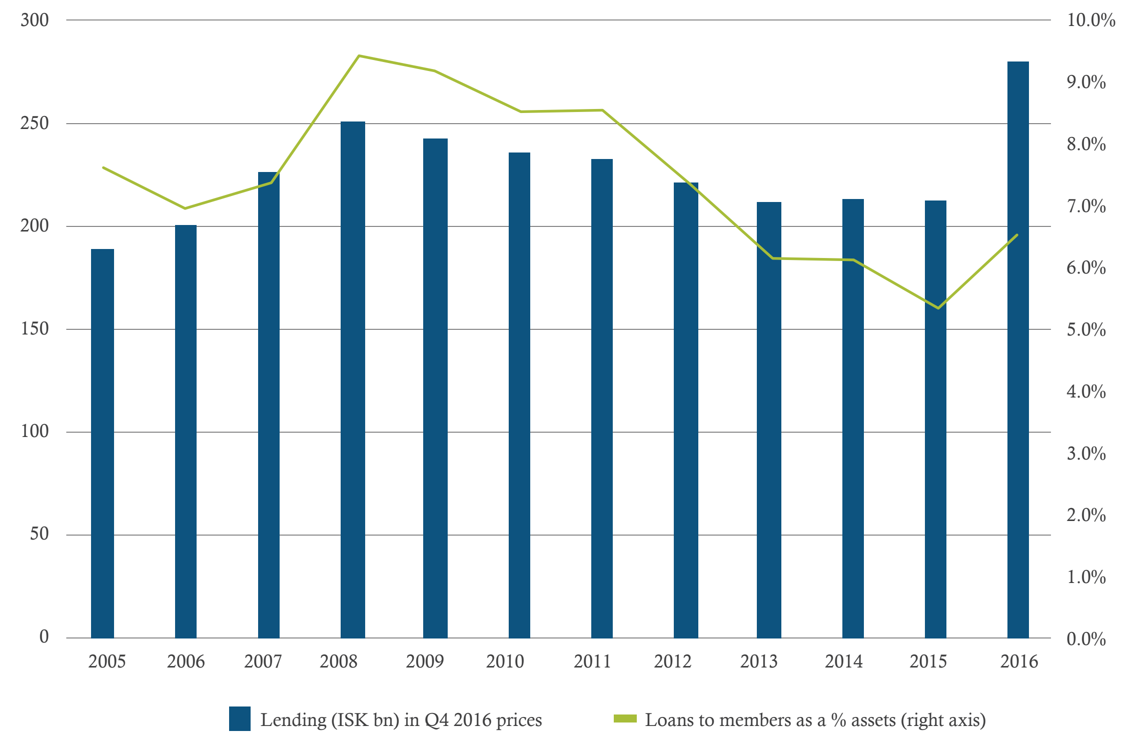
Composition of assets and lending

The asset composition of the pension funds' mutual insurance divisions changed significantly after the financial crisis in 2008 since the ratio of state and municipal-backed financial undertakings increased significantly as a percentage of total assets. The percentage of foreign assets also increased at the same time as prices dropped in the domestic markets for shares and securities and the percentage reached a maximum of 30% of total assets in 2009. Since pension funds were entitled to invest in foreign financial instruments, they have never fully utilised their investment quota to hold up to 50% of assets in foreign investments.

Domestic equities have increased significantly in the pension funds' asset portfolios in the last 2–3 years and it is estimated that their total direct and indirect shares, through funds and companies, is almost 45%. The pension funds have increasingly added to their investments in domestic financial instruments to fund partnerships limited by shares and other companies, due in part to various real estate projects, and those are classified as other securities. See Figure 4.

Real estate backed lending increased significantly in 2016, mostly as lending to members. The pension funds have always been one of the largest funders in the housing scheme, primarily through the Housing Financing Fund. In the last two years, they have entered this sector of the financial market without intermediaries by lending

Figure 5 Pension fund lending



Source: Financial Supervisory Authority and the Central Bank of Iceland

members directly and competing with banks and other financial institutions. The percentage of the pension funds' loans to members is currently at similar levels as it was before the financial crisis of 2008. See Figure 5.

Risk-based supervision

In October 2016, Act no. 113/2016, Amending the Act on Mandatory Pension Savings and on the Activities of Pension Funds No 129/1997 was adopted. The Act will enter into force on 1 July 2017 and concerns, on the one hand, changes to the authority and strategy for investments of the pension funds and, on the other hand, new provisions on risk management. The Act amends the classification of asset categories and quantitative limits and enacts the general principles regarding the pension fund investments based on the prudent person principle. The principles are, among other things, meant to encourage informed decision-making, forward-looking investments, and to ensure that the best interests of members are taken into account.

The prudent person principle aligns well with FME's focus on a risk-based approach to supervision. The aim of conducting an efficient and regular assessment of the principal risk factors in the activities of pension funds is to ensure sensible prioritisation of supervisory tasks. A comprehensive risk assessment, with an aim to reveal adverse incentives or excessive accumulation of risk, is furthermore the basis for discussions and comments on what practices the funds can improve.

Figure 6 Risk-based supervision

Actuarial life tables

For a while, the Icelandic Actuarial Society has worked on updating life tables so that they take into account estimates of continued decrease in mortality rates. The Society had announced that the new methodology would come into effect in 2016, which would have led to increases in the pension funds' liabilities with changes in regulation. The Ministry of Finance and Economic Affairs is now responsible for the publication of new life tables. Although this the new tables published by the Ministry do not assume increased longevity.

2.6 Management companies of UCITS, UCITS and investment funds, and institutional investor funds

Fund management companies are financial undertakings that have been granted operating licenses pursuant to the Act on Financial Undertakings and operate funds for collective investment pursuant to the Act on Undertakings for Collective Investment in Transferable Securities, Investment Funds and Professional Investor Funds. Undertakings for Collective Investment (UCITS) and investment funds are approved by FME and are subject to stringent requirements for their organisation, activities and management. Institutional investor funds are only open to institutional investors and pursuant to applicable legislation they are only required to notify the Authority and are subject to restricted supervision, mostly related to information disclosure. Furthermore, investments of institutional investor funds are not subject to any restrictions that apply to the investments of UCITS and investment funds. However, the supervision of institutional investor fund management companies will increase with the adoption of the 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 2017.

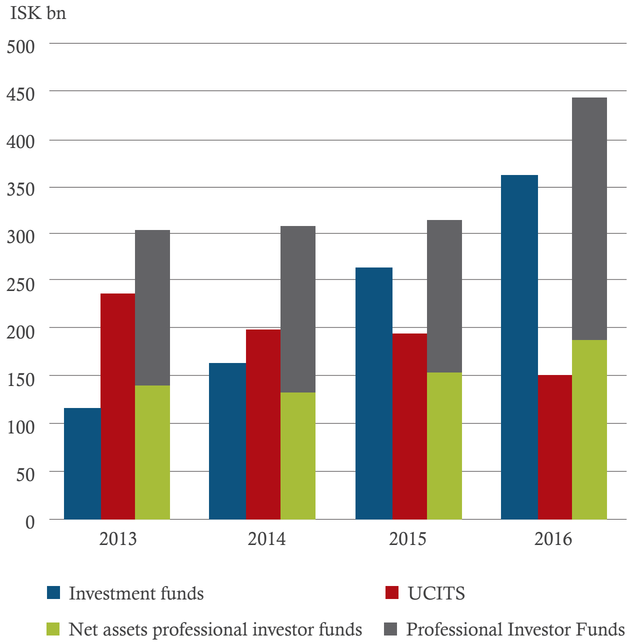
There were ten management companies regulated by FME at year-end 2016 and the number of companies has not changed since 2014. The principal activities of fund management companies involve managing UCITS and investment funds but also institutional investor funds even though management companies are not the only companies authorised to manage them. The adoption of the above-mentioned AIFMD will require management companies for alternative investment funds to apply for operating licenses as management companies for alternative investment funds.

The number of UCITS has decreased in recent years and 5 funds ceased operations last year. In 2016, a total of 45 UCITS and feeder UCITS were operated in 2016. The number of investment funds is still growing with the addition of 8 new funds last year. In 2016, a total of 61 investment funds and investment compartments were operated in 2016. At year-end 2016, total assets of UCITS and investment funds amounted to ISK 516 billion. Of these, assets of UCITS totalled ISK 154 billion and assets of investment funds totalled ISK 362 billion.

Assets of UCITS and investment funds have grown substantially in recent years with the greatest increase in 2015–2016, or a total of ISK 150 billion. The growth in 2015 and 2016 was ISK 93 billion and ISK 57 billion respectively. 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 growth is fairly equally divided between 2015 and 2016. The UCITS' assets decreased continuously 2013–2016, after having grown significantly in the first few post-crisis years. The decrease was largest in 2014 and 2016, i.e. approximately ISK 40–45 billion or about 20% each year.

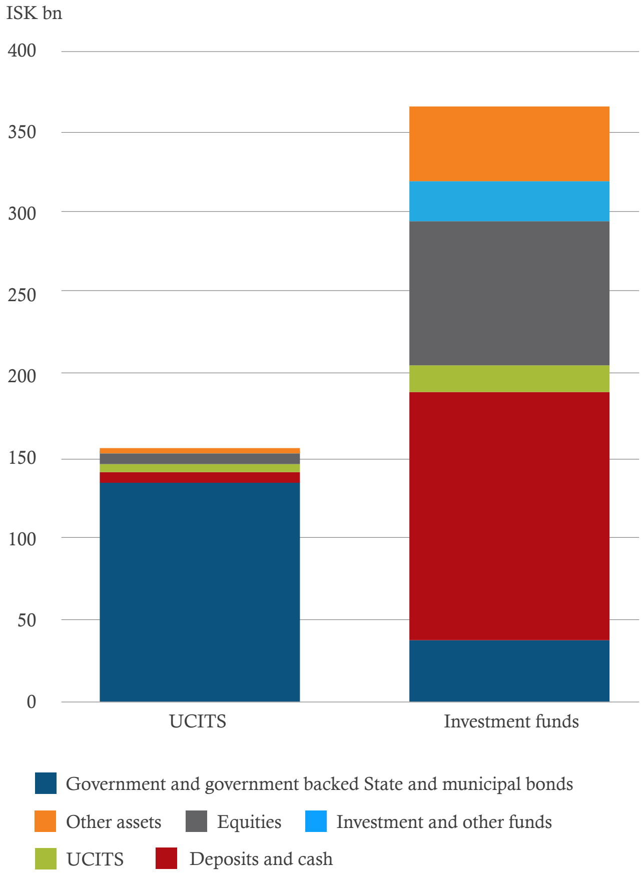
The number of regulated institutional investor funds increased by 17 funds during the year and at year-end 2016 a total of 102 institutional investor funds were operated by 15 entities. The total assets of the professional investor funds increased significantly, i.e. approximately ISK 129 billion or about 41% last year. Their total assets amounted to approximately ISK 444 billion at year-end, and net assets amounted to approximately ISK 189 billion. The leverage of the professional investor funds has increased since 2015, from about 50% to 57% at year-end 2016.

Figure 1 Asset trend for UCITS, investment funds and professional investor funds



Source: Financial Supervisory Authority

Figure 2 Asset breakdown of UCTS and investment funds as of year-end 2016



Source: Financial Supervisory Authority

UCITS and investment funds' asset breakdown

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

The asset breakdown of UCITS is substantially different from the asset breakdown of investment funds and approximately 87% of UCITS holdings are securities issued by or with State and municipal guarantees. Investment funds' holdings are substantially more varied. Approximately 42% is held deposits and cash, approximately 25% is in equities, and approximately 10% are securities issued by the State or with guarantees from the State and municipalities. The proportional division changes significantly in 2016 as investment funds previously mostly invested in equities. The proportional increase in deposits is, among other things, due to the increased number of liquid funds that mostly invest in deposits, those funds are intended for short-term investors.

Institutional investor funds mainly hold their assets in equities, mortgage-backed bonds, loan contracts, and other debt securities.

Ingibjörg Sigrún Stefánsdóttir
director of operations and finance
at FME

'I have always enjoyed biking and have been a biker since I was a child. After my children got older and I didn't need to drive them to and from practice as much I started thinking more about using bikes for transport. Last year I finally bought a new bike and used it for commuting to and from work most of the year.

The bike is useful to get to places where I can neither drive nor walk and I also get to enjoy breathing in the fresh air from plants and the ocean, air that people sitting inside cars miss out on.'

3. Events of the past year

3.1 Highlights from May 2016 to end of April 2017

Prior notification of an insurance portfolio transfer
On 17 May 2016, FME announced the transfer of the portfolio of Guardian Assurance Limited to R&Q Insurance (Malta) Limited.

Second meeting of the Financial Stability Council in 2016
On 19 May 2016, it was reported on FME's website that the second meeting of the Financial Stability Council in 2016 had been held the day before at the Ministry of Finance and Economic Affairs. It stated among other things: 'The risk factors currently considered to be most significant are signs of increased tension in the national economy, which can result in financial instability in the long term, adverse changes in international markets, which can affect the access of Icelandic banks to foreign credit markets, and the increased inflow of capital, which could result in domestic parties increasing their leverage and therefore lowering their resilience in a downturn.'

New rules on bonus schemes under the Act on Financial Undertakings
On 23 May 2016, it was announced on FME's website that the Authority's Board of Directors had adopted new rules on bonus schemes under the Act on Financial Undertakings.

FME publishes the methodology and common procedures for FME's supervisory review and evaluation process
On the last day of May 2016, it was announced in a news update that FME had published the methodologies and common procedures for FME's supervisory review and evaluation process. It stated that the methodology is based on EBA's Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP), and FME had worked in accordance with those Guidelines since they entered into effect in the beginning of the year 2016.

Prior notification of an insurance portfolio transfer

On 7 June 2017, the intended transfer of the portfolio of SA Insurance Ireland Limited to Royal & Sun Alliance Insurance plc. was announced on FME's website.

FME has deemed the Arion Bank hf. eligible to own a qualifying holding in Vörður tryggingar hf. and Vörður líftryggingar hf.

On 10 June 2016, it was announced on FME's website that the Authority had concluded that Arion Bank hf. was eligible to hold a 100% qualifying holding in Vörður tryggingar hf., pursuant to Chapter VI of Act No 56/2010, on Insurance Activities. Arion Bank hf. was furthermore eligible to hold a 100% indirect qualifying holding in Vörður líftryggingar.

Overall results of financial undertakings' annual accounts etc. 2015

On 16 June 2016, FME published a report on the overall results of financial undertakings' annual accounts for 2015, commercial banks, savings banks, credit undertakings (collectively referred to as credit institutions), securities dealers, securities brokers, 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 investor funds operated by management companies and other operators. In addition, the report included detailed information on payment institutions and co-operative deposit departments.

Interpretation — Release of information regarding the results of financial instrument offers and primary insiders' notification requirement pursuant to Act No 108/2007 on Securities Transactions

On 24 June 2016, FME announced on its website that the Authority had published interpretations on its website entitled: Release of information regarding the results of financial instrument offers and primary insiders' notification requirement pursuant to Act No 108/2007 on Securities Transactions The first interpretation addressed when to publish results of financial instrument offers. The second interpretation addressed primary insiders' notification requirement concerning securities lending.

FME publishes annual accounts and information on the performance of Icelandic insurance companies' lines of business

On 28 June 2016, FME published a compilation of annual accounts and information on the performance of Icelandic insurance companies' lines of business for the 2015 fiscal year in a standardised form. The income statements, balance sheets and cash flows were published. When the insurance company was part of a consolidation the consolidated accounts were published.

Prior notification of an insurance portfolio transfer

On 28 June 2016, FME announced the transfer of the portfolio of Atradius Credit insurance N.V. to Compania Espanola de Seguros y Reaseguros de Crédito y Caución S.A.

FME publishes information on contributions to, and the combined market share of, foreign insurance companies in Iceland 2010-2014

On 30 June 2016, FME published quantitative information prepared by the Authority on the activities of foreign insurance companies in Iceland 2010–2014. These companies have headquarters within the European Economic Area and are authorised to operate in Iceland pursuant to Chapter IX of Act No 56/2010 on Insurance Activities. The information was based on data submitted by the financial and/or insurance supervisory authorities in the relevant states.

FME issues draft rules concerning technical standards for the CRD IV/CRR framework

On 1 July 2016, FME announced that the Authority had issued six Consultation Papers, No 3–8/2016. The consultation papers contain draft rules concerning the adoption of the technical standards related to the CRD IV Directive.

EBA Consultation Paper relating to the transparency and disclosure requirements of credit companies in the European market

On 1 July 2016, FME pointed out a Consultation Paper published on the website of the European Banking Authority (EBA). The Consultation Paper in question concerned the transparency and disclosure requirements of credit companies in the European market.

FME issues draft rules concerning credit facilitation from financial undertakings to parties with close links

On 5 July 2016, FME announced in a news update the publication of Consultation Paper No 9/2016, which includes draft rules on credit facilitation from financial undertakings to parties with close links. The draft concerned a review of Rules No 162/2011 Credit provided by a Financial Undertaking to BM, a Managing Director, Key Employees or Parties with a Qualifying Holding in the Undertaking or Closely Connected to the Afore-mentioned.

Third meeting of the Financial Stability Council in 2016

On 7 July 2016, it was reported that the third meeting of the Financial Stability Council in 2016 had been held at the Ministry of Finance and Economic Affairs. The Council's meeting reviewed the principal risk factors in the financial system and an explanatory report from the Systemic Risk Committee to the Financial Stability Council. It stated among other things that the changes in risk in the financial system had been small since the last meeting of the Financial Stability Council held in May 2016.

The private sector resilience was still improving and the national foreign liabilities were decreasing. Systemic risk concerning lending had not changed significantly. Lending to individuals and companies had increased slightly in the preceding months. Systemic risk due to maturity mismatch and liquidity was not considered great and mostly unchanged since the preceding meeting.

Prior notification of an insurance portfolio transfer

On 8 July 2016, the transfer of the portfolio of Tryg Garantiforsikring A/S to Tryg Forsikring A/S was announced on FME's website.

Transfer of the professional investor funds Burðarás HL1, Burðarás HS1, and Burðarás SK1 form IV Funds hf. to Straumur Funds hf.

On 11 July 2016, it was announced the FME had on 30 June 2016 authorised the transfer of the professional investor funds Burðarás HL1, Burðarás HS1, and Burðarás SK1 form IV Funds hf. to Straumur Funds hf. on the basis of Article 106(1) of Act No 161/2002 on Financial Undertakings.

Prior notification of a life insurance portfolio transfer

On 25 July 2016, an announcement was made on FME's website of the transfer of the portfolio of Aviva Annuity UK Limited to Aviva Life & Pensions UK Limited.

FME has deemed Megind ehf. eligible to supplement a qualifying holding in Summa rekstrarfélag hf.

On 2 August 2016, FME announced its conclusion concluded that Megind ehf., kt. 640413-1310, was eligible to supplement a large enough qualifying holding in Summa rekstrarfélag hf. to consider a financial undertaking a subsidiary, pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.

European Insurance and Occupational Pensions Authority (EIOPA) issues a consultation paper with a draft information document for insurance products

On 2 August 2016, it was announced that the European Insurance and Occupational Pensions Authority (EIOPA) had issued a press release the day before concerning a Consultation Paper on the Implementing Technical Standards on a presentation format concerning non-life insurance. The objective was to standardise the presentation of information on insurance products. The customer would receive an information document before deciding on insurance.

Prior notification of a partial transfer of a life insurance portfolio

On 9 September 2016, an announcement was made concerning the intended partial transfer of a life insurance portfolio from Phoenix Life Limited to ReAssure Limited.

Prior notification of a life insurance portfolio transfer

On 12 September 2016, an announcement was made concerning the intended transfer of a life insurance portfolio from ReAssure Life Limited to ReAssure Limited.

FME has deemed Solo Invest ehf. and Örn Þorsteinsson eligible to own a qualifying holding in Straumur Funds hf.

On 8 September 2016, it was announced on FME's website that the Authority had concluded that Solo Invest ehf., kt. 620109-0610, was eligible to own a qualifying holding of up to 50% in Straumur Funds pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.

Implicit risk in trading financial instruments in foreign currencies

On 19 September 2016, FME had reason to warn the general public as well as investors about the implicit risk involved in trading financial instruments in foreign currencies. Lately, some ongoing unconventional marketing relating to such trading had been occurring and it could be considered misleading. The Authority also wanted to encourage consumers who were considering investment in such instruments to seek expert advice from parties authorised to provide investment advice to ensure their own best interests.

FME addresses the pension funds' situation in 2015

On 27 September 2016, FME published its summary of the position of Icelandic pension funds at year-end 2015. The summary was prepared from data submitted to FME by the pension funds and private pension custodians as of year-end 2015.

Fourth meeting of the Financial Stability Council in 2016

On 19 May 2016, it was reported on FME's website that the fourth meeting of the Financial Stability Council in 2016 had been held Friday, 30 September 2016 at the

Ministry of Finance and Economic Affairs. It explained, among other things, that the macroeconomic conditions had mostly been favourable to the financial system in recent quarters. There had been vigorous economic growth, unemployment had decreased, disposable household income had increased significantly, and companies had been quite profitable.

Conclusion reached that Aktiva lausnir ehf. offered payment services without the requisite license

On 5 October 2016, FME announced that earlier in the year Aktiva lausnir ehf. had begun offering to facilitate lending between its customers. The role of Aktiva lausnir ehf. had included connecting borrowers and lenders in a so-called lending platform. The company's services also included classifying lenders based on their credit scores and receiving and intermediating payments between borrowers and lenders.
The transparency notification on the situation noted that FME considered the company to have operated without a license and conducting activities covered by the provisions of Act No 120/2011 on Payment Services and that on 31 August 2016 the Authority had ordered the company to immediately cease activities subject to authorisation. The transparency notification furthermore noted that the company had met FME's requirements.

Implicit risk from so-called peer-to-peer lending

On 5 October 2016, sent out an announcement concerning implicit risk from so-called peer-to-peer lending, also known as lending-based crowdfunding.

Insider trading and FME's supervision

On 7 October 2016, FME sent out an announcement concerning insider trading and the Authority's supervision. It stated among other things: 'FME has cause to note that the Authority requested information and data from Nýherji's compliance officer regarding trading done by the chair of the company's board last November. FME considered the compliance officer's clarification satisfactory and the Authority's examination concluded this past February.'

FME holds meetings with external auditors for regulated entities that are also public-interest entities

On 10 October 2016, FME announced on its website that the Authority would schedule meetings with several external auditors for regulated entities in the coming weeks. This would be done in line with Guidelines No 4/2015 on the Dialogue Between FME and External Auditors for Regulated Entities that are also Public-Interest Entities.

Gable Insurance ordered to cease the sale of insurance policies

On 12 October 2016, FME announced that the Financial Market Authority Liechtenstein (FMA) had ordered Gable Insurance AG to cease the sale of new insurance policies and the renewal of existing policies, see report on FMA's website. Gable Insurance AG had sold rental insurance in Iceland through insurance brokers for some while.

Special Administrator appointed over Gable Insurance AG

On 14 October 2016, FME announced in a news update that FMA Liechtenstein had appointed a Special Administrator for Gable Insurance AG and referred to the news update it published two days earlier on its website.

Public consultation on a potential EU personal pension framework

On 18 October 2016, FME pointed out to stakeholders that the European Commission was holding public consultation on a potential EU personal pension framework and noted where and before when the comments should be submitted.

FME has deemed Stálskip ehf. eligible to own a qualifying holding in Borgun hf.

On 20 October 2016, FME announced its conclusion that Stálskip ehf. was eligible to own a qualifying holding up to 20% in Borgun hf., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings. The qualifying holding in question would be indirect through the ownership interest of Stálskip ehf. in Eignarhaldsfélag Borgunar slf.

FME's recent interpretations concerning specific provisions of the Act on Securities Transactions

On 20 October 2016, FME announced that a circular had been sent to issuers, financial undertakings, and pension funds pointing out recent interpretations of specific provisions of the Act on Securities Transactions that FME had published on its website in the preceding months.

FME's decision on increasing the countercyclical buffer

On 1 November 2016, FME announced its decision to increase the countercyclical buffer in accordance with recommendations from the Financial Stability Council dated 30 September 2016.

Prior notification of an insurance portfolio transfer

On 2 November 2016, FME announced the intended transfer of portfolios from Bosworth Run-Off Limited, Bramton Insurance Company Limited, Knapton Insurance Limited, Marion Insurance Company

Limited, Mercantile Indemnity Company Limited, and Unionamerica Insurance Company Limited to River Thames Insurance Company Limited.

Presentation of new requirements for insurance companies concerning public disclosures

FME announced on its website that on 3 November 2016 it had held the third presentation on the Solvency II regulatory framework for insurance companies. The presentation included discussion of the requirements resulting from Solvency II concerning the content and presentation of the insurance companies' Solvency and Financial Condition Report (SFCR) and the Regulatory Supervisory Report (RSR).

FME deems Dittó ehf., Kristján Arason, and Karl Þorsteins eligible to own a qualifying holding in Centra Corporate Finance Ltd.

Early in November 2016, it was announced on FME's website that on 28 October 2016 the Authority had deemed Dittó ehf., Kristján Arason, and Karl Þorsteins eligible to own a qualifying holding in Centra Corporate Finance Ltd.

Information on the position of Gable Insurance AG

On 9 November 2016, FME addressed the position of Gable Insurance AG. It stated, among other things, that according to an announcement from the Financial Market Authority Liechtenstein (FMA) dated 7 November 2016 that PWC, the appointed Special Administrator for Gable Insurance AG, had announced that there was reason to believe the company was overly indebted. An extraordinary shareholders meeting was called on 11 November 2016 where shareholders would have the opportunity to inject capital to avoid winding-up the company. The Special Administrator had asked the competent court in Liechtenstein to delay taking a decision to begin the winding-up proceedings until after the meeting of the shareholders.

EBA publishes a report on the results of its assessment of the adoption and impact of IFRS 9 on European banking institutions

On 11 November 2016, FME announced in a news update on its website that the European Banking Authority (EBA) had published a report on the first assessment of the adoption and impact of IFRS 9 on European banking institutions. The report contained the conclusions from both the qualitative and quantitative parts of the assessment as well as information on the related measures and tasks EBA proposed. Icelandic commercial banks had not participated in the assessment at this time but FME would recommend the three largest commercial banks to participate in EBA's follow-up assessment.

EBA's Consultation Paper on proposed changes to technical standards on credit companies' reporting

On 15 November 2016, FME pointed out a Consultation Paper available on the website of the European Banking Authority (EBA) concerning proposed changes to technical standards on credit companies' reporting.

Three commercial banks with an independent consumer ombudsman

On 30 November 2016, FME published a news update after having acquired information on consumer ombudsmen at Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf.
The news update highlighted the vital role of consumer ombudsmen and the importance of the commercial banks' customers taking advantage of their services.

Prior notification of an insurance portfolio transfer

On 30 November 2016, FME published a news update announcing the partial transfer of the portfolio of Markel International Insurance Company Limited to RiverStone Insurance (UK) Limited.

Prior notification of a portfolio transfer from Vörður líftryggingar hf. to Okkar líftryggingar hf.

On 1 December 2016, FME published an announcement concerning the transfer of a portfolio from Vörður líftryggingar hf. to Okkar líftryggingar hf.

Earned Trust published

On 2 December 2016, FME announced the publication of the work Earned Trust. The work contains FME's strategic focus for the years to come and this was the first time the Authority published a summary like this.

Prior notification of an insurance portfolio transfer

On 2 December 2016, FME announced the intended transfer of a portfolio from Chubb Insurance Company of Europe SE to ACE European Group Limited.

FME points out two consultation papers from the European Banking Authority (EBA)

On 7 December 2016, FME pointed out two consultation papers from the European Banking Authority (EBA) available on its website. One of the papers is a draft for joint ESMA and EBA guidelines on the assessment of the suitability of members of the management body of European financial undertakings. The other paper is a draft for revised EBA guidelines on internal governance (GL44), which FME had adopted earlier in the year with Guidelines No 1/2016 on the internal governance of financial undertakings.

FME has updated Common procedures and methodologies for the supervisory review and evaluation process for financial undertakings

On 9 December 2016, FME announced in a news update on its website that the Authority had updated Common procedures and methodologies for the supervisory review and evaluation process for financial undertakings.

FME has deemed Vörður tryggingar hf. eligible to own a qualifying holding in Okkar líftryggingar hf.

On 14 December 2016, FME announced in a news update that the Authority had concluded that Vörður tryggingar hf. was eligible to own a qualifying holding in Okkar líftryggingar hf.

Comments on discussion in the news programme Kastljós

On 14 December 2016, FME commented on discussions in Kastljós a few days earlier. The comment included: 'At the end of the last episode of Kastljós on 7 December, the discussion addressed fund withdrawals, in particular from Sjóður 9, in the days leading up to the collapse of the banks at the beginning of October 2008. It stated that the withdrawals had been scrutinised by Althing's Special Investigation Commission on the collapse of the banks. The discussion implied, wrongly, that FME had not taken any action with regard to these withdrawals, and we cannot avoid correcting what was said.
The truth of the matter is that soon after the collapse, FME conducted a wide-reaching investigation into these withdrawals which concluded in a complaint being lodged with the Special Prosecutor in March of 2009.'

Prior notification of an insurance company merger

On 15 December 2016, FME announced a proposed merger: Chubb Bermuda International Insurance dac (previously ACE Bermuda International Insurance (Ireland)), Chubb Insurance Company of Europe SE and ACE European Group Limited (AEGL) International Insurance Company Limited.

Presentation for changes to reporting on the insurance market

On 22 December, FME announced that the Authority would hold several presentations concerning changes to reporting on the insurance market relating to the adoption of Solvency II. The focus will be on new tables being adopted in 2017.

Amicable settlement for the infringement of Megind ehf. of Article 40 of Act No 161/2002 on Financial Undertakings

On 23 December 2016, FME announced in a news update that on 14 November the same year, FME and Megind ehf. had reached an amicable settlement for the infringement of Article 40 of Act No 161/2002 on Financial Undertakings.

Consultation Paper on a draft of revised rules on the Fit and Proper Assessment of Managing Directors and BM of Financial Undertakings

On 10 January 2017, FME announced that the Authority had issued Consultation Paper No 1/2017 containing a draft of revised rules on the Fit and Proper Assessment of Managing Directors and BM of Financial Undertakings.

Draft rules concerning information disclosure on investment costs for pension funds

On 10 January, FME announced that the Authority had issued Consultation Paper No 2/2017 containing draft rules amending Rules No 335/2015 on Annual Accounts of Pension Funds.

FME grants Íslandssjóðir hf. additional operating authorisation

On 11 January 2017, FME announced in a news update that on 6 January the Authority had granted Íslandssjóðir an extended operating license as a UCITS management company on the basis of Act No 161/2002 on Financial Undertakings.

Deadlines for processing notifications on qualifying holdings are based on receiving completed notifications

On 23 January 2017, FME published comments responding to reporting in the newspaper Morgunblaðið and on the website of Viðskiptablaðið over the weekend where it was stated that FME still had not processed the notification from BLM Investment ehf. on supplementing its qualifying holding in Lýsing hf. and that the Authority had exceeded the statutory deadlines. FME's comment included: 'As is actually noted at the back of Morgunblaðið's article, deadlines are measured as of when the Authority receives a completed notification of a qualifying holding. Therefore, the measurement of the deadline is not based on other dates, such as the purchase date, but rather it is the date that FME confirms the reception of a completed notification.'

FME has deemed Birta Pension Fund eligible to own a qualifying holding in Virðing hf.

On 25 January 2017, FME announced on its website that the Authority had concluded that Birta Pension Fund was eligible to own a qualifying holding up to 20% in Virðing hf., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.

FME has deemed BLM Investment ehf. and related

entities eligible to supplement a qualifying holding in Lýsing hf.

On 27 January 2017, FME announced in a news update on its website that the Authority had deemed BLM Investment ehf. and related entities eligible to supplement a qualifying holding in Lýsing hf.

Prior notification of a life insurance portfolio transfer

On 2 February 2017, FME announced the partial transfer of a life insurance portfolio from Zurich Assurance Ltd. to Rothesay Life plc.

Authorisation for a portfolio transfer

On 3 February 2017, FME announced it had authorised the transfer of a portfolio from Vörður líftryggingar hf. to Okkar líftryggingar hf.

Risk-based supervision presented to pension funds

On 7 February 2017, FME held a presentation for pension funds on risk-based supervision and many representatives attended from the pension funds. The presentation, as well as the question and answer session, was also recorded and made available on the Authority's website.

Pricing of the financial undertakings' services

In the middle of February 2017, FME published a news update on its website pointing out that no specific laws or regulations exist concerning charges for service fees at financial undertakings. Their pricing, much like other companies, is unrestricted. Individual acts address the cost of products or services. The provisions stipulate that the customer be informed of all potential costs related to the dealings or services. A summary of the principle acts on the subject followed.

Operating licenses for insurance brokers

On 21 February 2017, FME granted Hákon Hákonarson an operating license as an insurance broker.

FME's new list of tariffs

On 28 February 2017, FME announced on its website that the new list of tariffs for the Authority had entered into force and been published in the electronic issue of the Official Journal of Iceland the day before.

Notification of the merger of Vörður líftryggingar hf. and Okkar líftryggingar hf.

On 1 March 2017, FME announced it had authorised the merger of Vörður líftryggingar hf. and Okkar líftryggingar hf. pursuant to Act No 100/2016 on Insurance Activities.

New rules on the Fit and Proper Assessment of Managing Directors and BM of Financial Undertakings

On 2 March 2017, FME announced on its website that in February the Authority's Board had adopted new rules on the fit and proper assessment of managing directors and BM of financial undertakings pursuant to Act No 161/2002 on Financial Undertakings.

FME releases a schedule for regulation and the publication of guidelines for 2017–2018

On 3 March 2017, FME announced on its website that in the future a schedule would be released concerning upcoming regulation and guidelines and the Authority released the schedule for the next two years on that occasion. The schedule shows the titles of all regulations and guidelines that will be prepared in the period, categorised by market, and showing the estimated completion date of each project. The schedule also contains clarification/comments for additional information on the origination of individual projects.

Registration of creditors and credit intermediaries

On 3 March 2017, FME made note of the entry into force of Act No 118/2016 on Consumer Mortgages on 1 April 2017. The Act stipulates that entities must be registered by FME in order to have authorisation to grant mortgages to consumers on a professional basis. The same is true of entities wishing to intermediate such lending. However, credit companies, Housing Financing Fund, and insurance companies can grant mortgages without pre-registration and in addition credit companies, and under certain circumstances, lawyers and auditors, can intermediate lending without pre-registration.

No evidence of leaking information

On 6 March 2017, FME published a news update on its website responding to an article published in the newspaper Morgunblaðið that morning concerning Borgun hf. The article described the Authority's general procedure when possible criminal cases arise. It stated among other things: 'The chairman of Borgun hf. stated in Morgunblaðið that FME not informing Borgun when referring a case to the District Prosecutor was an example of unusual administration. To the contrary, FME is of the opinion that normal administration dictates that it is the recipient of comments or referrals that assesses how the general public, and the party concerned, should be informed of the presence or subject of the matter. ... ...
In the opinion of FME, there is also reason to comment on the report of Morgunblaðið alleging the leaking of information concerning the above-mentioned referral.
It is clear that the District Prosecutor has informed the media about the case and there is no evidence showing the leaking of information.'

FME deems VÍS hf. eligible to own a qualifying holding in Kvika banki hf., Akta Capital Management hf., Jupiter Capital Management hf.

On 10 March 2017, FME pointed out that it had concluded that VIS Insurance hf., kt. 690689-2009, was eligible to own a qualifying holding of up to 33% in Kvika banki hf. pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.
FME had also deemed VIS Insurance hf. eligible to own an indirect qualifying holding of up to 33% in Akta Capital Management hf. and Jupiter Capital Management hf.

Prior notification of a life insurance portfolio transfer

On 10 March 2017, FME announced the proposed partial transfer of a life insurance portfolio from Scottish Equitable plc. to Rothesay Life plc.

Draft rules concerning Implementing Technical Standards related to Solvency II

On 16 March 2017, FME announced the publication of four Discussion Papers No 3 – 6/2017. The consultation papers contain draft rules concerning the adoption of the implementing technical standards related to the EU Solvency II Directive. The rules will be set on the basis of Act No 100/2016, on Insurance Activities.

Share purchase in Arion Bank

On 20 March 2017, FME published a news update on its website regarding the share purchase in Arion Bank. It stated among other things: 'The four investors purchasing almost 30% in Arion Bank does not result in a new qualifying holding in the bank since the ownership interest of individual investors is smaller than 10% The purchase does not affect FME's conditions from 2010 for Kaupthing's qualifying holding in the bank through the holding company Kaupskil, which significantly limits the influence of Kaupthing's shareholders in the management of the bank, and the investors concerned hold the share in Kaupthing directly or indirectly. FME has reserved the right to capture the above-mentioned conditions and has introduced time limits for that purpose.'

Prior notification of an insurance portfolio transfer

On 23 March 2017, FME announced the intended transfer of the portfolio of Colbourne Insurance Company Limited to NRG Victory Reinsurance Limited.

New rules and updated reporting concerning credit facilitation from financial undertakings to parties with close links

On 28 March, FME announced new Rules No 247/2017 laid down on credit facilitation from financial undertakings to parties with close links, based on Act No 161/2002 on Financial Undertakings. When the rules entered into force they superseded the older Rules No 162/2011 concerning the same subject.

Prior notification of an insurance portfolio transfer

On 4 April, FME announced the intended partial transfer of the portfolio from QBE Insurance (Europe) Limited to Colonnade Insurance S.A.

Consultation paper concerning draft rules on the proper and sound business practices of insurance companies

On 5 April 2017, FME announced in a news update the publication of Consultation Paper No 8/2017 that contained a draft rule on the proper and sound business practices of insurance companies.

Consultation paper concerning a draft revision of rules on the proper and sound business practices of financial undertakings

On 5 April 2017, FME announced in a news update the publication of Consultation Paper No 7/2017 that contained a draft of the updated rules on the proper and sound business practices of financial undertakings. The update resulted from the amendments to the act on financial undertakings that included amendments to the provisions of Article 19 on proper and sound business practices.

First meeting of the Financial Stability Council in 2017

On 11 April 2017, FME announced in a news update that the first meeting of the Financial Stability Council had been held. The update reported, among other things, that in the middle of March the capital controls on individuals and companies had been lifted almost completely. There would be significant uncertainty on the impact on the national economy likely resulting in increased sensitivity to financial conditions in foreign markets.

Circular to financial undertakings concerning the impending law on short selling financial instruments and specific aspects of credit default swaps

On 19 April 2017, FME announced in a news update that financial undertakings had been sent a circular notifying them that a bill concerning short-selling and specific aspects of credit default swaps had been submitted to Althing.

Notification of continuing capital buffers for systemically important financial undertakings and unchanged countercyclical buffers

On 26 April 2017, FME announced continuing capital buffers for systemically important financial undertakings and unchanged countercyclical buffers in accordance with recommendations from the Financial Stability Council on 10 April 2017.

Reporting on transactions with financial instruments - TRS II supersedes TRS I

On 27 April 2017, FME announced in a news update that a new system will be implemented at the turn of the year 2017 2018 for receiving notices on transactions with financial instruments, the so-called TRS II system.

3.2 Summary of decisions and notifications on transparency from 1 May 2016 to end of April 2017

6 May 2016: Amicable settlement for the infringement of Fjarskipti hf. of Article 126 of Act No 108/2007 on Securities Transactions

13 May 2016: Conclusion of an examination into bonus payments to two managing directors of Tryggingamiðstöðin hf. (TM Insurance)

24 May 2016: Conclusions of an examination into the asset and liability duration of the mutual divisions of Stafir Pension Fund

24 May 2016: Conclusions of an examination into the asset and liability duration of the mutual divisions of Stapi Pension Fund

1 May 2016: Examination of the scope of regulated entities' services to legal entities registered in low-tax states and their investments in such legal entities

25 May 2016: Administrative fine for the infringement of Marel hf. against Article 87(1) of Act No 108/2007, on Securities Transactions

27 May 2016: Conclusion of an examination of the lending of Suður-Þingeyingar Savings Bank ses.

3 June 2016: Amicable settlement for the infringement of Greiðslumiðlunin Hringur ehf. of Article 58(1) of Act No 108/2007 on Securities Transactions

23 June 2016: Conclusion of an examination of the lending of Strandamenn Savings Bank ses.
24 June 2016: Amicable settlement for the infringement of Drómi hf. of Article 78(1) of Act No 108/2007 on Securities Transactions

24 June 2016: Amicable settlement for the infringement of Central Bank of Iceland Holding Company ehf. (ESÍ) of Article 78(1) of Act No 108/2007 on Securities Transactions

13 July 2016: Conclusion of an examination of the lending of Austurland Savings Bank hf.

29 July 2016: Conclusion of an examination into the investments of an investment fund under the management of Stefnir hf.

21 Sep. 2016: Conclusion of an examination of an assessment of suitability and compliance of the financial services offered by Arion Bank hf.

28 Sep. 2016: Conclusions of an examination of the risk management of General Pension Fund

28 Sep. 2016: Conclusions of an examination of the risk management of Almenni Pension Fund

5 Oct. 2016: Conclusion reached that Aktiva lausnir ehf. offered payment services without the requisite license

14 Nov. 2016: Conclusions of an examination into the notice period for insurance contracts and the related notifications

21 Nov. 2016: Amicable settlement for the infringement of Íslandsbanki hf. of Article 18(1) of Act No 108/2007

23 Dec. 2016: Conclusion of an examination of an assessment of eligibility and compliance of the financial services offered by Kvika banki hf.

23 Dec. 2016: Amicable settlement for the infringement of Megind ehf. of Article 40 of Act No 161/2002 on Financial Undertakings

3 Jan. 2017: Conclusions of an examination into the status of regulatory compliance at Virðing hf.

3 Jan. 2017: Conclusions of an examination into the status of regulatory compliance at Kvika banki hf.

3 Jan. 2017: Conclusions of an examination into the status of regulatory compliance at Gamma Capital Management hf.

20 Jan. 2017: Conclusion of an examination of the separation of functions at Kvika banki hf.

27 Jan. 2017: Conclusion of an examination of an assessment of eligibility and compliance of the financial services offered by Arctica Finance hf.

24 Feb. 2014: Conclusion of an examination of supervision of money laundering and terrorist financing at Borgun hf.

14 March 2017: Conclusion of an examination of Kvika banki hf. on certain aspects of measures against money laundering and terrorist financing

22 March 2017: Conclusions of an examination of the cyber security of Nasdaq Iceland

24 March 2017: Conclusion of an examination of supervision of money laundering and terrorist financing at Valitor hf.

4 April 2017: Administrative fine for the infringement of Eimskipafélag Íslands hf. against Article 122(1) of Act No 108/2007, on Securities Transactions

11 April 2017: Conclusion of an examination into the collection process concerning primary and secondary collection measures at Motus ehf., Reykjavik Energy, and Síminn hf.

12 April 2017: Amicable settlement for the infringement of Stefnir hf. of Article 59(1), see Article 30 of Act No 128 on Undertakings for Collective Investment in Transferable Securities (UCITS), Investment Funds and Professional Investment Funds

26 April 2017: Conclusion of an examination into the collection process concerning primary and secondary collection measures at Gildi – Pension Fund and The Pension Fund of Commerce

28 April 2017: Amicable settlement for the infringement of Birta Pension Fund of Article 40 of Act No 161/2002 on Financial Undertakings

Summary of issues of Fjármál and articles from 1 May 2016 to end of April 2017

Fjármál, Vol. 5, Iss. 2 (September 2016)

Life expectancy by social class
Jón Ævar Pálmason, head of risk analysis

Does the cost of preparing offering circulars pose an obstacle for the funding of companies?
Arnfríður K. Arnardóttir, specialist in offering circulars

The importance of contingency plans concerning liquidity risk in the activities of financial undertakings
Brynjar Harðarson, risk analysis specialist

Fjármál, Vol. 5, Iss. 3 (November 2016)

Systemic importance of pension funds and regulatory arbitrage in the mortgage market
Loftur Hreinsson, risk analysis specialist and María Finnsdóttir, specialist in financial supervision

Company and risk culture – essential element in companies' activities in the financial market
Guðrún Finnborg Þórðardóttir, head of legal affairs and Hrafnhildur Mooney, risk analysis specialist

Financial Supervisory Authority and the media
Sigurður G. Valgeirsson, Press Officer

Fjármál, Vol. 6, Iss. 1 (March 2017)

Who should be on the board of a pension fund?
Helga Rut Eysteinsdóttir, lawyer with off-site supervision, Hrafnhildur S. Mooney, risk analysis specialist, and María Finnsdóttir, specialist in financial supervision

FinTech – the future of financial instruments
Hildigunnur Hafsteinsdóttir, lawyer with Off-Site Supervision

The pension system – The risk for members
Björn Z. Ásgrímsson, pension fund risk analysis specialist

Book review: Naked Statistics by Charles Wheelan
Jón Ævar Pálmason, head of risk analysis

Hallmundur Hafberg
specialist in financial control

'Painting with watercolours is very challenging but at the same time very rewarding and enjoyable. After a busy day it feels good to replenish the soul working on a painting. The drive to create must come from within but it is difficult to define, when, how, or why that drive exists. This is something I've felt as long as I remember.'

4. Entities regulated by FME

4.1 Number of entities regulated by FME

Categories of regulated entities at year-end	Skýr.	2013	2014	2015	2016
Subject to licence or operating under specific:					
Commercial banks		4	4	4	4
Savings banks		8	7	4	4
Credit undertakings		6	6	5	5
Housing Financing Fund (HFF)		1	1	1	1
Deposit departments of co-operative societies		1	1	1	1
Securities dealers		10	9	10	10
Securities brokers		2	2	1	0
Fund management companies	1)	9	10	10	10
UCITS (not legal entities)	2)	57	53	50	45
Investment funds (not legal entities)	2)	44	48	53	61
Institutional investor funds (not legal entities)	2)	63	65	71	81
Institutional investor funds - legal entities		7	9	14	21
Stock exchanges		1	1	1	1
Securities depositories		1	1	1	1
Pension funds	3)	27	26	26	25
Insurance companies		13	12	12	12
Insurance brokers		11	9	9	9
Entities with debt collection licenses		5	6	8	8
Payment institutions		1	1	1	1
Currency exchange establishments			1	1	1
Guarantee funds		2	2	2	2
Total		*273*	*274*	*285*	*303*
Other regulated entities:					
Custodians of private pension savings	4)	14	13	8	8
Issuers of listed shares		18	17	20	21
Issuers of listed bonds		57	60	60	57
Holding companies	5)	12	10	11	9
Financial undertakings undergoing winding-up		15	11	2	2
Total		***389***	***385***	***386***	***400***

1) Furthermore, see the number of UCITS and investment funds and institutional investment funds lower on the table.
2) Funds that are not legal entities but operated by fund management companies. Several UCITS and investment funds have more than one division. The number of divisions is reflected in the figures in the table.
3) 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.
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 100/2016. 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	2013	2014	2015	2016
Foreign banks (credit and financial institutions) without establishments	239	254	263	274
Foreign payment institutions without establishments		193	266	299
Foreign payment institutions with agents	2	2	2	2
Foreign electronic money undertakings without establishments		38	49	84
Foreign electronic money undertakings with distributors	1	1	1	1
UCITS (no. of divisions in parentheses)	56 (370)	65 (410)	70 (518)	75(596)
Securities dealers/brokers (Investment firms)	2148	2280	2461	2512
Insurance companies with establishments	2	2	2	2
Insurance companies without establishments	381	352	389	408
Insurance brokers and insurance agents	5030	5223	5055	5008

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