



Cooperation Agreement

between the Central Bank of Iceland and the Financial
Supervisory Authority

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Cooperation Agreement between the Financial Supervisory Authority and Central Bank of Iceland

The Central Bank of Iceland (the Bank) and the Financial Supervisory Authority (the FME) are required by law, according to Article 35 of the Act on the Central Bank of Iceland, no. 36/2001, and Article 15 of the Act on Official Supervision of Financial Activities, no. 87/1998, to conclude a cooperation agreement. The main objectives of the Central Bank of Iceland are to promote price stability and to contribute to a safe, effective financial system, including domestic and cross-border payment systems. The Financial Supervisory Authority shall attempt to ensure that financial activities in Iceland are in accordance with current regulatory provisions governing those activities and are consistent with sound, appropriate business practice in other respects, and it shall carry out monitoring and surveillance to this end.

In accordance with the foregoing, the roles and tasks of these two institutions diverge in many ways from one another, but both have the objective of promoting a healthy, effective, and secure financial system. The objectives of one institution cannot be achieved unless the objectives of the other are achieved. In view of this, the Central Bank of Iceland and the Financial Supervisory Authority conclude the following

Cooperation Agreement:

1. Aim of the Cooperation Agreement

The aim of the Cooperation Agreement between the Central Bank of Iceland and the Financial Supervisory Authority (FME) is to promote a healthy, effective, and secure financial system in Iceland, including payment and settlement systems. In order to achieve this aim, the following is necessary:

- To define explicitly the responsibilities of each institution and the division of tasks between them;
- To ensure that the institutions work together on their defined tasks;
- To ensure that the acquisition and communication of information from financial institutions and between the institutions is carried out in a systematic manner;
- To ensure that analysis of stability generates a clear picture of financial institutions' strengths and weaknesses and their ability to respond to changes, both in the macroeconomic environment and in domestic and foreign markets;
- To ensure that the work of the two institutions aims at reducing systemic risk, thereby reducing the likelihood of a financial shock;
- To ensure that coordinated contingency plans are in place and that experience is drawn from conducting contingency exercises;
- To assess, on a regular basis, how well the existing regulatory framework conduces towards the achievement of financial stability objectives.

2. Cooperation on supervision and monitoring

2.1 Division of tasks and cooperation – fundamental principles

The Bank and the FME shall cooperate closely in monitoring the financial system. This cooperation involves three things: exchanging necessary information, consulting with the other party before drafting rules or taking action affecting the work of both institutions, and collaborating on defined tasks or projects. The division of tasks between the two institutions takes account of the provisions of the legislation governing their activities. The following principles shall be upheld:

- Where there is an explicit division of tasks, the party carrying out supervision in a given area shall inform the other party on a regular basis of the supervision conducted; cf. Section 3 of this Cooperation Agreement.
- Where tasks overlap to some degree, supervision shall be coordinated to the extent possible, and information shall be exchanged, including work carried out by risk assessment groups comprising experts from both institutions.

2.2 Supervision of individual risk factors

The following summary defines the main risks facing financial undertakings and specifies which institution is responsible for monitoring them. An entity that monitors risk pledges to prepare, twice a year, a summary of the status of risk factors that it supervises. In areas where responsibility for monitoring and supervision overlap, risk assessment groups shall operate and the supervisory entities shall make available an assessment of risk, together with recommended responses. In assessing risk and recommending responses, the supervisory entities shall take a position on systemic risk in particular.

Included here is a summary defining the main risks facing financial undertakings and specifying which institution is responsible for monitoring them. There will be four risk assessment groups: a foreign exchange risk assessment group, a funding risk assessment group, a settlement and payment intermediation risk assessment group, and a special micro/macro risk assessment group whose task is to analyse risk related to the operations of individual financial undertakings, on the one hand, and systemic risk, on the other.

The groups shall divide tasks amongst themselves and shall coordinate monitoring of foreign exchange risk, liquidity risk, settlement risk, and payment intermediation. In dividing up tasks and coordinating the committees' work, it should be noted in particular that both institutions carry out off-site monitoring, while the FME also conducts on-site inspections. The FME's monitoring the above risks is a part of risk management monitoring and internal audit of supervised entities and will be useful to the Central Bank in following up on the precautionary rules set by the Bank.

Risk of financial undertakings	Monitored by Central Bank	Monitored by the FME	Risk assessment groups
Credit risk		X	
- including large exposures		X	
- including other concentration risk		X	
Market risk		X	
- including derivatives		X	
Risk due to asset-liability mismatches		X	
- including foreign exchange risk	X	X	X
Funding risk		X	
- including liquidity risk	X	X	X
- including capital adequacy		X	
Operational risk		X	
- including legal risk		X	
Systemic risk			
Micro/macro	X	X	X
Payment and settlement systems			X
- including oversight	X		
- including monitoring of systems	X	X	
- including monitoring of entities	X	X	

2.3 Cooperation on drafting and adoption of rules

In their work, the Central Bank and the Financial Supervisory Authority attempt to maintain a clear overview of how current laws, regulations, and other directives achieve the objectives aimed at in this cooperation agreement. The Central Bank and the Financial Supervisory Authority also adhere to the policy of being leaders in the development and shaping of new laws and rules in their respective areas and to propose statutory innovations to the Minister of Economic Affairs or other relevant minister. Where the roles of the two institutions overlap – cf. the summary of the main risks faced by financial institutions, in Section 2.2 above – they shall consult and cooperate on such development. The initiative for such work may come from regular consultation meetings between the Governor of the Bank and the Director

General of the FME, from currently working risk groups, or from other parties. The contact persons for the implementation of such cooperation are the Chief Attorney of the Central Bank and the Chief Attorney of the Financial Supervisory Authority.

3. Analysis of systemic risk

The FME and the Bank cooperate in their attempts to improve both institutions' analysis of the interplay between risk related to the operations of individual financial institutions and macroeconomic factors. The rules and monitoring directed at the operations of individual financial institutions may be referred to as microprudential supervision, while those aimed at reinforcing the stability of the financial system as a whole may be referred to as macroprudential supervision. An analysis of systemic risk must incorporate both of these. To that end, a special micro/macro risk analysis group shall be established; cf. Section 2.2 and Section 3.1, which covers the topics for discussion at joint meetings of the Central Bank Governor and the Director General of the FME.

3.1 Joint meetings of the Central Bank Governor and the Director General of the FME

At least twice a year, the Governor of the Central Bank and the Director General of the FME shall meet, together with senior experts from both institutions. The two institutions shall take turns preparing and calling the meetings. The aim of the meetings is to assess the scope of systemic risk in the Icelandic financial system. Expert groups from both institutions, including the risk assessment groups, shall meet in advance of these meetings in order to review the topics for discussion. The topics to be discussed at these meetings include the following:

- Macroeconomic stability, market developments, and the likely impact of both on the financial system, with macroprudential considerations as a guiding principle.
- An assessment of microprudential risk factors. The key financial ratios from the financial institutions' accounts, such as capital ratio, liquidity ratio, leverage ratio, foreign exchange balance, and other figures that could shed light on risk in the financial system, including developments in large exposures and lending to related or connected parties.
- An assessment of the interplay between risk related to the operations of individual financial institutions and macroeconomic factors.
- The status of payment and settlement systems and monitoring of these systems.
- Statutory and regulatory instruments governing financial activities.
- Improvements to contingency plans.

In addition, the Governor of the Central Bank and the Director General of the Financial Supervisory Authority shall meet at least once a year, together with the pertinent experts, in order to exchange information and discuss cooperation between the two institutions in a broader context. The two institutions shall also take turns preparing and calling these meetings.

3.2 Meetings of expert groups

Groups of experts from both institutions, including the risk assessment groups, shall meet as often as necessary in order to review risk factors; cf. Table 1 in Section 2. The groups shall set their own rules on preparing and calling the meetings.

4. Acquisition and reciprocal communication of information

4.1 Current arrangements

Appendix 1 to this Agreement specifies the current arrangements concerning the data to be collected by the respective contracting parties and states which information shall be provided to the other party and in what form. This arrangement shall be maintained until a revised and improved arrangement has been prepared; cf. Appendix 2.

4.2 Revised arrangements

The contracting parties are of the opinion that it is possible to make major improvements concerning acquisition, communication, and processing of data (see Appendix 2). To that end, ideas concerning a joint database for data acquisition and processing are being considered and evaluated. The fundamental idea is that the financial institutions will send data to a data submission system operated jointly by the Financial Supervisory Authority and the Central Bank. The data would be read in automatically, and the integrity of the data would be verified. The database would be connected to user-friendly report-generation tools where employees in each of the two institutions can retrieve the data they need and are authorised to access according to access control rules.

Elements of this attempt to improve execution are:

- To prevent gaps in the collection of data necessary for satisfactory monitoring and supervision and for an assessment of systemic stability.
- To take account of information that is not submitted during regular data submission but can have a decisive effect on stability; for example, market conditions, changes of loan agreement terms, etc.
- To reduce duplication of effort, which places unnecessary strain on financial institutions, raises supervisory entities' costs, and causes confusion.
- To enhance technical cooperation in the information field.
- To transmit information seamlessly between the Central Bank and the Financial Supervisory Authority and facilitate data processing.
- To work together on information exchange with foreign supervisory entities.

5. Responses to systemic risk or shock

5.1 Reporting requirements in the event that an imminent problem is suspected

If examinations by the FME reveal suspicions concerning shortcomings in the financial position of parties that are subject to official supervision and are engaged in transactions with

the Central Bank or operate extensively in the markets, concerning violations of rules governing payment and settlement systems, or concerning the risk of a systemic crisis in the financial markets in other respects, the FME shall immediately notify the Governor of the Central Bank.

If examinations by the Central Bank reveal suspicions of shortcomings in the financial position of companies in the financial markets, operational risk or violation of rules and agreements governing payment and settlement systems, or of serious difficulties in the financial markets in other respects, the Central Bank shall immediately notify the Director General of the FME.

In the above cases, the Director General of the FME and the Governor of the Central Bank shall respond in accordance with their institution's respective internal procedures.

5.2 Cooperation on contingency plans and exercises

The contracting parties shall attempt to develop measures to foresee operational difficulties in the financial market and in the operations of individual financial institutions in the market. They shall cooperate in presenting scenarios that will be useful in stress tests and as the basis for contingency exercises.

The Financial Supervisory Authority and the Central Bank shall formulate and maintain their own contingency plans, which shall take account of the contingency plans drafted by the other entity. Each institution shall grant the other access to this information. The need for improvements to contingency plans is assessed at senior management meetings (see Section 3.1).

At least once a year, joint contingency exercises shall be held for the financial system. Contingency exercises for payment and settlement systems shall be held separately. The Central Bank and the Financial Supervisory Authority shall participate in contingency exercises based on international agreements.

5.3. Cooperation on measures

When severe difficulties such as liquidity or capital adequacy problems arise in the operations of a financial institution that, due to its position or to external conditions, is systemically important in the financial market, the contracting parties shall consult on the measures to be taken. The same applies when the problems concern other companies in the financial markets, or the financial markets as a whole. If the Central Bank considers the possibility of providing a loan or guarantee to a credit institution in accordance with Article 7, Paragraph 2 of Act no. 36/2001, it will act in close collaboration and consultation with the FME on resolving the problem that may have arisen.

Each contracting party is solely responsible for the measures it is authorised to take in accordance with its role.

6. Other matters

6.1. Participation in international cooperation

Contracting parties shall consult with each other on participating in international cooperation and attending meetings connected with the role of both parties. Furthermore, each contracting party shall inform the other of matters that arise in international cooperation and concern the role of the other party.

6.2 Confidentiality

By law, information provided by one contracting party to the other shall be kept confidential. Such information shall only be used in the contracting parties' activities. The contracting parties shall ensure that they do not disclose information on the basis of the Information Act without consulting with the party that acquired it.

6.3 Validity

This Agreement supplants the Cooperation Agreement dated 3 October 2006. It shall be reviewed if either or both parties consider it necessary, or at least once every two years.

Appendices to this Agreement may be amended by the Director General of the Financial Supervisory Authority and the Governor of the Central Bank with their signatures.

Reykjavík, 6 January 2011

Financial Supervisory Authority

Central Bank of Iceland

Gunnar Þ. Andersen
Director General

Már Guðmundsson
Governor