The Financial Supervisory Authority

Annual Report 2009

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Cover photograph of Emstruá river. Photographer: Ragnar Th./Arctic Images

INTRODUCTION

The Annual Report of the Financial Supervisory Authority of Iceland (FME) covers the period from July 1st 2008 to June 30th 2009. (The report therefore discusses the fall of the Icelandic commercial banks in October 2008, government measures taken as a result of the bank crisis and the significant changes that occurred in the Icelandic financial market in the wake of the economic collapse. The report also contains detailed sections on the position and outlook in the securities market, the pension and UCITS markets and the insurance market. An account is given of changes in the organisation of the FME and new points of focus in the Authority's operation. Furthermore, the report covers the tightening of financial market regulations, new approaches to financial market supervision, both at home and abroad, increased transparency and new regulatory functions of the FME.)

In its previous reports, the FME has published lists of parties which are subject to supervision by the Authority together with a summary of changes in their operating licences. Earlier reports also contain details of amendments to laws and regulations pertaining to the financial market that have come into effect during the reporting periods, as well as information on FME guidelines and legal interpretations. This has been changed so that the present report contains only a brief listing of the number of inistutions under the Authority's supervision. More detailed information can be obtained from the FME website. Highlights from the FME's annual financial statements for the year 2008 are appended to the report. The website also contains diverse information on the financial market and the structure of financial supervision in Iceland.

The Financial Supervisory Authority did not publish an annual report in 2008 as this was made impossible by the exceptional circumstances created by the fall of the largest commercial banks in the autumn of 2008 and the specific measures entrusted to the FME under the emergency legislation adopted in consequence.

FME Board of Directors:
Gunnar Haraldsson, PhD, Director of the Institute of Economic Studies, University of Iceland, Chairman
Kristín Haraldsdóttir, LLM, Attorney
Jón Th. Sigurgeirsson, Director, Governors' Office, Central Bank of Iceland, nominated by the Central Bank of Iceland

Alternates:
Óskar Sigurdsson, Supreme Court Attorney
Thóra M. Hjaltested, Attorney
Gudrún Ögmundsdóttir, Economist, nominated by the Central Bank of Iceland
Pursuant to Article 4 of Act 87/1998 on Official Supervision of Financial Operations, the Minister of Economic Affairs appoints three members to serve on the Board of the Financial Supervisory Authority for a term of four years, while one board member is appointed on the recommendation of the Central Bank of Iceland. The present Board of the FME was appointed on February 5th 2009 to serve until December 30th 2010, when previously appointed board members, as of January 1st 2007, requested to be released from their duties on January 25th 2009. The earlier Board of Directors of the FME was composed as follows: Jón Sigurdsson, Economist, Chairman (joined the Board on January 1st 2008); Sigrídur Thorlacius, Attorney, Vice-chairman; Stefán Svavarsson, Chief Auditor, nominated by the Central Bank of Iceland (joined the Board on October 9th 2008) to replace his predecessor, Central Bank Governor Ingimundur Fridriksson, also nominated by the Central Bank. Alternates on the FME Board at that time were: Kjartan Gunnarsson, Office Manager; Thurídur Jónsdóttir, District Court Attorney; Sigrídur Logadóttir, Chief Attorney, nominated by the Central Bank of Iceland.

Director General of the FME: Gunnar T. Andersen
Deputy Director: Ragnar Haflidason

Jónas Fr. Jónsson was Director General of the FME until January 2009. Gunnar T. Andersen took over as Director General in mid April 2009. Deputy Director Ragnar Haflidason acted as Director General for the intervening three-month period.

1 COLLAPSE OF THE ICELANDIC BANKS AND SUBSEQUENT MEASURES

1.1 Director General's Address

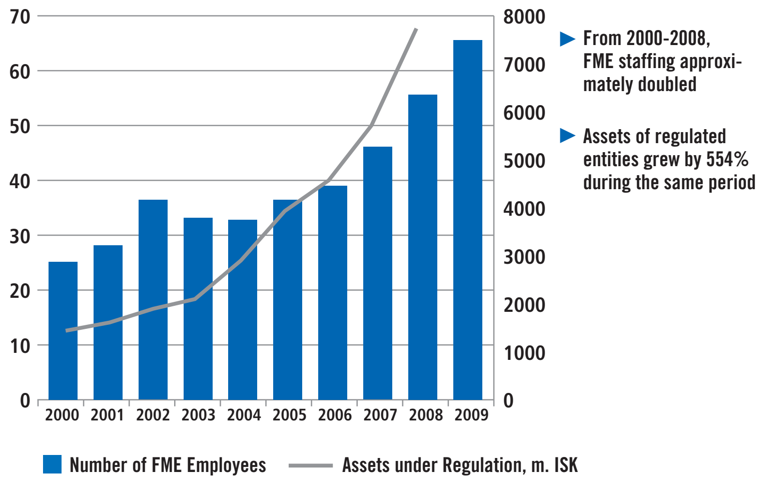
The collapse of the Icelandic banking system did not happen overnight. There had already been certain signs indicating difficulties ahead, as reflected by the extraordinary write-offs in the loan portfolios of domestic credit institutions. Looking back, it is clear that credit institutions showed numerous weaknesses in their risk management, governance and internal procedures. The risk appetite of Icelandic financial undertakings in recent years led to dangerous risk levels, which in turn brought about their downfall. At the same time, internal control mechanisms were lax and trade practices, in the FME's opinion, in many respects irregular.

As the banks collapsed, a sizeable portion of the assets of credit institutions disappeared into thin air as can be seen by a simple comparison of their balance sheets. Total assets on a consolidated basis thus amounted to ISK 16,550 billion in June 2008 but are estimated at merely ISK 3,300 billion, exclusive of the assets of the Old Banks, at the end of June 2009.

Investigations by the FME of a number of cases in the wake of the collapse indicate that in addition to irregular business practices there are also indications of serious breaches of law in Icelandic financial undertakings. These include market manipulation, insider trading and possibly breach of trust. In addition to violation of legislation under which the FME conducts its supervisory activities, these actions may also be subject to the Penal Code in Iceland and criminal law in other countries.

Quite simply the "Icelandic business model" that had been so widely praised by so many was imperfect at best. The ambitious spirit of cross-border expansion was totally inconsistent with the capacity of the banks and other sectors of the economy. It is also clear that supervision and control systems, both external and internal to the banks, failed to function properly. As for the FME, it had neither the required number of employees nor sufficient financial resources to keep pace with the rapid growth of the financial sector. A case in point is the fact that net assets of the parties regulated by the FME increased by 554% between 2000 and 2008 while the number of FME employees grew by less than a fifth of that percentage. The extensive staff turnover during that time, which peaked at 25% in 2005, also weakened the FME's position. This instability damaged the FME and restricted its ability to carry out its supervisory functions.

Employees versus industry size



The workload of the FME changed substantially after the collapse of the banking system, particularly after the adoption of emergency legislation in response to the financial crisis (Act 125/2008). Pursuant to the emergency law the three large commercial banks, Kaupthing Bank, Landsbanki and Glitnir Bank, were taken over by the Financial Supervisory Authority and divided into "Old" and "New" banks, with the old banks placed under the supervision of their respective resolution committees. Further takeovers of financial undertakings were to follow when the FME took control of the operations of Straumur-Burdaras, the Reykjavík Savings Bank (SPRON) and Sparisjodabanki (Icebank) in March 2009.

The FME immediately launched audits of these undertakings and at the same time instructed their respective resolution committees to appoint experts to investigate certain aspects of the activities of the three principal banks prior to their fall. Since that time the FME has focused its activities on further investigations of events leading to the collapse of the banking system. Numerous cases have already been referred to the office of Special Prosecutor, as further outlined later in this report. This is, however, only the tip of the iceberg and the FME is likely to continue its investigations throughout 2010 at least.

Among the tasks facing the FME after the crash was the settlement of accounts between the Old Banks and the New Banks, finalizing financial instruments between them and securing sufficient capital for the New Banks to ensure their viability. Part of this work involved the valuation of assets transferred to the New Banks. The FME employed the international accounting and consulting firm Deloitte to conduct the valuation and the international management consulting firm Oliver Wyman as an impartial third party to oversee the valuation. In the spring of 2009 the FME conducted an audit of the New Banks and their business plans, financial strength and capital requirements in a sign-off project with the assistance of Oliver Wyman. With regard to the quality of asset portfolios and anticipated economic uncertainty in coming months, the FME concluded that it would be necessary to place higher capital requirements on the three banks than the statutory minimum. The FME's required CAD ratio for the three banks was therefore set at a minimum of 16%. A comparable capital requirement will be made on other financial undertakings. The position of the savings banks remains a cause for concern, but the authorities have been seeking ways to secure the future of savings banks in Iceland.

The fall of the major banks has created a great deal of work for all units within the FME. The credit market unit was largely responsible for work concerning the takeover of financial undertakings. The securities market unit, on the other hand, took charge of various investigations. The insurance market unit dealt with the bankruptcy of one of the largest Icelandic insurance companies. The pension market and UCITS unit carried out a range of investigations concerning the difficulties of pension funds and UCITS in the wake of the banking crash.

The FME has been entrusted with numerous new tasks in 2009. These include the supervision of debt collection agencies and professional investment funds. In addition, the FME has the role of chief investigator in cases of alleged foreign exchange violations. In total, these new tasks require over 6 full-time positions.

In recent months the FME has been undergoing organisational changes in order to strengthen the Authority internally and give greater effect to its regulatory powers. A new unit of forensic accounting was set up to this end, a legal expert has been appointed for the new position of Senior Legal Advisor. On-site inspections will be given added emphasis in the future and the FME will continue to keep a close watch on the ongoing discourse on new approaches to the supervision of financial markets in our neighbouring countries and in the EU. The Authority has also played a role in legislative reforms in areas which are relevant to its regulatory responsibilities.

FME employees have been under great strain in recent years. The fall of the banks gave rise to demands for immediate results of investigations and restructuring projects, adding to the already severe pressure. Despite these difficult conditions the morale of the FME staff has been high and no efforts have been spared to deliver work of the highest professional standard.

1.2 Government Measures and Reports on the Crash

The causes of the Icelandic bank crisis have been investigated on numerous fronts. The Office of Special Prosecutor was established and also a Special Investigation Commission (SIC) on the downfall of the Icelandic banks. The FME plays an important part in these investigations and has already referred a number of cases to the Special Prosecutor and to the economic crime department of the National Commissioner of Police. Various matters that were uncovered in relation to the crash have been under investigation by other authorities.

The Office of Special Prosecutor was established for the purpose of investigating suspicions of criminal actions in the period preceding and following the collapse of the banking system. Since its establishment the office has been reinforced significantly and on October 6th this year three new prosecutors were appointed. At the end of 2008 Althingi passed a bill to establish a parliamentary commission to investigate and assess whether the fall of the Icelandic banks and the related economic troubles might to some extent be traced to deficiencies in procedures and ethics. The commission was fully manned by December 30th 2008 and is due to submit its report on February 1st 2010.

In addition, the authorities have employed foreign specialists. Eva Joly, who has been appointed special adviser for the investigation of economic crime relating to the fall of the banks, is renowned for her investigations into financial crimes and corruption in Europe and elsewhere. In November 2008 the government of Iceland hired the Finnish banking expert Kaarlo Jännäri to assess the legal framework and organisation of financial supervision in Iceland and propose changes as required. The government also hired the Swedish banking expert Mats Josefsson as an adviser on the rebuilding of Iceland's banking system.

1.3 FME Investigations of the Banking Crisis

Around mid-October 2008 the FME launched investigations of possible violations of financial markets legislation in the periods preceding and following the fall of the three commercial banks. These investigations focused primarily on insider trading, foreign exchange transactions, marketing practices and investments by money market funds, market manipulation and lending procedures. The FME sped up its investigations in 2009 and so far a total of 27 cases involving activities of this kind have been referred to the Office of Special Prosecutor. The FME and the Office of Special Prosecutor have collaborated effectively on the cases under investigation and have signed an MoU to formalise their co-operation. The investigations are expected to continue for several months, as a number of cases, many of which are extremely complex and far-reaching, are still being processed.

In 2009 the FME referred two cases to the economic crime unit of the National Commissioner of Police. Five cases of alleged breaches of confidentiality have been referred to the state prosecutor. Administrative fines have been levied in a total of five instances and 45 cases concluded with conciliation. Conciliation is generally offered in minor cases when parties are invited to bring proceedings to a conclusion by paying an agreed amount in settlement. FME cases involving sanctions since the end of 2008 have reached a total of 84.

FME cases involving sanctions since year-end 2008

Referred to special prosecutor	27
Referred to economic crime department	2
Referred to state prosecutor	5
Administrative fines	5
Settlements	45
Total	**84**

The FME recommended that the resolution committees of the three banks should appoint experts to investigate certain aspects of the banks' activities before the fall. The expert investigations focused on compliance with internal rules and financial markets legislation during the time of the old banks. This included the examination of unusual or irregular capital movements between undertakings forming the consolidated groups of individual commercial banks or across borders, revisions of lending terms, changes in guarantees and collateral, the handling of derivative instruments, trading in securities and UCITS shares and the use of current assets.

Investigations by FME employees and experts hired by the resolution committees were conducted concurrently and organized so as to avoid duplication of efforts. Regular meetings were held with the experts during the investigation period, not to discuss individual cases, as three separate financial undertakings were involved, but rather to concentrate on methodology, what areas needed looking into and other matters relating to the investigations.

The experts' investigations produced extensive findings that were submitted for further analysis. Priority was given to the most difficult, complex and serious cases. In order to obtain speedier results, the FME hired lawyers and other experts to process specific parts of the reports.

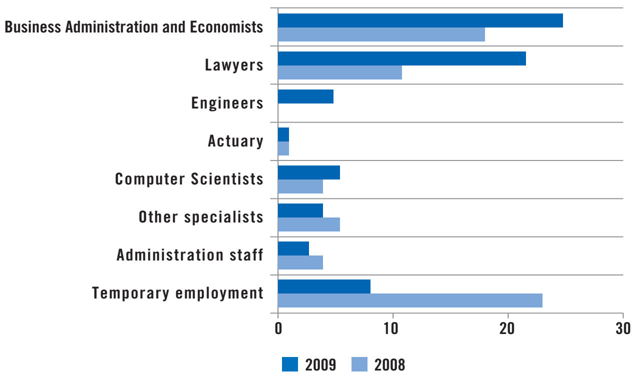
Among cases that are currently being investigated by the FME are alleged violations of foreign exchange laws and regulations. The FME and the Central Bank of Iceland work closely together on this matter and have signed an MoU concerning the investigation of foreign exchange violations. Cases of this nature are extremely far-reaching, complex and time-consuming. The FME and the Directorate of Internal Revenue have also signed a memorandum of understanding in order to strengthen their cooperation to the extent permitted by law.

The collapse of the banking system has naturally created vast media attention and the FME has inevitably been caught up in this maelstrom. In its dealings with the media the FME has repeatedly needed to point out that the Authority is bound by the confidentiality clauses of the legal framework by which it operates and is thus only able to provide very general answers and comments.

2 FOCUS AND ORGANIZATION OF FME ACTIVITIES

2.1 Post-crisis Personnel Developments

The FME is proud of its well educated staff. Around mid-year 2009 the total number of FME employees was 73, compared with 66 at the same time the previous year. The division of employees is shown in the chart below. The variety of new tasks in the wake of the banking crisis together with the heavy load of investigative work have made the appointment of new staff imperative for the FME.



Division 2008

- 18 economists and business specialists
- 11 lawyers
- 1 actuary
- 4 IT specialists
- 5 other specialists
- 4 office staff
- 23 temporary and summer employees

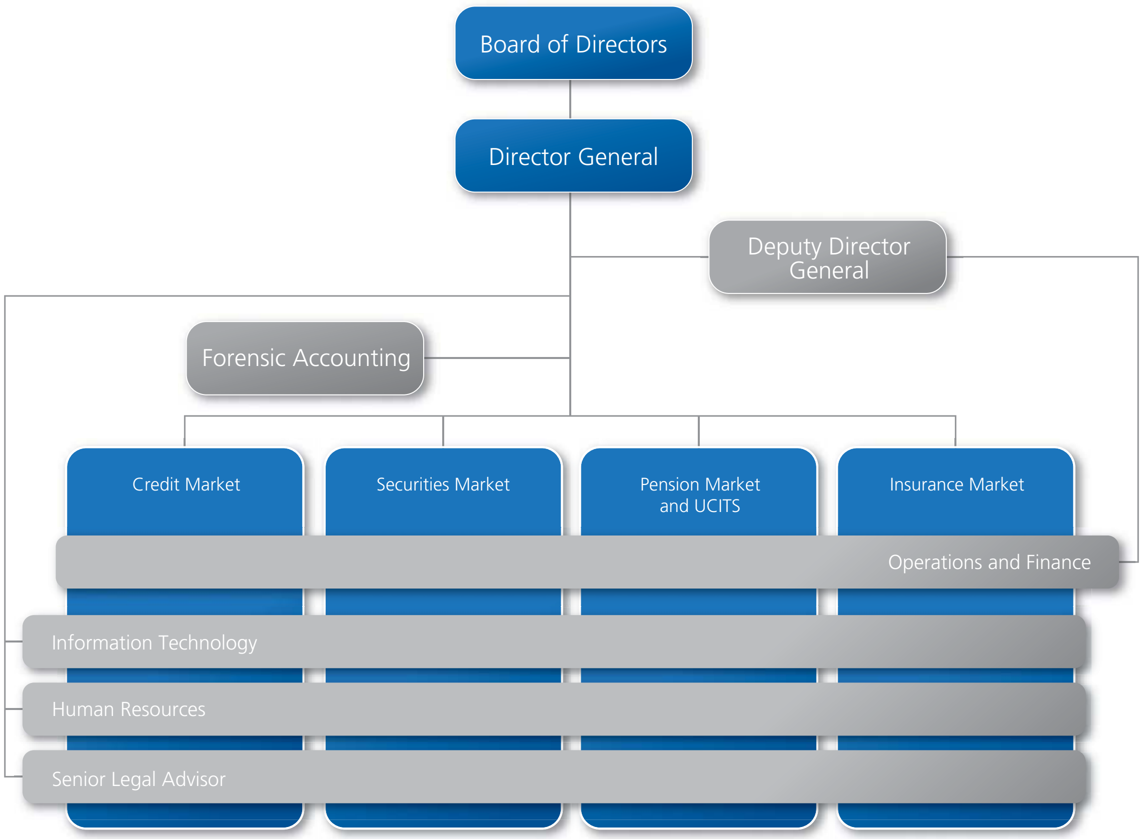
Division 2009

- 25 economists and business specialists
- 22 lawyers
- 5 financial engineers
- 1 actuary
- 5 IT specialists
- 4 other specialists
- 3 office staff
- 8 temporary and summer employees

Efforts have been made to give added weight to human resource management within the FME, for instance by placing greater responsibility on the heads of the different operating units and outsourcing recruitment services. As for the recruitment of new staff, the FME has focused on changing its human resource profile with regard to education, experience and age by giving preference to applicants with experience from fields related to the activities of the FME.

2.2 New Organization and Operational Emphasis

A new organizational structure was introduced at the FME in the autumn of 2009. The new structure is intended to foster more efficient administrative practices, give added power to supervisory activities and encourage a more disciplined approach in dealings with regulated entities. It is also hoped that the new organizational structure will reinforce the FME's image as well as general faith and trust in the institution. As before, the activities of the FME are divided into four operational units: credit market, securities market, pension market and UCITS and insurance market. Support services are divided into three units: administration and finance, information technology and human resources. The new organisational chart also incorporates two new units, i.e. that of forensic accounting and senior legal advisor. With the organizational changes, the administrative function of unit managers is also broadened.
In addition to the above, two new FME workgroups have been set up: the data processing group and the on-site group. A special sanctions group, which had been operating for a while with a mandate to harmonize procedures for imposing sanctions, was reinforced. The on-site group is responsible for planning and preparing supervisory visits and surveys in cooperation with other FME units. The data processing group is responsible for the examination of information and data sent to the FME through regular report submissions.



2.3 Operations and Financing

The FME case record database provides information on the division of disposable time between groups of regulated entities. Reference is made to this information over a period of three years in order to determine the proportional division of the FME's operational costs between these parties in the form of supervision fees. The following table shows the division of disposable time for the years 2007 and 2008. It should be noted that regular FME activities were somewhat disrupted in the last quarter of 2008 as a result of the banking crisis and this affects the proportional division of disposable time in 2008.

Table 1

Proportional division of disposable hours between groups of parties subject to FME supervision	2007	2008
Credit institutions	59,0	65,2
Insurance companies and insurance brokerages	16,2	9,7
Pension funds	7,7	9,1
Management companies of UCITS	2,8	5,8
Securities undertakings and securities brokerages	2,5	1,0
Issuers of equity and bonds	10,9	7,2
Others	0,9	2,0
	100,0	100,0

The FME's disposable time can also be analysed in terms of project categories. The following table shows a summarised analysis for the years 2007 and 2008:

Table 2

Proportional division of disposable hours between FME project categories	2007	2008
Supervision	52,4	57,6
Ongoing off-site supervision	16,1	21,2
On-site inspection	11,6	9,3
Other supervisory tasks	24,6	27,1
Regulations	7,3	7,1
Day-to-day administration	28,0	25,9
International collaboration/ communications	12,4	9,4
	100,0	100,0

Ongoing off-site supervision in the table above refers to various kinds of inspections, monitoring and market surveillance activities which are for the most part based on the systematic gathering of information and regular report submissions to the FME. This category also covers more specific inspections concerning the activities, business practices and procedures of regulated entities. On-site inspections refer to supervisory tasks which are initiated through specific on-site visits. Other supervisory tasks include all kinds of licensing, eligibility assessments, the dissemination of information and the handling of complaints and consumer affairs. Day-to-day administration refers to the group work and document storage systems of the Authority, computer and information technology, personnel matters, education and other tasks relating to daily office work.

FME Operations in 2008 and Estimates for 2009

The sudden and dramatic disruption of the Icelandic financial market in early October 2008, the collapse of the country's largest banks, the complex reconstruction of the entire banking system and extensive investigations of the bank crisis and its aftermath have caused some disorder in the activities and operations of the FME. The FME's operating budget for 2008 was disrupted and significant cuts were made in the budget for 2009 immediately following the financial collapse to adapt to the new conditions. The current economic climate and ongoing changes in the activities and operating environment of nearly all Icelandic financial undertakings is likely to create considerable uncertainty as regards the work of the FME in coming months.

In 2008 the FME's expenses including the equipment purchases amounted to ISK 1,069.4 million while revenue including interest income was ISK 961.0 million. Income from supervision fees was ISK 912.7 million. The FME received a special Treasury contribution to the amount of ISK 549 million. As a result, the FME showed a surplus of ISK 440.6 million for 2008. Not included in the preceding figures are costs and revenues related to complaints committees which are hosted by the FME. Capital at year-end 2008 was ISK 528.3 million.

The FME's operating plan underwent two revisions in 2008. Firstly, in June 2008, the proposed move to new premises was postponed, thus saving ISK 42.9 million on the budget for the year. The second revision was made in November 2008 following measures determined by Act 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances. This time the total salaries paid by the FME were cut back by ISK 32.8 million.

Pursuant to the Budget Supplement Act which was approved on December 22nd 2008, the FME was granted a special allocation of ISK 549 million to meet costs arising from the implementation of Act 125/2008. Principal cost items include remunerations to the resolution committees of the commercial banks which were appointed by the FME, auditing and appraisal costs for the compilation of opening balance sheets for the new commercial banks and other specialist services purchased in connection with the restructuring of the financial system. The full cost of the above measures was somewhat lower than anticipated in the Budget Supplement Act, or ISK 310.6 million. The sum of ISK 238.4 million from this special Treasury allocation was thus carried over to 2009.

Excluding the supplementary Treasury allocation and related expenses, the FME showed an operating surplus of ISK 202.3 million for 2008 and a year-end capital of ISK 289.9 million.

In the FME's budget for 2009 it is anticipated that expenses for the year, exclusive of the rulings committees, will come to ISK 953.7 million. Revenue, including interest income is estimated at ISK 778.5 million, thereof income from supervision fees to the amount of ISK 766.0 million. This gives a budget deficit of ISK 175.2 million. Taking into account the ISK 289.9 million equity at the beginning of the year, the FME is expected to show a positive equity of ISK 114.7 million at year-end 2009.

According to Act 99/1999 on the Payment of Cost for Public Supervision of Financial Activities, the FME is permitted to maintain reserves, which are projected at ISK 38.9 million at the end of 2009. Equity, net of reserves, is projected at ISK 76.3 million at year-end 2009 which will be subtracted from levied supervision fees for 2010.

Key statistical information from the FME's annual accounts for 2008 is detailed in Chapter 6 of this report. The annual accounts are published in their entirety on the FME website. The FME's operating budgets and source documents are enclosures with the annual legislative bill proposed by the Minister of Economic Affairs to amend Act 99/1999 on the Payment of Cost for Public Supervision of Financial Activities.

3 FINANCIAL MARKETS

3.1 Credit Market

Extraordinary Year for the Credit Market

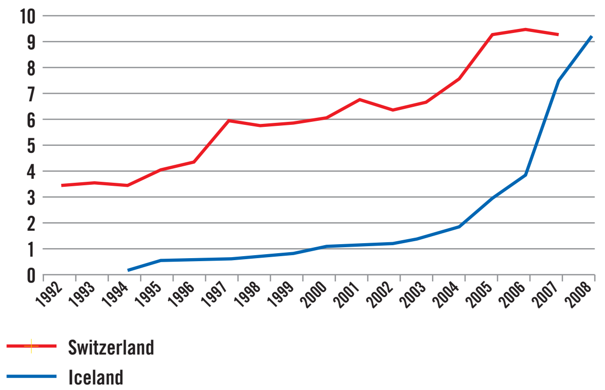
The last few quarters have been turbulent for the Icelandic economy. Due to disastrous market developments it became necessary to intervene in the operations of the largest credit undertakings in the country and this placed supervisory bodies in a most unusual position. The FME was entrusted with the huge task of appraising all the assets that were transferred from the old banks that had failed to the new banks that had been set up to replace them in order to keep the financial market funcional.

The financial crisis has had a profound impact on economic activity in the country and it will take a long time before credit market operations have returned to some sort of normality. All the same, a great deal has already been accomplished since the fall of the banks.

The Banking Crisis and the Emergency Legislation

September 2008 saw considerable tightening of credit in international markets following escalating distrust over the preceding months. It is, however, safe to claim that the collapse of the US banking giant Lehman Brothers around the middle of the month took most of the world by surprise, as did the bankruptcy threat facing the US insurance company AIG. Since none of the Icelandic banks had direct business relations with Lehman Brothers, the fall of the bank did not pose a direct threat to them as such. The indirect global impact, however, was of such a magnitude that two weeks later all the principal Icelandic banks had gone bankrupt. Interbank credit markets froze up altogether and all trust between participants in the market vanished. Doubts had already been raised regarding the creditbility of the Icelandic banks and their assets were considered to be extremely vulnerable to price slumps. Thus it was perhaps of little surprise that the Icelandic banks would be hit hardest this soon.

Assets of banks in relation to GDP 1992-2008



On September 25th 2008 the Board of Glitnir Bank informed the Central Bank of Iceland that the bank would be unable to meet 600 million euros in payments on its loans, which were due in the coming days that was due within the next few days and requested an emergency loan from the Central Bank in order to meet the payment. The Central Bank notified the Financial Supervisory Authority and the Government of Iceland of the bank's position and on September 29th the Government issued a declaration to the effect that it would take control of the bank by providing it with new equity capital to the amount of 600 million euros in return for a 75% share in the bank. The Central Bank had thus rejected Glitnir Bank's last-ditch effort to obtain an a last-resort loan. It was clear that the loan would only tide the bank over until the end of January, when it would again be faced with sizeable payments,with all its credit lines closed. The reactions of the market were negative. Following the Government's announcement of the takeover of Glitnir Bank, Iceland's sovereign credit rating dropped and contracts on credit lines to the commercial banks were rescinded. Landsbanki was in a bad position to withstand the fall of Glitnir and the ensuing tightening of credit. In addition, withdrawals amounting to 500 million pounds were made from Landsbanki's Icesave deposit accounts in the UK and the Netherlands during the week after the takeover of Glitnir. Kaupthing Bank also suffered the effects of panic withdrawals and balances on its Edge deposit accounts, which were substantial at the time, shrank by over 30% in a matter of days at the end of September and the beginning of October 2008.

On October 6th 2008 it was clear that Landsbanki was facing serious liquidity problems. Act no. 125/2008 (the Emergency Act) authorised the FME to take necessary measures in light of the serious position of the Icelandic banks. On October 7th, upon the request of the Board of Glitnir Bank, the FME took control of the bank's activities and placed it in receivership. Later that same day, Landsbanki was also placed in receivership. The following day British authorities took the unexpected move of invoking their anti terrorism law to freeze the UK assets of Landsbanki. This meant that Icelandic authorities were no longer in a position to access Landsbanki's assets in the UK. The Financial Services Authority (FSA) also determined that the British bank KSF (Kaupthing Singer and Friedlander), the British subsidiary of Kaupthing Bank, did not meet minimum liquidity requirements. The FSA prevented KSF from accepting deposits and instituted legal proceedings in Britain to place the bank in administration. These actions rendered the parent company, Kaupthing Bank, inoperative and on October 9th the FME took control of the bank and placed it in receivership. By now all the principal commercial banks in Iceland were in the custody of the Icelandic goverment and the collapse of the banking system was imminent.

The primary objective of the Icelandic authorities was to ensure the functionality of domestic payment systems and that basic financial services would be available so people could buy food and continue with their daily lives. At the same time it was imperative to prevent the creation of a domino effect that would result in a general collapse of the Icelandic economy. The fall of the banks posed a real threat that domestic payment services would come to a halt or that serious problems would make it difficult to provide the services.

New banks were established on the foundations of the old ones or, rather, each bank was divided up into an Old Bank and a New Bank. All foreign assets, liabilities and obligations were left in the old banks while all domestic loans, deposits and real estate were transferred to the New Banks in order to enable them to continue their activities in Iceland. The FME had appointed resolution committees for all the Old Banks with the mandate of salvaging as much as possible of their assets and thereby safeguarding the interests of their creditors. As the difference between the assets and liabilities transferred to the New Banks needs to be paid up in full, it was necessary to employ an impartial third party to valuate the assets.

The fall of the largest banks had a tremendous impact on the remaining Icelandic credit undertakings, who suffered liquidity problems, dwindling trust and a downgrading of their assets. In addition, shares in the fallen banks had to some extent served as collateral for loans issued by these undertakings. On March 9th 2009 the FME took control of the operations of Straumur-Burdaras Investment Bank hf. and appointed a resolution committee to assume the powers of its former board of directors. On March 21st the FME took control of the operations of Sparisjodabanki Islands hf. (formerly Icebank) and SPRON at the request of the respective boards of directors and appointed a resolution committee for each undertaking.

In the industrialized world there are no parallels to what happened in Iceland. The nation's banking system had totally collapsed and its credit ratings had reached rock bottom. International payment services were severely disrupted and the importation of consumer goods was in turmoil. The only feasible way out of the situation seemed to be an attempt to regain international creditworthiness by entering into an agreement with the International Monetary Fund on a programme to help restructure the national economy. Negotiations with the IMF soon resulted in a Stand-By Arrangement.

Restructuring of the Banks

The FME assessed the operational fitness and financial position

VALUATION OF THE ASSETS AND LIABILITIES OF THE NEW BANKS

Following extensive preparations by the FME, the international accounting and consulting firm Deloitte LLP was engaged to conduct an impartial valuation of the difference between the assets and liabilities that were transferred to the New Banks on the basis of the emergency legislation. Another international financial consulting firm, Oliver Wyman, was appointed to oversee the valuation and conduct an assessment of the appropriateness of the valuation methodology on behalf of the FME. The FME instructed Deloitte to prepare its valuation based on a concept of "fair value", which assumes that the New Banks continue to operate as fully capitalized domestic Icelandic banks with no requirement to divest their assets (or settle their liabilities) in the short-term or on a distressed basis. The application of the "fair value" concept was intended to ensure that the principle of proportionality would be observed in distinguishing between the emergency situation that called for the takeover of the banks, on the one hand, and the rightful interests of their creditors, on the other hand.

The understanding of the FME is that, as a consequence of this assumption, the resulting value will be substantially higher than the distressed market price while also reflecting the added value of transferring the assets to fully functioning banks.

For purposes of the fair value assessment, Deloitte used different methods for different asset classes. The principal asset classes were loans to customers, on the one hand, which were further subdivided into loans to large corporations, small and medium sized enterprises and retail loans and, on the other hand, other assets. Liabilities consisted almost solely of deposits, which were valued at principal value. Gross loans to customers (that is the outstanding loan balances before any provisions or adjustments) represented over 80% of gross assets in each of the three new banks. Large corporate group loans (with liabilities in excess of ISK 2.5 billion) represented ca. 40%-70% of total gross loans to customers and ca. 55%-85% of corporate loans to customers across the three new banks at the respective carve-out dates.

Deloitte undertook a case-by-case review of the information available in each of the New Banks relating to each of the large corporate groups and the respective companies within the given group. In total Deloitte reviewed over 130 large corporate groups and close on 500 companies within those groups. Particular consideration was given to the underlying security supporting the gross loans, namely collateral pledged by the borrower, and the enterprise value of the given borrower and whether the borrower was already, or soon to be, in a process of liquidation.

The recoverable amounts of SME and retail loans were assessed using various assumptions including, but not limited to, average default of borrower segments, the recovery rate of borrower segments in case of default, interest rates and indexation characteristics of the loans and economic outlook. The assumptions were based on information available from the New Banks, the Central Bank and third party sources regarding earlier banking crises abroad. Deloitte also considered sensitivities to various assumptions used.

Because of the economic stress taken into account in the valuation, both in domestic and international settings, the estimated „fair value" turned out to be lower than the gross book values before the respective carve-out dates. By the same token, owing to the assumptions implicit in the "fair value" definition used, many conceivable scenarios that may imply an even lower valuation lie outside the scope of the Deloitte analysis.

The results of Deloitte's net asset valuations are contained in three separate reports, one for each of the three New Banks. The valuation reports have been made available to core stakeholders, with certain restrictions, in order to assist them with upcoming negotiations regarding compensation for the net asset transfer from the Old Banks to the New Banks.

of the New Banks after reviewing their business plans and needs for capital. Part of the assessment of the New Banks was specific stress tests to measure their solvency and liquid assets in order to ensure they had adequate funding and financial resources. The FME also assessed the risk management and governance of the New Banks.

The most serious threats facing the New Banks are credit risk and liquidity risk. The credit risk is due to the uncertainty of credit quality. The liquidity risk is primarily a by-product of the uncertainty concerning cash flow from assets that have been transferred to the New Banks and their dependency on short-term financing through deposits. The FME believes that, owing to the severity of this risk and the balance sheets of the New Banks, capital adequacy ratios cannot be measured by conventional methods.

The capital of the New Banks is, however, relatively high by international standards and higher than stipulated by their own internal criteria. Furthermore, FME stress tests indicate that the New Banks are likely to sustain prolonged deep recession as defined by the FME in collaboration with the Central Bank of Iceland. The New Banks also have the added benefit of considerable liquid assets, i.e. initial capital supplied by the Treasury. They will thus be able to endure potential delays in the recovery of assets although domestic lending increases.

The FME's inspection of the New Banks showed certain deviations from good governance practices concerning internal control strategies and risk management. Plans were made for corrective action to be taken by all the banks and the FME's monitoring of compliance with these plans has already been set in motion.

Like other financial supervisory authorities, the FME conducts assessments of the eligibility of key managers and board members of regulated entities. The directors of regulated entities are required to ensure that their key managers possess the knowledge and experience needed to carry out their functions in a responsible manner. Furthermore, their credentials and backgrounds should provide no grounds for suspicion that they might resort to abusing their positions or causing harm to the undertaking that they serve.

At the end of June 2008 the total assets of Icelandic credit undertakings amounted to ISK 16,550 billion on a consolidated basis, which corresponds to 11.2 times the GDP in 2008. However, the total assets of credit undertakings excluding the Old Banks at the end of June 2009 are estimated at around ISK 3,300 billion, or just over double the GDP in 2009. At year-end 2002, when the activities of credit undertakings concentrated primarily on domestic trade, as indeed they did in 2009, the comparable ratio of total assets to GDP was 1.5. It should be noted here that the assets of the Housing Financing Fund are not included in these figures.

Credit institutions	Total assets end of June 2008 bISK		*Post crash*
Commercial banks (3)	14.430	*87%*	
Other CI	1.340	*8%*	
Other CI	625	*4%*	
Other CI	155	*1%*	
CI total	16.550	*100%*	
Proportion of GDP	1121%		
GDP 2008 bISK	1.477		

Credit institutions	Total assets end of June 2009 bISK	
Commercial banks (3)	2.560	*79%*
Other CI	700	*21%*
CI total	3.260	*100%*
Proportion of GDP	221%	
GDP 2009 bISK	1.474	

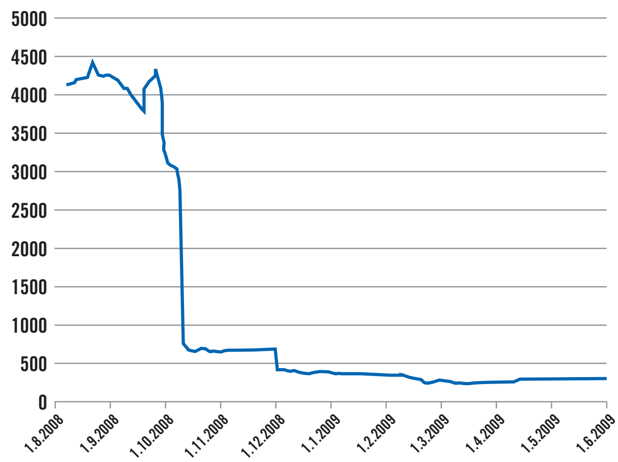
Moratorium Insufficient own funds Adequate own funds

3.2 Securities Market

Developments in the Securities Market

The Icelandic securities market and the FME's securities market unit have experienced deep and wide-ranging changes over the past year. After a period of a soaring rise in share prices, the year 2007 concluded with a 3.2% drop in the market index OMXI15. Projections for 2008 anticipated a continuing fall in share prices, but no one could envisage the disaster that ravaged the Icelandic economy at the beginning of October 2008. The principal Icelandic banks, Landsbanki, Glitnir Bank and Kaupthing Bank, were the true pillars of the Icelandic share price index, rightly named the financial index, as the weight of financial undertakings in this index reached up to 90%. With the nationalization of the banks, they disappeared from the market and this had a considerable impact on the Icelandic market index which plummeted by 76% over the weekend of October 10th-13th 2008having already dropped by 61% over the course of the year.

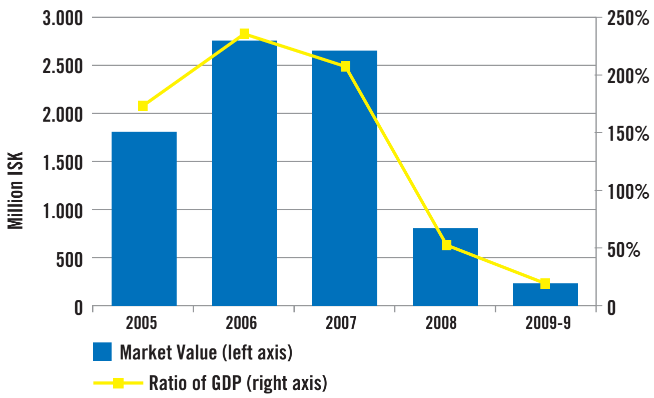
Figure 1 | **The OMXI15 index from 1.8.2008 – 30.6.2009**



At the beginning of October 2008 the FME temporarily suspended all trading in the shares of the three banks as well as Exista hf, Straumur-Burdaras Investment Bank hf. and SPRON hf. in order to protect investors and the normal functioning of the market in the existing extraordinary market conditions. At the same time the FME decided that the naked shortselling of the shares of these issuers should be prohibited.

The market value of OMX Iceland listed companies is now only a fraction of what it used to be. At the end of 2007 the market value of listed companies was ISK 2,570 billion and had remained relatively unchanged from the previous year's value. The share of financial undertakings in that value was around 70%. Since the collapse of the banks in the autumn of 2008 the market value of listed companies has plummeted to stand at ISK 203 billion at the end of September 2009.

Figure 2 | Market Value of listed Shares



Number of Listed Companies on OMX Iceland

From year-end 2007 to the end of September 2009 the number of companies listed on OMX Iceland has decreased from 30 to 14.

Number	2002	2003	2004	2005	2006	2007	2008	2009-9
ICEX listed companies	64	48	34	26	27	30	18	14

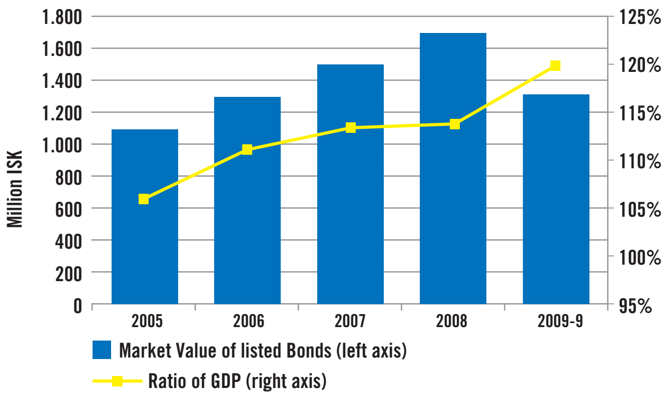
Over the years there has been a more or less steady downward trend in the number of listed companies and it is impossible to predict when the Icelandic stock market will reach its previous heights in terms of stock exchange listed companies. OMX Iceland expects that next year some 15 new companies will be listed and that the number of listed companies will have reached 30 by year-end 2010.

The Bond Market

The sharp increase in bond market turnover since October 2008 can largely be explained by the collapse of the Icelandic banks. The monthly turnover of bonds in 2008 totalled ISK 435 billion, whereas overall trading in debt securities on OMX Iceland was ISK 5,225 billion, which is twice the turnover of 2007 when the overall trading in debt securities amounted to ISK 2,430 at year-end. The results for 2009 are not likely to be as dramatic. The turnover until the end of September 2009 totalled ISK 2,060 billion with an average monthly turnover of ISK 229 billion.

The market value of bonds and bills was ISK 1,691 billion at year-end 2008, up 14% between years. At the end of September 2009 the market value of bonds and bills was ISK 1,323 billion, which constitutes a drop of 22% since the beginning of the year.

Figure 3 | Market Value of listed Bonds



SHARE TRADE INVESTIGATIONS

In the wake of the banking collapse the FME moved to investigate share trading in the period immediately preceding the difficulties of the three principal banks with a special focus on possible violations of laws falling within the scope of the Authority's supervisory responsibilities. At the same time, impartial third parties were hired to investigate deviations from the internal rules of the banks, laws and regulations on the activities of financial undertakings, laws on securities transactions and other sources of law pertaining to the conduct of those individuals and legal persons that came under investigation. The FME carries out further investigations where there is suspicion of violations of the laws that fall within its supervisory mandate.

In March 2009 the operations of Straumur-Burdaras Investment Bank, SPRON hf. and Sparisjodabanki Islands hf. were taken over. Impartial experts were recruited to investigate the activities of these undertakings by methods similar to those that were applied in the case of the three commercial banks.

3.3 Pension Market and UCITS

Pension Funds

Net assets of Icelandic pension funds at year-end 2008 amounted to ISK 1,598 billion, as compared to ISK 1,697 billion at the same time in 2007. The decrease between years was 5.9%, which corresponds to a decrease of 19% in real terms as measured by the consumer-price index. Pension fund assets as a proportion of GDP at year-end 2008 were 108% but were 133 % at year-end 2007. Figure 4 shows the trend in net pension fund assets as a percentage of GDP for the years 2002 to 2008.

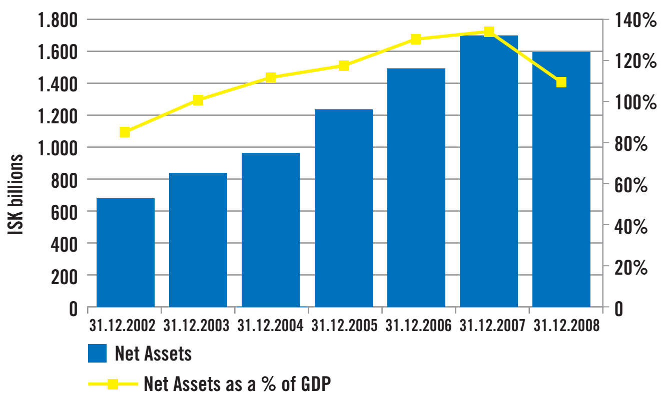
REPORTING REQUIREMENT OF ISSUERS

The FME and OMX Iceland collaborate on the supervision of regulated securities markets, including supervision of the reporting requirement of issuers. OMX Iceland monitors issuer notifications (including flagging notifications) and transactions in the OMX system with a view to verifying issuer compliance with their statutory disclosure obligations. OMX Iceland also monitors news reporting concerning the issuers of financial instruments by major Icelandic media. Final responsibility for the supervision, however, rests with the FME.

For the purposes of supervision and investigation of certain cases, the FME has requested information and data from issuers as well as other parties believed to be able to throw light on specific parts of a particular investigation. The FME has also made visits to the premises of issuers in order to collect data, such as management e-mail correspondence, as well as calling individuals in for hearings.

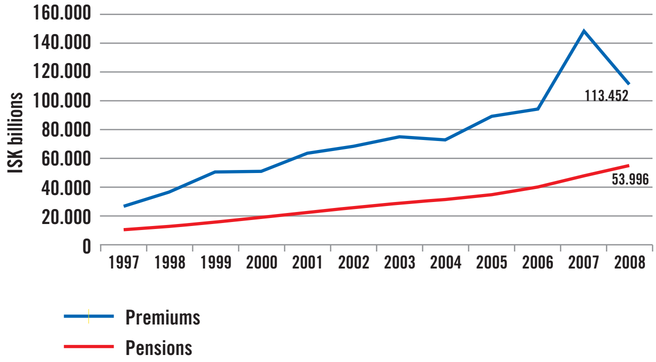
In the spring of 2009 the FME held a meeting with all securities issuers on the regulated market for the specific purpose of discussing disclosure requirements.. The obligation to disclose any information that could have a significant impact on the market value of financial instruments if it were made public was given particular attention. The meeting also highlighted the penalties that could be imposed for violations of laws and regulations concerning reporting requirements. The FME anticipates that meetings on disclosure obligations will become an annual feature of the Authority's work.

Figure 4 | Net Assets of Pension Funds



Since the entry came into effect of the Pensions Act, there has been a steady increase in pension fund premiums as shown in Figure 5, which depicts the trend of premium and pension payments from 1997. Premium payments have increased on average by 16% since 1997 despite a drop of 22% between 2007 and 2008, from ISK 146 billion to just over ISK 113 billion. The average per-annum increase in pension payments has been around 14% and in 2008 pension payments amounted to just under ISK 54 billion.

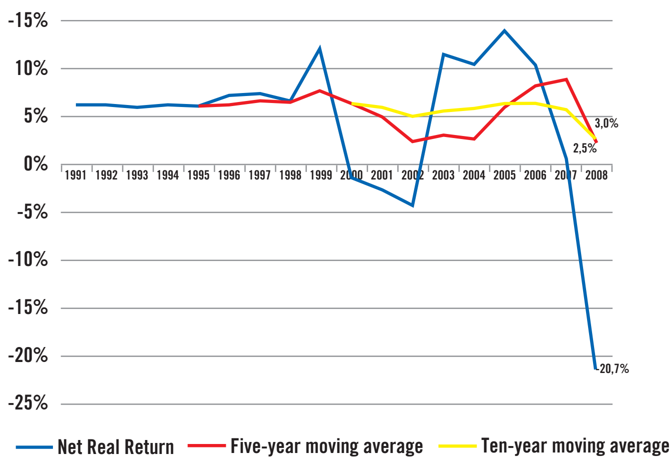
Figure 5 | Premiums (contributions) and Pensions (benefits) through 1997-2008



Return on Investment

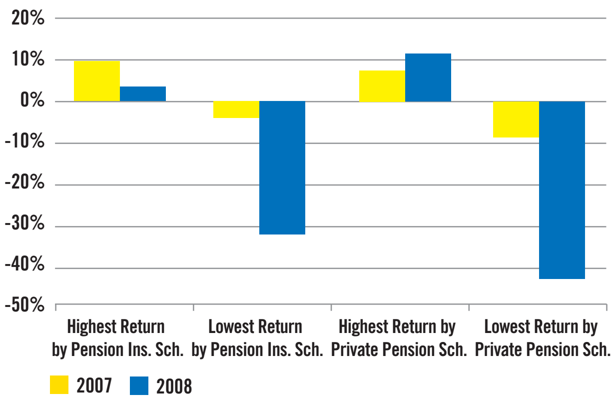
Net real return on Icelandic pension fund investment dropped dramatically between years and was -20.7% in 2008, as compared to 0.5% in 2007. The net real return of a pension fund is the return on its assets adjusted to the consumer-price index after deducting cost from investment income. The pension funds are long-term investors and therefore it is important to consider long-term returns when assessing their performance. As depicted in Figure 6, which shows the trend in net real returns of Icelandic pension funds from 1991, the five-year and ten-year averages are positive despite last year's heavy blow.

Figure 6 | Net Real Return of Pension Funds 1991 - 2008



As stated earlier, the net real return on Icelandic pension fund investment was -20.7% in 2008. Individually, the highest return of a pension insurance scheme was 2.3% and the lowest -31.4%. Comparable outcomes for the private pension schemes that operated throughout 2008 were 10.7% and -42.4% respectively. The net real return for most schemes was negative in 2008. Figure 7 shows changes between 2007 and 2008 in the highest and lowest return on investment by pension insurance schemes and private pension schemes. Periodical fluctuations in the returns of pension funds can for the most part be explained by differences in their asset portfolios.

Figure 7 | Highest and Lowest Net Real Return of Pension Insurance Schemes and Private Pension Schemes year end 2007 and 2008

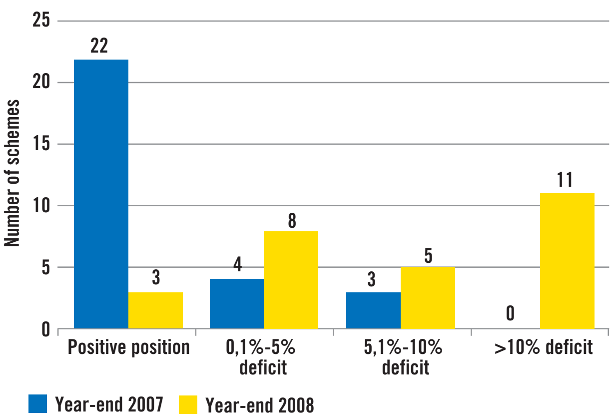


Actuarial Position

After a period of recovery which dates back to 2003, the actuarial position of pension funds without employer guarantee deteriorated for the second year running in 2008. At year-end 2008 a total of 27 such schemes were operated by 23 pension funds. As shown in Figure 8 the position in 3 schemes was either balanced or positive, as compared to 22 schemes in the previous year. This means that 24 schemes showed a deficit and 11 of those had deficits in excess of 10%. The term 'actuarial position' refers to the overall position of assets over obligations, i.e. both accrued and future obligations. Pursuant to the Pensions Act, pension funds must amend their statutes in order to achieve a balance between their assets and obligations if the difference is greater than 10% or exceeds 5% for five consecutive years. An interim provision applicable for 2008 allowed the pension funds a 15% difference between assets and obligations.

The actuarial position of employer-guaranteed pension funds also deteriorated dramatically. The actuarial deficit of these funds is estimated at nearly 45%.

Figure 8 | Actuarial Position of Pension Funds not Guaranteed by Third Party



Calculations to assess the actuarial position of pension funds are based on the number of current fund members at the time of calculation. Accrued position is calculated on the basis of rights earned through contributions to the fund and the fund's assets at the time of settlement. Future position is based on estimated future premiums and obligations on behalf of fund members. These calculations do not take into account recruitment to the funds.

Investment

The percentage of variable-yield securities dropped at the expense of fixed-income securities in 2008. The percentage of variable-yield securities in pension insurance schemes was 48% at year-end 2007, as compared to 36% at the same time in 2008 as shown in Figure 9. In private pension schemes this percentage fell from 68% to 51% in 2008. The higher percentage of variable-yield securities in the private pension schemes is a direct reflection of more risk-seeking investment strategies in this sector. There is also a marked increase in the category 'Other' with the private pension schemes; bank balances are classified under this category.

TAKEOVERS

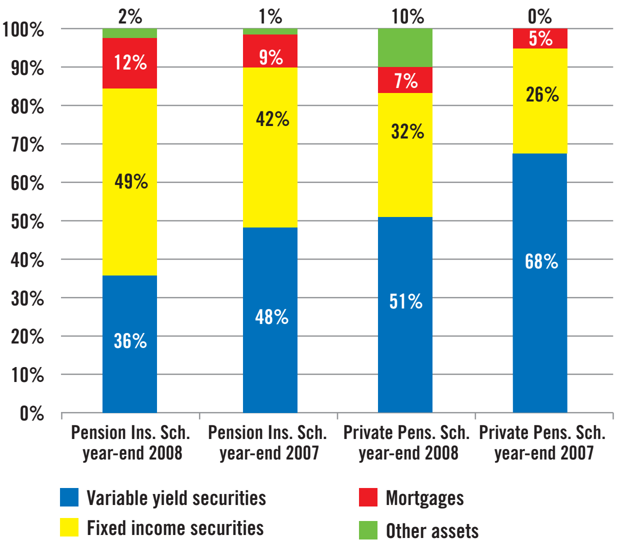
Certain controversial takeovers have been investigated by the FME in recent months.

At the beginning of 2009 the FME received a request to lower the price floor in the takeover bid of BBR ehf. for Exista hf. from ISK 4.62 per share to ISK 0.02 per share, i.e. the price paid by BBR ehf. for each share in the share capital increase of Exista hf. on December 8th 2008 on account of extraordinary circumstances. The FME ruled that extraordinary circumstances justified the lowering of the price floor of the takeover bid. The professional services firm PriceWaterhouseCoopers was engaged to conduct a limited valuation of the assets of Exista hf. The FME's conclusion was that the price floor of the takeover bid should be lowered but to a minimum of ISK 0.02 per share.

The FME investigated the ownership of Icelandair Group hf. The investigation revealed that Islandsbanki hf. had indirect control of Icelandair Group hf. owing to its position as the creditor of major shareholders who were not in a position to honour their contractual obligations so that Islandsbanki hf. was obliged to make a takeover bid to other shareholders. The FME determined that Islandsbanki hf. should be granted a conditional exemption from making a mandatory bid on the basis of Article 100, par. 5 of Act 108/2007 on Securities Transactions to control up to 50% of the shares in Icelandair Group because of the bank's extraordinary circumstances as the creditor of large shareholders in the company.

Alfesca shareholders reported to the FME a case of alleged discrimination among shareholders on account of terms offered to Kaupthing Singer & Friedlander (KSF) by Alta Food Holding B.V. (AFH), who were acting in collaboration with the offeror Lur Berri Iceland ehf. The FME ruled that the instrument in question between KSF and AFH constituted a transaction in the understanding of Article 13, paragraphs 2 and 3, of the Securities Transactions Act. However, since it was, uncertain whether KSF's contractual rights would indeed bring gains over and above those of other shareholders, it was impossible to conclude that the principle of non-discrimination had been breached. The contention that exceptional circumstances justified the application of the exemption clause to raise the bid price was rejected.

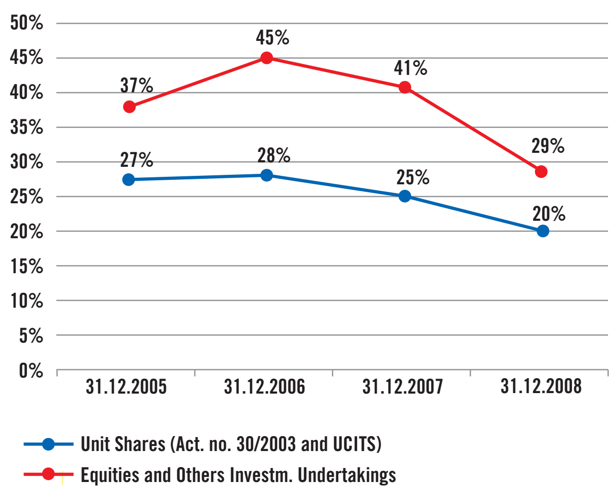
Figure 9 | Pension Fund Asset Classes at Year - end 2007 and 2008



Equities and units and shares in collective investment undertakings other than UCITS, cf. Act 30/2003 on UCITS, as a percentage of net pension fund assets, was 29% at year-end 2008, as compared to 41% at year-end 2007, as shown in Figure 10. Pursuant to the Pensions Act, pension funds are currently permitted to hold equity amounting to a maximum of 60% of net assets, so there is still considerable scope for the pension funds to increase their investment in this type of securities.

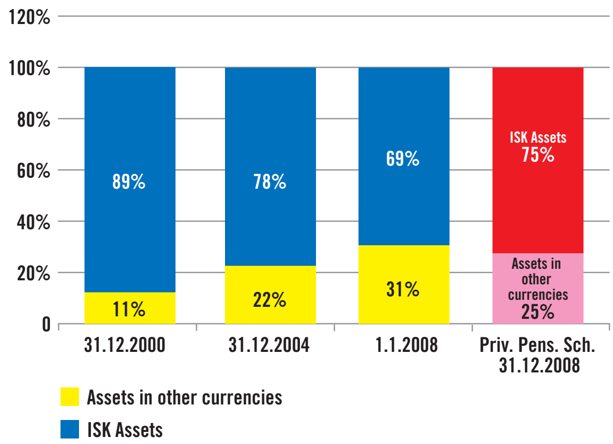
The ratio of shares in UCITS operating in accordance with Act 30/2003 of net pension fund assets was 20% at year-end 2008, as shown in Figure 10. Pursuant to the Pensions Act, a pension fund is not permitted to invest in more than 25% of all the issued shares in a single UCITS. The classification of units takes into account the underlying assets of the UCITS but there are no legal limits to maximum holdings as a ratio of net pension fund assets. Part of the equity holdings of the pension funds are therefore shares in UCITS and shown as such in the following chart.

Figure 10 | Investment Funds and Equities as a Percentage of Net Assets



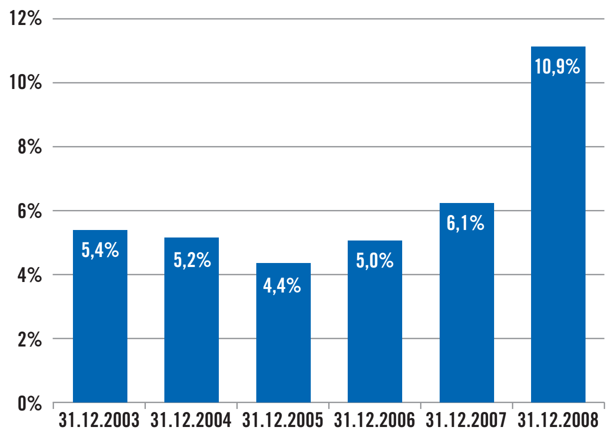
The ratio of assets denominated in foreign currencies to net pension fund assets has been growing since the entry into effect of the Pensions Act as shown in Figure 11, which depicts the trends since 2000. The percentage rose somewhat between 2007 and 2008, or from 25% to 31% in pension insurance schemes. Conversely, during the same period, the percentage fell from 29% to 25% in private pension schemes. According to the Pensions Act, assets denominated in foreign currencies are permitted up to a maximum of 50% of net assets. Thus, the pension funds still have considerable scope for investment in foreign securities.

Figure 11 | Exchange -rate linked Assets as a Ratio of Pension Fund´s Net Assets



The percentage of unlisted securities in net pension fund assets rose from 6.1% at year-end 2007 to 10.9% at year-end 2008. This ratio, which has been rising steadily since 2005 as shown in Figure 12, is limited to a maximum of 20% pursuant to the Pensions Act. The reason for this upward swing in the percentage of unlisted securities can to some extent be traced to the delisting of securities on regulated markets and the limited supply of listed securities under the prevailing economic conditions.

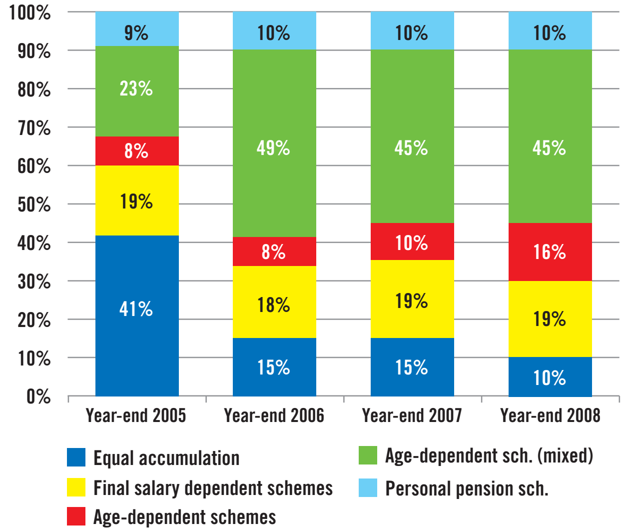
Figure 12 | Unlisted Securities as a Percentage of Pension Fund Net Assets



Pension Funds and Pension Rights

The assets of age-dependent pension schemes have been gradually increasing since the enactment of the Pensions Act. During 2006 there was a sharp upwards turn when five funds took up age-dependent schemes instead of their previous equal accumulation systems. 2007 saw further changes with one fund replacing its composite scheme with an age-dependent scheme. Figure 13 shows the trend in the years 2005-2008.

Figure 13 | Types of Pension Rights Acummulation Schemes at year end 2005, 20006, 2007 and 2008



Supplementary Pension Cover and Private Pension Savings

Pension funds, banks, savings banks, securities undertakings and life insurance companies are permitted to accept contributions under a contract for supplementary insurance benefits over and above the statutory minimum pension cover pursuant to the Pensions Act. The contributions make up private pension savings that are fully inheritable upon the death of the beneficiary.

Accumulated supplementary pension savings with pension funds and other pension savings depositories amounted to ISK 256 billion at year-end 2008, as compared to ISK 238 billion at year-end 2007, which constitutes an increase of 7% between these years. During the period 1999-2008 there was an average per-annum growth in supplementary pension savings of around 28% - ranging from 7% to a peak of 41%. Figure 14 shows the proportional division of private pension savings between depositories at year-end 2000 and 2008. As indicated in the chart, by far the largest share of private pension savings is still in the custody of pension funds which were operating solely as personal pension savings schemes prior to the entry into effect of the Pensions Act. This share, however, is gradually decreasing.

Figure 14 | Relative Market Shares of Personal Pension Schemes at Year-end 2000 and 2008

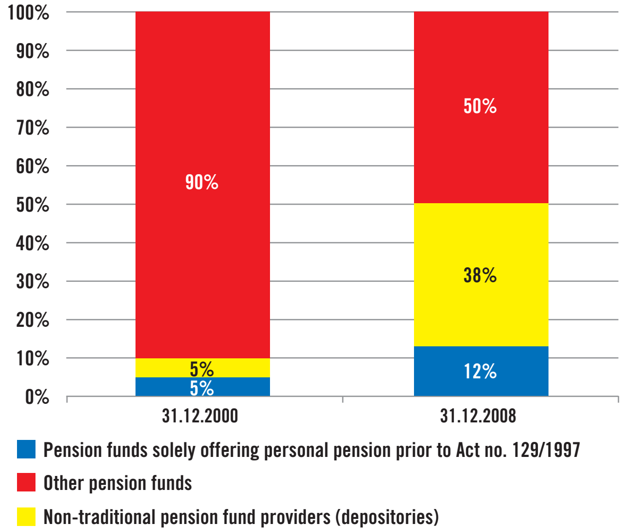
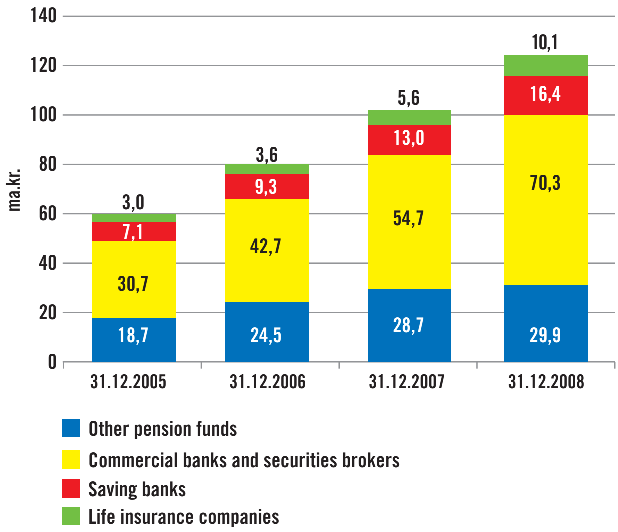


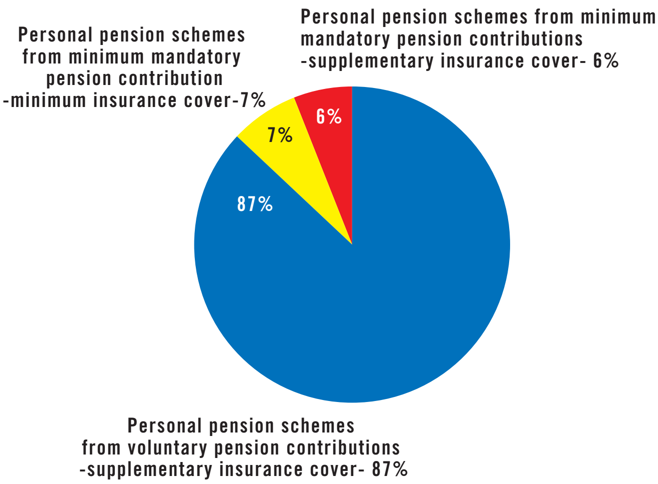
Figure 15 shows the trend in accumulated supplementary pension savings over the years 2005-2008 with depositories other than pension funds previously operating solely as personal pension savings schemes. Accumulated supplementary pension savings with other pension funds amounted to ISK 30 billion at year-end 2008 whereas such savings with depositories other than pension funds, i.e. banks, securities undertakings, savings banks and life insurance companies, totalled ISK 97 billion and was divided as shown in the chart below.

Figure 15 | Personal Pension Schemes Assets (Excluding Pension Funds Operating Solely as Personal Pension Scheme)



According to the Pensions Act, pension funds are permitted to allocate a part of the minmum statutory contributions paid into the fund (currently 12% of wages) to private pension accounts in the names of the contributors. Such individual pension savings can either be part of the minimum pension cover or a supplementary pension cover. This means that personal pension savings are not solely derived from direct contributions towards supplementary pension coverage although this is true of the largest proportion of such savings as shown in Figure 16 below.

Figure 16 | Types of Personal Pension Schemes at Year-end 2008



The chart shows that around 87% of accumulated personal pension savings, amounting to a total of ISK 256 billion, derive from contributions towards supplementary pension coverage. Around 13% of such savings, however, derive from premiums paid for minimum pension insurance, which may be subdivided into 6% in personal pension accounts as part of supplementary pension insurance and around 7% in personal pension accounts as part of the minimum pension insurance.

Personal pension savings in the custody of the pension funds amounted to ISK 159 billion at year-end 2006, or 9.9% of net pension fund assets. This ratio has been increasing since the entry into effect of the Pensions Act and was, for instance, 9.7% at year-end 2007.

Adding the total personal pension savings with depositories other than pension funds amounting to ISK 97 billion at year-end 2008 to the net assets of pension funds amounting to ISK 1,598 billion at the same point in time brings the overall assets of the entire pension system to ISK 1,695 billion, or 114.8% of GDP. For comparison, this amount stood at ISK 1,771 billion at year-end 2007, or 138.4% of GDP.

UCITS

At the end of June 2009 there were a total of nine management companies of undertakings for collective investment in transferable securities under supervision by the FME, as compared to seven at the same time in 2008. Four of the management companies have been granted licences to engage in asset management.

At the end of June 2009 there were 22 UCITS in operation, as compared to 21 at the same time in 2008. By the end of June 2009 a total of 14 investment funds had been approved by the FME, as compared to 30 at the same time in 2008 as shown in the following table.

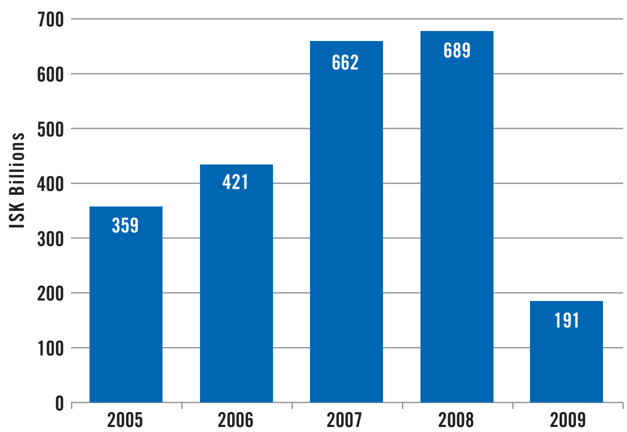
Number:	30.06.2008	30.06.2009
UCITS	21	22
Thereof compartmentalised	8	9
Compartments	29	29
Investment Funds	30	14
Thereof compartmentalised	6	4
Compartments	20	11

One UCITS, four UCITS compartments, 14 investment funds and six investment fund compartments were wound up. At the end of the period three UCITS, one investment fund and five investment fund compartments were undergoing winding-up procedures.

The FME has received 50 notifications from foreign UCITS with around 350 sub-funds declaring their intentions to market their unit shares in Iceland. A list of those foreign UCITS can be accessed on the FME's website.

The assets of UCITS and investment funds, according to Act No. 30/2003 governing the operations of such funds, decreased by 72% between 2008 and 2009. On June 30th 2009 these assets amounted to ISK 191 billion, as compared to ISK 689 billion at the same time in 2008. Figure 17 shows the development of the assets of UCITS and investments funds from 2005 to 2009. As the chart shows, the assets of the funds increased by 92% from 2005-2008 but a sizable proportion was lost during the latter part of 2008 and the beginning of 2009 as a result of the bank crisis. The largest proportion of the assets of UCITS and investment

Figure 17 | Total Assets of UCITS and Non UCITS Investment



funds is made up of fixed-income securities. By mid-year 2009, 83% of the assets of UCITS and investment funds were tied up in fixed-income securities. Figure 18 shows the assets of UCITS and investment funds during the period 2005-2009.

Figure 18 | Asset Classes of UCITS and Non UCITS Investment Funds

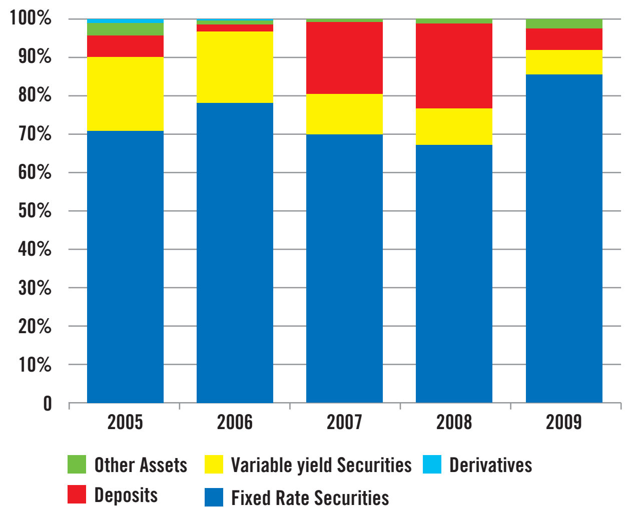
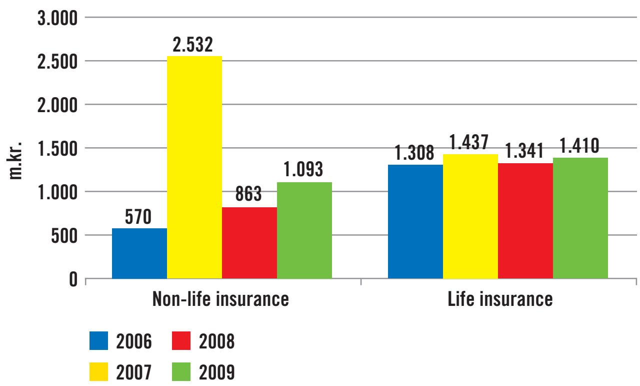


Figure 19 | Profit on Insurance Companies' Main Areas of Activity, 2008 price levels



3.4 Insurance Market

Performance of Insurance Companies in 2008

The performance of domestic insurance companies deteriorated drastically last year when compared with the performance in 2006 and 2007. The aggregate loss of these companies came close to ISK 50 billion, which constitutes a change of nearly ISK 70 billion compared with the outcome in 2007, when the profit of domestic insurance companies reached ISK 20.3 billion. Investment activities have in recent years been profitable for insurance companies, but this trend took a sharp u-turn last year. After experiencing profits from financial activities in the region of ISK 10 billion in 2007, the results for 2008 were negative by ISK 48 billion. The losses can primarily be traced to the loss suffered by Tryggingamidstodin hf. in connection with the sale of their Norwegian subsidiary Nemi Forsikring ASA, on the one hand and, on the other hand, the loss resulting from the revaluation of the investments of Sjova-Almennar tryggingar hf.
The operations of non-life insurance companies are divided into insurance activities, which form their operational core, and financial activities which focus on earning returns on assets to meet underwriting liabilities. Insurance activities are further divided into a range of sub-activities, such as motor vehicle insurance and property insurance.
The loss of the non-life insurance companies from regular insurance activities in 2008 was ISK 3.8 billion. Compensations paid by the Iceland Catastrophe Insurance on account of the earthquakes in South Iceland are the largest single contributor to that loss. Compared with the previous year, when profits reached ISK 3.6 billion, the performance has deteriorated by ISK 7.4 billion. Excluding the Iceland Catastrophe Insurance, non-life insurance companies showed a profit of ISK 819 million. Profits in 2007 were ISK 2.5 billion, so performance has deteriorated by ISK 1.7 billion.

Results by Insurance Classes

Motor vehicle insurance is the largest domestic insurance class and has generally been operated at a profit. However, when mandatory and optional motor vehicle insurance are viewed separately it becomes clear that the optional insurance class has been operated at a loss. Profits from the mandatory insurance class balance out losses from the optional class to give the insurance companies positive results for motor vehicle insurance as a whole. Although accident claims have been decreasing in number, the average cost of each accident has risen annually, largely due to price level and wage increases.

Figure 20 | Premiums, Claims and Profit/Loss in Motor insurance 2006-2008, 2008 price levels

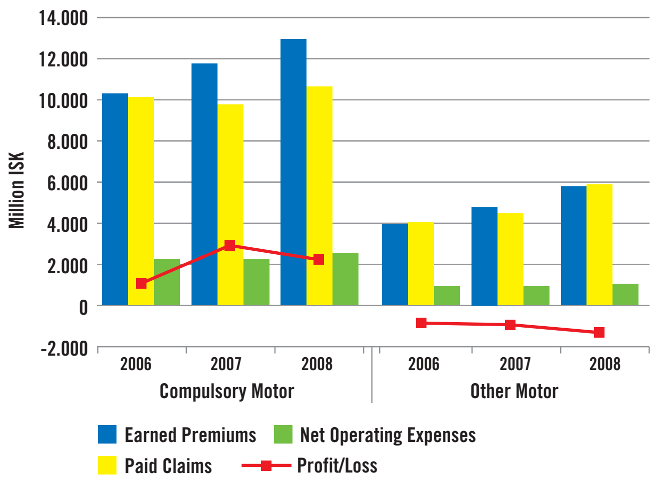
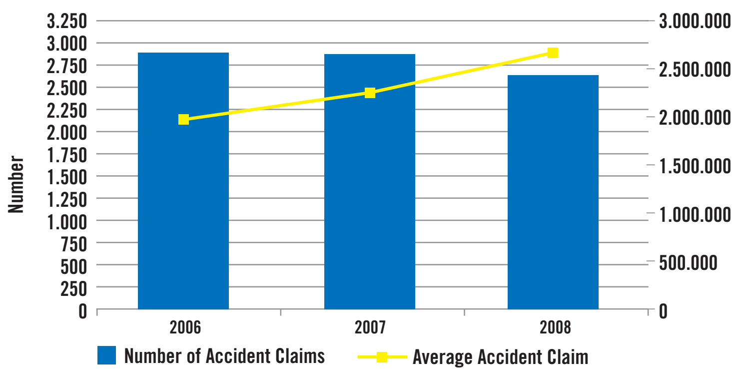
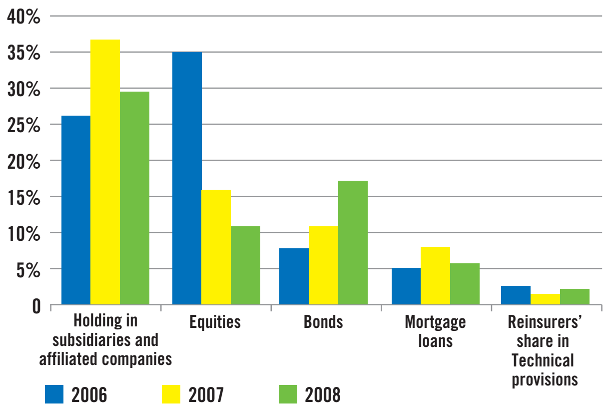


Figure 21 | Number of Accident Motor Claims and Average Accident Claims 2006-2008



The assets of non-life insurance companies lost a quarter of their value between 2007 and 2008, or ISK 33 billion. At year-end 2007 the assets stood at ISK 130.6 billion but had decreased to ISK 97.9 billion a year later. At the same time, there were also considerable changes in the asset portfolios of the companies, i.e. those assets that are intended to meet technical provisions with listed and unlisted securities replaced by bonds and bank balances.

Figure 22 | **Share of Various Asset Items in Insurance Companies Assets 2006-2008**

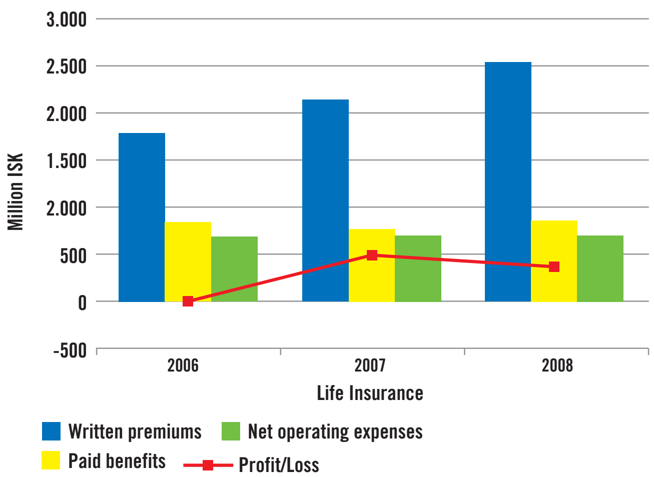


Performance of Life Insurance Companies 2008

Net profits from domestic life insurance activities were in the region of ISK 1.5 billion in 2008, as compared to just over ISK 1.3 billion in 2007.

The operations of life insurance companies are divided into life insurance activities and financial activities. Life insurance activities showed slightly lower profits in 2008, or ISK 1.3 billion, than in the previous year, when they reached ISK 1.4 billion. Financial activities, on the other hand, yielded a tenfold increase in revenue during the same period, from ISK 30 million to ISK 300 million in 2008. Extensive changes were made to the companies' asset portfolios. Assets in variable-income securities (equity shares and UCITS) were reduced by 51% and bonds by 33%. Assets in funds and bank balances increased from ISK 500 million to ISK 2.7 billion, which explains the increased income from financial activities.

Figure 23 | **Premiums and profit/Loss in Life Insurance 2006-2008, 2008 price levels.**



The assets of life insurance companies decreased by 11.4% between years, from ISK 13.8 billion at year-end 2007 to ISK 12.2 billion at year-end 2008. The equity of life insurance companies was ISK 4.7 billion decreasing by 7.5% in the course of the year. Investment on account of unit-linked life insurance decreased by 21.3% during the year, most likely as a result of the depletion of assets and early repayment of contracts.

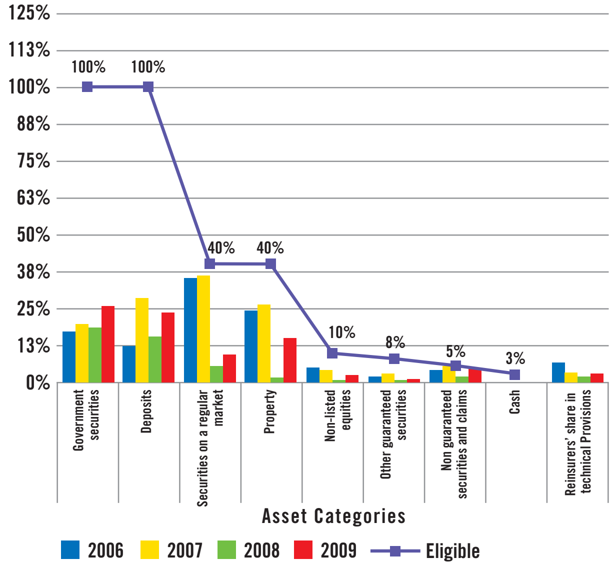
Q1 – Q3 Performance of Insurance Companies

The FME requested information from insurance companies on key statistics in their balance sheets and profit and loss accounts. This information showed profits of ISK 5.9 billion for non-life insurance companies and ISK 1.1 billion for life insurance companies. Profits from insurance activities were ISK 0.9 billion, which means that profits from financial activities were 5 billion. Conversely, life insurance companies showed profits to the amount of ISK 183 million from financial activities and 1,128 million from life insurance activities. Technical provisions of non-life insurance companies were ISK 63 billion at the end of September and equity was ISK 38 billion. Life insurance provisions were ISK 2 billion and the equity of the five domestic life insurance companies was ISK 5.3 billion.

Assets to Meet Technical Provisions as at June 30th 2009

The largest single asset type of insurance companies for meeting technical provisions is "listed securities guaranteed by the Treasury or municipalities" which amounted to well over 26% of the technical provisions. Second in size are "deposits with credit institutions" amounting to 23%. It is permissible to use a combination of these asset classes to meet technical provisions in their entirety. Insurance companies are increasingly moving towards selling Icelandic shares out of their asset portfolios and placing the proceeds from the sales in listed bonds, Treasury bonds and bank accounts; this trend clearly reflects the situation in global financial markets. The third largest asset type is "property, land and building plots". According to the Regulation on assets to meet technical provisions no. 646/1995, there are certain limits on the amounts from each asset class which may be used by the insurance companies for this purpose. The Regulation also serves as an investment guide for insurance companies with assets in excess of technical provisions, since assets must always meet technical provisions at any given time. Some insurance companies have been granted an exemption from the ceiling on non-guaranteed securities and claims.

Figure 24 Ratios of Asset Covering Technical Provisions 2006-2009



Qualifying Holdings in Domestic Insurance Companies

The problems facing Icelandic investment companies and holding companies have affected domestic insurance companies. Stodir hf. (formerly FL Group) is the owner of the insurance company Tryggingamidstodin hf. and its subsidiaries. Following Stodir's composition with its creditors, the company came into the hands of new owners. The principal creditors of Stodir are Glitnir and New Landsbanki together with foreign banks, which brings Tryggingamidstodin under the indirect ownership of Icelandic financial undertakings.

The insurance companies Vatryggingafelag Islands hf. and Liftryggingafelag Islands hf. are owned by Exista, which is currently undergoing a process of financial restructuring, the outcome of which is still uncertain. Exista's ownership of these insurance companies therefore remains unchanged for the time being.

Sjova-Almennar tryggingar hf. was part of the Swedish financial conglomerate Moderna Finance (formerly Invik) which was owned by Milestone. Milestone is currently in receivership and companies belonging to the group are now in the hands of new owners. Earlier this year, Glitnir banki hf. took control of the collateral and operations of Sjova-Almennar Tryggingar and appointed a new board of directors for the company. Glitnir assumed the leadership in the financial restructuring of the company in collaboration with the Ministry of Finance and the Central Bank of Iceland. The restructuring was concluded around midsummer with the establishment of a new insurance company, SA tryggingar hf., on the foundations of Sjova-Almennar tryggingar hf. The new company received its operating licence in September and the insurance portfolio of the old company was transferred to the new company.

Vordur tryggingar hf. has been indirectly owned by Landsbanki, Byr and SP financing, and this did not change with the collapse of the banks. However, the company has been, been experiencing financial difficulties and was placed under special supervision by the FME at mid-year 2008. The company's position changed in September 2009 when Føroya Banki applied to become a majority shareholder in Vordur insurance ltd. and also to hold 20% in Vordur life insurance ltd. The bank's application has recently been approved by the FME. Føroya Banki has undertaken to increase the share capital of Vordur tryggingar hf.

Finally, after the fall of Kaupthing Bank, the New Kaupthing Bank took over the ownership of the life insurance company Kaupthing liftryggingar hf. The company now operates under the new name of Okkar liftryggingar hf.

Financial Position of Icelandic Insurance Companies and Insurance Brokerages

Although the performance of Icelandic insurance companies was nowhere near as promising in 2008 as in previous years, their position can nevertheless be regarded as sound. Last year, a total of four companies were placed under specific supervision (cf. Article 90 of the Insurance Act) for failure to fulfil minimum solvency requirements.

The FME took up specific supervision of Sjova-Almennar tryggingar hf. in the autumn of 2008. The company was released from this supervision last September following the issuing of an operating licence for SA tryggingar hf.

Vordur tryggingar hf. insurance company and Vordur liftryggingar hf. life insurance company have also been subject to specific supervision since mid-year 2008. This status is, however, about to change with the advent of new owners. It is anticipated that under new ownership the companies will be in a position to meet the mandatory solvency requirements stated in the Insurance Act.

European Risk Insurance Company hf. (ERIC) had been subject to specific supervision on the basis of the aforementioned Article 90 of the Insurance Act. In September 2008 the company fulfilled all mandatory solvency requirements and was therefore released from the specific supervision.

Commissions from insurance brokerage increased slightly last year, or from ISK 396 million in 2007 to ISK 403 million in 2008. The performance of insurance brokerages has improved in recent years despite a fall in profits between 2007 and 2008. Net profits from insurance brokerage decreased by ISK 3 million between years and were ISK 50 million for the year 2008.

On-site inspections

Insurance Companies and Insurance Brokerages

The FME conducted surveys of the procedures for determining premiums and the business practices of the four largest non-life insurance companies with special emphasis on motor vehicle insurance.

On-site visits were made to the premises of four insurance brokerages to review the main features of their activities, such as financial position, management and compliance with the reporting requirement clause of Act 32/2005 on insurance brokerage etc.

As follow-up measures to the on-site visits the FME carried out special surveys of the reporting requirements of insurance intermediaries and the websites of insurance brokerages.

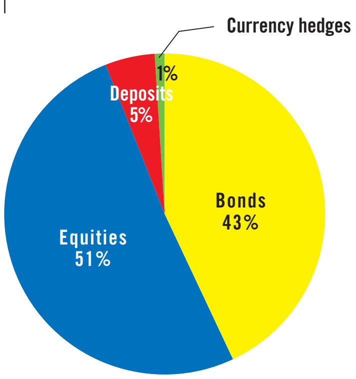
Off-site Inspections

The FME surveyed the policy conditions of business insurance, comprehensive motor vehicle insurance and credit card insurance as well as conducting a survey of the reporting requirements of insurance agents on the basis of Article 55 of the Insurance Act. Various observations were made, including special remarks on precautionary clauses in insurance policies.

The FME requested statements from the three largest insurance companies concerning investments relating to their owners following their takeover. The request included questions concerning investments where an owner was counterparty in a transaction or participated in decisions on a transaction. The information was used as part of an investigation of possible abuse by the owners.

The FME decided to request data from regulated entities in the life insurance market that would provide an overview of total investment in unit-linked life insurance at the end of 2008. Although there are no legal restrictions on the investment strategies of life insurance companies of this kind, the FME saw reason to verify the observance of good business practices and responsible investment of customers' assets. The chart in Figure 25 shows the results of the FME's survey.

Figure 25 | **Investments in Unit-Linked Insurance 2008**



4 SUPERVISION – A VIEW TO THE FUTURE

4.1 New Outlook on Supervision and International Perspectives

Supervisory authorities in Iceland and in Europe are currently in the process of revising their supervisory frameworks in the wake of the financial crisis. On an international level, this work is being carried out under the auspices of the Basel Committee on Banking Supervision. The focus is on what lessons can be learnt and what inferences may be drawn from the global financial crisis. Various noteworthy reports have written on a range of key issues that need to be considered by supervisory and regulatory authorities, for instance the Turner Review, written by Lord Turner, Chairman of the Financial Services Authority in Britain. Concerning capital adequacy ratios, the emphasis is on revising regulations with the object of requiring financial undertakings to increase their capital. This might reduce procyclicality, which many critics believe to have unduly deepened the financial crisis. It is advisable to build up reserves during times of expansion, which can then be drawn upon under less favourable economic conditions. Remuneration systems also need thorough revision in order to reduce the short-term risk appetite resulting from the incentive remuneration schemes of financial undertakings. Instead, the kind of behaviour that best serves the long-term interests of the financial undertakings should be encouraged. There have also been suggestions concerning stricter rules on the liquidity of financial undertakings.

Supervisory authorities all over the world have recognized the need to investigate financial activities in a wider context in addition to more traditional investigations of the financial position and strength of individual financial undertakings. This should be done by studying the impact of certain undertakings on the financial system as a whole. Supervisory-regulatory authorities intend to coordinate their efforts better with the efforts of central banks and their role of maintaining general financial stability.

The European Capital Adequacy Rules are currently under revision. EU member states have agreed to follow the proposals on a European supervisory framework put forward by a committee chaired by Jacques de Larosière, former Managing Director of the International Monetary Fund. The Committee of European Banking Supervisors (CEBS) will become the European Banking Authority (EBA) which will, among other things, be competent to develop binding technical standards. The same applies to the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) which will both become separate European supervisory authorities. In addition, a European Systemic Risk Council will be established to assess system-inherent risk and threats to financial stability. This institution will coordinate its efforts with those of the European Banking Association (EBA).

4.2 New Approaches to Supervision

The supervisory procedures of the FME are currently under review. The review is based on the results of a range of studies, both domestic (e.g. the Jännäri Report) and international (e.g. the Turner Review). The new organisational chart for the FME incorporates a new unit - forensic accounting, which will be in charge of precise examinations of the annual financial statements of financial undertakings. The FME will also place increased emphasis on on-site monitoring of regulated parties in order to verify their internal control and reporting systems. Multidisciplinary teams will be formed within the FME to focus on systematic on-site supervision.

Since the beginning of 2009, an FME representative has participated in the work of a committee appointed by the Minister of Commerce (now Minister of Economic Affairs) to review the regulatory framework for the financial market. The committee is due to submit a parliamentary bill in November 2009. Among the changes proposed by the committee are amendments to provisions concerning large exposures, the eligibility of managing directors and board members, internal auditing, the collateral of financial undertakings in their own instruments and collateral in the shares of other financial undertakings, and the eligibility of the owners of qualifying holdings. The committee also proposes the adoption of rules concerning loans to the owners of qualifying holdings, board members and managing directors. Furthermore, there are proposals concerning a special credit registry intended to provide a better overview of large exposures at national level and reduce system-inherent risk.

The FME will continue its active participation in collaboration on regulation and supervision of financial markets within the EEA.

4.3 Solvency II

On April 22nd 2009, after intensive negotiations within the EU, agreement was reached on a compromise text for a new Directive on the establishment and operations of insurance companies, the Solvency II Directive, which proposes substantial reform of the financial requirements made on insurance companies where "total balance sheet" risk is taken into account. A final version of the Directive is expected to be published before the end of this year when the text has been translated into the official languages of the EU member states. The Directive will enter into effect on October 31st 2012.

The legislative framework of the EU concerning internal markets for financial activities assumes that parts of the Directive will be further developed by the European Commission, in the course of the Level 2 implementation measures. CEIOPS is currently working on a set of consultation papers for Level 2. The first two parts of the papers have been forwarded to interested parties for comment and CEIOPS has agreed to submit these parts to the Commission when ready. The third set of the consultation papers will be published for comments at the beginning of November. Comments will be received until December 11th 2009.

CEIOPS has conducted four Quantitative Impact Studies on Solvency II. The fifth study, QIS5, is planned for the period August to October 2010 to test the impact of the Level 2 implementation measures. Participation in these studies is important in preparing for new legislation, as insurance companies will have the opportunity to assess their potential need for increased capital and human resources upon the entry into effect of Solvency II. The FME will stress the importance of participation in QIS5 for all insurance companies which, on the basis of their current size, fall within the scope of the new Directive.

4.4 Supervision of Professional Investment Funds

There has been much debate about professional investment funds of late, which to date have not been subject to FME supervision. Professional investment funds have extensive investment powers and can therefore have a significant impact on the market. The FME therefore believes that such funds should be subject to minimum supervision at least.
On 30 March 30th 2009 the Minister of Economic Affairs appointed a committee to review the provisions of Act 30/2003 on UCITS and investment funds. One of the results of this review was a proposal to add a new chapter to the current Act concerning the supervision of professional investment funds. According to the proposal, operators will be required to notify the FME of currently operating professional investment funds as well as the establishment of new funds. The operators of professional investment funds will also be required to submit to the FME itemized reports of their investments at half-yearly intervals. Furthermore, all managers of professional investment funds will be required to have completed examinations that qualify them as securities brokers.
The findings of the Ministerial Committee will be presented to Althingi in the form of a bill this winter. A new EU Directive on the supervision of professional investment funds is anticipated in the near future.

4.5 Supervision of Debt Collectors

The Debt Collection Act no. 95/2008, which entered into effect on January 1st 2009, assigns the supervision of debt collection activities to the FME. In order to collect debts on behalf of a third party, a licence must first be obtained from the FME. The same applies to parties who purchase debts for the purpose of collecting them for profit. Lawyers, public bodies, commercial banks, savings banks, other credit undertakings and securities firms, on the other hand, are permitted to engage in debt collection activities without a special licence. Since the entry into effect of the Debt Collection Act, the FME has issued six licenses to the following: Alskil hf., Fjarvakur – financial services ehf., Intrum Iceland ehf., Rarik ohf., SPRON Factoring hf. and Veita, debt collection services ehf.

The FME also monitors the debt collection activities of licence holders, public bodies, commercial banks, savings banks, other credit undertakings and securities firms in order to verify compliance with laws and regulations pertaining to such activities. To assist the FME in this area, the following rules have been adopted: Rules no. 1210/2008 on the supervision of debt collection activities, which entered into effect on January 1st 2009, and Regulation no. 37/2009 to fix the maximum amount of collection charges, etc., which entered into effect on February 1st 2009.

4.6 Investigations of Alleged Violations of "Currency Restrictions"

Following the collapse of the three commercial banks, on November 28th 2008, Act no. 134/2008 was passed to amend the Foreign Currency Act no. 87/1992. The amendment authorizes the Central Bank of Iceland to fix rules to limit certain capital movements and related foreign currency transactions. Furthermore, the Central Bank was authorized to set rules that require domestic parties to deposit foreign currency with domestic financial undertakings. This amendment is generally referred to as the "currency restrictions".

The Central Bank of Iceland monitors compliance with laws and regulations on foreign currency matters and is required to notify the FME of any suspicion of alleged infringements. The amendments to the Foreign Currency Act referred to above conferred on the FME the exclusive role of investigator in cases of alleged violations of laws and regulations that come under the scope of another authority. The FME and the Central Bank work closely together on the investigation of alleged foreign currency violations and signed an MoU to this effect at mid-year 2009.

As official investigator of alleged foreign currency violations, the FME has extensive authority to collect data concerning natural and legal persons, even when they do not come directly under its jurisdiction. The FME may, for instance, request any data that it considers necessary for the purposes of a particular investigation, call parties in for hearings, conduct special examinations and seize documents pursuant to Act 88/2008 on criminal procedure. The FME may, at any stage of an investigation, refer a case to police authorities. A special MoU has been signed between the FME and the economic crime unit of the National Commissioner of Police.

Depending on the seriousness of the infringement, the FME may impose fines of up to ISK 20 million on natural persons and up to ISK 75 million on legal persons. These fines are much higher than hitherto permissible for the FME, but in accordance with Act 108/2007 on securities transactions and Act 161/2002 on financial undertakings, fines imposed on a legal person cannot exceed ISK 50 million. The FME is required to refer all serious cases to the police. Violations are punishable by fines or imprisonment of up to two years. Sanctions shall be imposed notwithstanding whether the infringement was premeditated or negligent. Attempted violations and involvement in violations of the Foreign Currency Act and regulations grounded in the Act are also punishable. A court of law can order any proceeds from such unlawful activity be confiscated.

The cases notified to the FME by the Central Bank vary in scope and may concern illicit trading in foreign currency, unauthorized foreign currency transaction relating to specific capital movements, and negligence in transfering foreign currency to Iceland. FME investigations have revealed that cases and perpetrators are often interconnected and for obvious reasons these cases extend across borders. The FME has collaborated with overseas authorities on the procurement of necessary data.

4.7 Increased transparency

The FME's transparency policy has been subjected to a thorough review in order to improve the transparency of its activities. Increased transparency can serve as a deterrent and encourage better business practices in the financial market as a whole. Improved transparency could also result in improved public approval of the FME's work and counter the general perception outside the financial markets that failure to comment on individual cases is indicative of lax supervision.

The FME was first authorized to disclose publicly the results of its investigations by Act 31/2005 amending the Securities Transactions Act no. 33/2003. The provision was consistent with the requirements made on EEA member states in several EU Directives that provide for public disclosure by competent authorities of information concerning all measures and sanctions imposed in case of violations of the rules adopted to implement the Directives. The provision, however, only covered investigations relating to legislation on securities trading but not other laws that fell within the scope of the FME.

There has been much debate lately about transparency in the activities of the FME and clearly the aforementioned authorization needed to be extended. This was done by Act 20/2009 with the result that there are now provisions concerning transparency of FME activities in Article 9(a) of Act 87/1998 on official supervision of financial activities.

The amendment gives the FME the authority to disclose publicly the results of all its cases and investigations with a view to increase the transparency of its activities. The wording of the provision is more or less the same as that of the older provision in the Securities Transactions Act.

Article 9 (a) Transparency of FME Activities
The Financial Supervisory Authority may publicly disclose its findings on cases and investigations conducted pursuant to this legislation unless such disclosure is deemed to endanger the interests of the financial market, does not concern the interests of the market as such, or causes damage to the parties concerned that is out of proportion to the infringement in question. The Financial Supervisory Authority shall make public the policy it adopts for such disclosures.

5 REGULATED PARTIES

5.1 Number of Parties Subject to Supervision 30.06.2009

As of June 30th 2009 the number of parties subject to FME supervision was as follows:

	Number 30.06.2009[1)]	*Operate in accordance with:*
Commercial banks	4	Act161/2002 on Financial Undertakings
Savings banks	14	Act 161/2002 on Financial Undertakings
Credit undertakings	11	Act 161/2002 on Financial Undertakings
Deposit departments of co-operative societies	1	Act 22/1991 on Co-operative Societies
Securities companies	8	Act 161/2002 on Financial Undertakings
Securities brokerages	3	Act 161/2002 on Financial Undertakingsi
Management companies of UCITS *UCITS - 22, incl. 9 compartmentalised* [2)] *Investment funds - 14, incl. 4 compartmentalised*[2)]	9	Act 161/2002 on Financial Undertakings Act 30/2003 on UCITS and Investment Funds Act 30/2003 on UCITS and Investment Funds
Stock exchanges and other regulated OTC markets	1	Act 34/1998 on Stock Exchanges and Regulated OTC Markets
Central securities depositories	1	Act 131/1997 on Electronic Registration of Title to Securities
Pension funds	37	Act 129/1997 on Mandatory Guarantee of Pension Rights and the Operation of Pension Funds
Insurance companies	13	Act 60/1994 on Insurance Activities
Insurance brokerages	6	Act 32/2005 on Insurance Brokerage
Debt collection agencies	6	Act 95/2008 on Debt Collection Practices
Other parties subject to supervision	3	Various Acts of law
Total	**117**	

[1)] Not included in the list are financial undertakings currently in moratorium/undergoing winding-up proceedings, i.e. Glitnir Bank, Kaupthing Bank, Landsbanki, Sparisjodabanki Islands, Straumur-Burdaras Investment Bank, Sparisjodur Myrarsyslu, SPRON, Frjalsi fjarfestingabankinn, SPRON Securities.

[2)]UCITS and investment funds are operated by management companies, The funds are not included in the total number of parties subject to supervision. Some of the funds are compartmentalised.

Foreign Financial Undertakings Operating in Iceland

The following summary shows the number of foreign parties/companies which at mid-year 2009 were authorized to offer their services in Iceland on the basis of current regulations applying within the European Economic Area:

Foreign banks with branches	1[*)]
Foreign banks without branches	218
UCITS	50 (350 divisions)
Investment firms / brokerages	1878
Insurance companies with branches	2[*)]
Insurance companies without branches	439
Insurance brokerages and insurance agents	4654

[*)] One foreign financial undertaking, the Sweden-based Forex Bank AB, operates a branch in Iceland. Similarly, the German insurance companies Allianz Lebensversicherungs AG and Allianz Versicherungs AG have branches in Iceland.

6 HIGHLIGHTS OF THE FME'S 2008 ANNUAL FINANCIAL STATEMENTS

The following is a summary the main outcomes of the FME'S annual financial statements for 2008. The annual financial statements were approved by the FME'S Board of Directors on June 15th 2009 and endorsed by the National Audit Bureau the same day. A full and complete version of the annual financial statements is published on the FME website: www.fme.is.

Profit and Loss Account 2008

	2008	2007
Financial income		
Income from supervision fees	912,709,000	602,636,000
Other income	11,179,627	14,525,093
	923,888,627	617,161,093
Financial expenses		
Salaries and related expenses	530,444,447	422,873,353
Complaints committees	5,891,996	5,859,565
Administrative expenses	53,772,095	42,244,882
Travel and personnel related expenses	43,880,921	33,862,326
Expert services purchased	340,375,184	43,826,554
Operation of equipment	21,520,080	11,912,657
Other operating expenses	13,649,786	5,900,142
Housing	49,445,540	25,531,801
Transfers	1,486,500	1,603,150
	1,060,466,549	593,614,430
Purchased assets	14,797,816	4,485,962
	1,075,264,365	598,100,392
(Operating loss)/profit before net interest income	(151,375,738)	19,060,701
Interest income	43,014,668	19,691,550
(Loss)/profit before Treasury contribution	(108,361,070)	38,752,251
Treasury contribution*)	549,000,000	0
Profit for the year	440,638,930	38,752,251

**) Pursuant to the Budget Supplement Act for 2008, approved on December 22nd 2008, the FME is granted a special allocation of ISK 549 million. This is to meet increased costs arising from measures taken on the basis of Act 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc*

Balance Sheet December 31st 2008

	2008	2007
Assets		
Current assets		
Treasury	502,026,300	377,325
Accounts receivable	92,101,662	1,558,363
Other receivables	47,597,811	3,379,082
Cash and cash equivalents	129,266,695	92,236,672
	770,992,468	97,551,442
Total assets	770,992,468	97,551,442
Equity and liabilities		
Equity		
Principal at the beginning of the year	87,704,829	48,952,578
Profit for the year	440,638,930	38,752,251
Equity	528,343,759	87,704,829
Current liabilities		
Current liabilities	242,648,709	9,401,973
Other short-term liabilities	0	444,640
Liabilities	242,648,709	9,846,613
Equity and liabilities	770,992,468	97,551,442

FINANCIAL CRISIS – TIMELINE OF EVENTS

OCTOBER 08
NOVEMBER 08
DECEMBER 08
JANUARY 09
FEBRUARY 09
MARCH 09
APRIL 09
MAY 09
JUNE 09
JULY 09
AUGUST 09
SEPTEMBER 09
OKTOBER 09

OCTOBER 6TH 2008

Act 125/2008 (the Emergency Act) enacted by Althingi.

OCTOBER 7TH 2008

The FME takes control of the operations of Landsbanki as authorized by the Emergency Act and appoints a resolution committee.

The FME takes control of the operations of Glitnir Bank as authorized by the Emergency Act and appoints a resolution committee.

OCTOBER 9TH 2008

The FME takes control of the operations of Kaupthing Bank as authorized by the Emergency Act and appoints a resolution committee.

NOVEMBER 15TH 2008

Entry into effect of Act 129/2008 amending Act 161/2002 on Financial Undertakings.

NOVEMBER 24TH 2008

Glitnir Bank granted moratorium by Reykjavik District Court.

Kaupthing Bank granted moratorium by Reykjavik District Court.

NOVEMBER 28TH 2008

Amendments to laws on foreign exchange confer powers on the FME to investigate alleged violations of these laws and regulations as notified to the Authority by the Central Bank of Iceland.

DECEMBER 5TH2008

Landsbanki granted moratorium by Reykjavik District Court.

MARCH 9TH 2009

The FME takes control of the operations of Straumur-Burdaras Investment Bank and appoints a resolution committee.

MARCH 17TH 2009

FME decision on the transfer of liabilities of Straumur-Burdaras Investment Bank to Islandsbanki hf.

MARCH 19TH 2009

Straumur-Burdaras granted moratorium by Reykjavik District Court.

MARCH 21ST 2009

The FME takes control of the operations of SPRON hf. as authorised by the Emergency Act and appoints a resolution committee. The FME decides on the disposal of the assets and liabilities of the savings bank.

The FME takes control of the operations of Sparisjodabanki (formerly Icebank) as authorized by the Emergency Act and decides on the disposal of the assets and liabilities of the bank.

MARCH 23RD 2009

Sparisjodabanki (formerly Icebank) granted moratorium by Reykjavik District Court.

MARCH 27TH 2009

The FME appoints a resolution committee for Sparisjodabanki (formerly Icebank).

APRIL 3RD 2009

The FME takes control of the operations of Sparisjodur Myrasyslu as authorized by the Emergency Act and decides on the disposal of the assets and liabilities of the savings bank.

APRIL 22ND 2009

Entry into effect of Act 44/2009 to amend Chapter XII of the Act on Financial Undertakings.

The resolution committee of SPRON automatically becomes its transitional board of directors by the entry into effect of Act 44/2009.

APRIL 27TH 2009

Sparisjodur Myrasyslu granted moratorium by West Iceland District Court.

29TH APRIL 2009

Reykjavik District Court appoints a resolution committee for Landsbanki.

MAY 12TH 2009

Reykjavik District Court appoints a resolution committee for Glitnir Bank.
Reykjavik District Court appoints a resolution committee for Straumur-Burdaras Investment Bank.

MAY 19TH 2009

Reykjavik District Court appoints a resolution committee for Sparisjodabanki (formerly Icebank).

MAY 25TH 2009

Reykjavik District Court appoints a resolution committee for Kaupthing Bank.

JUNE 23RD 2009

Reykjavik District Court appoints a resolution committee for SPRON.
Reykjavik District Court appoints a resolution committee for Frjalsi Investment Bank.

JULY 2ND 2009

The FME appoints a transitional board of directors for Sparisjodur Myrasyslu.

AUGUST 7TH 2009

Reykjavik District Court appoints a resolution committee for SPRON Securities.

SEPTEMBER 3RD 2009

Agreement on the issue of financial instruments in settlement of the transfer of assets and liabilities of Old Kaupthing Bank to New Kaupthing Bank.

SEPTEMBER 11TH 2009

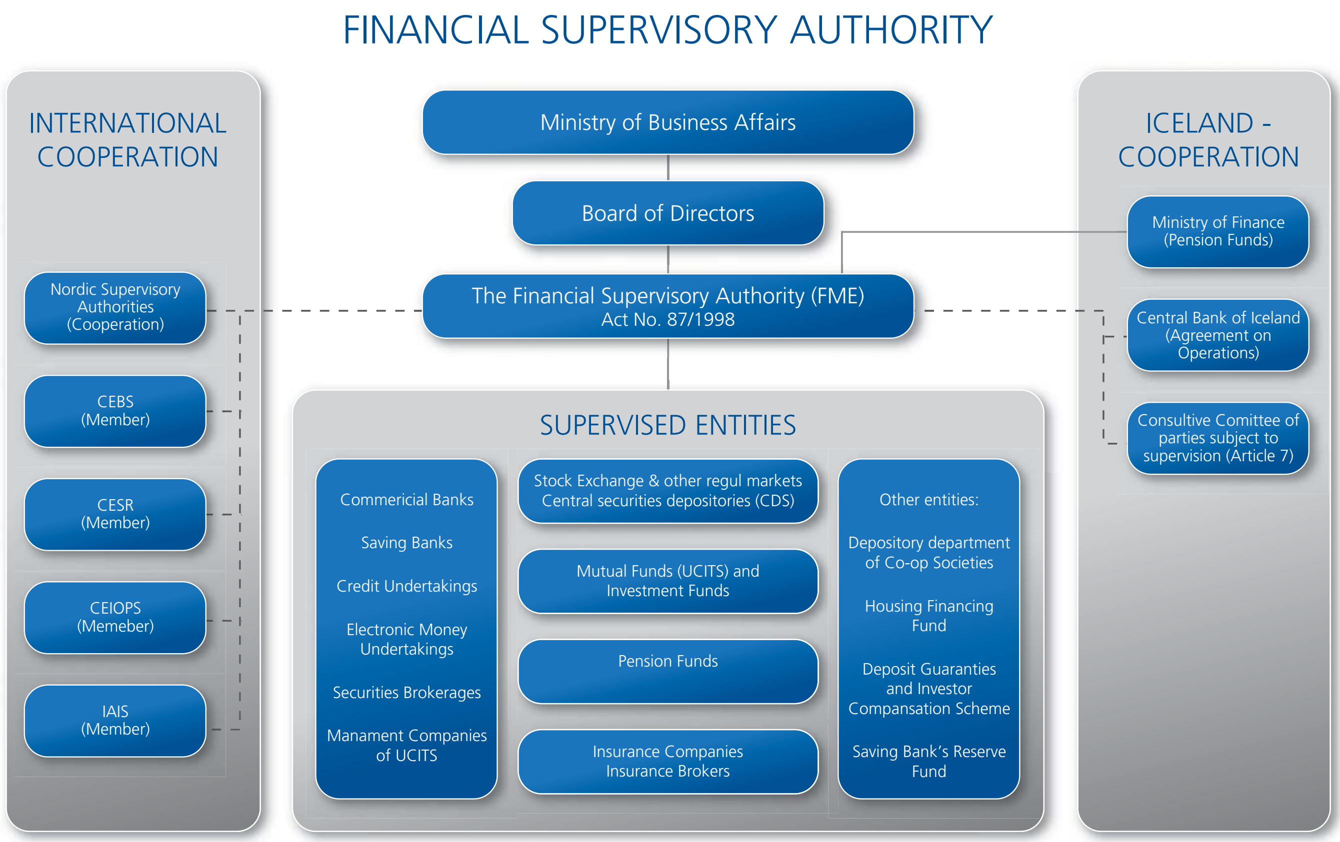
Agreement on the issue of financial instruments in settlement of the transfer of assets and liabilities from Glitnir Bank to Islandsbanki.

OCTOBER 13TH 2009

Icelandic authorities, the resolution committee of Landsbanki and Landsbanki sign a framework agreement on the division of assets and liabilities between the Old and New Landsbanki.

OCTOBER 15TH 2009

Glitnir exercises its contractual right to acquire 95% of Islandsbanki's share capital.


FINANCIAL SUPERVISORY AUTHORITY
INTERNATIONAL COOPERATION
Ministry of Business Affairs
Board of Directors
The Financial Supervisory Authority (FME)
Act No. 87/1998
ICELAND - COOPERATION
Ministry of Finance (Pension Funds)
Central Bank of Iceland (Agreement on Operations)
Consultive Comittee of parties subject to supervision (Article 7)
Nordic Supervisory Authorities (Cooperation)
CEBS (Member)
CESR (Member)
CEIOPS (Memeber)
IAIS (Member)
SUPERVISED ENTITIES
Commericial Banks
Saving Banks
Credit Undertakings
Electronic Money Undertakings
Securities Brokerages
Manament Companies of UCITS
Stock Exchange & other regul markets
Central securities depositories (CDS)
Mutual Funds (UCITS) and Investment Funds
Pension Funds
Insurance Companies
Insurance Brokers
Other entities:
Depository department of Co-op Societies
Housing Financing Fund
Deposit Guaranties and Investor Compansation Scheme
Saving Bank's Reserve Fund

The Financial Supervisory Authority
Annual Report 2009

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