21 February 2012

Screening report

Iceland

Chapter 9 – Financial services

Date of screening meetings:

Explanatory meeting: 18-19 November 2010
Bilateral meeting: 14-15 December 2010

I. CHAPTER CONTENT

The main objectives of the EU *acquis* as regards financial services are to ensure financial stability, the financial soundness of companies operating in the financial sector, and appropriate protection of consumers, investors and policyholders. The aim is to build up confidence in the financial markets and to provide a common level playing field. The *acquis* on financial services includes rules for the authorisation, operation and supervision of financial institutions in the areas of banking, insurance, supplementary pensions, investment services and securities markets as well as with regard to financial market infrastructure. A new financial supervisory framework for Europe entered into force in January 2011. The new European System of Financial Supervisors (ESFS) consists of a network of national financial supervisors working in tandem with three new European Supervisory Authorities – a European Banking Authority (EBA), a European Securities and Markets Authority (ESMA), and a European Insurance and Occupational Pensions Authority (EIOPA). In addition, a European Systemic Risk Board (ESRB) was established which will monitor and assess potential threats to financial stability that arise from macro-economic developments and from developments within the financial system as a whole.

In the field of **banks and financial conglomerates**, the *acquis* sets out requirements for the authorisation, operation and prudential supervision of credit institutions, as well as requirements concerning the calculation of capital adequacy requirements applying to credit institutions and to investment firms. The current Capital Requirements Directives 2006/48 and 2006/49 incorporate the new capital requirements framework based on the Basel II Accord. The *acquis* in this sector also lays down rules relating to supplementary supervision of financial conglomerates and to the taking up, pursuit of and prudential supervision of the business of electronic money institutions. Credit institutions are required to join an officially recognised deposit guarantee scheme, which must provide for a protection of 100,000 EUR per depositor. The *acquis* lays down rules regarding the annual and consolidated accounts of banks and other financial institutions. It also harmonises certain provisions concerning the reorganisation and winding up of credit institutions with branches in more than one Member State.

In the field of **insurance and occupational pensions**, several directives set out rules concerning the authorisation, operation and supervision of life assurance and non-life insurance undertakings. Specific provisions exist in the non-life sector for co-insurance, tourist assistance, credit insurance and legal expense insurance. The *acquis* establishes rules for the supplementary supervision of insurance groups. It also incorporates a prudential regulatory framework for reinsurance activities in the EU aiming at removing barriers to the pursuit of reinsurance business, such as the obligation for the reinsurance undertaking to pledge assets. The Directive 2002/92/EC on insurance mediation establishes a legal framework for the taking-up and pursuit of the activities of insurance and reinsurance mediation by natural and legal persons operating in the EU. In the field of motor insurance, the motor insurance Directive 2009/103/EC harmonises requirements concerning insurance against civil liability in respect of motor vehicles with a view to facilitating the free movement of goods and people, in particular by abolishing frontier controls on motor insurance. Directive 2003/41/EC regulates the activities and supervision of institutions for occupational retirement provision. The insurance *acquis* also lays down rules regarding the annual and consolidated accounts of insurance undertakings. It also harmonises certain provisions concerning the reorganisation and winding up of insurance undertakings with

branches in more than one Member State. The recently adopted Solvency II Directive 2009/138/EC repeals, as of 2012, current general and specific life and non-life insurance directives as well as rules for the supplementary supervision of insurance groups, consolidates them and also introduces new solvency requirements.

In relation to **financial market infrastructure**, there are three main Directives. First, Directive 98/26/EC on Settlement Finality, which aims to reduce the systemic risk linked to the insolvency of a participant in payment and securities settlement systems. Secondly, Directive 2002/47/EC which aims to reduce and harmonise the formal requirements and procedures to create and enforce collateral across the EU. Third, Directive 2009/44/EC, which aims to strengthen the protection of financial collateral arrangements by including credit claims as eligible for the collateralisation of central banks' credit operations. The Directive is also promoting the proper protection and functioning of settlement systems. Particularly in times of market turmoil, this is indispensable for the stability of the financial markets.

In the field of **securities markets and investment services,** Directive 2004/39/EC on markets in financial instruments (MiFID) together with its amendments and implementing measures set out a comprehensive regulatory regime covering the authorisation, operation and supervision of investment firms and regulated markets. The Prospectus Directive 2003/71/EC together with its amendments and implementing measures reinforce the protection for investors by guaranteeing that all prospectuses, wherever in the EU they are issued, provide them with the clear and comprehensive information they need to make investment decisions. The *acquis* also prescribes minimum transparency requirements for listed companies concerning both periodic and ongoing information. Directive 2003/6/EC on market abuse together with its amendments and implementing measures introduce a harmonised and comprehensive administrative regime for prohibiting and prosecuting insider dealing and market manipulation. The *acquis* also requires that Member States ensure that at least one officially recognised investor compensation scheme is established offering compensation up to EUR 20,000. The legislation on undertakings for collective investment in transferable securities (UCITS) sets out common basic rules for the authorisation, supervision, structure and activities of investment funds to facilitate the cross-border distribution of units of funds in the EU and to ensure adequate investor protection.

The *acquis* in the field of financial services is covered by the European Economic Area (EEA) Agreement. In addition, the EU secondary legislation listed in Annex IX to the EEA Agreement applies to the financial services sector in the European Economic Area. The rules of the EEA Agreement on financial services are focused on developing a single European financial market where providers of services can freely offer their services within the EEA. Financial institutions can operate across the EU in accordance with the ‘single passport’ and the ‘home country control’ principle, either by establishing branches or by providing services on a cross-border basis. The EEA States can only apply national restrictions if the relevant field is not fully harmonised by EEA secondary legislation and provided that the restriction is justified under the criteria of the ‘general good’.

It may be noted that, in the wake of the financial crisis, the EU regulatory landscape is changing fundamentally and very fast in the financial services sector. Several of the centre-pieces of the EU financial market legislation set out in this Chapter have recently been amended or are currently being revised. Further fundamental changes to these rules will be adopted in the EU during 2012. In addition, the EU has adopted completely new legislation on hedge funds and other alternative investment funds, as well as credit rating agencies, short-

selling practices and credit default swaps and has agreed legislation on derivatives and central clearing.

II. COUNTRY ALIGNMENT AND IMPLEMENTATION CAPACITY

This part summarises both the information provided by Iceland and the discussion at the screening meetings. Iceland indicated that it can accept the *acquis* regarding chapter 9- Financial Services, and it does not expect any difficulties to implement the *acquis* by the time of accession.

II.a. Banks and financial conglomerates

Iceland stated that Directive 2006/48/EC on rules associated with the **taking up and pursuit of the business of credit institutions** is implemented through Act 161/2002 on Financial Undertakings with later amendments, and related implementing measures. They regulate the conditions for establishment, authorisation, operation and termination of operations of credit institutions, as well as their supervision. The elements of Directive 2006/48/EC concerning best practices regarding liquidity management, internal auditing units, stress-testing, concentration and interest rate risk, harmonization of the application of the Supervisory Review Process as well as internal control and risk management of financial undertakings are implemented in Iceland through Financial Supervisory Authority (FME) rules and guidelines.

Icelandic credit institutions need an authorisation from the FME for their establishment and operation in Iceland. The Act on Financial Undertakings provides for an exhaustive list of conditions to grant or refuse an operating licence. Similarly, it lays down an exhaustive list of circumstances in which a credit institution's authorisation may be withdrawn or revoked. Any refusal or withdrawal notification must respect clear deadlines and include the appropriate reasoning. On the granting of an operating licence, the minimum paid-in initial capital of a financial undertaking must be in the form of cash money. The share capital of a commercial bank and credit undertaking and the guarantee capital of a savings bank must amount to a minimum of EUR 5 million, on the basis of the current official exchange rate (buying rate). However, savings banks that operate within certain geographical boundaries are required to have a minimum of EUR 1 million guarantee capital.

Icelandic and EU financial institutions can operate across the EEA in accordance with the ‘single passport’ and the ‘home country control’ principle. An Icelandic financial undertaking intending to operate a branch in another EEA member state shall notify the FME of such intention and provide the appropriate information in advance. The FME must send the competent authorities of the host state information on the undertaking's own funds, liquidity, deposit guarantees and compensation system to protect branch customers. A foreign financial undertaking, which is established and holds an operating licence in another member state of the European Economic Area (EEA), may establish a branch in Iceland two months after receipt by the FME of notification of the proposed activity from the competent authority in the undertaking's home state. The FME shall confirm that the foreign undertaking is subject to supervision in its home state and check its authorisations to operate and activities.The branch may pursue any activity, provided the undertaking is authorised to do so in its home state.

In June 2010, the Icelandic Parliament passed Act 75/2010, amending Act 161/2002. The amendments tighten rules and increase financial prudential surveillance in a number of ways: the FME is granted increased powers, financial institutions are required to deliver information on large exposures, the conditions upon which a financial institution may own its own shares are clarified, financial institutions are prohibited from granting loans against collateral in their own shares or guarantee capital shares, conditions for loans to specific related parties and rules on large exposures are tightened, as are rules on incentive programmes, bonus schemes, and termination agreements. The new framework is to be supplemented with further measures to be adopted by the FME.

The FME and the Central Bank of Iceland (CBI) have finished work to set up a registry on large exposures. The National Credit Registry became operational in fall of 2011. The FME will collect information regarding exposures over ISK 300 million (about EUR 2 million). The credit registry will only be accessible to the FME. The information, however, will be shared with the CBI without specific data regarding particular obligors and financial undertakings. .

Work is in progress on specifying and implementing rules concerning: good business practices and customs; loans secured by mortgage on shares or guarantee capital certificates issued by the undertaking; remuneration policies; the calculation of the amount of exposure; what constitutes secure collateral; the evaluation of connections between parties within the meaning of rules on large exposures, exception from internal auditing units of financial undertakings; and qualifying holdings outside the financial sector. Credit institutions have to set up independent internal audit system staffed with qualified employees. Once a year, at a minimum, the internal audit sections within the financial undertakings shall report to the Financial Supervisory Authority on the conclusions of their reviews. Contracts for external auditing are allowed only for a limited period of 5 years.

Iceland applies Article 1, point 2 of Directive 2007/18/EC on the capital requirements and risk weighted assets of financial undertakings. However, Article 1, point 1, concerning exemptions from Directive 2006/48/EC, was not implemented into Act on Financial Undertakings 161/2002.

Directive 2007/44/EC on the prudential assessment of acquisitions has been transposed into Acts 161/2002 and 56/2010. The FME has published a list that specifies the information requested for the purpose of assessment. This list is based on procedural rules and evaluation criteria for the prudential assessment of acquisitions and increases in holdings in the financial sector required by Directive 2007/44/EC.

Directive 2009/83/EC regarding technical provisions concerning risk management has not been implemented into Icelandic law. The FME is working on secondary legislation which will come into force in early 2012. Directive 2009/27/EC on technical provisions concerning risk management has been implemented with the FME´s Rules 378/2011, amending Rule 215/2007 on the Capital Requirements and Risk Weighted Assets of Financial Undertakings. The rules came into force in April 2011. The FME has completed its work concerning secondary legislation. Directive 2009/111/EC concerning banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management has been implemented with Act

119/2011 amending Act 161/2002 on Financial Undertakings. The Act came into force September 2011. The FME will begin work concerning secondary legislation in 2012.

Capital adequacy requirements for investments firms and credit institutions, as foreseen by Directive 2006/49/EC, are included in the Icelandic Act on Financial Undertakings 161/2002, and the implementing Rules 215/2007 on the capital requirement and risk weighted assets of financial undertaking (as amended by Rules 1167/2008), and Rules 216/2007 on large exposures incurred by financial undertakings. Directive 2008/23/EC on the capital adequacy of investment firms and credit institutions, as regards the implementing powers conferred on the Commission does not have EEA relevance and has therefore not been implemented into the EEA Agreement and into Icelandic law.

In the context of the 2008 financial crisis, the Icelandic banking sector embarked upon a major restructuring process. Through significant government intervention and foreign private capital, the new banks have been capitalised with capital adequacy ratios of minimum 16%, of which 12% is tier 1 capital. End of September 2011, all three main commercial banks had capital adequacy ratios of over 20%. The purpose of this was to compensate for credit liquidity and foreign exchange risk, partly caused by lack of access to international capital markets given the existing capital controls. Despite rather high capital adequacy ratios, banks are faced with vulnerabilities arising from weak asset quality and currency and maturity mismatches.

Iceland has transposed Directive 2002/87/EC on the comprehensive framework for the supplementary supervision of **financial conglomerates** through the adoption of Act 130/2004 amending Act 161/2002 on Financial Undertaking, and Act 60/1994 on Insurance Activities. The Rules of FME 920/2008 on supplementary supervision of financial conglomerates, together with the adoption of Act 56/2010 on Insurance Activities, complete the implementation of the financial conglomerates Directive and consequently of the *acquis* in this field.

Iceland has established a **deposit guarantee scheme** in line with the requirements of the Directive 94/19/EC (meanwhile amended at EU level with the protection of depositors being increased to 100.000 EUR). According to the current legislation Act No. 98/1999, Art 10, the current minimum deposit guarantee per deposit in Iceland equals EUR 20.887. There is however no ceiling on the guarantee. If the deposit guarantee scheme, after having paid out EUR 20.887 to each deposit holder, still has funds available then each deposit holder shall receive a pro rata payment until the funds are depleted. In 2011 the Parliament voted down a bill of law, presented by the Ministry of Economic Affairs, on deposit guarantees and guarantee schemes for investors, aimed at, among other things, transposing Directive 2009/l4/EC amending Directive 94/l9/EC. The amending directive (which has still not been incorporated into the EEA agreement) has increased the coverage level for guaranteed deposits to EUR 100,000.

The deposit guarantee scheme is administered by the Depositors' and Investors' Guarantee Fund (TIF) which is subject to the provisions of Act No. 98/1999, with later amendments, the Regulation 120/2000 and Regulation 864/2002. The objective of the TIF, which is a non-profit foundation under surveillance of the Icelandic Financial Supervisory Authority (FME), is to guarantee a minimum level of protection to depositors in commercial and savings banks, and to customers of companies engaging in securities trading pursuant to law, in the event of difficulties in meeting customer obligations according to the provisions of the Act. All commercial banks, savings banks,

companies providing investment services, and other parties engaging in securities trading pursuant to law and established in Iceland, are obliged to be members of and contribute to the Fund. The same applies to branches of such parties within the EEA. There are currently no branches of Icelandic banks in other EEA countries.

Foreign deposits with EEA subsidiaries of Icelandic banks are guaranteed by the guarantee funds in the countries concerned. In cases of deposits in cross border branches, the national schemes involved are required to cooperate fully to ensure that depositors receive compensation promptly and in the correct amount.

Following the 2008 collapse of the three main privately owned Icelandic banks (Glitnir, Landsbanki and Kaupthing), TIF did not have sufficient funds to reimburse the depositors at the foreign branches of the banks. The British and Dutch depositors with Icesave - an on-line branch of Landsbanki that operated in the UK and the Netherlands - were particularly affected.

The EU legislation on **bank and branch accounts** is fully transposed into Icelandic law through the revised Act on Financial Undertakings 161/2002, the Rules 834/2003 on the Annual Accounts of Credit Institutions and the revised Act on Annual Accounting No. 3/2006 (*See also Chapter 6 – Company law*).

The EU legislation on **reorganisation and winding-up** is fully transposed into Icelandic law. Procedures for banks are regulated by Act 161/2002 on Financial Undertakings, Act on bankruptcy 21/1991, and Regulation 1049/2008 amending Regulation 872/2006 on the notification and publication of decisions on the financial reorganisation and winding up of credit institutions.

Following restructuring and recapitalisation of the three major commercial Icelandic banks that collapsed in 2008, two of the new banks were taken over by the estates of the old banks with the government retaining only a small minority shares. The government at this time still retains majority ownership (81%) of one of the three banks, NBI (Nýi Landsbanki). It also owns the Housing Financing Fund and stakes in a few savings banks and credit institutions. The restructuring and recapitalisation of the savings banks has further progressed. Overall, banking sector restructuring has further progressed, but significant vulnerabilities remain with respect to banks' asset quality. Banks are now much smaller in size compared to pre-crisis levels and focus almost exclusively on domestic operations. However, non-performing loan ratios are exceptionally high. Currently, around 35% of bank'loans is performing after restructuring, while 40% are in non-performing status[1].

As regards **administrative capacity**, the institutions mandated to exercise and share the regulatory and supervisory powers in this area are the Central Bank of Iceland (CBI) and the Financial Supervisory Authority (FME), both under the auspices of the Ministry of Economic Affairs. The FME and the Central Bank cooperate in their attempts to improve both institutions' analysis and monitoring of the interplay between risk related to the operations of individual financial institutions (micro-prudential supervision) and those related to factors affecting the stability of the financial system as a whole (macro-

[1] The non-performing definition is such that if one payment of loan is in default then all the loans of the obligor are deemed in default. The ratio in October 2011 is 25%. The per facility based non-performing ratio is about 15% in October 2011.

prudential supervision). Both institutions carry out off-site monitoring, while the FME also conducts on-site inspections.

The CBI was established by an act of parliament in 1961 and its current activities are primarily governed by the Central Bank Act No. 36/2001 as amended by Act 5/2009 and Act 98/2009. The CBI is an independent institution, owned by the Icelandic state and under the administration of the Minister of Economic Affairs and a Supervisory Board. Parliament elects seven members to the Supervisory Board after each parliamentary election. The Minister of Economic Affairs appoints the Governor and Deputy Governor of the Central Bank for a five-year term. The Central Bank mandate isto promote the security of the financial system by closely monitoring the macroeconomic environment, relations between financial institutions and financial markets, the evolution of the financial system both in Iceland and elsewhere, its strength and efficiency, and the impending risks for the system as a whole. Twice a year, the Central Bank publishes a report on financial stability. Iceland stated that the Central Bank of Iceland is likely to need additional policy tools to be able to fulfil its mandate to promote the security of the financial system. This need has increased awareness in Iceland that the Act on the Central Bank of Iceland and the Act on Official Supervision of Financial Activities needs to be reviewed (please see chapter 17- *Economic and Monetary Policy*)

The activities of the Financial Supervisory Authority (FME) are primarily governed by two Acts. Act 87/1998, with subsequent amendments, on the Official Supervision of Financial Operations, covers the institution and its administrative position, operations and confidentiality. Act 99/1999 on the Payment of Cost Due to the Official Supervision of Financial Activities, relates to the payment of supervisory expenses. Parties subject to supervision pay a special fee as defined in the Act to meet the FME's operational expenses.

According to Act 87/1998 on Official Supervision of Financial Activities, the parties subject to FME supervision are: commercial banks, savings banks, credit undertakings (investment banks), parties that are authorised by law to receive deposits (deposit departments of co-operative societies), securities companies, securities brokerages, mutual funds (UCITS) and management companies of UCITS, stock exchanges and other regulated markets, central securities depositories, pension funds, insurance companies and insurance brokers licensed to operate in Iceland. The new Rules of the FME 920/2008 provide for supplementary supervision of financial conglomerates.

The FME has also been entrusted with the supervision of the following parties, whose operations are governed by special laws: the Housing Financing Fund and two special guarantee funds for deposit owners and investors.

The new Act 75/2010 amending Act 161/2002 on Financial Undertakings improves the overall regulatory and supervisory framework, strengthens the supervisory powers of the FME and introduces improvements in the regime for and monitoring of large exposures by *inter alia* creating a separate national registry, laying down stricter rules on financial institutions' trading their own stock and prohibiting lending with collateral in own shares. It also introduces provisions for good business practices. Moreover, in response to the findings of the April 2010 report of the Parliamentary Special Investigation Commission (SIC) originally set up in order to investigate the background and causes of the collapse of the Icelandic banks in 2008, a committee on financial stability was established, in

August 2010, to address cooperation amongst Icelandic institutions in the field of financial stability and financial crisis prevention. The agreement to establish the committee is based on a previous agreement which addresses cooperation in the field of financial stability and financial crisis prevention from 2006. Also, a new cooperation agreement between the FME and the Central Bank of Iceland was signed in January 2011 to eliminate the shortage of systematic co-operation among supervisory bodies and a lack of timely response to danger signals in the financial system. The new agreement provides for closer and more systematic collaboration and aims to promote a sound, effective, and safe financial system in Iceland, including payment and settlement systems. In 2012, two years after the SIC report, an independent evaluator will assess the extent to which FME has addressed all the weaknesses emphasised in the report. This evaluation will be preceded by an FME self-assessment.

In order to achieve its function of sound supervision, the FME has recently (January 2012) completed an institutional reorganisation from a sector-oriented approach to on-site, off-site and oversight departments. This re-design is matched, according to Iceland, by sufficient human resources. Between 2008 and 2012 the number of FME staff increased from 45 to 132. However, the number of staff is going to slightly decrease in the next years. FME now includes more legal and IT experts, together with a forensic accounting team.

In mid-2011 an assessment of the Basel Core Principles for Effective Banking Supervision was performed by an internationally recognised expert .The FME has devised a detailed plan to tackle the problems of non compliance outlined in that report. The anticipated implementation of the plan will be finalised by end 2013 or mid 2014. The FME has already sent a request for IPA funding on this action plan in January 2012. The plan also explains the increased revenue given to the FME in the Authority’s financing bill for 2012 (passed in December 2011).

Up to end of 2011, more than 770 cases of alleged financial misconducts have been referred by the FME to the Special Prosecutor Office, which was set up in 2008 with the mandate to investigate suspicions of criminal actions related to the 2008 Icelandic banks collapse. Given the complexity of the cases, only 6 of them were referred to the State Prosecutor, 4 to the police and only 2 to the Court. Iceland stated that there is a good level of cooperation between the two institutions in the light of the cooperation agreement signed in 2009

Until the entrance into force of the new European Supervisory Authorities in January 2011, the FME was an observer on the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance Supervisors (CEIOPS) and Committee of European Securities Regulators (CESR). Steps have been taken in view of Iceland's regular attendance as observer in the work of the three new European Supervisory Authorities – the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA).

II.b. Insurance and occupational pensions

The Icelandic legislation on **life assurance and non-life insurance** consists of the Act on Insurance Activities, with Amendments (56/2010), the Act on Insurance Brokerage (32/2005), the Act on Insurance Contracts, with Amendments (30/2004), the Act on Official Supervision of Financial Operations with Amendments (87/1998) and the Act on Payment of Cost Due to Official Supervision of Financial Activities (99/1999). The new Act 56/2010 provides for more strict responsibilities of directors and for more strict conditions in respect of qualifying holdings. There are also new provisions on risk management, internal and external audit, and tighter restrictions on own shares, loans and other exposures to board members, CEO's key employees and owners of qualifying holdings.

Directive 2002/83/EC on **life assurance** has been fully implemented in Iceland with Act No. 56/2010 on insurance activity. Changes were made to improve the transposition of a few paragraphs of the Directive in accordance with existing recommendations from the EFTA Surveillance Authority. Directive 2008/19/EC amending Directive 2002/83/EC on implementing powers conferred on the Commission is still not implemented in Iceland due to its non-incorporation into the EEA Agreement.

Iceland implements a large part of EU legislation in the area of **non-life insurance**. Exceptions are Directive 91/371/EC, Regulation 2155/91 and Directive 2008/36/EC which have not yet been incorporated into the EEA Agreement. Iceland has also implemented specific provisions in the non-life insurance sector for co-insurance, tourist assistance, credit insurance and legal expense insurance in line with the EU *acquis*.
Insurance undertakings need an operating licence from the FME for their establishment and operation in Iceland or abroad. FME has the custody of the Register on Insurance Companies which have received operating licences in Iceland. Foreign insurance companies with head offices in member states, which have obtained an operating licence from their supervisory authority, may establish a branch in Iceland or provide services in Iceland without having an establishment in the country, provided they are authorised for insurance activities in the same classes of insurance and sub-classes as in their home state. The FME is entitled to ask for any documentation in this regard from the insurance companies.

Insurance undertakings must regularly provide various accounting, prudential and statistical information to the supervisory authority. This relates in particular to capital requirements, the solvency margin and technical provisions. In addition they provide policy conditions on compulsory insurance, premium bases in life insurance and several internal rules, such as on internal control and investments. The internal rules must be approved by the FME. The minimum solvency margin varies according to the type of service provided.

The acquisition of a qualifying holding in an insurance undertaking and the acquisition of shares beyond certain thresholds require the permission of the FME, which also monitors the dealings by insurance companies with their subsidiaries, affiliated companies or individuals holding 20% or more in the above-mentioned companies. The Act on Insurance Activities contains an exhaustive list of circumstances in which the FME can refuse to authorise an application.

Icelandic legislation on insurance contracts No. 30/2004 provides for relevant provisions on contract information to customers. The cancellation period (the so-called cooling off period) for both life and non-life is 30 days.

Act 87/1998 on official supervision of financial activities together with the Act 56/2010 on Insurance Activities, with Amendments, implements the EU *acquis* on the **supplementary supervision** of insurance undertakings in an insurance group. Icelandic legislation contains clear definitions and provisions concerning insurance undertakings, including the definition of an insurance group and rules on supplementary supervision, reporting, risk management, capital requirements, minimum solvency, intra-group transactions, close links, and supervisory coordination across the EEA. The FME has increased powers, *inter alia*, to set new rules on adjusted solvency margin, aligning it with the rules on financial conglomerates.

Iceland stated that it applies, to a large extent, EU legislation in the area of **re-insurance**. Directive 2005/68/EC has been transposed in Iceland with Act 56/2010 on insurance activity. Exceptions of non transposition of the *acquis* - due to not being part of the EEA Agreement - are Article 3 of Directive 64/225/EEC on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of reinsurance and retrocession and Directive 2008/37/EC on reinsurance, regarding the implementing powers conferred on the Commission.

As an EEA member state, Iceland has taken an active part in the preparation of Directive 2009/138/EC (Solvency II). The Ministry of Economic Affairs has observer status in the Commission Solvency Working Group. Since 2004 the FME has taken part as observer in the CEIOPS (Committee of European Insurance and Occupational Pensions Supervisors) working group regarding Solvency II. The FME receives emails of all the working groups and attends meetings in the Financial Requirement Expert Group and Internal Governance Review and Reporting Expert Group.

In early 2010, the Ministry of Economic Affairs nominated an implementation committee regarding the Solvency II Directive. The committee is chaired by the FME with members nominated from the FME, the Icelandic Financial Services Association and the Actuarial Association. The committee plans to propose a bill for the implementation of the Solvency II Directive later in 2011 or early 2012. Iceland stated that the implementation method of the Solvency II will probably include changes to Act 56/2010 on insurance activity along with special legislation on different aspects, such as capital requirements and insurance groups, and a regulation issued by the Ministry of Economic Affairs with direct reference to the level II regulation.

Article 8 of Directive 2009/138/EU lists institutions which pursue non-life insurance activities and are excluded from this Directive. With the adaptation of the Directive into the EEA Agreement it was agreed that Viðlagatrygging Íslands (a natural catastrophe insurance provider in Iceland) was to be added to the list in Article 8.

There are 11 operating insurance companies in Iceland that took part in the last quantitative impact studies (QIS 5). QIS 5 provides for increased capital requirements for non-life companies, significant underwriting risk and reduced capital requirements for life insurance companies. The FME has made some comments to the submitted results..

According to FME, market risk has been reduced since QIS 4, however some companies have quite a high concentration risk.

Apart from QIS5, the FME has had other information sharing with the companies, i.e. a questionnaire on the use of internal model and asked for a status report on their preparations. The FME has also held several presentations on Solvency II for insurance companies since 2005.

The fifth **motor insurance** Directive 2005/14/EC was implemented in Iceland with Act 155/2007 on amendments to Act 50/1987 on road transport, Act 60/1994 on Insurance Activity and Regulation 424/2008 on Compulsory Insurance in Respect of the Use of Motor Vehicles. The Codified Motor Insurance Directive 2009/103/EC only repeals the First, Second, Third, Fourth and Fifth Motor Insurance Directives 72/166/EEC, 84/5/EEC, 90/322/EEC, 2000/26/EC and 2004/14/EC and codifies them within its body. Therefore, the Motor Insurance Directive 2009/103/EC can be considered as implemented.

Directive 2002/92/EC on **insurance mediation** has been transposed into Icelandic law with Act 32/2005 on insurance mediation, Act 30/2004 on insurance contracts, Act 87/1998 on official supervision of financial operations, Regulation. 592/2005 on professional indemnity insurance, Regulation 590/2005 on trust accounts for insurance brokers and insurance agents and Regulation 972/2006 on examination in insurance mediation. The Act on Insurance Activities 60/1994, along with its amendments, brought insurance brokers under regulation and licensing requirements. The Act on Insurance Contracts of 2004 enhanced consumer protection by requiring the insurers and brokers - both domestic and foreign - to provide information to their customers (insured and policyholders). The Act also provided legal status to the Insurance Complaints Committee that has been in existence since 1994. Furthermore, the 2005 Act on Insurance Mediation also places emphasis on the right of the consumer to information and requires insurers to apprise their customers, in writing, as to why they should enter into a specific insurance contract with them. The legislation introduces registration requirements, minimum professional requirements, minimum requirements for the professional liability insurance, off-site and on-site supervision, and penalties. According to the Directive, an insurance intermediary must give customers clear explanations for the advice they give on which products to buy.

Directive 91/674/EEC on the **annual accounts and consolidated accounts of insurance undertakings** was implemented by Act 60/1994 on insurance activity, now Act 56/2010, Act 144/1994 on annual accounts - now Act 3/2006 - and several implementing measures issued by the FME. (*See also Chapter 6 – Company law.*) Accounts for insurance and reinsurance undertakings must be drawn up in accordance with international accounting standards; a summary of the audited annual report must be made public and the annual report must be submitted to the FME within a certain deadline. The leading insurance undertaking in an insurance group needs to prepare consolidated accounts. The FME is entitled to issue detailed regulations prescribing the chart of accounts, as well as the type, form, layout, content and publication of financial reports.

Directive 2001/17/EC on **reorganisation and winding-up** of insurance undertakings was implemented by Act 60/1994 on Insurance Activity, now Act 56/2010.. The FME is the competent authority for the re-organisation and winding-up of insurance undertakings.

As regards **occupational pensions**, the Icelandic Pension Act 129/1997 provides a comprehensive legal framework for all general pension funds whereby the rights of pension fund members are clearly defined, the obligations of pension funds - as recipients of contributions and payers of pensions, as well as investors - are spelled out. In the mutual insurance part of the pension system, the rights are not transferable from one pension fund to another. When a member leaves a pension fund the accumulated rights are kept until retirement plus investment performance. In case of private pension schemes, rights are transferable at any time without any losses except minimum transfer fees are charged. Act 129/1997 sets a framework for the operation of pension funds to ensure their financial soundness. In addition to the Pension Act, several pension funds – notably the Government Employees Pension Fund and the municipality employee funds – are subject to special legislation.

The Pension Act furthermore provides for provisions on fit and proper conditions both for board members and managing directors of pension funds. Implementing rules with respect to areas such as accounting, investment strategies and auditing procedures are further defined in secondary legislation.

Pension funds are supervised by the FME, which may demand, if deemed necessary, documentation or information. Pension funds don´t operate subsidiaries nor affiliates.

Directive 2003/41/EC on the activities and **supervision** of institutions for occupational retirement provision (IORP) has been fully implemented in Iceland by Act 78/2007 on institutions for occupational retirement provisions, and by Act 129/1997 on mandatory pension insurance and activities of pension funds. However, given the fact that it has not yet been incorporated into the EEA agreement, Iceland does not implement the Directive 2008/25/EC amending Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, as regards the implementing powers conferred on the Commission.

In 2011, 13 domestic insurance companies (two of them are reinsurance companies in run-off), 6 insurance brokerages and around 40 pension funds were active in the Icelandic insurance sector. There are also more than 400 registered foreign insurance companies that have been authorized to provide services without establishment or that have opened a branch in Iceland, but only a few are operating actively.

As regards **administrative capacity**, the insurance and pension sector in Iceland is regulated and supervised by the FME. According to Iceland, the FME's recent reorganization in on-site, off-site and oversight departments is matched by sufficient human resources. However, only one insurance on-site inspection was carried out in 2011. FME has a wide range of competences which include regulatory activities, licensing and on-site and off-site supervision of the entire non-banking financial sector in Iceland. It can impose sanctions such as the withdrawal of licenses, referral of cases to the judicial authorities and it can put undertakings in the finance sector under special administration. The supervised entities are mandated to pay a special fee that goes towards funding the supervisory activities and operational expenses of the FME. FME's management and its employees are bound to full confidentiality concerning any information they may acquire which is relevant to the activities or transactions and operations of parties subject to supervision, related parties or others. FME is a member of the International Association of Insurance Supervisors (IAIS) and has extensive contacts and cooperation arrangements with foreign regulators, including those from the Nordic

countries (Denmark, Sweden, Finland, and Norway), the EEA countries, and several non-EEA countries through separate Memorandums of Understanding (MoU). In line with the reference to Article 101 and Protocol 37 of the EEA Agreement, Iceland has participated as an observer in meetings of the European insurance and occupational pensions committee set up by Directive 2008/21/EC.

II.c. Financial market infrastructure

Directive 98/26/EC on **settlement finality** in payment and securities settlement systems and Directive 2002/47/EC on **financial collateral** arrangements as regards linked systems and credit claims are fully implemented in Iceland by Act 90/1999 respecting the Security of Transfer Orders in Payment System and Act 46/2005 on Financial Collateral Arrangements.

Directive 2009/44/EC amending Directive 98/26/EC and Directive 2002/47/EC is in the process of transposition. The Icelandic Ministry of Economic Affairs foresees no hindrances in transposing the elements amending Directive 98/26/EC. The EEA implementation deadline was 30 June 2011. To this purpose, amendments are needed on Act 90/1999 respecting the Security of Transfer Orders in Payment System. The bill is expected to go into parliamentary discussion early 2012. The Icelandic Ministry of Justice and Human Rights foresees no problem in transposing the elements amending Directive 2002/47/EC. To this purpose, amendments are needed on Act 46/2005 on Financial Collateral Arrangements. The EEA implementation deadline was 30 June 2011. The bill is expected to go into parliamentary discussion early 2012.

As regards the **withholding tax procedures**, the implementation in Iceland of the European Commission Recommendation 2009/784 on withholding tax relief procedures is done through Regulation 1082/2009. This regulation also specifies the implementing method of the provision included at point 8 of Article 3 of the Income Tax Act 90/2003 that no withholding tax from interest shall be paid or a lower rate used according to a double taxation agreement (DTA). Article 2 of Icelandic Act 45/1987 on withholding of public levies at source, also specifies the type of income that falls under the scope of this Act. There are two electronic forms in use regarding withholding tax relief: the RSK 5.42 application according to a DTA for exemption or partial relief from Icelandic taxation and the RSK 5.43 application according to a DTA for a refund of taxes paid in Iceland.

II.d. Securities markets and investment services

Icelandic legislation in the area of **securities markets** is, according to Iceland, broadly in line with the EU regulatory framework. It includes the need to obtain authorisation from the FME for the provision of investment services and activities, criteria to be fulfilled by persons who effectively direct the business and the main shareholders of the firm, the definition of trading platforms (regulated markets, multilateral trading facilities and systematic internalisers) and their authorisation, the general provisions regulating the identification and the management of conflicts of interests by firms providing the services and their organisational requirements and the conduct of business rules aimed at protecting investors. Market supervision is carried out by the FME.

In general, certain thresholds from the *acquis communautaire* are transposed into Icelandic legislation on the basis of a tied exchange rate, mostly the one of 3 January 2007 but sometimes even older. Due to the sharp decrease of the Icelandic currency

during the financial crisis, some thresholds are no longer considered by Iceland to be in line with the EU models (e.g. Act 108/2007 on Securities Transactions). Other thresholds are accompanied by a fallback threshold denominated in EURO.

Directive 2004/39/EC on markets in financial instruments (MiFID) and its amending Directive 2006/31/EC were implemented with the Act 108/2007 on Securities Transactions, Act 110/2007 on Stock Exchanges, and Act 161/2002 on Financial Undertakings, Act 87/1998 on Official Supervision of Financial Activities, Act 98/1999 on Deposit Guarantees and Investor Compensation Scheme and Act 30/2003 on UCITS.

Directive 2006/73/EC implementing Directive 2004/39/EC as regards organisational requirements and operating conditions for investment firms, was implemented with Regulation 995/2007 on Investor Protection and the Business Conduct of Financial Undertakings.

Regulation 1287/2006/EC implementing Directive 2004/39/EC on record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms was enacted with Regulation 994/2007. Directive 2000/64/EC on exchange of information with third countries was implemented in 2000 with amendments to the already existing Act 87/1998 on Official Supervision of Financial Activities. However, Directive 2008/10/EC amending Directive 2004/39/EC on markets in financial instruments, on the implementing powers conferred on the Commission, has not been incorporated into the EEA Agreement, and, consequently, it has not yet been implemented in Iceland.

Directive 97/9/EC on the establishment of an **investor-compensation scheme** was implemented in Iceland through Act 98/1999 on Deposit Guarantees and Investor-Compensation Scheme and Regulations 120/2000 and 864/2002 (for more details please refer above to *Bank and Financial Conglomerates - Deposit Guarantee Scheme*).

Directive 2001/34/EC on the admission of securities to official stock exchange listing and on information to be published on those securities, which has been amended by Directive 2003/71/EC ("Prospectus Directive") and Directive 2004/109/EC ("Transparency Directive"), has been implemented with Act 110/2007 on Stock Exchanges, Act 108/2007 on Securities Transactions and Regulation 245/2006 on the Official Listing of Securities in a Stock Exchange.

Notably, the Act on Stock Exchanges regulates the conditions for the admission of securities to trading and empowers the stock exchange to adopt more detailed requirements and to impose sanctions when issuers violate the provision.

The Prospectus Directive 2003/71/EC was implemented in Iceland with the Act 108/2007 on Securities Transactions, Regulation 242/2006 on Public Offers of Securities, Regulation 243/2006, Regulation 169/2007, Regulation 324/2008 and Regulation 215/2010. Commission Regulation 809/2004/EC implementing the Prospectus Directive on information contained in prospectuses was entirely implemented in Iceland through Regulation 243/2006. Regulation 244/2006 provides a framework for conducting public offers when the offer price is at a range from 8.4 to 210 million ISK while Regulation 242/2006 covers public offers when the offer price is ISK 210 million or higher.

Commission Regulation 1569/2007/EC, establishing a mechanism for the determination of equivalence of accounting standards applied by third country issuers of securities, is transposed in Act No. 3/2006 on Annual accounts with amendments and Act No. 108/2007 on Securities.
Concerning periodic and ongoing information, Iceland stated that it has reached a high level of alignment with Directive 2004/109/EC ("**Transparency Directive**") on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market. Where there are differences, Iceland stated that it usually chooses to implement more stringent requirements than those stated in the Transparency Directive.

Act 108/2007 on Securities Transactions requires issuers of securities to publish certain periodic and ongoing information; issuers are required to publish annual and, as far as equity or debt securities are concerned, semi annual financial statements. In addition, the regulated market's rules may require also quarterly financial interim reports.

Furthermore, and in compliance with the Transparency Directive, information on the acquisition and disposal of major holdings reaching/crossing certain thresholds (5%, 10%, 15%, 20%, 25%, 30%, 35%, 40%, 50%, 66 2/3% and 90%) must be notified to FME and the issuer.

The Market Abuse Directive 2004/6/EC and its accompanying legislation are implemented in Iceland through Act 108/2007 on Securities Transactions, the Rules 1013/2007 on Investment Recommendations, Regulation 630/2005 on Inside Information and Market Abuse - as amended with Regulation 887/2008 - and the Rules 987/2006 on Treatment of Insider Information and Insider Trading together with an existing FME manual on the matter. However, Directive 2008/26/EC on insider dealing and market manipulation (market abuse), as regards the implementing powers conferred on the Commission, has not been incorporated into the EEA Agreement, and, consequently, it has not yet been implemented in Iceland.

Undertakings for collective investment in transferable securities are regulated in Iceland by the Act 161/2002 on Financial Undertakings, Act 30/2003 on Undertakings for Collective Investment in Transferable Securities (UCITS) and Investment Funds, Regulation 792/2003 on UCITS and investment funds, Act 87/1998 on Official Supervision of Financial Activities, Regulation 924/2009 on changes of Regulation on UCITS and Investment Funds 792/2003, Regulation 925/2009 on foreign management companies operating in Iceland, and, finally, the Financial Supervisory Authority (FME)´s Rules 1065/2009, amending Rules 97/2004 on the financial statements of management companies of UCITS.

Despite already being incorporated into the EEA Agreement, Directive 2007/16/EC on the coordination of laws, regulations and administrative provisions relating to UCITS as regards the clarification of certain definitions, has not yet been implemented in Iceland. Act No 30/2003 on UCITS and Investment Funds has now been replaced by Act 128/2011 on the same subject. The Act came into force November 2011. Regulations further detailing the new Act are expected to be issued early 2012.

Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to UCITS has not yet been implemented. The deadline is end of 2011 and Iceland stated that no challenges were foreseen in the transposition process.

Iceland stated that 27 UCITS funds have been authorised in Iceland, thereof 10 umbrella funds with 35 sub-funds. Nineteen non-UCITS funds that are marketed to the public have been authorised, thereof 4 umbrella funds with 7 sub-funds. No UCITS funds are presently listed in the stock exchange. Forty-seven UCITS funds with 313 sub-funds that have not been authorised in Iceland market their units in Iceland.

UCITS management companies can operate across the EEA in accordance with the 'single passport' and the 'home country control' principle.

The current Icelandic capital controls also apply to operations in securities normally traded on the capital market, operations in securities and other instruments normally traded on the money market as well as UCITS operations (see chapter 4 – free movement of capital). Due to the current capital controls, pension funds cannot invest abroad.

As regards **administrative capacity**, securities markets and investment services in Iceland are under the supervision of the FME.

III. ASSESSMENT OF THE DEGREE OF ALIGNMENT AND IMPLEMENTING CAPACITY

Overall, Iceland has already reached a high level of alignment and applies a substantial part of the *acquis* in the fields covered by this chapter, due to its EEA membership and should therefore be well prepared to take on the obligations of membership by the time of accession. New EU legislation, relevant to this chapter, is regularly incorporated into the EEA Agreement.

Further alignment with the *acquis* is expected to take place in line with existing EEA deadlines for transposition. The Commission will continue to monitor Iceland's alignment with the updated EU *acquis* by the time of accession.

Concerning the fulfilment by Iceland of its obligations under the EEA Agreement in the areas covered by this chapter, ESA decided to bring a lawsuit against Iceland before the EFTA Court on reasons associated with breach against the Deposit Guarantee Directive 94/l9/EC.

In terms of **administrative capacity**, the investigatory and sanctioning powers of the Financial Supervisory Authority (FME) are in line with those of Member States. The institutional reorganisation of the FME from a sector-oriented approach to on-site, off-site and oversight departments, which is in the process of implementation, needs to prove functional and be matched by sufficient human resources. In addition to the reinforcement in the staff number, FME needs to make further efforts to increase the quality of its technical expertise, supervisory systems and practices and of the IT systems used by the FME to ensure effective and reliable prudential supervision.

Iceland's overall administrative and institutional capacity in the areas of insurance and occupational pensions, financial market infrastructure and securities markets and investment services also needs to be strengthened in view of the FME's increasing responsibilities and future obligations deriving from the application of the evolving *acquis.*

III.a. Banks and financial conglomerates

Iceland has already reached a good level of alignment of the *acquis* in this area. However, the collapse of Iceland's banking system in 2008 has highlighted major weaknesses in the implementation of laws in the field of financial services supervision, such as in the monitoring of compliance with rules on large exposures, concentration risks and liquidity. It is important to make sure that Iceland has the appropriate capacity to apply EU legislation. Iceland needs to take, as already started, necessary steps to address the existing gaps in the area of prudential supervision, and to ensure application of EU legislation concerning capital requirements as well as the new coverage level of the deposit guarantee scheme.

Iceland has reached a high level of alignment with the *acquis* requirements for the **taking up and pursuit of the business of credit institutions.**

The high rate of non-performing households and corporate loans still undermine confidence in and the strength of financial institutions with impact on the level of investments and the growth of the economy.

Work needs to be finalised on specifying and implementing the new rules concerning: good business practices and customs; loans secured by mortgage on shares or guarantee capital certificates issued by the undertaking; remuneration policies; calculation of amount of exposure; what constitutes secure collateral; the evaluation of connections between parties within the meaning of rules on large exposures; exception from internal auditing units of financial undertakings; and qualifying holdings outside the financial sector.

Iceland has reached a good level of alignment with the *acquis* requirements on **capital adequacy** for investment firms and credit institutions. However, Iceland needs to start the alignment of Directive 2008/23/EC on the capital adequacy of investment firms and credit institutions, as regards the implementing powers conferred on the Commission, and specify its entry into force by the time of Iceland's EU accession.

Iceland fully applies the *acquis* requirements on **financial conglomerates.**

Iceland has not yet reached a satisfactory level with *acquis* requirements on the new coverage level of the **deposit guarantee scheme.** Steps need to be taken in order to transpose Directive 2009/l4/EC amending Directive 94/l9/EC. Under the amended Directive, EUR 100.000 is both a minimum and maximum amount and therefore any lower and higher (included unlimited) guarantee is incompatible with the Directive. A draft bill to this purpose was rejected by the Icelandic Parliament in late 2011. Iceland needs to continue its work to achieve implementation of this directive by the time of accession.

Following the 2008 default of the Icelandic deposit guarantee scheme, the British and Dutch governments compensated, from their own resources, losses incurred by their domestic account-holders with Icesave, on the understanding that the Icelandic government would provide reimbursement. Despite various efforts to reach an agreement between the parties involved, at this stage the Icesave case still remains unresolved**.**

In April 2011, Icelandic voters rejected for a second time in a referendum an agreement negotiated by the three governments setting the terms and conditions of reimbursement together with legislation providing a state guarantee for the reimbursement payments by the Icelandic Deposit Guarantee Fund to the British and Dutch governments. The Icelandic government reiterated that the outcome of the referendum will not affect the commencement of payments by the estate of Landsbanki Íslands hf. to priority claimants (including the British and Dutch authorities). On 28 October 2011, the Supreme Court of Iceland decided to uphold the priority ranking assigned to retail and wholesale depositors in Iceland's banks by the 2008 Emergency Act, including the priority creditor status of the British and Dutch Icesave depositors in the estate of Landsbanki. As a result, on 7 December 2011 the first Icelandic partial payments to priority creditors in the winding-up of Landsbanki Íslands were made. The total amount disbursed to the United Kingdom and the Netherlands was close to one-third of the recognised priority claims. Timing of further instalments will depend on the liquidation of Landsbanki's remaining assets. However, according to EFTA Surveillance Authority (ESA), despite the first Icelandic partial payments to priority creditors, the legal proceedings against Iceland will continue in the EFTA Court. The European Commission services share the legal analysis of ESA on this issue.

The Icelandic emergency measures in the aftermath of the banking collapse have raised questions as regards their compatibility with the EEA law, in particular the treatment of retail depositors in foreign branches of Icelandic banks. The EFTA Surveillance Authority (ESA) is the institution responsible for ensuring Iceland's compliance with the EEA Agreement.

In May 2010, the ESA sent Iceland a letter of formal notice - the first step in the infringement procedure, arguing that, by differentiating between depositors in banks' branches in Iceland and branches abroad when resorting to emergency measures following the banking collapse in October 2008, and by failing to ensure payment of the minimum amount of compensation to Icesave depositors in the Netherlands and in the United Kingdom within the time limits laid down in the Deposit Guarantee Directive 94/19/EC, Iceland has failed to comply with its obligations deriving from the EEA Agreement. Iceland replied to this letter on 2 May 2011 and denied any discrimination or that the state has to cover costs related to the Icesave deposit insurance guarantees, unless the legal obligation for doing so is clear.

In a next step, on 10 June, ESA issued a *reasoned opinion* reiterating Iceland's obligation to ensure payment of the minimum compensation by 10 September 2011. Iceland's government provided the answer to the reasoned opinion at the end of September 2011 reiterating their previous position. In December 2011, since a bilateral solution between Iceland, United Kingdom and the Netherlands was not found, ESA decided to bring a lawsuit against Iceland before the EFTA Court. The two issues in front of the Court are: a) whether Iceland has acted in breach of its EEA obligations deriving from the Deposit Guarantee Directive 94/19/EC by failing to provide the British and Dutch depositors with the minimum guarantee, and b) whether Iceland committed a discrimination on ground of nationality forbidden by EU law when it afforded a different treatment to the British and Dutch depositors compared to national depositors.

In line with the EU's Negotiation Framework, the advancement of the negotiations with Iceland will be guided by progress in Iceland's capacity to fully implement the relevant

acquis by the time of accession and also by the country's progress in fulfilling its obligations under the European Economic Area Agreement.

Iceland fully applies the *acquis* requirements on **bank and branch accounts**. (*See also Chapter 6 – Company law*).

Iceland fully applies the *acquis* requirements on **reorganisation and winding-up**. Overall, banking sector restructuring has further progressed, but significant vulnerabilities remain regarding banks' asset quality and capitalisation.

The financial supervisor of Iceland has already observer status with the three new European Supervisory Authorities – the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA), and the European Insurance and Occupational Pensions Authority (EIOPA). However, Regulations 1093/2010, 1094/2010 and 1095/2010 creating the three European Supervisory Authorities have yet to be incorporated into the EEA Agreement and implemented by the three EFTA-EEA states. The three regulations need to be fully implemented by Iceland by the time of accession.

Despite the reinforcement in the staff numbers of the FME (which however does not seems secured as a slight staff reduction is foreseen for the end of 2012), Iceland needs to make further efforts to increase the quality of their technical expertise, supervisory systems and practices, and IT systems so as to ensure effective and reliable prudential supervision. Improvements are still required on the supervisory tools (e.g. data collection from supervised institutions, data verification and expert evaluation, frequency of on-site inspections, supervisory review process of institutions, etc.) and the resource allocation of the FME in order to ensure that this authority can properly perform its task of monitoring financial institutions and promptly and adequately responding to growing risks or violations of prudential rules. Iceland has taken initial steps in this direction with the reorganisation of the FME in January 2012 that is expected, after becoming fully operational, to increase productivity, specialisation and efficiency. Plans are ongoing for improving supervisory tools (in particular for developing a risk model to supervise and assess banks in accordance with the risk they pose and of an early warning system for indentifying financial problems in institutions at an early stage), for ensuring compliance with the Basel Core Principles for Effective Banking Supervision and for upgrading IT systems. Considerable efforts need to be made in order to timely implement these plans.

III.b. Insurance and occupational pensions

Iceland has reached a high level of alignment in the insurance sector and applies a substantial part of the *acquis* in this area. Iceland has a relatively large insurance market which is transparent, offers largely homogenous products across companies, and is closely monitored by a competition authority. Since the adoption in June 2010 of the Act on insurance activities, Iceland has been implementing the provisions of the Reinsurance Directive. However, some provisions concerning the Life Assurance Directive as well as the Insurance Group Directive and the Insurance Mediation Directive remain to be transposed. In terms of administrative resources, the FME's recent reorganization in on-site, off-site and oversight departments needs to be matched by sufficient administrative capacity, such as the appointment of an insurance specialist on the board of directors of the FME and a yearly inspection programme focussed specifically on on-site and off-site insurance inspections.

Iceland has reached a high level of alignment with the *acquis* requirements for **life assurance.** Iceland needs to start alignment with Directive 2008/19/EC amending Directive 2002/83/EC on the implementing powers conferred on the Commission and specify its entry into force at the time of Iceland's EU accession.

Iceland has reached a high level of alignment with the *acquis* requirements for **non-life insurance.** However, Iceland needs to transpose Directive 91/371/EC and Directive 2008/36/EC, which have not yet been incorporated into the EEA agreement, and also fully implement Regulation 2155/91.

Iceland is highly aligned with the *acquis* requirements on **supplementary supervision.** By the time of accession, Iceland will need to align with the Directive 2008/25/EC amending Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, as regards the implementing powers conferred on the Commission.

Iceland has reached a high level of alignment with the *acquis* requirements for **re-insurance**. As an EEA member state, Iceland has taken an active part in the preparation of Directive 2009/138/EC (Solvency II). However, Iceland needs to transpose Directive 64/225/EEC on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of reinsurance and retrocession and start the alignment of Directive 2008/37/EC on reinsurance, as regards the implementing powers conferred on the Commission, and also specify its entry into force by the time of Iceland's EU accession. Moreover, work needs to continue on adopting the bill for the transposition of the Solvency II Directive. The Commission will give proper consideration to Iceland's request to include one public national entity (Viðlagatrygging Íslands, a natural catastrophe insurance provider) under Article 8 of Directive 2009/138/EC.

Iceland has reached a high level of alignment with the *acquis* requirements for **motor insurance.**

Iceland has reached a high level of alignment with the *acquis* requirements for **insurance mediation.**

Iceland has reached a high level of alignment with the *acquis* requirements for **annual accounts and consolidated accounts of insurance undertakings.** (*See also Chapter 6 – Company law*)

Iceland fully applies the *acquis* requirements for **reorganisation and winding-up** of insurance undertakings.

Iceland has reached a high level of alignment with *acquis* requirements for **occupational pensions** and fully applies requirements on the **supervision** of institutions for occupational retirement provision. Due to the current capital controls, pension funds cannot invest abroad.

Although the FME is in a good position to provide for effective supervision, some of its powers should be completed (such as competences over key personnel or powers to impose sanctions to pension funds.)

III.c. Financial market infrastructure

Iceland has reached a high level of alignment in the field of financial market infrastructure and applies a substantial part of the *acquis* in this area.

Iceland has reached a high level of alignment with *acquis* requirements for **settlement finality** in payment and securities settlement systems, as well as for **financial collateral** arrangements regarding linked systems and credit claims. Work needs to continue on transposing Directive 2009/44/EC amending Directive 98/26/EC and Directive 2002/47/EC.

Iceland has reached a satisfactory level of alignment with the *acquis* requirements for **withholding tax procedures.** Iceland has implemented Recommendation 2009/784 by Regulation 1082/2009. This regulation also specifies the implementing method of the provision included at point 8 of Article 3 of Income Tax Act 90/2003, according to which no withholding tax from interest shall be paid, or a lower rate used, according to a double taxation agreement. Article 2 of the Icelandic Act 45/1987 on withholding of public levies at source also specifies the type of income that falls under the scope of this Act.

III.d. Securities markets and investment services

Iceland has reached a high level of alignment in the field of securities markets and investment services and applies a substantial part of the *acquis* in this area.

Iceland has reached a high level of alignment with *acquis* requirements for **markets in financial instruments**. Iceland needs to align with Directive 2008/10/EC amending Directive 2004/39/EC on markets in financial instruments, regarding the implementing powers conferred on the Commission and specify its entry into force by the time of Iceland's EU accession.

Iceland has reached a satisfactory level of alignment with the *acquis* requirements for **investor compensation schemes** and needs to continue preparation to align with the new EU amendments on the existing legislation.

Iceland has reached a high level of alignment with the *acquis* for **admission to trading** and **transparency obligations of traded companies**.

Iceland has reached a high level of alignment with *acquis* requirements for **prospectus** to be published when securities are offered to the public or admitted to trading. However, Iceland needs to fully implement Regulation 809/2004/EC on information contained in prospectuses.. Following the review of the Prospectus Directive, Iceland will also need to transpose the amended Prospectus Directive 2010/73/EU.

Iceland has reached a high level of alignment with the *acquis* requirements for **market abuse**. However, Iceland needs to align with Directive 2008/26/EC on insider dealing and market manipulation (market abuse), as regards the implementing powers conferred on the Commission, and specify its entry into force by the time of Iceland's EU accession.

Iceland has reached a high level of alignment with the *acquis* requirements for **undertakings for collective investment in transferable securities** (UCITS). However, Iceland needs to finalise work on the full implementation of Directives 2007/16/EC and

Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to UCITS.

The current capital controls have a far-reaching impact on trading of securities and the investment possibilities of the pension funds.