

CENTRAL BANK OF ICELAND



2021

# FINANCIAL SUPERVISION

One of the Central Bank of Iceland's roles is to promote sound and secure financial activities.

The Central Bank Financial Supervisory Authority (the FSA or the Authority) carries out monitoring to ensure that the activities of regulated entities are in compliance with laws, regulations, rules, and company statutes governing such activities, and that they are consistent with sound and appropriate business practices. The objective of supervising financial activities is to promote a sound and secure financial market and to reduce the likelihood that the activities of supervised entities will result in losses for the general public.

The purpose of this *Financial Supervision* report is as follows:

- to explain how the FSA performs the tasks entrusted to it by law and how it followed its supervisory policy and project timetable in 2020;
- to provide information on key priorities in the FSA's 2021 timetable;
- to explain recent and forthcoming changes in the regulatory framework for the financial market.

In publishing this report, the Central Bank also attempts to ensure an appropriate level of transparency about the FSA's work and priorities and to foster informed discourse about the financial system.

The report is published concurrent with the *Central Bank Financial Supervision Committee report to Parliament 2020*.

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**Symbols:**

- \* Preliminary or estimated data.
- 0 Less than half of the unit used.
- Nil.
- ... Not available.
- . Not applicable.

**Icelandic letters:**

ð/Ð (pronounced like th in English this)

þ/Þ (pronounced like th in English think)

In this report, ð is transliterated as d and þ as th in personal names, for consistency with international references, but otherwise the Icelandic letters are retained.

# Foreword by the Governor and the Deputy Governor for Financial Supervision

This publication is a new Central Bank of Iceland report entitled *Financial Supervision*. The Bank intends to publish it once a year. With the addition of this publication, each of the Central Bank's core functions issues a report in connection with the Bank's key objectives. The other two reports are *Monetary Bulletin* and *Financial Stability*.

On 1 January 2020, Iceland's nearly sixty-year-old Central Bank merged with the twenty-year-old Financial Supervisory Authority. The two institutions were at different stages in their evolution and therefore have a number of things they can learn from one another. In the past year, Bank staff have done an outstanding job on the enormous task of integrating the activities of the two organisations. This work is not yet done, but much has been accomplished. The COVID-19 pandemic has brought tremendous challenges with it, and the Central Bank has played an important role in mitigating its adverse impact on the economy and financial system. The merged institution has demonstrably achieved the intended results.

The Prime Minister's Office recently issued a detailed report on how, and to what extent, the recommendations of the three Parliamentary Special Investigation Commissions appointed to investigate the 2008 financial crisis had been implemented. The report sheds light on the ground gained and the scope of the reforms made to legislation and to the activities of the Icelandic authorities tasked with economic and monetary policy conduct and decisions, as well as supervision of the financial market. In the dozen or so years since the financial crisis, comprehensive reforms have been made to the environment and regulatory architecture of the Icelandic financial market, both at the behest of domestic authorities and due to Iceland's participation in the European Economic Area (EEA). Both the statutory framework and supervision of the financial market have been transformed, with the aim of bolstering financial system resilience and fostering sound and secure financial activities. These reforms affect activities in the banking, insurance, and securities markets. The strong position of the financial system at the beginning of 2021 reflects the fundamental shift that has taken place in the financial market in the past decade and bears witness to the importance and the success of the changes made. Significant challenges lie ahead, however, in the financial and economic fallout from COVID-19, and the Central Bank must continue to deliver a harmonised response.

In the future as in the past, the Central Bank's overarching objective will be to safeguard the public interest. The Bank does this by applying the policy instruments at its disposal with the greatest possible degree of expertise and professionalism. A merged Central Bank responsible for monetary policy, financial stability, and financial supervision is well positioned to carry out its supervisory role steadfastly and confidently, thereby promoting sound and secure financial activities for the future.

Ásgeir Jónsson,  
Governor

Unnur Gunnarsdóttir,  
Deputy Governor for Financial Supervision

# Introduction



With the entry into force of the Act on the Central Bank of Iceland, no. 92/2019, and the merger of the Bank and the Financial Supervisory Authority at the beginning of 2020, the Central Bank took over all of the tasks entrusted to the Financial Supervisory Authority by law. The merger of the two institutions had been under consideration for a number of years. After the financial crisis of 2008, financial supervisors' and central banks' tasks have expanded, macroprudential policy and systemic risk have accorded greater weight, and the institutional framework of the financial market was strengthened significantly all over the world. In Iceland, a Systemic Risk Committee and a Financial Stability Council were established, which provided for consultation and cooperation between the two institutions and other Governmental authorities. Merging the Central Bank and the Financial Supervisory Authority represented an important step towards further reforming the institutional architecture for the financial market and improving decision-making, with emphasis on the interactions between financial stability and monetary policy, on the one hand, and supervision of financial market entities, on the other.

Three committees now take decisions on the application of the Central Bank's powers and policy instruments. The Monetary Policy Committee has been in operation since 2009, and with the entry into force of the new Central Bank Act at the beginning of 2020, it was joined by the Financial Stability Committee and the Financial Supervision Committee. Decisions on the application of the Bank's financial stability policy instruments are now taken by the Financial Stability Committee, and decisions falling under the aegis of the Financial Supervisory Authority are entrusted to the Financial Supervision Committee. The Financial Supervision

Committee is authorised to entrust the Deputy Governor for Financial Supervision with taking non-major decisions and has done so, as is provided for in its Rules of Procedure. The aim of merging the Central Bank and the Financial Supervisory Authority was to improve oversight and decision-making in the areas of systemic risk and macroprudential policy by making the Central Bank solely responsible for the application of macroprudential tools. Furthermore, the merger was viewed as an opportunity to benefit from various synergies and prevent unnecessary duplication of effort, and further integration of microprudential and macroprudential supervision in a merged institution was considered likely to bolster preparedness for shocks in the future.

Now, slightly more than a year after the merger took effect, some experience has been gained of this new institutional framework and management structure. The Central Bank's activities in 2020 were greatly affected by the COVID-19 pandemic and the responses to its economic impact, as this report shows. The economic shock posed a number of challenges for the Central Bank. The Bank's response has focused on the application of monetary policy instruments and macroprudential tools, as well as more frequent supervision of and communication with financial market entities, which entails increased monitoring and information gathering on the impact of the pandemic on financial system preparedness, operations, and asset quality. The new institutional architecture has proven its value under these demanding circumstances, and it has been demonstrated that easier access to information and a clearer overview of the financial system fosters professional decision-making and enhanced efficacy in such an environment.

Furthermore, a number of other synergies have come to the fore elsewhere in the Bank's operations in the wake of the merger. One example of this centres on the assessment of risk due to money laundering and terrorist financing, as the merged institution has a larger amount of information at its disposal. Other benefits include synergies relating to collection of data from supervised entities and harnessing of expertise across the Bank. For example, granting operating licences in the financial market often requires a wide range of expertise such as knowledge of payment system functioning. In this regard, cooperation among experts across the Bank's departments has already borne fruit. There are other unutilised opportunities for synergy and increased efficacy that the Bank has now begun to harness, including in the securities market and in supervision of mutual funds and alternative investment funds. It is hoped that this will also be more economical for supervised entities.

With this annual publication, the Central Bank's aim is to ensure appropriate transparency about its tasks and priorities in the field of financial supervision. It does this by explaining how it carries out the tasks entrusted to the FSA by law and by providing information to supervised entities concerning key priorities in the current project timetable. These priorities have not been published before but will now be made public at the beginning of each year, when the new timetable has taken effect. The purpose of publishing the FSA's priorities is to make the Authority's work even more transparent and to signal which functions and risks it considers most important at any given time. Such transparency enables supervised entities to take the Authority's strategy and priorities into account in their activities. This new report now joins the Bank's other regular publications. By issuing *Financial Supervision* and its fellow reports, the Bank attempts to account for its actions and promote informed discourse about the financial system.

## The FSA's activities

This chapter describes how the Central Bank of Iceland Financial Supervisory Authority (the FSA or the Authority) followed its supervisory policy and project timetable in 2020 through regulatory supervision and other monitoring activities. It also explains key financial system variables pertaining to the objective of promoting sound and secure operations among supervised entities.

### Supervision of financial undertakings

At the end of 2020, there were four commercial banks, four savings banks, four credit undertakings, and nine investment firms under supervision by the FSA. Supervision of payment institutions (two in operation) and electronic money institutions (one in operation) is closely linked to supervision of financial institutions; therefore, supervision of these institutions is also discussed in this section.

The FSA supervises licensed financial institutions pursuant to the Act on Financial Undertakings, no. 161/2002, with subsequent amendments. On the one hand, it conducts regular supervision in accordance with its risk-based supervision model, and on the other hand, it conducts proactive checks based on circumstances and risk assessments. The main focus of supervising financial institutions is to ensure that they have the strong capital and liquidity they need in order to respond to unexpected shocks.

The Bank's Financial Stability Committee has designated three commercial banks – Arion Bank hf., Íslandsbanki hf., and Landsbankinn hf. – as domestic systemically important banks (D-SIB). Supervision of systemically important banks is a broad task that involves conducting regular, systematic reviews of data on the

position of the banks, carrying out specific checks and analyses, and taking interviews with selected key employees. Key metrics in the banks' operations are monitored, and an assessment is made of the sustainability and viability of their business plans. In addition, various risks in their operations are examined and analysed systematically – and more frequently than usual if conditions warrant it.

### Supervisory review and evaluation process

Every year, the FSA carries out a detailed supervisory review and evaluation process (SREP) on the systemically important banks. In the SREP, the FSA evaluates the risks entailed in the banks' operations and the methods they use to manage those risks. The Authority also assesses and determines the banks' capital requirement under Pillar II-R, which indicates how much capital the bank in question must hold in view of the risks it faces or could face. The Pillar II-R capital requirement is in addition to the minimum capital requirement provided for under Pillar I. The SREP is carried out in accordance with the *Guidelines on common procedures for the supervisory review and evaluation process (SREP)*. The guidelines are revised regularly and are in line with the European Banking Authority (EBA) guidelines on the same topic.

For less significant financial institutions, the SREP is carried out less often than for the systemically important banks; i.e., every third year, unless circumstances call for greater frequency. In intervening years, less extensive annual risk analyses are carried out for less significant financial institutions. This accords with the fundamental principle of risk-based supervision: that supervision should be broader in scope when it applies to institutions that could jeopardise financial stability or expose a large group of customers to severe inconvenience or loss.



## Capital and liquidity requirements

The COVID-19 pandemic and associated response measures significantly affected the supervision of financial institutions' activities in 2020. The systemically important banks' SREP was already underway when the COVID-19 pandemic reached Iceland in Q1/2020. Because of the uncertainty that had developed by that time, the Bank's Financial Supervision Committee (FMEN) decided in April 2020 to postpone its decision on additional capital requirements for the D-SIBs. In September 2020, the Committee decided that the results of the 2019 SREP should remain unchanged. As a result, it will not be reviewed until 2021. For the same reason, it was decided not to conduct supervisory stress tests in connection with the SREP. Chart 1 shows the capital ratios and capital requirements for the D-SIBs as of end-2020.

Therefore, the D-SIBs' capital requirements did not change year-on-year except that the countercyclical capital buffer, previously 2%, was lowered to 0% in March 2020 with a decision by the Financial Stability Committee (FSN). The main objectives of the countercyclical capital buffer are to strengthen financial institutions' resilience to cyclical risk and to strengthen credit intermediation during contractionary episodes, thereby mitigating the impact of the financial cycle on the real economy. In previous years, the countercyclical capital buffer had been built up for precautionary reasons.

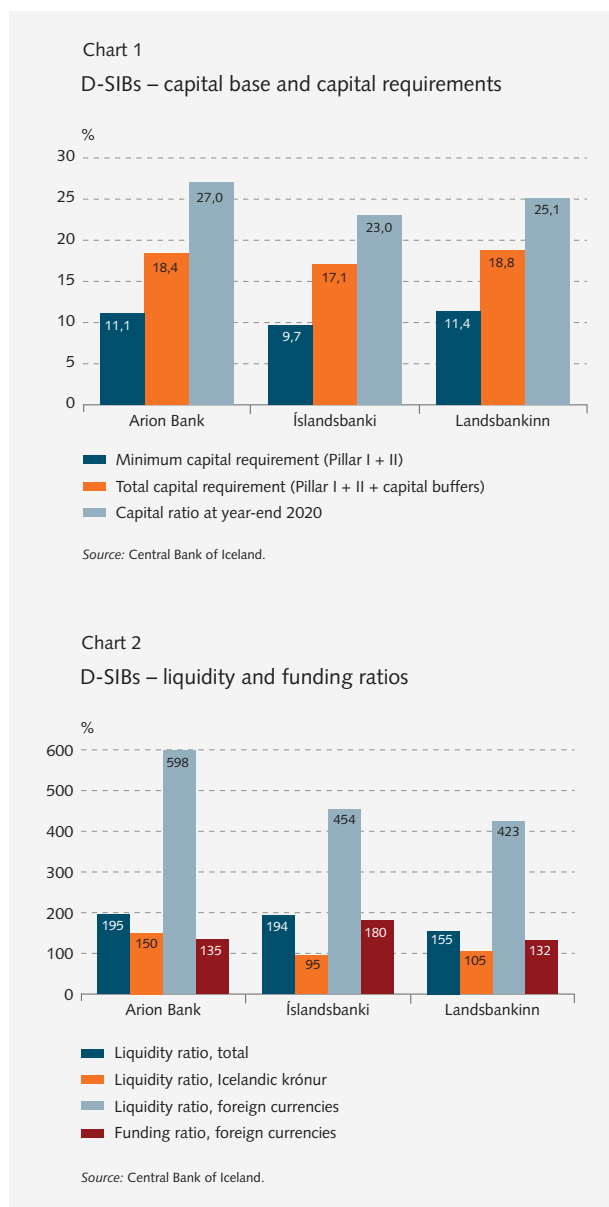
The liquidity and funding requirements<sup>1</sup> according to Central Bank rules are as follows: 100% liquidity ratio for all currencies combined, 30% liquidity ratio for Icelandic krónur, and 100% funding ratio for all foreign currencies combined. At the end of 2020, the D-SIBs' liquid assets were well above the required minimum (Chart 2).<sup>2</sup>

### Comments on the 2020 SREP

The SREP assessment also covers factors such as business model viability and sustainability, governance practices, operational risk, credit risk, concentration risk, market and IRRBB, and liquidity and funding risk, as the evaluation of these factors could affect the overall assessment of a bank's capital requirement. Even though it was decided that the additional capital requirement should remain unchanged in 2020, comments on the above-mentioned factors were communicated to the banks with decision letters late in the year, and the related transparency announcements were published in January 2021.

<sup>1</sup> LCR and NSFR minimum requirements.

<sup>2</sup> Parent company figures for all ratios.



### Monitoring operational and credit risk

During the year, operational risk received increased weight in the financial market risk analysis, owing to the situation created by the COVID-19 pandemic, including the increase in teleworking, and with emphasis on cyber/IT security. The impact of the pandemic on financial institutions' staffing levels was examined, as were the ways in which institutions' contingency plans were used in response to the pandemic. Furthermore, firms' cyber defences were examined, with particular focus on defences relating to teleworking and new digital solutions; furthermore, monitoring of credit risk was stepped up because of the impact of the pandemic on loan quality (for further information, see the section below on on-site inspections).

The FSA has encouraged credit institutions to use the flexibility embedded in the regulatory framework,

while simultaneously emphasising the fundamental principle of prudent financial reporting; i.e., that short- and long-term credit risk must be estimated correctly in the institutions' balance sheets. It is important that the banks manage risk actively and effectively and that they identify risks in a timely manner if asset quality deteriorates. The FSA has stressed that, in connection with possible default classification – i.e., granting of concessions – the banks must evaluate whether borrowers are unlikely to pay.

Banks and other credit institutions play an important role in the intermediation of capital, and in the current circumstances this role is put to the test. The banks responded to the impact of the pandemic by granting broad general payment moratoria in order to support businesses and consumers, in accordance with EBA guidelines and the agreement among credit institutions. At the mid-2020 peak, nearly 13% of the D-SIB total loans to customers were under moratoria. This percentage has declined steeply since then and was very small by the beginning of 2021.

The use of the moratoria is fading out in Iceland, and instead there has been a strong increase in classification of *forborne loans*. The main forbearance measures are continued payment holidays and partial payment holidays. There are clear signs of large-scale freezes on loans to borrowers in tourism and related sectors. In late 2020, just over 8% of the D-SIBs' loans were classified as performing with forbearance measures. At the same time, their non-performing loan ratios were 4.4% for corporate loans and 1.3% for household loans and had not risen significantly.

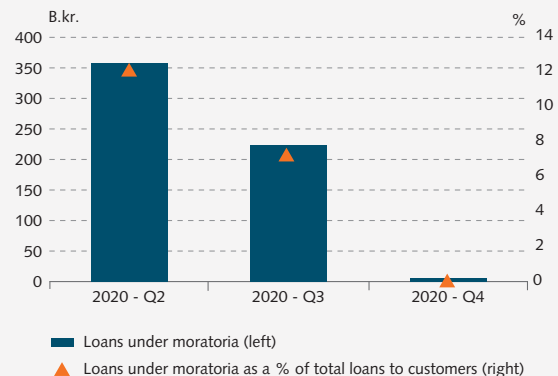
The D-SIBs' loan loss impairment loss allowances increased markedly in 2020. They rose most in H1/2020, but the pace has eased since then. The banks all use the IFRS 9 transitional arrangements, which includes adding part of impairments to CET 1 own funds.

As a result, increased loan impairment has affected their operating performance rather than their capital base. In 2020, the banks' impairment ratio rose from 1.2% to 1.8% (Chart 4).

### On-site inspections

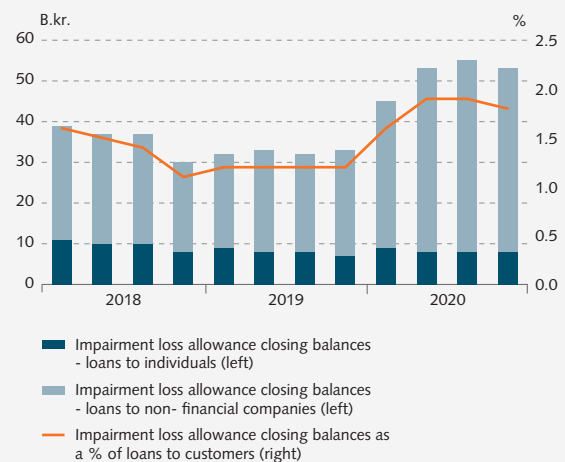
In 2020, particular emphasis was placed on on-site inspections relating to credit risk and operational risk. The D-SIBs were subjected to such inspections, which entailed evaluating procedures for reporting under the common reporting framework (COREP). The results of the inspections were published at the beginning of 2021. Further on-site inspections relating to credit risk were carried out as well. Some of them are still underway,

Chart 3  
D-SIB loans subject to non-expired moratoria



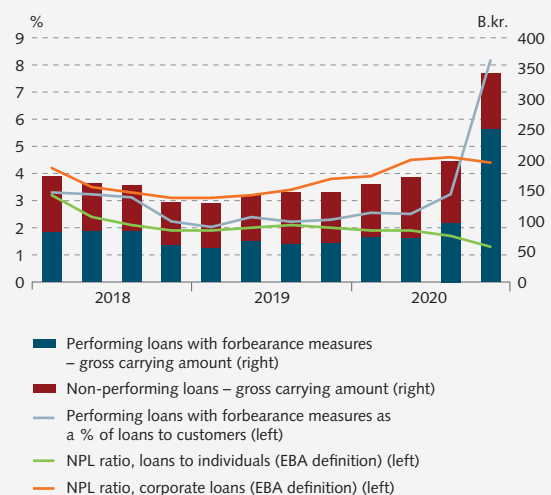
Source: Central Bank of Iceland.

Chart 4  
D-SIBs' development in impairment loss allowances



Source: Central Bank of Iceland.

Chart 5  
Developments in non-performing and forborne D-SIB loans



Source: Central Bank of Iceland.

and in other cases the results have yet to be published. These include inspections relating to valuation and to the banks' procedures for classification of forborne exposures.

Moreover, inspections focusing on analysis, measurement, and management of recourse risk in connection with acquiring were carried out at one credit undertaking and two payment institutions. The results of these inspections have not yet been published.

In addition to the above, an on-site inspection was conducted at Arion Bank hf. with the aim of examining the evolution and operation of specified digitally issued household loans. The inspection covered, on the one hand, system risk and model risk, and on the other, conduct risk in connection with digital lending. These results were published on the Central Bank website in January 2021. Cyber/IT risk is a growing risk factor in the activities of financial market entities, and in coming years the FSA plans to place greater emphasis on this type of risk in supervised entities' operations.

Furthermore, inspections on business conduct (see p. 16) and anti-money laundering and terrorist financing measures (see p. 22) were carried out, as were on-site inspections of the quality of Arion Bank hf. and Kvika banki hf.'s transaction reporting system (TRS II) notifications (see p. 19).

### **Sanctions**

In June 2020, the FMEN decided to impose an administrative fine in the amount of 10.5 m.kr. on Fossar Markets hf. for violations of Article 57(a) of the Act on Financial Undertakings, no. 161/2002, with subsequent amendments, and rules set on the basis of that provision. The violations in question entailed payments of bonuses from 2016 through 2019 without the existence of a variable remuneration system, payment of bonuses in excess of 25% of the annual salary (excluding bonuses) of the employee concerned, and failure to defer part of the payments. Fossar Markets hf. also violated Article 57(a) of Act no. 161/2002 by having paid bonuses to the chairman of its board of directors in 2016 and 2017 and having paid bonuses to its compliance officer in 2017 through 2019. The company was only sanctioned for violations committed in 2016 and 2017, as this was the period under scrutiny at the outset of the Authority's investigation, before the case was classified as pending while a comparable case was being decided by the courts. Fossar Markets hf. has initiated legal action to demand the invalidation of the decision. The case is awaiting judicial handling.

### **COVID-19-related data collection**

The FSA collected data and other information more frequently than usual in 2020, owing to measures adopted by the banks and other supervised entities in connection with COVID-19. Documents and data were collected in order to assess the impact on the banks' credit risk and their capital and liquidity, so as to obtain a comprehensive overview of the impact of COVID-19 on financial stability and developments in financial system risk. The Authority also collected information more frequently on recourse risk among clearing entities.

### **Recommendation on dividend payments**

In April 2020, the FSN urged financial institutions to postpone planned dividend payments and share buybacks while uncertainty about the impact of COVID-19 on the economy and the banks persisted. Thereafter, the D-SIBs' boards of directors announced that they had abandoned plans to pay dividends on 2019 profits.

On 13 January 2021, the FMEN published amended recommendation on financial institutions' dividend payments and purchases of their own shares, which remain in effect through 30 September 2021. The recommendation is based in part on the 15 December 2020 statement from the European Systemic Risk Board (ESRB). In that statement, supervisory authorities in ESRB member countries were encouraged to instruct financial institutions under their supervision to observe the utmost caution in paying dividends and purchasing their own shares through 30 September 2021. The EBA issued a similar statement that same day. In its revised recommendation, the FMEN does not prohibit dividend payments or share buybacks but urges financial institutions to bear certain factors in mind concerning their operations and projected developments in capital in the coming three years before deciding to pay dividend buy back shares.

### **Recovery plans**

The systemically important banks submitted recovery plans to the FSA in late 2020, and the Authority began reviewing them in 2021. Three years have now passed since the banks submitted such plans for the first time. Less significant financial institutions submitted simplified recovery plans for the first time in October 2020.

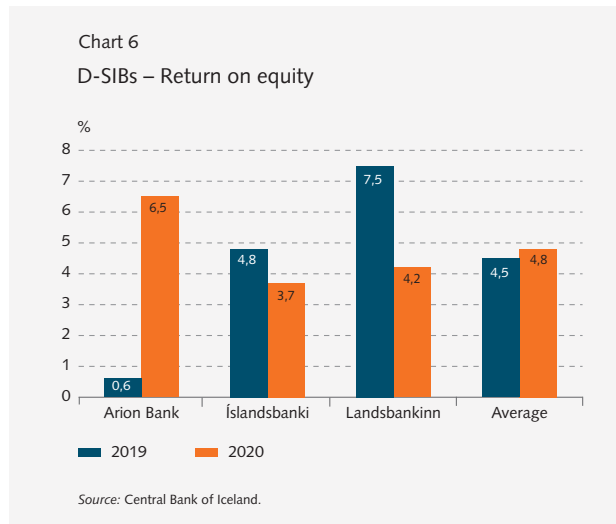
The Act on Resolution of Credit Institutions and Investment Firms (BRRD), no. 70/2020, entered into force in September 2020. The provisions of the Act apply to credit institutions and large investment firms. At present, nine credit institutions in Iceland and no investment firms fall under the scope of the Act. The Act entrusts the Central Bank of Iceland with powers of resolution

– i.e., administrative powers – thereby authorising it to take action and prepare and execute resolution procedures for credit institutions and investment firms. This entails the authorisation to take decisions on resolution procedures and apply resolution measures in the case of credit institutions and investment firms that are failing or likely to fail; i.e., those that are unable to service their liabilities or are highly likely to be unable to do so. According to the Act on Resolution of Credit Institutions and Investment Firms (BRRD), the Central Bank of Iceland Resolution Authority shall be separate from other activities within the Bank's organisational structure, particularly the Financial Supervisory Authority.

### Systemically important banks' operating results and funding

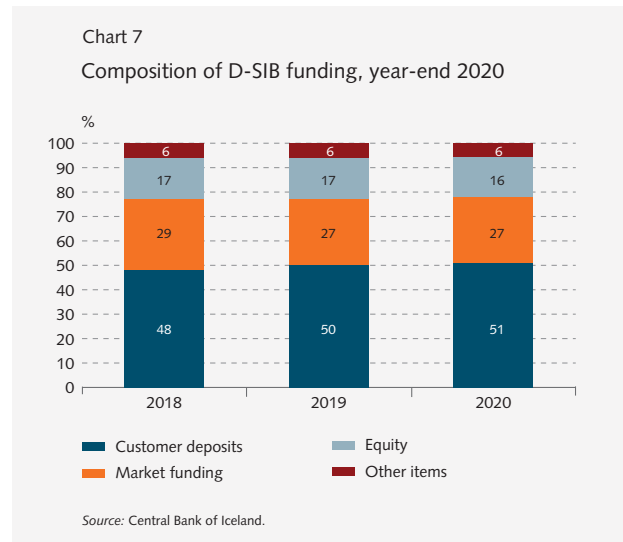
#### Systemically important banks' operating results

The D-SIBs' overall operating results have been deteriorating in recent years. In 2020, their after-tax profit totalled just under 30 b.kr., about the same as in 2019, whereas it totalled 38 b.kr. in 2018 and over 47 b.kr. in 2017. Their return on equity averaged 4.8% in 2020, as compared with 4.5% in 2019. Impairment increased markedly year-on-year, from 11.3 b.kr. in 2019 to 26.6 b.kr. in 2020.



#### Systemically important banks' funding

The stock of covered bonds issued by the D-SIBs totalled 564 b.kr. at the end of 2020, after increasing by 107 b.kr. during the year. As before, customer deposits constitute the largest single funding item, accounting for about 50% of the D-SIBs' funding. Covered bonds denominated in krónur provide about 13% of their funding, and unsecured foreign-denominated bonds about 14%.



### Supervision of the insurance sector

In 2020, four non-life insurers and four life insurers were operating in Iceland on the basis of operating licences issued by the FSA. Also in operation were two reinsurance companies engaged in the settlement of legacy obligations, as well as the national catastrophe insurance provider NTI, a Government institution operating under special legislation. Furthermore, nine insurance brokerages have received operating permits from the FSA, and a number of insurance undertakings and insurance brokers in the EEA submitted notifications of activities in Iceland. At the beginning of 2021, TM hf.'s insurance portfolio was transferred to TM tryggingar hf. and TM hf.'s licence was revoked at the company's request. The transfer was an element in the proposed merger between TM hf., Lykill fjármögnun hf., and Kvika banki hf., which was approved by the boards of the companies concerned in Q4/2020.

The FSA supervises insurance undertakings that have received operating licences in accordance with the Act on Insurance Activities, no. 100/2016. This entails, on the one hand, regular monitoring in accordance with the FSA's risk-based supervision model, which defines the frequency with which key risk factors in the undertakings' operations are examined; and on the other inspections hand, proactive inspections carried out based on the circumstances in each given instance. The Authority analyses key risks and developments in the markets; furthermore, it monitors closely to ensure that the entities concerned satisfy the requirements for their operating licences, that their operating practices are in compliance with regulatory provisions, and that appropriate measures are taken at all times.

Furthermore, the FSA supervises the activities of insurance brokerages and monitors the business conduct of foreign insurers licensed to do business in Iceland.

## Supervision of insurers' solvency and financial condition

Regulatory supervision of insurance undertakings centres on their solvency position and their ability to cover financial obligations. Among other things, the FSA reviews insurers' own risk and solvency assessments (ORSA) and regular supervisory reports (RSR), as well as taking interviews with selected key employees. Furthermore, the Authority carries out an annual assessment of risks relating to insurance undertakings' operations in accordance with its *General criteria and methodology for supervision of insurance companies*. In 2020, emphasis was placed on governance risk and operational risk, including risk due to the impact of COVID-19 on insurance operations.

Insurance undertakings publish solvency and financial condition reports (SFCR) and are required to submit regular supervisory reports (RSR) to the FSA. Both reports are part of EEA insurance companies' harmonised information disclosure. In 2020, the Authority examined sections in the reports on insurance undertakings' returns on investment activities, risk profiles, and system of governance, and gave feedback on them.

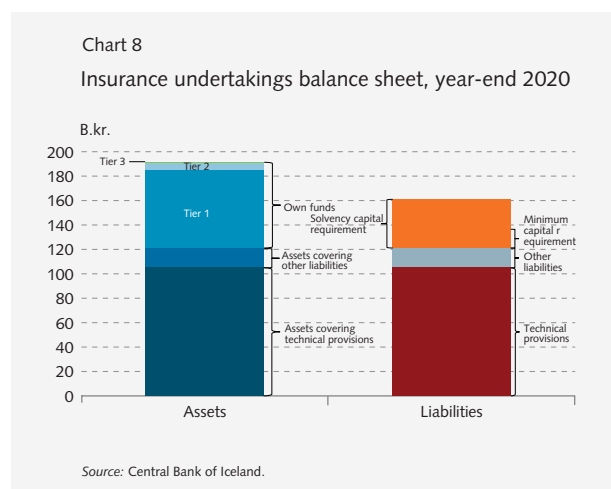
Insurers' own funds are divided into three tiers, according to permanence (i.e., quality) and loss-absorption capacity. At the end of 2020, the insurance undertakings' own funds totalled nearly 70 b.kr., with 90% of that amount falling under Tier 1. This includes assets in excess of liabilities but excludes intangible assets. Subordinated debt and net deferred tax credits fall under Tiers 2 and 3.

FSA carried out proactive inspections at insurance undertakings, which included reviewing boards of directors' self-evaluations and the undertakings' procedures for investing in specialised and/or unlisted assets. No comments were issued to the undertakings as a result of the inspections. In addition, a proactive inspection was carried out on treatment of assets, premiums, and technical provisions in the calculation of subcomponents of market risk and insurance risk in connection with the insurance undertakings' calculations of their solvency margins. Comments were conveyed to the companies following that inspection.

### On-site inspections

A part of insurance undertakings supervision involves determining whether the undertakings satisfy requirements concerning technical provisions. In a proactive check conducted at Vörður tryggingar hf., an assessment was made of information integrity and the approach used to determine technical provisions, as well as the methods and procedures used in their determination. The

check also entailed an examination of requirements due to outsourcing of actuarial work. These results were published on the Central Bank website in September 2020.



### COVID-19-related measures

During the year, activities in the insurance market were monitored closely in connection with impact of the COVID-19 pandemic. In March 2020, because of uncertainty about the short- and long-term impact of the pandemic, the Central Bank encouraged insurance undertakings to take appropriate measures to shore up their resilience. Thereafter, the insurance undertakings abandoned plans to pay dividends to shareholders. This decision strengthened the undertakings' resilience, and their end-2020 solvency ratio was 1.95 before deductions due to foreseeable dividend payments, allocations, and expenses – its highest since the Solvency II directive entered into force. In comparison the solvency ratio was 1.83 at year end 2019.

The FSA also carried out inspections on business conduct (see p. 16) and anti-money laundering and terrorist financing measures (see p. 22) in the insurance market.

### Insurance market

At the end of 2020, insurance undertakings' assets totalled 195 b.kr., an increase of 12.3% from the prior year. Technical provisions increased by 9.4% over the same period, to 105 b.kr. Assets net of liabilities according to the Solvency II balance sheet increased by 16.5% year-on-year, to 74 b.kr. at the end of 2020.

### Operating results

During the year, operating results were negative by 405 m.kr. for non-life insurance activities, and positive by 2,451 m.kr. for life insurance activities. The combined



profit on insurance operations therefore totalled 2,046 m.kr. in 2020, yielding a combined ratio of 97%, as compared with 98% in the prior year.

### **Premiums**

The COVID-19 affected both insurance and investment activities during the year. After several years of uninterrupted growth, net premiums earned for non-life insurance contracted by 1.7%. A portion of insurers' premium base is linked to tourism, and reduced activity in the sector has affected developments in premiums. The most pronounced difference is in motor insurance premiums, which declined by 2.6% year-on-year.

### **Investment activities**

After steep COVID-induced declines in Q1 markets turned around in Q2, which affected insurers' operating performance. A large share of insurance undertakings' assets are domestic; therefore, their returns on investment activities are highly dependent on developments in domestic markets. Icelandic share prices activities improved by nearly 90% year

### **Foreign insurance undertakings**

Insurance undertakings with headquarters in other EEA states are authorised to sell insurance and reinsurance policies in Iceland, either through branches or without a fixed business establishment. Premiums paid to foreign insurers in Iceland totalled the equivalent of 19.1 b.kr. in 2019. The majority of these premiums were for the purchase of foreign life insurance policies (13.5 b.kr.), while just under 500 m.kr. were for other life and health insurance. Information on sales in Iceland by insurers licensed in other EEA states is obtained from the European Insurance and Occupational Pensions Authority (EIOPA). Figures for 2020 are not yet available.

## **Supervision of pension funds and pillar III pension savings custodians**

In 2020, a total of 21 pension funds accepted mandatory pension fund contributions in pillar II private pension savings, and 13 of them offered voluntary pillar III personal pension savings. There were also 7 pillar III personal pension savings custodians in a total of 30 divisions. Among them were two foreign insurers that offered pillar III pension savings through custom-designed life insurance policies.

The FSA supervises private pension funds and pillar III pension savings custodians. This entails, on the one hand, regular monitoring in accordance with the

FSA's risk-based supervision model, which defines the frequency with which key risk factors in the pension funds' operations are examined; and on the other hand, proactive inspections carried out based on the circumstances in each given instance. The Authority analyses key risks and developments in the markets; furthermore, it monitors closely to ensure that the entities concerned satisfy the requirements for their operating licences, that their operating practices are in compliance with regulatory provisions, and that appropriate measures are taken at all times. Furthermore, the pension funds' risk assessments are examined, and interviews are taken with selected key employees.

Regular supervision of pension funds and third-pillar pension savings custodians entails monitoring their compliance with regulatory provisions. In addition, the Authority conducts an annual assessment of the risks in pension fund operations. In 2020, emphasis was placed on factors such as governance and operational risk, particularly with respect to the impact of the COVID-19 pandemic on the funds' operations.

### **On-site inspections**

On-site inspections were carried out at the Bank Employees' Pension Fund and the Farmers' Pension Fund (LSB), with focus on whether the funds' internal monitoring systems were satisfactory – particularly to include monitoring of investment activities. Several comments were made following the inspections, and the results were published on the Central Bank website in May and November 2020.

### **Investment authorisations**

Pension funds and third-pillar pension savings custodians are required to send the FSA quarterly reports regarding their asset allocation. The review of these statements in 2020 revealed violations by Almenni Pension Fund, the Pension Fund for State Employees, Íslenski lífeyrissjóðurinn, and Lífeyrissjóður Vestmannaeyja. The Authority issued comments on these violations and demanded remedial action. The results of the inspections were published on the Central Bank website in May and July 2020.

### **Own risk assessment**

The FSA reviewed the pension funds' own risk assessments and took interviews with external auditors, managing directors, and other key employees. The Authority also examined specified pension funds' investment procedures. Emphasis was placed on examining how decisions and follow-up were handled, and whether the funds had documented their investment procedures for specialised invest-

ments in a satisfactory manner. Furthermore, the Authority reviewed the mechanisms under which the boards, investment committees, and risk management departments of the pension funds participated in and supervised the investment process. The inspections concluded without any comments issued to the pension funds.

### Corporate governance

The FSA placed strong emphasis on pension funds' governance practices in its work during the year, including examining the internal monitoring role of their boards of directors; communications between the board, on the one hand, and the risk officer and internal auditor, on the other; and the boards' self-assessments. When warranted, the Authority examined involvement by several pension funds' boards in specific investments, including how the decision-making was handled in each case. Governance practices in connection with decision-making were examined as well. The results have not yet been finalised nor published.

### COVID-19-related measures

The FSA monitored pension funds' activities closely in 2020, in connection with the potential impact of the COVID-19 pandemic. In April 2020, a circular on the pandemic was sent to pension funds and third-pillar pension savings custodians, containing pointers on business continuity, operational risk, liquidity, and fund members' interests. Furthermore, the Authority began a special COVID-related monthly data collection effort focusing on non-performing loans and third-pillar pension savings withdrawals.

The FSA also carried out inspections on anti-money laundering and terrorist financing measures (see p. 22).

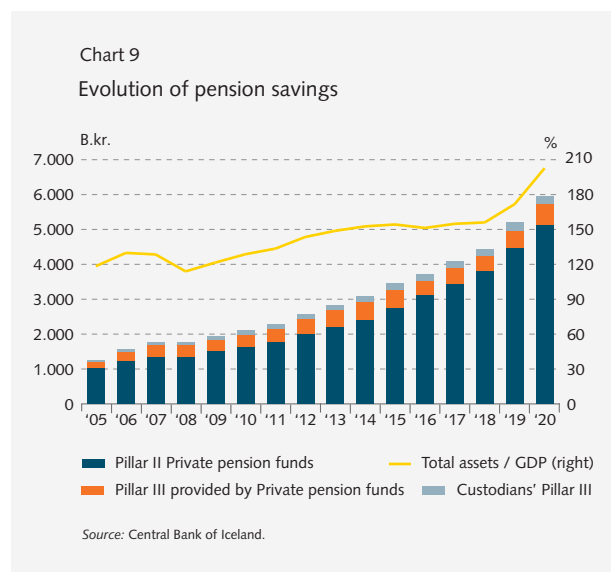
### Developments in pension savings

Icelanders' pension savings increased markedly in 2020 despite volatility and uncertainty in the financial markets. According to preliminary figures, the pension savings' total assets came to just over 6,000 bn.kr. at the end of 2020, or twice estimated year-2020 GDP. Assets held by the Pillar II private pension funds' increased by 15% in 2020, to 5,119 bn.kr. by the year-end, and pillar III personal pension savings held by them totalled 595 b.kr. Pillar III personal pension savings held by pension funds and other domestic custodians totalled just under 842 b.kr. at the end of 2020, after increasing by around 100 bn.kr. during the year. In addition pillar III personal pension savings held by foreign custodians totalled an estimated 100 bn.kr. at the year-end. Authorised third-pillar savings withdrawals totalled 24 bn.kr. in 2020.

### Foreign-denominated investments in 2020

Private pensions' foreign-denominated assets totalled just under 1,900 b.kr. at the end of 2020, an increase of 25%, or almost 400 bn.kr., during the year. Of that total, new foreign-denominated investment totalled an estimated 56 bn.kr. The ratio of foreign-denominated assets to total assets varies from one fund to another, and some pension funds are closing in on the statutory limit for exchange rate risk. The funds are obliged to limit their exposure to exchange rate risk by ensuring that at least 50% of their total assets are denominated in the same currency as their liabilities.

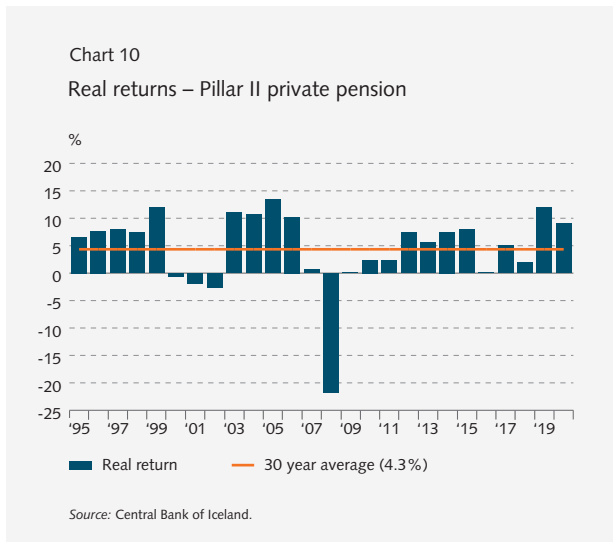
Foreign financial markets were highly volatile in 2020. At the end of Q1/2020, securities markets plunged worldwide in response to the first wave of the COVID-19 pandemic. Since Q2/2020, however, foreign markets have been rising virtually without interruption. The share of foreign-denominated assets in pension funds' portfolios has never been higher. It rose by 4 percentage points year-on-year, to an average of 37% by end-2020.



### Returns in 2020

According to preliminary figures, the private pension funds recorded net real returns of 9% in 2020. Although the outcome varies from one fund to another, it appears that all of the funds' returns were positive during the year. Over the past 30 years, their real returns have averaged 4.3%, which is above their long-term benchmark of 3.5%.<sup>3</sup>

<sup>3</sup> It should be noted that the method used to calculate real returns according to the Rules on Annual Accounts of Pension Funds differs from that used to calculate the 3.5% benchmark used in actuarial assessments.



## Supervision of business conduct and consumer affairs

The FSA is tasked with carrying out general supervision of sound and appropriate business conduct by supervised entities, thereby fostering better financial market functioning and protecting consumers from poor business practices. The term *business conduct* includes any type of communications between sellers and customers, as well as services provided to customers, particularly to include information disclosure, advice, pricing transparency, marketing, and handling of customer complaints.

Supervising business conduct involves, among other things, ensuring that information provided to consumers is correct and honest, that advisory services are provided in customers' interests, that pricing is transparent, and that marketing materials and sales practices are neither misleading nor deceptive. The FSA carried out checks on a wide range of matters relating to business conduct and consumer protection in 2020.

### Itemisation of costs in insurance bids

The FSA made comments on itemisation of costs in several companies' insurance bids – Sjóvá-almennar tryggingar hf., TM hf., Vátryggingafélag Íslands hf., and Vörður hf. – after examining whether the companies itemised costs and discounts satisfactorily in bids for individuals' motor insurance and fire and contents insurance. Comments were made on the companies' presentation of cost itemisations and/or discounts. The results of the inspections were published in February 2020.

### Investment advice

During the year, the FSA concluded a check on public investment advice at Capacent ehf., which revealed

flaws in the identification of the parties responsible for public investment advice and in monitoring of compliance with the regulatory instruments governing the company's activities. The results of the inspection were published in March 2020.

### Handling of complaints

A check was made on a payment institution's handling of complaints and communications with merchants. The case was concluded without comments, but instances involving amendments to payment contracts were examined. Procedures were examined and complaint resolution procedures analysed, and the Authority checked on whether the company had contingency plans in place to address market conditions such as the COVID-19 pandemic.

### Sales and marketing

In November 2020, the FSA decided to impose an administrative fine on insurance brokerage Tryggingar og ráðgjöf ehf., in connection with a check on the brokerage's sale and marketing of the Wealth Insuring product offered by Slovak insurance company NOVIS Insurance Company, NOVIS Versicherungsgesellschaft, NOVIS Compagnia di Assicurazioni, NOVIS Poistovňa a.s.

The company was fined 35 m.kr. for violations of the Act on Insurance Contracts, no. 30/2004, and the investigation also revealed violations of the Act on Distribution of Insurance, no. 62/2019. The violations entailed failure to inform customers that it was not possible to assess whether the insurance-linked investment products for which the company acted as broker were appropriate for customers' needs, as customers either did not provide the information required or provided inadequate information. It was also concluded that the company had not acted in accordance with customers' instructions concerning investment options, loss tolerance, and risk level of investments as presented on the needs analysis form; therefore, the company advised customers to choose investment options that were incompatible with their needs. In its decision, the Financial Supervision Committee demanded that the company take remedial action in view of the results, including revising the demands and needs test form and the procedures for sales and marketing of insurance-linked investment products so as to ensure that they were in compliance with the law.

### Information disclosure to consumers

Over the course of 2020, information was published on the Central Bank website concerning the status of NOVIS Insurance Company, NOVIS Versicherungsgesellschaft,

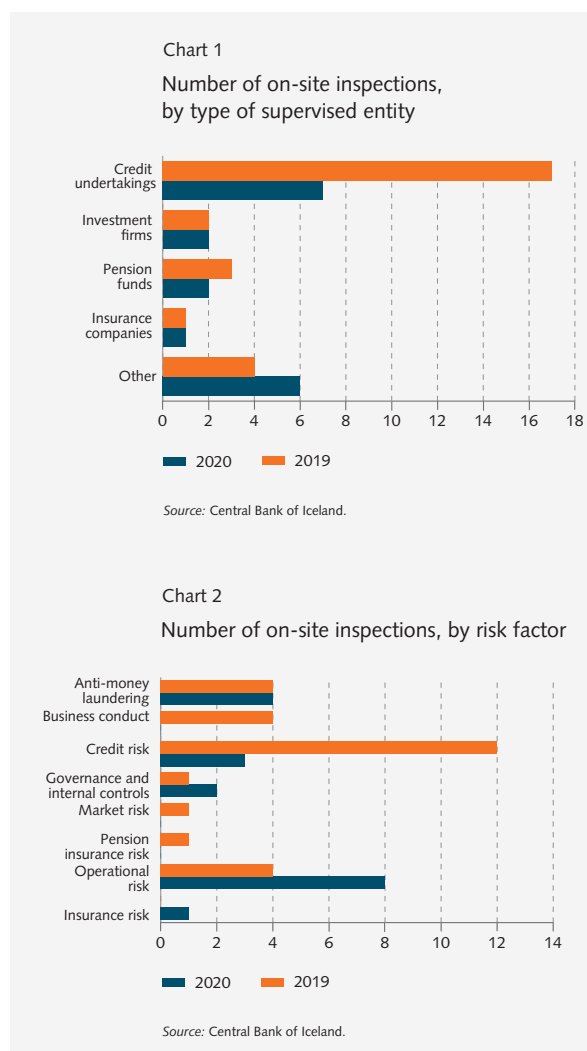


## On-site inspections

On-site inspections are among the methods the FSA uses to carry out its legally mandated role. The aim of on-site inspections is to analyse risks in supervised entities' activities in depth and evaluate their business plans, governance practices, and internal controls. The COVID-19 pandemic made an impact on the on-site inspections planned for the year, in that some of them could not be carried out on the entities' premises and instead were conducted in part via remote meetings held with representatives of the entities concerned. Furthermore, it was decided to postpone several checks and inspections that had been planned for 2020, so as to enable the entities in question to concentrate on pressing matters relating to the pandemic.

### 18 on-site inspections completed in 2020

The FSA completed 18 on-site inspections in 2020, as compared with 27 in 2019. The inspections carried out in 2020 focused mainly on supervised entities' anti-money laundering and terrorist financing measures, credit risk and operational risk in their activities, and internal control systems. Decisions about on-site inspections are based on supervised entities' impact category, as well as the results of risk assessments. Supervised entities' size, activities, and risk profile are also taken into account



NOVIS Compagnia di Assicurazioni, NOVIS Poistovňa a.s. (NOVIS), in connection with actions taken against the company by the National Bank of Slovakia (Národná banka Slovenska, NBS). In all, four press releases were published on NBS' actions, as there are a number of NOVIS customers in Iceland. In September 2020, NBS took an interim decision to impose a conditional prohibition on new sales of unit-linked insurance contracts, which entailed that NOVIS was prohibited from concluding such contracts unless it satisfied the conditions laid down in NBS' interim decision. NOVIS was also required to invest all premiums in accordance with the terms and conditions of insurance contracts and to send regular reports to NBS so as to ensure sufficient oversight of the company's position. Then, in November 2020, NBS took a decision imposing temporary restrictions on the disposition of NOVIS assets. Under the decision, the company was to avoid disposing of assets (i.e., transferring

ownership or transferring assets from its bank accounts) and avoid concluding legal instruments that could lead to a reduction in company assets unless this was done to remit payments on claims relating to insurance contracts and to ensure the continuity of regular operations. In February 2021, NBS revoked a part of the September 2020 decision prohibiting the sale of new unit-linked insurance contracts. At the beginning of April 2021, other parts of the September 2020 decision, and the November 2020 decision remained in effect.

The FSA compiled and published information for consumers of financial services on questions that could arise in connection with the extraordinary circumstances created by the COVID-19 pandemic. Among the points covered are increased risk of cybercrime, contactless payments, pointers on measures introduced by credit institutions in connection with mortgages and consumer loans, travel insurance, third-pillar pension savings with-

drawals, rules on handling of complaints, and measures for consumers in connection with disputes.

The Authority also drew consumers' attention to the information sheet from the European Banking Authority (EBA), which was translated into Icelandic and published on the Central Bank website. The info sheet presents points that consumers should have in mind when choosing banking services online or via smart device apps, particularly when they select services or enter into contracts for services. Consumers are advised to examine closely what the service entails and to familiarise themselves with the length of the contract period, total costs and fees, and terms for cancelling the service. They are also advised to examine the annual percentage rate where possible, in order to compare various options and keep track of them, and to report immediately any suspicious bank account activity or unauthorised access to the account so that the service provider can take prompt action.

#### **Comments from consumers**

The FSA receives queries, comments, and complaints from the public concerning supervised entities' business conduct, and it provides information and guidance to the parties concerned. Such comments on supervised entities' business conduct are also used to analyse and identify potential risks and problems. They can also lead to proactive checks undertaken by the Authority. In 2020, the Authority received 246 comments pertaining to business conduct in the financial market.

## **Supervision of the securities market**

The objective of securities market supervision is to promote a safe and effective securities market. This is done by, among other things, monitoring securities issuers' information disclosures and monitoring market participants' behaviour as regards insider dealing and market manipulation. The FSA also monitors the activities of securities exchanges (one entity) and central securities depositories (two entities). In 2020, the Nasdaq CSD Iceland securities depository merged with Nasdaq CSD SE, which is licensed in Latvia and now operates Iceland's securities settlement system through a branch.

#### **Monitoring market conduct**

There were a number of tasks relating to the monitoring of market participants' conduct in 2020. Eleven cases involving issuers' information disclosures were investigated, as well as ten cases of possible insider dealing, five involving possible market manipulation, and six that fell into other categories.

#### **Sanctions**

In May 2020, the FSA and Síminn hf. concluded a settlement pertaining to Síminn hf.'s violation of Act 93 of the Act on Securities Transactions, no. 108/2007. The violation involved Síminn's failure to publish the proportion of its own shares within the required length of time after a purchase that pushed its holdings above the 5% voting rights threshold. A fine of 1.7 m.kr. was levied in the case.

In the same month, the FSA and an individual concluded a settlement pertaining to the individual's violation of the first sentence of Article 117, Paragraph 1, Item 3 of the Act on Securities Transactions, no. 108/2007. The individual concerned, who was a primary insider and a member of the board of directors of an issuer of securities in a regulated securities market, notified the issuer of transactions by a company to which the individual was connected. The notification, which was published, was considered to entail the distribution of information that gave, or was likely to give, incorrect or misleading information or indications about financial instruments in that issuer, as the individual knew or should have known that the information contained in the notification was incorrect or misleading.

In July 2020, the Financial Supervision Committee decided to impose an administrative fine of 87.7 m.kr. on Arion Bank hf. for a violation of Article 122, Paragraph 1 of the Act on Securities Transactions, no. 108/2007. The violation entailed the company's failure to publish, as soon as possible, insider information on proposed organisational changes and streamlining measures, of which the bank had postponed publication in accordance with statutory provisions after the conditions for the postponement no longer existed. Arion Bank hf. has initiated legal action to demand the invalidation of the decision. The case is awaiting judicial handling.

Furthermore, a case involving the Pension Fund of Commerce's violation of Article 86, Paragraph 1, cf. Article 78, Paragraph 1, of the Act on Securities Transactions, no. 108/2007, was concluded by settlement in July 2020. Under the settlement, the pension fund acknowledged having violated the aforementioned provision by having neglected to report a change in a large share of voting rights in Hagar hf. by the statutory deadline. A fine of 2.2 m.kr. was levied in the case.

#### **On-site inspections**

On-site inspections were conducted to examine the quality of trade reporting system (TRS II) notifications sent to the FSA by Arion Bank hf., Kvika banki hf., and Íslensk verðbréf hf. concerning transactions with finan-

cial instruments that had been admitted to trading on a regulated securities market and financial instruments connected with them. The results of the inspections were published on the Central Banks website in July 2020.

### Notifications of short positions

On the basis of Regulation (EU) no. 236/2012 on short sales and certain aspects of credit default swaps, the European Securities and Markets Authority (ESMA) has powers of intervention under extraordinary circumstances. ESMA has viewed the circumstances prevailing because of the COVID-19 pandemic as a serious threat to the orderly functioning and integrity of the markets; therefore, on 16 March 2020, ESMA and the EFTA Surveillance Authority (ESA) decided to temporarily lower the notification thresholds for net short positions in shares that had been admitted to trading on a regulated securities market. The decision made it obligatory to notify the FSA of net short positions in equity securities when the position rose above or fell below 0.1% of the issued share capital in the company concerned. In addition, it was required to send a notification each time the net short position changed by 0.1% in excess of this threshold. As a result, the notification threshold in Iceland was lowered to 0.1% from the previous 0.2%. The decision resulted in an increased number of notifications filed with the FSA, and short positions in 13 companies were reported in 2020. From 20 March 2021 onwards, the notification threshold reverted to 0.2%, in accordance with a decision by ESA and ESMA.

In 2020, a total of 163 notifications of short positions were filed. Of these, 53 pertained to positions ranging between 0.1% and 0.2% of issued share capital. Even excluding the number of notifications of short

Table 1: Notifications of short positions

	2020		2019
	Number of notifications	– notifications between 0.1% and 0.2%	Number of notifications
January	9	0	6
February	3	0	7
March	13	1	21
April	20	8	9
May	14	4	9
June	20	7	0
July	9	4	0
August	8	4	3
September	23	8	14
October	20	7	14
November	14	4	5
December	10	6	6
Total	163	53	94

positions totalling less than 0.2%, there was an increase year-on-year, with 110 notifications in 2020 versus 94 in 2019.

### Prospectuses and supervision of securities offerings

One of the most extensive tasks of 2020 was the approval of prospectuses and supervision of securities offerings. The FSA approved 34 prospectuses in 2020, an increase of 42% year-on-year. From 2013 until last year, the number of prospectuses had held relatively stable. The jump in 2020 is due primarily to the revision of prospectuses because of an EU regulation that entered into force on 1 April 2020. All prospectuses issued under the previous regulation expired on 21 July 2020, and some securities issuers therefore had to issue new ones on the basis of the new regulation. Of the 34 prospectuses approved by the FSA during the year, 14 were base prospectuses, as opposed to nine in 2019. In addition, 21 supplements to registration documents were approved in 2020, an increase of six year-on-year. During the year, the FSA published a total of 109 final sets of terms on its website.

Table 2: Number of prospectuses and supplements approved by the FSA

	2017	2018	2019	2020
Prospectuses	19	24	24	34
Base prospectuses	9	10	9	14
Supplements	14	13	15	21

The biggest task of the year relating to prospectuses, apart from the implementation of the new regulation, was the prospectus for Icelandair Group hf. The company applied for approval on 14 April 2020. The prospectus was approved on 8 September, and another prospectus for subscription rights was approved on 8 October. The process therefore took nearly six months.

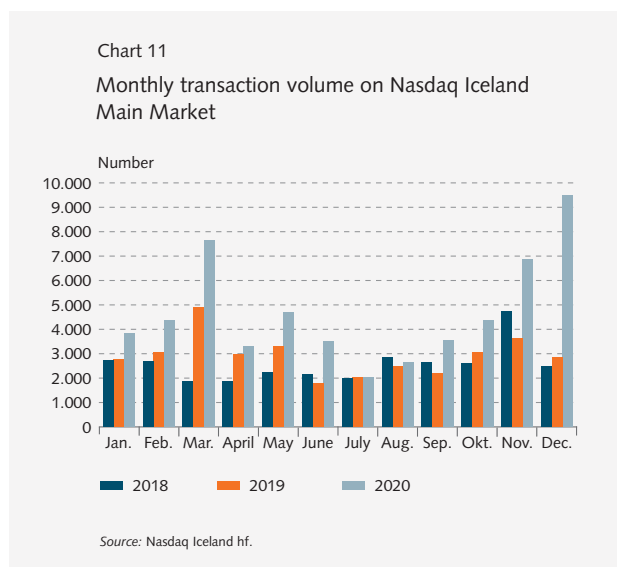
### Developments in the securities market

#### Equity market

Equity market turnover remained virtually unchanged year-on-year, at just over 600 b.kr., yet number of trades rose by more than 60% over the same period.<sup>4</sup> The number of companies listed on the Main Market declined by one during the year after Heimstaden (previously Heimavellir hf.) was delisted in September 2020. There were more acquisitions in 2020 than in previous years. The FSA was notified of takeover offers for shares in Heimavellir hf., Skeljungur hf., and Eimskipafélag

4 Source: Nasdaq Iceland hf.

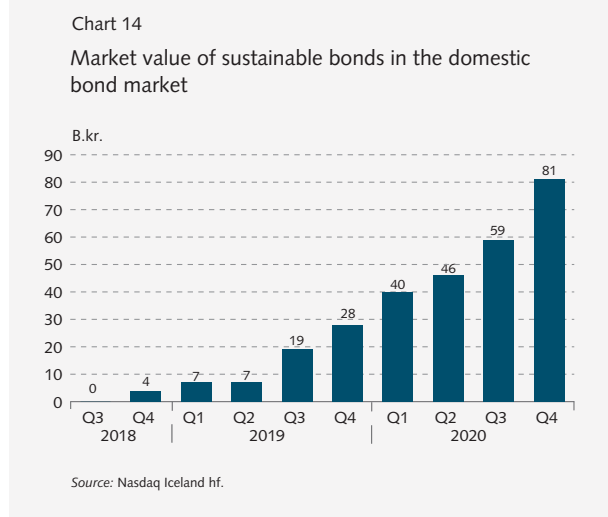
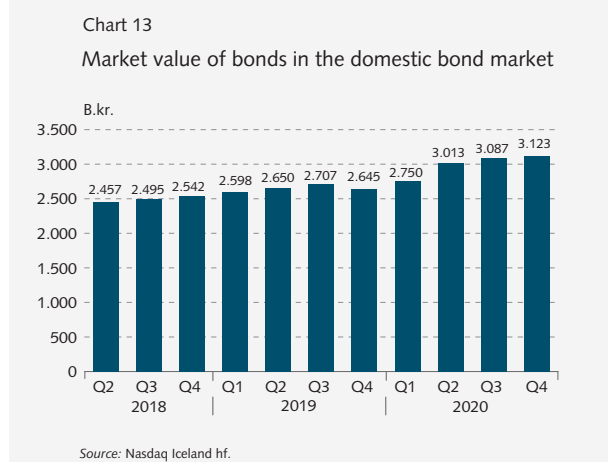
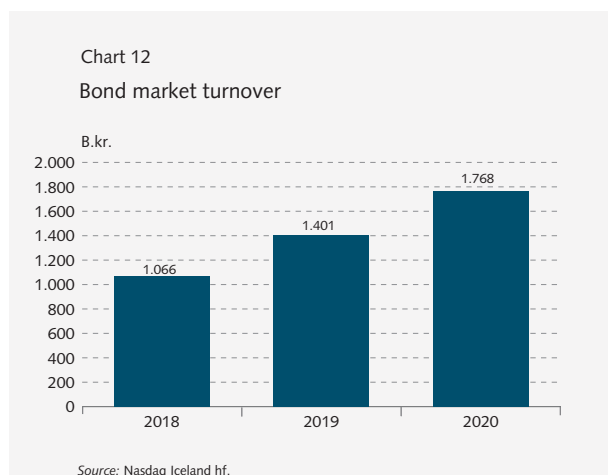
Íslands hf., and earlier in the year the Authority had granted an exemption to the mandatory takeover bid requirement for shares in Eimskipafélag. Furthermore, three listed companies increased their share capital: Icelandair Group hf., Reitir hf., and Reginn hf. Participation in the equity market by the general public nearly doubled in 2020, and by the end of the year, just under 17,000 individuals held shares listed on the Nasdaq Iceland exchange.<sup>5</sup>



### Bond market

Bond market turnover increased by a fourth between years, to a total of nearly 1,800 b.kr. Thirty new bond issues were admitted to trading on a regulated securities market, and the Republic of Iceland was the most active issuer. Turnover in bonds issued by the Treasury and the banks surged at the beginning of the COVID-19 pandemic, with total turnover reaching 319 b.kr. in March alone. Chart 12 shows bond market turnover in 2020, and Chart 13 shows the development of market value of bonds in the domestic bond market.

Issuance of bonds marketed as sustainable instruments increased by more than 50 b.kr. in 2020, nearly trebling during the year, as can be seen in Chart 14.<sup>6</sup> Sustainable bond turnover displayed a similar pattern, increasing from 4.3 b.kr. in 2019 to 27.5 b.kr. in 2020.



<sup>5</sup> Source: Nasdaq CSD SE, Iceland branch.

<sup>6</sup> This refers to bonds marketed as sustainable following an assessment by an impartial expert who guarantees that the issuer will use the proceeds of the bond for green investments and will comply with specified information disclosure requirements.

## Supervision of UCITS management companies, UCITS funds, and AIF management companies

The FSA supervises collective investment fund (undertakings for collective investment in transferable securities, UCITS) management companies, UCITS funds, and managers of alternative investment funds, or AIF (i.e., investment funds and other special-purpose funds). Such supervision revolves mainly around whether or not the funds in question invest in accordance with statutory authorisations and their own internal rules. Factors such as UCITS funds' risk management, conflicts of interests, and liquidity management are now monitored as well, as are the obligations of fund custodians. At the end of 2020, nine fund management companies were in operation, all of which had also received licences to operate AIF. Another seven entities had registered as alternative investment fund managers (AIFM).

### On-site inspections

During the year, on-site inspections were carried out at Iceland Funds hf. and Kvik eignastýring hf. (then Júpíter rekstrarfélag hf.). The inspections focused on notifications of UCITS funds' and investment funds' deviations from the investment authorisations provided for in the Act on Mutual Funds, Investment Funds, and Institutional Investment Funds, no. 128/2011, particularly to include an inspection on whether the FSA had been notified of the deviation within the legally mandated period of time. The efficacy of the funds' risk management was also examined with respect to the relevant requirements laid down in current legislation, regulations, and guidelines. The results of the inspections were published in November 2020.

### Common supervisory action

In 2020, the FSA participated in a common supervisory action pertaining to UCITS funds' liquidity management, together with all of the other EEA states. The aim is to carry out such joint actions annually in the future. The check was carried out at the behest of ESMA. In addition, the FSA has stepped up its communications and data disclosures to ESMA in connection with the position and activities of funds, owing to the impact of the COVID-19 pandemic.

### Changes in funds' statutory environment

With the entry into force of the Act on Alternative Investment Fund Management Companies, no. 45/2020, at mid-year, the operating environment of alternative investment funds changed markedly. Supervision of AIFMs reflected this. Act no. 45/2020 provided for mandatory operating licences and registration of AIFMs. Whether fund management companies are subject to licensing and registration requirements or not depends on the total assets they have under management, among other factors. Companies that managed AIFs at the time the Act entered into force were authorised to continue operating until 1 January 2021. Nevertheless, they were required to take all measures necessary to satisfy the conditions laid down in the Act and either apply for licences as AIFMs or register with the FSA by 1 November 2020.

During the year, the Authority dedicated significant time and effort to the receipt and review of documents relating to licensing applications and registration requests, as well as to the preparation and implementation of new reporting requirements provided for in the Act.

## Box 2

### Suitability assessments and qualifying holdings

Assessment of board members' and senior executives' suitability.

The FSA assesses the suitability of supervised entities' board members and managing directors. A suitability assessment is carried out when board members and managing directors begin work for a supervised entity, although the FSA may conduct a repeat assessment if necessary. However, the entities concerned are always responsible for ensuring that their board members and managing directors satisfy the regulatory requirements for eligibility.

The FSA assessed the suitability of 105 board members and managing directors in 2020, the vast majority of them board members. Because of the COVID-19 pandemic, it was not possible to interview all of the board members concerned, and the assessments could not be completed by the year-end. They are scheduled for completion in Q1 of 2021, however.

During the assessment, written documents are evaluated, and in a large number of instances, board members are interviewed and their expertise examined further. In determining

whether a board member should be interviewed, consideration is given to factors such as the type, size, and scope of the supervised entity's operations, and whether there is any doubt about whether the person concerned meets the regulatory requirements for the expertise and experience needed to fulfil their role in a satisfactory manner.

In the case of managing directors, a verbal assessment of the person's expertise is always carried out, and written documents are evaluated as well.

Table 1: Suitability assessments

	2020	2019	2018
Number of board members and managing directors assessed	105	108	100
Number who did not pass the assessment due to inadequate expertise or failure to appear for interview	0	4	6

Table 2: Suitability assessments 2020 – number, by type of supervised entity

Type of supervised entity	
Commercial banks	5
Savings banks	10
Credit undertakings	22
Investment firms	5
UCITS management companies	13
Payment institutions	8
Pension funds	23
Insurance undertakings	19
Total	105

### Qualifying holdings

The FSA assesses the eligibility of parties planning to acquire qualifying holdings in financial institutions, insurance companies, electronic money institutions, and payment institutions. A qualifying holding is a direct or indirect holding in an undertaking that represents 10% or more of its share capital, guarantee capital, or voting rights, or that enables the exercise of a significant influence on the management of the company concerned.

There were some changes in ownership of financial institutions and other supervised entities in 2020. Notifications of qualifying holdings were as follows: Rapyd Financial Network (2016) Ltd. and related party, holding in Rapyd Europe hf. (previously KORTA hf.); Salt Pay Co Ltd. and related parties, holding in SaltPay IIB hf. (previously Borgun hf.); Brynhildur Ingvarsdóttir, indirect holding in Summa Rekstrarfélag hf.; TM tryggingar hf., holding in Íslensk endurtrygging hf. and TM líftryggingar hf.; and Ascraeus ehf. and related party, holding in Arctica Finance hf.

## Supervision of anti-money laundering and terrorist financing measures

The FSA carries out risk-based supervision of entities subject to notification requirements (obliged entities) in accordance with the Act on Measures Against Money Laundering and Terrorist Financing, no. 140/2018. There were 82 such obliged entities at the end of 2020, up from 72 a year earlier. They include financial institutions, payment institutions, electronic money institutions, life insurers, pension funds, currency exchange services, and virtual currency service providers, as well as branches, agents, and distributors representing foreign financial institutions in Iceland. It should be noted that in 2020, lenders and credit intermediaries, which are subject to registration requirements in accordance with the Act on Consumer Loans, no. 33/2013, were classified as obliged entities and in this respect were subject to supervision by the FSA.

### Risk-based supervision

The FSA carries out risk-based supervision of obliged entities' anti-money laundering and terrorist financing

measures. Risk-based supervision is a methodology that entails assessing the risk of money laundering and terrorist financing in the financial market and prioritising supervisory measures in accordance with the results of that assessment.

Risk assessments are carried out on all obliged entities on a regular basis in order to determine the likelihood that their operations will be used for money laundering or terrorist financing. The results of the analysis of each obliged entity generate a risk score that determines the entity's risk classification. The risk classification determines which supervisory measures are included in the next year's work schedule for each obliged entity. Risk-based supervision is not a one-time measure but a regular, ongoing analysis of risk relating to money laundering and terrorist financing, both in the financial market as a whole and in individual obliged entities' operations. On the basis of supervisory measures, the FSA revises its follow-up and methodology to take into account new information, including updated EU risk assessments and new regulatory requirements.



## Inspections and interviews

Inspections on obliged entities' anti-money laundering and terrorist financing measures may take the form of on-site inspections or proactive checks. They may be theme-based checks in which the same factors are examined at numerous entities. In 2021, the Authority will also begin holding interviews with obliged entities' company officers to discuss anti-money laundering and terrorist financing measures. The frequency of such interviews is determined by the company's risk classification.

A questionnaire is sent to obliged entities on a regular basis so as to gather information on matters such as their business plans and their customers. The responses are used in preparing the risk assessment. In addition to the above, the FSA uses other methods to highlight obliged entities' obligations or to gather information on measures carried out by them. Examples of such measures include presentations given by the FSA and queries.

### 64 anti-money laundering checks in 2020

The FSA conducted 64 inspections on anti-money laundering and terrorist financing measures in 2020, including four on-site inspections.

### On-site inspections

The Authority conducted on-site inspections at Arctica Finance hf. and Sparisjóður Strandamanna ses. and in addition at one commercial bank and one payment institution to check the companies' compliance with the Act on Measures Against Money Laundering and Terrorist Financing. The inspections entailed examinations of on risk assessments, customer risk classifications, due diligence checks, regular supervision, obligations to investigate and to notify, compliance with international sanctions, and monitoring of individuals in high-risk groups due to political connections, as well as policies, management, and procedures. The inspection at Sparisjóður Strandamanna ses. concluded in December 2020 with a settlement involving a fine of 2.5 m.kr. due to violations of the Act on Measures Against Money Laundering and Terrorist Financing, no. 140/2018. The substance of the settlement was published on the Central Bank website in January 2021. The savings bank's violations involved risk assessments, policy and procedures, due diligence checks, and monitoring of individuals in high-risk groups due to political connections. The results of the inspection at Arctica Finance hf. were published in the Central Bank website in February 2021.

### Other checks

Other checks pertained to compliance with the Act on Freezing of Funds, no. 64/2019, in which the Authority

examined how supervision of parties on sanctions lists was handled. The checks were carried out in part because the Financial Action Task Force (FATF) had required verification of satisfactory compliance with Act no. 64/2019, which had entered into force in mid-2019. Because the FSA conducts risk-based supervision, emphasis was placed on checking compliance at all entities in the high-risk and medium-risk categories, as well as those in lower risk categories that were deemed most vulnerable to money laundering and terrorist financing.

### Educational materials and recommendation

In 2020, the Authority prepared special educational materials on risk-based and preventative anti-money laundering and terrorist financing measures. The materials were published in early 2021, with the aim of explaining how statutory requirements and interactions between various measures are intended to prevent the abuse of obliged entities' activities for money laundering and terrorist financing purposes. The FSA also gave informal guidance to obliged entities.

In April 2020, the FSA issued recommendation on the COVID-19 pandemic to obliged entities. The recommendation reiterated that the entities concerned should continue their anti-money laundering and terrorist financing measures and be on the watch for new methods and channels for money laundering, owing to the changed economic environment.



### Iceland removed from FATF grey list

In October 2020, the Financial Action Task Force (FATF), an international anti-money laundering and terrorist financing body, decided to remove Iceland from the "grey" list of countries under increased scrutiny due to inadequate anti-money laundering and terrorist financing measures. The decision was made following an

on-site inspection conducted in Iceland in September 2020, which confirmed that the Icelandic authorities had completed the measures required for removal from the grey list. The Icelandic Government had been engaged in broad-based reforms of its anti-money laundering architecture since April 2018. The Central Bank and other Governmental authorities will continue to strengthen Iceland's defences against money laundering and terrorist financing.

Twice during the period of increased scrutiny, the FSA carried out surveys to determine whether the FATF decision had affected supervised entities' activities and,

if so, what impact it had made. It could be concluded from the responses that the FATF decision had made very little impact during the period in question. The main difference involved submittal of additional documents or information because of enhanced due diligence checks in connection with both new and existing business relationships. Several entities attributed the extra reporting to additional regulatory requirements and increased awareness of money laundering rather than to the FATF decision. Furthermore, there were few instances of rejected payments, delayed transmittal or receipt of SWIFT payments, or other unusual processing delays.

## Box 3

### Operating licences and other permits

One of the FSA's tasks is to grant businesses – and, in some instances, individuals – licences to operate in the financial market. Such work requires the involvement of experts with a wide range of knowledge. With increased emphasis on financial technology (fintech) and other areas, the merger of the Financial Supervisory Authority and the Central Bank has consolidated the expertise needed for such tasks, particularly in the area of payment systems.

There were numerous changes relating to supervised entities' operating licences and other permits in 2020:

- During the year, the Authority granted Valitor hf. a licence to operate as a payment institution according to the Act on Payment Services, no. 120/2011. After the new licence was granted, its licence to operate as a credit undertaking was revoked; cf. the Act on Financial Undertakings, no. 161/2002.
- TM tryggingar hf. was granted an extended licence to operate as an insurance company; cf. the Act on Insurance Activities, no. 100/2016. In addition, authorisation was granted for the transfer of TM hf.'s insurance portfolio to TM tryggingar hf. The TM hf. group was also defined a financial conglomerate in the insurance sector; cf. the Act on Additional Supervision of Financial Conglomerates, no. 61/2017.
- Tryggingavernd ehf. was granted a licence to operate as an insurance brokerage in accordance with the Act on Distribution of Insurance, no. 62/2019.
- BPO innheimta ehf. and Debitum ehf. (previously Erra ehf.) received debt collection licence in accordance with the Act on Debt Collections, no. 95/2008. In addition, Fjárvakur-Icelandair Shared Services' Debt collections licence was revoked.

- Myntkaup ehf. and Bálfar Miðlun ehf. were registered as virtual currency service providers in accordance with the Act on Measures Against Money Laundering and Terrorist Financing, no. 140/2018.
- Framtíðin lánasjóður hf. was deregistered as a lender; cf. the Act on Mortgage Lending to Consumers, no. 118/2016. At that time, Kvika banki hf. took over its operations and brand.
- Approval was given for the transfer of specified segments of GAMMA Capital Management hf.'s operations to Akta sjóðir hf. and Kvika eignastýring hf., and for the transfer of a specified segment of Kvika banki hf.'s operations to Kvika eignastýring hf.; cf. the Act on Financial Undertakings, no. 161/2002.
- Following the entry into force of the Act on Alternative Investment Fund Management Companies, no. 45/2020, all nine asset management companies of ucits were also granted licences to operate as AIFMs. In addition, Alfa Framtak ehf., Algildi GP ehf., investment firm ALM Verðbréf hf., Strawberry Capital GP ehf., Eyrir Venture Management ehf., Fossar GP ehf., and Vex ehf. were registered as AIFMs.

#### Unauthorised operation of licensed activities

FSA regularly receives tips on companies that are suspected of carrying out licensed activities without the required licence or registration, and it also conducts proactive checks of such cases. In 2020, it handled 35 such cases, five of which had been opened in 2019. Of these cases, 27 stemmed from proactive checks and eight were opened in response to tips. Eight of these cases are still pending, and it is hoped that they will be concluded in 2021.



# Key priorities in the 2021 project timetable



At the beginning of each year, the FSA prepares a detailed work timetable for the upcoming twelve months. This work is based in part on the Authority's *Supervisory Strategy for 2021-2024*,<sup>1</sup> recent risk assessments, and the strategic supervisory priorities prepared by EBA, EIOPA, and ESMA. This section contains a summary of key priorities in the 2021 project timetable. It is not an exhaustive list of all tasks scheduled for the year.

The FSA publishes key priorities in its timetable, with the aim of promoting transparency in the Authority's work. Such transparency enables supervised entities to take the Authority's strategy and priorities into account in their activities. The priorities are published with the provision that they may be subject to change, as supervision of financial activities is based on the most recent information available at any given time.

## Key priorities in 2021

### Loan quality

Loan quality has deteriorated in the recent term because of the COVID-19 pandemic and measures aimed at curbing the spread of the disease. Arrears have increased, collateral values are uncertain, and a sizeable share of corporate loans have been in moratorium. It is important to keep abreast of developments in credit risk in the coming term and ensure that loans previously in moratorium are handled effectively and in a clear-cut way.

In 2021, the FSA will conduct checks on banks' and savings banks' loans, with the aim of assessing their value and the methods used for write-downs.

### Governance framework

When circumstances in the financial market are challenging, sound governance and strong internal control systems are of vital importance. During the year, the FSA will attempt to ensure that supervised entities' governance framework and conduct are in line with best practice.

The Authority will continue to emphasise risk culture and to stress sound governance as an essential part of supervised entities' internal monitoring environment, including by carrying out assessments of banks' and insurance companies' "three lines of defence" systems and pension funds' risk management.

### Outsourcing

Supervised entities have increased their outsourcing of both operational segments and key functions in the recent term. Concentration among providers of such outsourced services could give rise to systemic risk. Furthermore, outsourcing could make it more difficult for supervised entities and the FSA to maintain an overview of outsourced activities and the tech solutions being used, including the characteristics of those solutions and the risks associated with them.

A check on compliance with EBA guidelines on outsourcing by financial institutions will be conducted during the year, as will a check on outsourcing by pension funds.

### Supervision of anti-money laundering and terrorist financing measures

It is vital to continue placing strong emphasis on effective risk-based supervision of anti-money laundering and terrorist financing measures, including supervision based on international obligations in the field.

<sup>1</sup> This report is in preparation and will be issued later in 2021.

During the year, top priority will be given to supervision of obliged entities' risk-based approach and clarification of the links between prudential supervision and risks stemming from money laundering and terrorist financing.

The FSA will conduct checks on compliance by entities such as banks, investment firms, and lenders with selected aspects of the Act on Measures Against Money Laundering and Terrorist Financing during the year.

### **Sustainability of business models**

In view of the major technological advances taking place in the financial market, the challenges posed by COVID-19, and the current low-interest environment, it is considered necessary to analyse the risks that these factors pose for supervised entities' business models.

In 2021, the Authority will carry out an appraisal of the business models and strategies of companies in the financial market, with a view to the aforementioned factors, in order to assess their sustainability.

### **Product development and management in the retail financial market**

Harmonised guidelines for financial product oversight and governance (POG) have taken effect in the banking market and are currently being implemented in the insurance market. The guidelines are intended to ensure sound business conduct in the sale and marketing of financial products, including ensuring that products are sold or marketed to the appropriate parties.

The FSA will follow up on the implementation, including by checking on whether supervised entities have developed satisfactory management systems for product development.

# Changes in regulatory framework of the financial market

## IV

This section is devoted to the amendments made to financial market legislation in 2020 and covers amendments made to rules and guidelines issued by the FSA during the year. In addition, it explains the main substance of forthcoming European regulatory instruments in the financial market whose implementation is expected in the near term.

### Statutory amendments in 2020

The FSA participates actively in shaping the regulatory framework that applies to the financial market in Iceland, including by issuing its own rules and guidelines. In addition, the Authority participates actively in ministerial committees and work groups that prepare bills of legislation applying to supervised entities' activities, bringing its employees' expertise to bear on this work. Moreover, the FSA has an overview of all legal authorisations pertaining to the Icelandic financial market, and it applies and interprets them, as well as keeping abreast of amendments proposed within the EEA. The Authority plays a key role in the financial market in terms of monitoring technical standards, guidelines, and recommendations issued by European financial market supervisors.

The following acts of law pertaining to the financial market were passed by Parliament in 2020:

- Act on Central Securities Depositories and Settlement and Electronic Registration of Financial Instruments, no. 7/2020.
- Act no. 8/2020 amending the Act amending the Acts on Consumer Loans and on Measures Against Money Laundering and Terrorist Financing, no. 163/2019.

- Act on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading on a Regulated Market, no. 14/2020.
- Act on Measures to Address the Economic Impact of the COVID-19 Pandemic, no. 25/2020.
- Act no. 37/2020 amending various Acts to address the economic impact of the COVID-19 pandemic (further measures).<sup>1</sup>
- Act on Financial Support for Small Businesses due to the COVID-19 Pandemic, no. 38/2020.
- Act on Alternative Investment Fund Management Companies, no. 45/2020.
- Act no. 62/2020 amending the Act on Consumer Mortgages, no. 118/2016 (activities of cross-border credit intermediaries).
- Act on Resolution of Credit Institutions and Investment Firms, no. 70/2020.
- Act no. 96/2020 amending the Act on Measures Against Money Laundering and Terrorist Financing and the Act on Registration of Beneficial Owners (anti-money laundering and terrorist financing measures).

### Rules and guidelines issued in 2020

#### Rules

In 2020, the Central Bank of Iceland set the following rules pertaining to financial supervision, including rules implementing technical standards adopted by European financial market supervisors:

- Rules on Secure Storage of Funds Received by Payment Institutions, no. 88/2020

<sup>1</sup> Article 4 of the Act contains amendments to the Act on Mandatory Insurance of Pension Rights and on Activities of Pension Funds, no. 129/1997.

- Rules on Countercyclical Capital Buffers for Financial Undertakings, no. 227/2020.
- Rules on Key Financial Information in the Summary of a Prospectus, the Publication and Classification of Prospectuses, Advertisements for Securities, Supplements to a Prospectus, the Notification Portal, and Notification of a Public Offering, no. 320/2020.
- Central Bank of Iceland Tariff no. 321/2020 for proactive checks by the FSA.
- Rules on Technical Information for the Calculation of Technical Provisions and Basic Own Funds for Reporting with Reference Dates from 31 December 2019 through 30 March 2020, no. 322/2020.
- Rules on Systemic Risk Buffers for Financial Undertakings, no. 323/2020.
- Rules on Capital Buffers for Systemically Important Financial Undertakings, no. 324/2020.
- Rules no. 514/2020 amending the Rules Laying Down Implementing Technical Standards with Regard to the Procedures, Formats and Templates of the Solvency and Financial Condition Report, no. 1365/2019.
- Rules on the Determination of Types of Alternative Investment Fund Managers, Including Whether the Fund is Open-Ended or Closed-Ended or Both, no. 815/2020.
- Rules on Technical Information for the Calculation of Technical Provisions and Basic Own Funds for Reporting with Reference Dates from 31 March 2020 through 29 June 2020, no. 860/2020.
- Rules on Technical Information for the Calculation of Technical Provisions and Basic Own Funds for Reporting with Reference Dates from 30 June 2020 through 29 September 2020, no. 964/2020.
- Central Bank of Iceland Tariff no. 1100/2020 for proactive checks by the FSA.
- Rules on the Annual Accounts of Mutual Fund Managers, Alternative Investment Fund Managers, Mutual Funds, and Investment Funds, no. 1240/2020.

### Guidelines

The FSA also issued the following guidelines during the year:

- Guidelines on Harmonised Presentation of Specified Explanatory Items in Insurance Companies' Annual Accounts, no. 1/2020.
- Guidelines on the Contents of Simple Recovery Plans, no. 2/2020.

### EEA Guidelines

A number of EEA guidelines were adopted by the FSA during the year. They include guidelines issued by

the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities and Markets Authority (ESMA); cf. the authorisation contained in Article 16 of the Regulations Establishing a European Supervisory Authority, no. 1093-1095/2010, which were incorporated into Icelandic law with the Act on a European Financial Supervisory System, no. 24/2017. These EEA guidelines are not incorporated into the FSA's guidelines; instead, a circular describing the substance of the Guidelines and containing a link to the English version is posted on the Authority's website. In addition, presentations of the substance of the Guidelines are held as needed. The purpose of Guidelines is to bring about harmonised, successful, and effective supervisory execution within the European financial supervisory system and to ensure collective, homogeneous, and harmonised application of EU legislation. As a result, the FSA bases its supervisory activities on the Guidelines.

## Forthcoming new financial market legislation

This section discusses the principal directives and regulations governing the European financial market that are currently being incorporated into Icelandic law or will be in the near future. The FSA experts are involved in the implementation in various ways, including participating in ministerial committees and issuing rules and guidelines.

### PSD II

Directive (EU) 2015/2366 is the second EU Payment Services Directive (PSD II), which focuses on the requirements made of payment institutions' operations and the rights and responsibilities of payment service providers, including information disclosure to consumers. PSD II will oblige banks to provide information on their customers to third parties, provided that their customers have given their explicit and unequivocal consent. On the basis of this, the third parties concerned will be authorised to use information in connection with consumers' payment accounts (account information service providers/AISP) and/or provide them with service to initiate payment from their accounts (payment initiation service providers/PISP).

According to PSD II, third parties should be able to use this access to provide payment services to consumers, thereby competing with banks on the basis of information in the customers' business history. In order to guarantee the security of the data and information in question, both the third parties concerned and other

payment service providers must satisfy new security and risk management requirements. These requirements involve strong customer authentication (SCA), both for execution of payments and for technical communications between AISP and PISP, on the one hand, and the credit institutions that administer the payment accounts, on the other. Furthermore, payment service providers must have systems in place to monitor operational and security risk and to respond to serious incidents, including notifications to the FSA. The Ministry of Finance and Economic Affairs, with assistance from the Central Bank, has prepared a draft of new comprehensive legislation on payment services based on PSD II. A bill of legislation implementing PSD II has been introduced before Parliament.

Information on PSD II has been published on the FSA's website.

### **MiFID II/MiFIR**

The aim of Directive 2014/65/EU (MiFID II) and Regulation (EU) no. 600/2014 (MiFIR) is to enhance transparency and improve functioning in the market for financial instruments within the EEA. FSA Iceland participates in legislative committees appointed by the Ministry of Finance and Economic Affairs. The committees are tasked with drafting legislation implementing MiFID and MiFIR. This work continued in 2020. The legal instruments in question focus on investor protection, the organisation of trading venues and investment firms, and trade transparency. Alongside this committee participation, work is underway within the Central Bank on the implementation of various changes that follow from the new regulatory framework. The original intention was for the legislation to enter into force at the beginning of 2020, but work on the bill of legislation took longer than anticipated. An implementing bill of legislation has been introduced before Parliament.

Information on MiFID II and MiFIR has been published on FSA's website.

### **MAR**

A bill of legislation on measures to combat market abuse, which is intended to implement Regulation (EU) no. 596/2014 (the Market Abuse Regulation, MAR) was introduced before Parliament in March 2021. The regulation repeals Directive 2003/6/EC on insider dealing and market manipulation (market abuse), which was incorporated into Icelandic law by means of Chapter XIII of the Act on Securities Transactions, no. 108/2007. MAR focuses on market abuse and public disclosure of inside information by issuers. The term *market abuse* encom-

passes insider dealing, unlawful disclosure of inside information, and market manipulation, which are unlawful, and the regulation provides for minimum administrative sanctions in cases of violation. Such conduct prevents full and proper market transparency, which is a prerequisite for uniform competitive conditions and investor activity in integrated financial markets. The bill also discusses sanctions for violations of MAR and proposes that the penalties for market abuse in Iceland remain unchanged. Public disclosure of inside information by issuers is essential to preventing insider dealing and fostering the public's trust and confidence in the securities market. MAR applies to all financial instruments traded on a regulated market, multilateral trading facility, or organised trading facility, and all types of conduct or actions that could affect such financial instruments, irrespective of whether the conduct or actions take place on a trading venue. The same is true of financial instruments for which a request has been filed for admittance to trading on a regulated market or trading facility. In addition to MAR, the EU has issued 16 ancillary instruments that contain more detailed provisions on various aspects of MAR, which will be incorporated into Icelandic law by regulation or through Central Bank rules.

### **PRIIP**

Regulation (EU) no. 1286/2014 on key information documents for packaged retail and insurance-based investment products (PRIIP) entered into force in EU member states on 1 January 2018. The purpose of the regulation is to strengthen consumer protection, enhance transparency, and boost consumer confidence in packaged insurance-linked investment products. It lays down harmonised requirements for disclosure of information on investment products to retail investors across the banking, insurance, and securities markets. According to the regulation, information on products shall be provided to retail investors in the form of a so-called key information document (KID) whose purpose is to enable investors to understand and compare key elements of the document and the risks associated with the investment product in question. The Ministry of Finance and Economic Affairs, with assistance from the Central Bank, has prepared a draft bill of legislation implementing the regulation. The bill also proposes changes that would require those authorised to offer supplemental insurance according to the Act on Mandatory Insurance of Pension Rights and on Activities of Pension Funds to prepare KIDs in accordance with the regulation, for the benefit of consumers. An implementing bill of legislation has been introduced before Parliament.

## UCITS V

Directive (EU) 2014/91/EU (UCITS V) is intended to update Directive 2009/65/EC on UCITS funds. The principal changes arise from detailed provisions on the role and responsibility of custodians, the obligation to maintain a remuneration policy in UCITS management companies, and the harmonisation of powers entrusted to supervisory authorities. The Ministry of Finance and Economic Affairs, with assistance from the Central Bank, has prepared a draft of new comprehensive legislation on UCITS funds based on the UCITS directive, with subsequent amendments. An implementing bill of legislation has been introduced before Parliament.

## Sustainability in the financial market

In 2018, the European Commission published its Action Plan on Financing Sustainable Growth. Several regulations have been passed within the EU since then, including the following two, which are to be implemented in 2021:

Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector contains harmonised rules for participants in the financial market. The regulation applies to a large number of financial market entities, including insurance companies, financial undertakings, alternative investment fund management companies, etc. It requires that these parties publish information on their websites about how they incorporate sustainability risk into their risk management and how they assess the impact of their investment decisions on sustainability factors.

Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, called the Taxonomy Regulation, is an important step taken by the European Commission to reduce the likelihood of greenwashing and make it easier for investors to understand the premises underlying the classification of products marketed as *green or sustainable*. The regulation therefore harmonises the use of terminology and the rules on interpretation of what can be considered a sustainable investment.

## CRD V and CRR II

Directive 2013/36/EU (CRD IV) and Regulation (EU) 575/2013 (CRR) are the backbone of the European regulatory framework for prudential supervision of financial institutions and prudential requirements for their activities. They are referred to collectively as the CRD IV framework. The main substance of CRD IV consists of increased capital and liquidity requirements made of financial institutions in accordance with the Basel III

standard. CRR was incorporated into Icelandic law in 2016, and in recent years, Icelandic legislation has been amended in increments to incorporate the provisions of CRD IV. In 2019, the EU approved amendments to the CRD IV framework with Directive 2019/878 (CRD V), Regulation (EU) 2019/876 (CRR II), and Regulation (EU) 2019/630 on non-performing exposures (NPE). The main amendments include the implementation of minimum stable funding requirements, a new standardised approach for calculation of counterparty risk, and changes in supervision of holding companies. The Ministry of Finance and Economic Affairs, with assistance from the Central Bank, has prepared a draft bill of legislation completing the implementation of the CRD IV framework, with subsequent amendments, which will presumably be introduced before Parliament at the autumn 2021 legislative session. Targeted amendments to the Act on Financial Undertakings have been in preparation as well, with the aim of empowering the Minister and the Central Bank to implement the NPE and CRR II regulations, as well as a few selected ancillary instruments whose entry into force by autumn 2021 is considered vital, and a bill of legislation to this effect has been introduced before Parliament.

## MMF

Regulation (EU) 2017/1131 will apply to all funds for collective investment, whether they are UCITS or AIFs. The main purpose of the regulation is to create a harmonised set of rules to ensure the security and reliability of money market funds, support the effective functioning of the money market, and ensure equal treatment of investors.

## EMIR Refit

Regulation (EU) 2019/834 amending Regulation (EU) no. 648/2012 (EMIR), commonly referred to as EMIR Refit, provides for amendments to rules on derivatives trading. The purpose of EMIR Refit is to address unequal compliance costs, transparency, and restricted access to central clearing. The amendments focus mainly on clearing obligations for small financial counterparties, which will now be subject to the same rules as apply to non-financial counterparties. Financial counterparties will be obliged to handle reporting for non-financial counterparties upon request. Furthermore, the obligation to report older derivatives contracts to the trade repository is suspended. The amendments are intended to simplify various requirements pertaining to derivatives trading, level the playing field, and reduce transaction costs without compromising transparency in the deriva-

tives market or reducing supervisory bodies' authority to monitor and intervene in connection with systemic risk. An implementing bill of legislation has been introduced before Parliament.

#### **PAD**

Directive 2014/92/EU concerns the comparability of fees related to payment accounts, switching of payment accounts, and access to payment accounts with basic features. The purpose of the directive is to promote transparency and competition, facilitate comparison of fees and switching of payment accounts, and encourage effective and smooth financial mobility for consumers. A bill of legislation implementing the directive is to be introduced before Parliament during the autumn 2021 legislative session.



