ANNUAL REPORT OF THE FINANCIAL SUPERVISORY AUTHORITY

2016

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THE FINANCIAL SUPERVISORY AUTHORITY, ICELAND

Annual Report – Financial Supervisory Authority 2016

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Contents of the Annual Report

The 2016 Annual Report of the Financial Supervisory Authority (FME) primarily addresses the period between 1 May 2015 and 30 April 2016. The report describes the main tasks of FME. Furthermore, it discusses the 2015 situation and developments on the credit market, securities market, pensions and funds market, and insurance market. The report will be published on FME's website in Icelandic and English. The website also contains various information on the financial market and the arrangement of official supervision of financial activities.

FME's Board of Directors and Management

A three-person Board of Directors is ultimately responsible for FME's administration. Its role is to define the priorities in FME's work and to monitor its activities and operations. All major decisions are to be referred to the Board for approval or rejection. The Board appoints a Director General responsible for FME's day-to-day administration. As of May 2016, the Board comprises Ásta Þórarinsdóttir, economist and Chairman of the Board, Guðrún Þorleifsdóttir, Director and Vice-Chairman of the Board, and Arnór Sighvatsson, Deputy Governor of the Central Bank who is appointed by the Central Bank of Iceland. Alternate members are Friðrik Ársælsson, solicitor, Ástríður Jóhannesdóttir, Manager, and Harpa Jónsdóttir, Deputy Director at the Central Bank of Iceland. During the period from 1 May 2015 to 30 April 2016, Tómas Brynjólfsson served on the Board of Directors of FME in addition to the above-mentioned.

FME Management

Unnur Gunnarsdóttir, Director General
Jón Þór Sturluson, Deputy Director General
Anna Mjöll Karlsdóttir, Chief Legal Counsel

Heads of divisions

Off-Site Supervision

Halldóra Elín Ólafsdóttir
Rúnar Guðmundsson, Deputy Director

Oversight

Sigurður Freyr Jónatansson, Acting Director

On-Site Inspections and Securities

Sigurveig Guðmundsdóttir

Operations and Finance

Ingibjörg Sigrún Stefánsdóttir

From the Director General

The cloak of secrecy has been stripped away, revealing concealed funds in various offshore and low-tax havens. The impact has been wide reaching, both domestically and internationally. We have experienced a second shock, resembling an aftershock, from the collapse of the banks. The reputation of Iceland has again suffered abroad. However, this has resulted in the nation becoming more aware of the social responsibility of each and every citizen. The international community has held conferences on corruption and anti-corruption measures and people have discussed the need to change the prevailing rules and values by requiring transparency and mutual exchange of information on the beneficial owners of funds, wherever they are held. These issues have been highlighted by the publication of the Panama Papers resulting in the timely discussion of the necessity of legislation and morality complimenting each other.

Companies in the financial market are not perceived to be trustworthy. The same is true of public bodies involved with the market. It goes without saying that trust must be earned. And, the trust must be both real and perceived. Activities that cannot survive the light of day cannot be deserving of trust. Therefore, transparency and honesty is a fundamental feature in building and maintaining trust. Most of the companies regulated by FME are public-interest entities that are under stricter obligations by law due to their importance to the national economy. Their importance relates to reliability in services rendered to customers and to the systemic importance of financial stability. These activities, which are in the public interest, are risky by nature and involve various moral hazards for both managers and staff. Which is why they have such stringent legal and regulatory obligations and why a strong and independent body must conduct their supervision.

We are at the outset of a new era. Even though the financial system has been characterised by a certain stability since the restructuring following the collapse, which seems to be changing. Capital controls will be lifted completely in the near future and subsequently we can expect foreign parties to increase their investments in Iceland and for Icelandic parties to make substantive foreign investments again. Two of the three largest commercial banks are currently state owned and the Treasury also has a substantial interest in the sale of the third. If everything goes to plan, they will each be sold in the near future, either as a whole or in part. The pension funds hold domestic mandatory savings that are greater than ever before, approximately 155% of domestic product, and will increase further in the coming years and decades. Therefore, the pension funds have now become prominent owners of listed and unlisted companies, direct lenders to individuals and generally important investors. The Icelandic Parliament, Althing, is currently discussing draft legislation that will transform insurance companies' operational criteria. Furthermore, activity on the markets for registered shares and bonds has improved. Increased legal and regulatory obligations on the operations of financial companies restrain smaller companies. That also applies to their ability to provide consumer services that larger companies can provide, such as Internet banking and automated teller machines. These issues require targeted work by public authorities on the future structure of the financial system.

We are also on the cusp of a new era culturally. The technological development of financial services is very rapid which can result in new and unforeseen entities taking over parts of the services offered by regulated and licensed traditional companies. Companies in the financial market have started collaborating with public authorities on measures to promote public financial literacy. The financial literacy of the customers of entities regulated by FME is directly correlated with sound business practices and financial stability and FME will, therefore, emphasise financial literacy to a greater degree than before. Well informed consumers provide wider and stronger discipline for both the accessibility of financial services and its pricing. There is an increased call for sound governance and corporate social responsibility on the financial market that leads to a clearer definition of the role and responsibility of board members.

FME supervision of individual regulated entities takes, among others, the form of an assessment of operational risk factors and an assessment of the soundness of business practices as FME is empowered by law to mitigate risk or require corrective measures. Supervisory updates include increased dialogue between the Authority and external auditors and increased supervision of financial undertakings' governance in accordance with new legal provisions. FME has furthermore established a policy on the application of measures for enforcement and sanctions. Act No 58/2015 provides for substantive changes in FME's powers to impose administrative fines and the fine can now amount to a maximum of ISK 800 million or up to a maximum of 10% of the company's overall turnover, while the maximum fine for individuals can amount to ISK 65 million.

In addition, FME has now been tasked by law, in conjunction with CBI and the Ministry of Finance and Economic Affairs, with analysing and assessing market stability and taking corrective action should the stability be threatened. The year 2015 was the first full year of operations for the Systemic Risk Committee and the Financial Stability Council. This has formalised and strengthened macroprudential collaboration. By a Decision on 1 March 2016, FME imposed three different capital buffers on financial undertakings for the first time, on the basis of a recommendation by the Financial Stability Council and provisions in Act No 57/2015 amending the Act on Financial Undertakings.

FME's participation in the three European Supervisory Authorities, EBA, EIOPA, and ESMA (ESAs), will change if Althing supports the arrangements resulting from an agreement concluded by the Commission and officials of the EEA-EFTA States. The changes involve FME gaining full membership in the Authorities' activities, without voting rights. According to the agreement, the EFTA Surveillance Authority will be entrusted with making binding decisions, in certain cases, with respect to the supervisory authorities and market participants in the EEA-ETA States. In this case, it will be as if a dam bursts and a total of 31 European acts will be transposed into the EEA Agreement, requiring speedy transposition into Icelandic legislation while showing due care. Harmonising the domestic and European legal framework must be considered to be of great importance for the Icelandic financial system.

Above, the principal issues relating to major news and developments for the financial system and FME's supervision have been broached. The challenge to rebuild trust remains. Baron Munchausen once used an unusual method when he got stuck in a mire on his horse. He decided to pull up his own hair with one hand to lift both himself and the horse out of the mire. Unfortunately, we have no such easy solutions to regain trust since it must be earned with both real and perceived integrity. Let us all remember that 'in the end those who do their best, do well'.

FME Board of Directors

In the bottom row, seated from left to right: Guðrún Þorleifsdóttir, Vice-Chairman, Ásta Þórarinsdóttir, Chairman of the Board, and Arnór Sighvatsson, Board Member. In the top row, standing from left to right: Friðrik Ársælsson and Ástríður Jóhannesdóttir, alternates on the Board, with Harpa Jónsdóttir who is missing from the photo.

The Act on Official Supervision of Financial Activities defines the role of FME's Board stating: 'The Board of the Financial Supervisory Authority is composed of three members, appointed by the Minister for a term of four years at a time. The Central Bank of Iceland (CBI) shall nominate one member of the Board. Alternates shall be appointed in the same manner. The Minister appoints the Chairman of the Board and decides on the remuneration of the members of the Board.

The role of the Board is to specify the points of emphasis in the work of the Financial Supervisory Authority and oversee its activities and operations. Major decisions shall be referred to the Board for approval or rejection.'

The 2012 rules on the activities of the FME's Board address the Board's role in more detail. They detail, among other things, the division of duties between the Board and Director General, the Board's role, the Board's decisions in major cases, Board members competence and confidentiality. Furthermore, they address Board meetings, how often they should be held and how they are organised.

The Board met fifteen times in 2015. Examples of the Board's tasks during the year include seven adverse decisions relating to eligibility, administrative fines, filing a police report, and the acquisition of a financial undertaking. The Board also adopted five rules, six guidelines and granted two operating licenses.

Kristján Friðriksson
Security officer at FME and fisherman

‘It all began at the age of 6 when I ran away from my mom and rode west to Ölfusárós. Today, the other woman in my life takes me fishing every chance we get. I am surrounded by the paradise of lake fishing all year round.’

1. FME's Activities

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1.1 Supervisory activities

On-site inspections

On-site inspections in 2015 were conducted in accordance with FME's policy on risk-based supervision. Therefore, inspections at the largest commercial banks carried the most weight. The purpose of On-site inspections is to conduct inspections and gather data on individual aspects of the activities of regulated entities at their place of business.

During the year, an inspection was completed on the banks' compliance with their own lending rules for granting new loans to legal persons. The inspection included a review of lending to hotels, as investments in the sector have been substantial in recent years.

An inspection was conducted into the valuation of the loan portfolio of Islandsbanki hf. including a thorough review into how the bank values individual loans and whether the valuation was in accordance with the bank's rules. The inspection covered 11.5% of the book value of corporate loans.

Two inspections involved large exposures. The inspection at Kvika banki hf. was into whether the bank meets the requirements of risk exposure mitigation while the inspection at Landsbankinn hf. was into the bank's internal control mechanism for large exposures.

The systems for securities and pledges at the largest commercial banks were reviewed in order to confirm the systems' functionality and filing, and the filing procedures were inspected as well. During the year, FME examined the scope of concessions to applicable contractual terms for the largest commercial banks' loans. The objective of the examination was to assess the scope of concessions and whether the bank fulfilled its obligations for registration, supervision, and reporting to FME.

Examinations at the largest commercial banks involved the banks' supervision and compliance with the Act on Measures Against Money Laundering and Terrorist Financing. A particular focus was on the review of due diligence at the beginning of business, whether periodic monitoring followed, and whether updated information had been gathered on the customers.

In the previous year, FME commenced an examination into the loan portfolio of Sparisjóður Suður-Þingeyinga ses. (Suður-Þingeyingar Savings Bank) which was concluded in early 2016. The examination was focused on reviewing the savings bank's loan portfolio quality, in particular whether the savings bank, as a rule, had enough collateral for its lending. Furthermore, the savings bank's rules on lending and loan monitoring were reviewed thoroughly. In addition, FME commenced similar examinations at Sparisjóður Austurlands hf. (Austurland Savings Bank), Sparisjóður Höfðhverfinga ses. (Höfðhverfingar Savings Bank), and Sparisjóður Strandamanna ses. (Strandamenn Savings Bank) that are expected to conclude in the first half of 2016.

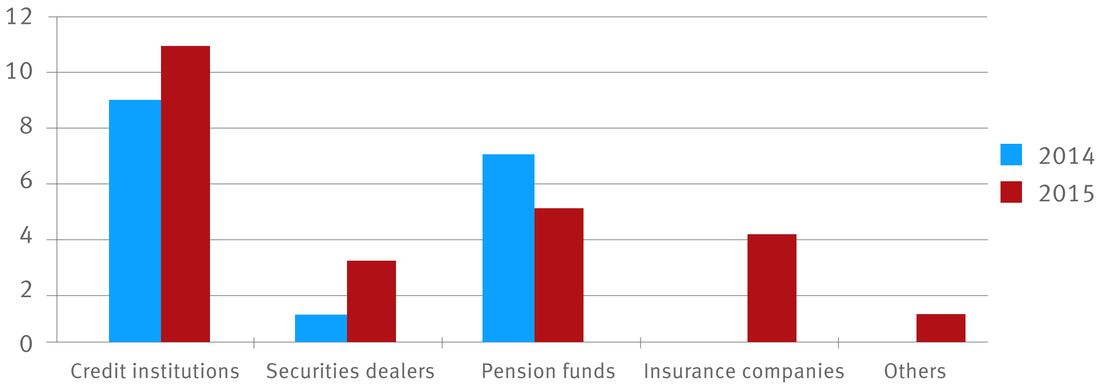
At the insurance companies, the claims process for motor vehicle liability insurance was examined with a focus on each company's internal processes, rules, and practises from when the notification of damage was received and until the company concerned closed the case, independent of the final results. The processing time for the handling of damages was also reviewed. Special attention was given to issues of consumer protection during the examinations.

During the year, examinations of the pension funds' risk management were concluded. The examinations involved risk-management implementation and compliance with guidelines on risk management (monitoring mechanism) for mutual insurance divisions of pension funds. The examinations were conducted at Gildi lífeyrissjóður (Gildi Pension Fund), Lífeyrissjóður bankamanna (Bank Employees' Pension Fund), Lífeyrissjóður starfsmanna sveitarfélaga (Pension Fund for Municipal Employees), Lífeyrissjóður verzlunarmanna (The Pension Fund of Commerce), and Sameinaði lífeyrissjóðurinn (The United Pension Fund).

Conclusions of FME's on-site examinations are published on FME's website in accordance with the Authority's transparency policy. A summary of FME's transparency notifications during the period covered by the annual report can be seen on pages 60-61.

The number of concluded examinations in 2015 is shown below by type of regulated entity. For reference, the number of concluded cases in 2014 is also shown. The numbers only reflect concluded cases and not the higher number of pending cases commenced in 2015.

Figure 1 The number of concluded on-site inspections in 2014 and 2015, by type of regulated entity



Financial supervision and other examinations

The Supervisory Review and Evaluation Process (SREP) for the three large commercial banks is undertaken annually in a continuous process and the results are presented to the boards of the banks at the end of the process. As part of the SREP, FME assesses the risk factors inherent in banking activities and how the banks treat those risk factors. The process further involves FME assessing and deciding the amount and composition of the necessary additional own funds due to the risks the bank in question faces, or could face, as well as the minimum capital requirement. SREP includes a review of the banks' reports on their internal assessment for capital adequacy due to risk endured from their activities (ICAAP). The purpose of the Internal Capital Adequacy Assessment Process is to ensure that the bank concerned analyses, assesses, and monitors risks inherent in its activities, that it has sufficient own funds in accordance with the bank's risk policy and that it implements sound risk management.

One of FME's tasks in the supervision of financial undertakings has been the introduction of a new data-reporting file format (XBRL). The introduction involves extensive permanent changes to data reporting to FME. Parallel reporting is required during the adjustment period and the new reporting has been assessed with reference to applicable requirements.

FME's largest project in the supervision of insurance activities has been the preparation for the transposition of the Solvency II Directive. Tasks include the above-mentioned XBRL data delivery, a review of the insurance companies Own Risk and Solvency Assessment (ORSA) and participation in a Working Group under the aegis of the European Insurance and Occupational Pensions Authority (EIOPA) in relation to a supervisory handbook for European insurance supervision. Furthermore, FME has reviewed whether the insurance companies price policyholder premiums in accordance with the risk and cost of providing the insurance in question. The companies' operational risk has been reviewed as well as their business models and related risk exposure.

FME has expanded the dialogue with external auditors of financial undertakings and now holds regular biannual meetings with the auditors at the beginning and end of each audit. The first meetings were held leading up to the audit of the banks' annual accounts for 2015. These communications are consistent with Guidelines No. 4/2015 on the Dialogue Between FME and External Auditors for Regulated Entities that are also Public-Interest Entities.

FME has, conforming with risk-based supervision, emphasised reviewing the pension funds' governance, operational risk, market risk, and credit risk. Numerous examinations were conducted to take account of the above-mentioned risk assessment. For example, the existence of written processes for tasks such as investments, employee securities transactions, authorisations, and signatures were confirmed as well as compliance to those processes. Pension fund lending was reviewed with an emphasis on confirming whether that lending complied with lending rules. Furthermore, lending defaults and the related collection process were reviewed. Many pension funds outsource a large part of their remit to other entities and therefore a decision was made to review their outsourcing. It was examined whether the agreements were in compliance with guidelines on outsourcing activities as well as whether a person had been appointed within the fund to monitor the sufficient execution of the outsourced tasks. Furthermore, the pension funds' governance was examined, in particular with regard to how well the boards of the funds carried out their supervisory function.

Information, whose publication is obligatory on the websites of securities companies, was examined specifically and comments were made as a result.

In December last year, FME sent a circular to financial undertakings on the presentation, publication, and delivery of key information to investors in mutual and investment funds With the circular, FME sought to emphasize the importance of key investor information for comparison purposes in deciding on investments in mutual or investment funds. The Authority's review of the websites of fund management companies and other financial undertakings that market mutual and investment funds has shown, as is set out in the circular, that the key information is not always given the importance as an information document that is intended by law.

In December 2015, FME sent a circular to fund management companies reaffirming the rules that apply to notifications to the Authority when the investments of a mutual or investment fund exceed the authorised investment limits pursuant to Article 43 Act No 128/2011, on UCITS, Investment Funds and Institutional Investor Funds.

FME conducted a review of the disclosure of the insurance brokers company Tryggja ehf. to its consumers. The examination resulted in a censure for several issues with the disclosure that were found not to conform to Chapter VI of Act No 32/2005 on Insurance Intermediation.

An independence examination was carried out at fund management companies. Two companies where censured which resulted in them making changes. Furthermore, a specific examination was carried out on the authorised activities of management companies.

FME does not monitor International Financial Reporting Standards (IFRS), however, in light of the Authority's expertise it offers certain guidance in the interpretation of the standards. Work is currently underway on the adoption of IFRS 9 on financial instruments, that addresses, among other things, new methods for the valuation of lending. Changes are also planned in IFRS 4 on insurance contracts.

FME's supervision of financial undertakings undergoing winding-up proceedings as a result of the collapse mostly concluded in early 2016 when the winding-up proceedings for all but two of the financial undertakings, Landsvaki hf. and Saga Capital hf., had concluded.

Follow-up to the International Monetary Fund's assessment from 2014

During 2014, the International Monetary Fund (IMF) completed its assessment of FME's compliance with the 29 Basel Core Principles on Effective Banking Supervision.

The assessment is based on the 2012 revised core principles issued by the Basel Committee on Banking Supervision that include an increased emphasis on the systematic assessment of risk factors and improved supervision of financial undertakings as a result of weaknesses that were revealed by the collapse of the financial markets in 2007 and 2008.
The recommendations for corrective action in the IMF assessment concerned aspects of FME's activities and as well as aspects concerning governance infrastructure including FME's statutory powers. The recommendations comprise five categories:

- Corrective actions requiring amendments to law
- Issuance of rules/guidelines addressing regulated entities concerning various risk factors in their activities
- That the implementation of risk-based supervision be concluded
- That FME adopt more detailed internal operating procedures concerning principles of supervision of specific risk factors in the activities of regulated entities
- That FME continue developing a policy of continuing education and human resources with the objective of encouraging employees' professional growth and that the Authority retain employees

Following the assessment, and in accordance with its results, an action plan on corrective action was implemented. Regular work on the rectifications is ongoing and should mostly finish by year-end 2016.

Applications for competence assessment, qualifying holdings, and licensing

In 2015, FME received numerous notices of new board members and managing directors and assessed their competence.

FME assesses the competency of entities that intend to acquire qualifying holdings in financial undertakings and insurance companies. A qualifying holding means a direct or indirect participating interest in a company that amounts to 10% or more of share capital, guarantee capital, or voting rights or allows the entity to assert significant influence on the management of the company in question. During 2015, the Authority dealt with a number of changes in ownership interests of companies including notifications from the Icelandic Treasury on qualifying interests in Islandsbanki hf., Borgun hf., Íslandssjóðir hf. (IS Funds), Summa rekstrarfélag hf., Lýsing hf., Sjóvá-Almennar tryggingar hf. (Sjova-Almennar Insurance hf.), and Sjóvá-Almennar líftryggingar hf. The above-mentioned changes in ownership interest result from the stability contributions of financial undertakings undergoing winding-up proceedings.

FME granted two companies collection licenses in 2015. One was granted to T-9 ehf. in September and the other to Premium ehf. in October. Furthermore, GAMMA Capital Management hf. was granted an extended operating license in September and Fossar Markets hf. in June and November 2015. In April 2016, Icelandic Investors Ltd. was granted an extended operating license.

In 2015, mergers of financial undertakings were common and they are subject to FME approval. In March, for instance, FME made a decision on the merger of Sparisjóður Vestmannaeyja (Westman Islands Savings Bank) with Landsbankinn hf. In addition, the Authority approved the merger of Straumur Investment Bank hf. and MP Bank hf. (now Kvika banki hf.) in June, the merger of Sparisjóður Norðurlands ses. (Nordurland Savings Bank) and Landsbankinn hf. in September, and the merger of AFL Savings Bank ses. with Arion Bank hf. in October. In March 2016, FME lastly approved the merger of H.F. Verðbréf hf. and Arctica Finance hf.

Applications for increasing the amounts of covered bonds issued by commercial banks have been processed.

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

One of FME's main tasks is assessing individual operational risk factors in the activities of regulated entities. The risk is graded on a scale of 1-4, which forms the basis of the overall risk-profile. Specialists in individual risk factors are involved in the risk assessment and it has now become a regular part of FME's activities.

Analysis and assessment of individual risk factors

Business model

The analysis of a business model involves an assessment of factors that are considered to constitute a threat to the viability of the current business model and the sustainability of the business strategy. The business strategy is analysed and reviewed in terms of the risk appetite and the operational results of the preceding years. The operational and economic fundamentals are assessed to ascertain whether they are sufficiently clear and viable.

Governance and internal control

An assessment of governance and internal control involves surveying whether the regulated entity meets the requirements made of governance and internal control and whether an appropriate and cohesive system is in place for governance, risk management, and internal control in terms of the degree of risk, nature, scope and activities of the entity. The assessment of governance and internal control considers whether the governance and internal control pose risk and impact viability. The assessment involves governance and internal structure, corporate and risk culture, the composition and the activities of the board, corporate bonus plans and remuneration policies, risk management, internal control, contingency plans, and IT infrastructure.

Credit, counterparty and concentration risk

Credit risk is the risk of loss from the borrower not fulfilling his or her obligations to the lender, e.g. not paying his or her loans in accordance with the agreed terms. Counterparty risk is the risk of loss where the counterparty in derivative trading, securities lending, or repurchase agreements does not fulfil his or her obligations in accordance with the agreed terms. Concentration risk is the risk of loss due to insufficient distribution of the loan portfolio and comprises single name concentration and sector and geographic concentration.

FME emphasises the underlying risk and risk management when assessing lending and counterparty risk. The assessment includes reviewing the loan portfolio composition, defaults and their treatment, writedowns, and methodology as well as risk mitigation and risk management. For the assessment of concentration risk, FME reviews risks resulting from a low number of exposures or exposures that behave in a similar manner with regard to defaults and control. The assessment involves an analysis of the potential correlation of exposures, in particular under stress. The concentration factors that are reviewed specifically during the assessment are, sectoral concentration and concentration of activities either in Iceland or other areas, concentration of product offerings, and concentration of securities and guarantees.

Market risk

Market risk is the risk of loss from the value of financial instruments that results from adverse changes in the underlying market factors. FME assesses the underlying market risk of regulated entities and its management, both for the trading book and the banking book. In the case of financial undertakings, FME uses its own criteria to assesses the following sub factors that are, among other things, based on sensitivity and Value-at-Risk analysis in compliance with guidelines:

- Interest rate risk,
- Equity risk,
- FX risk, and
- Inflation indexation risk

Due to the increased size of the pension funds, it is not sufficient to monitor whether they remain within the authorised investment limits, the systemic market risk must be monitored as a whole. The scope of those tasks has been expanded and Althing (the Parliament) is currently discussing a draft that increases the requirements on the pension funds' risk management.

Solvency II will repeal a regulation on authorised investment limits in relation to assets covering technical provisions and replace it with the so-called prudent person principle. That rule stipulates that insurance company managers shall be duly prudent in their investments and that FME is required to assess the prudence independently. FME has prepared to operate on this basis.

Fixed interest rate risk

Fixed interest rate risk is the risk of impairment in the present value of net interest-bearing assets and liabilities in the banking book due to adverse changes in interest rates on the market. FME assesses the underlying risk of fixed interest rates and the quality of the management of fixed interest rate risk. A review is conducted on the impact of shifting the appropriate yield curves symmetrically up and down in maturity in accordance with guidelines. The impact of these yield shifts on the present value of interest-bearing asset and liabilities in each currency forms the basis of FME's risk assessment for this risk factor.

Operational risk

Operational risk is the risk of financial damages due to unacceptable internal processes, systems, and employee mistakes or due to external events. FME assesses the underlying operational risk with an emphasis on compliance risk, conduct risk, legal and political risk, information technology risk, and reputational risk as well as the entities management of the risk.

Liquidity and funding risk

FME's assessment of liquidity and funding risk is based on three factors, (1) an assessment of the control and monitoring of liquidity and funding risk, (2) an assessment of the underlying liquidity risk, and (3) an assessment of the underlying funding risk. The assessment of the control and monitoring of liquidity and funding risk includes a review of liquidity policy and liquidity thresholds, analysis, measurement, management and monitoring of risk disclosure, stress tests, contingency plans, and financing plans.

The assessment of the underlying liquidity risk includes an assessment of short and medium term liquidity needs, intraday liquidity risk, liquid financial assets and the discretion for retaliatory action, and supervisory stress tests of liquidity risk.

The assessment of the underlying funding risk includes an assessment of the funding composition, threats to financial stability due to funding composition, market access and expected changes in funding risk relating to financing plans.

Pension insurance risk

Pension insurance risk is the risk of a pension fund underestimating its assets during an actuarial assessment. A pension fund actuary conducts the assessment of the obligations and bases it on a probability-weighted assessment and the present value of payments in accordance with the benefits the pension fund has promised its participants.

This risk factor mainly considers the impact of demographic factors on the pension fund obligations. FME monitors the development of these factors and assesses the impact of their changes on the position of the pension funds.

Insurance risk

Insurance risk is all risk related to the issuing of insurance contracts. The assessment of technical provisions, under the responsibility of the actuarial function, is a part of insurance risk. FME monitors the trend and assessment of the technical provisions. Insurance risk also involves the risk of premiums not covering obligations and the pricing of insurance contracts is an important risk management tool. Lastly, catastrophe risk is the risk that an insurance company will have to make payments due to catastrophes for which being covered by proper reinsurance protection is important.

A special macroprudential team operates within FME on analysing systemic risk in close collaboration with CBI. The collaboration with CBI includes, among other things, commercial bank stress testing. The macroprudential team prepares the four annual meetings of the Systemic Risk Committee in collaboration with CBI.

On 1 March 2016, FME decided that specific financial undertakings should maintain capital buffers for systemic risk, capital buffers for systemically important financial undertakings, and countercyclical buffers in accordance with recommendations from the Financial Stability Council. In addition to the three above-mentioned capital buffers, Act No 161/2002 on financial undertakings provides for capital conservation buffers, which does not require FME to make a specific decision. The capital buffers concerned will enter into force in the near future, as detailed on FME's website. The capital buffers are a part of so-called macroprudential tools that have been developed internationally and are intended to improve the resiliency of the financial system.

A proposal in a draft bill on consumer mortgages being discussed by the Economic Affairs and Trade Committee would authorise FME to apply a new macroprudential tool to limit the consumer mortgage leverage. In that context, it is important to monitor real estate developments and borrowing rates for real estate acquisition.

Securities Market Supervision

In 2015, 42 cases were reviewed for violations of securities market legislation. The examinations of 21 cases resulted from comments made by Nasdaq Iceland while FME commenced examinations of 21 cases on its own initiative or as a result of comments made by other entities than Nasdaq Iceland. 23 cases have been concluded without any action, 3 cases were forwarded to the FME research team, 3 cases were concluded with sanctions, and 13 cases are still pending when this is written in May 2016. Most of the cases involve possible violations of issuers' disclosure requirements (publishing inside information), flagging rules, insider dealing, and market manipulation.

On 8 June 2015, FME decided to temporarily suspend trading with most financial instruments that were either issued by the Treasury or were government backed. Trading was also suspended in insurance company shares and other funds that held a large interest in government bonds. The decision to suspend the trading concerned was made after consultations with representatives from the Ministry of Finance and Economic Affairs, Nasdaq Iceland, CBI and others. The purpose of the suspension was to safeguard investor equality as the Prime Minister and the Minister of Finance presented a plan to lift the capital controls.

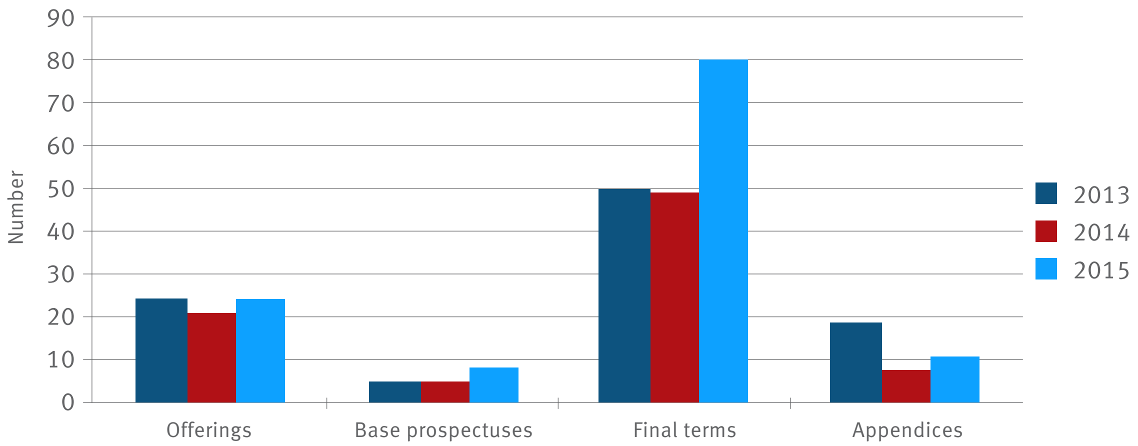
FME considered it essential to suspend the trading to safeguard market equality in light of the fact that the above-mentioned plan had been presented to multiple individuals. The trading was resumed later in the same day.

Steven Maijoor, full-time Chair of the European Securities and Markets Authority (ESMA), visited FME on 20 August 2015 and met with managers of the Authority and its employees briefed him on the Icelandic financial market and supervisory priorities for the securities market. In addition, Steven Maijoor met with representatives of CBI, the Icelandic Financial Services Association, Nasdaq Iceland, the Ministry of Finance and Economic Affairs. FME held an open information meeting in connection with the visit of the Chair to address developments in the securities market. At the meeting, Steven Maijoor presented the priorities of ESMA and an employee of FME discussed the EMIR regulation and its impact in Iceland.

During the winter 2015-2016, an examination was concluded of the separation of functions at the three large banks and four smaller financial undertakings. Employees of Securities Market Supervision participated in the examination with FME employees of On-site examinations. The scope of the examination was wide and it touched on multiple issues relating to the separation of functions and possible conflicts of interest including the access authorisations of financial undertakings' employees to electronic documents, the managing directors' participation in the activities of certain divisions, the physical separation of functions and many other issues. In addition, Securities Market Supervision has commenced other narrower examinations in the preceding months and years that concern various aspects of the securities market, including best practises in securities trading, nominee registration, public investment advice and other aspects.

FME's tasks include a review and confirmation of prospectuses for financial instruments. In 2015, a total of 24 prospectuses were confirmed, 3 equity prospectuses and 21 bond prospectuses. The confirmed appendices to the prospectuses totalled 11. During the year, 4 base prospectuses and 80 final terms were published on FME's website. The number of final terms reflects, among other things, the increased issuance of bills and covered bonds by the three commercial banks.

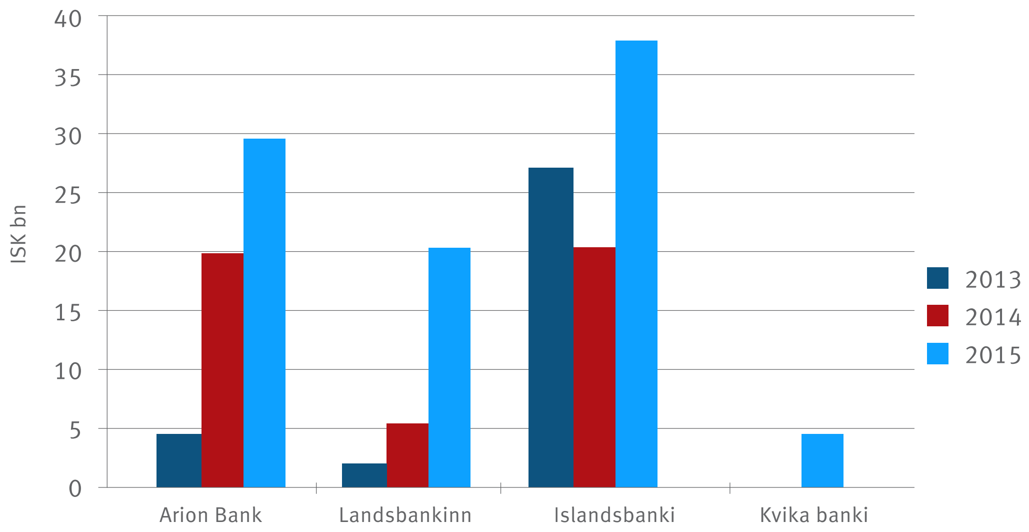
Figure 2 Confirmations of prospectuses



The monetary amount of the banks issuance of securities admitted to trading at the main market of Nasdaq Iceland has increased year-on-year. The increase was 36% between 2013 and 2014 and then surged between 2014 and 2015 and increased by 103%, going from almost ISK 46 billion to almost ISK 93 billion. The majority of the issuance has been in the form of covered bonds and covered proportion of the issuance was 67% of the total issuance in 2015. The issuance of Kvika banki, in the amount of ISK 4.5 billion, is included in the figures for 2015.

Figure 3 shows the breakdown of securities issues between the banks. In 2015, Islandsbanki issued 41% followed by Arion Bank that issued 32%.

Figure 3 Bank issuance of securities



FME participates in supervisory collaboration with the Nordic Nasdaq stock exchanges that operate trading venues in Iceland, Denmark, Sweden, and Finland. The collaboration takes place in a supervisory college that meets 3-4 times per year and conducts periodic examinations of the operation of the stock exchanges. A recent example is a cyber security examination of the stock exchanges.

1.2 Sanctions and regulation

Sanctions

On 1 October 2015, FME's policy on the application of measures for enforcement and sanctions was adopted. Pursuant to the policy, FME will react in a strong and targeted way to violations of laws or regulations, including those that relate to sound and proper business practices, and infringement of the Authority's decisions. The Authority will apply measures for enforcement, sanctions, including administrative fines, and, where applicable, reassess the competency of regulated entities' directors and board members. The policy further states that in the case of an offence FME intends to conclude the case with an amicable settlement if the litigant requests such a conclusion and subject to compliance with settlement requirements. However, it is noted that cases with major violations that are subject to criminal penalties cannot be settled amicably. An amicable settlement requires the litigant to admit infringement of law, rules, or FME decisions, paying a specified fine determined by FME, and, where applicable, subscribing to other terms stipulated by FME. The amount of the fine in amicably settled cases could be as low as half the administrative fine, with the reduction being based on the stage of the proceedings when the settlement is concluded. The policy is available on FME's website.

During the period 1 May 2015 to 30 April 2016, FME agreed to settle three offences amicably. The first case involved a litigant's infringement of Article 3 of Act No 95/2008 on Debt Collection for conducting collection activities on others behalf without a collection license. The settlement provided for the litigant to pay a fine in the amount of ISK 2,375,000. The second case involved the infringement of BankNordik of Articles 126 and 127 of Act No 108/2007 as the company contravened the provisions twice by firstly not disclosing information on trading by a primary insider or a related entity as early as possible and on equivalent terms and secondly by not notifying FME of the trade within the requisite deadline. The settlement provided for the company to pay a fine in the amount of ISK 1,800,000. The third case involved the infringement of Ríkisútvarpið ohf. (The Icelandic National Broadcasting Service) of Article 128 of Act No 108/2007 on Securities Transactions as the company contravened the provision by not submitting lists of primary insiders and entities financially connected to insiders validly and within due time. The settlement provided for the company to pay a fine in the amount of ISK 800,000.

During the period 1 May 2015 to 30 April 2016, four cases related to offences were concluded by imposing administrative fines. The first case involved the infringement of Arion Bank hf. of Article 123(1)(1) of Act No 108/2007 on Securities Transactions as the bank contravened the provision by selling the bank's equity shares in Hagar hf. at a time when the bank possessed inside information regarding the company. The Board of FME decided to impose an administrative fine on the bank for the violation in the amount of ISK 30,000,000. The second case involved the infringement of a litigant of Article 1(2) of Act No 32/2005 on Insurance Intermediation as the litigant contravened the provision by conducting insurance mediation for more than 13 months without the requisite operating license. The Board of FME imposed an administrative fine on the litigant for the violation in the amount of ISK 2,500,000. The third case involved the infringement of Kópavogur Municipality against Article 122(1) of Act No 108/2007 on Securities Transactions as the municipality contravened the provision by not disclosing inside information as early as possible and on equivalent terms. The Board of FME decided to impose an administrative fine on Kópavogur Municipality for the violation in the amount of ISK 3,000,000. The fourth and last case involved the infringement of Almenni lífeyrissjóðurinn (Almenni Pension Fund) of Article 123(1)(1) of Act No 108/2007 on Securities Transactions as the pension fund contravened the provision by acquiring bonds in a specific bond class at a time when the pension fund possessed inside information regarding the bond class. The Board of FME imposed an administrative fine on the pension fund for the violation in the amount of ISK 18,000,000.

Lastly, note that with Act No 58/2015, that came into force on 16 July 2015, substantive changes were made to FME's powers to impose administrative fines in Acts No 161/2002 on Financial Undertakings, No 108/2007 on Securities Transactions, No 128/2011, on UCITS, Investment Funds and Institutional Investor Funds, No 131/1997 on Electronic Registration of Title to Securities, and No. 110/2007, on Stock Exchanges. The principal change according to the Act is that the maximum amount of administrative fines imposed on legal entities can now amount to ISK 800 million, or up to 10% of overall turnover according to the most recent approved annual accounts or consolidated annual accounts, subject to certain conditions. The maximum amount of administrative fines imposed on individuals can now amount to ISK 65 million, instead of the previous ISK 20 million. In addition, the financial benefit can now be taken into consideration in determining the administrative fine. The provisions of Act No 58/2015 apply infringements committed after its entry into force.

Transposition of legal acts

During the year, work was conducted relating to FME's participation in the implementation of legal acts in connection with Iceland's membership in the European Economic Area (EEA). The legal acts concerned are regulations, directives, technical standards, and guidelines. FME's role mainly involves summarising and researching the content of the requisite legal acts to be implemented on Icelandic financial markets, drafting implementing rules and guidelines, in addition to providing expert advice to the Ministry of Finance and Economic Affairs for drafting bills and regulations.

During the year, substantial work was carried out on the transposition of large acts, in particular the CRD IV/CRR Directive and Regulation[1], the Solvency II Directive, and various acts relating to the securities market.

Act No 57/2015 amending Act No 161/2002 on Financial Undertakings, which came into force in July 2015, transposed provisions on capital buffers into Icelandic legislation in compliance with the CRD IV Directive. According to Article 84a of the Act on Financial Undertakings, in addition to the minimum own funds, a financial undertaking shall maintain capital buffers as provided by Articles 84b - 84e of the Act. In March 2016, a draft bill was submitted to Althing to amend Act No 161/2002 to transpose the provisions of the CRR Regulation into Icelandic legislation.

In recent years, work has been carried out on the transposition of the Solvency II Directive, which is a new framework for the insurance market that entered into force in the EU on 1 January 2016. The regulatory framework comprises the Solvency II Directive adopted in November 2009 and amended by Directive 2014/51/EU, the so-called Omnibus II Directive, and a Delegated Regulation adopted by the European Commission in October 2014. The Regulation provides further clarification on various issues relating to Solvency II. In short, Solvency II stipulates more stringent requirements for the solvency and risk management of insurance companies with a view to increase the protection of insurance policyholders and that the possibility of consumer losses or market interruptions will be reduced by the more stringent requirements. In December 2015, a draft law was submitted to Althing on insurance activities. The new laws will supersede applicable laws on insurance activities and, in addition, transpose the provisions of the Solvency II Directive.

In recent years, preparations have been carried out on the transposition of a number of EU Regulations and Directives on the securities market into Icelandic law and regulation. This work is expected to conclude in the next two years with the enactment of law and laying down rules. The following acts are noted as an example and further clarification of their content is available on FME's website.

- Regulation (EU) No 648/2012 on OTC derivatives[2], central counterparties and trade repositories (European Markets Infrastructure Regulation - EMIR)
- Regulation (EU) No 236/2012 (The Short Selling Regulation – SSR)
- Regulation (EU) No 909/2014 (Central Securities Depositories Regulation - CSDR)
- Regulation (EU) No 596/2014 (Market Abuse Regulation - MAR)
- MiFID II / MiFIR (Markets in Financial Instruments)

The above-mentioned regulations and directives on credit, insurance, and securities markets imply a number of new and permanent supervisory tasks for FME. Extensive preparation is currently being carried out for that purpose. The primary updates are being mapped and their impact is being analysed, as the changes concerned are substantive. Each regulation and directive comes with numerous technical standards clarifying specific provisions or specifying reference templates/forms. Account must also be taken of whether these new provisions contravene current laws and rules. Furthermore, new IT systems need to be considered as the requirements have been increased for reporting and systems, for both market participants and FME.

At the beginning of 2015, FME issued Rules No 335/2015 on Annual Accounts of Pension Funds that included amendments on valuation methods, amendments to the presentation of annual accounts and more stringent disclosure requirements on pension fund fees and expenses than had been provided for by previous rules. All pension funds are required to disclose more detailed information on fees and expenses related to their activities in 2015, the adjustment period is longer for other requirements provided for by the rules. During the year, FME also issued Rules No

1 Directive 2013/36/EU and Regulation (EU) No 575/2013.

2 Derivatives that are not exchange traded as defined in Article 4(1)(14) of Directive 2004/39/EC (MiFID).

1060/2015 on Annual Accounts of Mutual and Investment Funds that provide for more detailed disclosure to holders of unit share certificates. FME also issued Rules No 1270/2015 on maximum distributable amount and limitations on financial undertakings' distributions related to capital buffers, that limit financial undertakings' distributions for bonus plans and/or dividends, if they do not meet requirements for maintaining capital buffers. Furthermore, work was carried out on drafting a bill on alternative investment funds (AIFMD).

During the year, five guidelines were issued on various subjects, which is less than in the preceding year when seven guidelines were issued. Note that FME's website contains a summary of legal acts, by year issued, resulting from the Authority's work.

In addition, work was carried out on guidelines on the internal governance of financial undertakings, that draft is under review as of this writing. In July 2015, FME's criteria were published for the valuation of individual transferable quotas (ITQ) relating to lending and the draft of FME's criteria and methodology for the supervisory review and evaluation process is currently under review.

The supervision arrangement for financial services and participation in regulatory bodies

FME has taken part in the conclusion of an agreement between the EFTA States and the EU on the EEA financial services supervision regime and on the participation of EEA-EFTA States in the European Supervisory Authorities for the financial sector, EBA, EIOPA, and ESMA (ESAs). In 2014, an agreement was concluded in this regard that provides for full membership without voting rights in the ESAs and accordingly FME will take a seat on the Board of Supervisors of each of the three ESAs and participate in the Authorities' activities.

According to the agreement the EFTA Surveillance Authority will be entrusted with making binding decisions, in specific cases, with respect to the supervisory authorities and market participants in the EEA-EFTA States, including in Iceland. The EFTA Surveillance Authority will further be entrusted with direct supervision of credit rating agencies and trade repositories licensed to operate in the EEA-EFTA States.

Negotiations have been conducted, since the agreement was reached, between specialists from the EEA-EFTA States and the EU on its implementation through amending the legal acts concerned. FME has been an active participant in those negotiations and has given the Ministry of Finance and Economic Affairs assistance. The negotiations have reached important milestones and the transposition into the EEA Agreement of the regulations on EBA, EIOPA, and ESMA, including a total of 31 related acts, is expected in 2016. Amendments to law are expected to follow for the implementation of the new supervisory structure

1.3 Business practices and consumer affairs

One of FME's tasks involves scrutinising regulated entities' business practices, including business-to-consumer financial services, in addition to disclosing information and providing guidance in accordance with the provisions of the Public Administration Act. Provisions concerning the business practices of regulated entities are a part of all financial market sectorial laws as well as being part of the Act on Official Supervision of Financial Activities. FME's focus has been on the outward facing business practices of regulated entities' activities, i.e. consumer facing activities.

FME received 222 written suggestions and inquiries in 2015 and the Authority also provided guidance to the customers of regulated entities by phone.

The tasks concerning business-to-consumer practices in financial services varied greatly during the year. They involved among others:

- An examination of the business practices of Tryggingamiðstöðin hf. (TM Insurance) concerning disclosure to policyholders during insurance renewal under Article 11 of Act No. 30/2004, on Insurance Contracts.
- An examination of the consumer disclosure of Lýsing hf.
- An examination of the business practices of Arion Bank hf. concerning the bank's sale of shares in Siminn hf.
- An examination of the business practices of Landsbankinn hf. concerning the bank's sale of shares in Borgun hf.
- An examination of insurance companies' use of so-called PC-Crash reports.

FME's business practices supervision has mostly involved responding to information received on issues in the business activities of regulated entities that require examination. Projects have been determined based on the interests at stake and considering the Authority's policy on risk-based supervision.

FME's increased involvement with European supervisory authorities' committees on consumer protection, and the increased importance of the category within FME, allows for emphasising proactive business practices supervision by FME. That includes, for example, increased FME participation in thematic examinations conducted under the aegis of European supervisory authorities and FME's use of such pan-European examinations to assess the domestic situation.

FME reviews those aspects of the regulated entities' activities that may be subject to provisions on business practices even though they do not contravene specific provisions of laws and regulations. A recent amendment of Act No 161/2002 on financial undertakings clarified FME's powers to regulate financial undertakings' sound and proper business practices that facilitates financial supervisory enforcement.

1.4 Internal functioning

In recent years, FME's activities have been characterised by continuous improvement and developments in conjunction with increased requirements and criteria for best supervisory practices, the same held true in 2015. The scope of FME's remit and responsibilities has been expanded as a result of participating in the activities of the ESAs and work carried out in transposing EU rules into Icelandic legislation. Changing requirements call for more intricate and thorough supervision and analysis of a wide spectrum of risks facing the activities of regulated entities.

FME has reviewed all processes, improved supervisory efficiency and introduced new procedures for planning and prioritising projects in order to take on more projects under increased stress. In addition, substantive reforms have been carried out in project registration and unification of supervisory practices.

Extensive work has been undertaken in preparing for, and forming, the reception and processing of new reporting relating to the transposition of the Solvency II and CRD IV Directives in the year. The work is progressing well and uniform reporting is expected to improve the quality of data gathered by the Authority, in addition to providing a better overview.

Clearer policy-making and prioritisation of projects has resulted in more streamlined employee competency and performance assessments, which is reflected in more targeted education and training that improves employees' abilities to react to the constant changes in the financial market.

It is safe to say that the above-mentioned changes in FME's activities and procedures have resulted in more professionalism and improved supervisory quality. These results have been achieved without increasing FME's man-years and the Authority's annual working units have remained stable for several years even though projects have expanded hugely. The number of paid annual working units was 117.3 in 2015 compared with 117.5 in 2014.

Coinciding with the stable number of annual working units, FME has had strong employee retention, employee turnover was less than 10% during the year 2015 and the preceding year. In addition, the Authority has been successful in hiring skilled and trained people. The benefit of the stability in annual working units is the continuous improvement of employee supervisory experience.

1.5 Operations and Financing

According to FME's annual accounts for 2015, operating expenses totalled ISK 1,915.6 million and had increased by 5.1% from ISK 1,822 million in 2014. The comparison does not take account of a reversal of ISK 135.2 million in 2014 for the collection of supervision fees from financial undertakings undergoing winding-up proceedings that had been depreciated as a precaution in 2013. Labour costs are the largest item of operating expenses, and amounted to ISK 1,547.6 million in 2015 compared with ISK 1,414.0 million the preceding year. The labour costs increased by 9.4% year-on-year, which reflects contractual salary increases, as the number of paid positions remained unchanged between years.

FME's total operating revenues amounted to ISK 1,745.9 million in 2015. Thereof, the revenue from the supervision fee amounted to ISK 1,641.5 million compared with ISK 1,590.0 million in 2014, an increase of 3.2% year-on-year. Other operating revenues totalled ISK 104.4 million, including ISK 7.2 million in special revenue from providing food, ISK 15.3 million in reclaimed costs from two complaints committees hosted by the Authority, and ISK 44.8 million in various other tariff based revenues. Interest income exceeded interest expense by ISK 29.9 million.

The shortage was therefore ISK 169.7 million in 2015. Using the Authority's own funds was planned according to the 2015 operational schedule, in order to decrease the Authority's reserves to the authorised level under Act No 99/1999.

FME's equity at year-end 2015 was ISK 405.5 million, as compared to ISK 575.3 million at the beginning of the year. Thereof, the restricted equity amounted to ISK 92 million. Equity at year-end, less reserves amounting to no more than 5% of next year's supervision fees, reduces supervision fees the following year, in accordance with Act No 99/1999 on Payment of Cost due to Official Supervision of Financial Activities. Thus, the reserves amounted to ISK 85.5 million at year-end 2015.

The 2015 annual accounts are provided on FME's website.

2016 operational schedule

In a report on the 2016 operational schedule, submitted to the Minister of Finance and Economic Affairs pursuant to law in June 2015, the Authority's expected expenses total ISK 2,051.2 million for 2016. In addition, the Authority's revenues are expected to total ISK 1799.2 million, thereof the proposed supervision fee will total ISK 1,710.6 million, interest income will total ISK 15 million and other special revenue will total ISK 73.5 million. The proposed funding of the difference, in the amount of ISK 252.1 million, comes from decreasing own funds. Althing confirmed the above-mentioned schedule and proposal for imposed supervision fees with the adoption of the 2016 budget in December last year.

Distribution of working hours

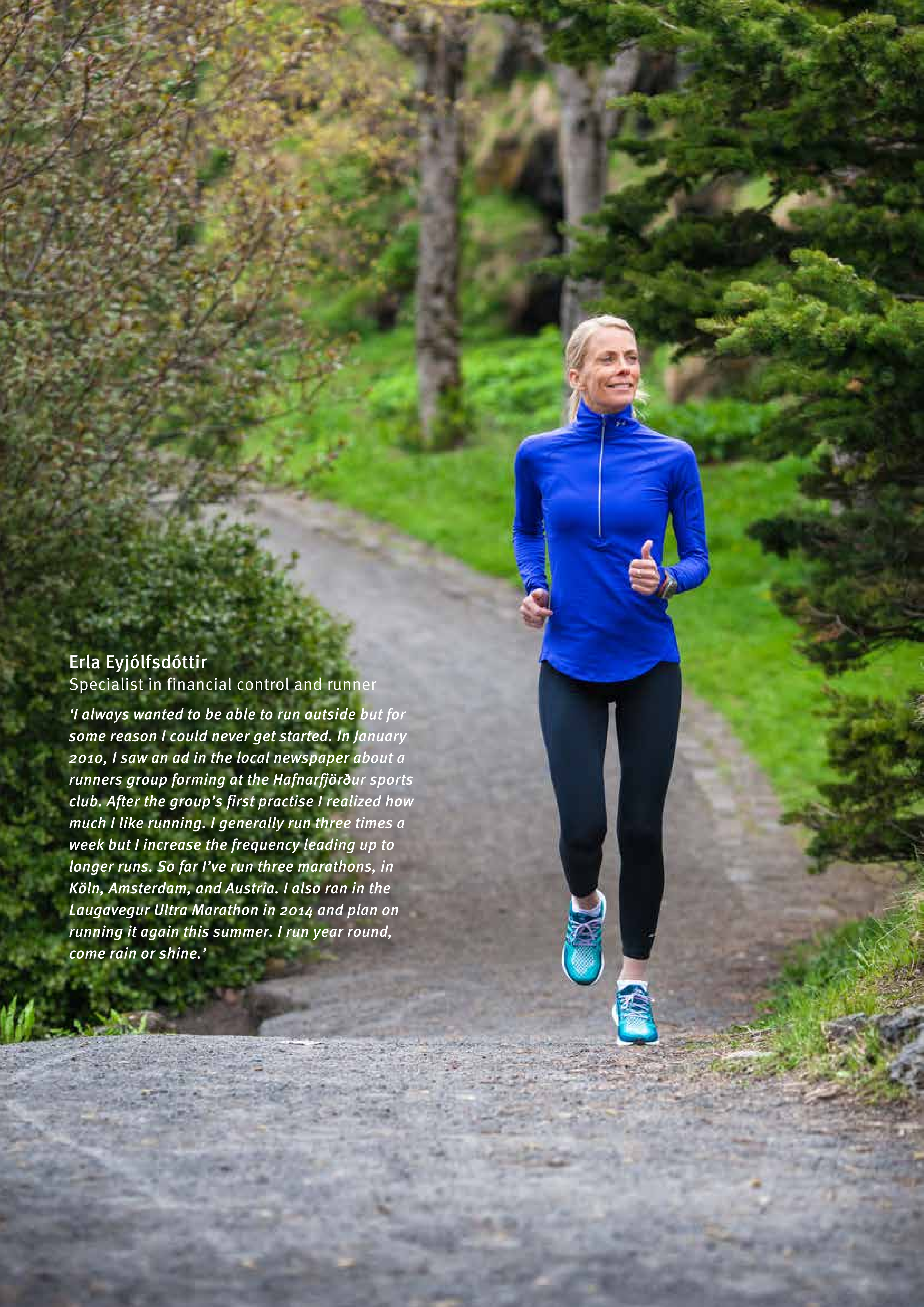
Pursuant to Act No 99/1999 on Payment of Cost due to Official Supervision of Financial Activities, regulated entities shall cover the operational expenses of FME through a special supervision fee. The Authority's operational schedule should therefore assess the development of its activities with regard to the time allocated to the supervision of each class of regulated entity. The assessment is based on the Authority's time sheet records. The following table shows a breakdown of FME's working hours devoted to each main category of regulated entity in 2014 and 2015:

Relative distribution of FME working hours by category of regulated entity	**2014**	**2015**
Credit institutions	54.6	61.4
Insurance companies and insurance brokers	11.1	12.3
Pension funds	15.3	12.3
Fund management companies	5.0	4.8
Securities companies and securities brokerages	2.5	2.8
Equity and bond issuers	5.5	4.7
Others	6.0	1.8
	100.0	100.0

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

Relative distribution of FME working hours among its main tasks	**2014**	**2015**
Supervisory tasks	57.6	58.2
Off-site supervision	28.5	29.2
On-site examinations	8.2	9.0
Other supervisory activities	20.8	20.0
Regulation	5.8	6.2
General operations	31.3	28.9
Foreign cooperation/communications	5.3	6.6
	100.0	100.0

Off-site supervision in the table refers to various kinds of examinations, monitoring, and market surveillance activities that are, among others, based on systematic gathering of information and reporting to FME. In addition, it covers various specific examinations of the activities, business practices, and procedures of regulated entities. On-site examinations refer to examinations at the establishments of regulated entities. Other supervisory activities refer to the organisation of supervision, various licensing, assessment of eligibility, sanctions, communications, information exchange, etc. General operations refer to work on FME's information management and archiving, IT, management, human resources, educational matters, and other aspects of regular operations and office administration.



Erla Eyjólfsdóttir
Specialist in financial control and runner

'I always wanted to be able to run outside but for some reason I could never get started. In January 2010, I saw an ad in the local newspaper about a runners group forming at the Hafnarfjörður sports club. After the group's first practise I realized how much I like running. I generally run three times a week but I increase the frequency leading up to longer runs. So far I've run three marathons, in Köln, Amsterdam, and Austria. I also ran in the Laugavegur Ultra Marathon in 2014 and plan on running it again this summer. I run year round, come rain or shine.'

2. Financial market

2. Financial market

2.1 Financial market outlook

The status of domestic and foreign markets has varied greatly recently. The Icelandic economy is characterised by great economic growth and expansion in the labour market while the prognosis abroad seem bleaker and less certain than they have for a long time. Both the International Monetary Fund and OECD have encouraged the nations of the world to adopt measures against recession for the major economies and have even warned of the threat to financial stability. The growth of the Chinese economy has slowed significantly, and imports and exports have both contracted significantly. The decrease in the price of oil and commodities has undermined the economic growth in countries that rely on the exporting of oil and other commodities.

The inherent risk in the domestic financial system has decreased substantially in recent years after the composition of the bankruptcy estates of the old banks. As of now, the impact of international unrest has been limited in Iceland. The main impact was unrest in the domestic equity market in the first half of the year resulting from substantial uneasiness in foreign equity markets. At the same time, the Icelandic banks' credit spread increased substantially in foreign financial markets as a result of the drop in the price of foreign banks' shares and bonds.

The economic growth has been strong recently and it was approximately 4.0% in 2015 and domestic product is now 5% higher than it was in 2008 in real terms. The economic growth has been powered by consumption and capital investment. Exports have also grown substantially. The growth in exports results to a great extent from increased numbers of tourists and improving trading conditions. Furthermore, inflation has been low even though salaries increased substantially in 2015 as the decrease in international commodity prices and strengthening Icelandic króna relieved domestic inflationary pressure. The decreasing prices in international commodity markets and the strengthening króna have given CBI's Monetary Policy Committee a margin of discretion to maintain the policy interest rates unchanged from November 2015; however, the monetary policy will likely require more discipline in the near future. The extent and timing will depend on both domestic and international developments.

Irrespective of the positive outlook on many of the major indicators the Icelandic economy is showing some signs of change. The long-term effect of the increased tension in the national economy increases the risk of financial instability. Inflows of foreign capital have restarted and the capital inflow has to be monitored closely for carry trade and to assess whether the capital inflows are encouraging domestic parties to increase leverage as the sudden outflow of capital can threaten financial stability. Property prices have increases substantially in recent years. Even though there are currently no signs of bubbles forming, the supervisory bodies must continue to monitor the developments closely. Household liabilities continued decreasing in real terms in 2015 while corporate liabilities increased slightly in excess of economic growth. The increasing housing prices and decreasing liabilities have resulted in lower loan-to-value ratios for households. Corporate equity positions have improved as well. Supervisory bodies are now certainly better equipped to respond to asset bubbles and the excessive leverage of households and corporations than before due to the improved regulatory framework for the financial market and the introduction of macroprudential tools to protect financial stability.

2.2 The Securities Market

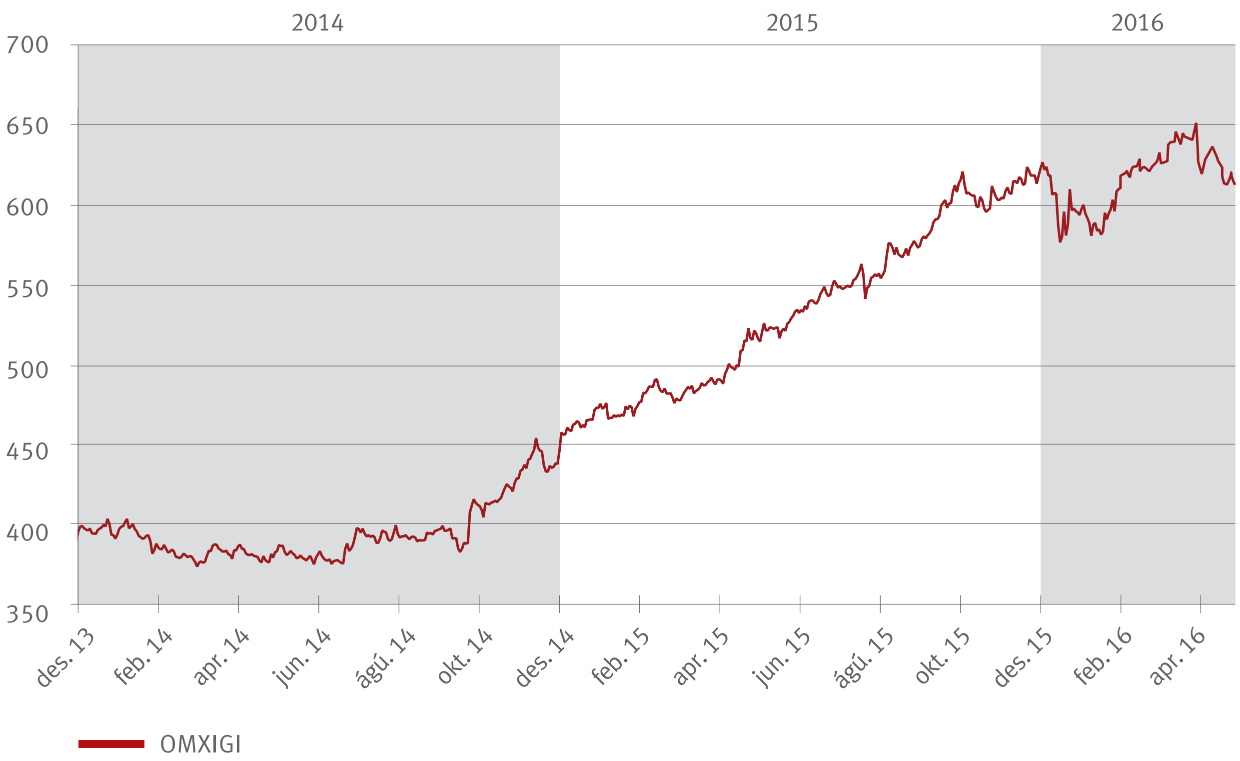
The Icelandic stock market was healthy in 2015. Three companies were added to the all-share index on the stock exchange and equity turnover increased by 41.7% year-on-year. Bond turnover improved well in 2015, turning around the developments of recent years..

Equity market trends

The growth period in the Icelandic equity market that started in the third quarter of 2014 continued in 2015. The real estate companies Reitir and Eik and the telecom company Siminn hf. were admitted to trading in the stock exchange during the year and the all-share index now comprises 16 Icelandic companies. Equity turnover continued growing and it amounted to almost ISK 392 billion. That is an increase in turnover of ISK 115 billion year-on-year, an increase of 41.7%.

Investors benefited greatly from Icelandic equities in 2015 and the share price increased for every listed company in the all-share index. The OMXIGI index, for the average return of every listed company on the main market with regard to dividends, increased by 42.3% in the previous year while international markets struggled. The prices have not faired as well in 2016 and decreased significantly in the beginning of the year in parallel with distressing news from international markets. However, the market has corrected and the decrease in the first five months is now 1% even though it had gone as low as 7.45%.

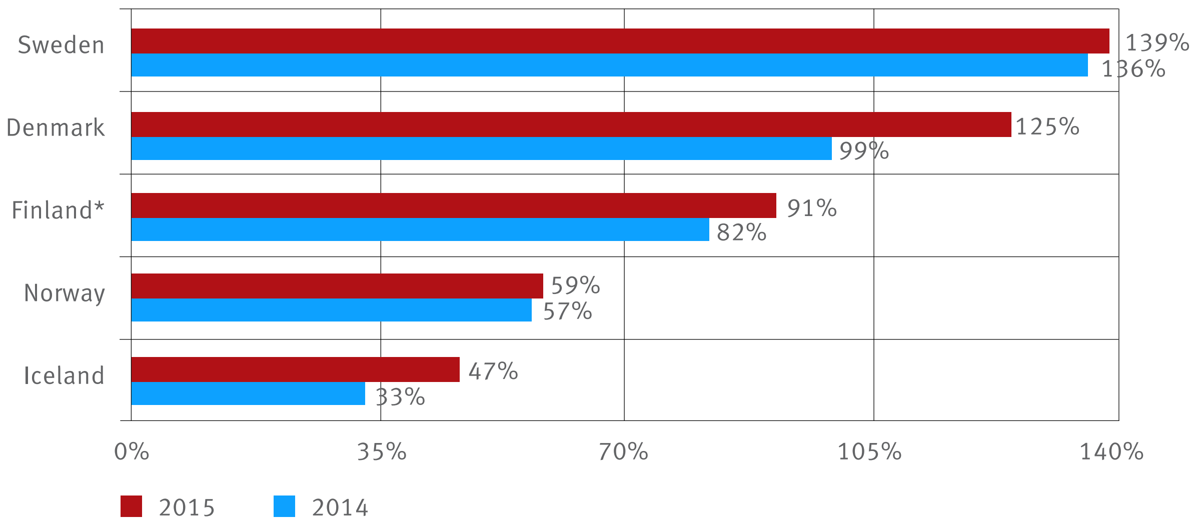
Figure 1 Trend of the NASDAQ OMXIGI Index



Source: Nasdaq Iceland hf.

In conjunction with the price increases and the larger number of companies admitted to trading, the total market capitalisation of companies in the all-share index on the stock exchange increased by more than ISK 367 billion in the preceding year and at year-end 2015 the total market capitalisation was ISK 1,028 billion. The total value of domestic equity as a percentage of gross domestic product has therefore grown and now amounts to 47%, in comparison to 33% in the preceding year, even though GDP has been increasing during the same time. Irrespective of these developments the proportion in Iceland is still substantially lower in Iceland in comparison to the other Nordic countries.

Figure 2 Total value of registered shares as a percentage of GDP



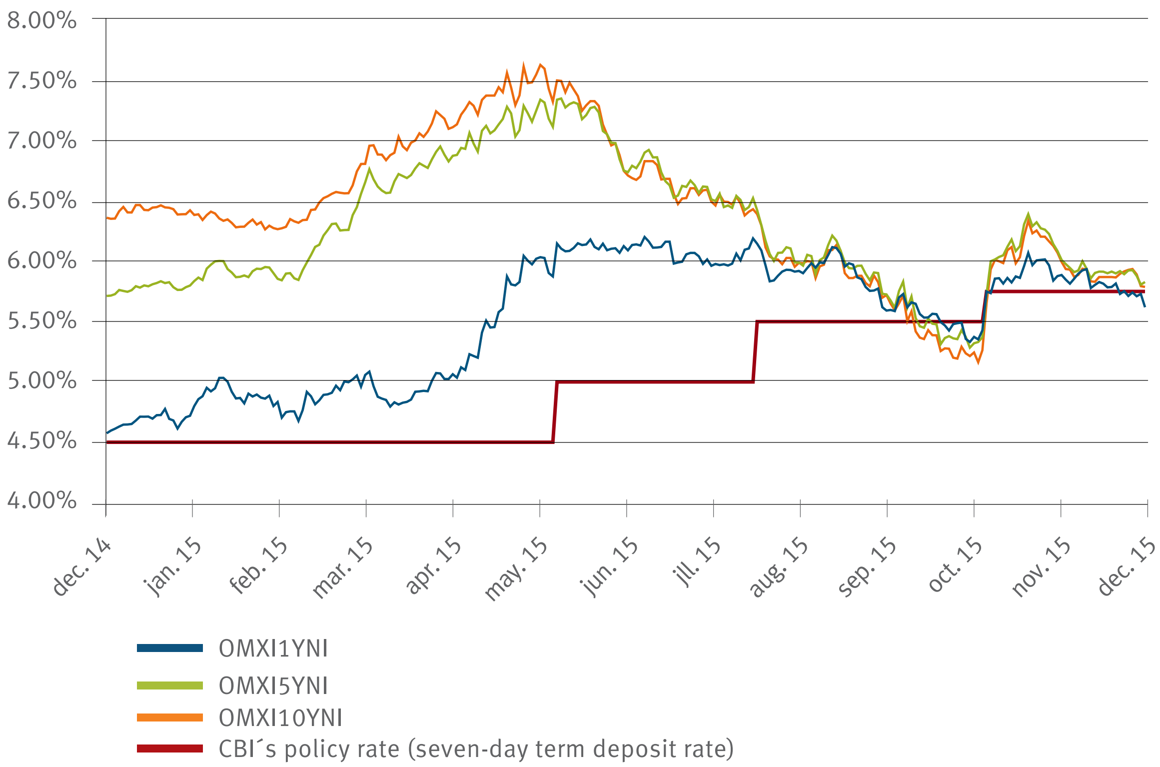
*Estimated size 2015
Source: Nordic statistical institutes, Nasdaq Iceland, Oslo Börs

Bond market trends

Unlike the developments in recent years, the annual turnover of bonds increased in 2015 and this is the first time since 2011 that bond turnover increases year-on-year. The increase in turnover amounts to ISK 463 billion or 30.2%. The turnover increased the most in unindexed and indexed government bonds as well as bonds issued by banks. The latter is mostly as a result of the increased turnover in covered bonds that increased markedly in the firth quarter of 2015. At the same time, the turnover of HFF bonds in Íbúðalánasjóður (Housing Financing Fund (HFF)) decreased substantially.

The development of the yield for unindexed bonds was interesting in the preceding year. The yield development was similar in the short and long end of the yield curve in the first half of the year when the yield increased significantly for most securities. However, the yield started decreasing in the long end of the yield curve in the second half of the year while the short end of the yield curve mostly did not change. At the end of the year, the yields according to the Nasdaq Iceland indices, OMXI1YNI, OMXI5YNI, and OMXI10YNI, varied from 5.62% - 5.83%. The yields of indexed bonds, measured by OMXI5YI and OMXI10YI, decreased by 54 and 57 points and both bond classes ended the year at 2.64%. Notably, the yield decreased contrary to CBI's increase in the policy interest rate, which was increased from 4.50% to 5.75% during the year. The developments can, in part, be explained by increased demand as foreign parties showed increased interest in domestic bonds after the presentation of the governmental plan to lift capital controls in June 2015.

Figure 3 Yield on non-indexed Nasdaq Iceland bond indices



Source: Nasdaq Iceland hf. and CBI

Figure 4 Yield on indexed Nasdaq Iceland bond indices

Source: Nasdaq Iceland hf.

The total value of listed bonds in the stock exchange amounted to ISK 2,119 billion at year-end 2015, compared with ISK 2,008 billion at year-end 2014. At year-end 2015, the market value of issued debt instruments was divided thusly, 73.7% were issued by public entities and private parties issued 26.3%. In 2014, the same ratio was 76.6% and 23.4% respectively; meaning the proportion of instruments issued by private parties has increased slightly year-on-year.

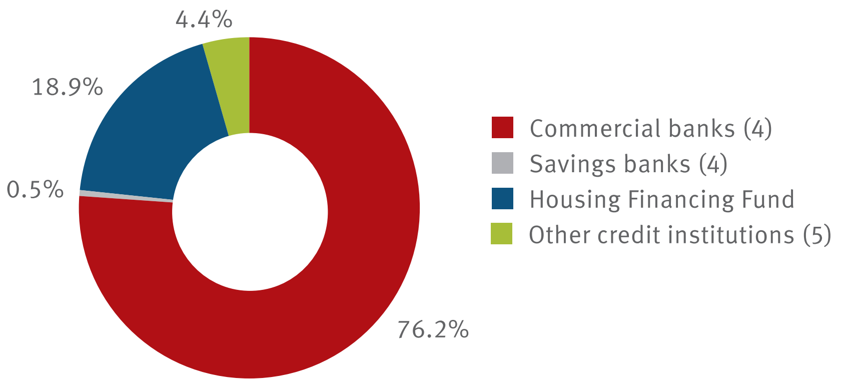
2.3 The Credit Market

At year-end 2015, 4 commercial banks, 4 savings banks and 5 credit institutions were operating in Iceland, in addition to the state-owned Housing Financing Fund, or a total of 14 credit institutions. At year-end 2015, their total assets amounted to ISK 4,247 billion, thereof the total assets of the commercial banks amounted to ISK 3,237 billion, and they have increased by 8% from the preceding year[3]. The ownership interest of the Treasury and public bodies dominates the credit market, as their interest in the equity of all credit institutions was 73% at year-end 2015. The future ownership and arrangement of companies in the credit market is uncertain and it is important that the sales process for credit institutions owned by the Treasury be sound.

Balance sheet structure

In recent years, the total assets of credit institutions, as a percentage of GDP, have been decreasing, from 277% at year-end 2009 to 193% at year-end 2015. The main reason is the fact that gross domestic product has increased proportionately faster than the assets of the credit institutions, which are almost unchanged from year-end 2009.

Figure 1 Proportional division of credit company total assets on a consolidated basis as of 31 December 2015



Equity position

At year-end 2015, the capital base of the three large commercial banks amounted to ISK 670 billion, compared with ISK 639 billion at year-end 2014, an increase of 4.9% year-on-year. Their capital adequacy ratio was 28.2% at year-end 2015 as compared to 28.5% at year-end 2014. The capital base is mainly composed of Tier 1 capital, or approximately 97% of the whole.

3 Straumur merged with MP Bank, AFL Savings Bank merged with Arion Bank and Westman Islands Savings Bank and Nordurland Savings Bank merged with Landsbankinn in 2015.

Figure 2 Capital adequacy ratio trend

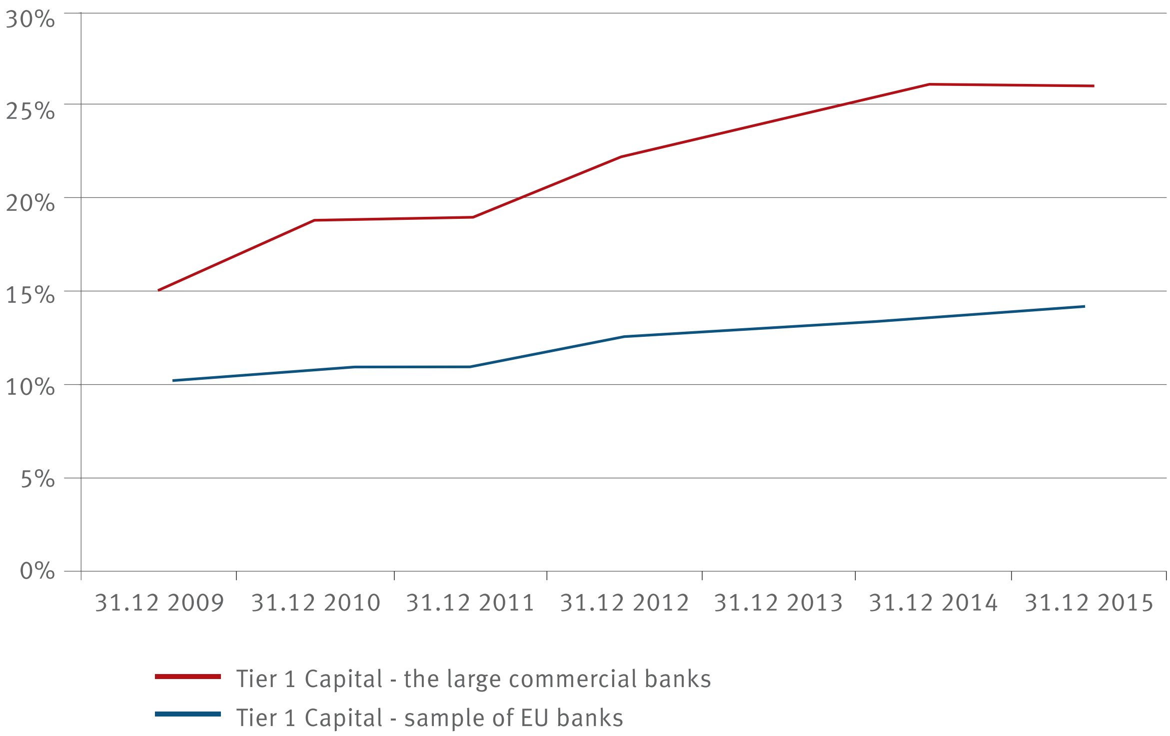


Figure 2 shows a comparison of Tier 1 Capital as a ratio of the risk-weighted asset base on one hand at the large Icelandic commercial banks and on the other hand for a sample of EU banks collected quarterly by the European Banking Authority (EBA). The weighted ratio of Tier 1 Capital for the large commercial banks was 26.2% at year-end 2015 compared with 14.2% at the EU banks in the third quarter of 2015 (for a total of 194 banks). The comparison shows that the Icelandic bank have a strong equity position although it bears mentioning that the capital adequacy ratios have been increasing in recent years as a result of increased international requirements for capital adequacy.

Operating results

In 2015, the profit of the three largest commercial banks amounted to almost ISK 106 billion compared with more than ISK 81 billion in 2014, an increase of 31% year-on-year. The increase is mostly due to revenues outside of the banks' core operations[4]. Return on assets (ROA) after tax amounted to 3.4% compared with 2.6% in 2014 and the return on equity after taxes increased year-on-year and amounted to 16.6% in 2015 compared to 14% in 2014. The banks return on core operations before tax also improved year-on-year and amounted to 8.1% in 2015 compared with 7.2% in 2014. The banks' net interest income increased by almost ISK 7 billion and their net commission income by approximately ISK 4 billion. The interest rate margin was 2.9% in 2015 compared with 2.7% in 2014. Operating expenses as a percentage of net operating income were 42.5% in 2015 compared with 54.6% in 2014. Operating expenses as a percentage of assets were 2.6% and remained unchanged between years.

Funding and liquidity

At year-end 2015, the majority of the banks' funding was customer deposits (51%), borrowing (20%) and equity (21%). The three large commercial banks' customer deposits amounted to

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

approximately ISK 1,652 billion at year-end 2015. The capitalisation of the banks changed during 2015 in connection with the settlement of the estates of financial undertakings undergoing winding-up proceedings, as provided by their compositions.

For example, the foreign currency claims on the banks were extended and the deposits of financial undertakings undergoing winding-up proceedings decreased by ISK 237 billion during the period of December 2015 to March 2016. Their deposits were classified as customer deposits.

The three banks are all partially financed by foreign borrowings in various currencies. The banks have significantly reduced the resulting refinancing risk and at year-end 2015 a total of ISK 9 billion was outstanding with a due date in 2016. In comparison, a total of ISK 55 billion was outstanding with a due date in 2016 at year-end 2014. The banks were therefore able to repay and refinance a total of ISK 46 billion, with a due date in 2016, in the preceding year. The refinancing has a positive impact on the ratio of stable financing and according to CBI rules the ratio of stable foreign currency financing shall be in excess of 100% and the banks' ratios averaged 115% at year-end 2015.

However, foreign credit markets were characterised by instability and uncertainty at the end of 2015 and in the beginning of 2016 which caused, among other things, the credit spread for financing the banks to rise and the impact is uncertain on the future financing of the banks in foreign markets.

The three large commercial banks have all exceeded the minimum ratio stipulated by CBI liquidity rules. The minimum liquidity ratio provided for by the rules was 80% in 2015 and the banks' ratios at year-end 2015 averaged 125%. According to the same rules the minimum liquidity ratio in foreign currencies is 100%. The banks all had high foreign currency liquidity ratios at year-end 2015, and the ratios averaged 326%.

Even though substantial risk was resolved with the conclusion of the composition for financial undertakings undergoing winding-up proceedings and their agreements with the authorities to pay a stability contribution the banks' liquidity position may be stresses as actions to lift the capital controls continue.

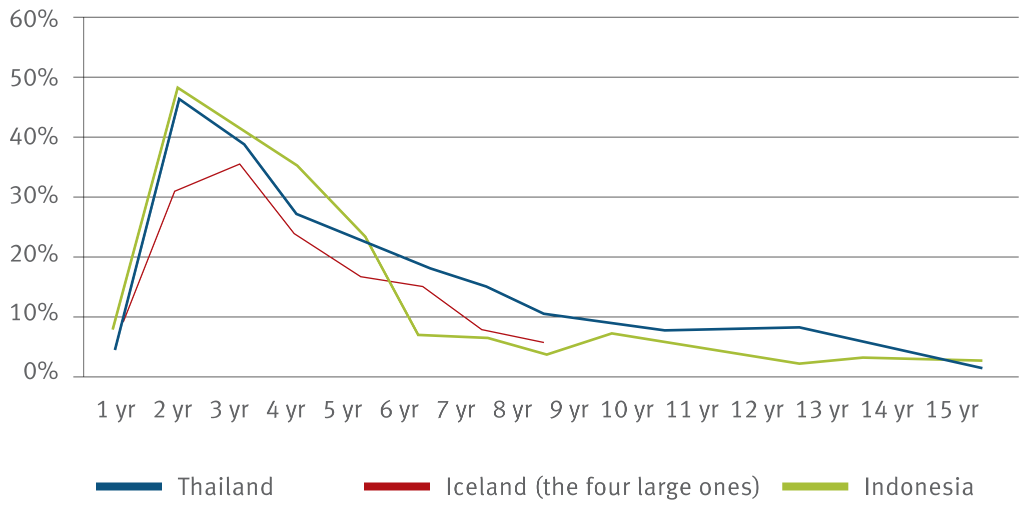
Credit risk and asset quality

The three large commercial banks' customer lending amounts to ISK 2,179 billion at year-end 2015, which is a 7.7% increase from year-end 2014 when lending was ISK 2,023 billion. The quality of the large commercial banks' loan portfolios has continued to increase since the collapse in 2008. The banks have almost completely restructured the finances of companies in need and the companies and individuals that withstood the collapse have reinforced their capital positions substantially.

Increasing asset prices and debt writedowns further improve domestic borrowers capital positions and the household and corporate indebtedness has decreased as a percentage of domestic product. Furthermore, the ratio of defaulted and frozen lending has decreased from autumn 2008 after a reorganisation of the finances of disadvantaged borrowers. The ratio of defaulted and frozen lending, according to book value and cross default, has decreased from 44% in March 2010 to 7.1% as of December 2015.

It is instructive to compare the results of Iceland after the financial shock in 2008 and the results of Thailand and Indonesia after the Asian financial crisis in 1997. The comparison is based on the claim value of defaulted lending based on the facility approach for the three large commercial banks and HFF.

Figure 3 Comparison between the default trends in Iceland, Indonesia, and Thailand after a financial crisis



As shown in Figure 3, the default trends are very comparable in Iceland, Thailand and Indonesia. As of late, the pace of decrease in the ratio of defaulted and frozen loans has slowed down and based on the experience in Thailand and Indonesia it could take a few more years for defaults at the banks to reach their minimum.

Housing Financing Fund (HFF)

At year-end 2015, the total assets of the Housing Financing Fund amounted to ISK 805 billion, compared with ISK 824 billion at year-end 2014. The profit in 2015 amounted to ISK 1.8 billion, compared with ISK 3.2 billion in 2014. At year-end 2015, the fund's equity ratio was 5.5% compared to 4.5% at year-end 2014, however, the fund is required to, in accordance with Article 7 of Regulation No 544/2004 on the Finances and Risk Management of the Housing Financing Fund, endeavour to keep the equity ratio over 5%. The Fund continues to face prepayment risk in the current interest rate environment since housing loan interest rates have decreased as a result of increased competition in the market for housing loans. In 2015 and in the first quarter of 2016, the Fund purchased contractual covered bonds issued by Arion Bank hf. for a total of ISK 83.5 billion to counteract inflation indexation risk and improve the return on the Fund's assets. The Fund's interest rate margin is approximately 0.28%, which is insufficient to cover the prepayment risk, normal impairment, and operating expense and, therefore, it remains necessary for the Treasury to continue supporting the Fund.

The savings banks

The system of savings banks has decreased at a rapid pace in recent years. In 2015, the number of savings banks decreased from 7 to 4 when AFL Savings Bank merged with Arion Bank hf. and Nordurland Savings Bank and Westman Islands Savings Bank merged with Landsbankinn hf. The assets of the three savings banks totalled 67% of the savings banks' total assets at year-end 2014. The savings banks still operating at the end of 2015 are Austurland Savings Bank, Höfðhverfingar Savings Bank, Suður-Þingeyingar Savings Bank, and Strandamenn Savings Bank. Their total assets currently amount to approximately 0.5% of the total assets of credit institutions.

Executive summary

The equity position of the three large commercial banks is healthy and significantly in excess to counterparts internationally. Uncertainty remains relating to the continued lifting of the capital controls, even though substantial risk was resolved with the conclusion of the composition for financial undertakings undergoing winding-up proceedings and their agreements with the authorities to pay a stability contribution. It therefore remains important for the banks to maintain high capital adequacy ratios due to the uncertainty and it is also important that the initial decisions have been made on capital buffers for financial undertakings. Furthermore, the banks need to maintain liquidity ratios in excess of the supervisors’ minimum requirements.

The banks improved their core operations between years by increasing net interest income and lowering operating expenses but one-time items remained a substantial part of the banks profits. Operational rationalisation resulted in lower operating expenses between years although it is clear that they have to strengthen their core operations further.

The ownership interest of the State and public bodies dominates the credit market as their interest in the equity of all credit institutions was 73% at year-end 2015. The future ownership and arrangements in the credit market are uncertain. It is important that the sales and restructuring process for credit institutions owned by the Treasury be sound. The Treasury will likely also need to continue supporting the operations of HFF.

2.4 Insurance Market

At year-end 2015, 12 insurance companies had an operating licence from FME, of which four operate in the non-life insurance market and five operate in the life insurance market. In addition, Íslensk endurtrygging hf. and Trygging hf. are reinsurance companies that only settle older obligations and the last one, Iceland’s Natural Catastrophe Insurance, operates in accordance with special legislation. All of the life insurance companies are subsidiaries of non-life insurance companies, except Okkar líftryggingar hf., a subsidiary of Arion Bank hf.

Shares in the three largest insurance companies are listed on the stock exchange. When the companies were listed the number of owners increased but the 10 largest shareholders held between 50 and 70%. At year-end 2015, the shareholders of these companies numbered between 950 and 1650, a decrease from the initial public offering. The largest shareholders in the above-mentioned companies are pension funds, investment funds and investment companies. At year-end 2015, the pension funds held approximately 43-46% of total shares in the insurance companies directly. In October 2015, Arion Bank hf. concluded an agreement with BankNordik P/f to acquire the insurance company Vörður tryggingar hf. The acquisition is subject to the agreement of the relevant authorities.

The transposition of the EU Solvency II Directive into Icelandic law, that had been planned to coincide with the entry into force in most other EEA States, was not completed by year-end 2015. Hopefully the draft bill for the transposition of the Directive will be adopted during the current assembly. FME recommends that the insurance companies take account of the provisions of the Directive for their activities, even though it was not transposed on time, as they operate in an international environment. Notably, FME has encouraged the insurance companies to operate with as much regard to the Directive as is possible since the entry into effect of EIOPA’s Preparatory Guidelines from 1 January 2014. In 2016, FME will follow-up the transposition by holding public information meetings, site surveys, and meetings with regulated entities and normal supervisory tasks will be in accordance with the work on the transposition.

At year-end 2015, the total assets of all insurance companies in Iceland amounted to approximately ISK 165 billion, decreasing by more than ISK 1 billion from the previous year. Figure

1 shows the development of assets and asset breakdown of insurance companies in 2012-2015. Various changes have taken place in the composition of the assets of the insurance companies. The proportion of equities continues growing as was expected and stands at 23% at year-end 2015. The proportion of bonds decreases substantially, from 50% at year-end 2014 to 43% at year-end 2015. Finally, the intangible assets are insubstantial at year-end 2015 after great impairment of this item during the year.

Figure 1 Insurance companies' assets and asset breakdown 2012-2015

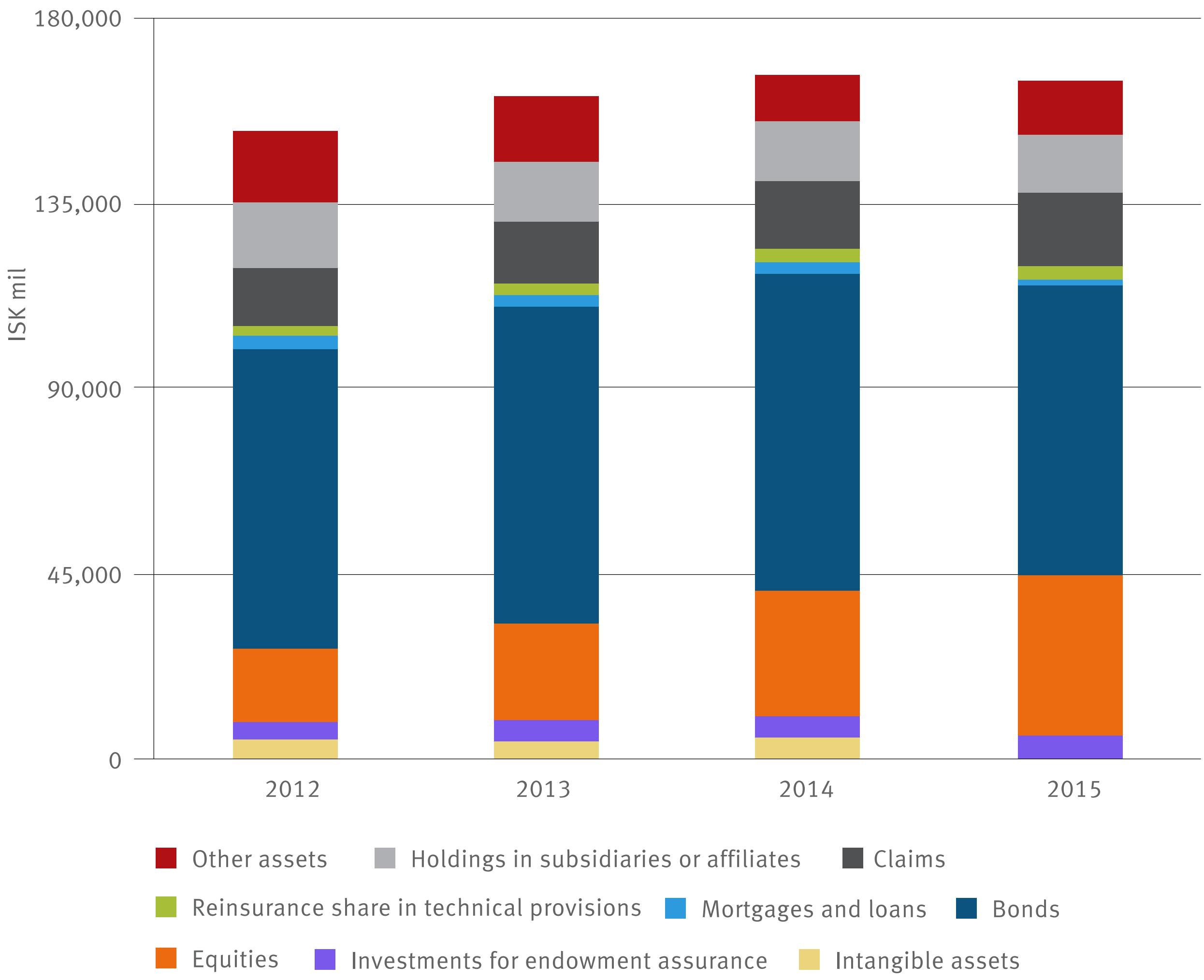
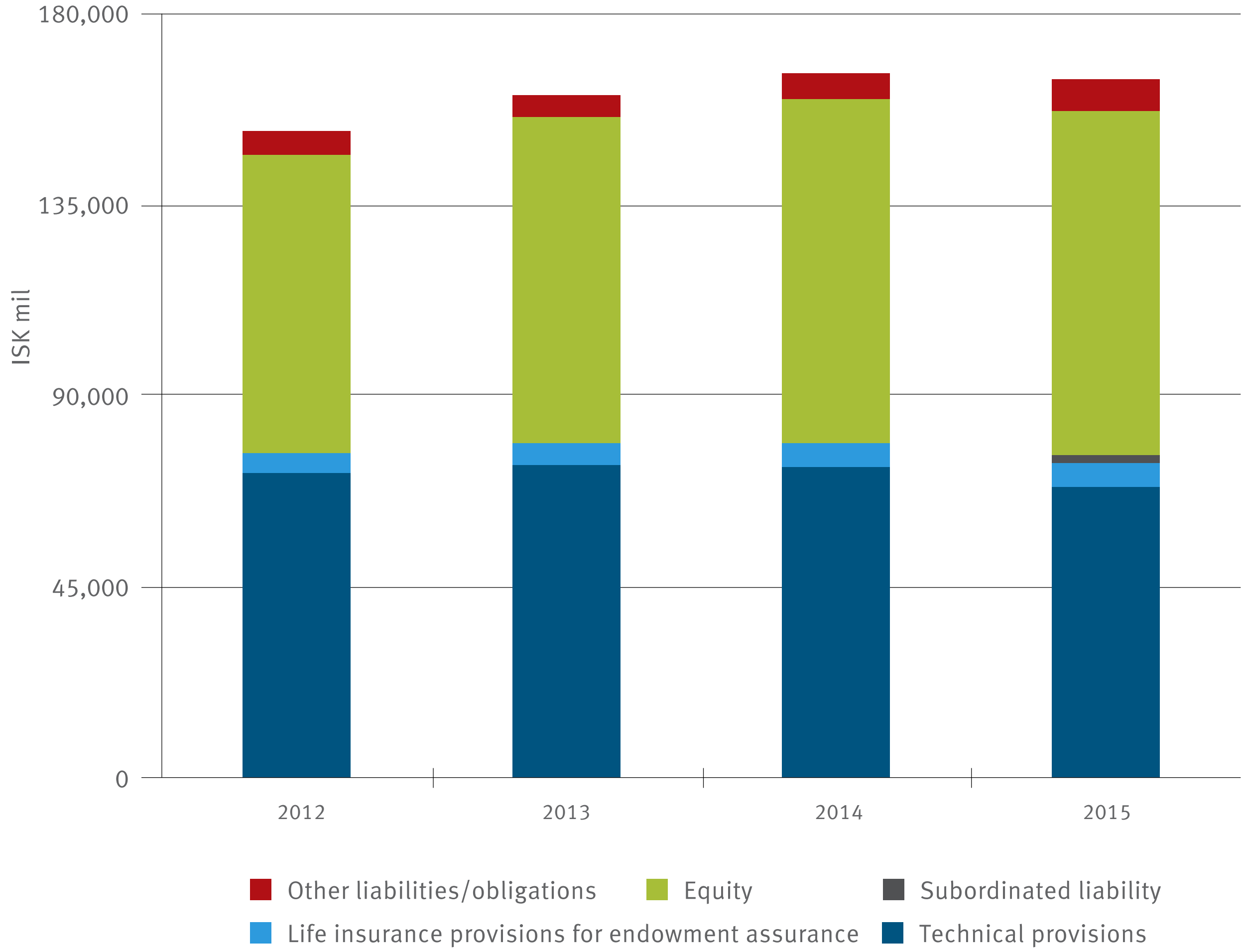


Figure 2 shows a breakdown of balance sheet liabilities for life and non-life insurance companies for the period 2014-2015. The equity position has improved steadily in recent years even though it has remained unchanged for the last two years. The insurance technical provisions have decreased by approximately ISK 5 billion between the preceding two years after mostly remaining unchanged in the beginning of the period The decrease is mostly the result of changes in the method for assessing the technical provisions. During 2015, both Sjova-Almennar Insurance hf. and VIS Insurance hf. changed the methodology for assessing technical provisions and TM Insurance hf. had changed its methodology in the preceding year.

Figure 2 Insurance companies' equity and liabilities 2012-2015

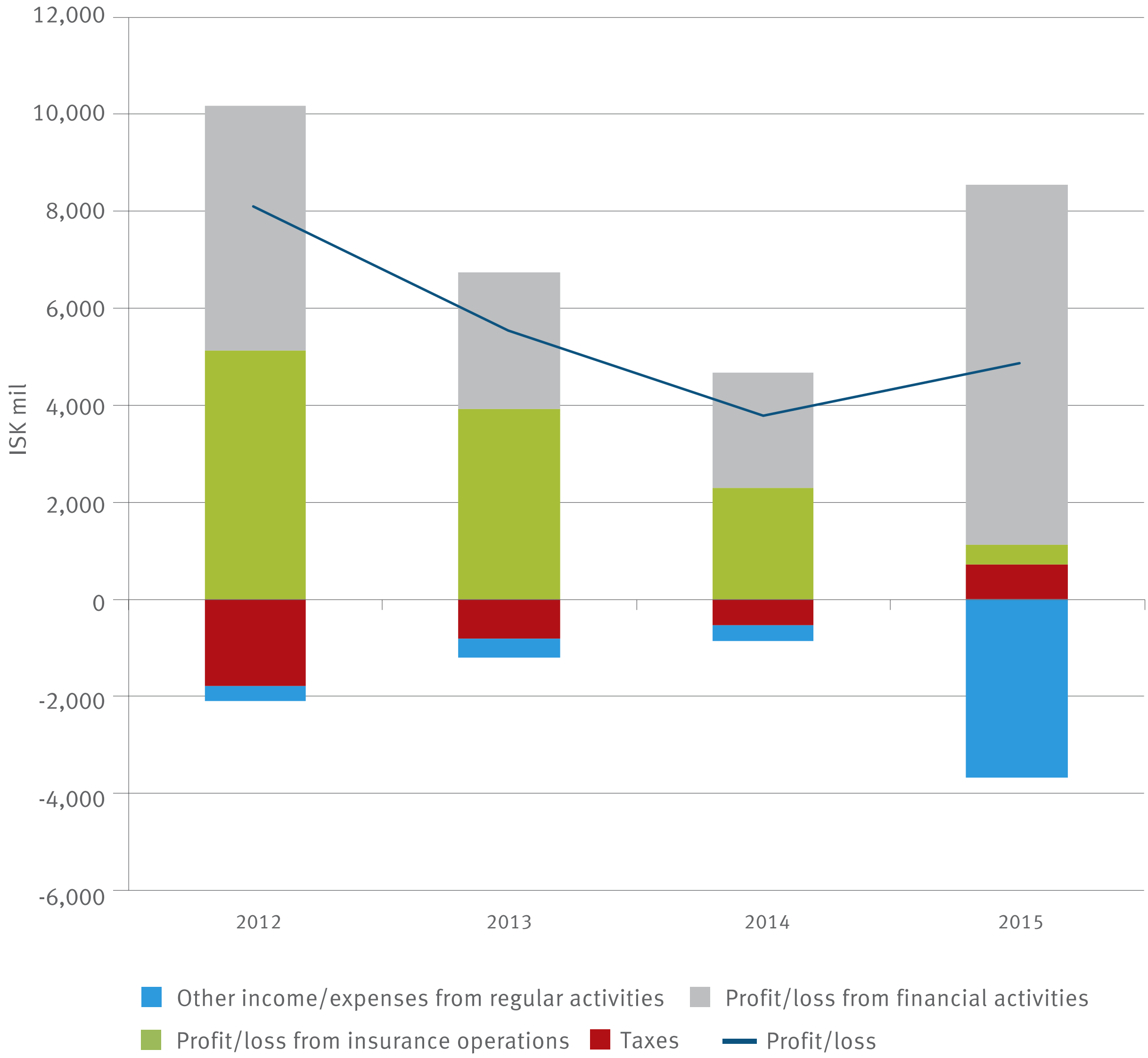


According to the Solvency II Directive, the solvency ratio for the three largest insurance companies was within the range of 124% and 156% on a consolidated basis at the end of last year. In 2016, a few insurance companies withdrew dividends and the total dividend payouts amounted to almost ISK 11 billion.

Operations of non-life insurance companies

The performance of the non-life insurance companies improved in 2015 compared to the preceding year based on insurance operations on the one hand and return on investment on the other hand. During 2015, the performance of these two main aspects varied by company, however, losses were prevalent during the year and catastrophes had substantially adverse effects on the insurance operations, leading some companies to suffer a loss from their operations. However, every company had great returns on their investment assets. Figure 3 shows the development and breakdown of profit for 2012 to 2015.

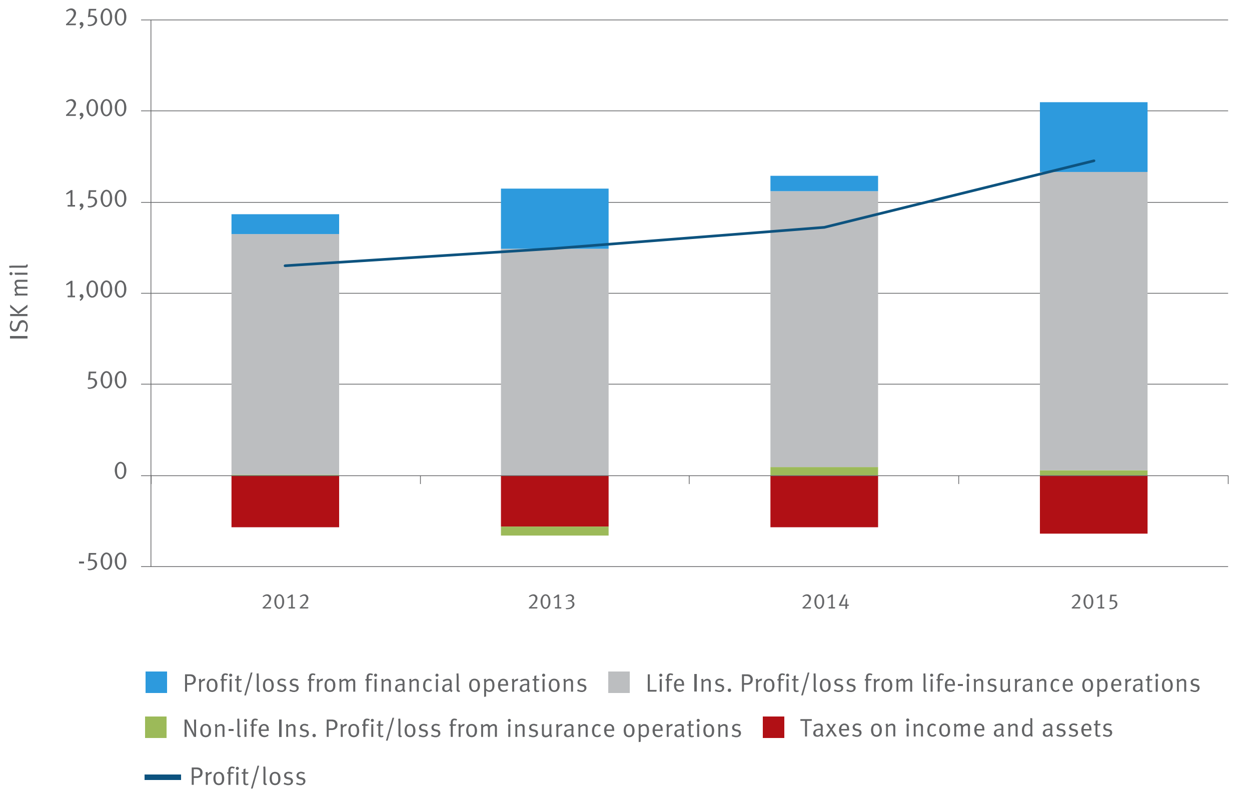
Figure 3 Performance of non-life insurance companies 2012-2015



Operations of life insurance companies

Operations of life insurance companies have generally been characterised by stability as opposed to the operations of the non-life insurance companies. The performance has improved substantially in recent years, as can be seen on Figure 4. Earnings from life-insurance operations have increased slightly during the period 2012-2015 and earnings from financial operations have varied substantially from year to year.

Figure 4 Performance of life insurance companies 2012-2015



Guidelines on the Annual Accounts of Insurance Companies

FME is currently drafting Guidelines on the Annual Accounts of Insurance Companies. FME considers such guidelines to be necessary as Regulation No 612/1996 on Annual Accounts and Consolidated Accounts of Life Insurance Companies and Regulation No 613/1996 on Annual Accounts and Consolidated Accounts of Insurance Companies Other than Life Insurance Companies were repealed recently. According to Article 56(1) of Act No 56/2010 on Insurance Activities, all insurance companies are obligated to compile their annual accounts in accordance with international accounting standards, cf. Chapter VIII of the Act on Annual Accounts, and the Guidelines will take that into consideration. During the drafting of the Guidelines, an emphasis has been on facilitating the understanding and comparison of key numbers from the operations and balance sheets of insurance companies for those who read the annual accounts. Furthermore, the uniformity and transparency for presentation and assessment of key information has been emphasised. The review period for the draft Guidelines is expected to begin later this year.

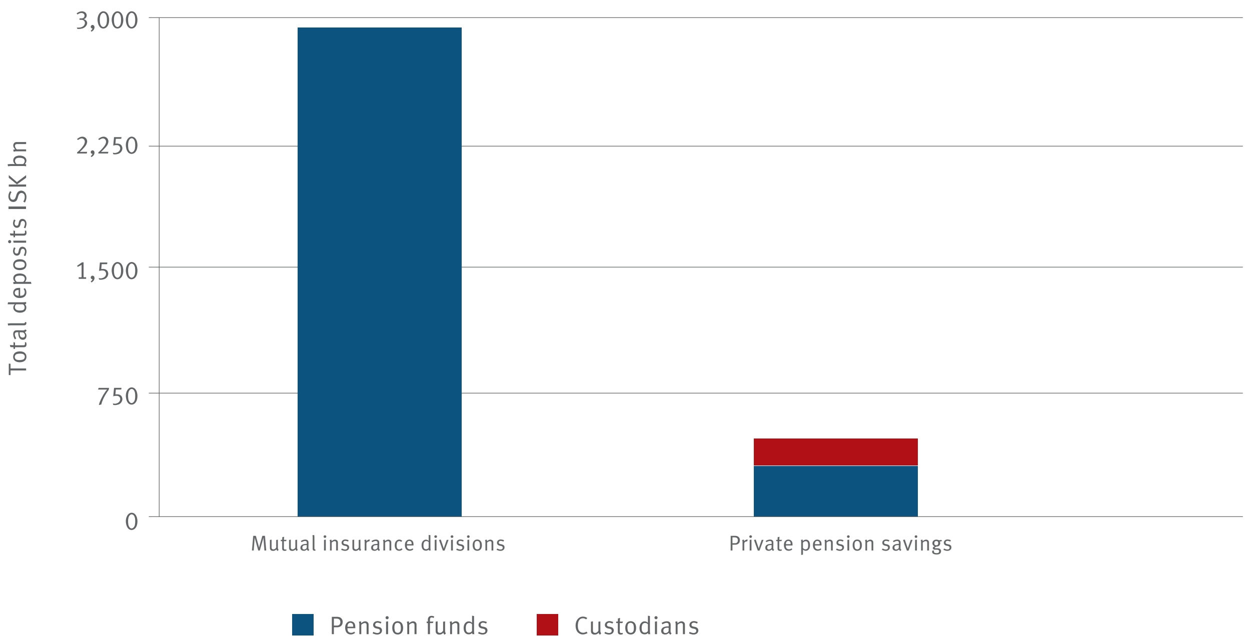
2.5 Pension Funds

At year-end 2015, 26 pension funds were in operation accepting pension savings in 30 mutual insurance divisions. Fourteen pension funds and 7 other custodians offered private pension savings. These entities offer 74 different investment products for private pension savings.

The total assets of Icelandic pension funds amounted to ISK 3,266 billion at year-end 2015, which is an increase of ISK 349 billion over the previous year, or 12%. Most pension fund assets belong to their mutual insurance divisions that totalled ISK 2,944 billion at year-end and had increased by ISK 309 billion from the previous year. Private pension savings held by the pension funds increased by ISK 40 billion during the year and amounted to ISK 322 billion at year-end. Private pension savings held by other domestic custodians amounted to ISK 153 billion at year-end 2015, which is an increase of ISK 17 billion over the previous year.

This is not including pension savings of Icelandic individuals that is held by foreign parties in the form of private pension savings and endowment assurance and is estimated to total between ISK 27 and 28 billion.

Figure 1 Bar diagram with assets by type of saving and custodian.

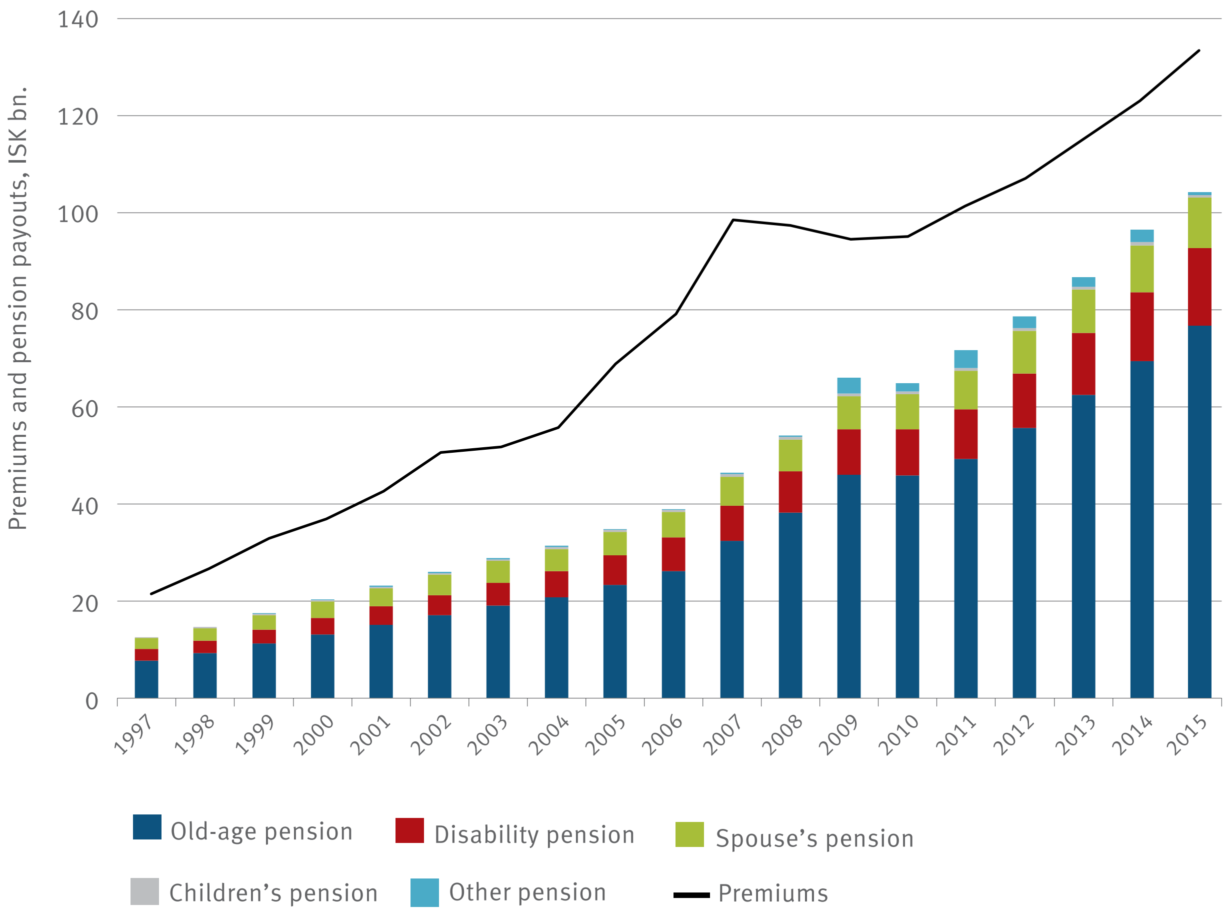


Assets of pension funds and custodians of private pension savings now equal 155% of gross domestic product (GDP) according to preliminary numbers from Statistics Iceland. This ratio is one of the highest in the Western World and is two percentage points higher than in the previous year.

The pension funds' performance in 2015 was very positive. According to preliminary numbers, the real return of total assets is estimated to be approximately 8%.

Premiums to the pension funds' mutual insurance divisions amounted to approximately ISK 35 billion in excess of the pensions paid out by the funds last year. In recent years, the pension payments from the mutual insurance divisions have grown faster than premiums to the funds. Pension payments have increased by 11-12% per year for the last few years and they will continue to increase faster than premiums in the future. Other things being equal, the premiums to the pension system as a whole are expected to exceed payouts for the next two decades. Under those conditions the pension funds will have to find new ways to invest their funds.

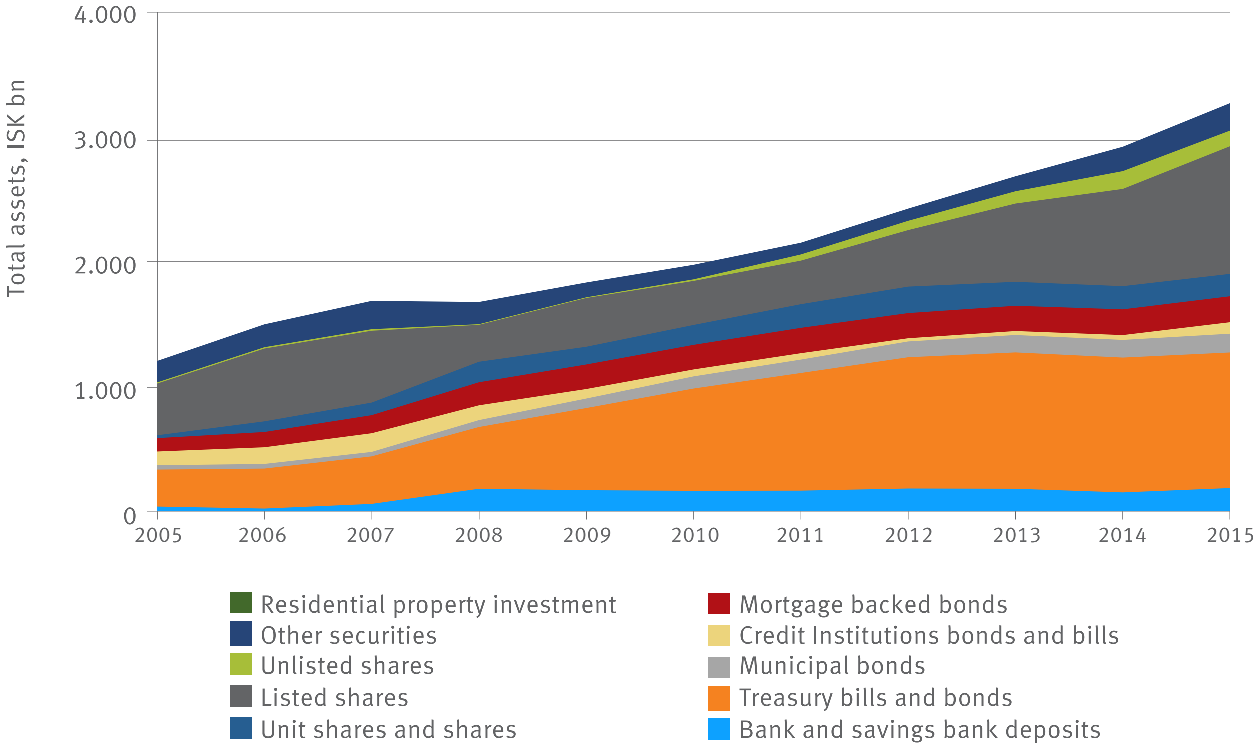
Figure 2 Bar diagram of pension funds' premiums and payouts 1997-2015



In recent years, the percentage of shares in the pension funds' asset portfolios has increased with new companies being admitted to trading in the equity market and the pension funds now own approximately half of all shares in the listed companies. The funds profited from the substantial increase in the domestic equity market. The total direct and indirect ownership share of the pension funds in domestic and foreign equity increased by over ISK 240 billion in 2015, which is approximately 70% of the asset increase in the year.

For the first time, pension funds' assets in equities are larger than their assets in public-guaranteed bonds and bills that have, until now, been their largest individual asset class. More than a third of their assets are now invested in listed and non-listed shares and less than a third is in public-guaranteed bonds and bills. In recent years, the pension funds have increased their share in bonds and bills issued by credit institutions and corporations. In the latter half of the previous year, the pension funds increased their participation in the market for real estate lending. That counteracted the use of private pensions to repay mortgages and, as a whole, the ratio of mortgage-backed bonds decreased slightly. The ratio of other asset classes has not changed significantly from the previous year.

Figure 3 Pension fund asset composition from 2005-2015



The capital controls have limited the pension funds' new investments abroad since the collapse of the banks, however, last year CBI authorised an ISK 10 billion investment by the pension funds abroad. The ratio of foreign assets as a percentage of the total asset of the pension funds has remained steady in recent years and it was 24% at year-end 2015.

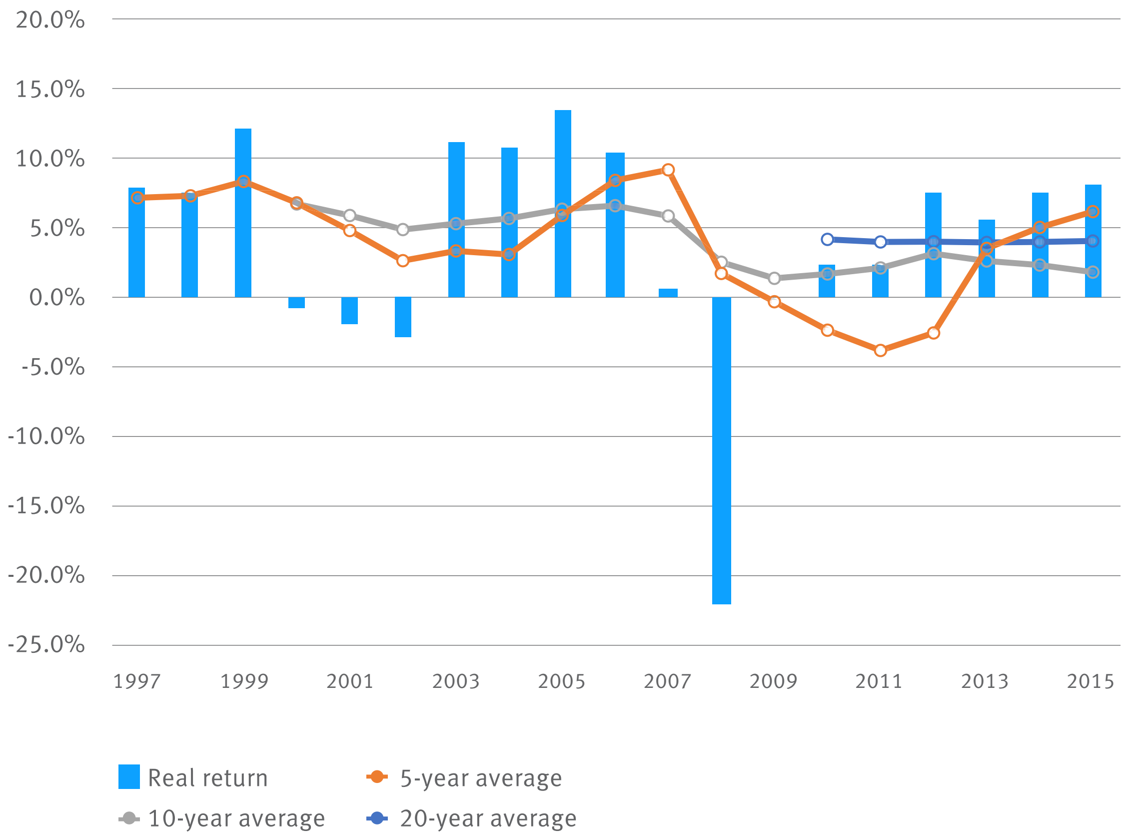
Participation in a European stress test

During the year, FME and Icelandic pension funds participated in the European Insurance and Occupational Pensions Authority (EIOPA) stress test. This was the first the EIOPA conducted a uniform stress test on the pension market but the Authority has conducted previous stress tests on the insurance market. The test endeavoured to assess the impact of three scenarios on the return and pension ratio of the funds' mutual insurance divisions; i.e. an asset price shock scenario, a long-term low return scenario and an increased longevity scenario.

Most people remember equity price shocks over the years and it is clear that the pension funds must take financial market volatility into account in their risk management. Most Icelandic mutual pension funds comprise a wide age range for participants in the same pension division. Therefore, asset price shocks impact the oldest participants in the Icelandic pension funds the hardest. The comparison of the above-mentioned stress test showed that foreign pension funds endeavour to reduce the weight of riskier assets as pension payments become due.

The low interest rates in many parts of Europe have brought attention to the challenges pension funds face if that situation remains for the long term. As is the case in other countries, younger pension fund participants are most sensitive to interest rate levels lowering further and staying low for the long term. Pension fund obligations in Iceland are assessed in comparison to a 3.5% real rate of return. For the preceding 20 years their real return has averaged 4.1%. Their real return has been more volatile in the short term. In the last 10 years it has averaged 1.8% and in the last 5 years it has averaged 6.2%.

Figure 4 Bar diagram of pension funds' annual return.



Life expectancy

Life expectancy has been increasing rapidly in the preceding decades resulting in increased obligations of the pension funds. Most of our neighbouring countries have started to include forecasts with increased life expectancy in assessments of pension fund obligations. For some time, the Icelandic Actuarial Society has been preparing amendments to the implementation of actuarial examinations at Icelandic pension funds.

Figure 5 Average life expectancy at birth, at age 65, and at age 67 1981-2015.

	Life expectancy at birth		Life expectancy at age 65		Life expectancy at age 67	
Year	Male	Female	Male	Female	Male	Female
1981-1985	73,9	79,8	15,3	18,4	14,0	16,9
1986-1990	74,9	79,9	15,7	18,9	14,4	17,3
1991-1995	76,1	80,5	16,1	19,1	14,6	17,4
1996-2000	76,9	81,2	16,5	19,3	15,0	17,7
2001-2005	78,6	82,5	17,5	20,3	15,9	18,7
2006-2010	79,4	83,0	18,0	20,4	16,4	18,8
2011-2015	80,6	83,5	18,9	20,9	17,3	19,3
2015*	88,4	90,5	20,1	22,1	18,3	20,3

Changes in male and female life expectancy are based on the Icelandic Actuarial Society's (FÍT) updated life expectancy tables. Source: Statistics Iceland and FÍT.

FME tasked actuaries at the Icelandic pension funds with calculating the impact of increased longevity on pension fund obligations. According to their preliminary calculations, the new life expectancy tables will increase the accrued obligations of public pension funds by 7.8% and pension funds in the mainstream labour market by 9.8%.

Pension funds in the mainstream labour market, which do not enjoy the counter-guarantee of employers, will have to respond to the increase of accrued obligations by impairing retirement benefits. The impairment can be achieved either by lowering the real amount of benefits or by delaying pension payouts. The funds will most likely seek a solution using both of these methods and will most likely call an extraordinary meeting this fall to amend their articles of association. Government employee pension schemes will need to receive increased contributions from their guarantor to cover the increased obligations.

Changes to annual accounts

Last year, FME issued new rules on the annual accounts of pension funds that entail several substantial changes. All pension funds are required to comply with the rules in preparing their annual accounts for 2016 but most pension funds used an exemption to specific provisions of the rules while preparing annual accounts for 2015. The rules cause changes in the presentation of annual accounts and stipulate increased transparency relating to the benefits of those who work on behalf of the funds.

The main change relates to the principle of measuring all securities at fair value. However, the pension funds will be allowed to measure bonds at the initial purchase price if they are intended to be held to maturity. The adoption of the rules is expected to increase volatility in the funds performance. The rules provide for a special summary of an actuarial examination that will now be shown independently in the annual accounts of the pension funds, unlike before.

However, the new rules on annual accounts do not deviate from the assumptions of the actuarial examination, which is determined pursuant to Regulation No 391/1998. The pension funds' obligations and fixed-income securities will, as before, be measured with a fixed rate of 3.5% in the actuarial examination.

2.6 Management companies and funds

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

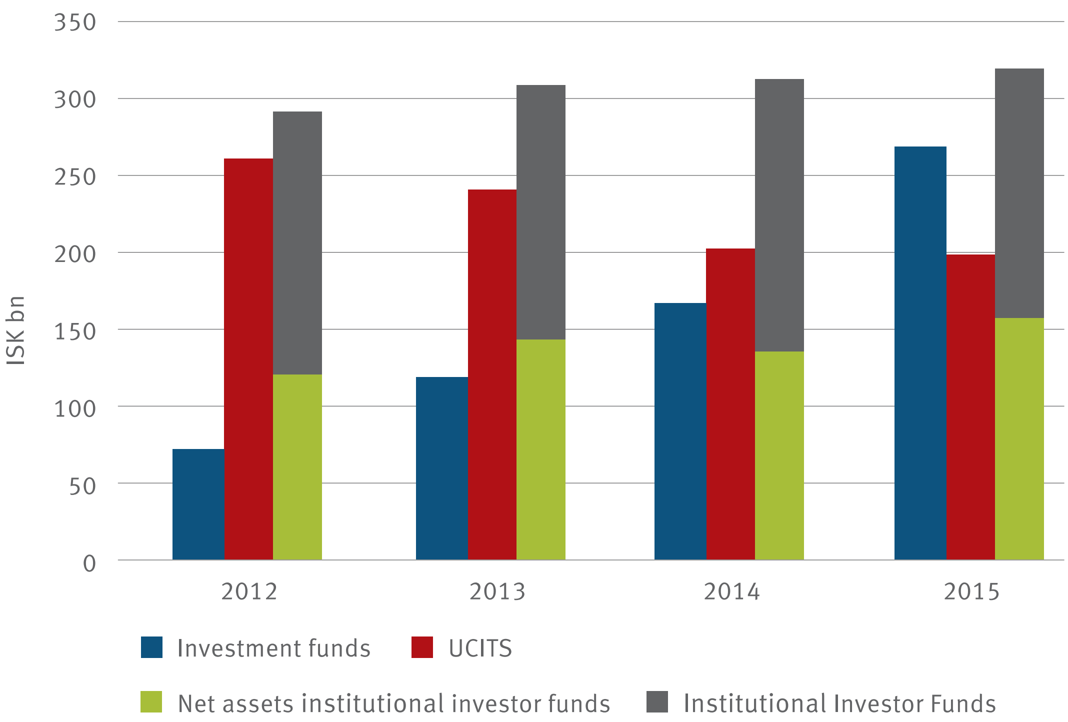
There were ten management companies regulated by FME at year-end 2015, the same number of companies as in the previous year. The principal activities of fund management companies involve managing UCITS, investment funds, and institutional investor funds even though management companies are not the only companies authorised to manage them.

The number of UCITS decreased by three during the year and there were 50 UCITS and investment compartments active during the year. The number of investment funds increased by five during the year and there were 53 investment funds and investment compartments active during the year. At year-end 2015, total assets of UCITS and investment funds amounted to ISK 460 billion. Of these, assets of UCITS totalled ISK 195 billion and assets of investment funds totalled ISK 265 billion.

UCITS and investment funds' assets increased by ISK 94 billion during the year and that increase is substantially higher than in recent years. The increase results from the investment funds as their assets increased by ISK 100 billion, or 61%. However, UCITS' assets decreased by ISK 6 billion during the year, or 3%, and that was the third consecutive year their assets decrease after substantial increases from 2008-2012.

The number of regulated institutional investor funds increased by 11 during the year and there

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



were a total of 85 institutional investor funds operated by 13 entities during the year. Their total assets amounted to ISK 315 billion; net assets amounted to ISK 155 billion. The funds' assets changed slightly year-on-year. The increase of total assets amounted to ISK 7 billion. The leverage of assets has generally been around 50% and has decreased slightly from the previous year.

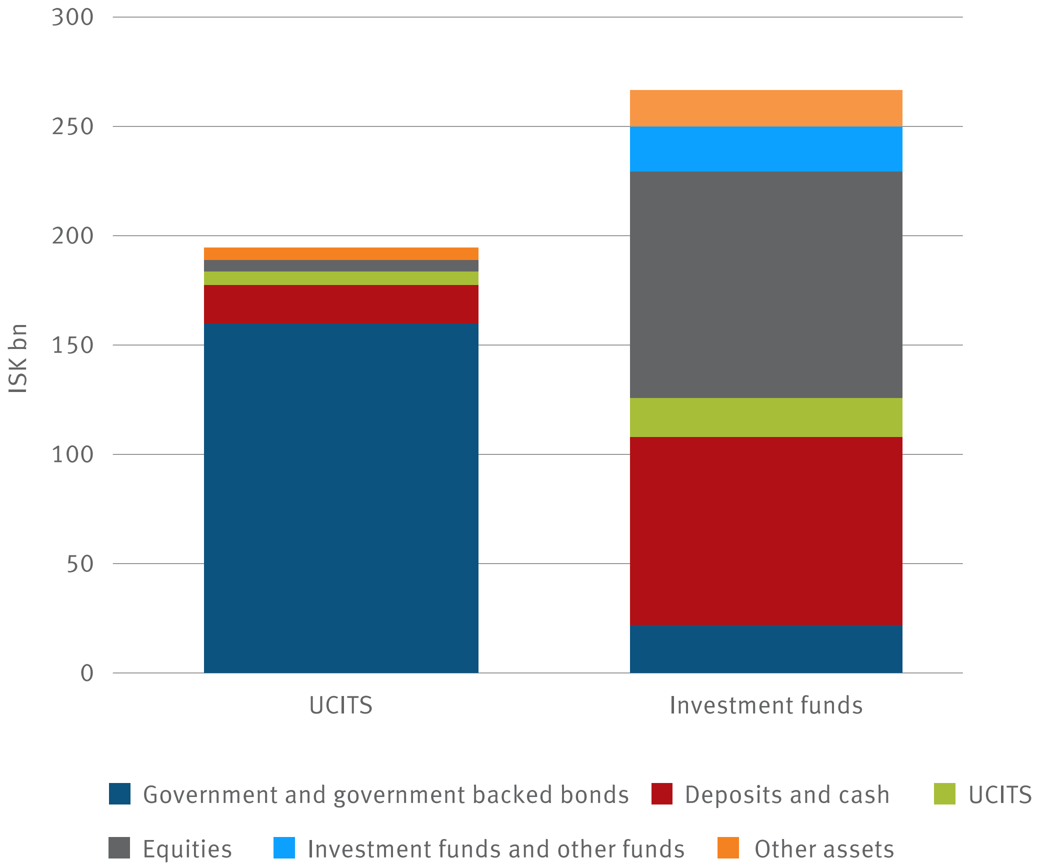
UCITS and investment funds' asset breakdown

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

The asset breakdown of UCITS is substantially different from the asset breakdown of investment funds and more than 90% of UCITS holdings are securities issued by the State or with guarantees from the State and other public institutions and deposits and cash on hand. However, investment funds' holdings are substantially more varied. Approximately 40% is held in equities, more than 30% is deposits and cash on hand, approximately 15% is held in other funds and only about 8% are securities issued by the State or with guarantees from the State and other public institutions.

Institutional investor funds mainly hold their assets in equities, mortgage backed bonds, other collective investment undertakings, and loan contracts.

Figure 2 Asset breakdown of UCITS and investment funds as of year-end 2015



Jón Þór Sturluson
Deputy Director General and trumpet player

‘I started learning how to play trumpet the winter I moved to Stykkishólmur at the age of 10. Stykkishólmur has had an active brass band for a long time, especially when I was growing up, under the leadership of Daði Þór Einarsson. I stopped playing in the band when I moved to Reykjavík for secondary school and started again, much later, where I had left off, playing with Royal, a band that was formed at Reykjavik University.’

3. Events of the past year

3. Events of the past year

3.1 Highlights from May 2015 to end of April 2016

FME published a Consultation Paper with a draft of rules on the annual accounts of mutual and investment funds

In mid-May 2015, FME published a Consultation Paper that includes a draft on rules on the annual accounts of mutual and investment funds.

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

At the end of May 2015, FME published the annual accounts and information on the performance of insurance companies’ lines of business. These included, as usual, the publication of income statements, balance sheets and cash flows. When the insurance company was part of a consolidation the consolidated accounts were published.

The proposed merger of AFL Savings Bank ses. with Arion Bank hf.

At the beginning of June 2015, FME announced on its website that the Icelandic Competition Authority had published a decision stating that, in light of the financial position of AFL Savings Bank, Arion Bank could no longer trade its shares in the savings bank.

Temporary suspension of trading

On 8 June 2015, FME announced its decision to temporarily suspend trading in certain financial instruments admitted to trading on a regulated market. The decision was made to safeguard investor equality. Trading resumed after a joint press conference of the Prime Minister and the Minister of Finance where the plan to lift the capital controls was presented.

The District Court rejects claims in a case against FME

On 11 June 2015, the conclusion of the District Court in the case Icelandair Group brought against FME for the Authority’s decision in March 2014 to fine Icelandair Group hf. (Icelandair) for breaches of Article 122(1) of Act No 108/2007 on Securities Transactions. Plaintiff’s claims were rejected and the decision thus remained intact.

The merger of Straumur Investment Bank hf. and MP Bank hf.

On 22 June 2015, FME approved the merger of Straumur Investment Bank hf. with MP Bank hf. on the basis of Article 106(1) of Act No 161/2002 on Financial Undertakings.

Four Guidelines issued in June

FME issued four Guidelines in June 2015. They are:

- Guidelines on Best Practises for the Preparation and Form of Stress-Tests for Financial Undertakings
- Guidelines on Key Information for Mutual and Investment Funds
- Guidelines on the Dialogue Between FME and External Auditors for Regulated Entities that are also Public-Interest Entities
- Guidelines on the Governance of Insurance Companies

FME grants Fossar Markets hf. an extended operating license

On 25 June 2015, FME announced that on 23 June Fossar Markets hf. had been granted an extended operating license as a securities company on the basis of Act No 161/2002 on Financial Undertakings.

Overall results of financial undertakings' annual accounts etc. 2014

On 30 June 2015, FME announced a report summarizing the overall results of financial undertakings' annual accounts for 2014, commercial banks, savings banks, credit undertakings (collectively referred to as credit institutions), securities dealers, securities brokers, and fund management companies, as well as information on the total assets of UCITS and investment funds operated by individual management companies and total assets of professional investor funds operated by management companies and other operators. In addition, the report included detailed information on payment institutions and co-operative deposit departments.

FME deems the holding company Icelandic Securities hf. eligible to own a qualifying holding in !!Straumur Funds hf.!!

O 16 July 2015, FME concluded that Icelandic Securities hf., kt. 610587-1519, was eligible to own a qualifying holding of up to 100% in Straumur Funds pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.

FME addresses the pension funds' situation in 2014

On 16 July 2015, FME published the overall results of Icelandic pension funds' annual accounts for 2014. The numerical information was based on data received from pension funds and custodians of private pension savings.

Securities market developments

On Friday 21 August 2015, FME held an open breakfast meeting entitled: Securities market developments Steven Maijoor, one of the presenters, introduced the priorities in 2015 for the European Securities and Markets Authority (ESMA) where he is full-time Chair. Furthermore, an FME specialist introduced EMIR and its impact in Iceland.

A presentation for companies in the credit market that use FINREP on a consolidated basis

On 25 August 2015, FME held a presentation for regulated financial undertakings that report on a consolidated basis. Changes were introduced in FME data collection related to the implementation of a European technical standard and a new version of the FINREP data package.

The merger of Nordurland Savings Bank ses. and Landsbankinn hf.

On 4 September 2015, FME authorised the merger of Nordurland Savings Bank ses. with Landsbankinn hf. on the basis of Article 106(1) of Act No 161/2002 on Financial Undertakings. A news update on the matter stated that Landsbankinn assumed all the rights and obligations of Nordurland Savings Bank and the companies would be merged under the name of Landsbankinn.

FME grants GAM Management hf. an extended operating license

On 3 September 2015, FME granted GAM Management hf. an extended operating license as a UCITS management company on the basis of Act No 161/2002 on Financial Undertakings

EIOPA issues the second part of technical standards and guidelines related to Solvency II

On 24 September 2015, a news update on FME's website noted that the European Insurance and Occupational Pensions Authority (EIOPA) had issued the second part of technical standards and guidelines related to Solvency II.

FME grants T-9 ehf. a collection license pursuant to the Collection Act

On 23 September 2015, FME granted T-9 ehf. a collection license pursuant to Act No 95/2008 on Debt Collection.

FME establishes a policy on the application of measures for enforcement and sanctions - Recent changes in the Authority's powers to impose administrative fines

In the beginning of October 2015, FME announced on its website the establishment of a policy on the application of measures for enforcement and sanctions. Pursuant to the policy, FME intends to react in a strong and targeted way to violations of laws or regulations, including those that relate to sound and proper business practices, and infringement of the Authority's decisions. The Authority will apply measures for enforcement, sanctions and, where applicable, reassess the competency of regulated entities' directors and board members.

FME grants Premium ehf. a collection license

On 24 August 2015, FME granted Premium ehf. a collection license pursuant to Act No 95/2008 on Debt Collection.

FME has concluded the Supervisory Review and Evaluation Process at Arion Bank hf., Islandsbanki hf. and Landsbankinn hf.

On 19 October 2015, FME announced the conclusion of the Supervisory Review and Evaluation Process at Arion Bank hf., Islandsbanki hf. and Landsbankinn hf. The release stated: 'A financial undertaking shall have a sound risk monitoring mechanism. The board and the !!director!! of the company shall carry out periodic assessments of capital requirements having regard to the risks inherent in their activities, pursuant to Act No 161/2002 on Financial Undertakings and Rules No 215/2007 on the Capital Requirement and Risk Weighted Assets of Financial Undertakings. The assessment is conducted in the Internal Capital Adequacy Assessment Process (lCAAP) and the financial undertaking shall inform FME, when requested, of the assessment in an ICAAP report.

The merger of AFL Savings Bank ses. with Arion Bank hf.

On 15 October 2015, FME approved the merger of AFL Savings Bank with Arion Bank hf. on the basis of Article 106(1) of Act No 161/2002 on Financial Undertakings. Arion Bank hf. assumes all the rights and obligations of AFL Savings Bank ses. and the companies will be merged under the name Arion Bank hf.

Consultation Paper on a draft rule on maximum distributable amount and limitations on financial undertakings' distributions related to capital buffers

On 15 October 2015, FME issued Consultation Paper No 5/2015 on a Draft Rule for Maximum Distributable Amount and Limitations on Financial Undertakings' Distributions Related to Capital Buffers.

Concerning comments made by the Iceland Chamber of Commerce on draft legislation on insurance activities

In a news update on 22 October 2015, FME referred to the comments of the Iceland Chamber of Commerce on the draft legislation on insurance activities that is based on the Solvency II Directive (No 2009/138/EC) and the media coverage resulting from those comments. The update stated that the comments by the Iceland Chamber of Commerce had included several misstatements that FME felt obligated to redress.

FME deems Arctica Eignarhaldsfélag ehf. eligible to own a qualifying holding in H.F. Verðbréf hf.

On 2 November 2015, FME concluded that Arctica Eignarhaldsfélag ehf. was eligible to own a qualifying holding in H.F. Verðbréf hf. pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.

FME grants Fossar Markets hf. an extended operating license

On 17 November 2015, FME granted Fossar Markets hf. an extended operating license on the basis of Act No 161/2002 on financial undertakings.

Reporting to FME in connection with the transposition of CRD IV

On 24 November 2015, FME published its plan for reporting and submission dates related to the transposition of CRD IV.

Meetings related to the transposition of the Solvency II Directive

On 1 December 2015, FME announced a series of meetings planned in relation to the transposition of the Solvency II Directive for the insurance market. The announcement stated that the meetings were, in particular, intended for insurance company representatives, their external and internal auditors and other interested parties.

Breakfast meeting on network security

On 3 December 2015, FME held a breakfast meeting on financial undertakings' network security. Frederick Hult, executive advisor with the security company Cyber Resilience Ltd., gave a lecture at the meeting entitled: From Bytes to Boardroom, a journey to cyber resilience. Hult's lecture was mainly intended for financial undertakings' managers and parties working in information technology and related safety issues.

Rules on the annual accounts of mutual and investment funds

In early December 2015, FME announced the issue of rules on the annual accounts of mutual and investment funds. The announcement stated that the implementation of the rules would begin the following year for the preparation of the interim financial statement as of 30 June 2016. Annual accounts for the accounting year 2016 would be prepared pursuant to the rules.

A circular on notifications to FME on the basis of Article 43 of Act No 128/2011

On 4 December 2015, FME sent out a circular to fund management companies. The circular reaffirmed the rules that apply to notifications to FME when the investments of a mutual or investment fund exceed the authorised limits pursuant to Article 43 Act No 128/2011, on UCITS, Investment Funds and Institutional Investor Funds.

The Supreme Court of Iceland confirms FME's decision to refuse access to documentation

On 17 December 2015, the Supreme Court ruled in Case No 263/2015. The case involved the public right to access documents and information held by FME pursuant to the Information Act. No. 140/2012 and limitations to those rights due to provisions on confidentiality in Article 13 of Act No 87/1998 on Official Supervision of Financial Activities and Article 58 of Act No 161/2002 on Financial Undertakings. The judgment validated FME's decision to refuse access to the documentation and concluded, by arguing a contrario from the latter sentence of Article 4(3) of the Information Act, that both Article 13 of Act No 87/1998 and Article 58 of Act No 161/2002 constitute special provisions of confidentiality that prevail over the public right to access pursuant to the Information Act.

Information meeting on reporting related to the CRD IV legislation

On 17 December 2015, FME held an information meeting for financial undertakings for plans related to CRD IV reporting in 2016.

A circular to insurance companies related to feedback from their ORSA process

On 22 December 2015, FME sent a circular to insurance companies summarizing comments from the companies' feedback related to their Own Risk and Solvency Assessment (ORSA). The Own Risk and Solvency Assessment involves the insurance company assessing its own risk, its response to the risks, and the impact of individual events on the company's solvency. The companies were should consider the comments during their next Own Risk and Solvency Assessment, as applicable.

A circular to financial undertakings on the presentation, publication, and delivery of key information to investors in mutual and investment funds

On 23 December 2015, FME sent a circular to financial undertakings on the presentation, publication, and delivery of key information to investors in mutual and investment funds With the circular, FME sought to emphasize the importance of key information as a comparison document for investors deciding on investments in mutual or investment funds.

Solvency II has entered into force

At the beginning of 2016, it was announced on FME's website that the European Insurance and Occupational Pensions Authority (EIOPA) had published a press release on its website announcing that Solvency II, a new regulatory framework for the insurance market, had entered into force.

FME has deemed BLM Investment ehf. and related entities eligible to own a qualifying holding in Lýsing hf.

On 30 December 2015, FME concluded that BLM Investment ehf. was eligible to own a qualifying holding of up to 33% with an indirect interest in Lýsing hf. pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings through ownership of the parent company of Lýsing hf., Klakki ehf. FME further concluded that the parent company of BLM Investment ehf., Burlington Loan Management Ltd. that previously held a 13.2% share in Klakki ehf., and related entities, Deutsche International Finance (Ireland) Limited, and Davidson Kempner Capital Management LP, was eligible to own a qualifying holding of up to 50% with an indirect interest in Lýsing hf.

Sænes ehf. and Grýtubakkahreppur deemed eligible to supplement their qualifying holding in the savings bank Sparisjóður Höfðhverfinga

On 8 January 2016, FME concluded that Sænes ehf. was eligible to supplement a qualifying holding up to 33% in Höfðhverfingar Savings Bank pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.

A circular on corrective measures on the basis of Article 43 of Act No 128/2011

On 11 January 2016, FME sent out a circular to fund management companies. The circular, sent following FME's circular from 4 December 2015, contained further clarification on the rules that apply to corrective measures when the investments of a mutual or investment fund exceed the authorised limits pursuant to Article 43 Act No 128/2011, on UCITS, Investment Funds and Institutional Investor Funds.

FME deems YNWA ehf. and Arnór Gunnarsson eligible to own a qualifying holding in Alda Asset Management hf.

On 18 January, FME concluded that YNWA ehf. was eligible to own a qualifying holding of up to 20% in Alda sjóðir (Alda Asset Management hf.) pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings.

Rules on maximum distributable amount and limitations on financial undertakings' distributions related to capital buffers

On 19 January 2016, FME announced on its website the issue of rules on maximum distributable amount and limitations on financial undertakings' distributions related to capital buffers, pursuant to Article 84a(7) of Act No 161/2002 on Financial Undertakings. The rules address how payouts from financial undertakings, such as withdrawals of capital dividend or bonuses, are limited if a financial undertaking does not maintain adequate own funds for capital buffers.

Comments on BRRD on FME's website

On 19 January 2016, FME published comments on Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (Bank Recovery and Resolution Directive). The Directive, most often known as BRRD, entered into force across the European Union on 1 January 2015.

Conclusion of an examination of insurance companies' use of PC-Crash reports

On 20 January 2016, FME published a news update on its website on an examination of insurance company use of so-called PC-Crash reports in cases involving damages. The review was conducted pursuant to Article 9(1) of the Act on Official Supervision of Financial Activities. To this end, FME had requested information and relevant documentation from insurance companies on the use of PC-Crash reports as well as the insurance companies' general view and position on the use of the reports.

Financial Stability Council's recommendation on the application of capital buffers

On 22 January 2016, the first meeting of the Financial Stability Council was held. Recommendations from the Council to the Authority were published on FME's website.

Deloitte and FME conclude an education and training contract

On 25 January 2015, Deloitte and FME concluded a one-year contract for Deloitte to provide FME with education and training as well as professional services for the introduction of a methodology, processes, and monitoring activities associated with lending impairment on the basis of IFRS.

FME has deemed the Icelandic Treasury eligible to own a qualifying holding in Sjova-Almennar Insurance hf.

On 2 February 2016, it was announced on FME's website that the Authority had concluded that the Icelandic Treasury was eligible to own a qualifying holding up to 20% in Sjova-Almennar Insurance hf., pursuant to Chapter VI of Act No 56/2010 on Insurance Activities, through ownership of the holding company SAT eignarhaldsfélag hf. CBI or its subsidiary will hold the Icelandic Treasury's share in Sjova-Almennar Insurance hf.

EIOPA issues a Consultation Paper on procedures relating to personal pension products

On 3 February 2016, it was noted that the European Insurance and Occupational Pensions Authority (EIOPA) had issued a press release on its website drawing attention to a new Consultation Paper with its advice related to the development of procedures for an EU Single Market for personal pension products (also known as 'Pillar III' pension savings which is similar to Icelandic individual private plans).

FME deems the Icelandic Treasury eligible to own a qualifying holding in Islandsbanki hf. and subsidiary financial undertakings

On 3 February 2016, FME concluded that the Icelandic Treasury was authorised to own a qualifying holding of 100% in Islandsbanki hf., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings. It stated: 'The Icelandic Treasury will acquire a 95% share in the bank through the intend acquisition of ISB Holding ehf. Prior to that, the Icelandic Treasury owned a 5% share in the bank. The Icelandic State Banking Agency (ISBA) will hold the share on behalf of the Icelandic Treasury pursuant to Act No 88/2009 on Icelandic State Financial Investments.'

EIOPA issues a Consultation Paper on the dialogue between supervisors and external auditors

On 5 February 2016, it was announced on FME's website that the European Insurance and Occupational Pensions Authority (EIOPA) had issued a press release on its website announcing a new Consultation Paper on Guidelines facilitating the effective dialogue between insurance supervisors and external auditors.

The Icelandic Treasury eligible to own a qualifying holding of 20% in Lýsing hf. with an indirect interest

On 9 February 2016, FME concluded that the Icelandic Treasury was authorised to own a qualifying holding of 20% with an indirect interest in Lýsing hf., pursuant to Chapter VI of Act No 161/2002 on Financial Undertakings, through the intended acquisition of a 17.58% share in Klakki ehf. It stated: 'CBI or its subsidiary will hold the above-mentioned share owned by the Icelandic Treasury.'

FME issues two Consultation Papers

On 26 February 2016, it was announced on FME's website that the Authority had issued Consultation Paper No 1/2016 on draft Guidelines on the Internal Governance of Financial Undertakings and Consultation Paper No 2/2016 on common procedures and methodologies for the supervisory review and evaluation process (SREP).

FME warns of misuse of debit card information

On Leap Day 2016, FME's website noted that the Authority had been informed of customers of Icelandic financial undertakings being asked to supply checking account information from their debit cards through the phone. The intent was likely fraudulent. Checking account information can for instance be used to make payments on the Internet and through other electronic means.

FME redresses false reports

On 7 March 2016, FME published a summary redressing false reports by the Icelandic Automobile Association in connection with planned withdrawals of capital dividend from the insurance companies.

FME approves the merger of H.F. Verðbréf hf. and Arctica Finance hf.

On 14 March 2016, FME approved the merger of H.F. Verðbréf hf. with Arctica Finance hf. on the basis of Article 106(1) of Act No 161/2002 on Financial Undertakings.

For the sake of clarity concerning insurance companies and so-called 'benefits funds'

On 15 March 2016, FME published a summary on its website concerning insurance companies and so-called 'benefits funds' The intent was to redress various misunderstanding from the discussion surrounding the expected withdrawal of capital dividend from the insurance companies.

Changes to consumer services FME provided by phone

On 15 March 2016, it was announced on FME's website that there had been changes to consumer services by phone and that the information on the website had been reformed to improve consumer access. The website now contains detailed and clear information on the process for consumers to have their issues resolved. As a result of the changes, the consumer services by phone will no longer be provided at specific published hours. However, consumers are still able to call FME by phone if they feel instructions on the dispute process on the website are unclear. It was noted that, as before, FME will nevertheless neither settle disputes nor reply to matters of law relating to the authorities of individual regulated entities in specific instances.

Comments on reporting by Skjóðan

FME made comments on reporting on insurance company supervision in the Skjóðan section of the newspaper Fréttablaðið from 16 March 2016. The information was distorted in a way to denigrate the activities of FME.

FME grants Icelandic Investors Ltd. an extended operating license

On 1 April 2016, FME granted Icelandic Investors Ltd., ID no 451294-2029, an extended operating license as a securities company on the basis of Act No 161/2002 on financial undertakings.

FME and Nasdaq Iceland sign a statement of collaboration

On 18 April, FME announced that Unnur Gunnarsdóttir, Director General of FME, and Páll Harðarson, President of Nasdaq Iceland hf. (Kauphöllin), had signed a new joint statement of collaboration between FME and Nasdaq Iceland on collaboration for the functioning of supervisory tasks and information exchange.

FME issues guidelines on internal governance

On 25 April, it was announced on FME's website that the Authority had issued Guidelines No 1/2016 on the Internal Governance of Financial Undertakings. The Guidelines are intended to harmonise financial undertakings' criteria and procedures with regard to governance.

FME encourages parties to review the registered interests of managers and employees

On 29 April, it was reported with an update on FME's website that the Authority had sent financial undertakings, pension funds, and insurance companies a circular encouraging these parties to review the registered interests of their managers and employees, having regard to the acts mentioned in the circulars.

3.2 Summary of decisions and notifications on transparency from 1 May 2015 to end of April 2016

8 May 2015:	Conclusion of an examination of the lending of Landsbankinn hf. to legal entities
8 May 2015:	Conclusion of an examination of the lending of Islandsbanki hf. to legal entities
8 May 2015:	Conclusion of an examination of the lending of MP Bank hf. to legal entities
21 May 2015:	Conclusion of an examination of the business practices of TM Insurance hf.
22 May 2015:	Amicable settlement for the infringement of ALM Verðbréf hf. (ALM Securities Ltd.) of Article 29 of Act No 161/2002 on Financial Undertakings
11 June 2015:	Amicable settlement for the infringement of X of Article 3 of Act No 95/2008 on Debt Collection
16 June 2015:	Conclusion of an examination of the consumer disclosure of Lýsing hf.
24 June 2015:	Conclusion of an examination of the governance of Lífeyrissjóður verslunarmanna (The Pension Fund of Commerce)
13 Aug. 2015:	Conclusion of an examination of the separation of functions at Virding hf.
14 Aug. 2015:	Conclusion of an examination of the separation of functions at Icelandic Securities hf.
17 Aug. 2015:	Conclusion of an examination of the separation of functions at Landsbankinn hf.
27 Aug. 2015:	Conclusion of an examination of the valuation of the loan portfolio of Islandsbanki hf.
9 Sep. 2015:	Conclusion of an examination of certain aspects of the actions of Kortaþjónustan hf. (KORTA PAY) to combat money laundering and terrorist financing
9 Sep. 2015:	Conclusion of an examination of the separation of functions at H.F. Verðbréf hf.
25 Sep. 2015:	Conclusion of an examination of new lending at Arion Bank hf.
1 Oct. 2015:	Conclusion of an examination of lending by Lífeyrissjóður bænda (The Farmers Pension Fund)
2 Oct. 2015:	Conclusion of an examination of the disclosure of Tryggja ehf. to its consumers
9 Oct. 2015:	Conclusion of an examination of the determination of the contribution for asset and liability insurance
25 Nov. 2015:	Conclusion of an examination of the internal control mechanism of Landsbankinn for large exposures
4 Dec. 2015:	Administrative fine for the infringement of Arion Bank hf. of Article 123(1)(1) of Act No 108/2007 on Securities Transactions
8 Dec. 2015:	Conclusions of an examination of the system for securities and pledges at Landsbankinn hf.
8 Dec. 2015:	Conclusions of an examination of the system for securities and pledges at Islandsbanki hf.
9 Dec. 2015:	Conclusion of an examination of the scope of concessions at Landsbankinn hf.
8 Jan. 2016:	Conclusions of an examination of the system for securities and pledges at Arion Bank hf.
11 Jan. 2016:	Conclusion of an examination of the separation of functions at Arion Bank hf.
12 Jan. 2016:	Conclusion of an examination of supervision of money laundering and terrorist financing at Arion Bank hf.
15 Jan. 2016:	Conclusion of an examination of supervision of money laundering and terrorist financing at Landsbankinn hf.
18 Jan. 2016:	Conclusion of an examination into the sale by Arion Bank hf. of shares in Siminn hf.

18 Jan. 2016: Administrative fines for the infringement of X of Article 1(2) of Act No 32/2005 on Insurance Intermediation

4 Feb. 2016: Conclusion of an examination of the separation of functions at Islandsbanki hf.

10 Feb. 2016: Conclusion of an examination of the lending of Suður-Þingeyingar Savings Bank ses.

15 Feb. 2016: Conclusion of an examination of the scope of concessions at Arion Bank hf.

16 Feb. 2016: Conclusion of an examination of supervision of resumes against money laundering and terrorist financing at Islandsbanki hf.

24 Feb. 2016: Administrative fine for the infringement of Kópavogur Municipality against Article 122(1) of Act No 108/2007 on Securities Transactions

26 Feb. 2016: Administrative fine for the infringement of Almenni lífeyrissjóðurinn (Almenni Pension Fund) of Article 123(1)(1) of Act No 108/2007 on Securities Transactions

1 March 2016: FME's decision on imposing capital buffers

7 March 2016: Conclusion of an examination of the scope of concessions at Islandsbanki hf.

18 March 2016: Amicable settlement for the infringement of BankNordik of Articles 126 and 127 of Act No 108/2007 on Securities Transactions

21 March 2016: Conclusion of an examination of the ownership interest of TM Insurance hf. in Hotel Laxá and related companies

22 March 2016: Amicable settlement for the infringement of Ríkisútvarpið ohf. (The Icelandic National Broadcasting Service) of Article 128 of Act No 108/2007 on Securities Transactions

31 March 2016: Conclusion of an examination of the business practices of Landsbankinn hf. related to its sale of an ownership share in Borgun hf.

28 April 2016: Conclusion of an examination of the lending of Höfðhverfingar Savings Bank ses.

3.3 Summary of issues of Fjármál and articles from 1 May 2015 to end of April 2016

Fjármál, Vol. 4, Iss. 2 (August 2015)

The tariffs of charges at the commercial banks and their effect on consumer price awareness
Þráinn Halldór Halldórsson, specialist with Off-Site Supervision

EMIR and central trade repositories for OTC derivatives
Hörður Tulinius, specialist with On-Site Inspections and Securities

Fjármál, Vol. 4, Iss. 3 (November 2015)

The effect new tables of life expectancy have on pension fund obligations
Jón Ævar Pálmason, risk analysis specialist

Recent changes in FME's authority to impose administrative fines
Hildur Jana Júlíusdóttir, lawyer with the Office of the Chief Legal Counsel

Future changes in legislation on the insurance market
Sigurður Freyr Jónatansson, Director of Oversight

Dialogue between FME and external auditors for regulated entities that are also public-interest entities
Ragnheiður Morgan, lawyer with Off-Site Supervision

Basel II and the capital requirements of banks in Iceland
Guðmundur Örn Jónsson, risk analysis specialist

Fjármál, Vol. 5, Iss. 1 (March 2016)

The separation of functions
Ása Magnúsdóttir, specialist with On-Site Inspections and Inga Dröfn Benediktsdóttir, lawyer with Securities Market Regulation

Long-term investments in infrastructure
Björn Z. Ásgrímsson, specialist with Oversight

FME's international collaboration
Ólöf Aðalsteinsdóttir, international coordinator

A macroprudential tool to reduce excessive expansion in the real estate market
Einar Jón Erlingsson, risk analysis specialist

A very instructive story
Andri Már Gunnarsson, market analysis specialist discusses the movie The Big Short

Ása Magnúsdóttir

Specialist with on-site examinations and horsewoman

'I got my first horse twenty years ago and have been heavily involved in horsemanship ever since. My children grew up surrounded by horses and my younger children were quite competitive for a while. They have, for instance, taken part in the National Icelandic Horse Competition so equestrianism turned out to be a great family activity. Each year, my friends and I go together on our well established five day horse-riding tour around the country.'

4. Entities regulated by FME

4. Entities regulated by FME

4.1 Number of entities regulated by FME

Categories of regulated entities at year-end	Notes	31/12/2012	31/12/2013	31/12/2014	31/12/2015
Subject to licence or operating under specific					
Commercial banks		4	4	4	4
Savings banks		9	8	7	4
Credit undertakings		6	6	6	5
Housing Financing Fund (HFF)		1	1	1	1
Deposit departments of co-operative societies		1	1	1	1
Securities companies		11	10	9	10
Securities brokers		2	2	2	1
Fund management companies	1)	10	9	10	10
Institutional investor funds - legal entities		4	7	9	14
Stock exchanges		1	1	1	1
Securities depositories		1	1	1	1
Pension funds	2)	32	27	26	26
Insurance companies		13	13	12	12
Insurance brokers		11	11	9	9
Entities with debt collection licenses		4	5	6	8
Payment institutions		1	1	1	1
Currency exchange establishments				1	1
Guarantee funds		2	2	2	2
Total		*113*	*109*	*108*	*111*
Other regulated entities:					
UCITS (not legal entities)	3)	56	57	53	50
Investment funds (not legal entities)	3)	28	44	48	54
Institutional investor funds (not legal entities)	3)	43	63	65	71
Custodians of private pension savings	4)	15	14	13	8
Issuers of listed shares		15	18	17	20
Issuers of listed bonds		49	57	60	60
Agent of foreign payment institution		1	1	1	1
Holding companies	5)	12	12	10	11
Financial undertakings undergoing winding-up proceedings		14	15	11	2
Total		346	390	386	388

1) Furthermore, see the number of UCITS and investment funds and institutional investment funds below in the table.
2) Many pension funds have more than one division. By including the divisions, the number of pension funds would increase by approximately 50 for each year shown in the table.
3) Funds that are not legal entities but operated by fund management companies. See the number of management companies above in the table. Several UCITS and investment funds have more than one division. The number of divisions is reflected in the figures in the table.
4) Commercial banks, savings banks, and two foreign custodians of private pension savings. Excluding the two foreign custodians of pension savings, all included in the above totals.
5) Holding companies in the financial sector and insurance sector and mixed holding companies, see more details in the definition in Acts No 161/2002 and No 56/2010. These are active shareholders that hold more than 50% in regulated entities. Active shareholders with stakes of 10-50% are not included in the table.

4.2 Activities by foreign parties in Iceland

The following summary shows the number of entities/companies authorised to provide services in Iceland based on rules that apply in the European Economic Area:

	30/6/11	30/6/12	31/12/13	31/12/14	31/12/2015
Foreign banks (credit and financial institutions) without establishments	222	224	239	254	263
Foreign banks without establishments				193	266
Foreign electronic money institutions without establishments				38	49
UCITS (no. of divisions in parentheses)	47 (367)	53 (352)	56 (370)	65 (410)	70 (518)
Securities companies/brokers (Investment firms)	2,113	2,020	2,148	2,280	2,461
Insurance companies with establishments	2	2	2	2	2
Insurance companies without establishments	405	377	381	352	389
Insurance brokers and insurance agents	5,158	4,990	5,030	5,223	5,055

FJÁRMÁLAEFTIRLITIÐ

THE FINANCIAL SUPERVISORY AUTHORITY, ICELAND