

securities market	credit market
pension- market	insurance market

## **“Mastery of the crisis from the position of the Financial Supervisory Authority of Iceland”**

**Presentation to the  
German Nordic lawyers association  
4<sup>th</sup> June 2010**

Rúnar Guðmundsson, lawyer and Head of Insurance Market

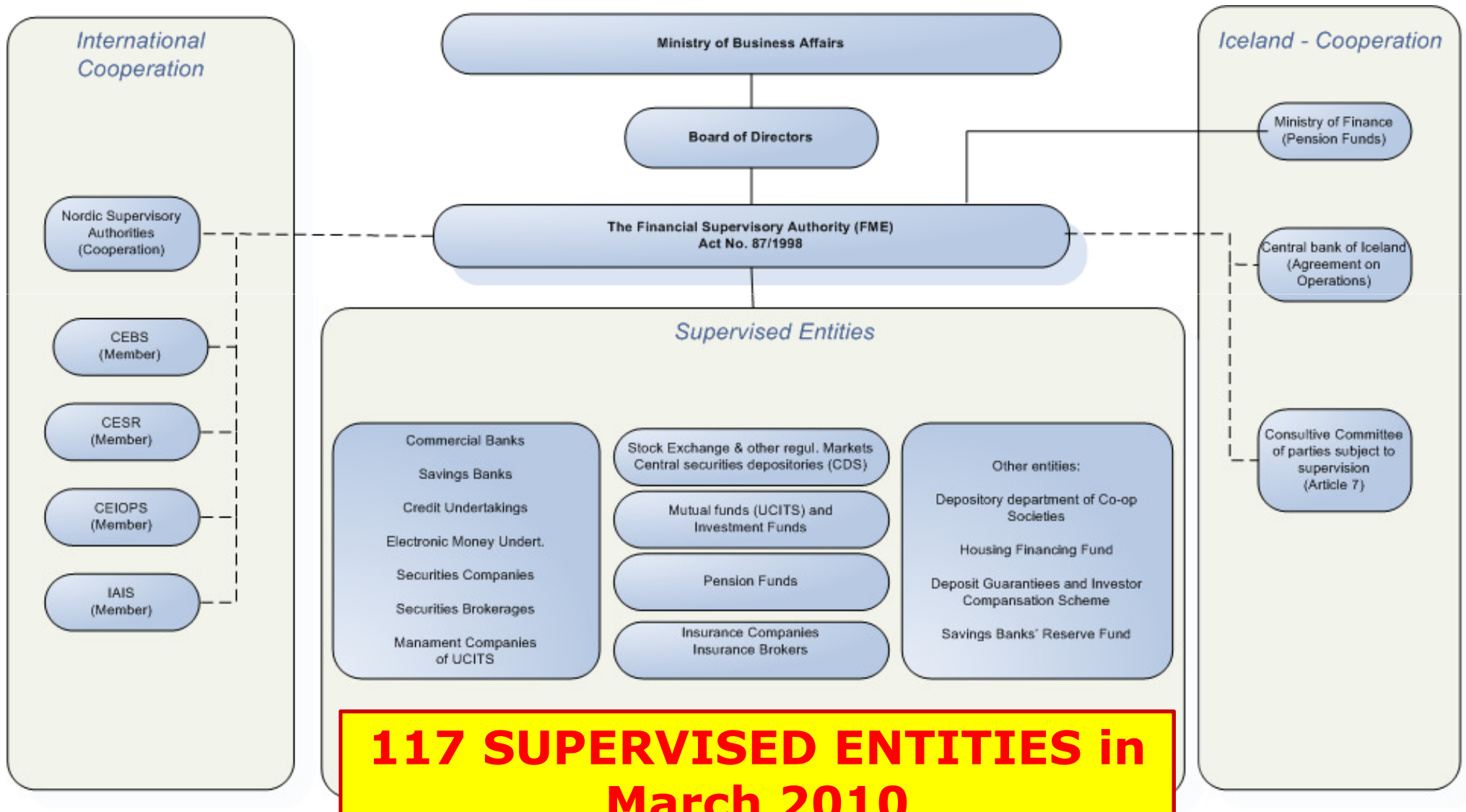
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## ***AGENDA – some main items***

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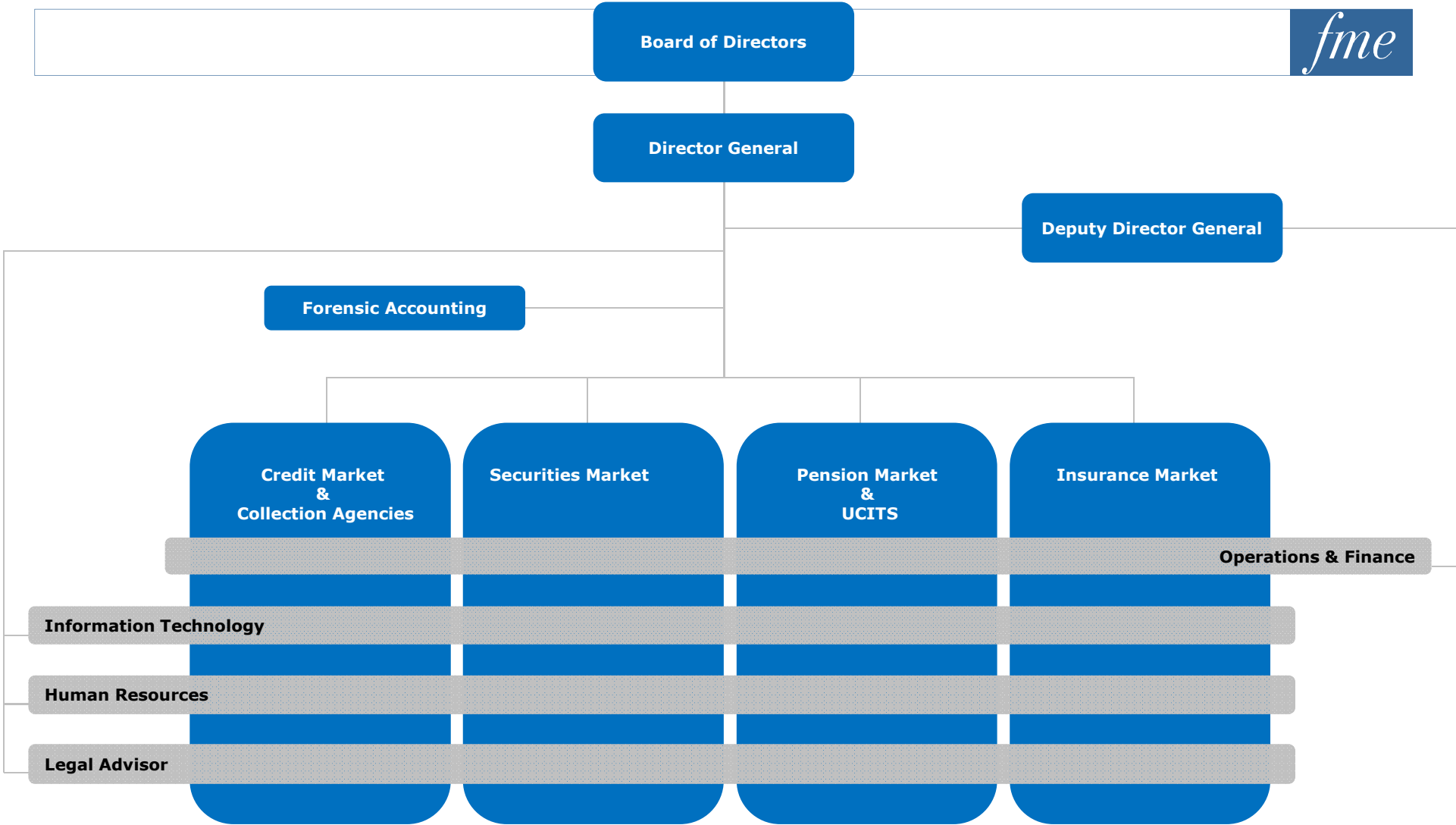
- FME supervisory and regulatory framework
- Growth of financial sector 2000 – 2008
- Collapse of banks and financial turmoil
- FME organization and structure
- Statutory powers and supervisory approach
- Investigations and sanctions
- Looking ahead and a conclusion

# FINANCIAL SUPERVISORY AUTHORITY



## **86 Employees in March 2010:**

- ⇒ 34 Have degrees in Business Administration or Economics
  - ⇒ 22 Lawyers
  - ⇒ 1 Actuarian
  - ⇒ 7 IT professionals
  - ⇒ 6 Engineers
  - ⇒ 7 Other Specialists
  - ⇒ 7 Support services
  - ⇒ 2 Trainees
- 
- 30+% of staff have advanced degrees from abroad
  - 20+% of staff have overseas work experience
  - In the year 2011 we expect to have about 117 employees!



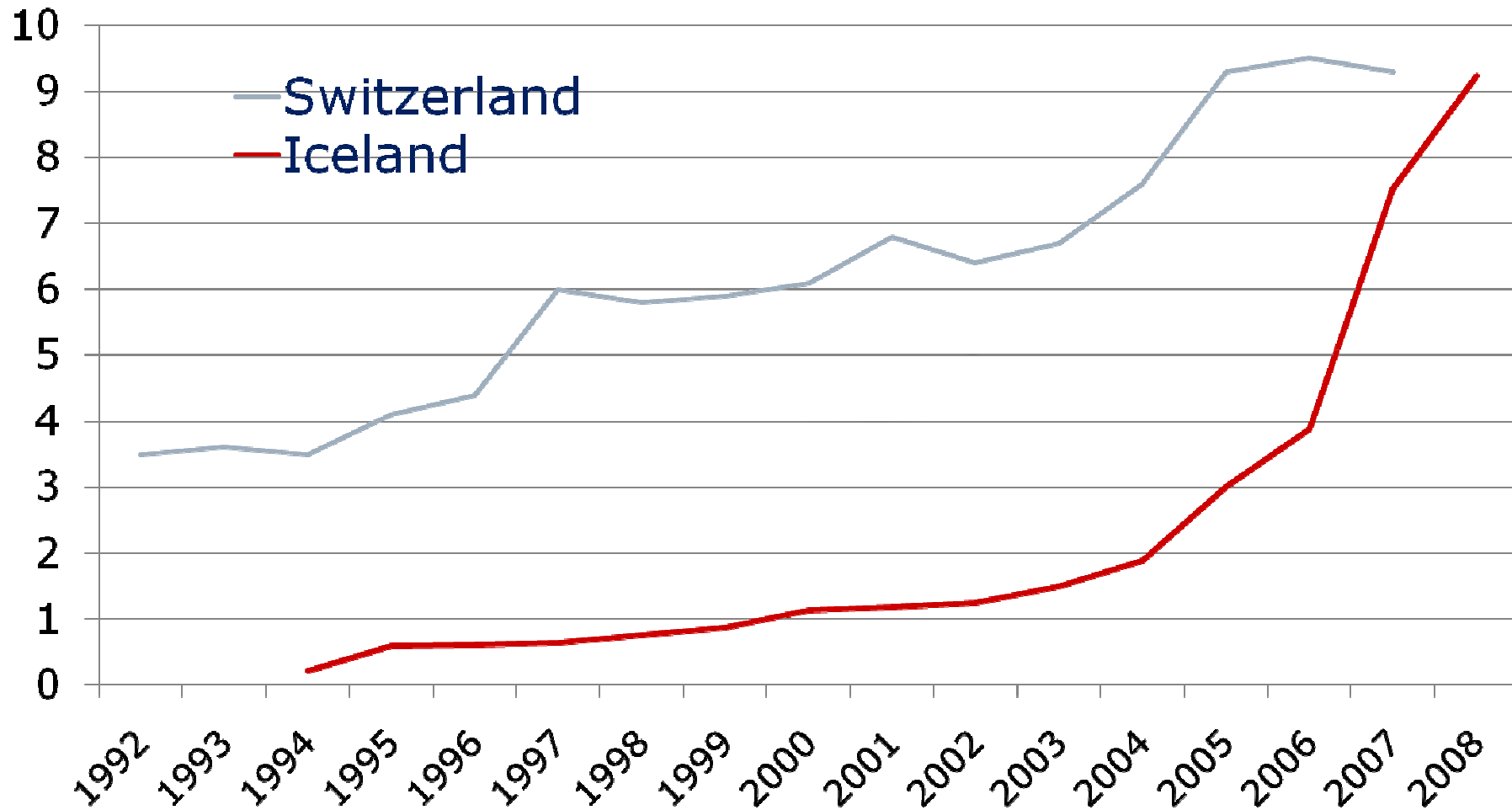
## ***ECONOMIC EXPANSION AND BOOM YEARS***

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- ⇒ Average annual increase in GDP during 5 years period 2003 to 2007 was **5,6%**
- ⇒ Stock market index grew by **174%** 2004 - 2007
- ⇒ Housing prices rose by **74.4%** 2004 - 2008
- ⇒ Disposable income grew by **73%** 2000 - 2007
- ⇒ Unemployment around **1%** for most of the 1998- 2008 period
- ⇒ Assets of regulated entities grew by **554%** 2000 - 2008

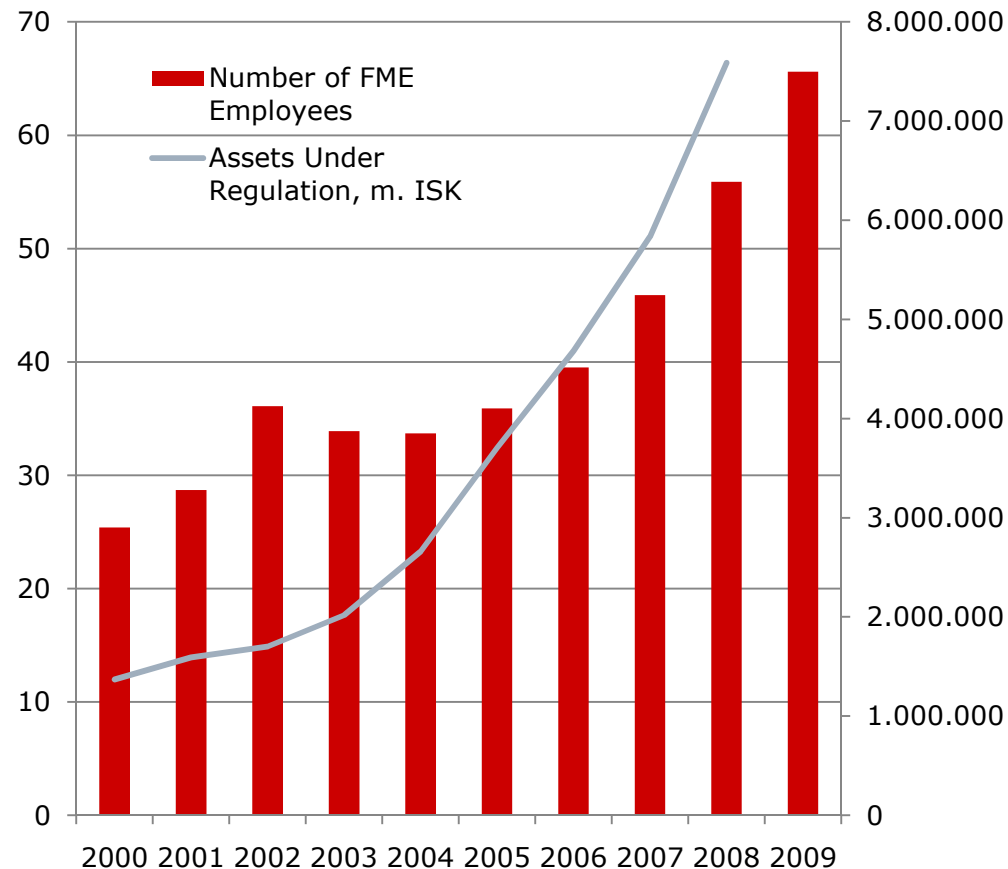
## FOREIGN LIABILITIES OF BANKS AS MULTIPLE OF GDP

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## NUMBER OF EMPLOYEES VERSUS INDUSTRY SIZE

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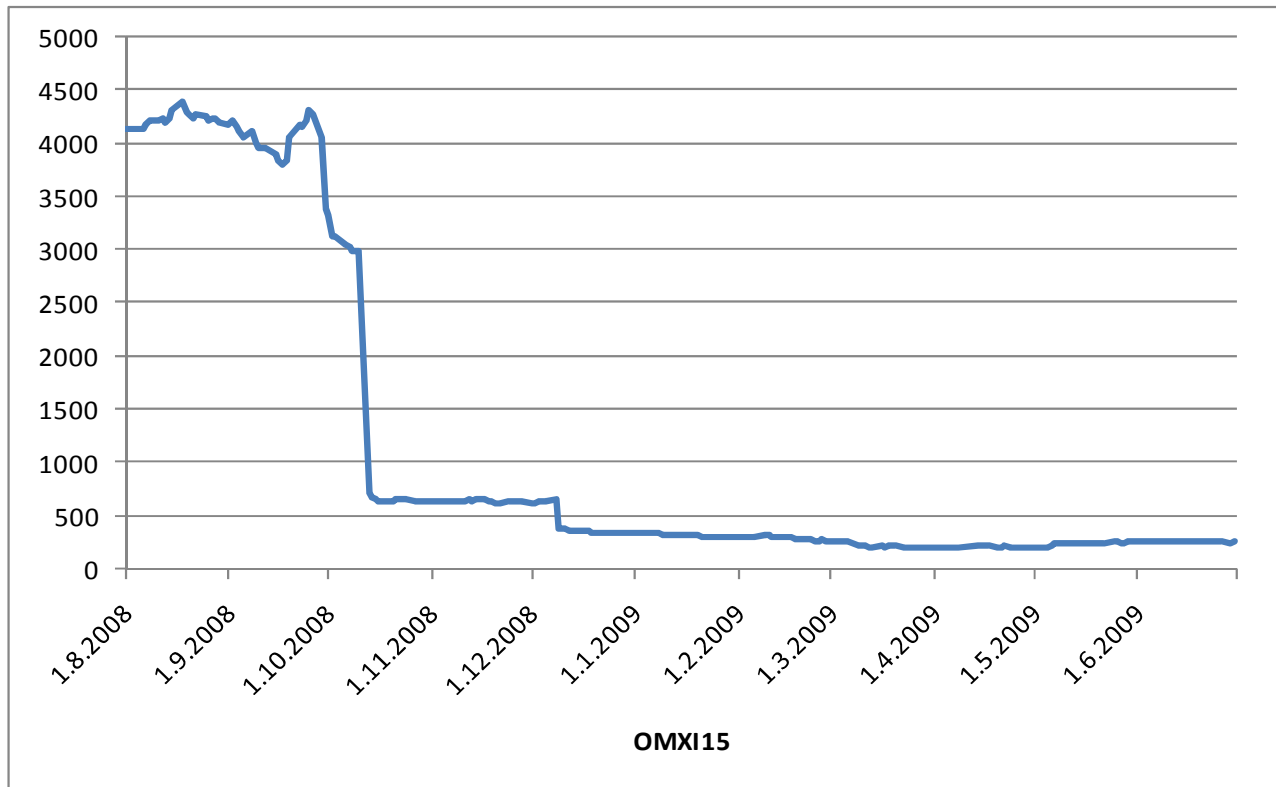
■ From 2000-2008, FME staffing approximately **doubled**

■ Assets of regulated entities grew by **554%** during the same period

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Source: Seðlabanki Íslands, Q3 2008 is last available for 2008

# THE OMXI15 INDEX 30.8.2008 – 30.6.2009



**The stock market lost 92% of its value in a few weeks**

# **FAILURE OF 3 LARGEST ICELANDIC BANKS**

**- SUPERIMPOSED ON LARGEST U.S. BANKRUPTCIES -**



Rank	Firm	Year	Type	Assets USD bn
1	Lehman Brothers	2008	Investment Bank	691
2	Washington Mutual	2008	Savings and Loans	328
3	WorldCom	2002	Telecommunications	104
4	General Motors	2009	Auto mfg.	91
<b>5</b>	<b>Kaupthing Bank</b>	<b>2008</b>	<b>Commercial/Investment Bank</b>	<b>83</b>
6	CIT Group	2009	Bank Holding Company	80
7	Enron Corp.	2001	Energy Trading, Natural Gas	66
8	Conseco	2002	Financial Services Holding Co.	61
<b>9</b>	<b>Landsbanki Islands</b>	<b>2008</b>	<b>Commercial/Investment Bank</b>	<b>50</b>
<b>10</b>	<b>Glitnir Bank</b>	<b>2008</b>	<b>Commercial/Investment Bank</b>	<b>49</b>

# MOODY'S RATING OF ICELANDIC BANKS



## Moody's rating system:

- |        |    |   |  |   |
|--------|----|---|--|---|
| 1. Aaa | Aa | A |  | Numerical modifiers are applied to each generic rating classification from Aa through Caa |
| 2. Baa | Ba | B |  |   |
| 3. Caa | Ca | C |  |   |

Bank	2003	2004	2005	2006	2007	2007	2008
Glitnir	A1	A1	A1	A1	Aaa	Aa3	A2
Kaupthing	A3	A1	A1	A1	Aaa	Aa3	A1
Landsbanki	A3	A2	A2	A2	Aaa	Aa3	A2

**In early 2007, the 3 Icelandic banks were briefly assigned higher ratings than e.g. ABN Amro**

## **FINANCIAL TURMOIL; SEPTEMBER-OCTOBER 2008**

*fme*

### ■ **The FME took control of:**

- ⇒ Landsbanki Íslands hf. - October 2008
- ⇒ Glitnir bank hf. - October 2008
- ⇒ Kaupthing bank hf. - October 2008
- ⇒ Straumur Investment Bank - March 2009

### ■ **The FME intervened in:**

- ⇒ Sparisjódabanki Íslands hf. (Icebank) – March 2009
- ⇒ Reykjavík Savings Bank (Spron) – March 2009
- ⇒ Sparisjóður Mýrasýslu (SPM) – April 2009
- ⇒ Byr Savings Bank (Byr) – April 2010
- ⇒ Sparisjóðurinn í Keflavík (Spfk) – April 2010

**Objective of takeovers by the FME:  
To ensure a functioning financial system**

## ***The Icelandic banking system in few words***

*fme*

- After the collapse of the three Icelandic banks in October 2008 the banks were overtaken by the authorities and split up into new banks and old banks. The old banks are still in winding-up proceedings.
- After lengthy negotiations between the resolution committees of the old banks, on behalf of the creditors, and the Government, on behalf of the new banks, on the valuation of the overtaken assets and compensation instruments, agreements were made in the 4<sup>th</sup> quarter 2009, more than one year after the split up.
- See next slide

## ***The Icelandic banking system in few words***

*fme*

- According to the agreements the old banks acquire stakes in the new banks according to following:
- Glitnir bank acquires 95% of Íslandsbanki's (ex. New Glitnir Bank) share capital, the Icelandic Treasury 5%.
- Kaupthing bank acquires 87% of Arion bank's (ex. New Kaupthing Bank) share capital, the Icelandic Treasury 13%.
- Landsbanki Íslands acquires 18.7% of NBI's (ex. New Landsbanki) share capital, the Icelandic Treasury 81.3%.
- Work is in progress

## ***The Icelandic banking system in few words***



- In January 2010 the FME authorised three different holding companies, subsidiaries of the old banks, to acquire qualifying holdings in the abovementioned new banks. The old banks, which are in moratorium and undergoing winding-up proceedings, are not eligible to own a qualifying holding in a bank. The authorisation to these holding companies are subject to various conditions to secure fit and propriety of the owners of the qualifying holdings and to facilitate supervision, cf. recent press releases on the FME's website: [www.fme.is](http://www.fme.is).
- The FME requires the new banks to have a minimum 16% capital ratio (thereof 12% core Tier 1 ratio).

## ***The Icelandic banking system in few words***

*fme*

- The remaining part of the depositary banks in Iceland, mainly small savings banks, went into financial difficulties after the collapse in late 2008. Work is in process on behalf of the authorities to find solutions to strengthen the financial position of the savings banks which hopefully will be concluded before end of 2nd quarter 2010.
- The Icelandic banks are now almost entirely operating domestically.

### **NEW TASKS 2009/2010**

- Investigations related to collapse of financial institutions
- Assessment of commercial banks' operability
- Assessment of old banks' eligibility to acquire a qualifying holding in new banks
- Investigation of foreign exchange laws
- Supervision of collection agencies
- Supervision of professional investment funds

### **TWO NEW DIVISIONS**

- Legal Advisor
- Forensic Accounting

### **NEW WORK METHODS**

- Higher frequency of on-site inspections
- Deeper analysis

## **POST-CRASH INVESTIGATIONS BY FME**

*fme*

- Investigations have turned up some long-running breaches of the law
  - ⇒ Cases under investigation involve widespread fraud stretching back for much of this decade
    - Market manipulation, insider trading, falsified reports
  - ⇒ In some cases, fraud appears to have been so prevalent as to have become normal business practice
  - ⇒ Fraud was perpetrated against the investing public, against the country as a whole, and against international lenders and bondholders

## **FME INVESTIGATIONS 2009**

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Referred to Special Prosecutor	31
Referred to the police	2
Referred to the State Prosecutor	5
Administrative fines and settlements	51
ALLS	89

## **LOOKING AHEAD**

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- Stepped-up supervision
  - ⇒ On-site inspections
- More forceful regulatory actions
- Greater deployment of IT
- Higher level of international cooperation
- New skills added to toolkit
  - ⇒ Forensic accounting
- New provisions in law such as
  - ⇒ Wider authority in dealing with bad practices

## ***Main legislation***

*fme*

- Information on the legislation regarding the FME and financial activities (laws, regulations, rules) can be found on our website [www.fme.is](http://www.fme.is)

Such as:

- ⇒ Act on official Supervision of Financial Operations with Amendments (87/1998)
- ⇒ Act on Payment of Cost Due to Official Supervision of Financial Activities (99/1999)
- ⇒ Act on Measures against Money Laundering and Terrorist Financing (64/2006)
- ⇒ Various Acts and regulations and rules regarding the credit market, pension market, insurance market and securities market

Regarding the Act (no. 87/1998):

- The purpose to promote compliance by financial activities covered by the Act with the laws, regulations, rules and by-laws which are applicable in each instance for those activities
- Activities to be supervised are mentioned in the legislation
- Articles on the establishment of the FME, Director General, employees and board
- Consultative Committee of parites subject to supervision
- Articles regarding the powers of the FME such as inpection and access, remarks and corrective action, liquidated damages and daily fines, duty of notification
- FME confidentiality
- Communication with supervisory authorities
- Relation wiht the Central Bank of Iceland

**The FME does supervise the credit market, pension market, insurance market and securities market (see FME website).**

- Domestic activities
- Foreign activities
  - ⇒ - EEA market
  - ⇒ - Non EEA market

## ***Many questions!***

*fme*

### **In this presentation I will discuss the activity of the FME but not in any detail the following questions:**

- ⇒ What was the FME doing before/and after the banking crisis?
- ⇒ What could the FME have done to hinder the crisis?
- ⇒ How the banks were supervised?
- ⇒ Serious infringements
- ⇒ Possible criminal offence and/or liability
- ⇒ The Parliament founded a special investigation committee; its report was issued on the 12 of April 2010.
- ⇒ Changes at the FME (staff and working procedures)
- ⇒ Changes to the legislation such as regarding lending between related parties.

## ***The consumer can!***

*fme*

- State his claim against the supervised party such as a bank or insurer
- Contact the FME but the FME does not rule on individual disputes between the consumer and supervised party
- There are two Complaints Committees located at the FME that handle individual disputes:
  - ⇒ Insurance complaints committee
  - ⇒ Complaints committee regarding financial undertakings
- The Courts

## ***Powers of the FME***

*fme*

In accordance to the Act on official Supervision of Financial Operations with Amendments (87/1998) and special legislation:

- FME has access to all information from parties subject to supervision, and relevant information from qualified shareholders and others closely linked to the parties
- FME insists on corrective action if activities are not consistent with rules and regulations or sound and proper business practices
- Authority to call and chair a board meeting
- Appointment of a special inspector of an entity subject to supervision
- Dismiss a board member or/and managing director

## ***Powers (cont.)***

*fme*

- FME can issue publicly its interpretations of laws, rules and regulations or guidelines for sound and proper business practices
- FME can conduct a house search and confiscate any material relying on a court order
- FME can impose financial sanctions on the parties subject to supervision
- FME issues and withdraws licenses
- Notification of criminal offence to the police
- Authority to take over the activity of a financial undertaking (in connection to the crisis)!

## **Regarding binding decisions – right to be heard**

*fme*

- The FME decisions must be in accordance with the Administrative procedures Act no. 37/1993.
- Right to be heard: A party to a case shall be given the opportunity to express his views on the subject-matter of the case before the authority reaches a decision thereon, unless his reasoned position on the matter already appears in the documentation on the case, or it is clearly unnecessary for him to do so.
- If the party in question can not abide the FME decisions, it can only take his case to the courts. That would not have an effect on the FME decision in the matter.

## ***The Administrative procedures act nr. 37/1993***

*fme*

- The Act does apply to state and municipal administration. The act does apply when the authorities, including boards of administration, decide as to individuals' rights and obligations. It shall not, however, apply in relation to the drafting of regulations and other general government edicts.

## ***Right to information from the FME***

*fme*

- A party to a case shall have the right in general to acquaint himself with the documentation and other material bearing on the case. If a party asks for duplicates or photocopies thereof he shall be given them unless the documents are of such nature or so voluminous that this presents a considerable difficulty.

**General rules such as:**

- Duty of guidance
- Setting of time limit
- Prompt handling
- Rule of investigation
- Principle of equality (equal treatment)
- Principle of proportionality (A public authority shall reach an adverse decision only when the lawful purpose sought cannot be attained by less stringent means. Care should then be taken not to go further than necessary).

## ***Regarding the role of the FME***

*fme*

- Security and stability of the market
  - ⇒ Financial requirements (sound basis – and minimum requirements)
  - ⇒ Good business practices
- Licences and registration requirements regarding domestic and foreign supervised undertakings
- Establishment of a supervised undertaking (technical provisions, holdings, fit and proper requirements, etc.)
- Board and directors
- Auditing and accounting
- Risk management

## ***Regarding the role of the FME***

*fme*

- Ownership (qualifying holdings in insurance companies)
- Business practices, terms of insurance, premiums, sales activities etc.
- Information requirements according to the Law on Insurance Contracts and Law on Insurance Mediation
- Transfer of insurance portfolios and mergers
- Special measures because of financial difficulty
- Loss of an operating licence
- Winding up procedure

## ***Changes to the legislation***

*fme*

- The FME does foresee changes to the legislation such as regarding the Act on financial undertakings and the Act on insurance activities.
- Changes such as:
  - ⇒ More possibility for the FME to evaluate the behaviour and business of the party in question, market conduct etc.,
  - ⇒ More emphasis on risk management and internal auditing,
  - ⇒ Special credit register regarding "large exposure" (0,25% of net lending),
  - ⇒ More emphasis on sound and proper business practices,
  - ⇒ Limitations regarding the choice of audit firms (5 year limit)

***Cont. changes to the legislation such as***

*fme*

- Articles regarding lending and/or severance agreement with CEOs, board members and key employees
- Remuneration bonus systems (in accordance with rules issued by FME)
- Articles regarding qualified holding such as regarding the criteria to be followed by the FME
- Authorisation for the FME to limit the activity of business units of financial undertakings (such as head office and branch),
- Articles on large exposure in relation to connected parties (such as control and/or financial difficulties which can effect other parties, definition of connected parties)

## ***Cont. changes in legislation such as***

*fme*

- ❑ The board of directors and CEO shall alert the FME without delay should they acquire knowledge of issues of decisive importance to the company's continuing activities.
- ❑ Members of the board of directors and CEOs shall be financially independent and they shall have completed a university degree which is relevant to their work. The FME may grant exemptions..... Furthermore, members of the board of directors and managing directors shall possess sufficient knowledge and work experience to be able to carry out their functions in a satisfactory manner.....They shall not have exhibited any conduct which gives occasion to doubt their ability.....
- ❑ A financial undertaking will not be permitted to grant loans secured by shares or guarantee capital certificates issued by the undertaking.

## ***Conclusion!***

*fme*

Has the FME changed since 2008?

I will conclude by saying yes! Different working procedures and more recourses will lead us in the right direction.

securities  
market

credit market

pension-  
market

insurance  
market

# THANK YOU

FJÁRMÁLA*e*FTIRLITIÐ

10 March 2010