

**Expansion of Icelandic financial companies abroad and the effects on
FME's operation
Jónas Fr. Jónsson, 11 June 2007.**

Mr. Chairman, Lárus Finnbogason.

Mr. Chairman, Liu Mingkang and the delegation from the China Banking Regulatory Committee,

Dear Guests,

This morning we aim at discussing the expansion of Icelandic financial services companies abroad and in particular towards China. The China Banking Regulatory Committee (CBRC) and the FME have for some time prepared a Memorandum of Understanding (MoU) and in relation to its conclusion, Chairman Liu Mingkang accepted to participate in this meeting. For that we are grateful and I'm sure that we will today enhance our knowledge of the Chinese capital market, which is growing fast. So far, only one Icelandic company, Glitnir Bank, has established an entity in China and Mr. Lárus Welding, the CEO of Glitnir Bank will tell us more about that. A MoU between the regulatory authorities should facilitate cross-border operations and I look forward to further cooperation with the CBRC.

The growth of Iceland's financial sector has been substantial during the last few years. The three Icelandic commercial banks have grown six fold during the last three years and transformed from local deposit institutions to international corporations with headquarters in Iceland offering sophisticated financial services.

In my view, the expansion by Icelandic banks abroad commenced for real in mid 2004 when Kaupthing acquired FIH in Denmark. Previous there had been some minor foreign ventures.

I will in this presentation focus mainly on the expansion of the banks abroad. However, it should be noted that the FME also has overseas tasks in other areas. Insurance companies have increased foreign operations, Icelandic investors have acquired qualified holdings in financial services companies abroad and there is a special Nordic cooperation regarding the supervision of OMX.

1. Statistics

As a starting point, it can be informative to look at some statistics.

In the year 2006, 52% of the income of the three Icelandic commercial banks originated abroad.

In 2006, 45% of the banks' total assets could be attributed to foreign subsidiaries. If assets held in branches abroad are added to this figure, the proportion of assets of entities inside and outside Iceland would be 50-50.

In 2006, almost half of those employed by the banks, were located at branches or subsidiaries abroad. Approximately, the banks have 3100 employees abroad and 3300 in Iceland. One could expect that during this year, the number of employees abroad will surpass the number in Iceland.

2. Modes of foreign operations

The foreign operation of the Icelandic banks is based on their license issued by the FME and foreign supervisors place confidence in FME's supervision in this respect. This is apparent in the European Economic Area (EEA) legal framework, which is founded on the principles of single license, common basic rules and supervisory cooperation.

Outside the EEA, the banks normally need a special approval or license, before they can establish a branch or a representative office. Nevertheless, in most instances, foreign supervisors ask the FME for information regarding their operation and conduct in Iceland.

The main modes of operation, in addition to directly providing services over borders, are either by subsidiary, branch or representative office. The main rules regarding supervision within the EEA are as follows:

- A branch, is supervised by the home authority, i.e. a UK branch of an Icelandic bank is supervised by the FME. The responsibility of the FME is similar as the operation would take place domestically.
- A subsidiary, is supervised by the host authority, i.e. a UK subsidiary of an Icelandic bank is supervised by the FSA. However, the consolidated operation is supervised by the FME.
- A representative office is of promotional nature and used to introduce the company to the respective market and establish a connection between the bank and prospective clients. It does not provide direct financial services and is generally under the supervision of the home authority whereas the host authority monitors its conduct.

Outside the EEA, there is not a common legal framework. Consequently, the host authorities supervise all operations of foreign institutions, including branches. Special agreements, called Memorandum of Understanding (MoU), are made in order to facilitate information exchange and make it possible for home supervisors to monitor effectively operations of branches.

3. Operations in 20 countries and 54 entities

Today Icelandic credit institutions have already established or notified the FME of 54 entities in 20 countries. At the end of the year 2005, there were 26 entities in 12 countries. One would not be surprised to see augmentation in these figures before end of the year.

Notably, as of late, the preferred mode of expansion has been a branch. The reasons behind this trend can be various. Without been exhaustive, some of this can possibly be explained by the following:

- It is relatively straight forward to establish a branch under EEA rules,
- The banks have grown in experience and confidence in their foreign ventures,
- The banks would prefer to have more direct managerial control over the operation,
- Transactions within the group are simpler,
- Supervision is done by the home regulator.

4. Cross-border tasks of the FME

In nutshell, the cross-border tasks of the FME come under three categories.

First, there is cooperation with financial regulators in other countries, in particular in those countries where Icelandic financial services companies have operations. Under this qualifies various exchange of information, at the beginning of an operation and on-going, participation in on-site visits, the making and management of MoUs' and crises management exercises.

Second, the FME participates in European and Nordic cooperation. At European level, the committees of regulators give advice to legislative bodies of the EU and develop pan-European guidance. Recent guidelines on FME's homepage regarding Basel II issues are illustrative of the latter. Furthermore, the regulators exchange information, discuss interpretations and are planning to facilitate staff exchange. The importance of active participation increases in tandem with the degree of internationalisation of the Icelandic market.

Third, there is a growing demand for information on the Icelandic market from various foreign parties, such as international organisations, rating agencies, analysts and the media. The FME decided early last year to increase transparency and hosted around 60 meetings with foreign parties. So far this year, the number of meetings is around 20. Furthermore, the FME has increased the number of material available in English and aims at doing more in that respect.

5. FME's strategy regarding overseas operations

In 2006, the FME laid down its strategy with 15 main objectives. Each objective has 1 or 2 measurements to measure results and whether the FME is making progress as planned.

The objective of a sound financial market, which in turn is a competitive market, can only be achieved if the regulatory framework, that is the rules and their enforcement, is credible.

The FME's contribution to the credibility of the market, in addition to general supervisory work, is demonstrated in bi-and multilateral cooperation with foreign supervisors, international organisations, credit rating agencies and other parties. This cooperation and direct supervisory responsibility makes the FME an important contributor to each expansion abroad.

The expansion of Icelandic financial companies has increased the responsibility and the workload on FME, both in volume and complexity. Our workload analysis of regular supervisory tasks gives the following picture regarding manpower.

Consequently, it was necessary to formulate a special strategy regarding overseas tasks of the FME and integrate it into the daily operations of the organisation.

In brief the strategy is as follows:

Branches

Branches come under direct supervision of the FME and the objective is to conduct on-site visits in larger branches every two years. For smaller branches, on-site visits will be decided on a case-by-case basis but with no less frequency than every four years. In April this year, the FME conducted its first on-site visit in the London-branches of two Icelandic credit institutions.

Subsidiaries

Foreign subsidiaries come under FME's supervision as a part of the consolidation. The FME aims at participating in on-site visits of the host-state authorities in the case of subsidiaries, of which the assets are 10% or more of the total assets of the consolidated company. Furthermore, the FME aims at visiting those companies every second year to receive an overview of the operation.

Information

Information is a key-material in the supervisory business in order to monitor developments and financial health. The FME will as of end 2007 request special reports regarding operations of foreign branches and subsidiaries.

Bi-lateral cooperation

The FME will regularly have status meetings with regulators in the countries with considerable Icelandic operations. In addition, the FME has the ambition to make MoU's, as much as possible, in parallel to operations of Icelandic companies outside the EEA.

6. Conclusion

Dear guests,

I have outlined briefly, the rapid expansion of Icelandic financial services companies abroad and how that has increased the overseas tasks of the FME.

I have discussed the different modes of expansion and the legal framework surrounding it.

Finally, I have described the cross-border tasks of the FME and our strategy for integrating it into the daily operations of the organisation.

In my view, financial supervision of capital markets is a necessary infrastructure, which underpins the confidence in the same markets. A strong and credible financial supervision at home is an important contributor to the expansion of financial services companies abroad. That in turn increases the competitiveness of the firms and enhances their possibilities for growth and wealth-creation. Our strategy is aimed at supporting and sustaining this development.