8 April 2009

Comments from Iceland on the proposals concerning financial supervision made in the de Larosière report published on 25 February and in the Commission Communication of 4 March 2009

As an integral member of the European single market through the EEA Agreement, Iceland welcomes the opportunity to contribute to the consultation process launched by the Commission on 10 March to improve the supervision of the financial services sector in the European Union. The consultation process follows the report of the de Larosière High-Level Group on financial supervision and the Commission Communication, *Driving European Recovery*, published on 4 March 2009.

General Comments

- Iceland became one of the first and hardest hit victims of the global financial crisis in the fall of 2008. The crisis now threatens the livelihood of millions around the world and calls into question the viability of the global financial system.

- The active leadership of the European Union in addressing these difficult challenges is of paramount importance and Iceland looks forward to contributing constructively to the important work ahead.

- Iceland broadly endorses the key principles and proposals for reform set out by the de Larosière report and the Commission Communication on 4 March 2009.

- The de Larosière report draws attention to the shortcomings of the regulatory and supervisory framework of the European single market, which have been exposed by the global financial crisis. Wide ranging reforms are urgently needed to remedy flaws in the patchwork of nationally based supervision.

- Iceland is in full agreement that the guiding principles of the EU recovery programme should be the single market, budgetary discipline and long term sustainability of public finances, open trade and targeted investments to bolster a low carbon economy.

Restoring and maintaining a stable and reliable financial system

- All relevant financial actors and all types of financial instruments must be subject to appropriate regulation and oversight. Iceland welcomes the Commission’s initiative to review and further improve the European supervisory arrangements covering all financial sectors.

- The establishment of a new European body under the auspices of the ECB, and involving the Commission and Committees of European Supervisors, to gather and assess information on all risks to the financial sector as a whole is a positive step. Nevertheless, in order to achieve optimal coordination on a macro-prudential level with the whole EEA, it is important that central banks of the EU/EEA countries outside the euro zone be given the opportunity to participate in the proposed European Systemic Risk Council (ESRC).

- Iceland's views on the role and responsibility of the new EU supervisory architecture are detailed in the joint EEA/EFTA comments on the proposals concerning financial supervision made in the de Larosière report and in the Commission Communication on 4 March 2009 (**see Annex I**).

The single market as a lever for recovery

- Iceland is fully integrated into the single market as a signatory to the EEA Agreement. The same rights and obligations that apply to EU member states in the single market apply to Iceland under the Agreement, including legal acts on all financial services.

- Iceland has benefited from its participation in the single market, which the Commission noted has been the motor of economic and social prosperity and job creation in the EU. National measures to address the financial crisis can be most effective if Member States work within the parameters of the single market.

- Iceland fully supports the Commission's proposals to provide assistance to Member States with the design and implementation of concrete measures, promoting the exchange of good practices and sharing policy experience. EU policies should acknowledge the economic and financial situations of all EU/EEA Member States. The consequences of disproportionate or misguided policies risk undermining the full functioning of the single market.

- Iceland welcomes the call for solidarity and cooperation among EU/EEA Member States during these challenging times. The financial crisis has revealed, for example, the growing interdependence of monetary policy and financial services that need to be reconciled with an open and fully harmonized single market.

Cross-border banking

- The current supervisory and regulatory framework for cross-border banking is inadequate. Additional measures are needed to reinforce depositor, investor and policy holder protection, covering the overall adequacy and scope of a broad range of existing financial market directives. The shortcomings of EU Directive 94/19/EEC on deposit guarantee schemes were fully exposed when the financial crisis hit Iceland and other EEA countries. Disparities between home country responsibility to guarantee deposits and company rights to accept deposits from host countries can be precarious.

- Due consideration should be given to addressing the current rules. In this vein, Iceland urges the Commission to speed up the ongoing revision of EU Directive 94/19/EEC, especially in light of the experience gained from the collapse of the Icelandic banks. The amendments to Directive 94/19/EEC earlier this year on funding levels and payments were a positive step, but additional measures are still needed.

- The approach to bank passporting, which allows for the establishment of branches in any EEA country on the basis of the mother bank's license, requires further review. The supervisory powers of host country regulators, and cooperation at the European level under European-wide processes to assess the effectiveness of home country supervision, must be strengthened.

Remuneration schemes

- Iceland strongly endorses the Commission's proposal to improve risk management in financial firms and align pay incentives with sustainable performance. Legislative proposals to include remuneration schemes within the scope of prudential oversight must be realised as soon as possible.

Credit Rating Agencies

- Iceland welcomes the recommendations concerning the regulation of Credit Rating Agencies (CRAs). The regulation of CRAs should not produce a false sense of security among financial institutions and sensible internal assessments and mechanisms should be the foundation for sound business decisions. Better regulatory oversight and registration should be extended to CRAs, their business model should be subject to a thorough review, the use of ratings should be reduced over time and the rating for structured products should be revised.

Burden Sharing

- Further consideration should be given to strengthening the system of crisis management under stronger burden sharing measures. Iceland agrees with the recommendations of the de Larosière Group in developing more detailed criteria on burden sharing than the principles established in the current Memorandum of Understanding. Provisions for burden sharing need to be strengthened, especially in cases where the impact of Europe-wide crises is concentrated disproportionately on certain economies.

Promoting Global Recovery

- Accountability and transparency must be strengthened to preserve trust in the financial services sector. An overriding aim must be to increase international cooperation and ensure a system of transparent information sharing to strengthen a regulatory regime that is binding on all market entities. In this vein, international cooperation against secrecy laws in tax havens needs to be significantly strengthened through the bolstering of supervisory and regulatory systems responsible for managing international capital movements.

- Comprehensive measures to promote integrity in financial markets must be delivered at the European and global level. The shadow economy and off-market derivative instruments must come under more effective regulatory supervision. Iceland strongly supports the Commission's request to move Credit Default Swaps on European entities and on indices of European entities onto a central clearing platform as soon as possible.

- Iceland supports the proposals to strengthen the relevant international bodies such as the International Monetary Fund (IMF) and the Financial Stability Forum, and welcomes the proposal to establish the ESRC. These bodies are necessary to meet the challenges at the global and European level. Iceland also supports the proposal to strengthen the role of the IMF in macroeconomic surveillance and increase its capacity to support member countries facing acute financial crisis.

8 April 2009

Annex I

E U R O P E A N   E C O N O M I C   A R E A

S T A N D I N G   C O M M I T T E E
O F   T H E   E F T A   S T A T E S

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Subcommittee II on the free movement of Capital and Services

EEA EFTA Comment on the proposals concerning financial supervision made in the de Larosière report published on 25 February and in the Commission Communication of 4 March 2009

1. Introduction

1. The EEA EFTA States refer to the consultation launched by the Commission on 10 March on the improvement of the supervision of the financial sector in the EU following the report of the de Larosière high level group on financial supervision and the Commission communication from 4 March.

2. Background information on the EEA Agreement and the EEA EFTA States current implication in the EU Financial Services structure

2. The three EEA EFTA States Iceland, Norway and Liechtenstein are fully integrated into the internal market through the EEA Agreement. In accordance with the Agreement all EEA legal acts relevant to financial services that have been adopted by the EU apply equally to Iceland, Norway and Liechtenstein. In other words rights and obligations ensuing from the single market legislation apply to the three EEA EFTA States to the same extent as to the EU members. The EFTA Surveillance Authority ensures that the acts are interpreted and implemented correctly and in a consistent manner.

3. Regarding the current EU “Lamfalussy” committee structure within Financial Services, the three EEA EFTA States have observer status in the existing Level 2 and most of the Level 3 Committees and have thereby contributed actively to regulatory and supervisory developments and convergence of supervisory practices. The EEA EFTA States contribute financially to the functioning of the Level 3 Committees on a bilateral basis.

3. General Remarks

4. The EEA EFTA States welcome the opportunity to comment on the recommendations in the de Larosière report and on the Commission’s proposals in its Communication with regard to the supervisory framework. The EEA EFTA States would like to contribute to developing a more efficient and pro-active financial regulatory and supervisory structure in the European Economic Area.

5. In general the EEA EFTA States agree with the analyses and the proposals outlined and can endorse the reforms suggested. Regulation and supervision did not succeed in preventing the global financial crisis. Reforms are therefore necessary and needed quickly. The current financial crisis and the consequence for the global financial system have revealed the importance of introducing a macro-prudential approach alongside improved micro-prudential arrangements to EU supervisory architecture. Also the methods of monitoring financial stability need to be improved. In this context, the EEA EFTA States welcome the Commission’s initiative to review and further improve the European supervisory arrangements covering all financial sectors.

6. Some of the roots of the crisis may be found in the strong growth of financial products and financial institutions which have not been subject to regulation, prudential supervision and capital requirements. The EEA EFTA States see it as an overarching goal to close these gaps and ensure that the whole financial sector is subject to supervision and regulation, and that regulation between different segments of the market is mutually consistent (based on the principle of ‘same risk, same regulation’). All relevant financial actors and all types of financial instruments need to be subject to appropriate regulation and oversight.

4. New framework for Macro-prudential Supervision

7. All the three EEA EFTA States have integrated financial supervisory authorities. Norway was in the forefront of this development with the first integrated supervisory authority established in 1986. After the Nordic banking crisis in the 1990's Norway also saw the need to include macro-economic surveillance into their day to day financial supervision of firms and of the financial market, and has since then had a macro-prudential approach to supervision. The macro-prudential issues are closely related to micro-supervision and provide valuable input to the supervision of firms and the analysis of the situation in the market pertinent to financial institutions. It is therefore based on prior experience that the EEA EFTA States fully support the proposal to bring macro-economic oversight and micro-prudential supervision together at a European level. In our view a financial crisis will always include macro-economic elements as well as elements related to supervision and regulation and it is

of great importance to involve financial supervisors in the new macro-prudential framework and the proposed European Systemic Risk Council (ESRC).

8. It is also the view of the EEA EFTA States that in order to achieve the best possible coordination on a macro-prudential level within the whole of the EEA, it is important that the central banks of EU/EEA countries outside the euro zone be given the opportunity to participate in the ESRC. As long as any financial institution from any country within the EEA can establish a branch in any other country within the EEA, risks can also be transferred to any country within the EEA, and the macro-prudential supervision should hence encompass all countries in the EEA. The EEA EFTA States are of the view that it would diminish the effectiveness of EEA-wide coordination if the EEA EFTA States did not actively participate from the outset in the EU macro-prudential supervisory structure.

5. Enforced and New Framework for Micro-Prudential Supervision

9. Based on the active participation of the EEA EFTA States in the existing Level 2 and 3 Committees as outlined in the introductory remarks, the EEA EFTA States assume that any change in the current regulatory and supervisory architecture in the EU, regardless of the model which eventually would be chosen, will provide for the opportunity for all EEA EFTA States to participate as observers. At the moment this opportunity is not fully provided for all EEA EFTA States, given that Liechtenstein is not allowed to participate and contribute to the work of CESR. In the light of the extended powers, which the future EU supervisory "authorities" will presumably assume, the opportunity of participation of all EEA EFTA States will be even more fundamental. We expect that experts from all EEA EFTA States will be invited as observers in the appropriate authorities within the new European System of Financial Supervision in addition to being present in the to be established European Systemic Risk Council.

10. With regard to the timing of the reforms, the EEA EFTA States support the Commission's intention to set up the new supervisory framework in the course of 2010. We agree that there is a need to move swiftly and to merge phase 1 and phase 2 of the supervisory reforms suggested by the de Larosière group.

11. With regard to the possible merger of the existing Level 3 Committees into a new authority, based on their longstanding and positive experience with integrated financial markets and integrated supervision, the EEA EFTA States support a merger of the current “sectors” of EU supervision into one authority. A single market conduct and prudential authority would in our view ensure the best possible coordination of financial market supervision in the future, thus avoiding possible regulatory and supervisory gaps.

12. Merging the current Supervisory Committees into one would also result in cost efficiency, decreasing the burden on each national supervisor as regards representation and reducing the Secretarial resource needed.

6. Role and responsibility of the new EU supervisory "authorities"

13. The EEA EFTA States agree that the day-to-day supervision of domestic financial institutions must remain the responsibility of the national authorities. We agree with the proposal to give the new European securities authority the responsibility for licensing and supervising specific EU-wide institutions such as credit rating agencies and post-trading infrastructures.

14. We understand that it is the Commission's intention that the new EU Authorities shall play a significant role related to mediation and shall set up legally binding mediation mechanisms. They shall be charged with oversight and ultimate decision making powers regarding colleges of supervisors for cross-border financial groups. We underline the importance of ensuring a fair balance of power between the home country supervisory authorities and the host country supervisory authorities. The competence must ultimately remain with the competent authorities responsible for the institution in question.

15. One important issue is the supervisory responsibilities for branches vs. subsidiaries, including the supervisory power for the host country authorities and its influence on supervision of branches. The host country authorities should have access to mechanisms to influence the supervision of the branches. Such measures should be investigated, i.a. powers to require conversion into subsidiaries for systemically important branches."

16. The Commission proposes that the authorities be mandated to adopt legally binding standards. At national level, supervisory authorities have different mandates and are not always empowered to adopt laws and regulations. Hence it might be a challenge to give the EU authorities the mandate to adopt decisions that are binding on the national supervisory authorities. This would pose a legal challenge to the EEA EFTA States as long as they are not included in the decision-making process.

17. In addition, the authorities shall play a coordination role in a crisis situation. These new roles cannot be assumed overnight as they require major legislative amendments. We agree that the authorities shall play a key role in early warning mechanisms and crisis management, in cooperation with the ESRC.

7. Concluding remark

18. The financial system is in acute need of reform. The EEA EFTA States are of the opinion that the recommendations by the de Larosière group and the measures and proposals signalled by the Commission in its Communication should be followed up swiftly and without undue protectionist resistance by national governments or authorities, as such a reform would be in the long term interest of the whole EEA. However, a new supervisory architecture cannot be superimposed on a still fragmented and unharmonised legal framework. In order for this new supervisory structure to work according to the intention, extensive legal reforms are needed.

19. The EEA EFTA States hope that their comments are found useful and that they will be taken into consideration in the Commission’s preparations for the proposal for a future EU Supervisory Architecture. The EEA EFTA States and their relevant authorities are prepared to take part in future work at EEA level to ensure harmonised improvement of the supervision for the financial services sector in the EEA.