Alþingi
Erindi nr. Þ 137/327
komudagur 22.6.2009

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Brussels, 19 September 2003
Doc. No: 03-5566-D
Ref. No: CFS020.000.010

AUTHORITY

Dear Sir/Madam,

Subject: Review of the Icelandic Financial Legislation.

Reference is made to the Authority's services letter from 11 April 2003 (Doc. No 03-2042-D) in particular point 1, sections b and c on saving banks. Reference is also made to the discussions at the package meeting in Iceland on 27 May 2003 and the reply letter from Iceland, dated 27 May 2003 and received by the Authority on 4 June 2003 (your ref. IVR03040085/66.010/BÁ).

After having assessed the information and observations presented by Iceland the Authority services state as a preliminary opinion that provisions in Articles 70(2-3) and 75(1) in the Icelandic Act on Financial Institutions no. 161/2002 are in breach of Article 40 of the EEA Agreement on the free movement of capital and the Capital Movements Directive 88/361/EEC. Following are the arguments for this preliminary opinion on each of the provisions.

At the end of the letter, there is a list of issues raised in the Authority's services letter of 11 April 2003, on which the Authority services are waiting for further information from the Icelandic Governement on possible changes in the legislation.

I. Prior approval on acquisition of a qualifying holding in a savings bank

In Article 70 paragraph 2 of Act 161/2002 on Financial Institutions *(Lög nr. 161/2002 um fjármálafyrirtæki)* the prior approval of the Financial Supervisory Authority *(Fjármálaeftirlitið)* is required before a qualifying holding in a savings bank can be aquired. The approval is subject to that either; a) the activity is part of a necessary financial restructuring of the savings bank and such financial restructuring is not possible without the depositor gaining a qualifying holding, or b) it is shown that the acquisition of the shares is part of an increased cooperation between savings banks in Iceland.

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BRU 03040048
MÓTT.: 22-09-2003

In the Authority's services letter questions were raised concerning the conformity of Article 70 paragraph 2 with the fundamental freedom of free movement of capital in Article 40 of the EEA Agreement, Article 16 paragraph 1 of the Banking Directive 2000/12/EC and the Capital Movements Directive 88/361/EEC.[1] The Authority's services considered the provision of Article 70 paragraph 2 a restriction to the free movement of capital and invited Iceland to explain any justification it had for the restriction.

The Icelandic Government argued that the guarantee captial certificates (GCC's) in saving banks are not equivalent to ordinary shares in companies. The value of the certificates is limited since it reflects only part of the saving bank own funds and restrictions have been on transfers of the certificates. The main justifications put forward by Iceland for the restricting rules are to safeguard the "own funds" of the savings banks as well as the independance and competitiveness of savings banks against other financial institutions. To this end and to ensure the important economic and social role of the saving banks the Icelandic government considers it necessary to ensure dispersed ownership of savings banks. In order to achive these aims the Icelandic Government considers it necessary to have some form of takeover defence in the legislation on saving banks. The Icelandic Government has also pointed out that saving banks are normally local finacial institutions with strong ties to their local community and therefore not a targed for cross-border acquisition. Accordingly, the restrictions are not likely to have any effect on the free movment of capital within the EEA.

The Authority services remain unconvinced by the arguments provided by Iceland and do not consider these restrictions justified under EEA law. First, on the question whether the GCC are subject to the free movement of capital since its character may differ from ordinary shares in companies. It should be stressed at the outset that the Authority services do not agree that there is such difference between the character of GCC's and ordinary shares which justifies the restrictions in Icelandic law. The holder of GCC's has the right to attend a participants meeting and cast his vote at the meeting. The GCC's has certain value and it is transferable. According to Article 1(1) of Directive 88/361/EEC the categories of capital movements that are subject to the Directive are classified in the Nomenclature in Annex 1 of the Directive. Section I 2 of the Nomenclature provides that participation in a new or existing undertaking with a view to establishing or maintaining lasting economic links falls under the scope of the Directive. In the explanatory notes, in Annex 1, it is stated that when establishing whether a transaction is considered a participation in the nature of direct investment the main criteria is whether the investor can aquire shares which gives him the right *"to participate effectively in the management of the company or its control"*. Since voting rights are attatched to GCC's this criteria is fulfilled. Moreover, Section III (a) stipulates that *"shares and other securities of participating nature"* fall under the scope of the Directive. Based on this the principle of free movement of capital applies to other participating interest than shares.

The Authority services are of the opinion that the restriction laid down in Article 70 paragraph 2 of the Icelandic Act on Financial Institutions is not in line with measures compatible with Article 16 paragraph 1 of the Banking Directive 2000/12/EC since the aims are not to ensure sound and prudent management of the bank.

The Authority services do not agree that the reasons given by the Icelandic Government justify the restriction under the criteria of general good as the aims pursued by Iceland can

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[1] See Case C-483/99 *Société Nationale Elf-Aquitaine* [2002] ECR I-04781, [illegible]

be optained by a less restrictive rules and that the restriction is not necessary to attain the aims.

The Authority services point out that the rules of the Banking Directive 2000/12/EC are considered sufficient to secure the financial status of credit institutions and to ensure that credit institutions are managed in a prudent manner. Iceland's concerns about the own funds of saving banks should therefore be protected sufficiently under the rules of the Banking Directive.

As regards Iceland's reference to safeguarding the independence of saving banks and ensure competition on the financial market it, the Authority services maintain that such aims cannot legally serve as justification grounds. In this respect reference is made to case C-376/98 *Commission v. Portuguese Republic* [2002] ECR I-4731, where the ECJ stated that the aim of *"strengthening the competitive structure of the market ... is not a valid justification for restrictions on the fundamental freedom concerned"* and case C-422/01 Skandia v. Sweden, judgment of 26 June 2003, not yet reported, where the Court held that *"considerations of equality of competition between different national forms of guaranteeing undertakings on occupational pensions could not be upheld at the cost of restricting the free movement of services"*.

This view is reinforced by the fact that, until now, the ECJ has considered the aim of strengthening the competitive structure of a market as constituting an economic aim. It is, however, generally accepted that economic grounds cannot constitute a matter of overriding general interest, which would justify a restriction of a fundamental freedom.[2] It follows from the overall aim and structure of the EEA Agreement that competition in the EEA market shall, as a general rule, be achieved on the basis of market economy, and that the opening up of the EEA market for foreign capital is an important aspect thereto. Competition issues must therefore be handled within the framework of EEA competition law, cf. Part IV of the EEA Agreement, and national competition law.

On the argument that saving banks are local institutions with strong ties to their local community and that they serve an importand economic and social role would justify the restriction, the Authority services point out that the Banking Directive 2000/12/EC does not provide for a different treatment of saving banks in this or any other respect. Even though the Authority services do not wish to dispute that many saving banks may have important role in their local community, some saving banks are fully comparable to other commercial banks in this respect. If the aim is to ensure banking service to certain local communities it is possible to obtain that aim by less restrictive measures. The takeover defence is not necessary nor proportionate to obtain that aim.

Finally, on the argument that GCC's are not targets for cross-border investments, the Authority services do not agree with that assumption. The GCC's have a value and as mentioned earlier qualify as subjects of the Capital Movements Directive 88/361/EEC.

Another argument for the conclusion that the said provision in Article 70 paragraph 2 of Act 161/2002 on Financial Institutions is in breach of EEA law is that it only permits aquisition if there is a cooperation between Icelandic saving banks but not between Icelandic and foreign saving banks. This is a clear national discrimination in violation of Article 4 of the EEA agreement.

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[2] Cf. Case C-265/95 *Commission v. France* [1997] ECR I-6959, paragraph 62 and case C-398/95 *Syndesmos*

With a reference to the observations above the Authority services must currently conclude that Article 70 paragraph 2 of the Iclandic Act on Financial Institutions is in breach of Article 4 and 40 of the EEA Agreement and Article 1 of the Capital Movements Directive 88/361/EEC.

II. Ceilings on the acquisition of voting rights within savings banks

According to Article 70 paragraph 3 and Article 75 paragraph 1 of Act 161/2002 no GCC holder in a savings bank can, on his own behalf or on behalf of others carry more than 5% of the voting rights in the savings bank. This restriction applies both to direct and indirect investments.

In its letter the Icelandic government argues that the limitations on voting rights have been in place for a long time to safeguard the dispersed ownership, which Iceland considers a basic feature of the Icelandic savings banks system. The Icelandic government then argues that these restrictions have not made savings banks shares unattractive as an investment alternative and considers the restrictions fully compatible with the EEA Agreement and Directive 88/361/EEC.

The Authority's services remain unconvinced by the arguments provided by Iceland and do not consider these restrictions justified under EEA law. In this respect the Authority's services would like to restate that the European Court of Justice has defined capital movements and direct investment within the EU law in case C-483/99 *Société Nationale Elf-Aquitaine* [2002] ECR I-04781 as follows:

"36 Although the Treaty does not define the terms 'movements of capital' and 'payments', it is settled case-law that Directive 88/361, together with the nomenclature annexed to it, may be used for the purposes of defining what constitutes a capital movement (Case C-222/97 Trummer and Mayer [1999] ECR I-1661, paragraphs 20 and 21).
37 Points I and III in the nomenclature set out in Annex I to Directive 88/361, and the explanatory notes appearing in that annex, indicate that direct investment in the form of participation in an undertaking by means of a shareholding or the acquisition of securities on the capital market constitute capital movements within the meaning of Article 73b of the Treaty. The explanatory notes state that direct investment is characterised, in particular, by the possibility of participating effectively in the management of a company or in its control."[3]

Restrictions of voting rights are liable to dissuade investments and as such constitute a restriction of the principle of free movement of capital within the EEA, cf. Article 40 of the EEA Agreement and the Capital Movement Directive 88/361/EEC.[4]

In its letter the Icelandic government also argues that savings banks have the option of converting themselves into limited liability companies, cf. Article 73 of Act 161/2002. In this respect the Authority's services would like to point out that according to Article 75 of

[3] Case C-483/99 *Société Nationale Elf-Aquitaine* [2002] ECR I-04781, para 35-36.
[4] See Case C-222/97 *Trummer and Mayer* [1999] ECR I-1661, para 26, and Case C-483/99 *Société Nationale Elf-Aquitaine* [2002] ECR I-04781, para 35-45

the Act the 5% ceiling on the aquisition of voting rights still appears to apply to the limited liability company.

With a referance to the observations above and the arguments laid down in the chapter on the prior approval for acquisition of GCC's it is the opinion of the Authority services that Article 70 paragraph 3 and Article 75 of the Iclandic Act on Financial Institutions is in breach of Article 40 of the EEA Agreement and Article 1 of the Capital Movement Directive 88/361/EEC.

III. Other outstanding issues

a. Regulation on Branches and Agency of Credit Institution Established in Another State within the European Economic Area no. 308/1994.

The Icelandic Government has informed the Authority that the language requirement will be repealed. The Icelandic Government is invited to inform the Authority when the requierment has been repealed.

b. Notification proceadure for UCITS

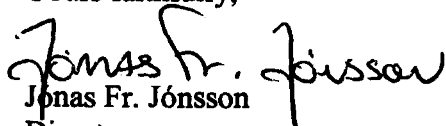
The Icelandic Government has infored the Authority that rules on notification procedure will be adopted by a regulation. The Government is invited to inform the Authority when the rules have been adopted.

c. Rules on Reserves no. 388/2002 and Liquidity Ratio no. 386/2002.

The Authority has been informed by the Icelandic Government that the new rules on liquidity ratio and reserves are being drafted. The Icelandic Government is invited to inform the Authority when the new rules will be issed.

The Authority services invite the Icelandic Government to submit its observations on the content of this letter no later than *17 November 2003*. After that date the Authority will proceed to consider, in light of any observations received from Iceland, whether to initiate infringement proceedings in accordance with Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and Court of Justice.

Yours faithfully,



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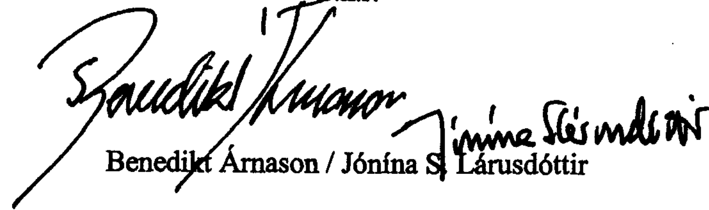
Ref : IVR03040085/66.010/BÁ

Vinsamlegast komið meðfylgjandi bréfi til ESA við fyrstu hentugleika.

E.h.r.



Benedikt Árnason / Jónína S. Lárusdóttir

To: **EFTA Surveillance Authority**
Rue de Tréves 74
1040 Brussels

From: **Iceland (Ministry of Commerce)**

Date: **May 27th. 2003.**

Subject: **Review of Icelandic Legislation in the Financial Sector.**

The Ministry has received your letter of 11 April 2003 on the review of Icelandic Legislation in the Financial Sector. Following is the Ministry's response.

1. Act on Financial Institutions no. 161/2002

a. Restrictions on the scope of activities of non-Icelandic Electronic Money Institutions

Icelandic Authorities recognise that foreign electronic money institutions' (EMI) activities are restricted to issuing electronic money, according to Article 24(2) of the Act 161/2002 on Financial Undertakings. Icelandic authorities are of the believe that this provision is in line with Article 2(2) of Directive 2000/46/EC, in which it is stated that the mutual recognition arrangements provided for in Directive 2000/12/EC shall not apply to electronic money institutions business activities other than the issuance of electronic money. Icelandic authorities also point out that the said Icelandic provision is in line with Article 9 of the Danish Act on Electronic Money institutions no. 502/2001 and Article 3-3(1), (4) and (5) of the Norwegian Draft Act on the same.

Remarks common to b-d.
Icelandic Authorities would like to point out that attraction of capital is one of the most vital interests of any credit institution, including savings banks. It is thus highly unlikely that the Icelandic savings banks and their association would have submitted to the provisions of Act. no. 161/2002 without comment, had there been any probability that their guarantee capital financing would be hampered as a result. Already for this reason, it is unlikely that the Act's provisions on savings banks have the effect of restricting free movement of capital.

b. Restrictions to the acquisition of a qualifying holding in a savings bank (Article 70 (2)).

Icelandic Authorities would respectfully like to submit its views on this matter. First, some legal and factual explanation of the circumstances surrounding the recent amendment to the savings bank legislation will be offered. Subsequently, the provisions will be viewed in an EEA perspective.

Icelandic legislation concerning savings banks has always contained provisions aimed at securing dispersed ownership, thus reflecting one of the most important underpinnings of the savings bank network in the country. In accordance with this principle, guarantee capital

certificates (GCCs) in savings banks were non-assignable up to 1985. This restriction has gradually been lifted in subsequent legislation. The assignment of GCCs has, however, to this day been subject to approval by the board of the savings bank.

In the summer of 2002, Iceland's largest savings bank became a target for a hostile takeover bid, engineered by one of the country's commercial banks with a number of guarantee capital holders acting as intermediaries. This episode demonstrated weaknesses, as well as a degree of legal uncertainty, in the legal environment for savings banks. It was thus deemed necessary to strengthen the powers of savings banks' boards to reject assignment of GCCs in connection with takeover attempts, by clarifying the legislation's tenet of dispersed ownership. Furthermore, bearing in mind the possibility that a group of guarantee capital holders connected to a takeover company could attain a majority in the board, it was considered necessary that a GCC assignment resulting in a qualifying holding would additionally be subject to the prior consent of the Financial Supervisory Authority (FME), in order to guarantee compliance with the substantive provisions of Art. 70 (2).

When assessing this requirement from a free movement of capital perspective, it must be emphasised that GCCs cannot be regarded as being equivalent to shares in limited liability companies. Their fundamental difference consists of the fact that ownership of a GCC does not entail ownership of the savings bank as such. Accordingly, ownership of a GCC does not correspond to a claim to a share of the savings bank's assets, unlike the ownership of a share in a limited liability company. An important feature of most Icelandic savings banks is the fact that the largest part of the capital consists of own funds, acquired over time, while guarantee capital constitutes a relatively small part of the total capital. Hence, most of the capital is owned by the savings bank itself without the guarantee capital owners having any right or claim thereto. In that respect, GCCs are more akin to debt certificates.

However, it is equally clear that control of the board of a savings bank entails the power to manage these funds. In the absence of safeguards relating to dispersed ownership, control over a savings bank's entire capital could be acquired by purchasing the rights to the disproportionately small amount thereof that consists of guarantee capital. In the Icelandic Authorities' view, this would run counter to the very purpose of the savings bank system and indeed the *ratio legis* of the savings bank legislation. The organizational structure of savings banks makes them ill-equipped to fend off such unwanted takeover bids. Consequently, some form of takeover defence is required.

An additional consideration is the fact that the competitiveness of the savings banks rests on their ability to achieve economies of scale through co-operation. In this respect, Iceland's 2-3 largest savings banks play a pivotal role, allowing the savings bank network to offer an alternative to consumers in an otherwise quite concentrated retail banking sector. It is equally clear that in the absence of any legal protection against hostile takeover, the larger savings banks will, one by one, become takeover targets while the smaller ones will not be able to compete without the synergies of the network. The end result would be lessened competition and reduced consumer choice. Additionally, the smaller savings banks are in many cases the only financial institutions with a presence in Iceland's smaller and more remote communities.

As regards the compatibility of the above-described provisions with EEA law, Icelandic Authorities would like to point out the following:

Firstly, the attainment of a qualifying holding in a savings bank has hitherto been subject to restrictions, in particular board approval and ceiling on voting rights, without this having been considered by ESA to be a violation of the Agreement.

National legislation and regulation concerning savings banks is only harmonized to a limited extent within the EEA. The legal environment concerning savings banks is for the most part national. Savings banks are regarded to have an important economic and social role, and most legal systems feature special rules that take into account the special functions and purposes of the savings banks as financial institutions. These include various restrictions concerning, ownership, organization, activites and/or geographical sphere of operation of savings banks, and, most importantly, immunity to hostile takeover. Therefore, the underpinnings of the Icelandic legislation appear to correspond to legal principles that are well-known and recognised throughout the EEA (see European Savings Banks - Coming of Age, Lafferty Publications 1999). Icelandic Authorities is not aware of any precedent challenge to the compatibility of such legislation with the principle of free movement of capital.

It should also be observed that Directives 88/361/EEC and 2000/12/EC were intended to attain a minimum of harmonization in their field. Neither directive purports to eliminate all restrictions contained in the savings bank legislation of the member states. For this reason, it would seem incongruous to interpret Article 16 (1) of Directive 2000/12/EC to exclude any regulation pertaining to ownership of savings banks at national level. The use in Art. 70 (2) of Act. 161/2002 of the term "qualified holding" should not detract from this. That Article uses the concept of qualifying holding as a yardstick to determine the existence of a concentration of ownership that might be detrimental to a savings bank's purpose and functioning.

Furthermore, the Icelandic Government is of the opinion, that when assessing the conformity of Art. 70 (2) to the EEA principle of free movement of capital, the actual role of European savings banks as economic operators and investment targets has to be taken into account. Although savings banks within the EEA form a fairly heterogeneous group that does not readily lend itself to generalization, some common elements may be identified.

Most significantly, savings banks are overwhelmingly local financial institutions with strong ties to their local community. They tend to be based on common ideologies, i.e. mutual status and support for their community. For this reason, their cross-border activities tend to be negligible.

For similar reasons, savings banks tend not to be targets for cross-border investment. Generally speaking, European savings banks have either committed themselves to their core principles of mutuality and proximity or converted themselves into purely commercial entities (in this context, it should be pointed out that Icelandic savings banks have the option of converting themselves into limited liability companies, cf. Arts. 73 et. seq.). Non-converted savings banks have not been involved in significant cross-border investment. Rather, consolidations and mergers have primarily taken place between savings banks within the same Member State, and most of what cross-border investment there has been has consisted of "strategic" cross-shareholding between savings banks in different countries, rather than e.g. mergers with commercial banks.

In general, it thus appears that restrictions on the acquisition of interests in savings banks are

generally not likely to affect free movement of capital within the EEA to an appreciable extent. Specifically, foreign investment in the Icelandic financial sector has been virtually non-existent. It is thus submitted that if the provisions of Art. 70 (2) are at all found to contain restrictions, these would in any case fall under the *de minimis* doctrine, as they are not capable of affecting movement of capital within the EEA.

c. Ceilings on the acquisition of voting rights within savings banks (Arts. 70 (3) and 75 (1)).

The limitation on voting rights in Art. 70 (3) is equivalent to the provision contained in Art. 35 of Act. no. 43/1993 and subsequent legislation. The provision in Art. 75 (1) corresponds to the provision contained in Art. 37 (A) (9) of the Act on Commercial Banks and Savings Banks no. 113/1996 as amended by Act. no. 71/2001.

In the opinion of the Icelandic government, the aforementioned ceiling is wholly compatible with the provisions of the EEA agreement and Directive 88/361/EEC. As previously explained, dispersed ownership is a basic feature of the Icelandic savings banks system, and limitations on voting rights have been in force ever since the legalisation of GCC assignments. These restrictions have to this day not made savings banks′ shares unattractive as an investment alternative. On the contrary, for the last few years the yield on GCCs has in general been better than on shares and demand for new GCCs has been significant. Furthermore, it should be pointed out that the revised provisions on revaluation of guarantee capital featured in Art. 67 of the new legislation will certainly make these shares more desirable as an investment.

d. Approval of the board of a savings bank for the sale of shares in the bank (Art. 64).

At the outset, it should be emphasised that a refusal on part of the board of a savings bank activates an obligation for the savings bank to redeem the guarantee capital holding in accordance with the provisions of Art. 65, cf. Art. 64 (4). Furthermore, the board of a savings bank may in other circumstances redeem a guarantee capital holding in the savings bank at the request of a guarantee capital owner, cf. Art. 65 (1). Hence, it may be argued that a GCC holder has a better possibility of liquidating his asset than, for example, a shareholder in a limited liability company.

As previously mentioned, the assignment of GCCs has been subject to board approval ever since it was legalised in 1985. It has thus been a feature of Icelandic savings bank legislation since the inception of the EEA agreement.

Again, there is no indication that the provision has in fact impeded investments in GCCs or liquidation thereof.

The substantive *raison d'ètre* for this provision is related to the special characteristics and purpose of the savings banks, which necessitates that they retain a degree of control over the ownership of holdings. The provision is intrinsically linked to the present organisation of savings banks in Iceland.

2. Regulation on Branches and Agency of Credit Institution Established in Another State within the EEA, no. 308/1994.

Icelandic Authorities would like to state that the abovementioned Regulation is currently being revised. It is envisaged that the requirement at issue will be abolished in the proposed Regulation.

3. Act on UCITS no. 30/2003.

Icelandic Authorities would like to point out that the requirements of Icelandic UCITS marketed in other EEA states are stipulated in the UCITS act of the host state. Art. 45 of the Act on UCITS no. 30/2003 only states that a simple notification to relevant authorities is necessary, but does not provide further details on the requirements for marketing UCITS in the host country. Hence, the penalty for not notifying relevant authorities is a fine. However, Art. 43 stipulates more detailed requirements for marketing UCITS in Iceland, based on the UCITS directive. The Financial Supervisory Authority may refuse to allow a UCITS if it fails to fulfil the requirements set for UCITS and it can cease the activities of a UCITS if it is pursued without the required authorization. Thus, the sanctions due to violation of Art. 43 are in conformity with the line taken in the revision of the law in the financial sector, namely that an activity pursued without authorisation should be subject to imprisonment, whereas less serious breach, such as lack of sending notices, activities outside the scope of the authorisation given, should be subject to a fine. Icelandic Authorities kindly point out the remarks on Art. 105 and 106 of the Bill of Law on Financial Firms in this respect.

4. Act on Currency Issues No 87/1992 and Regulation on Currency Issues No 679/1994.

Please be informed that the Central Bank has issued various rules in connection with the Act on Currency Issues No 87/1992 (the Act) and the Regulation on Currency Issues No 679/1994 (the Regulation). However, it has not issued any rules in connection with Article 3 of the Act.

As regards the implementation of Article 3 of the Directive, the Icelandic Authorities would like to call attention to that the Article is implemented in Icelandic Law with Article 3 of the Act and Article 8 of the Regulation. The procedure provided for in Article 43 to 45 of the EEA Agreement is not implemented in the Act itself. However, According to Article 2 of the Act No 2/1993 on the European Economic Area, the EEA Agreement shall have legal status in Iceland. Furthermore, in Article 3 of Act No 2/1993, it is stated that laws and regulations shall be interpreted in accordance with the EEA Agreement and the rules based on the Agreement. The Central Bank and the Ministry of Commerce would therefore have to apply the procedure provided for in the EEA Agreement when restricting or suspending capital movements in accordance with Article 3 of the Act, cf. Article 8 of the Regulation.

As to the conditions in Article 3 of the Directive, which must be fulfilled in order to justify restrictions on capital movements, Article 3 of the Act and Article 8 of the Regulation state that the Central Bank may decide in consultation with the Ministry of Commerce to restrict or

suspend certain categories of capital movements for a period of up to six months, if, in the Bank's opinion, short-term capital movements to and from Iceland create exchange-rate and monetary instability. In the comments of the bill to Article 3 it is furthermore stated that the Article is a safety-clause which the Central Bank can only resort to in consultation with the Ministry of Commerce, when no other traditional measures suffice. It is therefore clear when interpreting the Act and the comments to the Act together that Article 3 is only a safety-clause, which can be applied in exceptional circumstances.

As regards the Authority's question whether a regulation has been issued based on Article 4 of the Act, the Icelandic Authorities can inform the Authority that the Minister of Commerce issued a Regulation on Foreign exchange No 679/1994 on 29 December 1994. Restrictions on Foreign Direct Investment are based on the Act No 34/1991 on Investments by Non-residents in Business Enterprises as later amended.

With regard to the charge provided for in Article 7 of the Act, Icelandic Authorities would like to point out that the charge has never been applied. The provisions on the charge stem from an older versions of the Act and are mostly connected with restrictions, which ceased to exist 1 January 1995.

5. Act on Insurance Activity No 60/1994.

There are no compulsory life insurances in Iceland. Thus, the Third Life Assurance Directive 92/96/EEC is irrelevant in this context. Articles 55 and 58 of the Insurance Activity Act No 60/1994 (the Act) provides that policy terms of a compulsory insurance must be sent to the Financial Supervisory Authority (FME) prior to the insurance being offered on the insurance market. The same applies to any amendments to the policy terms. In the general comments to the bill, it is stated that Icelandic Authorities' general prior approval of insurance policy terms and scales of premiums is abolished. Furthermore, it is stipulated that domestic and foreign insurance companies can offer insurance products and close insurance contracts in coherence with their own policy terms, irrespective of the Insurance Supervisory Authority's (currently the FME) approval of the policy terms. In the comments to Article 55 of the bill, it is pointed out that it will nevertheless still be the role of the Insurance Supervisory Authority (now FME) to supervise that policy terms and premiums are in compliance with national laws and regulations.

Article 30(2) of the Third Non-life Directive 92/49/EEC states "Notwithstanding any provisions to the contrary, a Member State which makes insurance compulsory may require that the general and special conditions of the compulsory insurance be communicated to its competent authority before being circulated". Articles 55 and 58 do not require prior approval of the policy terms and conditions. The provisions only state that an insurance company must send policy terms to the FME no later than them being offered on the market, cf. Article 30 (2) of the Directive. Icelandic Authorities are therefore of the opinion that Articles 55 and 58 comply with the Third Non-life Assurance Directive.

Articles 64 and 65 of the Act concern establishment of branches and the freedom to provide services. It is the understanding of the Icelandic Authorities that Article 30 (2) of the Third Non-life Assurance Directive covers all provisions of the Directive, cf. the wording: "*Notwithstanding any provision...*". Therefore, the Icelandic Authorities maintain that

Articles 55, 58, 64 (2) 6 and 65 (2) 5 of the Act comply with the directive.

6. Rules on Reserves no. 388/2002 and Liquidity Ratio no. 386/2002.

Icelandic Authorities would like to state that the Central Bank of Iceland is currently revising the abovementioned Rules, taking into account the rules on reserves and liquidity ratio for branches of Icelandic credit institutions in another EEA state and of branches of EEA credit institutions in Iceland.

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Brussels, 11 April 2003
Doc. No: 03-2042-D
Ref. No: CFS020.000.010

AUTHORITY

Dear Sir,

Subject: Review of Icelandic Legislation in the Financial Sector

With respect to the increasing focus in the European Union on reforms of legislation in the financial sector, as has been presented in the European Commission's Financial Service Action Plan, the EFTA Surveillance Authority has decided to review various legislation in the financial sector of the Icelandic legal order. Similar review was performed on the financial services legislation in Norway in 2001 and in Liechtenstein in 2002.

In the review the Authority's services have come across several provisions in the Icelandic legislation which merit further assessment in the light of Iceland's obligations under the EEA Agreement. The provisions are in the following Acts:

- *Act on Financial Institutions no. 161/2002.*
- *Regulation on Branches and Agency of Credit Institution Established in Another State within the European Economic Area no. 308/1994.*
- *Act on UCITS no. 30/2003.*
- *Act on Currency Issues no. 87/1994 and Regulation on Currency Issues no. 679/1994.*
- *Act on Assurance Business no. 60/1994.*
- *Rules on Reserves no. 388/200 and Liquidity Ratio no. 386/2002.*

Based on preliminary examination of the legislation, referred to above, the Authority's services find that several provisions in this legislation require further investigation and explanation. The provisions that need to be addressed are listed below with comments to each of the provisions.

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MÓTT.: 14-04-2003
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Icelandic Mission to the European Union
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1. **Act on Financial Institutions no. 161/2002.**

a. Restrictions on the scope of activities of non-Icelandic Electronic Money Institutions.

According to Article 24(2) of Act 161/2002 on Financial Institutions *(Lög um fjármálafyrirtæki nr. 161/2002)* the business activities of foreign electronic money institutions (EMI) are restricted to issuing electronic money. Icelandic EMI's on the other hand are in addition allowed to operate closely related financial and non-financial services and the storing of data on the electronic device on behalf other undertakings or public institutions, cf. Article 24(1) 1 and 2. Therefore it appears that more restrictions apply to foreign than domestic EMI's.

First, this appears not to be compatible with Article 4 EEA, which provides that within the scope of the Agreement any discrimination on grounds of nationality shall be prohibited and Articles 31 and 36 of the EEA Agreement which provide for the freedom of establishment and freedom to provide and recieve services within the EEA area.

Second, Article 1 of Directive 2000/34/EC on the taking up, pursuit of and prudential supervision of the business of electronic money institutions sets out the scope, definitions and restrictions of activities for EMI's according to the Directive. Paragraph 5 of Article 1 of the Directive reads:

"The business activities of electronic money institutions other than the issuing of electronic money shall be restricted to:
a. the provision of closely related financial and non-financial services such as the administering of electronic money by the performance of operational and other ancillary functions related to its issuance, and the issuing and administering of other means of payment but excluding the granting of any form of credit; and
b. the storing of data on the electronic device on behalf of other undertakings or public institutions."

Accordingly, the Directive requires that EMI's are permitted to engage in the activities cited in Article 1 paragraph 5 a and b. The Directive does not permit any discrimination based on nationality as regards the scope of permissible activities. Therefore, it appears that restricting the activities listed in Article 1 paragraph 5 a and b of the Directive only to Icelandic EMI's is not in accordance with the Directive and Articles 4, 31 and 36 of the EEA Agreement.

The Icelandic Government is invited to submit to the Authority its explanations and comments on this issue.

b. Restrictions to the acquisition of a qualifying holding in a savings bank.

According to Article 70 paragraph 2 of the Act 161/2002 on Financial Institutions, approval of the Financial Supervisory Authority (*Fjármálaeftirlitið*) is required, if endorsement of shares (*stofnfjárhlutum*) or a share increase results in an individual depositor (*stofnfjáreigandi*), or a depositor and a natural or legal person whom he is affiliated with according to Article 18 paragraph 2, acquiring a qualifying holding in the savings bank. The approval can not been granted unless one of the two following conditions are met:

a) the activity is part of a necessary financial restructuring of the savings bank and it is apparent that such financial restructuring is not possible without the depositor gaining a qualifying holding,
b) it is shown that the acquisition of the shares is a part of an increased cooperation between savings banks in Iceland.

In Article 16 paragraph 1 of the Consolidated Banking Directive 2000/12/EC only a prior notification to the competent authorities is required when a natural or legal person proposes to hold a qualifying holding in a credit institution. The competent authorities have three months to oppose such a plan, if, in view of the need to ensure sound and prudent management of the credit institution, they are not satisfied as to the suitability of the person proposing to hold the qualifying holding. The restrictions in Article 70 paragraph 2 of the Act, cited above, appear to go beyond the scope of the sound and prudent management proviso in the Directive, since the conditions for the approval do not appear to be formulated in order to guarantee sound and prudent management of savings banks. Therefore, it appears that Article 70 paragraph 2 is not in accordance with Directive 2000/12/EC and the fundamental principle of free movement of capital within the EEA area, cf. Article 40 of the EEA Agreement and Capital Movements Directive 88/361/EEC.[1]

Furthermore, as regards the condition in Article 70 paragraph 2(b), it appears to be limited to the increased cooperation of Icelandic banks, and as such not to be in accordance with Article 4 of the EEA Agreement, which provides that within the scope of the Agreement any discrimination on grounds of nationality shall be prohibited.

The Icelandic Government is invited to submit to the Authority its explanations for imposing the above-mentioned restrictions as well as its comments on this issue.

c. Ceilings on the acquisition of voting rights within savings banks

According to Article 70 paragraph 3 and Article 75 paragraph 1 of Act 161/2002 no depositor in a savings bank can, on his own behalf or on behalf of others carry more than 5% of the voting rights in the savings bank. This restriction applies both to direct and indirect investments. The European Court of Justice has defined capital movements and direct investment within the EU law in case C-483/99 *Société Nationale Elf-Aquitaine* [2002] ECR I-04781 as follows:

"36 Although the Treaty does not define the terms 'movements of capital' and 'payments', it is settled case-law that Directive 88/361, together with the nomenclature annexed to it, may be used for the purposes of defining what constitutes a capital movement (Case C-222/97 Trummer and Mayer [1999] ECR I-1661, paragraphs 20 and 21).
37 Points I and III in the nomenclature set out in Annex I to Directive 88/361, and the explanatory notes appearing in that annex, indicate that direct investment in the form of participation in an undertaking by means of a shareholding or the acquisition of securities on the capital market constitute capital movements within the meaning of Article 73b of the Treaty. The explanatory notes state that direct investment is characterised, in particular, by the possibility of participating effectively in the management of a company or in its control."[2]

[1] See Case C-483/99 *Société Nationale Elf-Aquitaine* [2002] ECR I-04781, para 35-45.

Restrictions of voting rights are liable to dissuade investments and as such constitute a restriction of the principle of free movement of capital within the EEA, cf. Article 40 of the EEA Agreement and the Capital Movement Directive 88/361/EEC.[3]

The Icelandic Government is invited to submit to the Authority its explanations for imposing the above-mentioned restriction as well as its comments on this issue.

d. Approval of the board of a savings bank for the sale of shares in the bank.

According to Article 64 of Act 161/2002 on Financial Institutions the approval of the board of savings bank is required for the sale of shares in the bank. Since this measure will restrict the possibility for a depositor to sell his share in the bank it could be considered a restriction to the principle of free movement of capital within the EEA area, cf. Article 40 of the EEA Agreement and the Capital Movement Directive 88/361/EEC.[4]

The Icelandic Government is invited to submit to the Authority its explanations for imposing the above-mentioned restriction as well as its comments on this issue.

2. Regulation on Branches and Agency of Credit Institution Established in Another State within the European Economic Area no. 308/1994.

Article 2 of Regulation 308/1994 on branches and agencies of credit institutions established in another state within the EEA area *(Reglugerð um útibú og umboðsskrifstofu lánastofnunar með staðfestu í öðru ríki innan Evrópska efnahagssvæðisins nr. 308/1994)* requires the manager of a branch to be able to speak the Icelandic language. This requirement appears to represents a restriction of the fundamental rights of free movement of workers, cf. Article 28 of the EEA Agreement, and the freedom of establishment, cf. Article 31 of the EEA Agreement, which appears to be disproportionate and therefore not in accordance with the EEA Agreement.

The Icelandic Government is invited to submit to the Authority its explanations and comments on this issue.

3. Act on UCITS no. 30/2003.

Article 68 point 3 of Act 30/2003 on UCITS funds *(Lög um verðbréfasjóði og fjárfestingasjóði nr. 30/2003)* provides that a violation of the provisions on the marketing of Icelandic funds outside Iceland in Article 45 of the Act is subject to fines if stricter sanctions are not provided for in other Acts. In contrast, Article 69 point 6 provides that a violation of the provisions of Article 43(1) on the marketing in Iceland of funds established in another State within the EEA area, is subject to fines or up to one year in prison.

The Icelandic Government is invited to submit to the Authority its explanations and comments on why stricter sanctions are applied to the violation of the provisions of Article 43(1) than Article 45 of the Act on UCITS funds.

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[3] See Case C-222/97 *Trummer and Mayer* [1999] ECR I-1661, para 26, and Case C-483/99 *Société Nationale Elf-Aquitaine* [2002] ECR I-04781, para 35-45.

[4] See here Case C-222/97 *Trummer and Mayer* [1999] ECR I-1661, para 26, and Case C-483/99 *Société Nationale Elf-Aquitaine* [2002] ECR I-04781, para 35-45 [illegible]

4. Act on Currency Issues no. 87/1992 and Regulation on Currency Issues 679/1994.

Our review of the Icelandic currency legislation has raised questions concerning restrictions of the freedom to move capital in the European Economic Area as provided for in Chapter 4 of the EEA Agreement and the implementation of the Capital Movement Directive 88/361/EEC.

Article 3 of the Act on Currency Issues no. 87/1992 states that the Central Bank of Iceland can limit or stop movement of capital to and from Iceland in certain categories of transactions for up to six months. Such decision must, according to the provision, be done by a regulation. A similar provision is in the Regulation on Currency Issues no. 679/1994.

Article 3 of the Directive 88/361/EEC provides the following rule:

*"1. Where short-term capital movements of **exceptional magnitude** impose **severe strains** on foreign-exchange markets and lead to **serious disturbances** in the conduct of a Member State's monetary and exchange rate policies, being reflected in particular in **substantial variations in domestic liquidity**, the Commission may, after consulting the Monetary Committee and the Committee of Governors of the Central Banks, authorize that Member State to take, in respect of the capital movements listed in Annex II, protective measures the conditions and details of which the Commission shall determine." (emphasises added)*

According to point 1.(b) in Annex XII to the EEA Agreement application of measures referred to in Article 3 of the Directive shall follow the procedure set out in Protocol 18 of the EEA Agreement. Protocol 18 provides that the EFTA States shall notify the Standing Committee of the EFTA States of measures to implement Article 43 of the EEA Agreement. Article 44 of the EEA Agreement also stipulates that the internal procedures provided for in Protocol 18 shall be applied to implement Article 43.

Several questions arise regarding the above provisions. Have any rules been issued by the Central Bank in this context? If so please furnish the Authority with a copy of the regulation. Are there any rules in Icelandic legislation or practice that provide for a notification procedure in accordance with Article 43 to 45 of the Agreement and Article 3 of Directive 88/361/EEC? Moreover, the conditions in Article 3 of the Directive, of "exceptional magnitude", "severe strains", "serious disturbances" and "substantial variations in domestic liquidity", which must be fulfilled in order to justify restrictions on capital movements are not reflected in the Icelandic provisions. Therefore it seems that the said provision of the Directive is not clearly implemented into the national law.

Article 4 of the Act on Currency Issues empowers the Minister with the right to issue a regulation in order to restrict currency transaction on certain categories of capital movements. Article 7 of the Act on Currency Issues authorises the Central Bank to grant exemptions from the restriction issued in accordance with Article 4 of the Act provided that a 1% charge is paid.

Please inform the Authority if any regulation has been issued based on Article 4 of the Act. Please explain how Article 7 of the Act complies with the aforementioned provisions of the EEA Agreement and Capital Movement Directive 88/361/EEC.

5. Act on Assurance Business no. 60/1994.

Article 55 of the Icelandic Assurance Business Act no. 60/1994 requires providers of assurance services to send policy conditions to the Financial Supervisory Authority prior to offering of an insurance product on the market. Similar provisions are in Article 58 on compulsory assurances, Article 64 paragraph 2(6) and 5 on the establishment of branches, Article 65 paragraph 2(5), 3 and 4 on provision of assurance services.

The Third Life Assurance Directive 92/96/EEC stipulates in Article 5 the following rule regarding the authorisation of life assurance companies:

"Member States shall not adopt provisions requiring the prior approval or systematic notification of general and special policy conditions, of scales of premiums, of the technical bases, used in particular for calculating scales of premiums and technical provisions or of forms and other printed documents which an assurance undertaking intends to use in its dealings with policy-holders."

Similar provisions are in Article 29, on provision of services, and Article 39(2), on establishment of branches, of the Third Life Assurance Directive 92/96/EEC. Moreover, the Third Non-life Assurances Directive 92/47/EEC has identical provisions concerning non-life assurance business in Article 8, Article 29 and Article 39(2).

It appears that the provisions in the Icelandic Assurance Business Act, referred to above, do not comply with the provisions in the directives prohibiting prior approval and systematic notification of policy terms and conditions. The Icelandic Government is invited to give its opinion on the issue.

6. Rules on Reserves no. 388/2002 and Liquidity Ratio no. 386/2002.

Article 27 of the Consolidated Banking Directive 2000/12/EEC states that home Member States shall have the responsibility for the supervision of the liquidity of branches and measures resulting from the home Member States monetary policies. Reserve requirements for credit institutions fall under the latter measures.

The Icelandic Rules on Reserves no. 388/2002 and Liquidity Ratio no. 386/2002 do not clearly state how the reserves and the liquidity ratio shall be calculated when a credit institution has a branch in another EEA State or in cases where a foreign credit institution has a branch in Iceland. A consistent line of case law from the Court of Justice of the European Communities makes its clear that each Member State is obliged to implement directives in a manner which satisfies the requirements of clarity and legal certainty and thus transpose the provisions of the directive into national provisions having binding force.[5] This principle also applies to the provisions of the EEA Agreement.

In order to assess the implementation, the Icelandic Government is invited to describe the rules and administrative practice that applies to the situation where an Icelandic credit institution has a branch in another EEA State and also where a credit institution authorised in another EEA State opens up a branch in Iceland.

[5] [illegible]

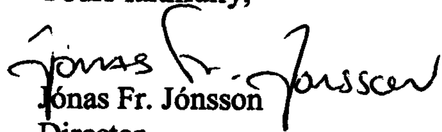
AUTHORITY

Conclusion

As its information currently stands, the Authority's services are of the preliminary opinion that some of the provision referred to above, do not conform with Iceland's obligations under the EEA Agreement. In order to examine further this issue and with reference to Article 6 of the ESA/Court Agreement, Iceland is invited to submit further information and observation on these provisions and the comments set forth concerning each provision.

May I ask your Government to provide the above information so that it reaches the Authority at the latest by *19 May 2003*.

Yours faithfully,



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