

# STATE OWNERSHIP POLICY 2009

## Financial undertakings

Following the foundation of the new banks in the autumn of 2008 and the division of the assets and liabilities of the old banks, there was a call for the state to lay down a special policy as the owner of the new undertakings.<sup>1</sup> Prior to this, virtually all of the financial undertakings in Iceland were privately owned and the state had no cause to set any policy for itself as the owner of financial undertakings. Now that the state has become the owner of several financial undertakings<sup>2</sup>, which also operate in competition with each other, the role and responsibilities of the state inevitably need to be defined, as well as the objectives related to its ownership. Moreover, it is important to ensure a sound and cost-effective use of the substantial financial contributions the state has put into Icelandic financial undertakings.

The state's ownership policy is intended to define the objectives of the state as the owner of financial undertakings. This is particularly needed now while the restoration of the Icelandic financial sector is in progress, and the government has therefore decided to create a special temporary body to manage its holdings in financial undertakings. The purpose of this is to foster credibility and trust in the state as an owner, both externally – in relation to the public at large, the customers of the financial undertakings, foreign creditors and partners – and internally in relation to the Icelandic parliament and public administration, as well as financial undertakings and their staff and management.

The policy covers four main areas:

1. The state's objectives in its ownership of financial undertakings
2. The organisation of the ownership function within the state, i.e. the responsibilities of each entity and how they relate to each other.
3. The principles laid down by the state as owner.
4. Requirements and criteria in the management of financial undertakings which the state owns a stake in.

This is the first time that the government explicitly sets down a written ownership policy. The intention is for the state ownership policy for financial undertakings to later form the basis for a general state ownership policy, on which work will commence in the coming months and which will apply to all of the enterprises and undertakings, which the state owns a stake in.

The policy will be regularly reviewed, first in March 2010 and, if need be, updated in light of financial market developments and the development of the state's ownership. It applies to parties who manage the state's ownership of financial undertakings, as well as parties that sit on boards of directors on behalf of the state, regardless of whether the state holds a majority stake in the undertakings or not. In those cases where the state holds a minority stake, the board members appointed on its behalf will promote the goals of the ownership policy within the board of directors, as applicable in each case. Although some aspects of the policy will only be relevant to undertakings in which the state holds a majority stake, the state expects

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<sup>1</sup> It should be noted that the conclusion of the negotiations between the state, as owner of the new banks, and the resolution committees of the old banks, on behalf of their creditors, assume that the ownership of the new banks could be transferred to the resolution committees to a considerable extent.

<sup>2</sup> Following the foundation of the three commercial banks, a number of savings banks have also requested equity capital contributions from the State on the basis of Act no. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc.

all the financial undertakings it participates in to follow its guidelines and objectives. Through a concerted effort, a sustainable Icelandic financial market can be restored.

## **I. The state's objectives in its ownership of financial undertakings**

Following the changes that have occurred in the Icelandic financial market since the autumn of 2008, the state currently owns a stake in the country's largest financial undertakings. The task at hand is to construct a healthy and efficient financial system which serves the interests of the Icelandic people. The restructuring of the financial system will be a challenging task. In order to guarantee its success, it is important that the state should come across as the informed and strategy-making owner of these undertakings and exercise its ownership function with due diligence. The state needs to be a credible owner of the financial undertakings and its function has to be above any suspicion of political interference in the day-to-day decision-making process of the undertakings. The objectives which are being set here, concerning ownership, organisation, governance and planning with regard to how the holdings are to be treated will have a marked impact on how the Icelandic financial market will develop in the next years.

The state's ownership of the financial undertakings is subject to the following three main objectives and four sub-objectives:

### **Main objectives**

#### **1. To facilitate the construction of a healthy and efficient financial system which serves the interests of Icelandic society.**

Emphasis needs to be placed on ensuring that the decisions made by entities that manage state owned undertakings in the financial market regarding the construction and development of the financial markets support the aforementioned objective. The ISFI, board members, managers and staff of these financial undertakings play a key role in this regard.

#### **2. To foster confidence and credibility in the Icelandic financial market.**

In the wake of the collapse of the banks, confidence in financial institutions has been undermined. A key task is therefore to regain that confidence and the owner, as a policy-maker, has a major role to play in this regard. The work, organisation, disclosure of information and procedures of financial institutions are important factors in that endeavour. The management and control of financial undertakings must be above all criticism and the guidelines and rules which they are operating under must be clear and accessible.

#### **3. The state should reap dividends from the funds it allocates to Icelandic financial undertakings.**

The Treasury is allocating considerable sums of tax money for the restoration of the Icelandic financial system. It is important that these investments should yield proper returns, although the main benefit will clearly be an efficient banking system service and its role in supporting the restoration of the economy.

### **Sub-objectives**

#### **1. To guarantee competition in the financial market for the future.**

Despite the fact that a large part of the financial undertakings are, at least temporarily, under state ownership, it is important to ensure that open competition can thrive in this market. It is important that the authorities and senior management of these banks and other financial institutions do not make any decisions in the restructuring of the financial system that might undermine or hinder competition.

#### **2. The financial institutions, which the state owns a stake in, should work in a manner that ensures that their management is effective and geared towards the restructuring and innovation of**

## **operations.**

It is important that the restoration of the Icelandic financial system should take into account the size of the Icelandic population and its needs. In light of this, there is a need to evaluate potential cost saving and restructuring measures for financial undertakings, and also look into the potential future developments of services and innovations in management.

- 3. The banks and financial institutions, which the state owns a stake in, should service the needs of Icelandic households and businesses in a targeted fashion.** Financial undertakings in which the state owns a stake shall place an emphasis on traditional banking services and keep investment banking activities, where they exist, clearly separate from basic operations. Many households and companies are in a difficult position in the wake of the economic collapse. The state, as an owner of the financial institutions, emphasises the necessity for these financial institutions to accommodate the needs of these people in these tight times. A special effort should be made to ensure that people can honour their obligations and to support viable businesses.
- 4. Financial undertakings should have a broader ownership base.** Despite the fact that a large proportion of Icelandic financial undertakings are currently under state ownership, the policy aims to broaden the ownership base in the future. Any changes in ownership or sales of stakes are subject to government decisions. If stakes are to be sold, the sale must be prepared with due diligence and parliament must be given the option to contribute to the drafting of the rules that would apply to such a sale.

## **II. Organisation**

The ownership role of the state is particularly pertinent to how it is perceived as an owner in the undertakings. It is very important how the ownership function is actually organised within the state and to determine what units or entities it involves. Being the owner of financial undertakings is, however, just one of the many functions which the state exercises in the financial market in general. It has three main functions:

1. Policy-making function.
2. Supervisory function.
3. Administration of holdings.

The broad range of state holdings in the financial market makes it important to clearly distinguish between these three functions. The state's policy-making (legislative) and supervisory functions differ from its ownership function. In order to safeguard the legitimacy of the measures the state implements and to rebuild confidence in both the state as an owner and the financial system as a whole, these functions must be separated.

The strategy is therefore to bring holdings, including the state's ownership function with regard to public limited companies, which the state owns a majority stake in, under one ministry – the Ministry of Finance, which manages the holdings exclusively. The policy-making (legislative) function is partly performed by the Althing and partly by the Ministry of Business Affairs (drafting of bills, regulations etc.) Finally, the monitoring function is covered by the Financial Supervisory Authority. This clearly separates the state's ownership function from its other functions. The advantages of this organisation are as follows:

1. To separate the state's ownership function from its other functions, such as its regulatory function in the financial markets.
2. To enhance the coherence of the state's ownership function and harmonise its coordination.
3. To better harmonise and provide a clearer overview of the financial information regarding the state's holding in financial undertakings.
4. To create a centralised pool of knowledge and experience on the state ownership function of financial undertakings.

This has been a general trend in other OECD countries in recent years and one which the OECD recommends in its Guidelines on the Corporate Governance of State-owned Undertakings. A decision has been made to entrust a special body, the ISFI (Icelandic State Financial Investments) with the task of temporarily managing holdings on behalf of the state, while the financial system is still in the process of being restored.

The following entities have an impact on the treatment of state-owned financial undertakings. It is important to define the function of each entity as clearly as possible.

### **The Althing (Parliament)**

Through its legislation, the Althing defines the state's participation in the management of undertakings, which are managed by independent legal entities, such as financial undertakings and grants the necessary legislative powers. A number of general laws cover the responsibilities and obligations of the state as an owner of financial undertakings and the state must adhere to these like any other owner of a financial undertaking.

The Althing therefore sets the principles which the executive must adhere to when exercising the state's ownership function and monitors the holders of executive powers in this area as in others.

### **Ministry of Finance**

The Ministry of Finance acts on behalf of the state in the administration of the state's holdings in financial undertakings and is responsible for their treatment before parliament. The Ministry of Finance is responsible for the state's ownership policy and oversees its implementation. Once a year, the Ministry of Finance submits a report on the position of the financial undertakings to parliament, in relation to the objectives and emphases set in the policy.

The ISFI is responsible for implementing the ownership policy set by the Ministry of Finance, which again is responsible for monitoring the body to ensure that it complies with the law and the state ownership policy.

### **The ISFI (Icelandic State Financial Investments)**

The ISFI exercises the state's ownership function in financial undertakings, while the reconstruction and restoration of the financial system is still in progress. The objective is to ensure that the administration of the holdings is professional, reliable and above criticism.

The ISFI is the professional administrative body of state holdings. It is subject to a special board and works under special laws which clearly define its function. The ISFI handles the state's holdings in financial undertakings on behalf of the Ministry of Finance and its staff attends shareholder meetings with the voting rights attached to the state holdings. The ISFI sets the management criteria to be followed by financial undertakings it holds majority stakes in in agreements, which relate to, among other things, the restructuring of financial undertakings, and it is also responsible for monitoring that these objectives are met. The ISFI's influence in an undertaking is proportionate to its level of ownership. If the state holds a minority stake it has to reach agreements in consultation with other shareholders.

The board of directors of the ISFI appoints a special three-person selection committee, which is nominated on behalf of the state, to sit on the boards of directors of banks and financial undertakings.

The ISFI is therefore responsible for handling all of the state's dealings with financial undertakings, which the state owns a stake in and which pertain to its ownership function. The managements and boards of directors of banks and financial undertakings shall not have any direct dealings with the Ministry of Finance or minister.

### **Boards of directors**

The function of the boards of directors of banks and financial undertakings is to ensure that undertakings operate within the framework of the laws, rules and guidelines that apply to their activities, in accordance with the priorities set in the state's ownership policy and the objectives defined in mutual agreements between them and the ISFI.

The boards of financial undertakings are responsible for the management of specific financial undertakings and may not evade that responsibility.

## **III. Principles**

As the owner of financial undertakings, the state needs to have a formed opinion of how its activities should best be run. At the same time, there is a need to ensure that the owner's involvement in the financial enterprise is structured, transparent, exemplary and presented in a professional and objective manner. The

following principles apply to instances in which the state is involved in the management of a financial enterprise as an owner. The ISFI must adhere to these principles in its work and dealings with financial undertakings, as must the boards of directors of undertakings and banks working on behalf of the state.

1. Equitable treatment in the activities of the financial undertakings and in their dealings with stakeholders.
2. Transparency in the state's dealings with financial undertakings.
3. The main proposals and decisions of the owners in matters pertaining to the management of financial undertakings shall be presented at general meetings, discussed and subject to approval.
4. The ISFI shall, in collaboration with other owners if applicable, set the performance criteria for the undertakings. The boards of directors of the banks are responsible for ensuring that these criteria are met.
5. The financial organisation of financial undertakings shall take into account the objectives of the state ownership and the position of the undertakings themselves.
6. The composition of the boards of directors and supervisory boards of banks shall reflect the skills and diversification that befit the nature of each enterprise and its activities.
7. Wage settlements shall be transparent and fair, in line with the general development of the economy and well-executed work shall facilitate promotion.
8. The boards of directors and supervisory boards of banks shall be independent of the directors and management of undertakings.
9. Top level management vacancies, such as vacancies for Bank CEO and Managing director posts, shall be advertised.
10. Members of boards of directors and supervisory boards shall work according to clear plans and constantly endeavour to improve their performance and meet the set targets.
11. Financial undertakings shall be conscious of their social responsibilities.
12. The human resources policies of financial undertakings shall endeavour to ensure the active participation of all employees, and that information is clearly and democratically disseminated to the staff. Priority shall be given to ensure there is no gender-based wage and promotion discrimination in undertakings.

## IV. Requirements and criteria for the management of financial undertakings

In accordance with the objectives of the state ownership of financial undertakings and its principles, the state has defined the requirements and criteria to be applied to their activities. Board members and other persons in any way involved in the control or management of these undertakings on behalf of the state, shall ensure that these requirements and guidelines are observed in their work.<sup>3</sup>

### Dealings between the state and financial undertakings it owns a stake in:

- Entities exercising the state's ownership function in financial undertakings should do so in accordance with the specific legal form of each enterprise. *In most cases the enterprise is a limited liability company and shall therefore be subject to the laws and regulations that apply to activities of this kind.*
- The state's involvement as an owner is founded on recognised general standards of good corporate governance. *In addition to the criteria presented in the state's ownership policy, financial undertakings must comply with the laws and regulations their activities are subject to and observe the guidelines on corporate governance, which are based on, among other things, the OECD guidelines. Annual statements on the enterprises' corporate governance shall be published in their annual reports.*
- The ISFI deals with the state's holdings in financial undertakings and represents the state at general and shareholder meetings. *The board and staff of the ISFI should not participate in the day-to-day management of the undertakings, nor have any influence on their decision-making other than through the traditional communication channels that apply to the specific legal form of the enterprise or those that have been agreed upon in mutual contracts between the ISFI and the financial undertakings. The ISFI shall endeavour to foster and boost competition in the financial market and must be clearly organised in its dealings with undertakings to ensure it has a credible standing..*
- The shareholders meeting (this also applies to an initial capital holders meetings or some equivalent forum in another form of enterprise) is the supreme authority in all matters relating to the financial enterprise. *The state, like other shareholders, presents its issues to the shareholder meeting.*
- The boards of directors, supervisory boards and management of financial undertakings shall not have any direct contact with the Minister of Finance or the ministry regarding aspects which concern specific undertakings or individuals. *All general communications with the state in its capacity as an owner of a financial institution shall be channelled through the ISFI.*

### Strategies and working procedures

- Financial undertakings shall have a clear vision of their future and the objectives of their activities. *In addition to the objectives and priorities defined in the ownership policy and agreements with the ISFI, financial undertakings shall set clear and ambitious targets in their management.*
- Financial undertakings shall clearly communicate their visions for the future, strategies and achievements on their websites. *This should include their vision of the future and principal features, such as human resources policy, corporate social responsibility, equitable treatment etc. There is no requirement for undertakings to disclose strategies which may be competition-sensitive.*

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<sup>3</sup> The guidelines apply to all financial undertakings which the state holds a majority or minority stake in. Naturally the state has more of a say in the undertakings in which it holds a majority stake and they have to provide an explanation if they are not observed. Although the state cannot demand the same from financial undertakings it holds minority stakes in, it recommends that all financial undertakings which it holds stakes in follow these guidelines as well as possible.

- Financial undertakings shall produce and pursue a written corporate ethics and social responsibility policy. *Undertakings should base these policies on international models. By setting these rules, undertakings will strengthen their management base and enhance the credibility of the activities they are engaged in. It is the role of the boards to approve these policies and rules, and the state, as an owner, shall lay a special emphasis on the disclosure requirements of undertakings.*
- Financial undertakings shall produce clear working procedures for the key aspects of their activities, such as the restructuring of indebted companies and the solving of individuals' debt problems, as well the sale of assets etc. *It is important that these procedures be effective and transparent and published on the enterprise's website. In this endeavour, financial undertakings should have regard to the Opinion of the Competition Authority no. 3/2008 regarding decisions by banks and state authorities on the future of companies in competitive markets.*
- Financial undertakings shall ensure they exercise transparency and non-discrimination in their procurement processes and calls for tender. *Many demands are made on state institutions and state-owned undertakings when it comes to the procurement of services. Procurement from large entities can therefore have a multiple impact, e.g. on the market, stocks and environment. Financial undertakings in which the state holds a majority stake adhere to the rules governing public procurement and make its purchases in the most cost-effective manner. Undertakings shall set themselves clear and simple rules in this field in collaboration with the State Trading Centre.*
- Financial undertakings need to develop a good image. *It is important to boost confidence in financial institutions in the future and a good image plays an important role in this regard. There is an important need for financial undertakings and the ISFI, on behalf of the owners, to focus on these aspects.*
- In their strategies and working procedures, financial undertakings shall have a particular regard for the environmental protection and sustainable development of the community. *Financial undertakings can play a key role in this regard.*

### **Working methods of the boards of directors and supervisory boards**

- The boards of directors of state-owned financial undertakings are independent in their work. They have the same supervisory powers and responsibilities as the boards of undertakings in the private sector and are subject to the same laws and regulations. *It is important to clearly define the responsibilities of all parties and that there is no doubt that the boards of the financial enterprise bear responsibility to their owners for their activities.*
- The boards of state-owned financial undertakings must observe the rules and guidelines of corporate governance in the private sector. *Most financial undertakings are limited liability companies and their boards therefore operate under the rules that apply to them and are, inter alia, set in the laws on limited liability companies. The boards of financial undertakings shall also observe the guidelines on the work of boards presented in the most recent issue of the Guidelines of Corporate Governance published by the Icelandic Chamber of Commerce.*
- The role of members of boards of directors and supervisory boards is to protect the interests of the undertakings and ensure the implementation of the state's ownership policy and mutual agreements between the undertakings and the ISFI. *The state's ownership policy provides the guidelines which board members must adhere to in their work. If the ISFI reaches agreements with financial institutions regarding operating criteria and goals, the management shall adhere to them.*
- Financial undertakings shall set written working rules which provide details of the function and work of the boards of directors and supervisory boards. *These rules should cover the division of tasks of the board and the relationship between the Chair and the CEO. Regulations shall be reviewed on an annual basis.*

- When selecting the members of the boards of directors and supervisory boards of financial undertakings, care shall be taken to ensure that there are no conflicts of interest with their other activities. *Board members should therefore not come from the administration, if they are in any way linked to aspects such as regulatory decisions or the supervision of the financial market or any other decisions that may be related to the state's role with regard to financial undertakings.*
- The boards of directors and supervisory boards of banks and financial undertakings shall set up committees. *The minimum number of committees should be: 1) A compensation committee which makes proposals regarding the salary policy. 2) An audit committee to monitor procedures related to the enterprise's accounting and financial reporting regulations. The risk management committee needs to set clear objectives in its work so that, if certain thresholds and stress test limits are exceeded, the committee can be informed and the board's response can be discussed in the committee.*
- There is a need to ensure the equitable treatment of board members, as representatives of the owners and the management. CEOs and chief bank executives should not be on the boards of financial undertakings and the staff of the undertakings should not include any executive chairmen or board members. *There has to be a clear separation between the board members and the management of the financial undertakings. This will clearly demarcate the powers and responsibilities in the management system of the enterprise. There is some danger of the state being an overly passive or ineffective owner, which could result in the management of the enterprise becoming too dominant and steering the enterprise towards goals that are not those of the owners. Boards need to be alert to this risk in their work.*
- The ISFI, as a representative of the state as the owner, shall monitor the work of the board members, who represent the state on the boards of financial undertakings, but does not report to them on their day-to-day business. *In this manner the responsibility of the board members is clear, as is the role of the ISFI.*
- A special selection committee nominates individuals to sit on the boards of directors and supervisory boards of financial undertakings, but the ISFI elects the boards of the undertakings at shareholders meetings. *The selection committee chooses board members, on behalf of the state, and informs the ISFI staff of their nominations. The committee evaluates, among other things, the independence of potential board members. People who feel they meet the criteria for a seat on the board of directors of a financial enterprise shall be encouraged to offer themselves as candidates to the selection committee.*
- Board members of banks and financial undertakings shall have a broad and firm knowledge of the management of a financial enterprise. *The state will endeavour to select candidates with a broad education and skills that are relevant to the management of a financial enterprise. The specific needs of each company and the state's objectives have to be borne in mind when it comes to selecting board members.*

### **Disclosure requirements of state-owned financial undertakings**

- State-owned financial undertakings shall publically publish their financial results on a quarterly basis. *These are the same rules that apply to companies that are listed on the market.*
- Every year state-owned financial undertakings shall publish a report, which presents both financial results and the results of general related activities. *In addition to the annual account figures, these reports should provide any information on the operations, results, management methods etc. of the business which the enterprise deems necessary to mention.*
- The ISFI shall publish an annual report with comprehensive information on its activities and the financial undertakings it manages holdings in. *This report shall contain the main information about the undertakings and an assessment of how successfully agreements and the ownership policy have been implemented.*

- The Minister of Finance shall make a special presentation of the ISFI report to parliament. *The Minister of Finance shall make the contents of the report known to the parliamentary committee that deals with banking matters and representatives of the ISFI shall attend the meeting if the committee deems it necessary.*

### **Supervision**

- The ISFI is responsible for supervising the state's holdings in financial undertakings, as well as the related work of boards of directors and supervisory boards. *Its function is to, among other things, select board members on the basis of nominations from a special selection committee, to monitor them and assess their financial performance and form opinions on aspects that call for a decision from the owners regarding their management.*
- Financial undertakings shall establish efficient procedures for internal supervision and auditing. *The main aspects of the financial enterprise's internal control mechanisms shall be presented on its website. It is important that internal auditors should be independent in their work so that their work is not influenced by instructions from the management of the enterprise. An independent unit shall be set up for the internal auditor directly under the board of directors of the enterprise and submit reports to the board and its audit committee.*
- Financial undertakings in which the state holds a majority stake shall comply with the same laws, rules and obligations regarding its accounting and financial statements as companies that are listed on the stock exchange. *This is the best way to ensure that state financial undertakings will be as transparent as companies that are listed on the regular securities market.*

### **Salary terms**

- The boards are responsible for ensuring that the remuneration policy is implemented and for explaining and justifying its wage settlements. *In the case of undertakings which the state does not hold a majority stake in, general rules apply and the board of directors determines the salary terms.*
- Public financial undertakings shall adopt a moderate approach when it comes to salary terms. *This means that the salaries of the management should be competitive, but not the highest in the market place in which the enterprise operates.*
- The board of directors submits advancement system proposals and remuneration policy proposals to the shareholder meetings on an annual basis.

### **Non-discrimination and equitable treatment**

- Equitable treatment between shareholders. There shall be total equality between the state and other shareholders that may hold a stake in financial institutions. *The state exercises its ownership function within the framework of the regulations that govern financial undertakings. If the state owns a stake in a financial institution in partnership with other owners, under normal circumstances, it shall not be privy to any more information than the other entities in the market, just like shareholders in any other enterprise.*
- Equitable treatment of customers. *The banks shall endeavour to ensure non-discrimination in their dealings with customers and that they follow defined working methods and procedures.*
- Adhere to equitable treatment objectives in its operations. Financial undertakings shall adhere to the equitable treatment objectives in all cases when appointing employees and establishing salaries.