



February 16, 2009

Standing Committees of Althingi  
Austurstræti 8 – 10  
150 Reykjavík

*Re:* The Central Bank of Iceland's comments on the legislative bill amending the Act on the Central Bank of Iceland, no. 36/2001

In an e-mail sent late on the afternoon of February 10, 2009, the Althingi Commerce Committee requested comments from the Central Bank of Iceland on the legislative bill amending the Act on the Central Bank of Iceland, no. 36/2001. The deadline for the submittal of comments was February 12. In a letter dated February 11, the Central Bank requested up to three weeks to submit comments on such an important matter, as is customarily granted in accordance with Parliamentary instructions. A letter dated February 12, from the chairman of the Committee, extended the Central Bank's deadline until Monday, February 16. Thus there was actually no working day included in this extension, which could hardly have been the Committee's intention.

The legislative bill under scrutiny proposes that changes be made to the administrative structure of the Central Bank of Iceland. In the comments accompanying the bill, it is stated that the changes are intended to ensure that the Bank "has a qualified senior management, thereby ensuring professional and objective decision-making concerning the application of the Bank's monetary policy controls". Neither in the comments nor in the Prime Minister's exposition accompanying the bill are there any indications that "professional and objective decision-making" has been lacking in the management of the Bank in recent decades.

Two principal substantive changes are proposed in the bill. On the one hand, it is proposed that the Board of Governors of the Central Bank be abolished and that a "single, professional Governor" be appointed to direct the Bank's operations. On the other hand, the bill proposes that a monetary policy committee operate within the Bank, and that this committee's task will be to "take decisions on the application of the Bank's monetary policy control mechanisms."

All legislation must be subjected to extremely careful preparation, particularly legislation that pertains to the institutions forming the foundations of economic management. In order to enhance credibility, it is vital that a legislative bill as important as the one under discussion

be based on thorough and careful reasoning that is in turn based on research and well-underpinned work. This seems to be lacking. There are few guidelines to be found in the comments to the bill, which consist more or less of reiterations of the articles of the bill itself. It has not been possible to discover who composed the bill, and no reasons for the secrecy have been forthcoming, yet when a legislative instrument of this type is drafted, it is customary to disclose the qualifications of those responsible for its composition. It is important that this bill be discussed in depth on the basis of expert commentary before it is passed into law.

The Central Bank can do little other than wonder at the short time it was given to prepare its comments.

## **General**

The economic shock that has struck Iceland certainly occasions consideration of the legislation on the Central Bank of Iceland. That appears not to be the motivation behind the current bill, however. The amendments proposed therein would do nothing to change the Bank's position or power to affect a sequence of events like the one that occurred. There would be ample reason to review the Central Bank's responsibilities under such circumstances, the measures available to it, and the division of tasks among institutions such as the Central Bank of Iceland and the Financial Supervisory Authority, for example. At this point, many who both care about these issues and are most knowledgeable about them consider it appropriate to examine whether the Financial Supervisory Authority's oversight and regulation of the financial markets should be tightened and the Central Bank's oversight role and responsibility for banking issues (supervision, inspection) strengthened at the same time, while the grey areas between such institutions should be minimised. The present legislative bill does not deal with such matters in any way, nor does it address others just as critical, yet these are the topics most discussed in countries that have experienced economic shocks similar to that in Iceland.

## **Article 1 – Preservation of foreign exchange reserves**

Article 1 of the bill proposes that the Supervisory Board of the Central Bank of Iceland, upon receiving the proposals of the Governor of the Central Bank, should approve procedures for preservation of its foreign currency reserves, cf. Article 28. The current structure of the Act on the Central Bank of Iceland, no. 36/2001, does not assume that the Supervisory Board is a holder of executive power. It is more appropriate that the Supervisory Board confirm rules set by the Governor/Board of Governors, and indeed, this is more consistent with

the actual role of the Supervisory Board, which is that of a supervisor; cf. Article 28.

### **Article 2 – Decisions on the application of the Bank’s monetary policy instruments**

Article 2 of the bill provides for the addition of a new administrative body within the Bank, a so-called monetary policy committee. The article stipulates that the monetary policy committee shall “take decisions on applying the Bank’s monetary policy control mechanisms” but that, in other respects, “the Bank’s direction shall be in the hands of the Governor”. As regards the monetary policy committee’s sphere of influence, reference is made to Article 24 of the Act, which is to be amended; cf. Article 4 of the bill.

When a new body is added to an administrative structure, it is necessary to take extreme care to ensure that it fits into the existing structure, so as to avoid uncertainty about where decision-making power lies and to avoid increasing administrative complexity instead of reducing it, which should be the objective. It appears as though the authors of the legislative bill did not conduct a thorough review of the Central Bank Act so as to determine how this new body will fit into the Central Bank’s administrative structure and ensure that the consistency of the Act is not compromised. It is necessary that it be clear, from reading the legislation, which functions fall under which authorities within the Bank. Should the second sentence of Article 4 of the bill be passed into law unamended, inconsistency will develop between Article 24 of the Act, on the one hand, and Articles 10 and 11 of the Act, on the other. Furthermore, it appears that the legislators forgot to make reference to Article 10, which states as follows: “*The Central Bank of Iceland determines the rate of interest on deposits with the Bank, on credit advanced by the Bank and on securities issued by it.*” Is the reader to interpret the first sentence of Article 4 to mean that the monetary policy committee decides to apply the interest rates that the Central Bank decides according to Article 10; that is, the rates presumably decided by the Governor, as is stated in the Article? The same applies to Article 11 of the Act, which states (in the first sentence of Paragraph 1) that the Central Bank of Iceland “may determine that credit institutions be obliged to maintain funds on reserve requirement accounts with the Bank.” This is all most unclear and is likely to generate administrative uncertainty and reduce transparency.

### **Article 3 – Qualifications of the Governor**

Article 3 of the bill stipulates that the Prime Minister shall appoint the Governor of the Central Bank for a seven-year term following

advertisement of the position. A governor must have completed a master's degree in economics and have extensive experience and expertise in monetary issues.

The requirements made of the Governor in this provision are both too narrow and too unclear to achieve the objective of guaranteeing successful execution of the tasks assigned to the Governor by law. For example, a master's degree in economics does not, in and of itself, reflect knowledge and competence relating to the functions falling under the Central Bank. An applicant who has completed a BS in economics and a doctoral degree in finance may have a much stronger background in the fields most useful in a Central Bank Governor's work than, for example, an applicant with a master's degree in health economics. The wording also provides choice opportunities for hair-splitting. An applicant who proceeded directly to a doctoral programme upon completing a BA/BS degree in economics could be rejected because of his lack of a master's degree. This requirement also conflicts directly with the International Monetary Fund's comments, which appear in a document sent by the Prime Minister's Office to the Central Bank on February 6 – and in fundamental ways. The IMF's comments specify in particular that a law degree coupled with extensive experience in economic affairs is sufficient to qualify an applicant to carry out the duties of a central bank Governor.

The additional requirements – that the Central Bank Governor shall “*possess extensive experience and knowledge of monetary issues*” – are unclear, and the bill sheds no further light on what is meant by them. They give rise to questions about how broad the definition of “monetary issues” is. The Central Bank of Iceland's principal objective is to promote price stability; therefore, it is normal that particular emphasis be placed on experience and expertise in monetary affairs. It is noteworthy, however, that it has not been deemed necessary to require that the Governor of the Central Bank possess knowledge and experience in other facets of central banking than those related to monetary affairs. Article 4 of Act no. 36/2001 states as follows: “*The Central Bank of Iceland shall undertake such tasks as are consistent with its role as a central bank, such as to maintain external reserves and promote an efficient and safe financial system, including payment systems domestically and with foreign countries.*”

The addition of a new body to the Central Bank's administrative structure reduces the Governor's decision-making power with respect to monetary policy formulation. It can be concluded, then, that the Governor's responsibility for functions related to financial stability, preservation of the foreign exchange reserves, and other areas of the Bank's activities will increase correspondingly. This change could make a difference when applicants' qualifications for the position are evaluated. Actually, the legislative bill dramatically reduces the power

wielded by the Governor/Board of Governors with respect to monetary policy, and presumably expands the Governor's role in the general management and operation of the Bank. The bill makes no mention of applicants' policy-making experience and decision-making qualifications, which are probably more meaningful traits in a Governor than those specified in the bill, particularly if the Governor is to serve alone and cannot draw support from the broad experience and education of his or her fellow Governors/Deputy Governors.

### **Article 3 – Appointment of the Governor**

In the comments to the bill, emphasis is placed on the importance of professional qualifications in the selection of the Central Bank Governor. This involves other factors, in addition to the education and experience required of applicants. It is no less important that the selection process be credible. Neither in the Article itself nor in the accompanying comments is any mention made of the process by which applicants' qualifications are to be evaluated.

Apart from the requirement that the applicant have a master's degree in economics, which is beset by the serious flaws mentioned above, it is clear that the bill gives the Prime Minister considerable flexibility in the selection of the Governor. Article 3, Paragraph 1 can only be interpreted to mean that the Prime Minister has the sole power to appoint the Governor of the Central Bank. It has been said that the credibility and independence of the Central Bank would be enhanced if the Prime Minister were to solicit an impartial outside opinion of the applicant's qualifications before actually making the appointment. It could be possible to assign the nomination of the Central Bank Governor to a specially appointed committee or parliamentary committee, with the Minister appointing the Governor from among a group of qualified applicants after considering the views of the committee in question.

It can be argued that the proposed decrease in the number of Governors from three to one makes it even more vital that the selection be made with extreme care. Under the current legislation, the responsibility and decision-making power of the Board of Governors is divided among three Governors, each of which is appointed for a term of seven years. This arrangement actually guarantees the Central Bank a certain independence vis-à-vis the governmental authorities in power at any given time and reduces the likelihood that the Prime Minister can exert political influence on the management of the Bank.

According to Act no. 36/2001, the Board of Governors of the Central Bank of Iceland comprises three persons, all of whom are appointed by the Prime Minister. One of the three is the Chairman of the Board of Governors and is appointed as such; he or she is not chosen by the

Board of Governors or selected by the Minister from among the Board members.

This represents a change from prior central bank legislation, under which the Board of Governors selected the Chairman. The change was a clear departure from previous practice, and the Chairman of the Board of Governors acts as the principal Governor of the Central Bank. The notes accompanying the current Central Bank Act state as follows, among other things: *“In the committee that drafted the bill of legislation, there was some discussion of whether titles should be changed so that the leader of the Board of Governors would be called the Chief Governor rather than the Chairman of the Board of Governors. There was no substantive difference in the perception of the two titles, so it was decided to retain the latter title.”*

The Act states that the Chairman of the Board of Governors is the spokesman for the Bank and the representative of the Board of Governors.

The comments on Article 24 of the Act state as follows: *“The position of Chairman of the Board of Governors of the Central Bank of Iceland will be a special position established with this Act. His or her role includes acting as spokesman for the Bank, presiding over meetings of the Board of Governors, and carrying out other tasks that may fall within the scope of such a chairmanship.”*

It is clear that the current legislation provides for two types of office: the office of the Chairman of the Board of Governors/Chief Governor, and the office of other members of the Board of Governors, who are appointed to that position because the legislature deemed it in appropriate that monetary policy be in the hands of a single individual. The comments on the Act state as follows: *“It is important that, in general, the Board of Governors be fully staffed; that is, that open positions be filled without undue delay. Otherwise, the power to take monetary policy decisions could fall into the hands of the Chairman of the Board of Governors alone.”*

This makes it clear that the current organisational structure of the Central Bank of Iceland provides for one Chief Governor and two Governors in addition to him or her. The legislative bill now before Parliament actually abolishes the position of the latter two Governors and not that of the Chief Governor, as it allows for a single Governor who will be the ranking employee of the Bank. Hence there is no need to advertise anew the position of Governor, as it is simply the current position of the Chairman of the Board of Governors/Chief Governor.

The change is therefore this: that instead of sharing his or her authority with two other Governors, the Chief Governor is to share the authority to make decisions on the application of the Bank's monetary policy instruments with a committee consisting of several individuals.

In essence, then, instead of a three-member committee there will be a larger committee, and the positions occupied by two of the Governors, neither of whom is the Chief Governor, are to be abolished. The position of Chief Governor/Chairman of the Board of Governors remains, however, and even though the Chief Governor will make future decisions on the application of the Bank's monetary policy instruments together with four other individuals instead of the present two, as the positions held by the two Governors who currently share that power with him are to be abolished, the enactment of the legislative bill under scrutiny does not require that the position of Chief Governor of the Central Bank be advertised anew, as the bill does not abolish his position.

During the drafting and discussion of the bill, it has been asserted that examination has revealed that other Nordic central banks generally have a single governor. This is entirely incorrect. In Denmark there are three central bank governors, and in Finland there are four, while the Swedish central bank has a six-member Board of Governors. The Norwegian central bank is led by one Chief Governor, one Deputy Governor, and a special committee that makes interest rate decisions. Both the Chief Governor and the Deputy Governor are members of that committee.

### **Article 3 – Absence of the Governor**

Article 3 does not provide for a substitute for the Governor of the Central Bank; that is, a person who shall wield the authority vested in the Governor in his or her absence. It is extremely uncommon that there should be no provision for one or more Deputy Governors in the organisational structure of a central bank. There is the danger of political interference in the vacuum that could develop in the Governor's absence. In case of absence, the Prime Minister may appoint a temporary substitute for the Governor. However, there are no provisions specifying the requirements for ministerial intervention – that is, the minimum duration or causes of the absence. Would the Governor's summer vacation perhaps suffice to authorise the Minister to step in?

It is critical to provide for Deputy Governors and define their terms of appointment. Furthermore, it must certainly be required that they possess qualifications comparable to those required of the Governor; however, it should be emphasised that the required qualifications may not be so homogeneous as to cast all of the successful candidates in the same mould. If there are two Deputy Governors, it is desirable that one of them be identified as the First Deputy Governors. In addition, there could be a clear division of tasks between the two Deputy Governors; for example, one could bear particular responsibility for financial

stability matters, while the other would focus on monetary policy, as is done in the Bank of England.

#### **Article 4 – the Central Bank's monetary policy instruments**

Article 4, Paragraph 1 of the legislative bill states the following: *“Decisions on applying the Central Bank's monetary policy control mechanisms shall be taken by the Monetary Policy Committee. In this context, the Bank's monetary policy control mechanisms include decisions on interest rates, transactions with credit institutions other than those listed in the second paragraph of Article 7, a decision on reserve requirements as provided for in Article 11, and currency market transactions as provided for in Article 18, intended to influence the ISK exchange rate.”*

It is not explained what is meant by “applying the Bank’s monetary policy control mechanisms.” Reference is made to previous comments in the discussion of Article 2 of the bill.

To state that *“the Bank's monetary policy control mechanisms include decisions on interest rates”* is extremely misleading. It is the interest rate itself that is the monetary policy instrument, and not the decisions pertaining to them. The same can be said of decisions on reserve requirements. If the intention is that the monetary policy committee shall decide interest rates – that is, the Central Bank’s interest rates – the Article concerned must be phrased so as to stipulate more clearly that the monetary policy committee makes interest rate decisions. And the legislature must also be aware that this weakens the position of the Governor/Board of Governors.

One of the Bank’s policy instruments mentioned in the second sentence of Article 4 is “currency market transactions as provided for in Article 18”. The reference to Article 18 is obscure and generates uncertainty. The Bank’s foreign exchange market transactions are either regular transactions or transactions resulting from other decisions concerning monetary policy. It can be difficult to distinguish between strategic intervention and other transactions – for example, those intended to strengthen the foreign exchange reserves rather than affecting the exchange rate. This change causes confusion and non-transparency.

No explanation is given of what is considered a *decision* on the application of the Bank’s policy instruments. Does this provision imply that the monetary policy committee is to make decisions on all rules set by the Bank if they involve monetary policy in any way? Numerous articles in Act no. 36/2001 stipulate that the Central Bank may set rules pertaining to the Bank’s various functions. For instance, do the Rules on Central Bank facilities for financial undertakings fall into the category of a decision on the application of the Bank’s



monetary policy instruments? Those rules discuss what securities are eligible as collateral for Central Bank facilities. They also contain provisions allowing the Bank to limit the amount it offers credit institutions in its regular facilities. Article 6, Paragraph 2 of the Central Bank Act states that the Bank lays down further rules on its activities according to the Article; namely, rules on deposits with the Bank. Does such drafting of rules according to Article 6 fall under the monetary policy committee's decision-making authority or that of the Governor, who is responsible for other aspects of the Bank's administration? Does it fall within the scope of the Governor's administrative authority to set rules on payment systems, which specify what type of securities are eligible as collateral for payment system participation?

It is important to bear in mind that communications and daily transactions with financial institutions are carried out on the basis of rules set by the Central Bank. Should it fall within the scope of the monetary policy committee to set most of the Central Bank's rules, difficult situations could arise when amendments are needed, given that the committee meets only eight times a year. Amendments to rules cannot always be predicted, and situations can arise that require amendments at short notice. If any members of the monetary policy committee reside abroad, it can be expected that no extraordinary meetings will be held unless there is urgent cause. It should be borne in mind that the rules set by the Central Bank provide a framework for day-to-day communications and transactions between financial institutions and the Bank; therefore, it is necessary that such rules reflect the practices considered most efficient at any given time.

It is also worth mentioning that Articles 12 and 13 of the Central Bank Act authorise the Bank to adopt so-called precautionary rules. The Bank has set rules on liquidity ratios and on foreign exchange balance. The fact that the legislative bill under consideration does not specify what is classified under monetary policy gives rise to the question of whether precautionary rules and payment systems pertain to monetary policy in this regard or to financial stability. In addition, it is worth noting that if rules on liquidity and foreign exchange are wielded as monetary policy instruments, this compromises their purpose and credibility as precautionary rules whose intention is to enhance the safety and security of financial institutions.

Furthermore, the phraseology in the second sentence of Article 4, Paragraph 1, which begins with "In this context, ..." calls for a counterargument; that is, an analysis of which decisions are not considered to involve the application of the Bank's monetary policy instruments. However, the bill does not discuss the treatment of the Bank's role as lender of last resort. The recent banking crisis clearly demonstrates the need for radical changes in the statutory rules on

loans of last resort, the conditions for such loans, and the obligations that the Governor/Board of Governors can impose when such loans are granted.

#### **Article 4 – Members of the monetary policy committee**

The first sentence of Article 4, Paragraph 2 of the bill states that “the Monetary Policy Committee is to be comprised of the Governor of the Central Bank, two of the Bank's executives responsible for formulating and implementing monetary policy and two monetary policy experts appointed by the Governor for a three-year term, after obtaining the endorsement of the Prime Minister.”

It is not clear what is meant by the term “*monetary policy experts*”. The bill appears not to stipulate any eligibility requirements for committee members, which is no less important than setting requirements concerning the education and experience of the Governor. It is possible to require that committee members’ education and professional experience be related to the Central Bank’s principal activities, or it could be desirable that their education and professional experience vary. Ideally, the appointment process should be clearly provided for in the bill, and it should be similar to that for the Governor, as appropriate.

The text of the bill does not indicate that the independence of committee members’ decisions is guaranteed, as is intended with the proposed legislation. It is assumed that the Governor will have considerable influence in the appointment of the experts, and it can be said that the monetary policy committee has little or no independence vis-à-vis the Governor himself. First, the bill assumes that the Governor has the explicit power to appoint two committee members upon receiving the endorsement of the Prime Minister. Second, the bill proposes that two senior Central Bank executives in the fields of monetary policy formulation and implementation shall be members of the committee. It is not clear which Bank executives these should be, and it difficult to conclude otherwise than that the Governor shall make this decision. The senior executives in question will always be subordinate to the Governor, who is the ranking executive within the Central Bank. Therefore, it is possible to conclude that the changes proposed in Article 4 dispense with the internal balance provided for in the current legislation: majority rule by two Governors and the distribution of power and responsibility provided for in the Act.

The term of appointment of the two experts is also too short, and this compromises their independence vis-à-vis the Governor.

The legal position and responsibilities of the external representatives on the monetary policy committee are subject to interpretation. Are they considered employees of the Central Bank of Iceland in the sense

of Article 25, Paragraph 2 of the Central Bank Act, which limits employees' participation in the boards of other institutions and commercial enterprises. Neither is it clear whether the provisions of Article 35 of the Central Bank Act, concerning confidentiality and unauthorised use of confidential information, extend to these external committee members.

If external committee members are not considered employees of the Bank and therefore do not fall under the provisions of Act on the Rights and Obligations of State Employees, no. 70/1996, it is difficult to do otherwise than conclude that the statutory authority to dismiss them – for example, due to ineligibility – is lacking.

Not all monetary policy committees in other central banks include outside experts among their members. The Bank of England's monetary policy committee, for example, includes external experts, but criticism of this arrangement is on the rise. The monetary policy committee in the Swedish central bank includes only the Governor and Deputy Governors. The inclusion of external parties in monetary policy committees has advantages and disadvantages. Among the advantages is that the committee members' collective background is likely to be more diverse if membership includes outside experts. On the other hand, it could prove difficult to find impartial experts – that is, those with no special interests at stake – or experts who are willing to take a seat on the monetary policy committee and thereby exclude themselves from other professional activities because of the conflicts of interest that it could engender. These points of view have emerged in an appraisal of the operations of the Reserve Bank of New Zealand.<sup>1</sup> It would be natural and appropriate to offer committee members attractive salaries in order to lure competent people to the position. For this reason and others, the Ministry's expense calculations related to this legislative bill are extremely flawed. In a small society like that in Iceland, it might be easier and less subject to criticism and the risk of conflicts of interest if a monetary policy committee were staffed only by Central Bank employees. In that instance, it would be possible to specify what positions they should hold in the bank; however, stipulating that monetary policy committee membership should be limited to Central Bank employees has obvious flaws as well.

Article 4 of the bill does not allow for alternate monetary policy committee members, even though the committee is not considered to have a quorum unless four of its five members are in attendance. Furthermore, no provisions are made for Central Bank executives' term of appointment to the monetary policy committee, which should be necessary in order to guarantee their independence, especially because they are the Governor's subordinates, as has been pointed out.

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<sup>1</sup> Lars Svensson, Independent Review of the Operations of Monetary Policy in New Zealand: Report to the Minister of Finance, February 2001, pp. 5 and 53.

Article 4, Paragraph 2 states that the monetary policy committee shall meet at least eight times a year. Clearly, these meetings must number more than eight, at least if the committee is to follow the procedure that has been used heretofore. Interest rate decisions are not made until several preparatory meetings have taken place. The legislative bill stipulates that “decisions by the Monetary Policy Committee, and the premises upon which they are based, shall be explained publicly.” It is appropriate to draw attention to the fact that the Central Bank of Iceland generally gives an in-depth account of the premises for its monetary policy decisions and the objectives those decisions are designed to achieve. This is done in the Board of Governors’ policy statements, in the press conferences that are held when interest rate decisions are announced, and – last but certainly not least – in the Bank’s *Monetary Bulletin*, which is published four times a year. In keeping with Article 27, Paragraph 1 of the Act on the Central Bank of Iceland, it would be appropriate to recommend that a record of minutes be held for meetings of the monetary policy committee.

Furthermore, Article 4, Paragraph 2 of the bill states that the monetary policy committee may hold meetings if the chairman – that is, the Governor – so decides, *or* if three committee members demand it. Thus it is conceivable that three members could demand a meeting in the absence of the Governor, which gives rise to the question of how matters subjected to a vote should be handled in the event of a tie.

According to Article 24, Paragraph 1 of the current Central Bank Act, the Chairman of the Board of Governors is the spokesman for the Bank. It would be desirable if the current legislative bill stated who should act as spokespersons for the Bank – for example, when interest rate decisions are explained – because it cannot be discerned from the text of the bill whether the Governor is to fill this role, or whether it should fall to the entire monetary policy committee. It is also necessary to consider that the Governor could be in the minority in a vote carried out within the monetary policy committee. In other words, the Governor’s subordinates could outvote him. The effects of this on the atmosphere in the Bank and on interactions internally would be an interesting research topic.

Finally, it should be mentioned that it would be appropriate to include a temporary provision stating that members of the monetary policy committee should be appointed for terms of varying length the first time, so that their first terms do not all end at the same time.

#### **Article 5 – Authorisation for board participation in external institutions and commercial enterprises**

Article 5 of the bill discusses the authorisation for the Governor and other Bank employees to sit on the board of directors of institutions

and commercial enterprises outside the Bank, or to participate in commercial activities in other respects. As is stated earlier in this document, it is unclear whether Article 5 of the bill applies to the external members of the monetary policy committee. In order to guarantee their eligibility, it is inevitable that no personal interests exist which could cast doubt on or create suspicion about the impartiality of the committee's decisions.

### **Article 6 – Meetings of the Supervisory Board**

In Article 6, it is proposed that the Governor attend Supervisory Board meetings and enjoy the right to submit motions and participate in discussions, as is currently the case. However, the wording of the Article does not indicate unequivocally whether the Supervisory Board may hold meetings in the Governor's absence. According to the bill, it is not planned to amend Article 27, Paragraph 1 of the Central Bank Act, which states that the Chairman of the Supervisory Board shall call meetings of the Board. The Supervisory Board shall always meet when two members of the Board request it. If the bill under consideration is passed into law, Article 27 will not indicate clearly whether the Supervisory Board is authorised to meet in the absence of the Governor. Under the current legislation, this is not a problem, as the Act allows for three Governors, and in the history of the Central Bank it has been almost unheard-of that they should all be absent at the same time. To date it has never occurred that all of the Governors have been away on the date of a Supervisory Board meeting.

### **Article 7 – Supervisory Board**

Article 7 of the bill proposes amendments to Article 28 of the Central Bank Act, which discusses the tasks of the Supervisory Board. It is worth noting here that the bill does not provide for changes in the appointment of Supervisory Board members, nor does it clarify the eligibility requirements for membership to the Supervisory Board. That being the case, anyone who is not a manager or employee of a credit institution or other financial institution engaged in transactions with the Central Bank is eligible to sit on the Supervisory Board; cf. Article 26 of the Central Bank Act. For example, Article 26 does not preclude the possibility that a representative of the State government could sit on the Supervisory Board, although this would undermine its independence. In other respects, no comments are made on this Article.

It could also be asked whether the Supervisory Board should be charged with the task of determining the salary and other terms of employment of the Governor and the monetary policy committee members who are not regular employees of the Central Bank. Under

this arrangement, the Supervisory Board controls the financial interests of the Governor and the committee members and can change their terms of employment, as was done at year-end 2008. The independence of these people would be better protected if an impartial body determined their remuneration and terms of employment.

### **Article 9**

Reference is made to previous comments on the fact that it is unclear whether the external members of the monetary policy committee are considered employees of the Central Bank. It is of vital importance that the provisions of Article 35 on confidentiality and treatment of confidential information extend also to these individuals.

### **Temporary Provision II**

Temporary Provision II proposes to “abolish the Board of Governors of the Central Bank of Iceland, and thereby the positions of the three Governors who currently sit on the Board, including the position of the Chairman of the Board of Governors”. The provision stipulates that the Prime Minister shall designate a person fulfilling the conditions of the proposed Act to serve as Governor of the Central Bank until the position has been filled on the basis of an advertisement.

If this Temporary Provision is applied, there is the risk that the operations of the Central Bank will be subjected to considerable disturbance, which should be avoided at all costs. Under this arrangement, the ranking official within the Central Bank must be initiated to the Bank’s operations on two occasions over a period of several weeks: first the interim Governor, and then the individual hired to fill the position. No grounds are presented to explain why removing the current Board of Governors should be a matter of such urgency that it requires ejecting the Governors in this unprecedented manner, even before any successors have been appointed. Both the current Prime Minister and her predecessor have declared that they have no fault to find with the work carried out by these individuals. This provision has a particularly distasteful air about it. It should also be noted that changes in the top management of the Bank are likely to cause delays in the execution of the economic programme being implemented in collaboration with the International Monetary Fund, whose representatives have expressed their concerns on this point.

Finally, it is appropriate to comment on the notes accompanying the legislative bill. In the comments on Article 3 of the bill, it is stated, concerning in the fourth sentence of Paragraph 1, that “according to the provision, the same person can be appointed Governor only twice,

which is the same as the rule currently applicable to appointments to the Board of Governors of the Central Bank of Iceland.” This statement is not entirely correct. The third sentence of Article 23, Paragraph 2 of Act no. 36/2001 states as follows: “*A Governor can only be appointed for two consecutive terms. A Governor who is not the Chairman of the Board of Governors but is in his second term of office may be appointed Chairman of the Board of Governors for one seven-year term.*”

It is of paramount importance not to do a hasty job of amending the Act on the Central Bank of Iceland. Such work must be carried out with great care and meticulousness so as to prevent the spawning of an administrative bastard that makes management inefficient and engenders distrust within the Bank and without. The current Central Bank Act was drafted as a single unit and garnered the support of all political parties represented in Parliament. The Act has never been amended to date. It would be extremely unfortunate if poorly grounded and ill-prepared amendments were rushed through the legislature for some bizarre purpose, without broad-based support either in Parliament or outside it. Nothing could be less conducive to protecting the Bank’s reputation and bolstering its credibility, which has been viewed as so desirable.

Respectfully yours,

CENTRAL BANK OF ICELAND

Dauid Oddsson  
Chairman of the Board of  
Governors

Eiríkur Guðnason  
Governor