

Economic and monetary chronicle

April 2010

On 12 April, the Parliamentary Special Investigation Commission (SIC) report on the background and causes of the collapse of the Icelandic banks in 2008 was published, both in printed form and on the website of the Parliament of Iceland.

On 13 April, the Financial Supervisory Authority granted Alfa Securities hf. a licence to operate as a securities undertaking pursuant to Article 4, Paragraph 1, Subparagraph 5 of the Act on Financial Undertakings, no. 161/2002.

On 14 April, the volcanic glacier Eyjafjallajökull erupted, after a smaller eruption on Fimmvörðuháls, north of the glacier, had been underway since 20 March. The Eyjafjallajökull eruption caused severe disturbances in air traffic in Iceland and across Europe and dramatically reduced the number of visitors to Iceland well into the summer. The eruption had largely subsided by mid-May.

On 16 April the Executive Committee of the International Monetary Fund (IMF) approved the second review of Iceland's economic programme. At the request of the Icelandic Government, the Fund agreed to extend Iceland's Stand-By Arrangement by three months, until end-August 2011, due to delays in programme reviews. Upon approval by the Executive Board, the third tranche of the IMF loan facility, SDR 105 million, became available. This tranche of the facility is equivalent to 160 million US dollars, or about 20 b.kr. Also released were loan facilities from the Nordic countries and Poland, in the amount of 85 b.kr.

In April 22, the Financial Supervisory Authority (FME) took over the operations of Byr Savings Bank and Keflavík Savings Bank upon requests by the two banks' boards of directors, following unsuccessful negotiations with creditors. In the FME's decision on the disposal of the savings banks' assets and liabilities, it is stated that Byr's assets and deposits had been transferred to a new commercial bank, Byr hf., and that Keflavík Savings Bank's assets and liabilities had been transferred to a new savings bank, SpKef Savings Bank. Both institutions are wholly owned by the State.

On 23 April, Parliament passed Act no. 31/2010 amending the Act on Bankruptcy, etc. no. 21/1991. According to the amended Act, the deadline for cancellation of measures entered into by a bankrupt shall be four years prior to the reference date, so as to ensure that it will be possible to conclude matters emerging in the wake of the banks' collapse without running the risk that interests will not be protected due to workload and time constraints.

On 23 April, Moody's changed its outlook for the Republic of Iceland's sovereign debt from negative to stable. Iceland's rating remained Baa3 for domestic and foreign long-term obligations and P-3 for short-term obligations. The change was attributable to the Treasury's improved liquidity position following the second review of the economic programme of the Government and the IMF.

On 23 April, the Financial Supervisory Authority authorised KEA svf. to own a qualifying holding in Sparisjóður Höfðhverfinga.

On 30 April, the Central Bank of Iceland amended its Rules on Foreign Exchange. The amendments clarified the Rules, reduced the maximum amount of foreign currency that can be purchased for travel, and changed specified exemptions so as to remove all doubt about the legality of offshore transactions.

May 2010

On 5 May, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.5 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 7.0%; maximum rates on 28-day certificates of deposit (CDs), to 8.25%; seven-day collateralised loans, to 8.5%; and overnight loans, to 10.0%.

On 19 May, the Central Bank of Iceland, the Banque centrale du Luxembourg (BCL), and the liquidator of Landsbanki Luxembourg entered into an agreement concerning the Bank's purchase of 98% of outstanding Avens B.V. bonds. The bonds were owned by Landsbanki and pledged to BCL as collateral for a liquidity facility provided in 2008. The Bank was granted full control of the assets of Avens, the largest single owner of króna-denominated assets outside Iceland, with about 120 b.kr., or one-fourth, of all non-residents' króna-denominated holdings at the time the transaction was concluded.

On 26 May, the EFTA Surveillance Authority (ESA) sent a letter of formal notice stating that, in its opinion, the Icelandic authorities were obliged to set up a deposit insurance scheme guaranteeing deposits in the amount stipulated by Directive no. EC 94/19/EC on Deposit-Guarantee Schemes, or roughly ISK 20,000 euros.

On 28 May, the Central Bank of Iceland, on behalf of the Treasury, negotiated the purchase of just over 2% of issued Avens B.V. eurobonds. With this transaction, the Treasury became the owner of all of the company's issued euro-denominated bonds, as it had previously finalised the purchase of 98% of outstanding bonds with an agreement concluded in Luxembourg on 19 May.

On 30 May, the Treasury sold 26 pension funds Housing Financing Fund bonds with a nominal value of 90 b.kr., which the Treasury had acquired upon the banks' collapse and through purchases from the Banque centrale du Luxembourg. The pension funds bought the bonds at a yield of 7.2%, financing the purchase by selling foreign assets. The sale reduced the Government's net foreign-denominated debt, which had grown due to the funding of the above-mentioned agreement concluded in Luxembourg. It also expanded the Central Bank's foreign exchange reserves by about 82 b.kr.

June 2010

On 1 June, Parliament passed Act no. 49/2010 amending the Act on Stamp Fees, no. 36/1978, and the Act on Treasury (Additional Revenue) Act, no. 88/1991. The amendments authorise a temporary ex-

emption from stamp fees upon refinancing of motor vehicle loans and expand the exemptions from payment of registration fees for refinancing of individuals' mortgages and motor vehicle loans.

On 9 June, the People's Bank of China and the Central Bank of Iceland signed a bilateral currency swap agreement. The amount of the agreement is 66 b.kr., or 3.5 billion Chinese yuan. The agreement remains valid for three years and may be extended subject to the approval of both parties.

On 9 June, the FME's application for International Organization of Securities Commissions (IOSCO) membership was approved. The membership allows the FME to exchange information on securities transactions with most other nations, within the framework of existing legislation.

On 10 June, Parliament passed Act no. 60/2010 amending the Act on Bankruptcy, etc., with the aim of improving the legal position of debtors. Among other provisions, the amended Act allows the debtor to continue living in his or her residential property for a period of time during bankruptcy proceedings or after forced sale. According to other new provisions, if a property is sold via forced sale at a normal market price, the difference is calculated to the benefit of the debtor.

On 10 June, Parliament passed Act no. 70/2010 amending the Act on Unemployment Insurance, no. 54/2006, and the Act on Rent Subsidy Allowances, no. 138/1997. The amendments extend the right to proportional benefits against part-time employment until year-end 2010; furthermore, income from third-pillar pension funds does not curtail unemployment benefits (retroactive to 1 March 2009), and the implementation of the Act shall take account of international obligations. According to the amendments to the Act on Rent Subsidy Allowances, income from third-pillar pension funds does not reduce benefits.

On 10 June, a new Act on Insurance Activities, no. 56/2010, entered into force, supplanting the previous Act on Insurance Activities, no. 60/1994. The Act applies to direct insurance in the areas of liability insurance and personal insurance, as well as any type of reinsurance. Supervision of such insurance remains in the hands of the Financial Supervisory Authority.

On 11 June, Parliament passed the Mortgage Rights Act, no. 67/2010, authorising financial undertakings to grant mortgage rights in connection with the Financial Supervisory Authority's disposal of assets and liabilities due to extraordinary circumstances in the financial markets. The Act was passed in order to facilitate settlement between the old and new banks.

On 12 June, Parliament passed Act no. 75/2010, amending the Act on Financial Undertakings. The amendments tighten rules and increase surveillance in a number of ways: the Financial Supervisory Authority is granted increased powers, financial institutions are required to hold a special register of large borrowers, the conditions upon which a financial institution may own its own shares are narrowed and clarified, financial institutions are prohibited from granting loans against

collateral in their own shares or guarantee capital shares, conditions for loans to specific related parties are tightened, and rules on large exposures are tightened, as are rules on incentive programmes, bonus schemes, and termination agreements.

On 14 June, Parliament passed Act no. 78/2010 amending the Foreign Exchange Act, no. 87/1992, and the Customs Act, no. 88/2005. The amendments assign the Central Bank of Iceland sole jurisdiction over investigations and fines in connection with surveillance of the Foreign Exchange Act and the Rules on Foreign Exchange.

On 15 June, Parliament passed Act no. 95/2010 amending the Act on Execution, no. 90/1989, and the Act on Bankruptcy, etc., no. 21/1991. The amendments entail, among other things, making composition of creditors a more effective measure for debtors, as well as expanding the conditions for enforcement of unsuccessful distraint and bankruptcy proceedings.

On 15 June, Parliament passed the Act on Concessions for New Investment in Iceland, no. 99/2010. The aim of the Act is to stimulate and promote investment in business operations in Iceland by specifying, in a transparent manner in the law, what authorisation the State and municipal governments have to grant defined concessions to investment projects, so as to depart from the previous arrangement of concluding separate investment contracts for individual projects on the basis of special legislation approved by Parliament.

On 16 June, Parliament passed Act no. 92/2010 amending the Income Tax Act, no. 90/2003, with regard to concessions for renovation and maintenance of real estate. In levying income tax in 2011 and 2012, it is permissible to deduct 50% of the amount paid for labour (net of value-added tax) carried out in 2010 and 2011, up to a maximum of 200,000 kr. for individuals and 300,000 kr. for couples and jointly taxed parties, for maintenance of residential and vacation property for personal use.

On 16 June, the Supreme Court of Iceland handed down judgments in two exchange rate linkage cases focusing on the legality of exchange rate-linked motor vehicle loans. The Supreme Court concluded that the agreements in question were indeed loan agreements and not motor vehicle agreements, and that the loan in question was a loan in Icelandic krónur and not a loan in foreign currency. Furthermore, the Court concluded that linking the principal of the loan to foreign currency exchange rates was in contravention of the Act on Interest and Price Indexation. The judgments set precedent for the interpretation of exchange rate-linked motor vehicle loan agreements; however, they did not answer the question of how to apply interest to those agreements.

On 22 June, the Republic of Iceland redeemed eurobonds maturing in 2011 and 2012, following a public auction. The nominal value of the purchase was 160 million euros for the first bond and 32 million euros for the latter. It was also decided to draw on the bilateral loan facility negotiated with Denmark, Finland, Norway, Poland, and Sweden, in connection with the economic programme of the Icelandic Government and the International Monetary Fund. The total amount,

639 million euros, was added to the Central Bank of Iceland foreign exchange reserves.

On 23 June, the Monetary Policy Committee of the Central Bank decided to lower the collateralised lending rate by 0.5 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 6.5%; maximum rates on 28-day certificates of deposit (CDs), to 7.75%; seven-day collateralised loans, to 8.0%; and overnight loans, to 9.5%.

On 24 June, Parliament passed the Act on the Debtors' Ombudsman, no. 100/2010, establishing the separate office of the Debtors' Ombudsman, whose task is to assist individuals, free of charge, in gaining an overview of their financial status and seeking solutions to financial problems. The Debtors' Ombudsman's role is to act as an intermediary in interactions and contractual agreements with creditors, and to implement debt mitigation. It also receives communications from debtors, protects their interests, and takes action if debtors' rights are encroached upon. Furthermore, it provides comprehensive advice and instruction on household finance.

On 24 June, Parliament passed the Act on Debt Mitigation for Individuals, no. 101/2010. The objective of the Act is to enable individuals in severe financial difficulties to restructure their finances and establish a balance between their debt and their capacity to pay, so that the debtor can realistically fulfil his obligations for the foreseeable future.

On 24 June, Parliament passed Act no. 102/2010 amending the Act on Temporary Mitigation of Residential Mortgage Payments, no. 50/2009, establishing as permanent the measures set forth in the original Act.

On 24 June, Parliament passed the Act on Temporary Measures for Individuals with Two Residential Properties, no. 103/2010. According to the Act, an individual who pays mortgages on two properties because of purchasing a property for residential use can request that one of the properties be transferred to the holder of collateral. The Act remains in force from 1 August 2010 until year-end 2011.

On 24 June, Parliament passed Act no. 104/2010, temporarily amending the Income Tax Act, no. 90/2003, as regards taxation of cancelled debt for corporations, self-employed persons, and individuals, with consideration of the extraordinary circumstances currently reigning. According to the Act, it will temporarily be permissible, upon fulfilment of specific conditions, to report only a specified percentage of the cancelled debt as taxable income.

On 30 June, the Central Bank of Iceland and the Financial Supervisory Authority issued guidelines based on the Supreme Court of Iceland judgments on exchange rate-linked loans. This was done because of the uncertainty that developed concerning the scope and terms of the agreements falling under the judgments. This uncertainty was considered to undermine stability in the financial markets and the financial system as a whole. The guidelines instructed financial institutions to calculate loans based on interest rates determined by the Central Bank

of Iceland, with reference to the lowest interest rate on new indexed or nominal loans instead of the foreign interest rate reference.

July 2010

On 6 July, the Prime Minister, Minister of Finance, Minister of Economic Affairs, Governor of the Central Bank, and Director of the Financial Supervisory Authority signed an agreement on the appointment of a Financial Stability Committee. The agreement and the work of the committee are based on the 2006 agreement on financial stability and contingency, between the pertinent ministries and institutions. The members of the committee represent the Ministry of Economic Affairs, Prime Minister's Office, Ministry of Finance, Financial Supervisory Authority, and Central Bank of Iceland. The representative of the Ministry of Economic Affairs steers the committee's activities.

On 7 July, the Government announced a campaign to increase employment. Reimbursements of value-added tax due to labour carried out on residential and vacation property were raised from 60% to 100%. A deduction from the income tax base of up to 200,000 kr. for individuals and 300,000 kr. for couples is granted for maintenance of residential real estate.

On 7 July, the Parliamentary Ombudsman sent the Central Bank of Iceland and the Financial Supervisory Authority identical queries concerning the 30 June guidelines issued in the wake of the Supreme Court judgments on exchange rate-linked loan agreements. The queries presented detailed questions in several numbered items, and the deadline for response was 16 July. After having received a one-week extension of the deadline, the Central Bank of Iceland responded on 23 July, as did the Financial Supervisory Authority.

On 12 July, the International Monetary Fund report on changes to the Icelandic tax system was published. The report was prepared for the Ministry of Finance, which sought guidelines on possible improvements with reference to output growth and efficiency, as well as the need to meet an increased need for revenue amounting to 1-2% of GDP over the medium term. The report proposes ways to increase revenues. The proposals are based in large part on bringing in revenues through individual income tax and value-added tax but also mention increases in corporate income tax, financial income tax, and fuel taxes.

On 13 July, the Financial Supervisory Authority appointed an interim board of directors for Avant hf. at the company's request, on the basis of Article 100(a) of the Act on Financial Undertakings, no. 161/2002; cf. Article 4 of Act no. 44/2009.

On 16 July, the total allowable catch (TAC) for the fishing year beginning on 1 September 2010 was announced. The permissible cod quota was raised by 10,000 tonnes, in line with recommendations, while the TAC for haddock and saithe was reduced, although less than was recommended. Restrictions on ocean shrimp fishing were removed.

On 30 July, Moody's changed its outlook for Iceland's sovereign credit rating on foreign and domestic obligations from stable to negative.

The change was made following the Supreme Court judgments on non-binding exchange rate linkage clauses in motor vehicle loan agreements.

August 2010

On 16 August, the Financial Supervisory Authority approved the Central Bank of Iceland Holding Company ehf.'s (ESÍ) application for permission to own a qualifying holding in the insurance company Sjóvá-Almennar hf. (SA tryggingar). The Central Bank of Iceland Holding Company is wholly owned by the Central Bank of Iceland. Other SA tryggingar shareholders are Íslandsbanki hf., with 9.3% of share capital, and SAT Holding Company hf., with the equivalent of 17.67% of share capital.

On 17 August, a cross-border collaboration agreement between the Nordic and Baltic countries took effect. The aim of the agreement is to ensure financial stability and coordinated response to financial shocks affecting more than one country. The agreement is not legally binding but allows for enhanced cooperation and coordinated response, including improved information disclosure between institutions.

On 18 August, the Monetary Policy Committee of the Central Bank decided to lower the collateral loan rate by 1 percentage point. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 5.5%; maximum rates on 28-day certificates of deposit (CDs), to 6.75%; seven-day collateralised loans, to 7.0%; and overnight loans, to 8.5%.

On 31 August, the Central Bank began purchasing foreign currency from market makers in the interbank foreign exchange market. The aim of the purchase is to expand the Bank's non-borrowed reserves. The Central Bank decided to buy 500 thousand euros from each market maker on Tuesday of each week.

On 31 August, the Financial Supervisory Authority revoked the operating licences of SPRON Securities and the operating company Reks-trarfélag SPRON hf. In both instances, the companies themselves had relinquished their licences.

September 2010

On 14 September, the Financial Supervisory Authority sent a circular to credit institutions on the treatment of operational, private, and financing leases. The circular included the following instructions to credit institutions: "Until a final ruling has been rendered on whether operational, private, and financing leases fall within the scope of Chapter VI of the Act on Interest and Price Indexation and whether such agreements contain non-binding exchange rate linkage clauses, such contracts shall be treated in the same manner as the discussed lease-purchase agreements from the credit institutions in question. In other words, they shall be treated in accordance with the 30 June 2010 guidelines issued by the Financial Supervisory Authority and the Central Bank of Iceland."

On 16 September, the Supreme Court of Iceland handed down a judgment in a case in which the treatment of the balance of an exchange rate-linked motor vehicle loan falling under the scope of the 16 June judgment was in dispute. The Supreme Court concluded that, in calculating the balance due, the interest rate specified in the contract should not prevail, as the premises for that interest rate no longer applied once exchange rate linkage had been deemed unlawful. Instead, the interest on the loan should be based on the lowest non-indexed interest rate published by the Central Bank of Iceland. The judgment set precedent for the treatment of other exchange rate-linked motor vehicle loan agreements.

On 17 September, a report by a special committee appointed by the Prime Minister was published. The committee expressed the opinion that there were no obvious legal flaws in the agreement concerning Magma Energy Sweden's purchase of shares in HS Orka. Other possible legal interpretation of the connection between the buyer and the parent company could lead to another conclusion, however.

On 19 September, the Central Bank sold a 99.89% stake in Danish bank FIH, which the Central Bank accepted as collateral for a last-resort loan granted to Kaupthing Bank in October 2008, in the amount of 500 million euros. The sale price was 5 billion Danish kroner (approximately 103 b.kr., or 670 million euros). The purchase is linked to the performance of FIH until 2014.

On 20 September, Moody's Investors Service issued an opinion on the Supreme Court's 16 September decision on exchange rate-linked loans. The agency was of the opinion that the judgment reduced uncertainty but did not affect Iceland's sovereign credit rating.

On 20 September, the Financial Supervisory Authority granted ALM Fjármálaráðgjöf hf. a licence to operate as a securities undertaking pursuant to Article 4, Paragraph 1, Subparagraph 5 of the Act on Financial Undertakings, no. 161/2002.

On 21 September, the Financial Supervisory Authority authorised Annex ehf. to own a qualifying holding of up to 50% in ARM Securities hf., cf. Chapter VI of the Act on Financial Undertakings, no. 161/2002.

On 22 September, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.75 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 4.75%; maximum rates on 28-day certificates of deposit (CDs), to 6.0%; seven-day collateralised loans, to 6.25%; and overnight loans, to 7.75%.

On 23 September, the Financial Supervisory Authority granted Virðing hf. increased authorisation to operate as a securities company. The company's operating licence was reissued to take account of this.

On 29 September, the Executive Committee of the International Monetary Fund (IMF) approved the third review of Iceland's economic programme. The programme is subject to seven reviews in all. Upon approval by the Executive Board, the fourth tranche of the IMF loan

facility, SDR 105 million, became available. This tranche of the facility is equivalent to 162 million US dollars, or just under 19 b.kr. It is expected that, with the approval of the review, bilateral loan financing from the Nordic countries (444 million euros) and Poland (210 million złotys, or 71 million US dollars) will also become available.

