

Opening statement of Gunnar T. Andersen, Director General of the Financial Supervisory Authority, at the press conference held by the Financial Supervisory Authority and the Central Bank of Iceland

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We now find ourselves confronting a situation of deep uncertainty following the recent judgment of the Supreme Court, which is affecting the stability of the financial system. It is the duty of the Financial Supervisory Authority and the Central Bank of Iceland to ensure continuity in the financial markets and support an efficient and secure financial system. When the important public interests at stake in the achievement of these objectives, which the legislature has entrusted to these two organisations, conflict with the special interests of certain groups, the organisations are required to work in the interest of the public. With the guidelines that are being introduced here, the Financial Supervisory Authority and the Central Bank are not taking sides with any particular party – or group of parties; they are carrying out their functions as regulatory bodies and responding to the uncertainty that has been created.

First, we are asking all financial undertakings whose loan agreements with customers contain non-binding provisions on links to foreign currencies of the kind referred to in the recent judgments of the Supreme Court to recalculate the agreements based on the lowest interest rates posted by the Central Bank for general non-indexed or indexed loans of credit institutions which are used in cases where there is uncertainty regarding lending terms. Second, we are asking that these guidelines should be implemented as promptly as possible. Third, we are asking these financial undertakings to re-assess their equity needs in the light of these new circumstances. Fourth, and last, we are asking these undertakings to base their reports to the Financial Supervisory Authority and the Central Bank regarding currency balance, liquidity and equity position on the above premises.

It is clear that every financial undertaking must now carefully review its portfolio and assess in a judicious manner whether it is likely that certain types of contracts would be found to be illegal by the courts of law. Where they

consider it likely that certain contracts will be found to be contrary to law, or if there are further adverse judgments, it is recommended that the provisions of law referred to above should be observed in the determination of interest rates. However, it is for the financial undertakings themselves to decide which cases they choose to defend before the courts and which cases they do not. In many instances they will no doubt choose to put the legality of certain types of loan agreements to the test before the courts of law. Regulatory authorities cannot deprive them of that right. Financial undertakings are of course also free to negotiate other solutions with their clients – their freedom to negotiate has not been curtailed – but they must be careful to ensure that such solutions do not excessively weaken their equity position.

We will continue to gather information in the coming weeks and months. A call has been issued for detailed information from financial undertakings, which will be used to map out the assortment of different contracts that the undertakings have entered into and which might contain non-compliant contractual provisions. Also, the financial undertakings have been asked to re-evaluate their equity needs in light of the information obtained. Once this detailed information is available, the authorities should have a sound base for their assessment of whether any further action will be needed.

When the Financial Supervisory Authority conducted an assessment of the business plans of the new banks last year, taking account of the risk management and corporate governance, among other things, a 16% CAD ratio requirement was imposed on all of them. This was done to create a cushion in the event of potential future setbacks. Furthermore, we required the owners of the bank to demonstrate their banks' ability to meet potential setbacks by setting up a contingency fund. These decisions have proven their worth in the light of the present events. The problem is so serious that in the darkest scenarios the CAD ratio could fall below our requirement of 16%. It is difficult to say at this moment whether the ratio could fall below the statutory minimum of 8%. The need for additional owners' equity – and the extent of the need – will not be revealed until the analysis already started by the Financial Supervisory Authority has been completed.

The question has been raised whether it might be an option to revise the equity requirement of the credit institutions affected. The response is, of course, dependent on future events and how the current uncertainty can be resolved, whether by a new judgment or by other means. I want to conclude by saying that the Financial Supervisory Authority has concentrated on responding to the circumstances based on a professional assessment of the situation. Our role is to promote stability and security in the Icelandic financial sector and to work in the interests of the public – without regard for popularity. We will continue on that path.