

Economic and monetary chronicle 2011

January 2011

On 1 January, the asset and income thresholds according to the rules on State-subsidised residential housing were raised by 2.46%. The asset limit for rent subsidy allowances was raised by the same percentage. The increases accord with the rise in consumer prices from the beginning of 2010 to the beginning of 2011.

On 4 January, the Minister of Welfare instructed the municipalities to increase financial assistance to individuals to equal the amount of unemployment benefits.

On 5 January, an agreement between the Government and the Icelandic Pension Funds' Association was announced. The agreement stipulates as follows: i) general increases in pension payments within the year 2011 will not reduce State payments through income linkage; ii) during the same period, the pension funds will not use income linkage to reduce payments, even though disability assessments are denied; iii) the tax-free threshold for pensioners will increase in three stages over the period 2013-2015, in accordance with the increase in the tax-free threshold for disability benefits.

On 6 January, the Central Bank and the Financial Supervisory Authority announced the conclusion of a new co-operation agreement. The aim of the agreement is to promote a sound, effective, and safe financial system in Iceland, including payment and settlement systems. Among other new provisions, senior management and relevant experts from both institutions are to meet regularly, at least twice a year, so as to assess systemic risk in the financial system, including macroeconomic risk factors, risks in financial institutions' operations, the interplay of risk factors, the status of payment systems, the need for amendment of regulatory instruments, and improvements in contingency exercises.

On 7 January, the Government agreed to extend the incentive programme called "Back to Work," which was established in collaboration with the Icelandic Federation of Labour, the Confederation of Icelandic Employers, the Federation of Icelandic Industries, and others. The authorisation for reimbursement of value-added tax on labour costs for work done on residential housing will be extended until year-end 2011 and will remain in effect for the same length of time as the authorised income tax deduction.

On 10 January, the Executive Committee of the International Monetary Fund (IMF) approved the fourth review of Iceland's economic programme. The approval by the Executive Board released the fifth tranche of the IMF loan facility, in the amount of SDR 105 million (just under 19 b.kr.). Iceland is also authorised to draw further funds on the loan facilities from the Nordic countries and Poland.

On 28 January, the Financial Supervisory Authority decided that the holding company Eignarhaldsfélag NBI ehf. is eligible to own qualifying holdings large enough that Landsvaki hf. and SP-Fjármögnun hf. will be considered its subsidiaries.

On 28 January, it was announced that the Competition Authority had approved the Central Bank's sale of its stake in the Icelandic Banks' Data Centre, concurrent with its takeover of Fjölgreiðslumiðlun hf., which will henceforth be called Greiðsluveitan. Before this change was implemented, Fjölgreiðslumiðlun operated the netting system and the joint payment channel for payment card transactions. Henceforth, it will also operate the RTGS system, the SWIFT-Alliance system for cross-border payments, the collections system for electronic claims and remittance slips (payables pool), and the system that handles the posting of electronic documents to online banking accounts (the check-free system). In its approval of the change, the Competition Authority makes reference to its ruling on the card companies' violation in 2008 and sets requirements for Greiðsluveitan's conduct in the market.

On 31 January, the Financial Supervisory Authority concluded that NBI hf. was eligible to own and administer up to a 33% qualifying holding in Borgun hf.

On 31 January, the Central Bank announced a minor change in the announcement of decisions by the Monetary Policy Committee. Beginning with the Committee's 2 February decision, the MPC statement announcing and explaining the decision would be published at 9:00 on the interest rate decision date instead of 11:00, as had previously been done. The change was made primarily to allow market agents to assess the Committee's decision before markets open. This arrangement allows members of the media, financial analysts, and other interested parties to acquaint themselves with the MPC statement prior to the press conference.

February 2011

On 2 February, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.25 percentage points. The current account rate was reduced to 3.25%, the maximum rate on 28-day certificates of deposit (CDs) to 4.0%, the seven-day collateralised lending rate to 4.25%, and the overnight lending rate to 5.25%.

On 2 February, Parliament passed Act no. 9/2011, amending the Act on Responsible Utilisation of Fish Stocks. The amendment authorises the Minister of Fisheries to impose per diem fines in order to enforce submittal of catch reports.

On 2 February, the Minister of Finance publicised the Government's debt management strategy for 2011-2014 and its plans for borrowing. The plans aim to reduce total Treasury debt from 83% of GDP at end-2010 to 70% of GDP at end-2014, and to reduce net debt from 43% of GDP to 35% of GDP over the same period. Annual repayments on domestic Treasury bonds shall be less than 6% of GDP, balances on the Treasury's current accounts shall equal at least 80 b.kr. at all times, and Treasury debt shall be 60-80% domestic and non-indexed, 20-40% indexed, and 0-20% foreign.

On 3 February, Parliament passed Act no. 12/2011, which increased the number of judges in the judicial system. Three new Supreme Court judges and five new District Court judges will be appointed because of the strain on the judicial system in the wake of the financial crisis.

On 7 February, the Minister of Welfare presented a report on consumption criteria for Icelandic households, prepared by a group of experts. Three types of consumption criteria were presented: i) typical criteria, which represent modest consumption; that is, the median expenses of Icelandic households; ii) short-term criteria based on the same assumptions, but assuming a temporary reduction in consumption and postponement of expenditure items; and iii) basic criteria, which indicate the minimum a household needs to support itself.

On 16 February, Parliament passed the so-called Icesave Act, no. 13/2011, which authorises the Government to guarantee repayment by the Depositors' and Investors' Guarantee Fund to the British and Dutch governments for the compensation paid for Icesave deposits.

On 18 February, the Ministry of Agriculture and Fisheries announced that the capelin quota for the year had been increased to 390,000 tonnes. The original quota was 200,000 tonnes.

On 20 February, the President of Iceland refused to sign Act no. 13/2011, the so-called Icesave Act, which confirmed the agreements providing for a State guarantee of the Depositors' and Investors' Guarantee Fund repayment to the British and Dutch governments. In so doing, the President referred the matter to the electorate for a national referendum, which was subsequently scheduled for 9 April.

On 23 February, the Financial Supervisory Authority revoked the operating licenses of the old financial institutions Byr Savings Bank, Frjálsi Investment Bank hf., and Reykjavík Savings Bank (SPRON) hf., in the wake of a ruling winding up these institutions pursuant to Chapter XII of the Act on Financial Undertakings, no. 161/2002.

On 23 February, rating agency Moody's Investors Service issued a special opinion on the results of the Icesave referendum. The opinion stated that if the Icesave agreements were approved in the referendum, the outlook for Iceland's sovereign credit rating would probably be changed from negative to stable. On the other hand, if the agreements were rejected in the referendum, the rating would probably be downgraded to non-investment grade.

On 23 February, Parliament passed Act no. 14/2011 in order to reinforce the Competition Act, no. 44/2005. Provisions include authorising the Competition Authority to take action against conditions or conduct that prevents, restricts, or is detrimental to competition and is contrary to the public interest. The Competition Authority is now authorised to initiate legal proceedings before the courts in order to revoke rulings by the Competition Appeals Committee.

On 25 February, the Financial Supervisory Authority concluded that the holding company Eignarhaldsfélag NBI ehf. was eligible to own a large enough qualifying holding in Rose Invest hf., a UCITS management company, that Rose Invest would be considered a subsidiary of the holding company.

March 2011

On 1 March, Parliament passed amendments to the Electricity Act. Among other changes, the amended Act expands the requirements for connecting to distribution systems. It also stipulates that Landsnet shall be directly owned by the State and/or the municipalities beginning on 1 January 2015. Furthermore, price lists shall be structured so that they can support average operating expenses plus a profit equivalent to taxes and cost of capital. The Act also requires a licence to operate a market for energy distribution.

On 3 March, Parliament approved amendments to the Act on Landsvirkjun, no. 42/1983, so as to comply with ESA guidelines and to ensure that State guarantees for Landsvirkjun are in compliance with the EEA Agreement provisions on State aid. According to the amendment, the State guarantee is not unlimited; that is, the Act on Bankruptcy, Etc., no. 21/1991, can apply to the company, the amendment covers only credit obligations, and a suitable guarantee fee must be paid for the State guarantee.

On 3 March, Parliament passed an amendment to the Act on State Guarantees, no. 121/1997. According to the amendment, instead of the general State guarantee fee (0.25%) pursuant to Article 6, Paragraph 2 of the Act, Landsvirkjun and others specified in Article 6, Paragraph 1 of the Act on State Guarantees shall pay a guarantee fee that fully corresponds to the concession enjoyed by the company on the basis of the State guarantee, in the form of credit terms more beneficial than those generally available in the market without such a guarantee. With Act no. 144/2010 amending the Act on the Establishment of the Partnership Orkuveita Reykjavíkur, no. 139/2001, with subsequent amendments, Parliament approved the same type of changes as regards owner liability for Orkuveita Reykjavíkur's credit obligations.

On 5 March, the Minister of Finance concluded an agreement with Landsbanki Íslands concerning the latter's takeover of SpKef Savings Bank. This was done in consultation with Icelandic State Financial Investments and with the approval of the Financial Supervisory Authority. On 5 February, SpKef's capital was assessed as negative in the amount of 11 b.kr. In all, the savings bank was deemed in need of 19.4 b.kr. in order to fulfil the FME's minimum capital adequacy requirements. The savings bank had been in liquidity difficulties as well. The agreement with Landsbanki limits the Treasury's expense in relation to deposit insurance. The additional economic capital was estimated at 8.2 b.kr.

On 16 March, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.25%, the maximum rate on 28-day certificates of deposit (CDs) was 4.0%, the seven-day collateralised lending rate was 4.25%, and the overnight lending rate was 5.25%.

On 16 March, Parliament authorised the Government to confirm various decisions of the EEA Committee on amendments to the following annexes to the EEA Agreement: Annex IX (on financial reporting standards, Parliamentary Document 1056; and electronic payment intermediation, Parliamentary Document 1057); Annex XIII (on maritime insurance, Parliamentary Document 1058); Annex XIX (on consumer protection, Parliamentary Document 1055); Annex XX (on environmental affairs, Parliamentary Document 1054); and Annex XXII (on company law, Parliamentary Document 1060).

On 16 March, Parliament passed Act no. 24/2011, amending the Act on Withholding of Public Levies, the Value-Added Tax Act, and the Act on Withholding of Investment Tax. Provisions were added to all of these Acts, authorising freezing of assets if the risk is considered to exist that the taxable party could avoid payment of public levies by transferring assets to another party. A comparable provision was added to the Income Tax Act in 2010.

On 17 March, an agreement was reached among major fishing nations apart from Russia, concerning fishing of the ocean perch stock around the Reykjanes peninsula. The agreement was reached after many years of discussions. The objective is that fishing will be carried out as advised and that Iceland's share will be 31%.

On 22 March, the Prime Minister issued a code of conduct for Government ministers. The code includes provisions on connections and conflicts of interest, finances and wage payments, conduct and demeanour, interactions between ministers and ministerial employees, and disclosure of information to the public.

On 22 March, Parliament authorised the Government to confirm two decisions of the EEA Committee on amendments to Annex XX to the EEA Agreement (on environmental issues, Parliamentary Documents 1090 and 1091).

On 25 March, it was announced that the Financial Supervisory Authority's advisory committee on board member eligibility had evaluated 47 insurance and financial company board members, including eight board members from holding companies. The conclusion was that the expertise, understanding, and attitudes of the board members as regards the main topics related to their sphere of activity were adequate in 35 instances and inadequate in 12 instances.

On 25 March, the Central Bank of Iceland published its capital account liberalisation strategy report. The report discusses the experience gained from the Central Bank's previous strategy and the conditions that must be met in order for it to be possible to lift the controls. In addition, two main phases of the strategy are described, as are smaller increments in the first phase. The report concludes that the conditions required to begin careful removal of some controls already exist, while major steps cannot be taken until the Treasury has demonstrated, through borrowing, that it is able to refinance its foreign loans.

On 28 March, Parliament agreed to add a temporary provision to the Housing Affairs Act, no. 44/1998, authorising the Housing Financing Fund (HFF), upon fulfilment of specified conditions, to write individual mortgage loans down to 110% of the value of the underlying residential property. The amendment is in accordance with the 3 December 2010 agreement between the Government, on the one hand, and credit institutions and pension funds, on the other. The cost of the HFF write-down is estimated at 21.8 b.kr.

April 2011

On 8 April, the Financial Supervisory Authority revoked the operating licences of Askar Capital hf., Sparisjóðabanki Íslands hf. – Icebank, and VBS Investment Bank hf.

On 9 April, a national referendum was held concerning Act no. 13/2011, which authorised the Minister of Finance to guarantee the Depositors' and Investors' Guarantee Fund's reimbursement of costs incurred by the UK and Dutch governments for minimum deposit insurance in British and Dutch branches of Landsbanki and to pay the outstanding balance, with interest, of those obligations. The President of Iceland had referred the matter for referendum on

20 February. Voter turnout was 75%, and the authorisation was rejected with 59.77% of valid votes. 40.23% voted in favour of the authorisation.

On 11 April, the Financial Supervisory Authority approved the transfer of a specified operational unit of EA Investment Company hf. (previously MP Bank hf.) to MP Bank hf. (previously nb.is-Savings Bank hf.) and granted the new bank a commercial banking licence. At the same time, the company's savings bank licence was revoked. In addition, the Financial Supervisory Authority concluded that Titan Investment Company ehf. was eligible to own a qualifying holding of up to 20% in the new MP Bank hf.

On 13 April, rating agency Standard & Poor's placed the Republic of Iceland on CreditWatch negative status.

On 15 April, the Central Bank of Iceland, on behalf of the Treasury, offered to purchase, at par, foreign-denominated Treasury bonds maturing in 2011 and 2012. The offer extended to two bond series in the original amount of 1,250 million euros. The measure was an element in Treasury liquidity and debt management, as well as the management of the Bank's foreign exchange reserves. The offer remained in effect until 5 May 2011.

On 20 April, the Competition Authority imposed per diem fines on the Central Bank of Iceland in order to force the delivery of information on lending by individual banks and savings banks, which the Central Bank considered confidential. The fines would amount to 1.5 m.kr. per day until the documents were submitted. The fines were recalled after the credit institutions concerned authorised the Central Bank to deliver the requested information.

On 20 April, rating agency Moody's Investors Service affirmed the Republic of Iceland's Baa3 ratings for long-term obligations in local and foreign currency in the wake of the rejection of the Icesave agreement in the 9 April referendum. The outlook on the ratings was negative. The agency had previously indicated that rejection of the agreement would probably lead to a rating downgrade. In its press release of 21 April, Moody's attributed the unchanged rating to the positive outlook for payments from the Landsbanki estate, Iceland's performance under the IMF-led economic programme, and support from the Nordic countries in the wake of the referendum.

On 20 April, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.25%, the maximum rate on 28-day certificates of deposit (CDs) was 4.0%, the seven-day collateralised lending rate was 4.25%, and the overnight lending rate was 5.25%.

May 2011

On 2 May, the Icelandic authorities delivered to the EFTA Surveillance Authority a letter from the Minister of Economic Affairs, rejecting the assertion that Iceland had violated the EU Directive on deposit guarantees and demanding that the case be dismissed. It was pointed out that the Landsbanki estate would cover the vast majority of the deposit claims, payouts were scheduled to begin in the near future, and the actions taken by the British and Dutch authorities had delayed settlement.

On 5 May, contractual wage agreements were signed by the national member organisations and the largest unions within the Icelandic Federation of Labour (ASÍ) and the Confederation of Icelandic Employers (SA). The main provisions of the agreements are: A general percentage increase in wages above a specified monthly wage threshold, a rise of a specific sum in wage scales below that threshold, an increase in minimum wages, and a bonus due to delays in contract negotiation. Similar agreements were then concluded in both private and public sectors. The agreements remain in effect until 31 January 2014 if the premises hold. They would have expired on 1 February 2012 if various contract-related pledges had not been formalised before 22 June 2011. The premises that must be met upon review of the agreements in 2012 are that real wages must have risen between December 2010 and December 2011, price levels must have remained stable, and the króna must have appreciated markedly between the effective date of the agreement and year-end 2011. Upon the latter review, in 2013, real wages must have risen between December 2011 and December 2012, twelve-month inflation must be below 2.5% in December 2012, and the trade-weighted

exchange rate index must be below 190 at that time. According to the agreements, wages above 282,353 kr. per month will rise by 4.25% on 1 June 2011; wages above 314,286 kr. will rise by 3.5% on 1 February 2012; and wages above 338,462 kr. will rise by 3.25% on 1 February 2013. Wage scales below these thresholds rise by 12,000 kr. on 1 June 2011 and by 11,000 on 1 February 2012 and 2013. The minimum pay for full-time employment shall be at least 204,000 kr. per month by the end of the contract period, an increase of 23.6%. Employers' costs rise very little due to the increase in minimum pay, as few workers are employed on those terms. One-time payments due to contract delays amount to 75,000 kr.: 50,000 kr. paid upon approval of the contract and 25,000 kr. in connection with vacation and December bonuses in 2011. The gross increase in expense incurred by employers affected by the contract will be about 13% over the lifetime of the agreement, or an average of 4.3% per year. Employers' net costs will increase less, however, as the payroll tax will decline in line with falling inflation, according to a Government announcement.

At the time the agreements were signed, the Government stated that the personal deduction would be indexed, benefits from the general and unemployment insurance funds would rise in line with wages, income linkage of child benefits and mortgage interest allowances reviewed, and the payroll tax reduced in line with declining expenditures related to unemployment. Other pledges included easing the corporate tax environment, improving corporate governance practises, and strengthening employees' position in the event of bankruptcy. The parties to the agreement declared that it was their objective to increase the investment ratio to 20% or more by the end of the contract period. This corresponds to an investment level of at least 350 b.kr. per year. A campaign to help unemployed people back to school was promised, with 2 b.kr. to be shifted from unemployment benefits to educational measures. The Government pledged to work towards the harmonisation of pension rights without curtailing public sector employees' accrued rights, with the aim of presenting the matter before Parliament before the end of the legislative session. Finally, it pledged to show stakeholders proposals for amendments to the Fisheries Management Act before presenting them to Parliament.

On 6 May, the Central Bank announced the approval of plans to purchase, at par, foreign Treasury bonds in the amount of 346 million euros (57 b.kr.). The bonds mature in 2011 and 2012. The transaction was carried out following a tender among investors in Treasury bonds, which was announced on 15 April. The tender centred on two bond series in the combined total amount of 1,250 million euros (204 b.kr.) nominal value. Prior to the purchase, approximately 800 million euros (130 b.kr.) were outstanding.

On 16 May, Fitch Ratings changed the outlook on Iceland's sovereign credit rating from negative to stable.

On 17 May, rating agency Standard & Poor's affirmed Iceland's sovereign credit rating for obligations in foreign currency. The rating for long-term obligations in domestic currency was downgraded to BBB-.

On 23 May, the Central Bank offered to purchase Icelandic krónur against cash payment in foreign currency. The auction was an element in the removal of restrictions on movement of capital as set forth in the Central Bank's capital account liberalisation strategy, published on 25 March 2011. The Bank offered to purchase 15 b.kr. in return for payment in euros. The objective of these initial measures in Phase I of the capital account liberalisation strategy was to enable investors to sell their króna assets in an orderly manner if they so chose.

June 2011

On 3 June, the Executive Board of the International Monetary Fund (IMF) approved the fifth review of Iceland's economic programme. It was also decided at that time to merge the two last reviews. The approval by the Executive Board released the sixth tranche of the IMF loan facility, in the amount of SDR 140 million (just under 26 b.kr.).

On 7 June, an auction was held of Icelandic krónur in return for payment in foreign currency. The auction was announced on 23 May. All accepted bids in the auction were based on the exchange rate at which they were submitted. Bids were submitted for 61.13 b.kr., and bids amounting to 13.4 b.kr. were accepted. The average accepted price was 218.89 kr. per euro, and the minimum price of accepted offers was 215.00 kr. per euro.

On 9 June, the Treasury concluded agreements for a bond issue in the amount of 1 billion US dollars, or 114 b.kr. The bonds bear fixed interest and are issued for five years at a yield of 4.993%. The terms are equivalent to a 3.20% premium on interbank market rates. Investors were keenly interested, with demand totalling 2 billion dollars.

On 10 June, Parliament passed Act no. 64/2011 Amending the Act on Greenhouse Gas Emissions, no. 65/2007. The amendment incorporates the European Union's system for emissions allocations into Icelandic law.

On 10 June, Parliament passed Act no. 78/2011, amending the Act on Financial Undertakings, no. 161/2002. The amendments strengthen creditors' and winding-up committees' right to dispose of assets, as well as strengthening creditors' rights in other countries vis-à-vis cancellation, setting eligibility requirements for participation in winding-up committees, confirming the Financial Supervisory Authority's right to supervise winding-up committees and resolution committees, and requiring winding-up committees and resolution committees to notify creditors of all major actions.

On 10 June, Parliament approved Resolution no. 42/139 providing for the appointment of a committee to investigate the collapse of the savings banks.

On 11 June, Parliament passed Act no. 70/2011, amending the Fisheries Management Act. The Act expands authorisations for inshore fishing and allocates supplemental quotas for several species versus payment. The deduction due to regional catch quotas and inshore fishing is to be applied in part to all catch quotas rather than to quotas for the species in question, and inshore fishing requirements for multi-vessel fisheries are tightened. The regional quota is increased, the fishing fee is raised from 9.5% to 13% of the calculated margin, and 15% of it reverts to the municipalities.

On 11 June, Parliament passed Act no. 73/2011, legalising points made in the Government's statement concerning the wage settlements in May.

On 11 June, Parliament passed Act no. 81/2011, extending the Central Bank of Iceland's temporary authorisation to restrict or stop specified types of capital movements and related foreign exchange transactions until 30 September 2011.

On 14 June, the Financial Supervisory Authority announced that it had approved the merger of Avant hf. and SP fjármögnun hf. with Landsbanki hf. under the name of Landsbanki.

On 15 June, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.25%, the maximum rate on 28-day certificates of deposit (CDs) was 4.0%, the seven-day collateralised lending rate was 4.25%, and the overnight lending rate was 5.25%.

On 16 June, the Central Bank of Iceland offered to purchase euros against payment in Treasury bonds. The auction was held in connection with the capital account liberalisation strategy. The aim was to recoup the foreign currency that the Central Bank of Iceland used to purchase offshore krónur in the previous auction and sell krónur to buyers prepared to hold them for at least five years. The Central Bank offered to purchase 64 million euros against payment in Treasury series RIKS 30 0701.

On 23 June, Registers Iceland announced the revision of the property valuation to be used to levy property taxes in 2012. The total nationwide property valuation rose by 6.8%, to 4,400 b.kr. The total valuation of residential housing rose by 9%.

On 24 June, the Financial Supervisory Authority announced that it had revoked SpKef's operating licence due to a ruling on the winding-up of the savings bank.

On 28 June, the foreign currency auction announced on 16 June took place. Bids totalling 71.8 million euros were submitted, and bids amounting to 61.74 million euros were accepted. The auction was structured with a single-price format, so that all accepted offers were made available to primary dealers at the same price, which was set at 210.00 kr. per euro. Purchasers receive indexed Treasury bonds in the RIKS 30 0701 series as payment for the foreign currency.

July 2011

On 4 July, the Financial Supervisory Authority announced that its board had approved rules on financial institutions' bonus payment systems, as was stipulated in the amendments to the Act on Financial Undertakings. The annual bonus may not exceed 25% of the annual salary without the bonus, and payment of a portion of the bonus must be deferred for at least 3 years. Payment of non-performance-linked bonuses is prohibited.

On 5 July, the Minister of Fisheries announced quota allocations for the 2011/2012 fishing year. The cod quota was increased by 17,000 tonnes, the haddock quota was reduced by 5,000 tonnes, and the perch quota was increased by 12,000 tonnes. Overall, quotas were increased by 32,500 tonnes in the species for which quotas were issued.

On 6 July, the Central Bank offered to purchase Icelandic krónur against cash payment in foreign currency. The auction was an element in the liberalisation of restrictions on movement of capital. The Bank offered to purchase 15 b.kr. in return for payment in euros.

On 12 July, the Central Bank announced the results of the auction of foreign currency against payment in Icelandic krónur, which was announced on 6 July. Bids were submitted for 52.2 b.kr., and bids amounting to 14.9 b.kr. were accepted. The average accepted price was 216.33 kr. per euro, and the minimum price of accepted offers was 215.00 kr. per euro. Offers above the minimum price were accepted in full, and those equal to the auction price were accepted pro rata, at a percentage of 44.0%.

On 13 July, an agreement between Byr and Íslandsbanki was announced, according to which Íslandsbanki would contribute new share capital to Byr and purchase the Byr shares held by the Byr winding-up committee and the Ministry of Finance. The two firms would then merge under the name of Íslandsbanki, subject to the approval of the Competition Authority and the FME.

On 14 July, the Parliamentary Ombudsman notified the Central Bank of Iceland that the Icelandic Homes' Coalition (HH) considered the Bank's Rules on Indexation of Savings and Loans, no. 492/2001, to lack statutory authority. According to Article 13 of the Act on Interest and Price Indexation, no. 38/2001, indexation should be applied to loan payments, not to principal, as the Rules stipulated. Consequently, HH considered the financial institutions' collection of indexed claims unauthorised. In its response of 30 August, the Central Bank pointed out that the Rules were set on the basis of instructions in the Act and that, in practise, payments were always the same, irrespective of whether the wording of the Act or the Rules was followed. Therefore, there could be no violation of the rule of legality.

On 15 July, the Minister of Fisheries issued a regulation based on the newly passed legislation and raised the fishing fee for cod equivalents by 6.44 kr., to 9.46 kr. The Treasury's estimated revenues from the fee rise from 2.7 b.kr. to 4.5 b.kr. per year. The increase is due both to increased fishing quotas and an increase in the fishing fee.

On 21 July, the Financial Supervisory Authority announced that it had revoked the operating licences of Glitnir Bank hf. and Kaupthing Bank hf.

On 26 July, the national accounts for 2010 were published. Treasury expenditures in excess of revenues totalled 123 b.kr., as opposed to 139 b.kr. in 2009. Revenues net of interest rose by 13½% due to an increase in tax revenues. Expenditures rose by 4% year-on-year and were 7½% over budget. Excluding interest, pension obligations, lost claims, and other expenditures related to the economic crisis of 2008, expenditures declined by 3% in nominal terms and almost 8% in real terms; therefore, the budget held by that measure.

On 28 July, it was announced that the Central Bank of Iceland Holding Company ehf. had finalised the sale of a 52.4% share in the insurance firm Sjóvá-Almennar hf., in accordance with a purchase agreement dated 18 January 2011. The purchaser is SF1 slhf., a firm operating under the oversight of Stefmir hf. The transaction has been approved by the Competition Authority and the Financial Supervisory Authority.

August 2011

On 2 August, the Central Bank of Iceland offered to purchase up to 72 million euros against payment in Treasury bonds. The auction was an element in the removal of restrictions on movement of capital as set forth in the Central Bank's capital account liberalisation strategy, published on 25 March 2011. The aim was to recoup the foreign currency that the Central Bank of Iceland used to purchase krónur in the previous auction and sell krónur to buyers prepared to hold them for at least five years.

On 4 August, it was announced that the EFTA Court had ruled that the Icelandic authorities were prohibited from requiring that employees sent temporarily to Iceland should enjoy the rights enjoyed by Icelanders in the Icelandic labour market if they exceed the rights set forth in the EU directive on minimum protection for such employees.

On 16 August, the Central Bank of Iceland publicised the results of the foreign currency auction of 72 million euros, announced on 2 August. Bids were submitted for a total of 3.4 million euros, and all offers were accepted in full. The auction was structured with a single-price format, so that all accepted offers were made available to primary dealers at the same price, which was set at 210.00 kr. per euro. Purchasers received indexed Treasury bonds as payment for the foreign currency.

On 17 August, the Monetary Policy Committee of the Central Bank of Iceland decided to raise the Bank's interest rates by 0.25 percentage points. Interest rates were raised to the following amounts: interest on deposit institutions' current accounts, to 3.5%; the maximum rate on 28-day certificates of deposit (CDs), to 4.25%; seven-day collateralised loans, to 4.5%; and overnight loans, to 5.5%.

On 26 August, the Executive Board of the International Monetary Fund (IMF) approved the sixth and last review of Iceland's economic programme. The approval by the Executive Board released the last tranche of the IMF loan facility, in the amount of SDR 280 million (51 b.kr.). The total loan facility from the Fund amounts to SDR 1.4 billion, or 257 b.kr. In addition, the Nordic countries and Poland loaned Iceland about 150 b.kr. in connection with the IMF programme and authorised borrowings in the amount of 160 b.kr.

On 31 August, it was announced that MP Bank had negotiated the purchase of Saga Investment Bank's corporate finance department.

On 31 August, the Financial Supervisory Authority granted Straumur IB hf. a licence to operate as a credit institution according to the Act on Financial Undertakings.

September 2011

On 1 September, Arion Bank introduced non-indexed 25- or 40-year mortgage loans. The loans bear 6.45% interest up to a loan-to-value ratio of 60%, with fixed interest for the first five years. Supplemental loans up to an LTV of 80% bear 7.55% interest. Interest will be reviewed after five years in line with market interest rates. Customers can then continue, change the form of their loan, or retire the debt without a prepayment penalty. Other banking institutions followed soon thereafter, offering similar non-indexed loans.

On 2 September, Parliament passed Act no. 103/2011, amending the Unemployment Insurance Act and the Act on the Legal Status of Employees upon Transfer of Ownership of an Undertaking. The act extends until year-end 2011 a temporary provision which lengthens the payment period for income-linked benefits in proportion to the entitlement for 100% job loss against utilised benefits. In addition, parties that assume control of an undertaking are

required to take on obligations vis-à-vis employees according to existing contracts. The changes were related to the Government's involvement in the wage settlements in May.

On 8 September, the Minister of Fisheries announced an initial capelin quota of 181,000 tonnes for the coming fishing season.

On 16 September, Parliament passed Act no. 119/2011, amending the Act on Financial Undertakings, no. 161/2002, with subsequent amendments (equity, large exposures, securitisation, etc.). The primary purposes of the Act were to incorporate into Icelandic law the provisions of Directive no. 2009/111/EC and to make minor amendments to other provisions of the Act, such as Article 52, Paragraph 4, concerning eligibility for participation in the board of directors of a financial undertaking.

On 17 September, Parliament passed the Payment Services Act, no. 120/2011, which incorporates into Icelandic law the European Payment Services Directive, no. 2007/64/EC and sets comprehensive legislation on payment services. The aim of the Directive is to create a comprehensive, harmonised, modern regulatory framework for payment services within the European Economic Area. The Act contains, among other things, detailed provisions on the rights and responsibilities of users and providers of payment services.

On 17 September, Parliament passed Act no. 122/2011, amending the Mandatory Insurance of Pension Rights and on Activities of Pension Funds. The amendment tightened the eligibility requirements for managing directors and board members and expanded the authorisation for third-pillar pension savings withdrawals.

On 17 September, Parliament passed Act no. 123/2011, amending the Mandatory Insurance of Pension Rights and on Activities of Pension Funds. The pension funds are authorised to own and operate residential housing, establish companies for the operation of residential housing, or negotiate with private entities for the provision of such services.

On 17 September, Parliament passed Act no. 127/2011 Amending the Foreign Exchange Act, the Customs Act, and the Central Bank Act, and enshrined in law the Rules on Foreign Exchange set by the Central Bank. It is assumed that the capital controls will remain in effect until year-end 2013. The validity period of related provisions in the Customs Act and the Central Bank Act was extended for the same period.

On 17 September, Parliament passed the Act on Mutual Funds, Investment Funds, and Institutional Investment Funds, no. 128/2011. Investment funds are thereby included in older legislation that now covers all funds for collective investment. In addition, the Act implements the provisions of Directive 2007/16/EC, amending the Directive on undertakings for collective investment in transferable securities (UCITS). Other principal amendments include narrowing the authorisations for investment, tightening the requirements for operation of funds, and expanding the requirements for disclosure of information to customers.

On 17 September, Parliament passed Act no. 134/2011, amending the Housing Act, no. 44/1998, with subsequent amendments. The Act authorises the Housing Financing Fund to offer nominal mortgage loans, whereas previous provisions stipulated that HFF bonds should be indexed to the consumer price index. The amendment also stipulates that interest on indexed HFF bonds shall be fixed for the entire duration of the loan, while interest on nominal HFF bonds may be variable.

On 17 September, Parliament passed the Local Government Act, no. 138/2011. The main new provisions concerning municipal finances are that budgets and annual financial statements must be submitted earlier and that deviations from budgets require an annex to the budget. The combined expenditures of municipalities and their institutions may not exceed regular revenues for each three years, and combined debt and obligations may not exceed 150% of regular revenues. Municipalities are given a 10-year grace period to adapt to the provisions of the Act.

On 21 September, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.5%, the maximum rate on 28-day certificates of deposit (CDs) was 4.25%, the seven-day collateralised lending rate was 4.5%, and the overnight lending rate was 5.5%.

On 26 September, the Financial Supervisory Authority ruled that Íslandsbanki hf. was eligible to own a large enough qualifying holding in Byr hf. for Byr to be considered its subsidiary.

On 28 September, the Financial Supervisory Authority announced that it had revoked the collections permit held by SPRON Factoring hf. and the operating licence of Vextir hf. – verðbréfamiðlun, as well as a portion of the operating license of old Landsbanki, as a ruling had been handed down on the winding-up of the bank.

October 2011

On 4 October, the Financial Supervisory Authority announced that it had granted Íslandsbanki hf. a licence to issue covered bonds. On 5 December, Arion Bank hf. received the same type of licence.

On 11 October, an agreement was reached at a meeting of coastal nations concerning blue whiting fishing in 2012. The total allowable catch will be 391,000 tonnes, a considerable increase year-on-year, and the Icelandic quota will be 63,477 tonnes.

On 14 October, the relevant coastal nations concluded an agreement on fishing from the Norwegian summer-spawning herring stock in 2012. The total allowable catch will be 833,000 tonnes, and the Icelandic quota will be 123,000 tonnes.

On 20 October, Parliament passed Act no. 146/2011. This Act amends Chapter XII of the Act on Financial Undertakings, no. 161/2002, so as to legalise a special venue provision concerning rescission cases involving Icelandic financial institutions undergoing winding-up proceedings, and to extend the deadline for initiation of rescission cases involving financial institutions.

On 20 October, the Financial Supervisory Authority announced that it had revoked Saga Investment Bank hf.'s licence to operate as a credit institution effective 3 October, as the company did not meet the statutory capital requirements.

On 28 October, the Supreme Court handed down judgments in 11 cases that had been appealed at the district court level. The cases centred on whether specified claims against the old banks should be considered deposits and whether they should be considered priority claims with reference to the Emergency Act, no. 125/2008. The priority of deposit claims was deemed to stand. On that occasion, the Prime Minister's Office published a statement to the effect that the provisions of the Emergency Act giving priority to deposit claims against the old banks were deemed valid by the Court.

November 2011

On 1 November, it was announced that MP Bank had purchased Júpiter rekstrarfélag hf. Júpiter specialises in asset management. It operates four mutual funds and one institutional investment fund.

On 2 November, the Monetary Policy Committee of the Central Bank of Iceland decided to raise the Bank's interest rates by 0.25 percentage points. Interest rates were raised to the following amounts: interest on deposit institutions' current accounts, to 3.75%; the maximum rate on 28-day certificates of deposit (CDs), to 4.5%; seven-day collateralised loans, to 4.75%; and overnight loans, to 5.75%.

On 7 November, the Ministry of Fisheries announced the Minister's decision to raise the total allowable catch of Icelandic summer-spawning herring by 40,000 tonnes for the 2011/2012 fishing year.

On 10 November, the boards of Auður Capital hf. and Tindar verðbréf hf. agreed to merge the two firms' operations under the name Auður Capital. Tindar verðbréf had been licensed by the Financial Supervisory Authority to operate as a securities undertaking and to offer its customers securities brokerage and corporate finance services, whereas Auður Capital had not offered securities brokerage services prior to the merge.

On 11 November, the Minister of Finance signed an agreement with the municipality of Reykjanesbaer concerning the State's purchase of land and energy resources owned by Reykjanesbaer, subject to Parliamentary approval. The acquisition was authorised in the budgetary supplement on 17 November.

On 15 and 16 November, rating agency Moody's Investors Service published a statement on Iceland's sovereign credit rating. The ratings were kept unchanged at Baa3 for long-term obligations and P-3 for short-term obligations.

On 17 November, the supplementary budget for 2011 was approved by Parliament. Estimated revenues rose by 8 b.kr. and expenditure authorisations by 17.4 b.kr., due primarily to transfers and increased expenses for Government operations, whereas interest expense declined due to falling interest rates. The budget supplement also authorised the sale of the Government's holding in Byr hf.

On 18 November, the Central Bank of Iceland announced a new step in capital account liberalisation under the title "Investment Programme." The Investment Programme is an element in the Bank's capital account liberalisation strategy of 25 March 2011. It authorises investors interested in investing in Iceland with foreign currency to purchase Icelandic krónur for a portion of their foreign currency via Central Bank auctions. The investor concerned must purchase at least the same amount of krónur through a conventional transaction with a financial institution, and the investment is subject to a long-term commitment period.

On 23 November, rating agency Standard & Poor's affirmed Iceland's sovereign credit rating of BBB-/A-3 for long- and short-term obligations in foreign and local currency. The outlook on the rating was changed from negative to stable.

On 25 November, it was announced that the Government had sold its holding in Byr hf. to Íslandsbanki with the consent of the Financial Supervisory Authority, the Competition Authority, and the EFTA Surveillance Authority. The purchase price was 740 m.kr. for an 11.8% stake.

December 2011

On 7 December, the National Budget for 2012 was approved by Parliament. Total revenues according to the 2012 budget are estimated at 523 b.kr., an increase of 9% over the 2011 budget supplement; total expenditures are estimated at 544 b.kr., an increase of 3%; and the deficit is estimated at 35 b.kr., as opposed to 57 b.kr. according to the 2011 budget supplement.

On 7 December, the Central Bank of Iceland Monetary Policy Committee decided to hold the Bank's interest rates unchanged. The current account rate therefore remained 3.75%, the maximum rate on 28-day certificates of deposit (CDs) was 4.5%, the seven-day collateralised lending rate was 4.75%, and the overnight lending rate was 5.75%.

On 14 December, the EFTA Court confirmed that capital controls like those in effect in Iceland are in compliance with the EEA Agreement. The ruling was a guideline opinion requested by the District Court of Reykjavík in connection with a case then under consideration by the Court.

On 14 December, the EFTA Surveillance Authority announced that it had been decided to refer the so-called Icesave case concerning Iceland's alleged violation of the EU Deposit Insurance Directive to the EFTA Court.

On 17 December, Parliament passed Act no. 156/2011, amending the Mandatory Insurance of Pension Rights and on Activities of Pension Funds. New provisions include these: a) extending by one year the pension funds' authorisa-

tion to maintain a difference of up to 15% between asset items and future pension obligations without amendment to the Articles of Association; b) requiring pension funds to pay into a vocational re-education fund; c) imposing a tax of 0.0814% on pension fund assets for supplemental housing benefits in 2011-2012; and d) postponing the implementation of a prohibition on simultaneous participation in numerous pension fund boards.

On 17 December, Parliament passed Act no. 164/2011, which sets forth various fiscal measures. It was decided, among other things, to reduce the payroll tax by 0.91% of the tax base beginning in 2012, to raise the share of the childbirth benefits fund from 1.08% to 1.28% of the base payroll tax, and raise payments to the guarantee fund by 0.05% of the same base. The personal income tax deduction was increased by 5.2%, the threshold between tax brackets #1 and #2 was increased by 15%, and the threshold between tax brackets #2 and #3 was increased by 8.4%. The national tax percentage did not change, but the average local tax rate and the tax withholding percentage rose by 0.03% of the tax base. Parish fees rose by 0.5%, the wealth tax levy was extended by two years, and the deduction from the tax base for premiums to acquire supplemental pension rights was reduced from 4% to 2% of income for the period 2012-2014. In addition, the fuel tax, the alcoholic beverage tax, and the carbon tax were increased. The imposition of a special tax on financial institutions was extended through 2013, as were various other tax provisions related to financial shocks.

On 17 December, Parliament passed the Financial Administration Tax Act, no. 165/2011. The Act provides for a tax on financial institutions and entities engaged in insurance operations. The tax base for the tax will be these entities' total wage and salary payments, and the tax rate was set at 5.45%. The Act is an element in special revenue generation measures in the 2012 National Budget, and revenues deriving from the new tax are estimated at 2.25 b.kr. in 2012. Concurrent with this, a special 6% income tax was levied on these companies' profits in excess of 1 b.kr.

On 17 December, Parliament passed Act no. 175/2011, amending the Act on Landsvirkjun, no. 42/1983, the Act on the Establishment of the Partnership Orkuveita Reykjavíkur, no. 139/2001, the Electricity Act, no. 65/2003, and Act no. 19/2011, amending the Electricity Act, no. 65/2003, with subsequent amendments. The amendment to the Act on Landsvirkjun is intended to eliminate all uncertainty about which financial obligations shall enjoy owner guarantees. A comparable amendment was made to the Act on the Establishment of the Partnership Orkuveita Reykjavíkur. In addition, Article 8 of the Electricity Act was amended so that, instead of stipulating that firms engaged in electricity transmission shall be directly owned by the Icelandic Government and/or Icelandic municipalities, they shall be majority-owned by them and/or firms owned by them.

On 17 December, Parliament passed Act no. 178/2011, amending various laws concerning social security. Among other provisions, social security benefits were increased by 3.5% starting in 2012, and the benefit period for those becoming unemployed after the end of February 2008 was extended by one year, until end-2012.

On 17 December, Parliament extended by one year the main provisions of Act no. 107/2009 on measures to assist individuals, households, and businesses due to extraordinary circumstances in the financial market. These provisions are now valid until year-end 2012.

On 21 December, the Ministry of Finance announced the key figures for tax withholding in 2012. The average local tax rate will be 14.44%, an increase of 0.03% year-on-year. Tax withholding percentages increase by this amount (0.03%), to 37.34% for income up to 230,000 kr. per month; 40.24% for income between 230,000 and 704,000 kr. per month; and 46.24% on income above 704,000 kr. per month. The tax-free threshold will be 130,000 kr. per month, an increase of 5.2%; the lower threshold for tax bracket #2 rises by 9.8% to 230,000 kr.; and the lower threshold for tax bracket #3 rises by 3.5% to 704,000 kr.

On 31 December, the temporary provision in the Act on Unemployment Insurance authorising payment of partial benefits against reduced employment expired. A corresponding provision for self-employed individuals expired at the same time.