

# Economic and monetary chronicle

## 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 Júpi-ter rekstrarfélag hf. Júpi-ter 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 merger.

On 11 November, the Minister of Finance signed an agreement with the municipality of Reykjanesbær concerning the State's purchase of land and energy resources owned by Reykjanesbær, 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 ratings. 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' authorisation 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 Wage 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.

### January 2012

On 3 January, it was announced that the Republic of Iceland and the Central Bank of Iceland had decided to draw the full amount of the Nordic loan facilities. The loans concerned were negotiated in connection with the Government-IMF Stand-By Arrangement programme that concluded in 2011. The decision to draw on the loans was made in view of the situation in the global credit markets. In all, the Nordic loan facilities totalled 1,775 million euros (just under 300 b.kr. at the

current exchange rate) and were to expire at the end of the year. The amount of the loan was 140 b.kr.

On 9 January, the Financial Supervisory Authority announced that it had imposed per diem fines on Stapi Pension Fund in the amount of 200,000 kr. per day due to shortcomings in the Authority's access to the fund's financial information.

On 10 January, the Financial Supervisory Authority approved the merger of Tindar verðbréf hf. and Auður Capital hf. under the name of the latter, on the basis of the Act on Financial Undertakings.

On 12 January, the Central Bank of Iceland offered to purchase euros in exchange for Icelandic krónur for long-term investment in the Icelandic economy, or in exchange for payment in Treasury bond series RIKS 30 0701. The Central Bank offered to purchase up to a maximum of 100 million euros in the two auctions combined. The objective of the measures was to sell Icelandic krónur for foreign currency to parties that have decided to invest in the Icelandic economy or in Icelandic Treasury bonds for at least five years. The deadline for submittal of bids was 15 February 2012.

On 20 January, the negotiating committees of the member organisations of the Icelandic Federation of Labour (ASÍ) and the Confederation of Icelandic Employers (SA) announced that the review committee had decided not to terminate the wage agreement signed on 5 May 2011, even though the commitment given by the Government in its statement at the time of the settlement had not been fulfilled. In the parties' opinion, other conditions considered during the review of the wage settlement had been met: that purchasing power must have grown in 2011, that prices must have been stable, and that the króna must have appreciated markedly.

On 23 January, it was announced that the board of directors of the Central Bank of Iceland Holding Company ehf. (ESI) had decided to drop claims against holders of guarantee capital in Sparisjóður Svarfdæla. The claims in question were loans granted by Saga Investment Bank to over 100 parties at the end of 2007 in connection with an increase in Sparisjóður Svarfdæla guarantee capital.

On 25 January, the Financial Supervisory Authority ruled that Íslensk verðbréf hf. was eligible to own a qualifying holding of up to 50% in T Plús hf., in accordance with the Act on Financial Undertakings.

On 26 January, Parliament passed Act no. 5/2012, authorising the Government to approve an increase in Iceland's International Monetary Fund (IMF) quota and confirm amendments to the IMF Articles of Agreement on Iceland's behalf. The Act authorises the Government to negotiate an increase in Iceland's IMF quota from SDR 117.6 million to SDR 321.8 million. The Central Bank of Iceland is to contribute the funds needed for the quota increase. The Government is also authorised, on behalf of Iceland, to approve the amendments to the IMF Articles of Agreement that concern the arrangements for the Executive Board and were approved by the Board of Governors of the Fund on 15 December 2010.

On 26 January, the Supreme Court ruled that the Icelandic Government was not liable to compensate the losses of those who owned shares in Landsbanki money market funds at the time the banks collapsed in 2008.

### February 2012

On 1 February, Parliament passed Act no. 8/2012 Amending the Act on Public Limited Companies and the Act on Private Limited Companies (simplification of merger and division rules, etc.). The Act primarily incorporates into Icelandic law EU Directive 2009/109/EC, which amends four directives in the field of company law. The main purpose of the Directive is to reduce the administrative burden in limited liability companies, which are subject to a variety of information requirements. Those obligations are reduced under certain conditions as regards preparation and publication of documents and reports. The authorisation to utilise companies' websites, among other things, is expanded.

On 8 February, the Central Bank of Iceland Monetary Policy Committee decided to keep the Bank's interest rates unchanged. The overnight lending rate therefore remained 5.75%, the seven-day collateralised lending rate was 4.75%, the maximum rate on 28-day certificates of deposit (CDs) was 4.5%, and the current account rate was 3.75%.

On 9 February, the Central Bank announced that the swap rate for the Bank's foreign currency purchases in connection with the sale of RIKS 30 0701 Treasury bonds would be based on the auction price and the fixed price of the Treasury bond, which was 115.675833 kr. per bond unit including accrued interest and indexation (dirty price), assuming settlement on 17 February 2012 (yield 2.50%). The formula is as follows: Swap rate = auction price/(bond price/100).

On 9 February, the Financial Supervisory Authority approved the transfer of Saga Capital hf. Corporate Finance to MP Bank hf.

On 10 February, the Ministry of Finance announced that it had finalised an agreement with the Icelandic Pension Funds Association concerning the pension funds' share in the financing of special interest rebates as stipulated in the 3 December 2010 memorandum of understanding concluded by the Government, the financial institutions, and the pension funds.

On 15 February, an auction took place in connection with 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. In all, 77 bids totalling 173.6 million euros were submitted, and bids in the amount of 141.3 million euros were accepted. All approved bids were accepted at the same price, which was set at 240 kr. per euro. Investors selling foreign currency according to the Treasury bond option received indexed RIKS 30 0701 bonds as payment. Bonds sold in the series had a total nominal value of 17.1 b.kr. As payment for foreign currency sold, investors participating in the Investment Programme received Icelandic krónur for long-term investment in the Icelandic

economy. Euros purchased in the auction totalled the equivalent of 14.2 b.kr.

On 15 February, the Supreme Court ruled that Frjálsi Investment Bank was prohibited from demanding increased interest, pursuant to Article 4 of the Act on Interest and Price Indexation, for interest periods that concluded prior to the date of the judgment in the same parties' case concerning the illegality of exchange rate-linked loans in Icelandic krónur (14 February 2011), subject to the existence of a receipt for full payment according to the loan agreement. Following the Court decision, the Competition Authority authorised financial institutions to work together to resolve the matter and recalculate comparable loans.

On 16 February, the Financial Supervisory Authority published a statement to the effect that the Supreme Court judgment of 15 February 2012 on recalculation of exchange rate-linked loans did not jeopardise financial stability.

On 17 February, international credit rating agency Fitch Ratings upgraded the Republic of Iceland's credit rating for long-term obligations in foreign currency from BB+ to BBB-. The rating for short-term obligations in foreign currency was also raised, from B to F3. The outlook remained stable.

### **March 2012**

On 2 March, a mission from the International Monetary Fund (IMF) concluded its visit to Iceland. The mission's assessment was that the outlook was for a good economic recovery. For the medium term, the source of output growth would shift from domestic demand (investment in particular) to foreign demand (with increased exports). In spite of this, however, the mission was of the opinion that a number of hurdles of domestic and foreign origin remain.

On 5 March, the Minister of Economic Affairs appointed Dr. Katrín Ólafsdóttir to a position on the Central Bank of Iceland Monetary Policy Committee. Katrín replaced Anne Sibert on the Committee.

On 5 March, the District Court of Reykjavík handed down a decision in the case Saga Capital hf. vs. Financial Supervisory Authority. Saga Capital filed suit in an attempt to have the Court nullify the Financial Supervisory Authority's decision to revoke the company's licence to operate as a credit undertaking. The Court ruled in favour of the Financial Supervisory Authority; therefore, the Authority's decision stands unchanged.

On 6 March, the Central Bank of Iceland sold 12 million euros in the interbank foreign exchange market. There had been unusually large foreign exchange outflows in previous weeks, a situation that the Bank considered temporary. Exemptions from the Foreign Exchange Act granted by the Bank had entailed substantial purchases of foreign currency in the market. The sale was carried out in accordance with the Central Bank's policy of intervening in the foreign exchange market when necessary in order to mitigate exchange rate volatility.

On 7 March, the Ministry of Finance published preliminary figures on Treasury finances for 2011. According to these figures, collected revenues totalled 468 b.kr., an increase of 1½% year-on-year in nominal terms. Expenditures excluding final accounting items totalled 526 b.kr., a decrease of 1%. Expenditures net of revenues totalled 57 b.kr. by that measure, as opposed to 69 b.kr. in 2010.

On 13 March, Parliament passed Act no. 17/2012 amending the Foreign Exchange Act, no. 87/1992, with subsequent amendments. The Act entered into force the same day, implementing the following amendments: First, it rescinded the exemption for payments from a bankruptcy estate and payments of contractual claims in accordance with composition of creditors agreements (cf. Act no. 21/1991) in domestic currency when payment is disbursed from the payer's account with a financial institution in Iceland. The purpose of the amendments was to provide the Central Bank of Iceland with a prudential tool to prevent disbursements from domestic bankruptcy estates from disrupting the balance of payments or undermining the capital account liberalisation strategy. Second, the Act amended Article 13(j) of the Foreign Exchange Act. According to the amendment, it is no longer permissible to purchase foreign currency for the value of indexation on bond principal; furthermore, it is prohibited to purchase foreign currency for instalments of bond principal. Third, the amendment rescinded the exemption from the statutory prohibition against cross-border movement of foreign currency, which was previously enjoyed by the resolution committees and winding-up committees of the old banks.

On 13 March, the Competition Appeals Committee confirmed the Competition Authority's decision to authorise the merger of Íslandsbanki and Byr Savings Bank, with respect to the provisions of the Competition Act pertaining to firms in distress.

On 14 March, the Central Bank offered to purchase euros in exchange for Icelandic krónur for long-term investment in the Icelandic economy, or in exchange for payment in Treasury bond series RIKS 33 0321. The Bank also advertised for bids on the sale of Icelandic krónur for cash payment in foreign currency. The three auctions were an element in the removal of restrictions on movement of capital as set forth in the Bank's capital account liberalisation strategy of 25 March 2011, and in the Bank's Terms of foreign exchange transactions according to the Investment Programme for capital account liberalisation, dated 18 November 2011, with subsequent amendments. The deadline for submittal of bids was 28 March 2012.

On 15 March, it was announced that the Treasury of Iceland and the Central Bank of Iceland had partially prepaid loans from the International Monetary Fund (IMF) and the Nordic countries. The prepayments totalled SDR 289 million (55.6 b.kr.) to the IMF and 366 million euros (60.5 b.kr.) to the Nordic countries, and are about 20% of the loans taken from these parties. The transaction was an element in paying down short-term debt and reducing the expense associated with maintenance of the Central Bank's foreign exchange reserves.



On 19 March, the Financial Supervisory Authority approved the merger of Alfa verðbréf hf. and MP Bank hf. under the name of the latter, on the basis of the Act on Financial Undertakings.

On 21 March, the Monetary Policy Committee of the Central Bank of Iceland decided to raise the Bank's interest rates by 0.25 percentage points. The overnight lending rate was raised to 6.0%, the seven-day collateralised lending rate to 5.0%, the maximum rate on 28-day certificates of deposit (CDs) to 4.75%, and the current account rate to 4.0%.

On 22 March, the Financial Supervisory Authority approved the transfer of the operation of 10 mutual funds, three investment funds, and eight institutional investment funds from Landsvaki hf. to Landsbréf hf., effective 31 March.

On 28 March, the Central Bank of Iceland held auctions for the purchase of euros against payment in Icelandic krónur and for the purchase of Icelandic krónur against payment in foreign currency. In the euro purchase auction, 79 bids totalling 92.9 million euros were submitted, and bids in the amount of 22.5 million euros were accepted. All approved bids were accepted at the same price, which was set at 239 kr. per euro. Investors selling foreign currency according to the Treasury bond option received indexed RIKS 33 0321 bonds as payment. Bonds sold in the series had a total nominal value of 416.7 m.kr. As payment for foreign currency sold, investors participating in the Investment Programme received Icelandic krónur for long-term investment in the Icelandic economy. In the króna purchase auction, the Bank purchased euros for a total of 4.9 b.kr., with the minimum price set at 235 kr. per euro.

On 30 March, the Financial Supervisory Authority approved the merger of Íslandsbanki hf. and Kreditkort hf. Íslandsbanki hf. will take over all rights and responsibilities of Kreditkort hf., and the two companies will be merged under the name Íslandsbanki hf.

