

# Economic and monetary chronicle 2010

## January

On 5 January, the president of Iceland refused to sign an act of law amending the Minister of Finance's authorisation to grant a Treasury guarantee of loans taken by the Depositors' and Investors' Guarantee Fund (DIGF) due to Icesave deposit accounts. In so doing, the president referred the matter to a national referendum. Three days later, Parliament passed an act of law stipulating that the referendum should take place as soon as possible, and no later than 6 March.

On 5 January, rating agency Standard and Poor's announced an unchanged rating for the Republic of Iceland, citing the risk of isolation in credit markets and heavy pressure from abroad to resolve the Icesave dispute.

On 5 January, rating agency Fitch Ratings announced a downgrade of Iceland's sovereign credit ratings for domestic and foreign currency obligations. Iceland's long-term foreign and domestic currency ratings are now BB+ and BBB+, and the short-term foreign currency rating is B. The country ceiling was lowered from BBB- to BB+.

On 6 January, rating agency Moody's announced that it was keeping Iceland's sovereign rating unchanged for the present, in spite of the president's veto of the Icesave guarantee legislation. The agency considered it likely that domestic political instability and external pressure to resolve the Icesave dispute would result, both of which could have a negative effect on Iceland's credit rating.

On 7 January, the Financial Supervisory Authority (FME) granted ISB Holding ehf. permission to own a qualifying holding in Íslandsbanki on behalf of Glitnir Bank hf. The permission was granted following a 13 September 2009 agreement between Glitnir and the Icelandic Ministry of Finance, authorising Glitnir to acquire a 95% holding in Íslandsbanki upon fulfilment of specified conditions.

On 8 January, Japanese rating agency R&I Rating announced that Iceland's sovereign credit rating would remain on the Rating Monitor with a view to possible downgrade. The agency affirmed its previous rating of BBB-.

On 11 January, the Financial Supervisory Authority (FME) authorised Kaupskil ehf. to own qualifying holding in Arion Bank hf. (Arion) on behalf of Kaupthing Bank hf. (Kaupthing). The permission was granted following a 3 September 2009 agreement between Kaupthing and the Icelandic Ministry of Finance, authorising Kaupthing to acquire an 87% holding in Arion upon fulfilment of specified conditions.

On 22 January, the Financial Supervisory Authority (FME) authorised Landskil ehf. to own a qualifying holding in NBI hf. on behalf of Landsbanki Íslands hf. The permission was granted following a contractual agreement with Landsbanki Íslands hf. and the Icelandic Ministry of Finance, dated 15 December 2009, stipulating,

inter alia, that Landsbanki Íslands hf. was authorised to acquire an 18.7% holding in NBI hf., upon fulfilling specified conditions.

On 27 January, 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 8.0%; maximum rates on 28-day certificates of deposit (CDs), to 9.25%; seven-day collateral loans, to 9.5%; and overnight loans, to 11.0%.

On 29 January, the Minister of Fisheries authorised a 130,000 tonne capelin quota for the winter fishing season. A quota of 97,100 tonnes was allocated to Icelandic fishing vessels.

## February

On 1 February, rating agency Standard and Poor's announced an unchanged rating for the Republic of Iceland but indicated that the rating would remain on CreditWatch negative due to uncertainty about external financing, capital account liberalisation, and the status of the Icesave dispute.

On 8 February, the Minister of Transport, Communications, and Local Government appointed a financial supervisory board for the municipality of Álftanes, upon the recommendation of the surveillance committee for municipal finances.

On 17 February, it was announced that the Financial Supervisory Authority had established a three-member advisory committee to assess the eligibility of board members in supervised financial companies.

On 24 February, the European Commission issued an opinion on Iceland's application for EU membership. Its conclusion was that Iceland met all of the conditions required of an EU applicant, and it was recommended that membership negotiations with Iceland begin.

On 25 February, Parliament passed an amendment to the Act on Forced Sale (Case no. 389 at the 138th Legislative Session), so that until 1 August 2010, a debtor can, upon filing an application, have the forced sale of his or her own residence deferred for up to three months. The amendment took effect the same day. Previously, the Act contained a provision deferring forced sale of residential housing through 28 February. On 26 February, rating agency Moody's expressed its concerns about the downward pressure that the stalemate in the Icesave dispute placed on Iceland's Baa3 credit rating. No changes in the credit rating were announced.

### March

On 4 March, Parliament passed amendments to the Act on Public Limited Companies (Case no. 71 at the 138th Legislative Session). The amendment restricts the role of the Chairman of the Board, thereby eliminating the position of Acting Chairman of the Board. Explicit provisions on gender equality in the boards of companies were also passed into law.

On 4 March, the Financial Supervisory Authority confirmed joint financial institution rules on corporate financial restructuring. This was done with Act no. 107/2009 on measures to assist individuals, households, and businesses due to extraordinary circumstances in the financial market.

On 5 March, the Financial Supervisory Authority announced the conclusion of information exchange agreements with the Financial Services Commission of the British Virgin Islands and the Alberta Securities Commission in Canada.

On 6 March, a national referendum was held on the authorisation to issue a Treasury guarantee for loans related to the Icesave accounts. The authorisation to grant the guarantee was rejected with 98% of valid votes. Hence the previous act of law authorising the guarantee with reservations, Act no. 96/2009, regained its validity.

On 10 March, the Financial Supervisory Authority granted Arev Securities hf. expanded authorisation to operate as a securities company. The company's operating licence was reissued to take account of this.

On 17 March, 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 7.5%; maximum rates on 28-day certificates of deposit (CDs), to 8.75%; seven-day collateral loans, to 9.0%; and overnight loans, to 10.5%.

On 22 March, Parliament passed an act of law prohibiting the air mechanics' strike that had begun at midnight the previous night (Case no. 483 at the 138th Legislative Session). The term of the wage agreement that expired on 31 October 2009 was extended through the end of November 2010.

On 23 March, the committee for foreign investment ruled that there was no occasion to make formal comment on Magma Energy Sweden AB's investment in HS Orka hf. The committee's ruling is considered final.

On 25 March, Parliament passed an amendment to the Income Tax Act (Case no. 386 at the 138th Legislative Session), which authorises the Director of Internal Revenue to demand that the assets of parties suspected of major violations of tax reporting rules be frozen, if it is considered that there is a significant risk of large-scale default in tax payments.

On 29 March, the Financial Supervisory Authority granted Arctica Finance hf. a licence to operate as a securities undertaking in accordance with the Act on Financial Undertakings. Concurrent with this, Arctica Holding Company ehf. received an authorisation to own and administer a stake of over 50% in Arctica Finance.

On 30 March, rating agency Standard & Poor's affirmed the Republic of Iceland's sovereign credit ratings for long- and short-term obligations in foreign currency at BBB-/A-3. The ratings for long- and short-term obligations in domestic currency were downgraded from

BBB+/A-2 to BBB/A-3. The ratings were removed from CreditWatch status, where they have been with negative implications since 5 January 2010. The outlook remains negative.

#### **April**

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 Fimmvorduhals, 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 Keflavik 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 Keflavik 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 Sparisjodur Hofdhverfinga.

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

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 krona-denominated assets outside Iceland, with about 120 b.kr., or one-fourth, of all non-residents' krona-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

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

exemption 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 kronur 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 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. 0/2009, 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

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

On 16 August, the Financial Supervisory Authority approved the Central Bank of Iceland Holding Company ehf.'s (ESI) application for permission to own a qualifying holding in the insurance company Sjóva- 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 Islandsbanki 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 Rekstrarfelag SPRON hf. In both instances, the companies themselves had relinquished their licences.

## September

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 lastresort 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 Fjarmalaradgjof 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 zlotys, or 71 million US dollars) will also become available.

## October

On 5 October, the report of the monitoring committee on measures to assist individuals, households, and businesses due to extraordinary circumstances in the financial market was presented to the Government and the opposition party leaders. The aim of the Act on Problem Debt Restructuring is to expedite the reconstruction of the Icelandic economy and establish equilibrium in private sector debt. The committee assessed the financial institutions' work on private sector debt mitigation and made suggestions for improvements in its report.

On 14 October, Parliament passed Act no. 128/2010 amending the Act on Debt Mitigation for Individuals, no. 101/2010, due to the extremely heavy workload at the newly established Office of the Debtors' Ombudsman. The amendments were intended to ease debtors' position by granting applicants a deferral of payment upon submittal of the application for debt mitigation and not upon approval.

On 14 October, the Ministry of Finance, the Byr Savings Bank winding-up committee, and the Byr hf. board of directors signed an agreement on the settlement and ownership of Byr hf. with the takeover of the savings bank by the Byr winding-up committee. The State's holding in Byr hf. will be 5.2%. Byr Savings Bank's stake, 94.8%, will be in the custody and oversight of the Ministry of Finance until the winding-up committee requests it, probably within two years. With this action, Byr hf. is fully capitalised and meets the capital adequacy and liquidity requirements of the Financial Supervisory Authority and the Central Bank of Iceland. The Treasury grants Byr hf. a subordinated loan of up to 5 b.kr. at market rates for a period of 10 years, which Byr hf. is expected to pay in full in five years' time. Byr Savings Bank's claim against Byr hf. will be converted to share capital.

On 15 October, the Financial Supervisory Authority authorised Arion Bank hf. to own a qualifying holding in Valitor hf. Arion Bank hf. requested permission to increase its qualifying holding in Valitor hf. indirectly, through its holding in Valitor Holding hf., cf. Article 40 of the Act on Financial Undertakings. The Financial Supervisory Authority considers Arion Bank eligible to own and administer the holding, partly because of Valitor's sound and reliable operations. On 12 October, the Financial Supervisory Authority authorised Arion Bank to own a stake of over 50% in Valitor.

On 15 October, the Ministry of Fisheries authorised a 15,000-tonne quota for Icelandic summer spawning herring, for the fishing year 2010/2011.

On 15 October, the committee on foreign investment submitted its third report on the legality of Magma Energy Sweden's investment in the subsidiaries of HS Orka. The committee expressed the opinion that there was no further reason to comment on the acquisition, citing two previous opinions wherein the majority of the committee considered Magma's purchase of HS Orka in compliance with the law.

On 18 October, the Financial Supervisory Authority announced that, on 1 October, it had recalled ALMC hf.'s (previously Straumur-Burdaras Investment Bank) commercial banking licence, as the company was dissolved pursuant to Chapter XII of the Act on Financial Undertakings, no. 161/2002; cf. Article 9, Paragraph 1, Subparagraph 6 of the same Act.

On 20 October, Parliament passed Act no. 129/2010 amending the Act on Forced Sale, no. 90/1991. Because the Office of the Debtors' Ombudsman had only recently commenced operation and because of the time required to resolve pending cases, the Act on Forced Sale was amended, and the respondent's deadline for requesting that the Commissioner postpone the continuation of a forced sale be deferred for three months was extended until 31 March 2011.

On 21 October, it was decided at a meeting of coastal nations that the total catch of the Norwegian spring spawning herring stock should be 988,000 tonnes in 2011. The total blue whiting catch was set at 44,000 tonnes. Iceland's share of the quotas is 143,000 tonnes of herring and 6,500 tonnes of blue whiting.

## November

On 1 November, the Central Bank announced that the review of the Rules on Foreign Exchange, no. 370/2010, was complete. The Bank considered it unnecessary to amend the Rules; therefore, they remained in effect unchanged.

On 3 November, 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 4.0%; the maximum rate on 28-day certificates of deposit (CDs), to 5.25%; seven-day collateralised loans, to 5.5%; and overnight loans, to 7.0%.

On 3 November, Már Guðmundsson issued a statement explaining the policy framework and plans for the removal of the capital controls. In the statement, the Governor reviewed the status of the controls and described the conditions that must be in place in order for liberalisation to take place.

On 3 November, the Ministry of Fisheries increased the maximum quota for Icelandic summer spawning herring from 15,000 tonnes to 40,000 tonnes.

On 14 November, a two-week visit to Iceland by an IMF mission under the leadership of Julie Kozack was completed. The mission discussed the fourth review of the IMF-supported economic programme with the Icelandic authorities. Meetings were held with the authorities, members of Parliament, academics, private sector representatives, and labour market representatives.

On 16 November, Parliament passed Act no. 132/2010 amending the Act on Financial Undertakings, no. 161/2002, as regards provisions concerning winding-up proceedings and bankruptcy proceedings for the failed commercial banks. The amendment was made following comments by the resolution committees and winding-up committees of the failed banks as a result of judgments handed down by an appeals court in France on 4 November 2010. It can be concluded from the judgment that there could be some legal uncertainty pertaining to the origination of financial institutions' winding-up proceedings according to general rules. Because significant interests were at stake, it was considered necessary to eliminate all doubt about the involvement of the courts in winding-up proceedings and to ensure that there was no doubt about whether the formal requirements set forth in Directive 2001/24/EC on reorganisation and winding up of credit institutions were fulfilled.

On 19 November, the Ministry of Fisheries issued a capelin quota of 200,000 tonnes for the winter fishing season dating from 23 November 2010 – 30 April 2011.

On 25 November, the Supreme Court of Iceland handed down Decision no. 274/2010 concerning the Act on Guarantors, no. 32/2009. In the case, payment was demanded of two guarantors for a debt of which the District Court had relieved a debtor with a composition of creditors agreement involving debt mitigation. The Supreme Court upheld the District Court decision, which was that the creditor's right against the guarantors of the debt was protected by Article 72 of the Constitution and that those rights could not be curtailed without compensation by means of retroactive legislation. The provisions of the Act on Guarantors were therefore in contravention of the Constitution.

On 30 November, Parliament passed Act no. 135/2010 amending the Act on Debt Mitigation for Individuals, no. 101/2010, and other Acts, with the aim of rectifying various flaws in the Act on Debt Mitigation, clarifying provisions and ensuring the effectiveness of debt mitigation, and co-ordinating the implementation of the debt mitigation measure.

## **December**

On 1 December, the Enterprise Investment Fund announced that the Competition Authority's examination and due diligence analysis of the Fund's purchase of the holding company Vestia from Landsbanki was complete. The valuation changed somewhat during the process, and Landsbanki retains more of the company's assets than was assumed at the time of the purchase on 20 August. As a result, the purchase price is 15.5 b.kr. instead of the 19.5 b.kr. assumed in August.

On 3 December, the Government announced an agreement with credit institutions and pension funds concerning measures to assist distressed households. Distressed borrowers with over-leveraged assets are offered the opportunity to reduce their outstanding debt to 110% of the value of the asset concerned. The original debt service burden must be at least 20% of the income tax base plus investment income. Collateralised debt could be reduced by as

much as 4 m.kr. for individuals and 7 m.kr. for couples or single parents. A much more detailed appraisal of assets and capacity to pay must be carried out if a larger write-down is needed, up to a maximum of 15 m.kr. for individuals and 30 m.kr. for couples and single parents. Changes were also made to problem debt restructuring measures so that they would benefit a larger number of households. Over 2 b.kr. would be allocated to the maintenance of a special increase in mortgage interest allowances that was implemented in 2009-2010. A new temporary measure would then be created to pay down interest expense due to residential housing. Lenders will also attempt to reach all households that are in arrears and offer them satisfactory solutions before 1 May 2011. In connection with the agreement on debt problems, the Government declared that it would reduce the linkage between pension benefits and social security benefits and that the tax-free threshold for pensioners would be raised in stages during the period 2013-2015.

On 7 December, the supplementary budget for 2010 was approved by Parliament. Estimated revenues for 2010 rise by 16 b.kr., due primarily to stronger asset sales, while estimated expenditures decline by 0.9 b.kr., because a 24 b.kr. increase stemming from appropriated bank debt offsets a 24 b.kr. reduction in interest expense.

On 8 December, the Monetary Policy Committee of the Central Bank of Iceland decided to narrow the Bank's interest rate corridor by 1 percentage point. Interest on deposit institutions' current accounts was reduced by 0.5 percentage points, to 3.5%. The maximum rate on 28-day CDs and the interest on seven-day collateralised loans were reduced by 1.0 percentage point each, to 4.25% and 4.5%, respectively. The overnight lending rate was lowered by 1.5 percentage points, to 5.5%. According to the MPC statement, the objective of the changes was to reduce volatility in short-term rates and move the overnight lending rate closer to the centre of the corridor.

On 9 December, the Icelandic negotiating committee in the Icesave dispute announced the results of discussions with the British and Dutch negotiating committees and presented a draft of a new agreement. The draft provides for an average interest rate of 2.64% until 2016 instead of the 5.5% in the previous agreement. It also provides for flexible repayment time if the outstanding balance in 2016 is higher than expected. In addition, annual payments are subject to a maximum of 1.3% of GDP, or 5% of Government revenues, whichever is lower. On 15 December, the Government presented a bill of legislation authorising the approval of the agreement.

On 15 December, Parliament passed Act no. 141/2010 amending the Act on Securities Transactions, which expands the exemptions from the takeover requirement when a company is listed on the market or lists financial instruments on the market.

On 15 December, the Ministry of Economic Affairs, Icelandic Federation of Trade, Ministry of Finance, Confederation of Icelandic Employers, Icelandic Financial Services Association, and Iceland Chamber of Commerce signed an agreement concerning a plan to expedite the settlement of small and medium-sized companies' debt with financial institutions. The agreement covers companies whose continued operation is most likely, in the opinion of the financial institution concerned, to protect the interests of creditors, employees, and owners. The objective is that companies' total indebtedness following financial restructuring not exceed their restated asset value or operational value, whichever is higher, plus the value of other collateral backing the debt of the company in question. Monthly goals will be set for the number of processed offers for the period January to May 2011. The State will facilitate the agreement by lengthening the payment deadlines for public levies and increasing authorisations to cancel public claims that are considered unlikely to be collected. The agreement was announced under the title "the Straight Path."

On 16 December, the National Budget for 2011 was approved by Parliament. Revenues are estimated at 473 b.kr., expenditures at 510 b.kr., and the deficit at 37 b.kr. The surplus before interest income and expense is estimated at 15 b.kr. Revenues are estimated to decline by 1% from the increased 2010 National Budget due to lower sales revenues and the transfer of revenue bases to municipalities. Tax revenues are estimated to rise by 3%, even though the transfer of revenues for the affairs of the disabled to municipalities will cause a 2.4% reduction. Expenditures are projected to decrease by 9%, including 1.6% due to the transfer of the affairs of the disabled.

On 16 December, the EFTA Surveillance Authority (ESA) confirmed its previously issued preliminary conclusion that the provisions of Act no. 125/2008, the so-called Emergency Act, were in compliance with the EEA Agreement and

fulfilled other legal requirements. This included both the provisions assigning higher priority to deposits than to general claims and the actions taken by the Icelandic authorities on the basis of the Act. ESA was of the opinion that the actions to which the authorities resorted were the only options that could have averted the complete collapse of the Icelandic economy.

On 16 December, the Financial Supervisory Authority announced that it had granted T Plús hf. in Akureyri a licence to operate as a securities undertaking in accordance with Article 4 of the Act on Financial Undertakings, no. 161/2002.

On 17 December, Parliament decided that it would have an impartial and independent investigation carried out of the operations of the Housing Financing Fund during the period 2004-2010.

On 17 December, Parliament passed Act no. 142/2010 amending the Act on Bankruptcy, Etc., which aimed at enabling individuals who have undergone bankruptcy proceedings but are still responsible for debt not paid during the proceedings to stabilise their finances. The changes entailed shortening the expiry deadline for those claims, or for the portion not paid during bankruptcy proceedings, so that the expiry date of all claims in the estate will be the same – two years – irrespective of the type of claim.

On 17 December, Parliament passed Act no. 144/2010 amending the Act on the Establishment of the Partnership Orkuveita Reykjavíkur, which limits the owners' liability in the wake of the EFTA Surveillance Authority's decision that unlimited owner liability is not consistent with the EEA Agreement provisions on state aid.

On 17 December, Parliament passed Act no. 152/2010, which stipulates that the municipalities of Iceland shall assume professional and financial responsibility for the provision of services for the disabled, and that this responsibility shall be transferred from the State to the municipalities as of 1 January 2011, in return for increased local tax revenues.

On 17 December, the Minister of Fisheries allocated a 147,000-tonne mackerel quota to Icelandic fishing vessels for 2011, a 17,000-tonne increase from the prior year.

On 18 December, Parliament passed Act no. 150/2010, which provided for a 40% year-on-year increase in supervisory fees paid to the Financial Supervisory Authority by financial institutions.

On 18 December, Parliament passed Act no. 151/2010 amending the Act on Interest and Price Indexation; the Act on Measures to Assist Individuals, Households, and Businesses due to Extraordinary Circumstances in the Financial Markets; and the Act on the Debtors' Ombudsman. The amendments were intended to reduce the uncertainty that developed in the wake of the Supreme Court judgments on exchange rate-linked loans, as regards the legality of contractual agreements covering a wide range of short- and long-term financing. The objectives were to ensure, to the extent possible, that comparable cases would receive comparable treatment, and to ensure legal security in the settlement of loan agreements with non-binding exchange rate linkage clauses.

On 18 December, Parliament passed Act no. 153/2010, amending legislation on unemployment benefits. For those who lost their jobs after end-April 2008, the period of entitlement to benefits was lengthened from three years to four, and the authorisation to pay benefits commensurate with reduced employment was extended by six months, until 30 June 2011. Benefits are only paid if the reduction in employment is at least 30% of a full-time position, as opposed to the previous 20%.

On 18 December, Parliament passed Act no. 155/2010, imposing a special tax on financial institutions in the amount of 0.041% of a base equal to total liabilities.

On 18 December, Parliament passed Act no. 156/2010, which changes the structure of the excise tax on imported motor vehicles, the motor vehicle tax, and the oil charge, so that levies rise with increased CO<sub>2</sub> emissions.

On 18 December, Parliament passed Act no. 163/2010 amending the Value-Added Tax Act, so as to enable monitoring and follow-up by the tax authorities, to clarify provisions on tax deductions for exported electronic services,

including data centre services, and to discontinue rebates for indoor heating while extending authorisations for special rebates due to distance coaches and construction work done on residential housing until year-end 2011.

On 18 December, Parliament passed Act no. 164/2010, which sets forth various fiscal measures. The main features of the Act are i) the investment tax is increased from 18% to 20%; ii) the corporate income tax is raised from 18% to 20%; iii) the wealth tax is raised from 1.25% to 1.5%, and tax-free threshold is reduced by 16.7%; iv) the inheritance tax is raised from 5% to 10%; v) the tobacco tax is raised by 7%, and a special, limited tobacco levy is imposed at the duty-free store upon arrival in Iceland; vi) the carbon tax is increased by 50% by raising the reference from 50% to 75% of the price of emissions allocations at EU auctions; vii) the overall authorisation to withdraw third-pillar pension savings before 1 April 2011 is raised from 2.5 m.kr. to 5 m.kr. per person. These changes are expected to generate a total of 11 b.kr. in tax revenues for the Treasury in 2011.

On 18 December, Parliament passed Act no. 165/2010, amending various pieces of tax legislation. Chief among them were i) the transfer of local tax revenues to municipalities due to the transfer of the affairs of the disabled; ii) the authorisation for companies to distribute the tax base due to cancelled debt over the years 2010-2014 and to pay the outstanding balance over five years; iii) the expansion of authorisations to defer or cancel businesses' tax debt; iv) the cancellation of the equity securities discount on individuals' income tax, in view of comments from EFTA, and increased authorisations for tax deductions for innovation companies; v) amendments to the statutory framework for tax investigations, so as to expedite case handling.

On 22 December, Parliament passed Act no. 141/2010 amending the Act on Securities Transactions, no. 108/2007, as regards mandatory takeover bids due to control of a company upon its listing on a stock exchange. The amendment was made because of comments indicating that the previous provisions could harm the securities market and could pose a serious risk that companies would remove their shares from trading in Iceland.

On 22 December, the Ministry of Finance published the tax brackets for withholding tax in 2011. The average local tax rate will be 14.41%, 66 of a total of 76 municipalities will levy the maximum local tax, and two municipalities will levy the minimum tax. The withholding percentages for income tax and local tax will be in three brackets: 37.31%, 40.21% and 46.21%. The monthly income thresholds for the three brackets will be 209,400 kr. for the first bracket; 471,150 kr. for the second bracket, and 680,550 kr. for the third bracket. The personal deduction will be unchanged at 44,205 kr. per month, and the tax-free income threshold will be 123,417 kr., after wage earners' mandatory 4% pension fund contribution. Municipalities' minimum and maximum local tax rates will rise by 1.20% due to the transfer of the affairs of the disabled to the local authorities, and the national tax percentages will decline accordingly, in each tax bracket. The tax-free income threshold and the thresholds between tax brackets will increase proportional to the twelve-month rise in the wage index, now about 4.7%.

On 30 December, the Central Bank of Iceland announced that it had concluded contractual agreements concerning the debt of five savings banks that did not meet minimum capital adequacy requirements in the wake of the banking collapse. The savings banks in question are: Sparisjóður Bolungarvíkur, Sparisjóður Norðfjarðar, Sparisjóður Svarfdæla, Sparisjóður Vestmannaeyja, and Sparisjóður Þórshafnar og nágrennis. In addition, Sparisjóður Suður-Þingeyinga and Sparisjóður Höfðhverfinga have paid their debts to the Central Bank. During the restructuring process, the Central Bank acquired a large part of the savings banks' guarantee capital. The guarantee capital shares have been transferred to Icelandic State Financial Investments, which administers the holding on behalf of the State.

Near the end of the year, the Central Bank purchased foreign currency for 24.6 b.kr. (160 million euros), as well as negotiating forward contracts amounting to 47.9 b.kr. (312 million euros). These transactions will expand the Central Bank's foreign exchange reserves by about 72.5 b.kr. (472 million euros) during the term of the agreement. These transactions were undertaken so as to correct imbalances between foreign assets and liabilities on the balance sheets of various financial institutions. In addition, they promote increased financial system stability and bolster the Central Bank's non-borrowed foreign exchange reserves.