



# Terms of Auction

## for the purchase of foreign currency by the Central Bank of Iceland in exchange for Treasury bonds

16 June 2011

1. The Central Bank of Iceland hereby solicits offers for the sale of foreign currency in exchange for Treasury bonds with a long-term holding period. Primary dealers in the secondary market for Treasury securities are invited to act, in their own names, as intermediaries for the purchases. The auction is an element in the removal of restrictions on capital movements with foreign currency, in accordance with the Central Bank's capital account liberalisation strategy, dated 25 March 2011, and is carried out with reference to Articles 14 and 18 of the Act on the Central Bank of Iceland, no. 36/2001. Investments deriving from the auction are not considered "new investment" in the sense of Rules no. 370/2010; cf. Temporary Provision I of the Foreign Exchange Act, no. 87/1992.
2. The Central Bank offers to purchase the following total amount of euros:  
Auction amount EUR 64,000,000.00.  
The Central Bank reserves the right to raise or lower the auction amount.
3. Euros in cash will be purchased with Icelandic krónur subject to the restrictions further described in these Terms of Auction.
4. Market makers send offers to the Central Bank through the Bloomberg Auction System between 10:00 hrs. and 11:00 hrs. Icelandic time on the transaction date. The deadline for submittal is at 11:00 hrs. on Tuesday 28 June 2011 (the transaction date). The results of the auction will be published on the Central Bank website at the end of the transaction date and sent to market makers by e-mail. Primary dealers shall then notify their customers of the results.
5. The auction will be structured with a single-price format; i.e., all accepted offers will be offered to primary dealers at the same price, and the highest accepted price will determine the auction price. The Central Bank reserves full right to determine the auction price after the deadline has passed. Offers *below* the auction price will be accepted in full, offers *over* the auction price will be rejected in full, and offers *equivalent to* the auction price will be accepted on a *pro rata* basis. However, the maximum price for the auction shall be 210,00 kr. per euro, and offers exceeding the maximum price shall not be considered valid.
6. The Central Bank reserves the right to accept some or all of the offers submitted, or to reject all of them.
7. Primary dealers (currently Arion Bank, Íslandsbanki, Landsbanki, Saga Investment Bank, and MP Bank) – that is, those that are primary dealers in the secondary market for Treasury securities – shall collect offers from their customers for the sale of foreign currency. Offers made between them shall be binding, with the limitations deriving from the auction. Primary dealers shall submit offers to the Central Bank in their own names. Primary dealers are authorised to submit as many offers as necessary, based on those of their customers.
8. In submitting an offer, primary dealers accept these Terms of Auction and the restrictions deriving from them and simultaneously assume responsibility for obtaining the same approval from their customers when soliciting their offers.
9. Offers shall be based only on the following:
  - a. Foreign currency that is *not* subject to repatriation requirements according to Rules no. 370/2010; cf. Temporary Provision I of the Foreign Exchange Act, no. 87/1992.

- b. Revenues deriving from capital account transactions. Offers based on revenues from current transactions shall be excluded from participation. For the purposes of this auction, revenues from current transactions are defined as is set forth in Article XXX, Item (d) of the International Monetary Fund Articles of Agreement.
10. Offers shall include, at a minimum, information on the amount of foreign currency offered for sale, and the price in Icelandic krónur per euro, with two significant digits. The minimum amount of each primary dealer's offer shall be EUR 500,000.00, and offers shall be presented in multiples of EUR 10,000.00. The same shall apply to each offer received by primary dealers from their customers.
  11. Primary dealers shall pay the Central Bank in euros for accepted offers no later than Friday 1 July 2011 at 11:00 hrs. (settlement date), according to standard Central Bank of Iceland payment instructions.
  12. If a primary dealer does not honour its offer, the Central Bank reserves the right either to cancel the transaction immediately and accept another offer or to demand compensation from the primary dealer *in natura*, plus the highest lawful penalty interest for the period corresponding to the delay in payment.
  13. Primary dealers shall settle the accepted offers of their customers as soon as possible, and no later than 30 days after the transaction date. No later than Wednesday 29 June 2011 at 9:00 hrs., each primary dealer shall provide the Central Bank with a list of the distribution of the Treasury bonds amongst its customers, in accordance with accepted offers. The list shall specify the custodial account to which the Treasury bonds shall be delivered, cf. Article 15(b), and the Central Bank will deliver the bonds accordingly.
  14. The Central Bank declares itself free of all liability for offers that do not reach the Central Bank due to system error or for any other reason. Primary dealers may request confirmation of receipt of offers by contacting the International and Market Operations Department of the Central Bank of Iceland. Offers that reach the Central Bank and are registered to individual terminals in the Bloomberg Auction System are binding and are the responsibility of the person who is registered for that terminal. It is permissible to amend or withdraw offers by sending an appropriate message through the Bloomberg Auction System to the Central Bank before 11:00 hrs. on the auction date (the transaction date).
  15. **The following RESTRICTIONS shall apply to the foreign exchange transactions:**
    - a. It will be required to receive all krónur purchased in the auction in the form of Treasury bonds, which the Central Bank sells on behalf of the Treasury. The Treasury bonds in question will be RIKS 30 0701. The swap rate for the number of units of Treasury bonds per euro shall be based on the auction price and the fixed price of the Treasury bond, which is 100,00 kr. per unit of Treasury bonds, based on the settlement date (yield 3,25%), according to the following formula:  $\text{Swap rate} = \text{auction price}/(\text{bond price}/100)$ .
    - b. The Treasury bonds must be held for five years from the date the offer is accepted. The Treasury bonds must be held by a custodian referenced by the Central Bank on its website or elsewhere, in an account in the customer's name, for the entire required holding period. **Both the primary dealer and the customer are prohibited to allocate or dispose of the Treasury bonds in any way, directly or indirectly, during the required holding period, including hypothecation, forward agreements, or other derivatives.** The prohibition on disposal or allocation does not apply, however, to the transfer from the primary dealer to the end customer on whose behalf the offer was submitted, provided that the customer agrees to these Terms of Auction and to the restrictions deriving from them.
    - c. The Central Bank is authorised to attach restrictions to the Treasury securities in accordance with these Terms of Auction, to attach restrictions to electronic securities held by the Icelandic Securities Depository hf. or another securities depository, or to attempt to ensure that such restrictions are made. Neither the primary dealer nor its customer shall be entitled to

allocate or dispose of the Treasury securities in any way not provided for in these Terms of Auction without the involvement and approval of the Central Bank.

- d.* The customer shall receive payment of any type of interest and/or principal on the Treasury bonds while these restrictions are in effect. If the restrictions in these Terms of Auction are not complied with, the Central Bank shall be entitled to withhold (stop) any type of payment on the Treasury bonds until the requirements have been met, or to apply other non-compliance measures as listed in Article 15(e).
  - e.* Violations of the restriction on allocation or disposal of the Treasury bonds, apart from the transfer from the primary dealer to the end customer on whose behalf the offer was submitted, shall be punishable by fines. The amount of the fine shall be one-third (33.333%) of the value of the Treasury bonds. The Central Bank announces the fine, which becomes due and payable on the day following the announcement. The calculation of the fine as a proportion of the value of the Treasury bonds shall be based either on the closing price in the securities exchange concerned on the day prior to the disposal by the customer or on the price that a major financial institution would pay for the bonds on that same day. The Central Bank reserves full right, if necessary, to initiate legal proceedings or impoundment proceedings, or resort to other legal means of collecting the fine.
16. While the restrictions concerning custody of the Treasury bonds according to these Terms of Auction are in effect, all payment instructions concerning any type of payment on the bonds, instructions on registration due to transfer between the primary dealer and the customer that submitted the offer in an auction, instructions concerning the delivery of the bonds at the end of the custodial period, or other queries concerning the bonds shall be directed to the custodian of the Treasury bonds. The Central Bank shall not be held liable for losses incurred as a result of communications between the customer and the custodian.
  17. While the restrictions concerning custody of the bonds according to these Terms of Auction are in effect, the Central Bank of Iceland shall be exempt from liability for all losses incurred by the customer as a result of events beyond human control (*force majeure*), including but not restricted to natural disaster, war, terrorist acts, and laws and regulations imposed by governmental authorities. It is clear that the regular and legally mandated activities of the Central Bank of Iceland can affect currency exchange rates or securities prices; therefore, the Central Bank of Iceland shall not be held liable for any direct or indirect loss that may be sustained by the customer due to the bonds and is traceable to the Bank's regular and legally mandated activities.
  18. The customer shall bear all expenses deriving from the custody of the securities, such as public levies or services rendered by the securities depository. The Central Bank of Iceland shall not be held liable for any such expenses and shall be entitled to retain any type of payment on the bonds for payment of such expenses if they should accrue to the Central Bank for any reason.
  19. These Terms of Auction apply between the Central Bank and the primary dealer as a participant in the auction, as well as the customers on whose behalf primary dealers' offers are submitted, as appropriate. The Central Bank is not liable for any obligation of the primary dealer vis-à-vis its customer due to foreign exchange transactions between them or brokering of Treasury bonds, as a result of the primary dealer's participation in the auction.
  20. These Terms of Auction have been translated into English; however, the Icelandic original shall be considered the authoritative text.