

# The Icelandic Economic Situation

Status Report - April 2012



ICELAND CHAMBER  
OF COMMERCE

## The Icelandic Economic Situation Status Report

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### About the Iceland Chamber of Commerce

The Iceland Chamber of Commerce (ICoC) is a voluntary association of companies and individuals with the mission of improving the operating environment of business in Iceland and to increase economic prosperity.



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# Republic of Iceland



The language is  
**Icelandic**

The population is  
**320,000**

The governmental system is a  
Constitutional republic with  
**Universal suffrage**

Per capita GDP in PPP terms in 2009 was  
**30,000** EUR

The capital is  
**Reykjavik**

The monetary unit is  
**Króna (ISK)**

The main religion is  
Lutheran, with  
**80%**  
followers



GDP Growth  
in 2011 was  
**3,1%**

The geographic size is  
**100,000** km<sup>2</sup>

## Useful websites

- [Central Bank of Iceland](#)
- [Parliament of Iceland \(Althingi\)](#)
- [Government of Iceland](#)
- [Statistics Iceland](#)
- [OMX Nordic Exchange in Iceland](#)
- [Government Debt Management](#)
- [Trade Council of Iceland](#)
- [National Association of Pension Funds](#)
- [Invest in Iceland Agency](#)
- [Financial Supervisory Authority](#)
- [The Official Gateway to Iceland](#)
- [Icelandic Fisheries](#)
- [Iceland Chamber of Commerce](#)

## Iceland's location on the world map







## Introduction

Since October 2008 the Icelandic economy has gone through dramatic changes due to the collapse of its financial sector. Because of a lack of external information flow, a lot of misconceptions have developed concerning the chain of events in the recent scenario and the current status of the Icelandic economy. This *Status Report* is meant to give a better insight into the chain of events and the current economic, business and political landscape in Iceland. Despite substantial difficulties, general economic activity is well functional and many Icelandic businesses remain strong and prosperous.

The *Iceland Chamber of Commerce* has from the banking collapse published this Status Report regularly with particular focus on the latest developments and information on the economic climate. The current edition is the 15<sup>th</sup> since October 2008. Major revisions were made in the 13<sup>th</sup> and 14<sup>th</sup> version, many graphs, charts and pictures were added. Additionally, the Chamber publishes slides to accompany the status report. The most up to date slides and *Status Report* are always available here: [www.chamber.is/statusreport](http://www.chamber.is/statusreport)

This report a collection of facts, data and references to websites rather than a deep analysis of the economic climate in Iceland. In the report there are hundreds of links which form its foundation.

The *Status Report* is split into three main parts, part A, B and C. Part A, consists of the first 4 chapters and focuses on the general historical background leading up to the collapse and immediate consequences. Part B, chapter 5 to 10 focuses on the current economic landscape in Iceland and prospects. Part C, from chapter 11 through 22, focuses in more detail on more recent economic developments and policy actions. In addition there are 11 appendices which some aspects of the crisis are listed in more detail.

The current economic turmoil in Iceland, which is gradually passing, is part of a complex global financial crisis and is by no means an isolated event. Governments around the world have introduced emergency measures to protect their financial system and rescue their banks, as they suffer from a severe liquidity shortage. Iceland was hit particularly hard by this unprecedented financial storm due to the large size of the banking sector in comparison to the overall economy.

The Icelandic Government, both past and present, has taken measures and is tirelessly working towards overcoming the obstacles in the way for stimulating economic growth. In that effort Iceland has been cooperating with its Nordic and European partners and the IMF. A timeline of the financial crisis in Iceland and it's aftermath can be found in [Appendix 1](#). It is worth noting that now there are sure signs of recovery of the Icelandic economy, as is detailed in the timeline and Status Report.

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# Part A A Historical Perspective

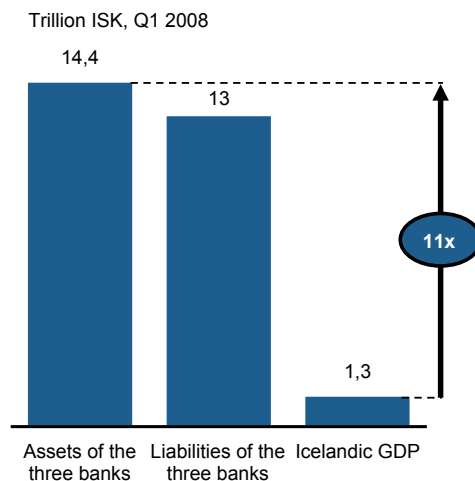
## 1 What Happened?

A globalized economy, and an active participant in the EU's common market through the EEA, Iceland was among the first nations to be seriously affected by the global financial turmoil. The situation has hit Icelandic households hard and many have lost a sizeable portion of their savings and purchasing power. Inflation was in double-digit numbers in late 2008 and early 2009 but is now around 6% in April 2012. Unemployment rose to close to 9.1% in early 2009 but is now around 7.3% and stable (1<sup>st</sup> quarter 2012). The domestic currency, the Icelandic Krona (ISK), depreciated significantly after economic collapse but has now stabilized, due to capital controls.

The large size of the banking sector in comparison to Iceland's overall economy is undoubtedly a driving factor behind the current economic turmoil. Their balance sheets and lending portfolios expanded beyond the capacity of their own infrastructure. The Financial Supervisory Authority (FSA) and the management and supervision within the banks did not keep up with the rapid expansion of lending. The banks' rapid lending growth had the effect that their asset portfolios became fraught with high risk and the quality of portfolio was considerably worse than originally estimated.

However, it should be underlined that the Icelandic banks operated under Icelandic and European banking legislation and the strictest of international regulatory standards. Nevertheless, as the liquidity crisis deepened, Iceland's three largest banks, Glitnir, Landsbanki and Kaupthing, whose balance sheets were several times larger than the total output of the Icelandic economy (around 10 times GDP), were no longer able to re-finance their operations.

**Figure 1** *The Icelandic banking system was very large compared to the economy*



As a response to these circumstances, the Icelandic Parliament (Althingi) passed a new law, the new Emergency Bank Act, allowing the FSA to take over the operations of the banks. On the basis of this new law, all three banks have now been restructured and re-capitalized. More information on the new banks is provided in [Chapter 12](#) and on the Emergency Act in [Appendix 3](#).

## 1.1 What Was Done – Restructuring of the Banking System

Progress in ensuring continued functioning of the Icelandic financial system was achieved at quite an early stage. The Icelandic government prioritized the tasks facing the economy based on their importance for the general public. The first task was to secure the functioning of the domestic banking, payment and settlement systems. The stock market was re-opened even though the operations were obviously limited considering that the turnover of the stock exchange consisted mostly of transactions related to the financial sector. See chapters below for a discussion of measures taken after the collapse.

### Banks Split Up to “New” and “Old” Banks

The three main banks, Glitnir, Kaupthing and Landsbankinn were split into “old banks” and “new banks”. The old banks consist mainly of foreign assets and while the new banks continue to operate in Iceland.

The new banks were originally financed by the Treasury. However, the creditors of the old banks have recapitalized the new banks, Arion bank (new Kaupthing) and Islandsbanki (new Glitnir) while Landsbanki continues to be mostly owned and funded by the Treasury. Re-capitalization and reconstruction of the banking system has been concluded. See [Chapter 12](#) for more information.

**Figure 2** The banks that were placed in receivership by the FSA were subsequently split into “new” and “old” banks

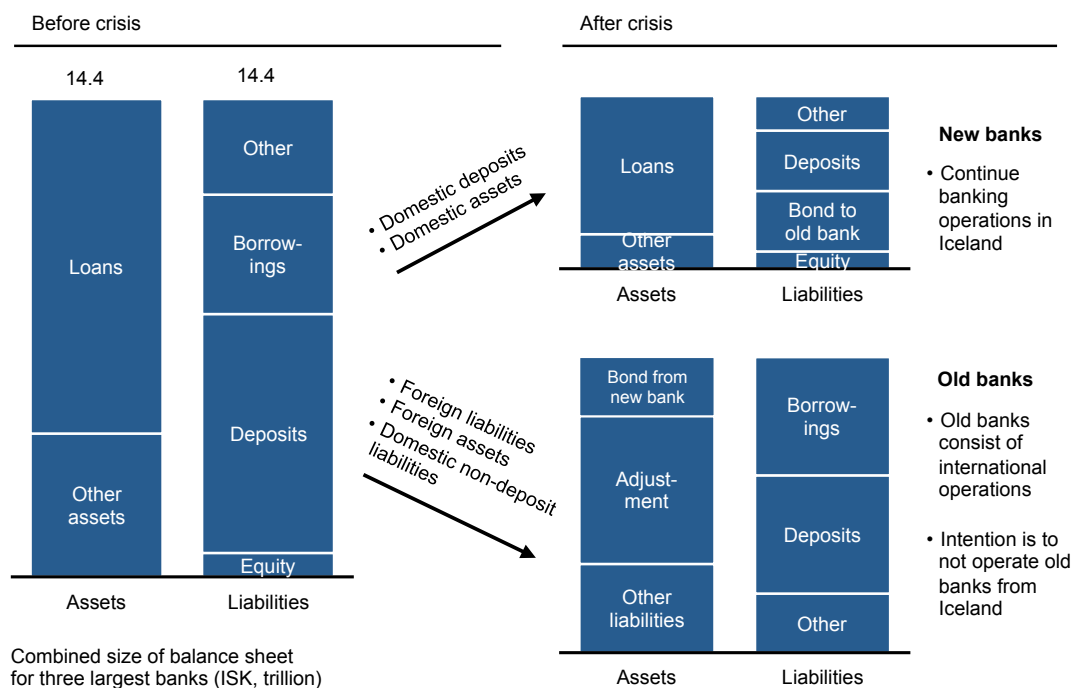
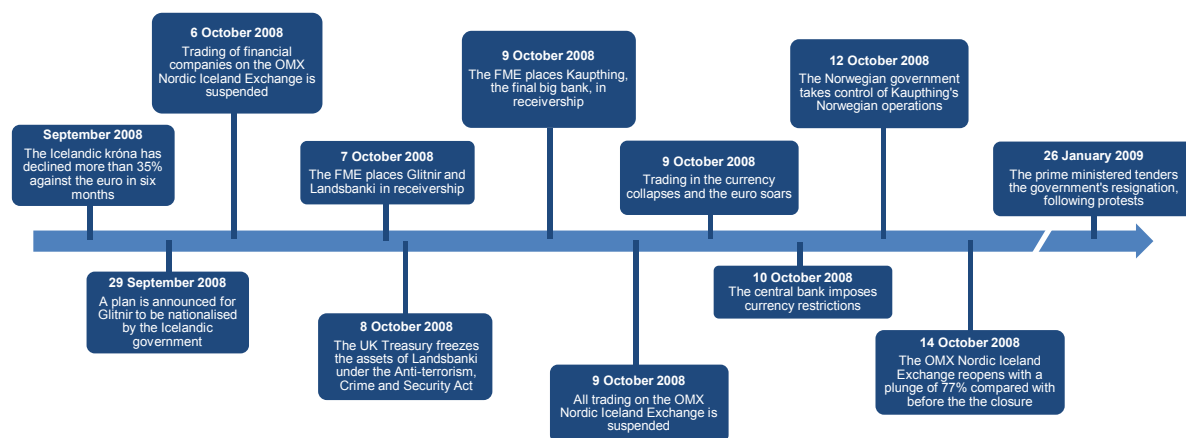




Figure 3 A timeline of the Icelandic financial crisis



Further information about the old banks can be found [here](#) (for Kaupthing Bank), [here](#) (for Glitnir Bank) and [here](#) (for Landsbanki).

## 1.2 What Happened to the Icelandic Banks Abroad?

The Icelandic banks' operations abroad were inevitably affected by the restructuring of the Icelandic banking system. Some of the banks continued to operate abroad as before, like Glitnir in Norway and Kaupthing in Luxemburg, most under new names and owners. Others e.g., Landsbankin's operations in the UK, were shut down and their assets will be used to reimburse deposits and other outstanding liabilities – with the backup of the Deposit Guarantee Funds in the respective country according to EU/EEA regulations.

Furthermore, Iceland worked closely and constructively with other countries to address problems that had arisen in connection with the government takeover of Iceland's three largest commercial banks. The government of Iceland clearly stated that it intended to honor its legal commitments and seek close cooperation with other countries' authorities. See [Chapter 12](#), [Appendix 8](#), [Appendix 9](#) and [Appendix 10](#) on the Icesave Dispute.

In several countries, the respective Government stepped in and offered further support to their banks, including Icelandic owned subsidiaries. In Sweden and Norway, for example, measures were taken by the Government to ensure the ongoing operation of banks. This was the best way to safeguard assets and investments, which might otherwise have been sold prematurely or liquidated at a price well below true value.

## 1.3 The Use of Anti-Terrorism Act and the Apology

However, the assets of Landsbanki in the UK were frozen via provisions in the Anti-Terrorism, Crime and Security Act from 2001. This was forcefully opposed through diplomatic channels with British authorities, as this clearly had a very damaging effect on the Icelandic banking sector and put Icelandic companies in Britain in a difficult situation. Iceland also took the issue up for discussion within NATO and Icelandic authorities have considered legal action. This was one of the main factors leading to disruptions in Iceland's international payments and settlements system.

On November 12<sup>th</sup> 2010 the British Secretary of State for Defense Liam Fox, apologized to Iceland through the Norwegian newspaper Aftenposten for the use of anti-terrorism law against Iceland. See [here](#).

## 2 International Monetary Fund (IMF)

The Icelandic government reached an agreement with the International Monetary Fund (IMF), on 24<sup>th</sup> of October 2008, on a comprehensive stabilization program, which included a \$2.1 billion loan from the IMF. There were three main objectives of the IMF program:

- To contain the negative impact of the crisis on the economy by restoring confidence and stabilizing the exchange rate in the near-term.
- To promote a viable domestic banking sector and safeguard international financial relations by implementing a sound banking system strategy that is nondiscriminatory and collaborative.
- To safeguard medium-term fiscal viability by limiting the socialization of losses in the collapsed banks and implementing an ambitious multi-year fiscal consolidation program. See [here](#)

**Figure 4** *The IMF's Board of Directors, which approved the Icelandic stabilization program in 2008.*



Source: [www.imf.org](http://www.imf.org)

Despite some delays, especially on the 1<sup>st</sup> review, significant progress was made towards attaining these goals as was confirmed in the IMF's first progress report, which was issued in the first week of February 2009. The most up to date statements from the IMF regarding Iceland can be found [here](#). Information and press releases from the Resident Representative Office in Iceland can be found [here](#)

The IMF's Executive Board approved the 1st review of the Economic Recovery Program on 28<sup>th</sup> of October 2009, the 2<sup>nd</sup> review on 16<sup>th</sup> of April 2010, the 3<sup>rd</sup> review on 29<sup>th</sup> of September 2010, 4<sup>th</sup> review on January 11<sup>th</sup> 2011, the 5<sup>th</sup> review on June 2011 and the 6<sup>th</sup>, and the last, review on August 26<sup>th</sup> 2011. Further information about the Economic Program can be found in [Chapter 14](#).

## 3 Foreign Exchange Markets

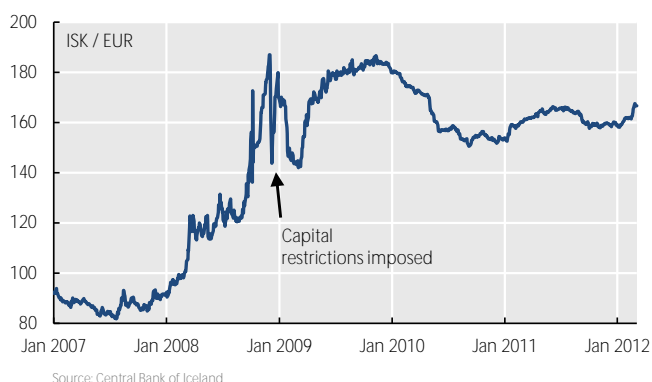
In order to prevent a potential shortage of foreign currency, the Central Bank of Iceland (CBI) implemented temporary restrictions on foreign exchange transactions with the ISK. These restrictions caused some initial frictions and problems with payments and settlements of international transfers between Iceland and other countries. However, there are no restrictions on currency transactions relating to the import and export of goods and services.

### 3.1 Unrestricted Trade of Goods and Services

On November 28<sup>th</sup> 2008, the Icelandic Parliament approved an amendment of Act no. 87/1992 on Foreign Exchange. The Act gave the CBI temporary authorization to set rules limiting international capital movements, with the aim of restricting

the outflow of foreign currency, for instance, by imposing obligations to repatriate foreign currency. It includes a temporary clause which authorizes the CBI to impose rules that prohibit foreign exchange related to capital account transactions. The purpose is to prevent excessive short term volatility in the ISK and is in line with the conditions of the IMF Stand-by Arrangement. Initially every restriction allowed by the law was implemented by the CBI. The amended Act made it however clear that all transactions connected to import and export of goods and services are - and will continue to be - unrestricted.

**Figure 5** The exchange rate of the Euro against the ISK (*data*)



On April 4<sup>th</sup> 2009 the Parliament approved amendments to the Act on foreign currency. The ISK exchange rate had been sliding steadily, and there were strong indications that the objective of building up strong foreign currency reserves through mandatory currency repatriation might be in jeopardy. This was attributed primarily to the fact that exporters were not obliged to receive payment for their products in foreign currency.

The amendment was intended to plug this loophole in the legislation. It adds a temporary provision to the Act on Foreign Currency, stipulating that exports of goods and services must be concluded in foreign currency. Following the amendment to the Customs Act, the price of exports recorded on export declarations must be in foreign currency and the enforcement of these provisions will be monitored

On 28<sup>th</sup> of November 2009 the Act was amended further. See [Chapter 16](#), [Appendix 2](#) and [Appendix 3](#) for a further discussion. A liberalization plan was published on March 25<sup>th</sup> 2011. See [Chapter 16](#).

## 4 Political Environment: New Government in the Spring of 2009

Due to strong social pressure and extraordinary circumstances, former Prime Minister Mr. Geir H. Haarde made an announcement in late January that national elections were to be held in May 2009. The coalition Government of the right-wing Independence Party and the Social Democratic Alliance came to an end a few days later.

A week later, a new Government was formed of the Social Democratic Alliance and the Left-Green Movement. The Progressive Party defended the Government in the event of motions of no-confidence. According to its official announcement its goal was to assure an effective administration to carry out urgent measures, particularly for the benefit of households and businesses, for rebuilding the banking system, in the field of administrative reform and to carry out measures in favor of increased democracy.

The economic policy of the Government was based on the program already established by the authorities and the IMF. The Government announced it would conduct a prudent fiscal policy according to which the fundamentals of the welfare system would be protected. The two parties agreed on holding early elections, set for 25<sup>th</sup> of April 2009.



**Figure 6** Prime Minister Johanna Sigurdardottir's first government, formed in May 2009



Source: [www.government.is](http://www.government.is)

Following the outcome of the national elections, the Social Democrats and Left-Greens held a majority of seats in the Parliament, 34 MP's against the oppositions 29 MP's.<sup>1</sup> The parties decided to continue their coalition partnership and formed a new Government.

According to its announcement the central aim of the Government is to rebalance the state budget by 2013 while at the same time implementing an ambitious plan of job creation and innovation to restore Iceland's position among the most energetic and competitive states in the world by 2020. See information about the 2020 plan in [Chapter 8.2](#) and on a government website [here](#).

A press release with further information on the agenda for the first 100 days of the new Government as well as the co-operation statement by the new Government can be found [here](#).

For more information on the fiscal policies and updated political framework see [Part C](#) of the report.

There have also been made some amendments to the Act on the CBI, which are outlined in [Chapter 14](#) and [Appendix 4](#).

A Special Investigation Commission (SIC) of Parliament was formed to investigate the collapse of the banking sector and i.e. whether any public officials were responsible of misconduct. The report was published in April 2010. See [Chapter 20](#) for more information and [here](#).

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<sup>1</sup> The majority is now only 32 government MPs to 29 opposition MPs and 2 independents., see also Chapter 11.







# Part B The Economic Landscape

## 5 The State of the Icelandic Economy

The Icelandic economy suffered severe shocks in the aftermath of October 2008. The whole banking system collapsed in a few weeks, currency restrictions were imposed, the ISK fell dramatically and both household and corporate debt soared. The economy still suffers from various consequences of the banking collapse.

Despite these weaknesses, it should not be forgotten that the economy is based on strong foundations and contains an abundance of opportunities. It is important that the public debate on future prospects of the Icelandic economy is based on facts rather than unsupported statements or opinions. The aim of this chapter is to describe the state of the Icelandic economy, based on economic indicators and international comparisons, and thus contribute to a fact-based discussion.

This part is divided into five chapters: The State of the Icelandic Economy, Iceland's Debt, Iceland in an International Comparison, Capital Markets in Iceland and Weaknesses of the Economy.

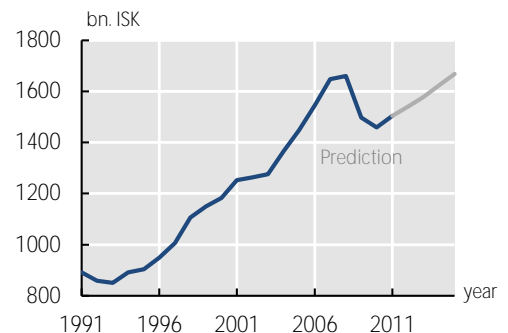
### 5.1 Economic Indicators and Future Prospects

#### Gross Domestic Product (GDP) is Recovering

The recession has most likely, according to macroeconomic variables, hit the bottom. Economic growth has been positive since last quarter of 2010 and for every quarter in 2011. Statistics Iceland (SI) national forecast predicts a recovery in the coming years, if that holds the worst consequences of the banking collapse are over and economic build-up and rising standard of living will resume. SI predicts 2.4% growth in 2012, 2.5% in 2013 and 2.8% in 2014-2016 for each year respectively. By that GDP will reach its peak of 2007 before the end of 2015.

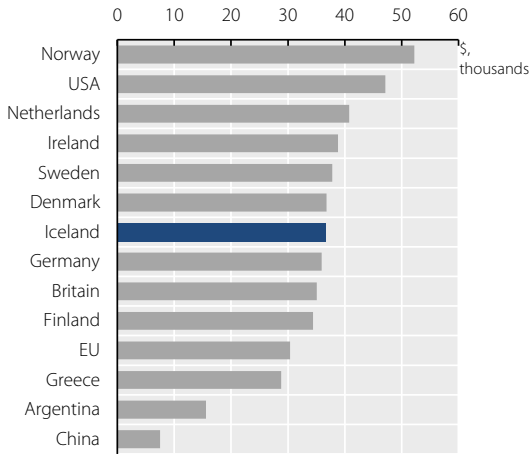
Economic forecasts can be found [here](#) and [here](#).

**Figure 7** Real GDP in Iceland, 2009 prices





**Figure 8** *Gross Domestic Product per capita, adjusted for Purchasing Power Parity*



Source: OECD

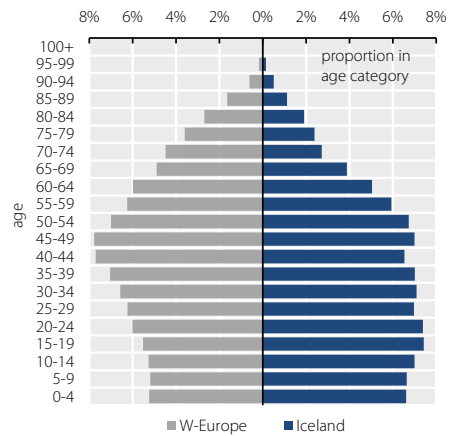
**GDP is Still High by International Standards**

Despite a deep recession, Iceland still has a high GDP per capita compared to other economies. Countries like Germany, Britain and Finland still have a lower GDP per capita than Iceland and despite a much smaller recession in Denmark and Sweden, their GDP per capita is similar to Iceland's.

**The Icelandic Nation is Young**

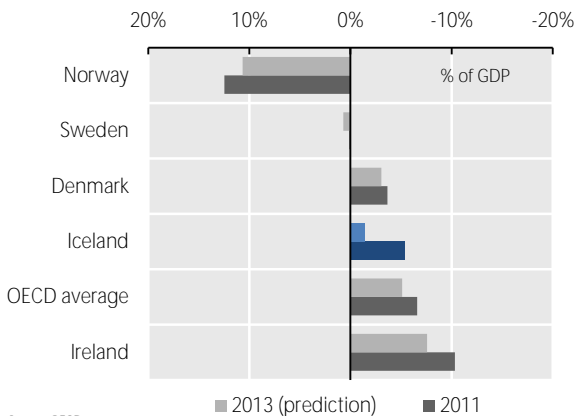
A nation's age structure is an important indicator of its capability to maintain economic growth in the long term. Young nations are in a better position than older nations to maintain this growth. Iceland's average age is substantially lower than in West-Europe, which is a positive sign for long-term economic growth.

**Figure 9** *An age pyramid of the Western-European and Icelandic populations*



Source: U.S. Census Bureau

**Figure 10** *Public budget deficit, percentage of GDP*



Source: OECD

**Budget Deficit Below OECD Average**

The Icelandic Budget Deficit has been reduced relatively fast thus far, although corporate investment ability and household consumption have suffered because of the substantial fiscal contraction. OECD's forecast assumes that in only two years, the budget deficit will be eliminated. It is important for a resumed economic growth that the deficit be eliminated as soon as possible so public debt can be reduced.

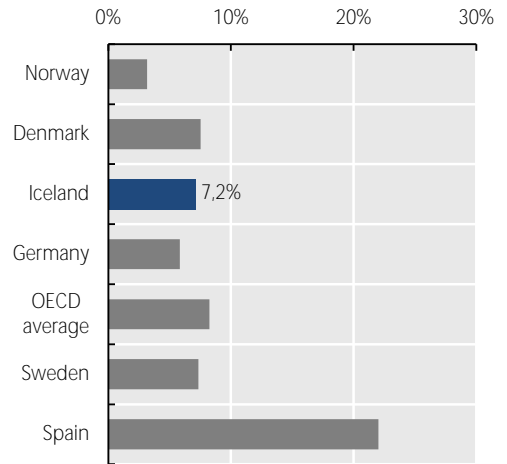
### Unemployment Lowering This Year

As a consequence of the collapse, unemployment in Iceland multiplied and went up to 9%, it's highest point in the beginning of 2010. This rise seems to have stopped and the CBI now forecasts a reduction in unemployment in the coming years. If the forecast realizes, the labor market's darkest days are behind and employment will increase steadily in the coming years.

### Unemployment Lower than the OECD Average

Despite a significant rise in the unemployment rate, it is still lower than the OECD unemployment average. Iceland has a higher level of unemployment than in Norway and Denmark, but less than in Germany and Sweden, for example. If the temporary unemployment resulting from the banking collapse will reduce in the coming years, like the CBI forecasts, Iceland could reclaim it's position as one of the OECD economies with the highest employment levels.

Figure 11 Unemployment in 2011

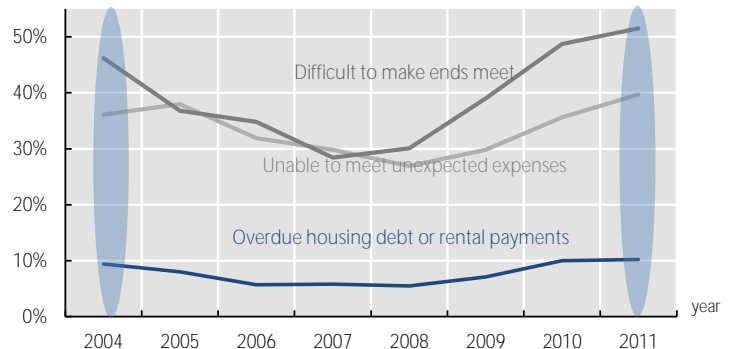


Source: OECD

### Iceland's Living Standard the Same as in 2004

Statistics Iceland conducts a yearly living standard survey by surveying household residents about their assessments of their own standard of living and financial situation. The results of the 2010 survey are worse than in 2007, when defaults and financial troubles were at a historical low. However, the 2010 results are similar to the outcome in 2004, which suggests that the living standard is similar to levels before the housing and the financial bubble.

Figure 12 Results from Statistics Iceland's Living Standard Survey. (data)

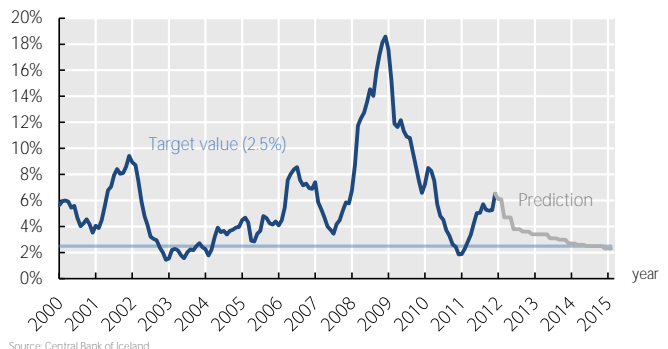


Source: Statistics Iceland

### Inflation Has Reduced

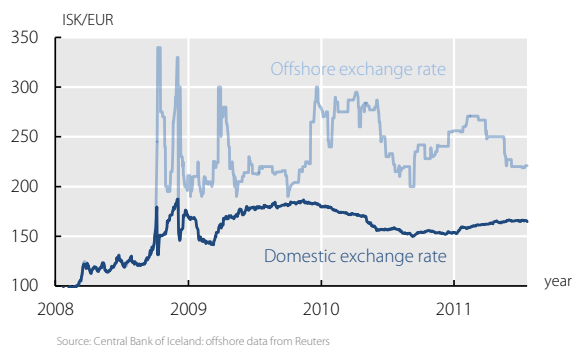
With the fall of the ISK in 2007 and 2008, a sharp surge in inflation ensued because of rising costs of all imported goods. It seemed as the surge had fully passed at the beginning of 2011. However, the krona started to depreciate at the end of 2010 and a year later the krona had devaluated by 6.5%, despite the capital controls, which may have caused part of the rise in inflation at the of 2011. Based on the CBI's forecast inflation will reach the inflation target on mid-year 2014. It is important that inflation is close to this target so interest rates can be lowered and economic stability obtained.

Figure 13 Inflation in Iceland (data)



Source: Central Bank of Iceland

**Figure 15** Exchange rate of the Euro against the ISK



### The Icelandic Krona is Strengthening

From the beginning of 2010, both domestic and offshore exchange rate of the ISK against the Euro has strengthened despite a sharp reduction in Icelandic interest rates. These currency developments are not highly significant because of low turnover in the offshore markets and currency restrictions on the domestic exchange rates. A trade surplus, lower inflation and reduced budget deficit will hopefully contribute to an environment where currency restrictions can be removed and the ISK will strengthen further. However, in 2011 the ISK has been weakening slightly.

**Figure 14** Icelandic Credit Default Swap (CDS) premium



### The Icelandic CDS Premium is Going Down

The Icelandic Credit Default Swap (CDS) premium rose dramatically in late 2008 when the banks collapsed. However, since the start of 2009, the rate has been steadily going down. This is favorable for large public companies such as Landsvirkjun Power (Iceland's largest electricity producer), because the company's bond issues have followed this rate, so the cost of capital for various infrastructure constructions is going down, which improves the overall economic environment. In June 2011 Iceland issued its first bond in foreign currency since the banking collapse. See [Chapter 18.5](#) for a further discussion.

**Figure 16** The logo of Danske Bank (click to see website)



### Favorable forecast by Danske Bank

On April 12<sup>th</sup> 2011, Lars Christensen, the chief analyst at Danske Bank, presented a new forecast on the Icelandic economy at a meeting with VIB

(the equity management operation of Islandsbanki). He predicts that the Icelandic GDP will grow by 3 - 4% per year over the next 2 to 3 years. Christensen said that the 'no' vote in the Icesave referendum increases uncertainty, but that it is unlikely to delay Iceland's economic revival. Inflation will continue its downward trend and will be below the CBI's target rate of 2.5% for the next 3 years, Danske Bank predicts. See [here](#). See a video of the meeting [here](#). See the report [here](#).

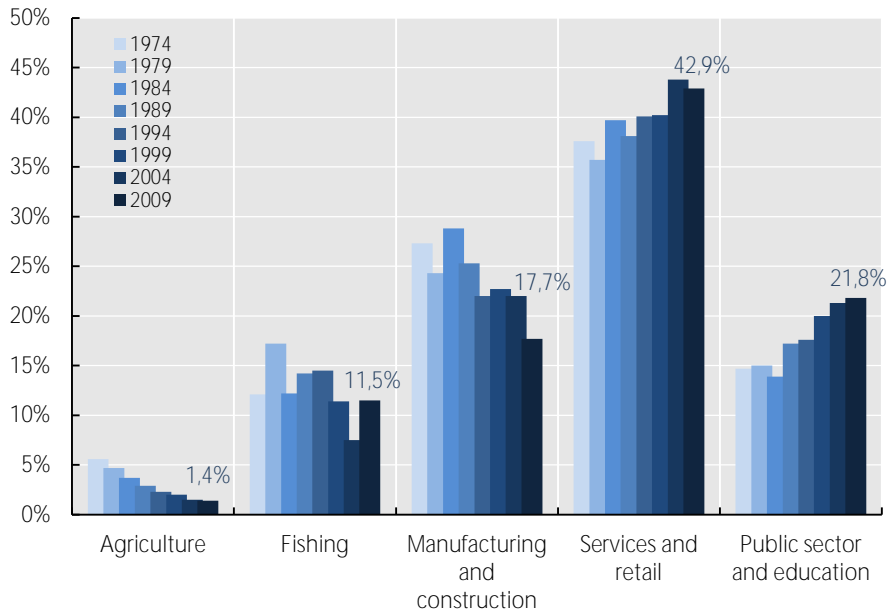
### Current account deficit

The current account balance in Iceland hasn't been favorable since the CBI started to collect the data in 1978. Iceland has experienced current account deficit since 2000 except for in 2002 and for most recent quarters. What this means is that Icelanders are spending more than they earn.

### Doing Business in Iceland

Invest in Iceland published a booklet with an overview of all the most important information regarding doing business in Iceland. The report summarizes the most important information on the regulatory and financial framework, e.g.: Regulations, Incentives, Tax System, Financial Reporting and Auditing, and Guidance and Services for Potential Investors. For further information see [here \(pdf\)](#).

**Figure 17** Iceland's GDP contribution by sector. The economic landscape has changed significantly in recent decades.

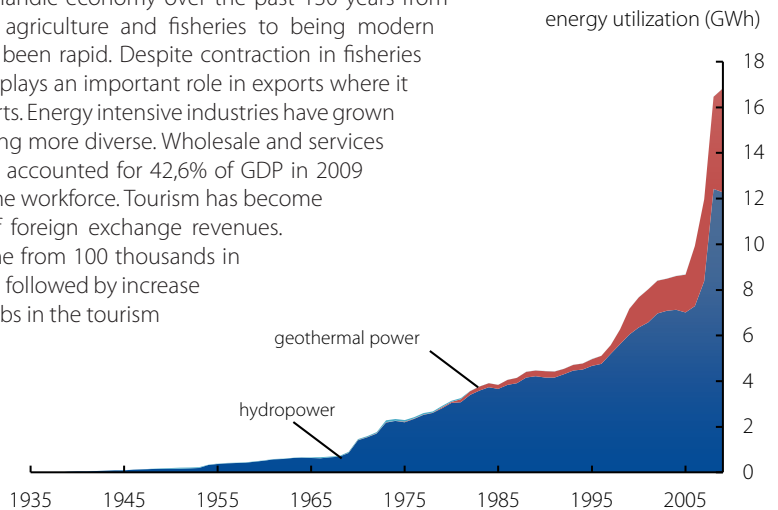


Sources: Statistics Iceland; Iceland Chamber of Commerce calculations

### Transformation of the economy

Till the end of the 19th century living standards were primarily based directly on the nation resources where agriculture and fisheries were the cornerstone of the economy. More than 90% of the workforce was located in these two industries until 1880 of which 80% worked in agriculture. At the beginning of the 20th century agriculture and fisheries still accounted for 75% of GDP.

The transformation of the Icelandic economy over the past 130 years from being built up primarily on agriculture and fisheries to being modern industrialized economy, have been rapid. Despite contraction in fisheries as a percentage of GDP it still plays an important role in exports where it accounts for 40% of total exports. Energy intensive industries have grown and at the same time becoming more diverse. Wholesale and services have grown substantially and accounted for 42,6% of GDP in 2009 and employed about half of the workforce. Tourism has become one of the main lifeblood of foreign exchange revenues. Numbers of tourists have gone from 100 thousands in 1986 to 565 thousands in 2011 followed by increase in the numbers of firms and jobs in the tourism industry.

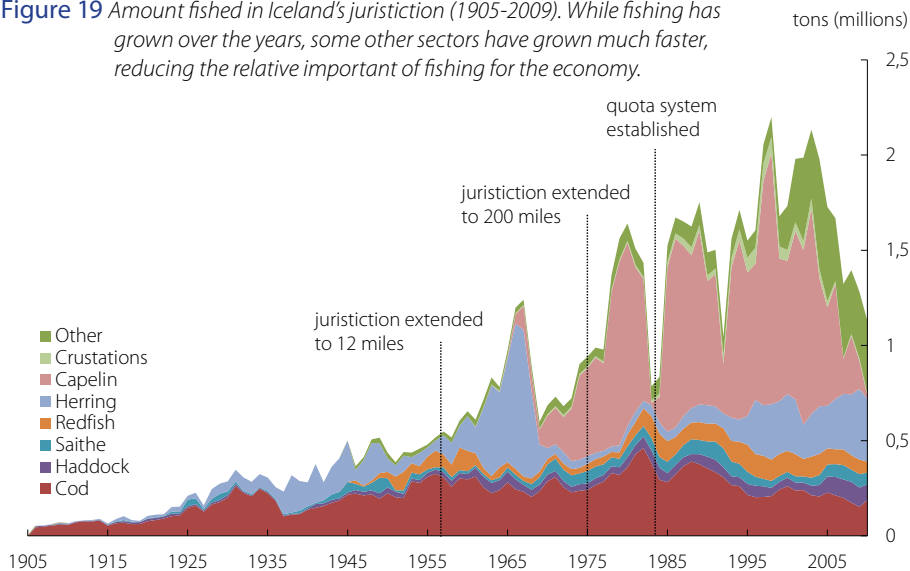


Source: Statistics Iceland

**Figure 18** Energy utilization by energy type (1935-2009)



**Figure 19** Amount fished in Iceland's jurisdiction (1905-2009). While fishing has grown over the years, some other sectors have grown much faster, reducing the relative important of fishing for the economy.



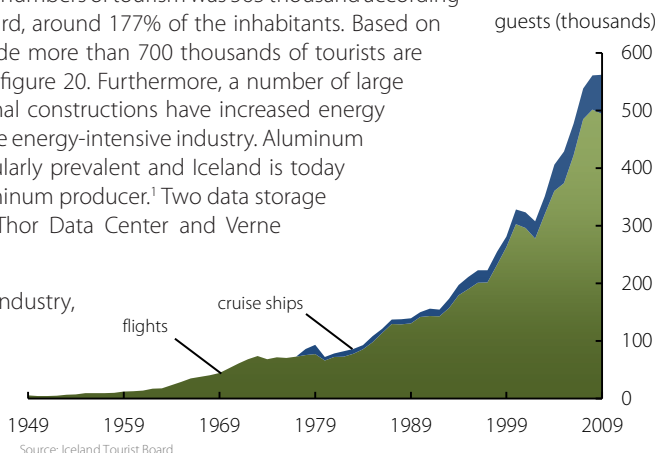
Sources: Statistics Iceland; Icelandic Directorate of Fisheries

## 6 The Economy's Composition

Iceland's economy has been increasingly diversified in recent decades. Historically, fishing and agriculture used to be the main sectors of the economy. However, industry, tourism and services have grown fast in the past decades and now all exceed the former two, both in terms of workers and contribution to GDP. Despite the declining emphasis on the fishing industry it remains to be one of the foundations of the Icelandic economy. Many of the nation's most prominent companies developed from a strong relationship with the industry, e.g. Marel, a leading global provider of advanced equipment to the fish, meat and poultry industries.

Some of Iceland's fastest growing sectors are tourism, energy utilization and industry. Iceland has seen a tenfold increase in the number of foreign visitors in about 40 years. In 2011 total numbers of tourism was 565 thousand according to the Icelandic Tourist Board, around 177% of the inhabitants. Based on the trend for the last decade more than 700 thousands of tourists are predicted in late 2014, see figure 20. Furthermore, a number of large hydropower and geothermal constructions have increased energy utilization and the size of the energy-intensive industry. Aluminum smelters have been particularly prevalent and Iceland is today the world's 12<sup>th</sup> largest aluminum producer.<sup>1</sup> Two data storage centers are in operation, Thor Data Center and Verne Global. See [here](#) and [here](#).

In addition to tourism and industry, innovative sectors such as software and design have grown fast.



Source: Iceland Tourist Board

**Figure 20** Number of foreign guests in Iceland (1949-2009)

1 <http://minerals.usgs.gov/minerals/pubs/commodity/aluminum/mcs-2011-alumi.pdf>

For example, the software design industry has grown by over 50% annually in the last 10 years and software exports now amount to 5% of all Icelandic service exports.<sup>2</sup> An increasing number of firms that rely on knowledge based industries and technologies have been developed and have grown rapidly in the past few years. An example of companies that have been doing well are, Össur (a global leader in orthopedics), CCP (computer gaming company and the developer of the computer game EVE Online), and Actavis (manufacturer of generic pharmaceuticals).

## 7 Iceland's Debt

The total amount of Iceland's foreign debt has been the subject of much debate since the collapse of the banks, and there is still considerable uncertainty about the accurate amount of Iceland's debt. The CBI recently published a report called "What does Iceland owe?" as a part of its publication series Economic Affairs. In the report, the current debt of Iceland is assessed. The report can be obtained [here](#).

Among other things, the report states the following:

*„Although there is still considerable uncertainty about the findings, it is virtually a certainty that, when the estates of the failed financial institutions have been settled and other factors that skew the overall picture have been accounted for, it will be revealed that Iceland's net debt has not been lower in decades. Net public sector debt, on the other hand, will be considerably higher. The report also estimates the country's latent current account balance, which (for the same reasons) is much more positive than official figures indicate, in part because accrued interest on the estates of the failed banks will never be paid.“*

### 7.1 Public Debt

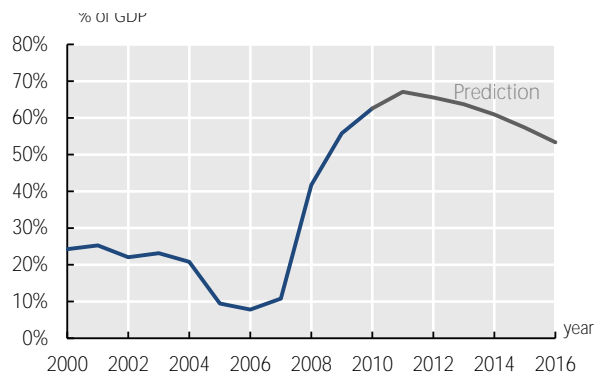
#### Prospects for Lower Public Debt

According to the Ministry of Finance total debt of the general government was estimated to be around 100% of GDP in the end of 2011, whereas it was around 120% in the end of 2010. In 2014 it is estimated that the total debt will be about 90% of GDP, see [here](#) (only in Icelandic). Furthermore the Ministry estimates that Treasury debt will be around 45-50% of GDP in 2016-2019 and total debt of the local government will be down to 12-15% of GDP, so all in all it is projected the total debt will be acceptable in the next 4-7 years or 60% of GDP.

This turn-around in the public finance is largely due to heavy increases in taxation and in part because of fiscal consolidation. It must also be noted that the outcome of the public finance was much more favorable than had been projected early on. Both the government debt was lower than originally estimated and the budget deficit was lower in 2009 and 2010 than expected

According to public finance estimates for 2012-2015 new income sources, higher dividends payments from state owned companies and sales of government assets will increase revenue by ISK 20,7 bn. in 2012, ISK 24 bn. in 2013, ISK 27,7 bn. in 2014 and 28,4

Figure 21 Net public debt in Iceland, % of GDP ([data](#))



Sources: Ministry of Finance, Statistics Iceland, Central Bank of Iceland

<sup>2</sup> According to export statistics from the Central Bank of Iceland

bn. in 2015. In each year it is estimated that sales of government assets will be ISK 7 bn. The government main assets are Landsvirkjun, its share in Landsbankinn (81,5%) and Vinbudin (liqueur stores). Other assets are its share in old Kaupthing, old Glitnir, Isavia (the public airport operator in Iceland), The National Broadcasting Service (RUV) and the National Postal Company (Islandspostur). However, the Minister of Finance recently announced that Landsbankinn will not be sold if market conditions are not favorable.

### **Interest Payments Have to be Reduced - Net Debt Decreases During the Year**

Net foreign interest payments have risen primarily because of loans that the Government has taken from the International Monetary Fund (IMF) and other countries to increase the Central Bank's foreign currency reserves. These interest payments need to be reduced by reducing public debt. For that, stronger economic growth is needed to facilitate a reversal in the fiscal position.

In March 2012, the Treasury of Iceland and the Central Bank of Iceland prepaid loans from the IMF and the Nordic countries in the amount of ISK 116 billion. See [here](#) and [here](#) for Moody's opinion. Some have stated that this might be due to new laws on the capital restrictions stating that investors can no longer exchange the amortization of bonds to foreign currency. See [here](#).

In this year's budget bill, a cost of about ISK 78 billion is reserved for interest payments or 14,3% of the total budget. This amount will have to decrease fast to facilitate economic growth and a reversal of recent tax raises. According to the CBI's forecast, the debt has already reached its height and will be decreasing in the coming years. It is important to increase fiscal policy restraints to reduce this debt as soon as possible.

A medium term debt management strategy for 2011-2014 was released in February 2011. The Treasury's debt management strategy reflects the government's plans for financing its activities during this period. See [here](#).

### **Impact of Icesave on Public Debt**

The Treasury's debt level and associated interest cost burden have turned out to be less than originally estimated, and the outlook for recovery of claims to finance the Icesave liabilities of the Depositors' and Investors' Guarantee Fund (DIGF) has improved; thus there is hope of a more favorable outcome in that matter than previously expected. The Resolution Committee of Landsbanki expects that the recovery ratio of their assets will be around 94%. If Iceland were to repay the UK and NL according to the Icesave agreement from late 2010 the cost to the Icelandic Government of meeting this obligation is estimated to be between ISK 20-30 billion (Down from 240 billion ISK in 2009). It is estimated that the Icesave agreement could raise the level of public debt relative to GDP by 2%. See more information about Icesave in [Chapter 13](#).

### **CBI Purchases Avens B.V. Bonds from Landsbanki Luxembourg S.A**

On May 18<sup>th</sup> 2010 the CBI, on behalf of itself and the National Treasury of Iceland, concluded an agreement with the Banque centrale du Luxembourg (BCL) and the liquidator of Landsbanki Luxembourg S.A., concerning the purchased all of outstanding Avens B.V. bonds. The bonds were owned by Landsbanki Luxembourg S.A. and pledged to BCL as collateral for a liquidity facility provided in 2008. Landsbanki Luxembourg S.A. was a subsidiary of old Landsbanki Íslands hf. See [here](#) and [here](#).

### **Bonds Sold to Pension Funds to Lower Debt**

The CBI reached an agreement on 31<sup>st</sup> of May 2010 with 26 pension funds according to which the funds purchased the Avens B.V. bonds the Central Bank purchased from BCL.

The total nominal value of the bonds is 90.2 b.kr., and the sale is made with the aim of expanding the foreign exchange reserves.

Furthermore, it reduces the Treasury's net foreign-denominated debt, which had increased because of the financing of the aforementioned purchase. According to the agreement, the pension funds sold foreign assets and paid for the bonds in Euros, remitting a total of EUR 549 million. This transaction increased the CBI's foreign exchange reserves by 82 bn. ISK (512 million euros), or by 17%.

The transactions (i.e. CBI purchase of the Avens B.V. bonds and re-selling them to domestic pension funds) had a positive overall effect on the Icelandic economy. First, both total debt and net debt were reduced by over 3,5% of GDP. The Treasury's total debt in foreign currency increased by just over 3,5% of GDP, but the foreign exchange balance of the Treasury and the CBI improved by the equivalent of 5,5% of GDP. With this transaction, it can be said that the Treasury has obtained financing equivalent to 0.75% fixed interest for 15 years which is considerably lower than prior financing. The agreement also ensured that revenues of the government are in line estimates. For more information see [here](#) and [here](#).

## 7.2 Household Debt

In consultation between the Government and representatives of the parliamentary opposition it was decided in October 2010 to convene a Working Group of Experts from ministries, financial institutions and the Household Association to assess the cost of various approaches to resolving the problem of household debt. The report was published on November 10<sup>th</sup> 2010. According to the report between 10.700 (14.7%) and 18.700 (18%) of households are facing payment problems or are in distress. The Working Group considered 11 different ways to address the problem. For more information about the results see [here](#).

On December 3<sup>rd</sup> 2010 the Icelandic government signed a declaration of intent with the country's pension funds and loan providers aimed at tackling the problems of indebted households. A government press release estimates that some 60,000 households could benefit from the new deal.

First of all, the requirements to qualify for financial help were lowered, to make it easier for people to receive assistance. Second, the government made it easier to choose the "110% way", wherein a household's total debt was reduced to 110% of their property's current value; leaving the debtor with monthly payments not exceeding a maximum of 20 percent of their earnings. Third, the government planned to completely re-organize interest schemes. The declaration allowed for the worst positioned households to reduce their debt by up to 70% of the value of their property. A government press release estimates that some 60,000 households could benefit from the new deal. For more information see [here](#) and [here](#). Information on other measures can be found [here](#).

The CBI held a symposium in April 2010 on the position of Icelandic households and what debt restructuring measures can achieve. See [here](#).

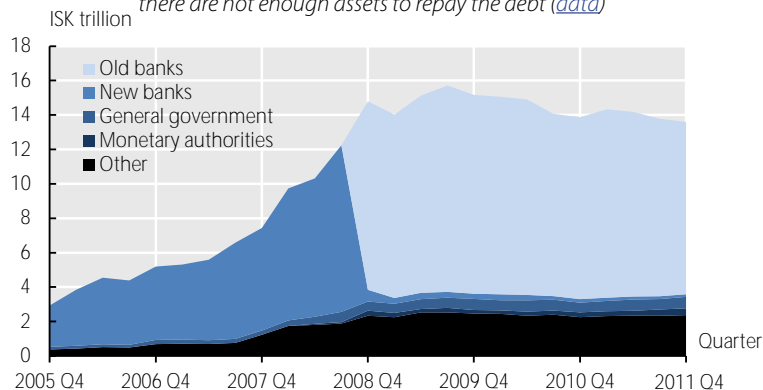
At the end of 2011 financial institutions had lowered debt of household of ISK 196,4 bn. or 12% of GDP since the "new" banks were formed. See [here](#) (only in Icelandic) and [here](#).

## 7.3 Corporate Debt

On December 15<sup>th</sup> 2010 an extensive agreement was introduced regarding the debt restructuring of small and medium enterprises. The agreement, called "The Right Track" (is. Beina brautin) involves speeding up the process of debt restructuring for small



**Figure 22** External debt of Iceland by category. Debt of the old banks in winding-up procedures will largely fall on foreign creditors as there are not enough assets to repay the debt ([data](#))



Source: Central Bank of Iceland

and medium enterprises, featuring common guidelines and reforms to the tax code. Financial institutions concluded a review of the companies concerned in June 2011 and offered viable enterprises debt restructuring. This action was viewed by many as a pivotal point of the restructuring of the small and medium sized companies in Iceland corporate sector. See [here](#). “The Right Track” agreement concluded in the summer of 2011. See the Iceland Chamber of Commerce information site about the “Right Track” project, see [here](#) (only in Icelandic).

Despite the Right Track many companies are still overly in debt. According to a new report (Published April 2012) from the Competition Authority around 27% of the biggest companies in Iceland are still under indirect control by one of the three big banks and about 25% of the companies in the report could not repay their loans. (see [here](#), only in Icelandic)

## 7.4 Foreign Debt of Iceland

The nation’s gross foreign debt was estimated to be about 320% of GDP at the end of 2010. The foreign debt of the state and municipalities, which is about 60% of GDP, is predicted to decrease rapidly in the coming years. The growth of public debt has decreased due to a better fiscal outcome than expected as described in [Chapter 18](#).

External debt of Iceland totaled ISK 13.331 bn. at the end of the 4<sup>th</sup> quarter of 2011 of which financial institutions undergoing winding-up proceeding accounted for ISK 10.017 bn. or 73,3% of total external debt. The assets of the fallen banks will go towards the external debt of those institutions and the outstanding amount will be written off. The government is therefore not responsible for that amount.

It gives therefore a better picture of the external position to look at the figures excluding the financial institutions undergoing winding-up proceedings (see figure above without DMBs winding up). The international investment position excluding DMBs undergoing winding up proceedings was negative by ISK 856 bn. in the 4<sup>th</sup> quarter 2011. See [here](#) for data on international investment position and [here](#) for external debt. Information about the 4<sup>th</sup> quarter of 2010 can be found [here](#). See also a report by the CBI on the debt of Iceland [here](#). For more statistics and economic indicators, see [here](#) and [here](#).

### Most Favorable International Investment Position in Ten Years

Ongoing and substantial trade deficit in Iceland's international trade from 2002 to 2008 accumulated about 1,380 bn. ISK in total in 2009. Normally a trade deficit of that magnitude would result in a less favorable net external position, but the opposite occurred. When the failed banks' foreign debts were separated from both the new banking system and the state, the deficit - largely accumulated in the failed banks' balance sheets - did not fall on the Icelandic economy, and the net external position is now the most favorable in ten years.

## 7.5 Iceland's Debt is Manageable Compared to Others

If Iceland's net debt as a percentage of GDP is compared to other OECD economies, one can see that Iceland is below the average. Compared to Ireland, where the state overtook the banks' debts, Iceland has lower debt. The Icelandic Emergency Laws Act, which separated the bank's debts from the state, contributes the most to this lower debt. Had the Icelandic state overtaken the banks' debts, the debt would have been unbearable. Possible Icelandic state obligations because of failed Landsbanki's Icesave deposit accounts in the UK and Netherlands are not included in these numbers. Those obligations could amount to about 1-3% of GDP according to old Landsbanki's newest estimations. See [Chapter 13](#) on Icesave dispute.

## 8 Iceland in an International Comparison

The figure below shows Iceland's rank on recent competitiveness rankings compared to its rank in 2007, the peak of the Icelandic economic expansion. Despite a lowering rank on a number of lists, Iceland still stands in front on most lists.

### 8.1 The 12 Pillars of Competitiveness

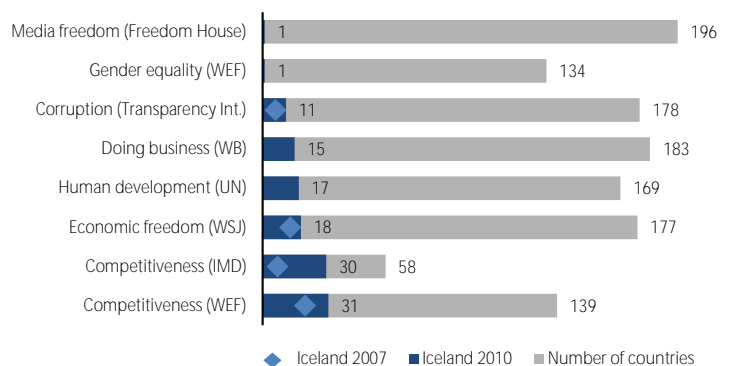
The World Economic Forum publishes its Global Competitiveness Report annually. It determines a country's competitiveness from 12 main pillars.

Iceland has a very different ranking among those pillars in the newest publication. It ranks very high on pillars such as institutions and infrastructure, but is drawn down by the macroeconomic environment, market size and financial market development. The WEF points out that the country's various strengths should draw the country out of the poor economic environment before long. Iceland is classified as an innovation economy, suggesting that innovation will be the primary source of economic growth.

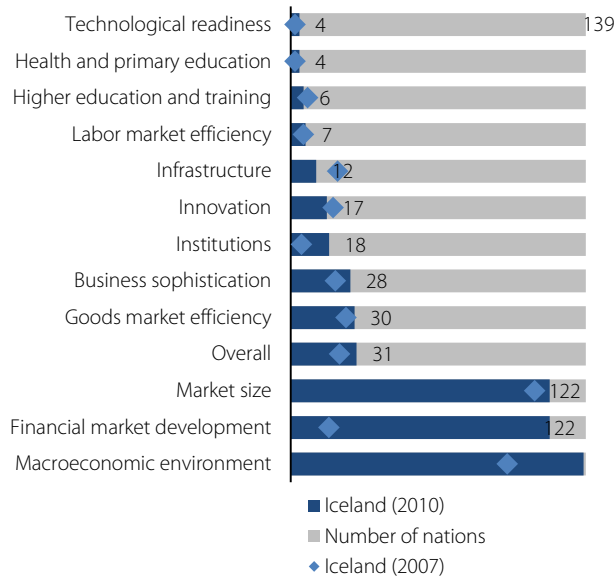
#### Development

Iceland falls 16 places from the UN's 2007 Human Development Index. The reason for this drop is primarily a sharp decrease in national income per capita, which decreased substantially because of the collapse of the major banks and the devaluation of the Icelandic currency. Iceland still ranks very high in education and life expectancy, the other two major factors which compose the index.

**Figure 23** Iceland's ranking in various competitiveness rankings



**Figure 24** Iceland's rank in the 12 pillars of competitiveness of the WEF report



Source: World Economic Forum

### Economic Freedom

Iceland drops the most of all countries on the Wall Street Journal's ranking of countries by their economic freedom. The reasons are a large budget deficit, increased size of the general government, macroeconomic instability, tax rises and currency restrictions.

### Other Assessments

Many other parties publish competitive lists between countries in various fields. Iceland is in front of many of those lists, including lists on innovation and democracy. The country has declined on lists on globalization, proprietary rights and online administration.

### A Peaceful Country

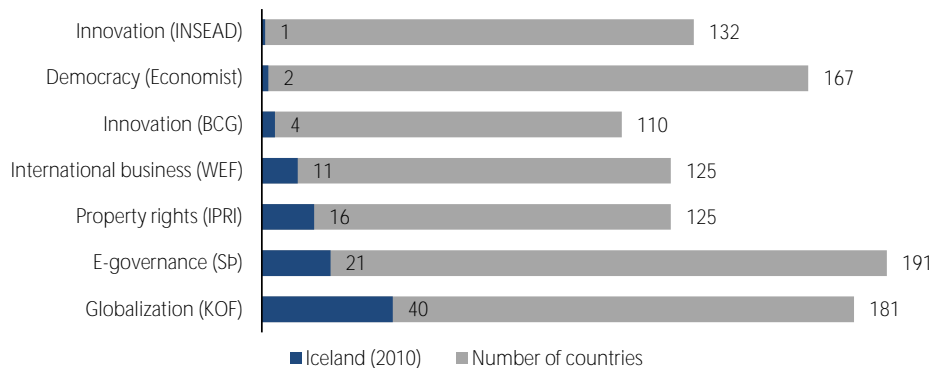
According to Global Peace Index (GPI). Which is compiled together by the The Institute for Economics and Peace, in conjunction with the Economist Intelligence Unit Iceland is the worlds most peacefull country in 2011. There is minimum risk is almost all categories, including the one addressing the degree to

which political instituions are sufficiently stable to support the needs of its citizens, businesses and overseas investors. See [here](#) and [here](#).

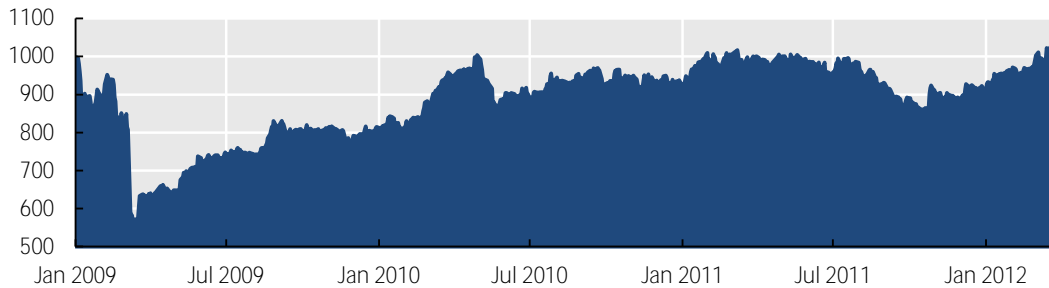
## 8.2 Long Term Economic Plan Introduced - Iceland 2020

On January 7<sup>th</sup> 2011 the Prime minister's office introduced governmental policy statement for the economy and community called Iceland 2020 – Knowledge, sustainability, welfare. Iceland 2020 is a policy statement for an efficient economy and society. It includes plans for investments in human resources and the necessary infrastructures for the economy, as well as policies on how to strengthen education and culture, innovation and development, the environment and social infrastructure. See [here](#).

**Figure 25** Ranking of Iceland in more competitiveness rankings



**Figure 26** *The Nasdaq OMX Nordic's Iceland 16 Index, Iceland's main stock index (data)*



Source: NASDAQ OMX

## 9 Capital Markets in Iceland

### The Nasdaq OMX Iceland: Slowly Picking up Pace

Before the financial crisis hit Iceland seriously, market cap on the equity market amounted to around 120% of GDP. This number has now been brought down to around 20% of GDP after the collapse of the three biggest banks, Glitnir, Landsbanki and Kaupthing. After trading was suspended for three trading days in the second week of October 2008 the OMX Iceland 15 index closed at 678.4, which corresponds to a plunge of about 77% compared with 3,004.6 closing on October 8<sup>th</sup>, 2008. This reflects the fact that the value of the three big banks, which formed 73.2% of the value of the OMX Iceland 15, had been set to zero.

On 2<sup>nd</sup> of January 2009 the OMX Iceland 15 index was replaced with a new index, the OMX16. The new index comprised of 6 companies instead of 15, which have the most trading volume of the listed companies and which are mostly industry based. The index combination will be revised 1<sup>st</sup> of January and 1<sup>st</sup> of July each year.

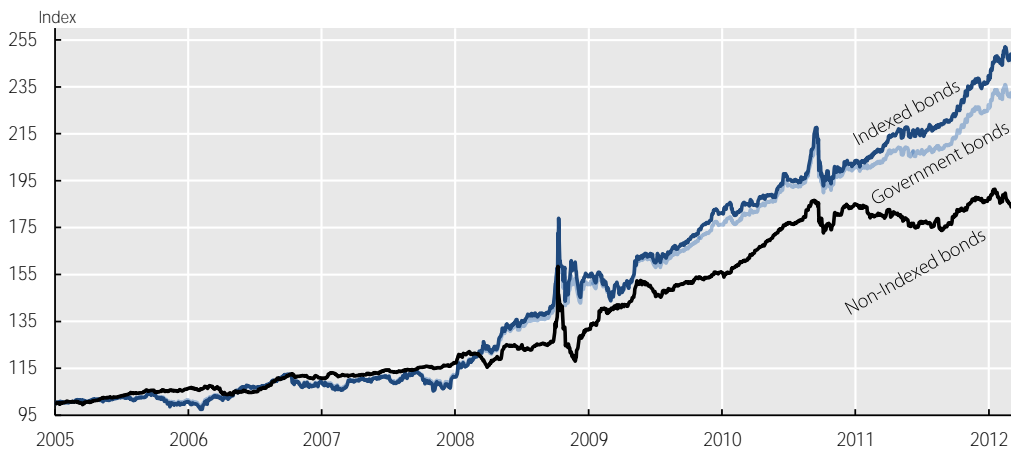


**GAMMA**

GAM Management hf

**Figure 28** *GAMMA publishes a bond index for the Icelandic bond market*

**Figure 27** *Icelandic bond indexes from 2005 to 2011 (January 1<sup>st</sup> 2005 = 100) (data)*



Source: Gam Management



### Slowly Picking up Pace in Late 2009 Until Beginning of 2012

Despite the heavy blow of the NASDAQ OMX Iceland Stock Exchange is on a good recovering phase. The OMXI6 index has risen to about 1.000 in mid-March 2012 from a low of about 600 in March 2009. More information on the NASDAQ OMX Iceland Stock Exchange can be found [here](#). Information on the bond market can be found [here](#). General information on the Icelandic stock and bond market can be found in the "Doing business in Iceland" booklet [here](#).

Hagar, a leading retail company in Iceland, was listed on the Stock Exchange on September 16<sup>th</sup> 2011 (see [here](#) and [here](#)). Seven other companies have announced that they will be joining the Icelandic Stock Exchange in 2012 or 2013, they are Eimskip, Reginn, Reitir, Advania, N1, Sjóvá and Landsbankinn. Marorka, Icelandic Group and SS meat processing had also stated their interest in joining the stock exchange in 2011. Horn, investment company owned by Landsbankinn, had announced its plan to join the stock exchange in 2012 but a recent statement from the company states that the process has been delayed.

On November 15<sup>th</sup> 2010 Össur, a global leader in non-invasive orthopedics, has been listed on both NASDAQ OMX Copenhagen and Iceland decided to request delisting from NASDAQ OMX Iceland. The Company will focus on the listing in Copenhagen. See [here](#).

Contrary to the equity market, the Icelandic bond market has grown very fast since the year 2008, or from around 581 bn. ISK to 1.456 bn. ISK. The main drivers for that expansion have been big issuances of government bonds and high inflation, since 74% of the bond market is index linked. Also the turnover has been rapidly increasing, in februar 2012 the average turnover was around 13 bn. ISK compared to around 8,5 bn. ISK in the beginning of the year 2011.

## 10 Weaknesses of the Economy

Despite the state of the Icelandic economy being better than one would think from the many media reports, experience shows that it is important to assess economic weaknesses, and various difficult problems are evident for the Icelandic economy. These problems are evident in both the private and public sectors. Many problems need to be corrected in the following seasons to prevent a further decline in economic prosperity.

### Government Operations Unsustainable Without Economic Growth

Despite a fair success in reducing the budget deficit, that success has been at the cost of firms' investment capabilities and individual purchasing power. Some believe that the Government has put too much emphasis on taxation to cover public expenditure rather than reducing the size of the public sector in light of the economic situation. The topic has been much debated in Iceland since the banking collapse. The Finance Minister however recently stated that the tax legislation would be revised e.g. in order to encourage companies with foreign operations to transfer their profits and dividends back to Iceland (see [here](#), only in Icelandic).

Under present circumstances, the government needs to even the trade and business cycles and encourage long-term economic sustainability. Public debt has soared and greatly increased public interest payments threaten fiscal sustainability. Furthermore, the government's basis of operations has changed significantly with lower tax revenue and higher welfare costs. Public expenditure policy from recent years turned out to be

far from sustainable and because of that, the government is now faced with the task of reversing a substantial deficit at the same time as the economy is going through a recession. Additionally, there are also signs of population emigration from Iceland. In 2007 net immigration was -167 compared to -2.466 in 2009, -1.703 in 2010 and -1.311 in 2011.

### Impaired Private Sector

In the wake of the banking collapse, the business environment of Icelandic companies degraded significantly and has not been worse for decades. To name a few examples, corporate debt has risen, costs increased, access to financing is poor and demand has decreased. Because of this, many companies are under the control of financial institutions and bankruptcies are much more common than before.

Resolution of the corporate debt problem has been going slow, but 987 companies declared bankruptcy in 2010 and bankruptcies have never been as many in a single year. Numbers for the first half of 2011 showed that the amount of bankruptcies were still increasing. Today, many companies are still dealing with significant financial problems. There have been some reactions to solve this situation soon so this trend does not continue, with pertaining curtailment of the standard of living.

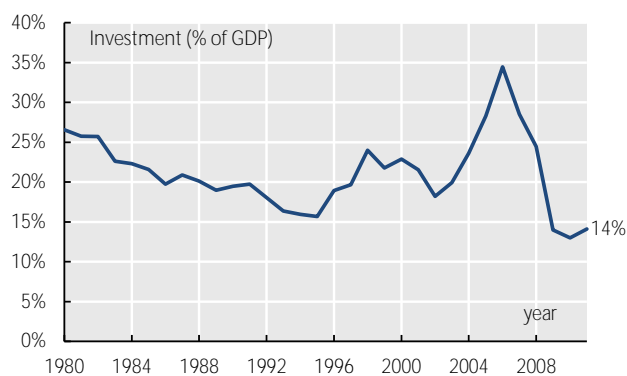
The corporate restructuring process is being hurried on one hand, and new business operations are being encouraged on the other hand. The government, the financial system and many private sector interest groups unified at the end of last year to help achieve those goals. The project "Right Track" aims at speeding up the financial restructuring of small and medium-sized companies. See the Iceland Chamber of Commerce information site about the "Right Track" project. (See [here](#), only in Icelandic, and chapter 7.3).

## 10.1 Lack of Investments

One of the main challenges facing the Icelandic economy is to increase investment. Investment in 2011 was at 14.1% of GDP, the second lowest in Iceland's history from 13% in 2010. There has been considerable talk of public investment projects in connection with the stability pack of 2009 and the collective wage agreements in May 2011 but the projects planned in those agreements have been delayed. See [Chapter 19](#) for information on the collective wage agreement.

Public investment projects only go so far, so investment both from domestic and foreign private investors must also increase. In January 2012 the total resident's deposits in DMBs amounted to ISK 1.544 bn., close to the annual GDP of which household's deposit amounts to ISK 614 bn. Therefore there seems to be ample domestic funds to invest. However, investment opportunities in Iceland seem to be few. As mentioned by Össur's CEO Jón Sigurdsson it is difficult to find investment opportunities in Iceland and some governmental activities seem to have played a role there according to Össur's Chairman of the Board at the company's AGM a few weeks ago. See [here](#) (only in Danish) and [here](#) (only in Icelandic).

**Figure 29** Investment in Iceland as a percentage of GDP has never been lower



Source: Statistics Iceland (national accounts statistics [here](#))

With regards to foreign investors there have been some inquiries made in recent months, but no solid plans have been announced. The most recent example is of the Chinese investor Huang Nubo, who came to Iceland with plans to invest in land. He had an eye on [Grímsstadir](#) as an investment opportunity where he planned to set up hotels and develop tourism in collaboration with Icelandic authorities. See [here](#). However, due to Icelandic legislation foreign investors outside of the EEA are not allowed to own a part of Icelandic land without certain permission from the Government. Minister of Home Affairs Mr. Ögmundur Jónasson refused to allow Mr. Huang Nubo to invest Grímsstadir. As of now, there is however an ongoing process of finding ways for Mr. Nubo to invest in Iceland. See [here](#) (only in Icelandic)

In November 2011 the Government agreed on a proposal for a parliamentary resolution on foreign investment. The proposal was set forth by a committee formed by the Minister of Industry. The main results of the project is that it is important to increase foreign investment that provides the most added value, creates new jobs and contributes heavily to innovation. See [here](#) and [here](#) (only in Icelandic).

## 10.2 Report of the Special Investigation Commission (SIC)

In addition to economic weaknesses, there are various systemic problems in Icelandic society which need to be addressed. These problems are well-covered in a report by the Special Investigation Commission (SIC), appointed by the Icelandic Parliament, to investigate the reasons for the banking collapse. See [Chapter 20](#) for a further discussion. Below is an overview of weaknesses which should have been addressed before the fall of the banking system.

### The Private Sector

- Fast and risky growth of isolated industries
- Incentive systems within companies which promote risk-taking
- Little understanding of the functioning and development of foreign markets, e.g. financial markets
- Too few and large industries which the public and the whole economy resided in
- Abnormal disbursements to owners and key managers
- Poor dissemination of information to corporate personnel
- Unclear procedure policies or day-to-day methods of work not in accordance with procedure policies
- High level of consolidation of ownership and highly leveraged corporate ownerships of largest shareholders
- Corporations bearing proprietary risk of their own stocks
- Lack of diversity in boards and corporate management, both with regard to experience and education
- Limited information about corporate operations and prospects

### The Public Sector

- Lack of adequate restraints, both from the public and private sectors
- Key participants working against each other
- Lack of formalism in decision-making processes
- Limited oversight of key participants in public administration

- Lack of intent when solving and following up on affairs
- Limited knowledge and unclear boundaries of responsibility
- Limited preparedness against various setbacks
- Inadequate information-systems
- Government decisions promoting an economic imbalance
- Hiring not based on merit; abilities, knowledge and experience

### 10.3 Opportunities in Solving Problems

A large part of the problems of Icelandic companies today related to unclear public policy. Since 2007 over 100 changes to the tax system have been introduced, mostly constituting increased taxation. This has created uncertainty as to what the future tax environment of business and households will look like, a problem compounded by the lack of clear governmental policy in many of Iceland's key industries.

Despite these home-grown problems, key economic indicators show that the situation in Iceland is much better than what could have been expected immediately after the banking collapse. Economic growth has returned and was 3.1% in 2011. Public debt is within manageable levels, the budget deficit will soon be eliminated, a trade surplus will continue due to favorable exchange rate for the export sector. Unemployment has gone down but there has been a steady increase in inflation since the beginning of 2011.

Without discounting the problems which inevitably come with a banking collapse of magnitude like the Icelandic one, the state of the Icelandic economy is nevertheless in many aspects good. This indicates that the foundations of the last decades were in many ways stronger than expected and given abundant resources and Icelander's healthy attitude towards work, there are good reason to be optimistic about Iceland's future.





# Part C

## Spring 2009 until August 2011

Significant progress has been made since spring 2009, both in terms of the financial sector and the Government's program with the IMF. A few highlights are listed in the table below.

### Progress Made Since Spring 2009 - Some Highlights

#### The Banks

Reconstruction has been concluded. ([Chapter 12](#))

#### The Icesave Dispute

Is before the EFTA Court, as of April 2012. ([Chapter 13](#))

#### The IMF Program

Final review concluded. ([Chapter 14](#))

#### Monetary Policy

Interest rates lowered from 10% to 4% in January 2010. At 5% since February 2012. ([Chapter 15](#))

#### Capital Restrictions

A new plan on capital controls introduced in November 2011 called the Investment Program. ([Chapter 16](#))

#### The European Union

Candidate status achieved and formal negotiations have begun ([Chapter 17](#))

#### The State Treasury

Hit Hard by the Turmoil. Better outcome in 2009 than expected. Private and public debt: Reconstruction of household and corporate mostly over. ([Chapter 18](#))

#### The Stability Pact and Collective Wage Agreements

Collective wage agreements expired in late 2010. Agreement reached in May 2011. ([Chapter 19](#))

#### The Investigative Report

Detailed report on the banking crisis published in spring 2010. ([Chapter 20](#))

## 11 Political Environment

In September 2010 a few changes in the government were announced. The same parties are in power but the changes concerned changes of two ministers and the merger of two ministries. Social Democrat Mr. Guðbjartur Hannesson is now the Minister of Social Welfare - a new ministry created to combine the Ministry of Health and the Ministry of Social Affairs. The previous Minister of Health, Ms. Alfreidur Ingadóttir, left the government altogether, while the previous Minister of Social Affairs, Mr. Arni Pall Arnason, was appointed the new Minister of Economics and Business, replacing the outgoing Mr. Gylfi Magnússon. See [here](#).

In the beginning of 2012 Mr. Steingrímur J. Sigfússon replaced Mr. Árni Páll Árnason and Mr. Jón Bjarnason as Minister of Economics and Business as as Minister of Fisheries and Agriculture. Ms. Oddný Hardardóttir, the head of the Social Democrats MP's in the Parliament, replaced Mr. Sigfússon as Minister of Finance. The Government plans to re-organize the Ministries around mid-year 2012. The Ministry of Finance will take over the economics part of the Ministry of Economics and Business, which will merge with the Ministry of Fisheries and Agriculture, a part of the Ministry of Industry and will become the Ministry of Industry and Innovation. The natural resource part of the Ministry of Industry will merge with the Ministry for the Environment, which will be named the Ministry of Environment and Natural Resources. The Ministry of Finance will become the Ministry of Finance and Economic. (See [here](#), only in Icelandic)

In late August and September 2010 the former Minister of finance, Mr. Sigfusson, wrote a six letter article series named *"Rising from the Ruins on the causes and consequences of the banks' collapse"*. The articles can be found [here](#).

On March 21<sup>st</sup> 2011 two members of the Left green party left the coalition and became independent. See [here](#).

On April 13<sup>th</sup> 2011 a voting took place on a vote of no-confidence submitted by the Independence party. The vote was not successful and the government therefore still holds a majority in Althingi.

Following the vote of "no-confidence" election one MP from the ranks of the Left-Green Movement, which voted against the coalition by backing the vote of no confidence, left the Left-Green parliamentary group. He later joined the Progressive party. See [here](#) and [here](#).

After these changes the majority of the Social democrats and the Left green party is now 32 MPs versus 29 MPs of the opposition and 2 independents.

At least four new political parties have been formed in the last few months which aim at taking part in the Parliamentary elections in 2013. The fifth party has yet to announce formally its participation. Icelanders might therefore be able to vote from around eight to nine political parties in the next elections.

## 12 Bank Reconstruction Concluded

### Considerably Lower State Contributions Than Anticipated

Since the Icelandic FSA took over the operations of the banks in October 2008 they have been appointed Special Resolution Committees and new banks have been established around the old banks domestic operations, in accordance with the FSA's decision on

the disposal of assets and liabilities between the old and new banks. The Government also appointed boards to govern the new state owned banks.

The decision of the FSA on the disposal of assets and liabilities, information about the resolution committees and various FAQ can be found [here](#).

In April 2009 Deloitte delivered its valuation of the assets that were moved from the old banks to the new banks and Oliver Wyman consulting firm also issued its independent assessment report. The Government also engaged with the corporate advisory firm Hawkpoint to negotiate with creditors of the old banks the appropriate compensation for assets transferred and also to advice on the capitalization and the imbalance issues.

On 20<sup>th</sup> of July 2009 the Government, the boards of the new banks and the resolution committees of the three old banks announced that an agreement had been made on the initial capitalization of the new banks and the basis for the compensation payable to the creditors of the old banks for the transfer of assets into the new banks.

The Government provided both the Resolution Committee of Glitnir and Kaupthing with options to acquire the majority of the Government's shares in the new banks. The announcement can be found [here](#). On 15<sup>th</sup> October of 2009 the Resolution Committee of Glitnir, on behalf of its creditors, decided to utilize that option and acquired 95% of the share capital in Islandsbanki. The Government will continue to own 5%. See [here](#).

The resolution committee of Glitnir expects to finalize the sale of Islandsbanki before 2015. See [here](#) (only in Icelandic). The Norwegian bank DNB is among potential investors. See [here](#) (only in Icelandic).

Similarly, on December 1<sup>st</sup> 2009, the Resolution Committee of Kaupthing Bank decided to utilize the option to acquire 87% of common equity in Arion Bank. The Government will continue to own 13%. Information on Kaupthing Resolution committee can be found [here](#).

On December 16<sup>th</sup> 2009 the Ministry of Finance and the Resolution Committee of Landsbanki Íslands hf announced that a final agreement had been reached on the settlement of assets and liabilities following the division of Landsbanki Íslands into old and new bank (NBI). The government acquired 81% of the share capital in Landsbanki (NBI hf, the new bank) and the Resolution Committee of Landsbanki, on behalf of creditors, will control 19% of NBI. The Icelandic Government's equity contribution will be ISK 122 billion, 5 billion lower than previously estimated. See [here](#). As mentioned in chapter 9 the government is looking into selling a part of its stake in Landsbankinn through the stock exchange.

In lines with an announcement from the Minister of Economic Affairs in early 2011 a bill was proposed and passed in the Parliament in June 2011 in which the Resolution Committees for the old banks were disbanded. All of their tasks were transferred to the Winding-up Boards. The work and positions of those who were in the Resolution Committee and those who are in the Winding-up Board are subject to the same rules as apply to liquidators pursuant to the Act on Bankruptcy. (See e.g. [here](#)).

Information on the Resolution committee's and creditors reports can be found on the following websites:

- [Landsbanki](#)
- [Kaupthing](#)
- [Glitnir](#)

**Figure 30** *The Icelandic Financial Supervisory Authority (FSA)*



Figure 31 State contributions to the restructuring of the Icelandic banks

Bank	Total equity (ISK bn)	State's equity (ISK bn)	State's holding (%)	Subordinated loans from the state (ISK bn)	Total state financing (ISK bn)
Arion banki	72	9,36	13	24	33,36
Íslandsbanki	65	3,25	5	25	28,25
Landsbanki	150	122	81	0	122
<b>Total</b>	<b>287</b>	<b>134,6</b>	<b>-</b>	<b>49</b>	<b>183,6</b>

## 12.1 Overview of the Restructured Banks

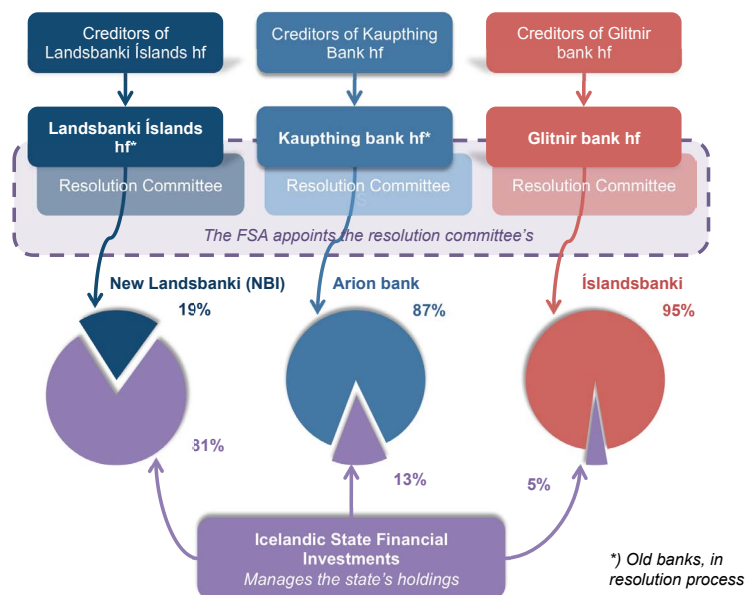
Following the restructuring of all three commercial banks the Ministry of Finance issued a press release outlining the contribution of the state in the bank restructuring. See [here](#)

The cost of capitalizing the new banks, ISK 135 billion, is significantly lower than the estimated commitment of ISK 385 billion at the time of the original transfer in October 2008. An overview of the state's contribution can be found in the Figure below.

The agreement reached between the Icelandic authorities and the new banks, on the one hand, and the Resolution Committees of all three Banks on behalf of their creditor on the other hand concerns the settlement of assets which were transferred from the old banks to the new ones established in October 2008.

In January 2010 the FSA authorized Kaupskil ehf., on behalf of the creditors of Kaupthing, to acquire a qualifying holding in Arion Bank hf. Similarly the FSA authorized ISB Holding ehf. on behalf of the creditors of Glitnir, to own a qualifying holding in Íslandsbanki See [here](#).

Figure 32 A diagram of the setup and ownership of the old and new banks



Source: Vilhjalmur Thorsteinsson

On November 22<sup>nd</sup> and 23<sup>rd</sup> 2010 Kaupthing and Glitnir bank entered winding-up procedure. Icelandic law provides for automatic end of the moratorium period upon entering into winding-up procedure. The ruling involves no changes to the bank's day-to-day activities or its legal status. See [here](#) and [here](#).

A good overview of the reforms in the Icelandic financial sector from October 2008 until April 2010 can be found [here](#).

### Report by the Ministry of Finance

In March 2011 the minister of finance introduced a report on the reconstruction of the three largest commercial banks in Iceland. The report is extensive and provides a more detailed overview of the process. The report can be found [here](#) (only available in Icelandic.)

## 12.2 Aid for the Icelandic Housing Fund

After the banking collapse new equity was needed to finance the Housing Financing Fund (HFF). HFF is an independent state-owned agency. Under the auspices of the FSA, a detailed appraisal of the HFF's assets was conducted in accordance with the premises used for the refinancing of the banks, as the Fund lost substantial amounts following the banking collapse. The fund has now been refinanced in accordance with regulations. The 2011 budget provides for the fund to reserve about ISK 33 billion for this task. Part of that amount is intended for cover costs related to measures for introduced for indebted households. See [here](#) and [here](#).

Additional equity might be needed in the amount of 11 bn. ISK. See [here](#) (only in Icelandic).

The aid was approved by the EFTA Surveillance Authority. See [here](#).

Some changes in the operation of the fund are expected. In part due to the comments and guidance of the EFTA Surveillance Authority. See [here](#).

## 12.3 Restructuring of the Savings Banks

After a long restructuring process the Icelandic authorities took over the operations of Byr savings bank and Keflavik Savings Bank (SpKef) on April 23<sup>rd</sup> 2010. Both were very small institutions compared to the old Icelandic banks. See [here](#) and [here](#).

An agreement was signed on October 14<sup>th</sup> 2010 between the winding-up committee of Byr Savings Bank, the Government of Iceland and Byr hf. regarding the settlement and ownership of Byr hf. The Government would own 100% of Byr hf. The agreement minimized cost for the Government. See [here](#). On April 13<sup>th</sup> 2011 the EFTA Surveillance Authority (ESA) approved temporarily state aid in support of Byr hf. See [here](#). At the end of November 2011 the Government agreed to sell its share in Byr hf. to Islandsbanki. See [here](#) (only in Icelandic) or [here](#). The combined asset base of the two banks amount to around ISK 800 bn. and its total capital ratio will be in excess of 20% (See [here](#))

On March 5<sup>th</sup> 2011 the Ministry of Finance and Landsbanki signed an agreement on the merger of Landsbanki and SpKef. A few branches have been merged where both Landsbanki and SpKef operate. The agreement is thought to minimize the cost for the government. See [here](#), [here](#) and [here](#) (Icelandic). Additional equity contribution by the government might be needed since some uncertainty surrounds the valuation of assets transferred from SpKef to Landsbankinn. The amount is estimated to be around 11 bn. ISK, see [here](#).



In February 2012 the Government sold its stake in a small savings bank (Sparisjóður Svarfdæla) to Landsbankinn, see [here](#). The agreement needs to be confirmed by the FSA, the Competition Authority and ESA. The Government still holds stakes in three savings banks, Sparisjóður Bolungarvíkur (90.9%), Sparisjóður Vestmannaeyja (55.3%) and Sparisjóður Þórshafnar (75.9%). Further information on the savings banks can be found [here](#).

On June 22<sup>nd</sup> 2010 ESA approved for a period of six months a state aid scheme for small savings banks in Iceland. ESA considered the measures taken by the Government to be appropriate as they met their objective to ensure that all savings banks would comply with the regulatory capital ratio requirements. See [here](#).

There is also a discussion on the recapitalization of the savings banks in the IMF status report see [here](#) (pdf).

## 12.4 Icelandic State Financial Investments

**Figure 33** *The Icelandic State's banking agency, which holds its financial assets*



The Government has furthermore set up a Banking Agency, [Icelandic State Financial Investments](#) (ISFI) which is intended to control the state's holding in financial undertakings in compliance with currently applicable law, good administrative and business practices, and the state's current ownership policy, and provide them with funding on behalf of the Treasury based on budget allocations. ISFI is expected to conclude its operations no later than 5 years after its establishment. Further information on the ownership policy can be found [here](#).

Further information and updates can be found on the ISFI website, see [here](#). In June 2010 a report on the activities of the ISFI was published. See [here](#) (pdf).

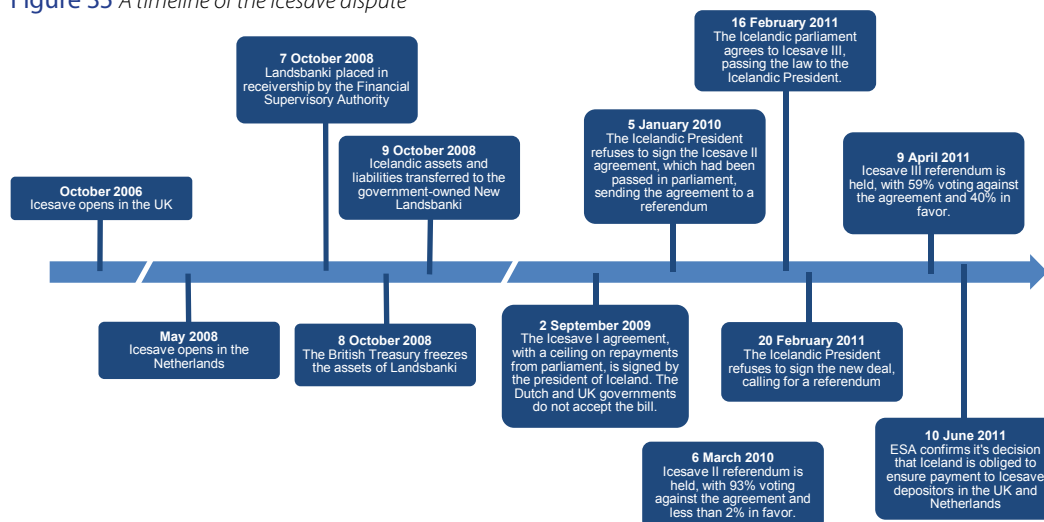
ISFI is set up in accordance with an expert report from the Coordination Committee led by Mr. Mats Josefsson, see [here](#) for further information. The Committee had the overall responsibility of developing, implementing and communicating a comprehensive strategy for bank restructuring. Another expert report, by Mr. Kaarlo Jännäri, on Banking Regulation and Supervision in Iceland was published in March 2009, see [here](#).

On September 10<sup>th</sup> 2011 the ISFI announced [Jón Gunnar Jónsson](#) as its new CEO. Jon superseded Elin Jonsdottir who served as CEO. It was the new board of the ISFI that hired Jon Gunnar Jonsson after a qualification committee had reviewed all applicants. The new board was appointed in November 2011. The old board had hired another individual which later announced that he would not accept the job.

**Figure 34** *The logo of Icesave in the UK*



Figure 35 A timeline of the Icesave dispute



## 13 The Icesave Dispute

One part of the collapse of the Icelandic banking sector was the insolvency of Landsbanki Íslands in December 2008. A part of the bank was an online savings bank, called Icesave, operating in the United Kingdom (UK) and the Netherlands (NL). See [Appendix 8](#) for a timeline of the dispute.

During the restructuring process of Iceland's financial system Landsbanki has been in moratorium and therefore creditors have not yet received reimbursements. Nevertheless, the governments of UK and the NL reimbursed depositors of Icesave in their respective country. See [here](#).

According to the European Economic Area legal framework the Depositors' and Investors' Guarantee Fund of Iceland (DIGF) is responsible for reimbursing the depositors up to certain amount, approximately 20.900 Euros. However legal doubt has remained about whether there was a state guarantee on the DIGF fund which only had sufficient funds to reimburse a small number of depositors. The reimbursement by the local governments was therefore thought of by the UK & NL Governments as an effectively a loan to the DIGF. The Icesave dispute has surrounded the terms of the loan, and what conditions should apply to a state guarantee of the loan, if it were to be given. See also information on the ESA ruling below.

### 13.1 The August 2009 Icesave Act

On August 28<sup>th</sup> 2009 the Icelandic parliament passed an Act authorizing a state guarantee for the loans granted by the Governments of the UK and the NL to the Depositors' and Investors' Guarantee Fund of Iceland. The law was signed with pre-conditions. The pre-conditions stipulated certain economic conditions for the repayments of the loans as well as legal rights regarding natural resources. The president of Iceland signed the Act on September 2<sup>nd</sup> 2009. More information can be found [here](#).

### 13.2 The December 2009 Act

In light of the pre-conditions the Icelandic Government had to re-negotiate with the Governments of the UK and the NL. The re-negotiations process was concluded on

18<sup>th</sup> of October 2009 with the Governments of the UK and the NL accepting some of the conditions set by the Parliament. Further information can be found [here](#). Since the agreement was not identical to the law passed in August 2009 a new law needed to be ratified as a successor to the earlier law. Many Icelanders felt that the key pre-conditions set forward in the Act that was passed in August had been removed and put tremendous pressure on the Icelandic parliament not to pass the bill. After several weeks of discussions in the Icelandic Parliament a new law was passed on December 30<sup>th</sup> 2009 with a majority of 33 votes against 30. Further information can be found [here](#).

### The December Act Was Not Confirmed by the President

According to the Icelandic constitution the President needs to sign every law that is passed. If the President does not sign a law it must go under a national referendum as soon as possible. The President does not have the power to veto or block the law from going into force.

Over 60 thousand Icelanders, about a quarter of the electorate, signed a petition urging the president of Iceland not to sign the law that was passed on December 30<sup>th</sup> 2009 and calling for the Act to be subjected to a referendum. Further information can be found [here](#) (site only available in Icelandic).

On January 5<sup>th</sup> 2010 the President of Iceland denied to sign the law passed on December 30<sup>th</sup>. According to the constitution the law remains in force but is put under a national referendum as soon as possible. The referendum was held on 6<sup>th</sup> March 2010. Further information on the President's decision can be found [here](#).

Jon Danielsson, professor at London School of Economics, wrote an article about the dispute in January 2010. See [here](#).

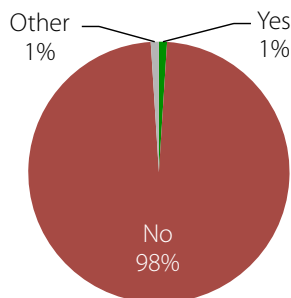
## 13.3 A Negotiation Committee Formed

In February 2010 a negotiation committee representing the Icelandic government was formed to meet with representatives of the UK and NL governments. Heading the negotiation committee was US attorney Lee C. Buchheit. Several meetings took place before the national referendum but talks were abandoned shortly before the national referendum. See [here](#). For information on Lee C. Buchheit, see [here](#). For more information on the negotiation committee see [here](#).

For information on Lee C. Buchheit, see [here](#). For more information on the negotiation committee see [here](#).

## 13.4 First Icesave Referendum - March 2010

**Figure 36** Results of the first Icesave referendum



The first national referendum in Iceland since the foundation of the Republic was held on March 6<sup>th</sup> 2010. The referendum, Icesave referendum, was on whether an amendment to the so-called December Icesave Act should stand or be repealed. The result was decisive and only around 1.5% voted in favor of the new amended act. The result is in a sense biased due to the fact that in the weeks leading up to the election it had been known that a better deal was available to the Icelandic authorities than the one that was voted on in March 2010. In light of the result the December Icesave Act was repealed and the Act passed on August 28<sup>th</sup> 2009 continued to be in force. For more information on the referendum and related information see [here](#) and [here](#).

The dispute received a great deal of attention leading up to the vote and an increasing number of articles were written in Iceland's favor.

## 13.5 An Agreement Reached

### Considerably More Favorable Terms

Both informal and formal talks between the negotiations committees of Iceland, Britain and the Netherlands continued in the summer and fall of 2010. See [here](#).

In early December 2010 an agreement was reached between the negotiations committees of Iceland, Britain and the Netherlands. On December 8<sup>th</sup> 2010 the negotiation committee of Iceland's introduced it's summary on the outcome of the recent discussions on Icesave between the relevant parties. See [here](#).

On Iceland's behalf the draft agreements were endorsed by all five of its negotiators, together with the Chairman of the Board of DIGF. Final signing and acceptance of obligation on Iceland's part needs to be granted by Parliament and then the President.

According to an estimate by the negotiation committee the cost to be borne by the Treasury would be around ISK 32 billion, or just over 2% of GDP. Payments should be completed in 2016. In the agreement there are several macroeconomic provisions that are aimed at limiting the potential cost for the Treasury. See [here](#). It was estimated that the agreement from 2009 would cost the Treasury around ISK 370 billion.

A more favorable agreement is not the sole reason for the lower state contribution. It also due to a better recovery of the assets of the resolution committee which now believes that around 90% of the claims related to Icesave can be retrieved. On March 2<sup>nd</sup> 2011 the resolution committee of Landsbanki announced that considerable success had been made in increasing reclaims of the asset portfolio of old Landsbanki Islands hf. during the last two quarters of 2010. See [here](#) (3Q) and [here](#) (Q4). More progress was made in the 1<sup>st</sup> quarter of 2011. See [here](#).

See [here](#) the original press release from December 2010 and [here](#) a news report without the adjustment for better recovery of assets. Also, see [here](#).

On February 16<sup>th</sup> 2011 the Icelandic Parliament passed a bill from the Minister of Finance that confirms the new agreement reached between Iceland, UK and The Netherlands on the Icesave issue. The result was that a strong majority, or more than 2 /3 of parliamentarians, approved the new agreement. A total of 44 MP's voted in favor of the agreement, 16 MP's were not in favor and 3 MP's abstained. See [here](#). Information on the agreement from December 2010 can be found [here](#) and [here](#).

## 13.6 A Second Icesave Referendum - April 2011

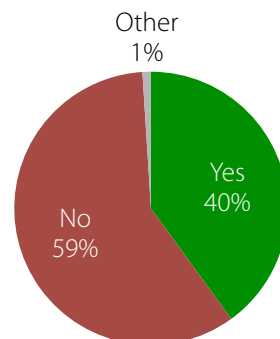
On February 20<sup>th</sup> 2011 the President of Iceland refused to sign the law and decided to refer the bill to a referendum. The President supported his decision by pointing out that there had been substantial support in Althingi in favor of another referendum (30 MP's in favor / 33 opposed , a separate vote from

**Figure 38** Mr. Olafur Ragnar Grimsson, the President of Iceland, at a World Economic Forum meeting in 2010



Source: World Economic Forum on Flickr

**Figure 37** Results of the second Icesave referendum



the one mentioned earlier). Additionally, he pointed out that more than 40,000 voters, about one fifth of the electorate, had formally requested that a referendum be held on the new bill.

The referendum took place on April 9<sup>th</sup> 2011. See [here](#) and [here](#). An informational website on the Icesave dispute and the second referendum, from the University of Iceland, can be found [here](#).

The turnout of the referendum was around 75%, with about 40% voting for and 60% voting against the law. The Act was therefore rejected by the majority of the voters and is repealed. The turnout was much higher than in the first Icesave referendum, but lower than in general elections in Iceland.

The Government of Iceland has stated that it will do all in its power to secure that the referendum outcome will not have a major impact on Iceland's economic program and the fiscal consolidation plan which it has been pursuing with a high degree of success. See [here](#). See an article from the Wall street journal about the referendum [here](#).

The prime minister of Iceland wrote an article about the election results in the Guardian on April 13<sup>th</sup>:

*"Second, the government of Iceland has always said it would honor its international obligations, but there is a great deal of uncertainty as to what these "international obligations" entail – opinion on and interpretation of the European directive in question is highly disputable. Therein lies the problem. The referendum outcome means that the Icelandic people will not accept a requirement to cover costs related to deposit insurance guarantees, unless the legal obligation for doing so is clear and unequivocal." See full article [here](#).*

A collection of links from foreign media in light of the referendum results can be found [here](#).

### A Few Legal Issues

One of the legal issues regarding the Icesave dispute is the implementation of a bank-funded deposit insurance scheme, in line with the EEA Treaty. Some believe that it was not correctly implemented but others say it was correctly implemented according to relevant EU directives before the collapse of the Icelandic banks. To support view of correct implementation it has been pointed out that ESA did not, in all the years the Icelandic scheme was up and running, comment on its structure.

The EU prescribed deposit insurance scheme is without any explicit or implicit sovereign guarantee. Some believe that the demands of the Dutch and British authorities that Iceland guarantee repayment of funds that were dispensed by UK and NL public coffers to Icesave depositors resident in these countries, are therefore without legal merit in Icelandic or European law.

It must also be noted that under the emergency law of October 2008, the UK and the Netherlands will receive an estimated 94 percent of their outlays from the old Landsbanki estate, including the full amount of the EU-prescribed minimum deposit insurance and a substantial fraction of additional sums paid to depositors. That amount is considerably larger than if the emergency act would not have been put in place. See [here](#).

The reimbursement being claimed by the UK and Netherlands Governments amounts to 1.320 billion ISK. The failed Landsbanki's assets will cover the whole sum according to latest news; see [here](#) (only in Icelandic).



ESA's decision to take Iceland into court over its unwillingness to accept a state guarantee for Icesave customers in the UK and the Netherlands was greeted in Reykjavik with little surprise in mid-December 2011. See [here](#) and [here](#).

### Why No?

The outcome of the referendum can however only be interpreted to the effect that the Icelandic people will not accept a deal requiring Iceland to cover costs related to the Icesave deposit insurance guarantees, unless the legal obligation for doing so is clear. The Icelandic Government has sought to resolve the Icesave dispute all along in good faith and through negotiations with the British and the Dutch Governments.

*"With the so called Emergency Law, implemented in October 2008 as the three major Icelandic banks ran out of liquidity, claims of depositors were given priority to the assets of the banks. As a result of this all depositors in Icelandic banks in other countries, apart from those who had deposits in the Icesave accounts, got their money back. This also means that the claims of the UK and the Netherlands have first priority definition when it comes to the assets of Landsbanki and will get most, if not all of the money they paid to depositors in their respective countries repaid. The Icesave dispute is about what potentially will thus not be recouped and about interests."*

On April 11<sup>th</sup> 2011 the president of Iceland, Mr. Olafur Ragnar Grimsson, was in a phone interview with Bloomberg after the results of the Icesave referendum. In the interview he criticized Moody's and answered claims from UK's Chief Secretary to the Treasury, Danny Alexander. See [here](#). See the comments by Mr. Alexander [here](#).

Peter Osborne the chief political commentator of the Daily Telegraph's also criticized Mr. Alexander for bullying Iceland. See [here](#).

Dutch Finance minister Jan Kees de Jager said in an interview with the BBC that he would be consulting Britain about taking further steps against Iceland, but added that the matter would likely end up in court. See [here](#).

Professor Michael Hudson wrote an article in favor of an Icelandic "no vote". See [here](#). After the second referendum Professor Hudson wrote another article about why Iceland voted no.

### Exchange Rate Risk

Gamma is a Icelandic asset management company that published an detailed opinion statement about the risks involved in the Icesave deal. According to their estimate the cost of the Icesave deal could range from a few billion ISK to over 200 billion ISK. The estimate of the negotiation committee was around 32 billion ISK. The considerable risk is related to the fact that currency weakening could increase the debt considerably. See the opinion statement in Icelandic [here](#) (only available in Icelandic). It must be noted that this assessment was done before the value of old Landsbanki assets increase in late 2010 and early 2011. The estimate is therefore overly pessimistic.

Frosti Sigurjonsson, CEO of Dophop and a member of the Advice group:  
*"The risk of accepting the current Icesave agreement [which involves an exposure to currency market movements and bankruptcy recoveries] is much greater than taking this matter to court, which is our civil right."* See [here](#).

### Financial Times Support Iceland's Point of View

After the first Icesave vote, in January 2010, Martin Wolf the chief economics commentator of the Financial Times noted a few arguments for why Iceland should say no to the Icesave agreement. They are:

- There is no legal obligation for Iceland to meet undertake these payments.
- The British government decided to bail out British depositors of its own accord
- Iceland was pressed to participate in the bailout of British and Dutch depositors
- People who were not fully responsible should not pay
- The amount is a few billion pounds, an error term in UK's deficits and debt, not a big issue for the UK
- People in the UK are beginning to feel ashamed that their government has forced Iceland to accept such a burden
- The people of Iceland have been more effective than the government in making Iceland's case abroad
- Governments generally don't meet obligation they cannot afford
- Many countries have defaulted on their debts, the UK defaulted on its post-war debt through inflation

See here for the main points of the interview [here](#). See [here](#) and [here](#) for a video of the interview. See an article by Mr. Wolf [here](#).

**Figure 39** *Martin Wolf, Chief Economics Commentator of the Financial Times*



From Horasis Global China Business Meeting in 2007.  
Source: User Horasis on Flickr

An editorial in the Financial Times from December 2010 was also in favor of Icelandic "no vote":

*"The Netherlands and the UK will keep Iceland's taxpayers hostage until they recover their outlays in full. [...] This is a pity. It encourages the current fad for furnishing banks with unlimited sovereign guarantees. In this case the need for guarantees can barely be argued on legal grounds, and not at all on the grounds of fairness: the UK or Dutch governments would never honor foreign depositors' claims to a third of yearly national output should one of their big banks fail". See [here](#).*

An article from February 2011 in the Financial Times can be found [here](#). A collection of links to articles written in Iceland's favor can be found [here](#).

*"The tiny island nation shouldn't have to bear the costs of the Dutch and British bailouts."* Wall street journal, see [here](#).

Peter Örebech a professor at the University of Tromsø submitted an opinion statement on the Icesave act in January 2011. In his opinion statement he argues that the ESA's opinion, which Iceland now has to answer, is incorrect. See [here](#). More information about the arguments why Iceland rejected the agreement can be found [here](#).

## 13.7 What Will Follow?

### Icelandic Authorities Will Honor Their Legal Obligations

Since the December 2009 and the January 2011 Icesave Act's were repealed the dispute will go to the EFTA Court. The first step after the vote in that process was to answer a letter from ESA from May 2010. See [here](#).

ESA released on May 26<sup>th</sup> 2010 a formal notice which states the authority's opinion that under EU directive 94/19/EB the Icelandic government had an obligation to implement a system of deposit insurance in order to ensure that each bank depositor was guaranteed a minimum compensation of EUR 20.000. The main arguments of ESA in favor of this opinion are that the EU directive implies an obligation by Icelandic authorities to ensure that implementation of the directive guarantees that each depositor is compensated in accordance with the directive. For more information see [here](#) and [here](#).

**Figure 40** The logo of the ESA (click to go to the website)



On April 11<sup>th</sup> 2011, two days after the second Icesave referendum, ESA issued a press release stating that a final warning had been given and an answer is expected within two months. See [here](#).

On May 2<sup>nd</sup> 2011 the Icelandic authorities replied to ESA. In the response, Iceland maintains that it did not fail to comply with its obligations. The Government urges the Authority to conclude the matter without any further action. See [here](#) and [here](#).

On June 10<sup>th</sup> 2011 ESA sent the government a reasoned opinion on the Icesave dispute where the authority reiterates its contention that Iceland is responsible for ensuring that Icesave depositors in the Netherlands and the UK receive a minimum of EUR 20,887, in accordance with the Deposit Guarantee Directive. See [here](#). The Authority did therefore not accept the arguments of the Icelandic government, sent in a letter of May 2<sup>nd</sup> 2011. The Government was granted a three month period to comply with the opinion. (See [here](#)). The Government responded on September 30<sup>th</sup> 2011 where it strongly urged ESA to close the case. (See [here](#)).

ESA announced nonetheless on December 14<sup>th</sup> 2011 that it would refer the Icesave dispute before the EFTA Court (see [here](#) and [here](#)). On January 11<sup>th</sup> the Minister of Foreign Affairs announced that Tim Ward QC had been hired as lead counsel in the proceedings before the EFTA Court and on March 10<sup>th</sup> 2012 the Government lodged its statement of defense in the Icesave Case (see [here](#)).

It is expected that the process for the EFTA Court will take between 1 and 2 years.

ESA has also compiled a Q&A on the Icesave dispute and the issues that regard the EFTA Court. The Q&A can be found [here](#).

### UK and Netherlands Will Recoup Most of Their Funds

Regardless of the outcome of the election the UK and the NL will recoup most of their financial outlays due to Icesave. The President underlined that fact in a statement following the election result;

*"Although a majority of the electorate has in this referendum said 'no' with respect to the conclusions of the negotiations which took place last year, it is necessary to emphasize that the nature of the Icesave issue is such that the British and Dutch authorities and agencies will still, notwithstanding this result, receive immense sums from the estate of Landsbanki. In all likelihood, the amounts paid to them will come to the equivalent of USD 7-9 billion, the first payment taking place within a few months. It is therefore not correct to maintain that the United Kingdom and the Netherlands will not receive any payments. The Icesave dispute has centered on interest payments and the interpretation of the European Union's regulations." See full statement [here](#).*

### The Sale of Iceland Foods Could Eliminate the Remaining Debt

News reports just before the referendum suggested that the sale of the supermarket chain Iceland Foods in the UK, which is one of the larger assets of the resolution committee, could wipe out the remaining Icesave debt. The resolution committee of Landsbanki is trying to obtain GBP 1.2-2.0 bn. for Iceland Food.

If GBP 2 bn. is obtained for Iceland Foods, as speculated by The Financial Times, Landsbanki's debt to the Icesave depositors in the UK and the Netherlands could be paid up in its entirety and the Icelandic state wouldn't have to contribute a penny. See [here](#) and [here](#). Recent reports suggest that the amount could be around GBP 1.2 billion. See [here](#).

According to a statement by Iceland Foods the management of Iceland Foods Group Limited, led by Chief Executive Malcolm Walker, has completed the acquisition of Iceland from the liquidators of Landsbanki and Glitnir. See [here](#) and [here](#).

### Icesave Case Could Close if Landsbanki Covers Debt

A representative of ESA has said that if the assets of Landsbanki will cover the obligations to the Dutch and British authorities the Icesave dispute need not to go to court.

*"If the government can demonstrate that they will either pay the Icesave claim or negotiate with the British and Dutch governments we will not take the case before the EFTA Court," said Per Sanderud, the president of ESA in an interview with Icelandic media. The resolution and winding-up committees of the defunct Icelandic bank Landsbanki has estimated that 94 to 99 percent of priority claims will recovered. That estimate does not include an updated and more favorable valuation of the Iceland Food supermarket chain which may lead to an even higher recovery." See [here](#).*

The rules and procedure of the EFTA Court can be found [here](#). However, since ESA has already referred the dispute before the Court it is highly unlikely that the case will be closed even though the assets of old Landsbanki are likley to cover the Icesave obligations after the sale of Iceland Foods in the UK.

A fact sheets and key figures on the Icesave issue can be found in English [here](#) (pdf). An fact sheet on the Icesave issue can be found in English [here](#) (pdf).

## 13.8 Impact on Credit Ratings

On April 11<sup>th</sup> 2011, Fitch Ratings published a memo on the impact of the Icesave referendum result on the country's credit ratings. At this time the credit rating of Iceland remained unchanged.

On May 16<sup>th</sup> the 2011 Fitch revised Iceland credit rating from negative to stable. In the memo Fitch's Paul Rawkins, senior director in the Sovereign Rating Group, said that solving the Icesave issue was an important step towards the normalisation of relations with international creditors. *"However, the capacity of this dispute to close off access to multilateral and bilateral funding for Iceland's IMF financial rescue programme and put Iceland's economic recovery at risk has clearly diminished,"* Rawkins said. See [here](#) and [here](#).

Moody's stated in early February 2011 that the Credit rating of Iceland might be downgraded in the event of a "no vote" in the Icesave referendum. See [here](#).

However, Governor of the Central bank and Ministers from the Government was in contact with Moody's and other rating agencies after the referendum in an effort to

Figure 42 Iceland's sovereign debt credit rating by the main credit rating firms (August 9<sup>th</sup> 2011)

	<b>MOODY'S</b> INVESTORS SERVICE	<b>STANDARD</b> & <b>POOR'S</b>	<b>FitchRatings</b>
Investment Grade	Aaa, Aa1, Aa2, Aa3 A1, A2, A3 Baa1, Baa2, <b>Baa3</b>	AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, <b>BBB-</b>	AAA, AA+, AA, AA- A+, A, A-, BBB+, BBB, <b>BBB-</b>
Speculative Grade	Ba1, Ba2, Ba3 B1, B2, B3 Caa1, Caa2, Caa3 Ca C	BB+, BB, BB-, B+, B, B-, CCC+, CCC, CCC- CC C	BB+, BB, BB- B+, B, B- CCC+, CCC, CCC- CC C
Outlook	Negative	Stable	Stable

inform them on the impact of Icesave on the economic climate. On April 20<sup>th</sup> Moody's stated that the rejection of the Icesave agreement would have no immediate impact on ratings. See [here](#) and [here](#).

Following the results of the Icesave referendum Standard & Poor's placed Iceland on CreditWatch status. It was removed from the list about a month later. See [here](#), [here](#) and [here](#).

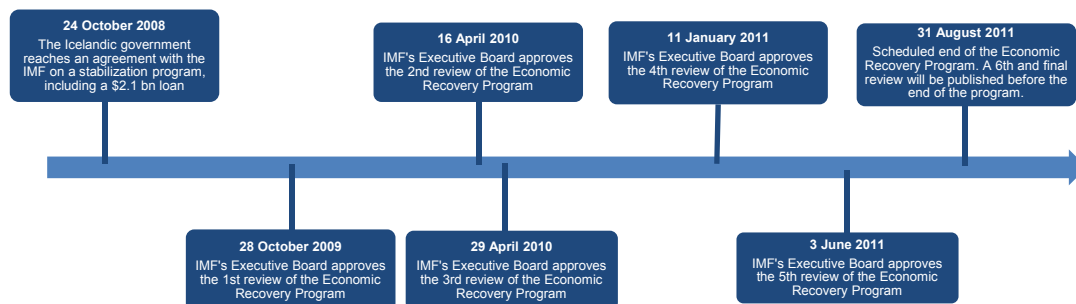
On February 20<sup>th</sup> 2012 Fitch Ratings agency issued a statement to say that it has upgraded Iceland's foreign currency IDR to BBB- with stable outlook. Standard & Poor's rating (currently BBB-) is unchanged but with stable outlook. Moody's is the only rating agency that still has negative outlook on the Government of Iceland. See [here](#), and [here](#).

## 14 The IMF Program

### 14.1 The 1<sup>st</sup> Review Approved in October 2009

On 28<sup>th</sup> of October 2009 the IMF's Executive Board approved the 1<sup>st</sup> review of the Economic Recovery Program, giving Iceland access to \$167.4 million from the IMF and also to \$675 million from the Nordic countries and Poland, see [here](#). The Governments statement regarding the approval and the Letter of Intent can be found [here](#). In connection with the 1<sup>st</sup> review of the IMF program a staff report was published. See [here](#).

Figure 41 A timeline of the IMF Iceland stabilization program





The 1<sup>st</sup> review of the Economic Recovery Program was delayed by several months because of the Parliamentary debate over the Icesave Act. As a part of the 1<sup>st</sup> review of the IMF program the first tranche of Nordic loans was disbursed to Iceland on December 21<sup>st</sup> 2009. The first tranche amounted to 300 million euro's. See [here](#). An overview of Iceland's Economic Recovery program supported by the IMF can be found [here](#).

Representatives from the IMF visited Iceland from December 1<sup>st</sup> and 14<sup>th</sup> 2009 to undertake discussions for the 2<sup>nd</sup> review under the IMF program. In a statement following the visit the IMF anticipated that by January all policy actions for the 2<sup>nd</sup> review would be in place provided that financing assurances could be secured from Iceland's Nordic counterparts. See [here](#).

Some uncertainty was on whether financing from the Nordic counterparts would be available until after the referendum on the first Icesave Act. Icelandic authorities have deliberated with their Nordic counterparts on the issue in an effort to resolve some of the uncertainty which had arisen. See [here](#).

## 14.2 The 2<sup>nd</sup> Review Approved in April 2010

On 16<sup>th</sup> of April 2010 the IMF's Executive Board approved the 2<sup>nd</sup> review of the Economic Recovery Program. Subsequently, USD 830 million in new funding from the IMF, the Nordic countries and Poland are available to strengthen the CBI's currency reserve. The IMF released USD 160 million, while Poland makes USD 73 million available under the agreement and the Nordic countries an additional USD 600 million. For more information about the second review of economic program by the board of the IMF see [here](#).

An IMF staff Report that was written leading up to the Second Review under the IMF program. See the full report [here](#).

## 14.3 The 3<sup>rd</sup> Review in September 2010

A mission from the International Monetary Fund (IMF), headed by Mark Flanagan, visited Reykjavik in June and July 2010 to hold discussions for the third review of the IMF program. See [here](#) and [here](#). On 29<sup>th</sup> of September 2010 the IMF's Executive Board approved the 3<sup>rd</sup> review of the Economic Recovery Program. See [here](#) and [here](#).

Leading up to the 3<sup>rd</sup> review a new letter of intent was sent to the IMF explaining the current status of the economy in regards to the program. See [here](#). The mission of the IMF also published a staff report following the 3<sup>rd</sup> review. See [here](#).

On October 4<sup>th</sup> 2010 a paper was also published by experts of the IMF on a few issues about overcoming constraints to growth, vulnerability of Iceland's external position and options on fiscal consolidations. See [here](#)

On October 5<sup>th</sup> 2010 Mark Flanagan, IMF former mission chief for Iceland, answered a few questions on the status in Iceland. In the interview he states that he expects a durable recovery to begin soon. He also answered some questions on Icesave, public debt and job creation in Iceland. See [here](#)

On November 4<sup>th</sup> 2010 Caroline Atkinson, Director of the External Relations Department, at the IMF answered a few questions on Iceland. See [here](#).

## 14.4 The 4<sup>th</sup> Review Concluded in January 2011

On January 11<sup>th</sup> 2011 the IMF approved the fourth review of the economic program with Iceland. See [here](#) and a staff report that was published following the approval [here](#). See [here](#) for a statement issued leading up to the 4<sup>th</sup> review.

## 14.5 The 5<sup>th</sup> Review Concluded in June 2011

In a preparation visit for the 5<sup>th</sup> review the IMF published a statement on February 11<sup>th</sup> 2011. See [here](#). The 5<sup>th</sup> review of the IMF program was expected in late April 2011 but was delayed due to the results of the Icesave referendum in early April. Another preparation visit by a IMF mission headed to Iceland in early May 2011. See their statement [here](#).

The 5<sup>th</sup> review of the stand-by was approved on June 3<sup>rd</sup> 2011. See [here](#), [here](#) and [here](#)

In a IMF report released in connection with the review said:

*"The economy is gradually recovering. Moderate growth is expected in 2011, but a key challenge is to bring down unemployment, which is still high. Program discussions focused on the authorities' revised strategy for lifting capital controls. The authorities and staff agreed that the lifting of controls should proceed gradually, as conditions permit."*

The Icelandic authorities issued a letter of intent leading up to the review which can be found [here](#). In relation with the 5<sup>th</sup> review, Julie Kozack, Mission Chief for Iceland, answered a few questions about the status and prospects for Iceland on June 6<sup>th</sup> 2011. See [here](#).

## 14.6 The 6<sup>th</sup> and Final Review Concluded in August 2011

On August 26<sup>th</sup> the Executive Board of the IMF completed the sixth and final review of Iceland's economic performance under program supported by a Stand-By Arrangement (SBA) making the country the first to complete such a program. The completion of this review enabled the immediate disbursement of an amount equivalent to SDR 280 million (ISK 51 billion). Total disbursement under the program amounts to SDR 1.400 million (ISK 200 billion).

Following the Executive Board's discussion, Ms. Nemat Shafik, Deputy Managing Director and Acting Chair, stated:

*"Iceland has successfully completed its Fund-supported program. Key objectives have been met: public finances are on a sustainable path, the exchange rate has stabilized, and the financial sector has been restructured. Strong policy implementation has underpinned this success".* See [here](#), [here](#), [here](#), and [here](#).

After the completion of the SBA with the IMF the Minister of Economic Affairs introduced, on November 10<sup>th</sup> 2011, a new Economic Program (See [here](#)). The Program is founded on measures in six priority areas:

- Investments will be incentivised through direct government measures and supporting the private sector.
- A sustainable fiscal policy will be ensured for the future, as well as economic stability.
- An increased emphasis on the integration of education with employment. Efforts will be made to tackle the negative effects of long-term unemployment.
- The debt restructuring of households and businesses in the wake of the collapse of the banks will be completed.
- Businesses and households shall have access to a competitive and strong financial system.
- A future monetary policy will be formed and capital controls will be eased in stages.

## 15 The Central Bank and Monetary Policy

The main policy rates of the Central bank of Iceland have been lowered by over 13 percentage points from January 2009 until late June 2011. After the last decision in June 2011 the main policy rates, on collateral loans and deposit rates, are at 4.25% and 3.25%. The next interest rate decision is scheduled on 17<sup>th</sup> of August 2011.

### 15.1 Monetary Policy From Late 2008 until November 2010

In the sub-chapters below is a more detailed description of monetary policy of the Central bank following the collapse of the banking sector by period.

**Figure 43** *The Central Bank of Iceland's coat of arms*



Image source: cb.is

#### Early 2009 Until Early January 2010

Inflation did not come down as fast as expected in early 2009 due in part by the weakness of the exchange rate. Inflation was 18.6% at the beginning of 2009 but down to 7.5% by the end of the year. The MPC of the Central Bank kept the collateral loan and deposit rates constant, at 12% and 9.5%, from June until November 2009. The MPC lowered both the deposit and loan rates on two occasions in the fall of 2009 and early winter, first in November to 11% and 9% and then in December to 10% and 8.5%. For more information on the November and December decision's see [here](#) and [here](#).

Some uncertainty regarding further monetary easing arose after the President declined to sign the Icesave Act and put the Act under a national referendum. However, the governor of the CBI, Mr. Mar Gudmundsson, stated in an interview on Bloomberg that there is still room for monetary easing despite the uncertainty following the decision. See [here](#) See also [Chapter 13](#) on the Icesave dispute. The rate has been lowered repeatedly since then. See below.

#### Progress From January 2010 Until February 2012

In 2010 the exchange rate strengthened by 11.5% and inflation rose by 2.5% on yearly basis. The inflation was within the target, 2.5% +/- 1.5%, in December 2010 until March 2011. The main policy rate of the CBI went from 10% in January 2010 to 4.5% in January 2011. In February 2011 the CBI lowered the policy rate to 4.25% and kept it at that rate until mid-August 2011 when it raised it back to 4.5% due to increase in inflation that had reached 5% in July 2011. Despite low inflation at the first quarter of 2011 the average inflation was above the upper bound of the CBI inflation target in 2011. The rise in inflation may be due to weakening in the exchange rate which fell by 4.8% from December 2010 until December 2011.

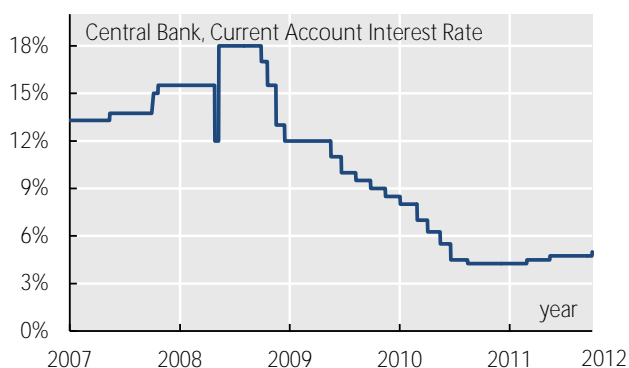
*"According to the updated Central Bank forecast, published in Monetary Bulletin today [08.02.12], Iceland's economic recovery continues despite weakening global growth and elevated uncertainty. The outlook for the real economy is broadly unchanged from the November forecast. Short-term inflation developments are also in line with expectations, although inflation is now projected to subside at a slightly slower pace over the course of 2012. Assuming a broadly unchanged exchange rate, inflation is forecast to remain above the Bank's inflation target for somewhat longer than was projected in November". See [here](#).*

The first two months of 2012 inflation was 6.5% and 6.3% respectively. The MPC decided not to raise the policy rate in February, however due to increase in inflation the policy rate was increased by 0.25 percentage points on their last meeting, the 21<sup>st</sup> of March 2012. As of now, the policy rate in Iceland is 5.0% and the Governor of the CBI, said further increase might be needed. Next meeting of the MPC is on 16<sup>th</sup> of May 2012.

#### Tobin tax as a solution to inflation

Dr. Zoega, professor at the University of Iceland and a member at the MPC, recently wrote an article where he brings up the idea of Tobin taxation for the Icelandic economy. He mentioned that the correlation of inflation and change in the exchange rate is around 0,9. He also mentions that by the use of Tobin taxation speculation on the exchange rate could be eliminated. As an example he shows that if Iceland were to impose 1% Tobin tax on every transaction made a speculator that would buy ISK at the beginning of the week and sell at the end would have to pay 2% which equals 180% on yearly basis. See [here](#).

Figure 44 Central Bank of Iceland's Interest Rates ([data](#))



## 15.2 Review of the Monetary Policy Framework

A review of the monetary policy framework is underway within the CBI. The review is written to outline the options available to Iceland going forward. CBI's governor has spoken about the review, first at a conference held by the Iceland Chamber of Commerce in October 2009 and then again in a speech at the annual meeting of the CBI in February 2010. He has outlined that in principal there are two main options, first, some type of a currency union and second what he has nicknamed, "inflation target plus" which would include considerable macro prudential measures to accompany the inflation target. For more information see [here](#) and [here](#).

#### Monetary Policy After Capital Controls

On December 21<sup>st</sup> 2010 the Central bank of Iceland published a report on domestic monetary policy and submitted it to the Minister of Economic Affairs. The report, "*Monetary Policy after Capital Controls*", summarizes the main viewpoints concerning Iceland's future exchange rate and monetary policy regime. See [here](#). A more comprehensive report is expected in the winter of 2011 and 2012.

On March 21<sup>st</sup> 2011, Mar Gudmundsson, the governor of the Central bank gave a speech on the lessons from the Icelandic financial crisis. See [here](#).

## 15.3 Other Matters Relating to the Central Bank

#### Report on the Financial Stability in Iceland

The Central Bank of Iceland publishes a two reports a year called *Financial stability*. See [here](#).

#### Annual Meetings

The 2010 Annual Meeting of the CBI was held in February. A speech by CBI's Governor Mr. Már Gudmundsson at the Annual Meeting can be found [here](#). Address by the

Chairman of the Supervisory Board at the Annual Meeting 2010 can be found [here](#). The annual report can be found [here](#).

The 2011 annual meeting of the CBI was held on April 7<sup>th</sup> 2011 celebrating the 50 year anniversary of the bank. The annual report can be found [here](#) and other documents from the meeting can be found [here](#), [here](#) and [here](#). In 2012 the CBI's Annual Meeting was held on March 30<sup>th</sup>. The speech of the Minister of Economic Affairs is [here](#) and the Governor's speech is [here](#).

#### **The MPC's Reports to Parliament**

The amended Act from 2009 on the Central Bank of Iceland stipulates that the Bank's Monetary Policy Committee shall submit a report on its activities to Parliament twice a year and report discussed in official governmental committees. Four reports have been published in December 2009, September and December 2010 and July 2011. They can be found [here](#).

#### **Bilateral Currency Swap Agreement With China**

On June 9<sup>th</sup> 2010 the People's Bank of China and the Central Bank of Iceland signed a bilateral currency swap agreement. The amount of the agreement is 3.5billion CNY/66billion ISK. The agreement has 3 year maturity and can be extended after both parties agree. See [here](#).

#### **Multinational Agreement on Financial Stability**

On August 17<sup>th</sup> 2010 a co-operation agreement was signed on cross-border financial stability, crisis management and resolution between the finance ministries and other relevant ministries, central banks and financial supervisory authorities of Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden. The agreement enhances preparedness to handle cross-border financial stability concerns in the financially integrated Nordic-Baltic region. It also establishes the first European cross-border stability group. For more information see [here](#).

## **16 The Capital Restrictions and Foreign Exchange Markets**

After the banking collapse capital control were introduced in the fall of 2008. On 5<sup>th</sup> of August 2009 the Central bank introduced a Capital Account Liberalization Strategy. The first step of the strategy was implemented on 1<sup>st</sup> of November 2009 allowing for foreign direct investments into Iceland. No specific timeline was set for further liberalization in the original plan. See more information on the Liberalization strategy here and on the first step of the liberalization here. A second plan was introduced in March 2011, see chapter 16.2. A new plan on capital controls was introduced in November 2011 called the Investment Program, see chapter 16.3.

On March 13<sup>th</sup> 2012 the Parliament approved changes to the law of foreign currency due to cracks in the capital restrictions. These cracks allowed investors to use the bonds amortization to buy more of these bonds but one a different exchange rate resulting in arbitrage opportunity for the investors. See [here](#), [here](#) and [here](#). These changes add to changes made in 2009 where rules were tightened to hinder parties being able to exchange ISK abroad and import them at a favorable exchange rate, surveillance on



the exchange rules was tightened, the surveillance unit was reorganized and the CBI's information gathering was improved.

In an announcement from the Government in relation to the new law it stated that substantial and rising circumvention of the capital controls reduces the CBI's ability to carry out the liberalization strategy thus prolonging the existence of the controls. It was also announced that with a more stable regime in place some amendments towards easing the controls would soon be proposed.

Those amendments were set forth on March 30<sup>th</sup> in a legislative bill which is e.g. intended to expand re-investment warrants, FX trade in relations to business and abilities to acquire loans from foreign financial institutions. In addition the CBI is granted permission to formulate rules on exemptions. Also, the surveillance unit of the CBI will be strengthened as well as the CBI's abilities to obtain information. Finally fines in relations to breach will be increased. The maximum fine for individuals will go from 20 million ISK to 65 million and for companies from 75 million ISK to 250 million. Fines can also be applied in cases where companies breach the terms of exemptions given by the CBI (see [here](#), only in Icelandic).

## 16.1 Developments From October 2010 Until March 2011

On October 19<sup>th</sup> 2010 the Governor of the CBI said that the exchange rate stabilized in the second half of 2009 with no supporting intervention since early November 2009. In 2010 the exchange rate has appreciated by 13% in trade-weighted terms, again without any supporting intervention. This has alleviated pressures on impaired private sector balance sheets and contributed to relatively speedy disinflation. In the speech the governor also spoke about the three main prerequisites for taking the next steps in lifting capital controls. The speech is named "*The Icelandic economy two years after the crash*", see [here](#). See also a speech by the Deputy Governor of the Central bank from October 7<sup>th</sup> 2010 where he goes over the reasons behind the controls and the prospects for lifting them in the near future. See [here](#).

On November 3<sup>rd</sup> 2010 the CBI issued a statement on the Capital controls. In the statement the main issues regarding the capital controls are summarized. See [here](#).

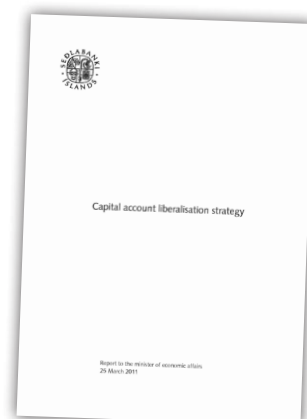
On December 14<sup>th</sup> 2011 the EFTA Court ruled that the capital restrictions are in accordance with the EEA Agreement (see [here](#)).

## 16.2 Liberalization Plan Introduced in March 2011

A special steering group, comprised of the Minister of Economic Affairs, the Minister of Finance, the Governor of the CBI and the Director General of the Financial Supervisory Authority, has recently lead the formulation of a program on lifting capital controls. The steering group has collaborated closely with specialists in relevant ministries and institutions. On March 25<sup>th</sup> 2011 a report was introduced that contains a new strategy for liberalization of capital controls.

The core of the strategy is that offshore ISK will be gradually released before onshore ISK. In particular, authorisations to invest offshore krónur in the domestic economy will be expanded substantially, concurrent with measures to facilitate transactions between owners of offshore ISK wishing to sell and parties wishing to buy them for foreign currency that they own or can obtain. Emphasis is placed on executing the strategy in moderate steps that allow for adaptation in view of experience. The

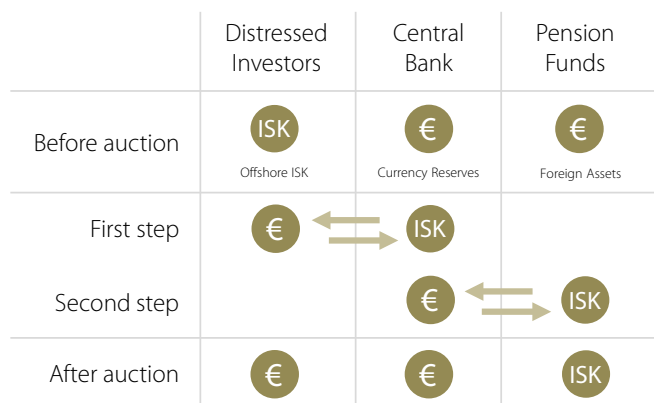
**Figure 45** *The liberalization plan report, click to view (only in Icelandic)*



first phase will focus on steps that will not place strain on the foreign exchange reserves; i.e., auctions whose aim is to direct unstable ISK holdings into the hands of long-term investors. See [here](#). The three main phases of the plan are:

- **Phase I** – reduction of offshore ISK position
- **Phase II** – removal of controls on onshore ISK

**Figure 47** *The architecture of the Phase I auctions*



**Phase I Underway**

Since the plan was introduced, the CBI has started reducing the offshore ISK position by conducting two auctions. The auctions are two tiered: in the first tier, the CBI sells Euros to so-called “distressed investors” of offshore ISK. In the second tier, the CBI sells these ISK to Icelandic pension funds and gets Euros instead.

Participation and prices in these auctions are sign of some optimism for those who want to lift the capital controls: these “distressed owners” have not offered too many offshore ISK for each Euro, indicating that they do not deem the Icelandic currency worthless. Additionally, their bids for Euros have not

vastly exceeded the offered amount by the CBI, which indicates that the amount of distressed capital will not cause large problems once the restrictions are lifted.

The liberalization plan aims at completely lifting the capital controls before the end of 2014. The Central Bank aims to lift the controls a couple of years before that time, and aforementioned developments indicate that this could indeed be possible. These is, however, still significant uncertainty regarding the duration of the controls.

**16.3 Investment Programme Introduced in November 2011**

The core of this plan is that owners of offshore ISK can sell them at auctions held by the CBI conditional on buying the same amount of ISK in long term treasury bonds. For more information see [here](#), [here](#) and [here](#) (only in Icelandic). [Here](#) is the CBI’s auction calendar and [here](#) is the first auction results. See also [here](#).

**16.4 Additional information**

Up to date information on rules and guidelines surrounding foreign exchange, capital controls and the liberalization strategy can be found [here](#) and in Appendix 3. Information on the CBI exchange rate can be found [here](#) and the off-shore exchange rate can be found here. CBI auction calendar can be found [here](#). Report on the capital restriction by Iceland Chamber of Commerce can be found [here](#) (only in Icelandic).

**Figure 46** *The logo of Iceland’s application to the EU, from the Iceland Ministry of foreign Affairs. An associated informational website can be accessed by clicking the logo.*

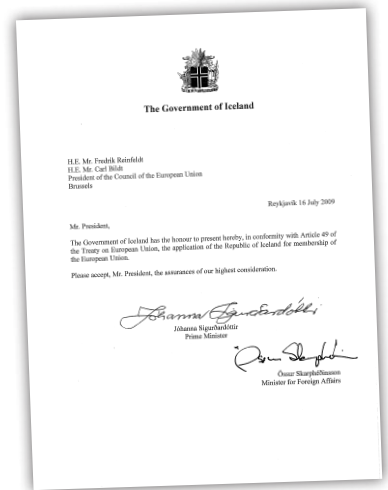


## 17 The European Union: Application in Process

The Icelandic Parliament voted on 16<sup>th</sup> of July 2009 in favor of applying for membership to the European Union (EU). Proposals from the Parliament's Foreign Affairs Committee regarding the application can be found [here](#). General information and updates on the application process can be found [here](#).

Iceland's application was submitted to the Swedish Government, which held the EU presidency at the time, on 17<sup>th</sup> July and on July 27<sup>th</sup> 2009 the Foreign Ministers of the EU invited the Commission to formulate an opinion on Iceland's application, see [here](#). A copy of the application can be found [here](#). The Commission questionnaire was formally presented to the Icelandic Prime Minister Ms. Johanna Sigurdardóttir by Mr. Olli Rehn, the European Commissioner for Enlargement on 8<sup>th</sup> of September and the answers were submitted on 22<sup>th</sup> of October 2009. See the questionnaire and the answers [here](#).

Figure 48 Iceland's application to the EU



### 17.1 Chief Negotiator Appointed in November 2009

The Minister for Foreign Affairs, Mr. Ossur Skarphedinsson, appointed Ambassador Mr. Stefan Haukur Johannesson on November 2<sup>nd</sup> to serve as Iceland's Chief negotiator in the upcoming accession negotiations with the European Union. Mr. Johannesson is an experienced international negotiator which has served as Iceland's Ambassador to the European Union in Brussels since 2005. See [here](#).

More information on Mr. Johannesson and other members of the negotiation committee can be found [here](#).

### 17.2 European Commission Delegation Establishment

In November 2009 an agreement was signed on the establishment of a European Commission Delegation in Iceland. Information regarding new developments concerning Iceland can be found in the press corner of the European Commission Enlargement webpage. See [here](#) and [here](#).

### 17.3 Changes From January Until May 2010

In January 2010 the Foreign Minister of Iceland met with Mr. Miguel Ángel Moratinos, during the Spanish Presidency of the European Union, regarding the impact of the Icesave debate on Iceland's application. Mr. Moratinos stated that the Spanish EU Presidency viewed the Icesave issue and Iceland's EU application as separate issues, and that the new situation that has arisen in Iceland would not have any impact on EU's treatment of the application.

Figure 49 Johanna Sigurdardóttir, Prime Minister of Iceland, meets with Jose Manuel Barroso, President of the European Commission



Image source: AFP

**Figure 50** *The first Pre-Accession Economic Programme*  
(click to view)



The Prime Minister of Iceland met with Mr. José Manuel Barroso, President of the European Commission and Mr. Olli Rehn, Commissioner for Enlargement and Commissioner Designate for Economic and Monetary Affairs in early February. At the meeting the Prime Minister gave a detailed account of the state of affairs in Iceland. For more information see [here](#).

On 24<sup>th</sup> of February 2010, the European Commissioner for Enlargement and European Neighborhood Policy recommended to the Council of the European Union to start accession negotiations with Iceland. See [here](#).

See also [here](#) for the key findings of the commission's opinion on Iceland.

While it was expected that Iceland would be considered for official candidate status at the EU summit in March, this was delayed to allow the German national parliament, which has the authority to debate important EU policy such as enlargement before action is taken by the government, to consider the matter. For more information on the Accession of Iceland to the European Union see [here](#). The German parliament voted in favor of Iceland's application on April 22<sup>nd</sup> 2011.

## 17.4 Progress From June Until January 2012

### Candidate Status Achieved

The European Council decided on June 17<sup>th</sup> 2010 to open negotiations with Iceland and Iceland was therefore given candidate status in the EU. See [here](#).

On July 27<sup>th</sup> 2010 Iceland's accession negotiations with the European Union were formally opened at the first intergovernmental conference in Brussels. Icelandic Minister for Foreign Affairs, Ossur Skarphedinsson, participated on Iceland's behalf in the conference, hosted by the Belgian Presidency of the EU. See [here](#). See an interview with Iceland's chief negotiator [here](#).

### Progress Report and Screening Meetings

The European Commission issued a Progress Report on Iceland in early winter of 2010. The report assesses economic and political development in Iceland from February to October 2010, and recapitulates the issues that need to be addressed in the upcoming accession talks. The Progress Report's key findings are that Iceland meets all political and economic criteria for EU membership. See [here](#).

The European Union law is divided in 33 chapters, in addition to two chapters on Institutions and Other issues. Before formal negotiations on individual chapters begin, an analytical overview of the national legislation of the applicant state is performed, to evaluate its degree of harmonization with EU law and what needs to be negotiated upon. The comparison is referred to as screening meetings.

On November 15<sup>th</sup> 2010 the first screening meeting between Iceland and the EU over was concluded in Brussels. See [here](#). Several other screening meeting have been held in November and December 2010. See [here](#). A timetable for the screening meetings can be found [here](#).

The Ministry for Economic Affairs handed in its first Pre-Accession Economic Program to the EU Commission in January 2011. The report sets out Iceland's main economic priorities until 2013. See [here](#).

The second Pre-Accession Economic Program was handed in to the EU Commission in January 2012. The report sets out Iceland's main economic priorities until 2014. See [here](#). The economic policy presented is based on Iceland's Economic Programme, introduced by the Government in November 2011. The economic vision presented in this governmental Economic Programme is designed to lay the foundations for clearer and more coordinated economic policy-making in the wake of this economic shock. See the full Economic Programme [here](#).

The Icelandic authorities and the International Monetary Fund (IMF) cohosted a high-level conference in Reykjavik, on October 27, 2011, to review Iceland's achievements and examine the challenges that still lie ahead. See [here](#). A video on Iceland's recovery can be found [here](#).

### Formal Negotiations Begin

The screen process ended and formal negotiations began on 27 June 2011. Four chapters of the EU law were opened for negotiations. The screening meetings have shown that Iceland already implements, in part or in whole, EU legislation in 21 of the 33 chapters through its membership of the European Economic Area (EEA). The exact duration of the negotiations is uncertain, but they are expected to be completed sometime in 2012. One reason for that is that general elections are to be held in the first half of 2013, with parties opposed to the EU gaining support according to polls. The current government will thus likely emphasize finishing the negotiations before that time. Once the negotiations are complete, the government has stated that it will hold a national referendum about whether to accept the agreement and join the EU or not.

### Further Information on Iceland's Application for EU Membership

The Ministry of Foreign affairs has dedicated a section on their website to Iceland's EU application process where up to date information and a timeline of events can be found. See [here](#) and a list of key documents can be found [here](#) and latest news [here](#).

Iceland's historic relations with the EU can be found [here](#).

Information on the Enlargement Strategy and Main Challenges of the EU for 2009-2010 can be found [here](#). Iceland's country profile at the European Commission can be found [here](#).

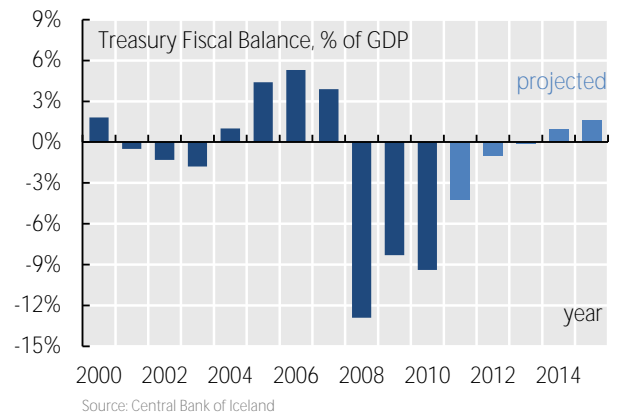
## 18 The State Treasury

### Overview of the Fiscal Consolidation Plan

The fiscal consolidation plan by the government is one of the cornerstones of the IMF economic program. The 2011 National Budget is an important step in that consolidation, as it enables the Government to achieve a surplus on the primary balance in 2011, the first important goal in the plan. The second goal is to achieve a sizeable overall surplus by 2013.

On the basis of the plan, consolidation measures were adopted in the latter half of 2009, in response to a deteriorating outlook for Government operations. Thereafter, it

Figure 51 Fiscal Balance of the Icelandic Treasury (data)





was decided to take radical steps on both revenues and expenditures sides of the 2010 Budget. See discussion below.

The original consolidation plan, introduced in the summer of 2009, envisaged an improvement in the primary balance that would total over 16% of GDP during the period covered by the plan; that is, 2009 –2013. Obviously, such planning concerning future developments in public finances entails considerable uncertainty and must undergo regular review in light of circumstances, so as to reassess the need for policy action.

Current plans aim for a 12% improvement in the primary balance during the period under consideration. The main reason for this easing of the consolidation path is that economic developments in 2009 were more positive than initial previous forecasts had indicated. In the Ministry of Finance's macroeconomic forecast from May 2009, for example, it was estimated that GDP would contract by 10.6% in 2009, while figures from Statistics Iceland suggest that the contraction was in fact 6.8%. The need for consolidation is less acute primarily because economic developments are more favorable and public debt lower than original forecasts indicated. More information can be found [here](#).

## 18.1 Fiscal Deficit in Line With Expectations In 2010

On July 18<sup>th</sup> 2010 the Government accounts were published for 2009. The fiscal deficit in 2009 was 139 billion ISK or 9.3% of GDP which considerably lower than the originally estimated deficit of 10.4%. See [here](#) (only in Icelandic). According to the Budget proposal for 2010 the deficit was expected to be 6.1% and the outcome was similar or a 6.2% deficit. See [here](#) and [here](#).

The latest Treasury finances and Budget Highlights for 2010 from the Ministry of Finance can be found [here](#) and [here](#).

## 18.2 Treasury finance: January - November 2011

The 10<sup>th</sup> of January 2012 the Ministry of Finance published the Treasury finance for January - November 2011, see [here](#). According to the fiscal budget for 2011 the overall fiscal deficit was projected to be ISK 37 billion. The deficit proved to be ISK 72 billion or 4,4% GDP in 2011. Cash from operational activities was negative by ISK 70,2 billion compared to ISK 72,7 billion in 2010. Revenues shrank by ISK 12,4 billion while expenses stayed the same. See [here](#) (only in Icelandic).

## 18.3 Fiscal Budget for 2012

In the budget for 2012, it is projected that the overall fiscal deficit will be ISK 20,7 billion or 1,3% of forecasted GDP and that the primary balance will be positive by roughly ISK 36 billion. The medium-term fiscal plan entails that the overall balance will be slightly negative in 2013 and positive in 2014 and 2015. See [here](#) for Moody's discussion on the 2012 budget plan.

### Overview of the Fiscal Budgets from 2008 – 2012

In 2008 the deficit was ISK 192 billion with the recapitalization of the Central Bank. See [here](#) and [here](#) for the data. Further information on the 2012 fiscal budget can be found [here](#). There is also a discussion on the fiscal budget in the November Monetary Bulletin. See [here](#) and [here](#) for the April 2011 Monetary Bulletin.

For more information on the fiscal budget, see [here](#).

## 18.4 Medium-Term Fiscal Plan – Through 2014

The medium-term plan envisages a considerable increase in revenues for the years 2012–2014, in which GDP growth will play a significant role. It is expected that the overall balance will be positive by 0.4% in 2012 and around 2.5% for both 2013 and 2014. It is also projected that, during the period, the Treasury's primary revenues as a share of GDP will rise by 3.3% over and above the estimate in the budget bill for 2011. It is estimated that primary expenditures will contract by 0.9% of GDP over the period 2011–2014. This is due primarily to a projected 40% reduction in unemployment-related expenses during the period, as well as the firm resolve that other expenditures will be tightly controlled. See [here](#) and [here](#).

As of August 2011, preliminary estimates indicate a slightly negative fiscal balance in 2012. Further information will be available in early October when the budget bill for 2012 will be released. See [here](#) (only in Icelandic).

On October 4<sup>th</sup> 2010 a paper was published by experts of the IMF on, among other issues, options on fiscal consolidations. See [here](#). A medium term debt management strategy for 2011-2014 was released in February 2011. See [here](#).

## 18.5 Foreign Bonds Issued

On June 9<sup>th</sup> 2011 Iceland issued a USD 1 billion worth of bonds due in 2016. This is the first issue in foreign currency by the treasury after the banking collapse in 2008. The transaction was well received by global investors and the book was two times oversubscribed. The bond is fixed rate issue with a 4.993% semi-annual yield, which reflects 3.20% premium over mid-swaps.

Steingrímur Sigfússon, Iceland's finance minister, said the issue was *"an important milestone for Iceland. We are encouraged to see the breadth and depth of investor interest,"* See [here](#), [here](#), [here](#), [here](#) and [here](#).

## 18.6 An Example of a Few Policy Actions

The Government has put forward a series of policy actions initiative in response to the crisis. Some highlights of policy initiatives are listed below:

- Personal income tax rates were increased by 1.25% and a temporary 8% surcharge was introduced on high incomes at the beginning of 2009. The system was re-organized for 2010 and was replaced by a new three bracket progressive tax system that was put in place in the beginning of 2010.
- In the budget for 2010 and 2011 some measure were taken to reduce expenditure of the government leading to a layoff of around est. 1.000 public employees.
- Various benefits were decreased, such as maternity/paternity leave benefits, and income thresholds for others were lowered. Public investments will be reduced and further decreases in benefits, such as child support benefits, have been introduced.
- Social security contribution, paid by Icelandic companies, was increased to a level that is expected to balance the unemployment fund's accounts.
- Both the capital tax and corporate income tax were raised from 10% and 15% first to 18% and in 2011 to 20%.
- A few other actions include: e.g. new energy, environmental and resource taxes increased capital and income taxes, as well as changes to commodity taxes and an expansion of the VAT base and reclassification of VAT levels.

- Various initiatives to guarantee partial payment relief for households have been adopted
- Major debt restructuring is ongoing for individuals and firms. Freezing of housing auctions has also been in place for several months.

An article written by the Prime Minister, at the end of 2009, stating some fiscal policy initiatives can be found [here](#).

## 19 The Labour Market

**Figure 52** *Unemployment in Iceland rose dramatically as a result of the financial crisis ([data](#))*



Near the end of June 2009 the Government, both central and local, and the Confederation of Employers and the Confederation of Employees signed an agreement, The Stability Pact. The Pact's aim is to secure broad social consensus for adjustment measures necessary to ensure economic recovery. Its aim is also to "create conditions for increased investment by both domestic and foreign parties, stronger growth, boosting employment and laying the foundation for improved living standards in the future."

The objective of the agreement was to deter a rise in inflation due to the interdependence of wage increases and inflation, i.e. hindering that a rise in wages due to collective wage agreements would lead to a rise in inflation. Additionally, the agreement

was signed in an effort to secure stability in the labor market and create a foundation for further growth.

The Pact stipulated e.g. that collective wage agreements shall remain valid until the end of November 2010; that the balance in the national budget were to be attained with a suitable mix of cuts in expenditure and higher taxes; that the Government would pave the way for major investment projects and seek co-operation with Icelandic pension funds to finance infrastructure projects. It also stipulated some monetary and economic conditions. See [here](#) and [here](#).

### 19.1 The Stability Pact

In the Stability Pact certain economic and monetary objectives needed to be met before November 1<sup>st</sup> 2009. Since it was foreseen that some conditions, e.g. monetary condition, would not be met the Government and the Confederation of Employers and the Confederation of Employees signed an extension to the agreement on 28<sup>th</sup> October 2009 that secured that the Pact would be in force until the end of November 2010. In the agreement modest wage increases were implemented from November 1<sup>st</sup> 2009 but a considerable part of previously agreed wage increases were postponed until 1<sup>st</sup> July 2010.

Further information on the renewed Stability Pact can be found [here](#) and [here](#) (both sites in Icelandic).

## 19.2 New Collective Wage Agreement in May 2011

After months of discussions collective wage agreements were signed on May 5<sup>th</sup> 2011. The agreement will raise salaries from June 1<sup>st</sup> 2011 by 4.25% and an additional lump sum of ISK 50,000 (USD 441, EUR 304) was also paid out. Further increases will be awarded in February of 2012 and 2013 by the amount of 3.5% and 3.25%. The agreement is in effect until 2013 and will raise wages of around 100 thousand individuals. The remaining groups in the labor force followed (e.g. public employees and other smaller labor groups) and signed agreements similar to the agreement from early May. An example of a collective agreement can be found [here](#).

In the agreements there are several provision regarding macroeconomic developments as well as public investment projects and changes to the tax system, in part to compensate employers for the increased wage costs. In a statement following the signature of the agreement the minister of finance welcomed the conclusions of wage negotiations. The declaration outlines the Government's program of work and priorities on a policy level as regarding fiscal consolidation as well as on economic and monetary matters. It also specifies numerous specific measures which aim to promote investment and growth. See [here](#).

More detailed information about the role of the government and the economic provisions can be found in a statement by the Government [here](#) (only in Icelandic).

Information on collective wage agreements in Iceland in general can be found [here](#).

## 20 Investigation Commission Report on the Collapse

A Special Investigation Commission (SIC) of the Parliament was formed to investigate whether any public officials were responsible of misconduct. The report was published in April 2010 and is around 3.000 pages long. Following the release of the Special Investigation Commission report in April 2010 three congressmen, one of which a former minister took a leave of absence from the parliament and one has resigned. See also a list of weaknesses listed in the report in [Chapter 9](#). See also [here](#) and [here](#).

The Icelandic government welcomed the report published by the SIC of the Parliament on the causes of the collapse of the Icelandic banking system. Consisting of independent experts, the Investigative Commission was established by the Icelandic parliament in December 2008. The report is the first comprehensive analysis of the causes of the collapse of the three largest Icelandic banks in the midst of the global financial crisis of October 2008.

### 20.1 Main Findings

According to the report the main cause of the failure of the banks was the rapid growth of the banks and their size at the time of the collapse. The big three banks grew 20-fold in size in seven years.

**Figure 53** *The Special Investigation Commission report*



Source: Wikipedia (Icelandic), user BIT and Birna Guðmundsdóttir

The report also finds that Iceland's government, former CBI Governors and the head of the FSA in 2008 all showed negligence in breach of existing laws that allowed the collapse of Iceland's financial industry. Former Prime Minister Mr. Geir H. Haarde, former Finance Minister Mr. Árni M. Mathiesen, Mr. Jónas Fr. Jónsson, the former head of the FSA and Mr. David Oddsson, the former Governor of the CBI, all acted negligently according to the Committee.

In September 2010, Mr. Haarde, became the first Icelandic minister to be indicted for misconduct in office, and is standing trial before the Landsdómur, a special court for such cases. See [here](#) and [here](#).

Several criminal and white collar investigations are under way both in regular channels as well as the special prosecutor which was especially established following the collapse. The Special Prosecutor will investigate suspicions of criminal actions in the period preceding, in connection with or in the wake of the collapse of the Icelandic banks, whether this is connected to activities of financial undertakings, other legal entities or individuals, and as the case may be, follow up on these investigations by bringing charges in court against those concerned. More information can be found [here](#).

The government issued a press release following the release of the report welcoming the report. *"This important report will enable us to look forward by understanding what took place here in the months and years leading up to the banking collapse"* said Prime Minister Johanna Sigurdardottir. The press release can be found [here](#).

News articles on the report can be found in the archive of the Iceland review website, see [here](#).

*Note: Most articles relating to the report are dated on April 12<sup>th</sup> 2010, the day of the release, or in the couple of weeks following the release.*

A presentation in English from the press conference following the release of the report can be found [here](#). The report can be found on the following site: [sic.althingi.is](http://sic.althingi.is)

A good overview of ongoing investigations and what measures have been taken can be found in [here](#). The overview lists the number of cases from the Special Prosecutor and as well as general information on the work by the SIC.

## 20.2 The revision report on the Icelandic pension funds

The State Mediator Mr. Magnus Petursson appointed a committee by the request of the Icelandic Pension Funds Association to investigate the investment policy, the decision making and the legal framework of the Icelandic pension funds during the period leading up to the Icelandic economic collapse in October 2008. A summary and the main findings of the committee's report can be found [here](#). The whole report can be found [here](#) (only in Icelandic).

## 21 Constituent Assembly and National Gathering

After the collapse of the banking sector there was a large outcry for a revision of the constitution. On June 16<sup>th</sup> 2010 Althingi passed a new law, The Act on a Constitutional Assembly in which a consultative Constitutional Assembly is summoned for the purpose of reviewing the Constitution of the Republic from June 1944. See [here](#).



## 21.1 National gathering

The Act on a Constitutional Assembly passed by Althingi on June 16<sup>th</sup> 2010 stated that a National Gathering of approximately one thousand people should be held in good time before elections to the Constitutional Assembly. Those thousand people should be selected by means of random sampling from the National Population Register, with due regard to a reasonable distribution of participants across the country and an equal division between genders, to the extent possible.

The purpose of the National Gathering shall be to endeavor to; call for the principal viewpoints and points of emphasis of the public concerning the organization of the country's government and its constitution; the Constitutional Committee shall process the information collected at the National Gathering and deliver to the Constitutional Assembly when it convenes. See [here](#).

Around thousand participants attended the national gathering; the oldest participant of the meeting is 89 years old and the youngest 18.

The results were divided into eight separate themes:

1. Justice, wellbeing and equality, morality
2. Human rights
3. The nature of Iceland- conservation and utilization
4. Democracy
5. Peace and international cooperation
6. Country and nation
7. Morality
8. Division of power, responsibility and transparency

For more information see [here](#) and [here](#).

## 21.2 Constituent Assembly

To select candidates for the Constitutional Assembly an election was held on November 27<sup>th</sup> 2010. Over 500 candidates were in the election. The Assembly was to be composed of a minimum of 25 and a maximum of 31 delegates and elected by direct personal election. The turnout in the election was rather poor, around 37%. The main purpose of the Assembly is to prepare a proposal for a revised Constitution of the Republic.

For more information, see [here](#), [here](#), [here](#), [here](#) and [here](#). The results of the election can be found [here](#).

### Election Found to be Invalid

On January 25<sup>th</sup> 2011 the Supreme Court of Iceland announced that the Constitutional Assembly election in Iceland in November 2010 had been invalid due to deficiencies in its execution. See [here](#). All the deficiencies were deemed to be rather technical and it was not proven that the deficiencies changed the results in any way. See [here](#) to read about the deficiencies.

Figure 54 A National Gathering, June 2010



Image source: Stjórnlagabing on Flickr

## 21.3 The Constitutional Council

**Figure 55** *A meeting of the Constitutional Council*



Image source: Stjórnlagabing on Flickr

On March 24<sup>th</sup> Althingi approved a proposal to appoint the 25 individuals that were elected to the Constitutional Assembly to serve in a Constitutional Council that will be given the identical assignment. The decision to appoint the constitutional council was taken in light of the verdict of the Supreme Court of Iceland to invalidate the election.

On April 6<sup>th</sup> the first formal meeting of the Constitutional Council took place. Mrs. Salvör Nordal was elected council president. See [here](#). The council was in session from April 2011 and concluded in July 2011.

The council handed over a bill for a new constitution to the Speaker of Althingi on July 29<sup>th</sup> 2011. The bill proposes several significant changes from the current constitution, including a dramatic increase in the use of referendums and a number of other changes regarding legislation procedures, natural resources and elections. Althingi will discuss the bill and can change it before approving or rejecting it. The discussions will likely take place this fall.

See [here](#) to read about the new bill and for further information about the council.

## 22 Other Notable Events & Publications

### 22.1 The Eruptions Come to an End

#### Two volcanic Eruptions Occurred in 2010 and 2011

An eruption started in Eyjafjallajökull in the southern part of Iceland on March 20<sup>th</sup> 2010 and came to an end in late May 2010. The second eruption, in Grimsvotn volcano, started on May 21<sup>st</sup> 2011 and came to an end on May 28<sup>th</sup> 2011. There has been no volcanic activity since then. For most up to date information see [here](#), [here](#) and [here](#).

The impact of the eruptions was mostly isolated to a small part of the country which was a few hours' drive from Reykjavik. For traveling instructions information and other useful information see the Visit Iceland webpage [here](#).

In light of the eruption in 2010 the government and travel corporations started a marketing campaign called Inspired by Iceland. For more information see [here](#). A few excellent images from the eruption can be found [here](#).

### 22.2 Various Initiatives, Reports and Measures

The Icelandic government is working along with the IMF to identify fiscal measures that need to be taken for the years 2011-13. The authorities' medium-term plan already identifies additional revenue options, but the authorities have also requested technical assistance from the Fund to facilitate continued work to improve the underlying structure of taxation. Further information can be found [here](#) in the IMF staff report.

Icelandic Pension Funds Association published a report in March 2010 on the responsibilities of the funds leading up to the crisis. The report entitled "Lessons that the pension funds can learn from the crash of 2008-2009" (is. Lærdómur lífeyrissjóðanna af hrúinu 2008-2009) The report can be found [here](#) (only in Icelandic). A news article on the report in English can be found [here](#). For more information on the pension funds see [here](#).

In December 2009 the Nordic Economic Report 2009 was presented at the Nordic finance ministers meeting in Copenhagen. The Nordic Economic Report is a joint project by the Nordic countries and is published once each year. See the full report [here](#).

The OECD published a report on the economic situation in Iceland which is called *Economic Survey of Iceland 2011*. It can be found [here](#).

### Statistics Iceland's Iceland in Figures

On August 4<sup>th</sup> 2011, Statistics Iceland published a small report, in English, which contains various highlights of statistical information about Iceland's geography, demographics and economy. The report can be found [here](#).

### IMF Reports on the Tax System

The Icelandic government asked the IMF for advice on tax reform to increase equity and revenue productivity of the Icelandic tax system. In response a mission from the Fiscal Affairs Department of the International Monetary Fund visited Reykjavik in the spring of 2010. The report presents the missions findings and recommendations to achieve the goals that the Icelandic authorities want to achieve.

The general conclusion of the report is; *"The Icelandic tax system already embodies in many of its features the state of the art in tax Policy. It is reasonably simple with relatively low rates, broad tax bases, and few special favorable treatments and opportunities for tax arbitrage or avoidance"* and also *„The recommendations that follow build on these strengths rather than taking the route of a radical departure from the current tax structure."* The report in whole can be found [here](#).

The IMF published a new report with tax reform proposals in June 2011. The report recommends removing a gap between VAT-rates, a taxation of Iceland's natural resources and a number of other changes. The full report can be found [here](#).

The Iceland Chamber of Commerce and Confederation of Employers published an extensive report on the tax system in September 2010. See [here](#) (only in Icelandic).

**Figure 56** *New Corporate Governance Guidelines, click to view (only in Icelandic)*

## 22.3 Corporate Governance

The Iceland Chamber of Commerce, NASDAQ OMX Iceland and the Confederation of Employers issued in March 2012 new guidelines on Corporate Governance. The guidelines are based upon similar guidelines from other countries, especially Nordic, and other relevant recommendations. The guidelines are suitable for and are particularly directed at undertakings that are considered public-interest entities, whether listed on a stock exchange or not.

As before the main aim of the guidelines is to provide companies with guidance on relations between shareholders, boards of directors, and management. Also, good methods of governance and increased information



Source: Iceland Chamber of Commerce

flow are important factors to increase transparency and trust towards business. It is in view of the guidelines publishers that systematic and determined compliance with the guidelines will strengthen Icelandic companies, which in turn is the prerequisite for increased competitiveness in the business sector and, at the same time, better living standards.

The main changes in the 4th edition of the Corporate Governance Code are the following:

- Information on the independence of candidates to the board should be disclosed.
- It is proposed that the board defines on an annual basis its most important projects.
- Company related communication between board members in between meetings is addressed and it is stipulated that further elaboration on the matter should be included in the board procedure rules.
- It is proposed that the board procedure rules address the authority of the CEO, board members access to information before and after board meetings and how that information should be handled.
- The independence criteria has been simplified, elaborated with regards to family ties and modified in lines with new legislation and updates in other Nordic Codes
- All references to board members access to a share based remuneration scheme have been removed in lines with new legislation.
- The chapter on internal audit and risk management has been simplified.
- It is proposed that the board defines at least annually the main risk factors which the company has to address.
- It is proposed that boards in companies that haven't set up a special internal audit division should annually evaluate the need for such a division.
- Board procedure rules should be reviewed annually and the rules should also stipulate as to how new board members are informed on the company's operations.
- It is proposed that a part of the board evaluation process should be on how well the board has followed the procedure rules.
- New guideline addresses the board meeting minutes, in accordance with other Nordic Codes and KPMG's Board Member Handbook.
- Board members should excuse themselves from board meetings if issues personally related to them are to be addressed.
- It is proposed that if the CEO has other interests, besides those that relate to his work cf. the independence criteria, it should be disclosed.
- The chapter on board sub-committees has been simplified and the committees' obligation to inform the board has been highlighted.
- It is stipulated that the audit committee shall annually set-up a meeting with the board and the company's external auditors, without the company's executives present.
- It is proposed that the audit committee should review the work of the company's external auditors.
- The remuneration committee shall review whether the company's remuneration policy has been followed, in accordance with other Nordic Codes.
- It is proposed that the remuneration committee and audit committee evaluate the impact of remuneration on risk-taking and risk management.
- It is stipulated that all information on the remuneration policy should be in such a way that it is easy for shareholders to form an opinion on the policy.

Also, in accordance with other Nordic Codes, if the policy allows for share based remuneration which might thin-out the shareholders stake it should be highlighted.

- Direct quote to legislation on certain additional remuneration to executive directors has been removed.
- The chapter Basic Aspects of the Remuneration Policy has been up-dated due to new legislation.
- It is stipulated that the nomination committee shall render its proposals at least 2 days before the Annual General Meeting in accordance with law and that the committee shall not only ask the shareholders for recommendations.
- It should be stated in Corporate Governance Statement if the company also follows other standards or guidelines on governance.
- Board procedure rules, the company's articles of association and the Corporate Governance Statement for the last three years shall be accessible on the company's website.
- Annexes in the 3rd edition on corporate governance, model law and regulation and the comply or explain rule have been removed.
- Main elements of the Corporate Governance Code for Public Companies have been put into an Annex within the new code.

For further information contact [Haraldur I. Birgisson](#), Deputy Managing Director of the Iceland Chamber of Commerce.

## 22.4 The Enterprise Investment Fund

The Enterprise Investment Fund (EIF) was formally established on 8<sup>th</sup> of December 2009 by 16 pension funds belonging to the National Association of Pensions Fund. The role of the EIF is to participate in shaping the financial and operational revitalization of the Icelandic economy after the financial system collapse of 2008. EIF aims to invest in Icelandic companies and will not exclude any sector of the economy. See [here](#) for current investments. For further news on EIF operation, see [here](#).

The CEO of the EIF, Mr. Finnbogi Jónsson, decided to step down as CEO after a successful two-year career since the Fund's foundation (see [here](#)). Mr. Brynjólfur Bjarnason took his place in March 2012 (see [here](#)).

## 22.5 McKinsey & Company – Charting the Icelandic growth path

At the Iceland Chamber of Commerce annual Business Forum, in February 2012, it was announced that McKinsey & Company has embarked on a review of Iceland's economic performance, focusing on opportunities for productivity growth across sectors.

The project is called *Charting the Icelandic Growth Path* and mirrors similar reviews that have been conducted for the economies of [Sweden](#), [Finland](#) and [Denmark](#).

## About the Iceland Chamber of Commerce

The Iceland Chamber of Commerce (ICoC) is a voluntary association of companies and individuals with the mission of improving the operating environment of business in Iceland and to increase economic prosperity.



## Operations of the Chamber

### General Safeguarding of Interests

As a general organization of the business community the Chamber works integral for the interests of every one conducting business. The Chamber is a powerful tool for the business community in its contest for improvements in the business environment and enhanced working conditions.

### An Advocate Towards the Authorities

The Chamber exerts itself for positive changes in law, regulation and administrative decisions which regard the business community. The Chamber receives from parliamentary committees, for review, all bills that bear upon the interests of the business community. Comments are made in collaboration with members and are presented to the committees.

### The Chambers Annual Business Forum

The Chamber's annual Business Forum is the largest and most attended event in the Icelandic business community. The Forum is attended by members, politicians and governmental officials and others that take an interest in Iceland's business community. The Chamber issues a report in connection with the Forum. The latest publications can be found [here](#).

### Corporate Governance

The Chamber has taken on the initiative of publishing guidelines on corporate governance in collaboration with the Confederation of Icelandic Employers and NasdaqOMX Iceland. The guidelines were first issued in 2004 and the fourth edition was issued in March 2012, see [here](#).

### Communication and Acquisition of Information

In recent years the Chambers has worked heavily on preparing accessible information and communicating them to foreign parties which are interested in Iceland's business and financial environment.



### Legal Counsel and Arbitration

The Chambers lawyer supervises various projects for members, free of charge. The lawyer assists members with matters relating e.g. to import and export of goods, employee and employer relations and specific law or regulations regarding companies.

## A Backbone for Business Education

The ICoC is an active advocate of technical and business education. Globalization and openness of the Icelandic economy has increased demand for educated individuals in Icelandic companies. To meet this demand, the ICoC owns and operates the following educational institutions:

### The Commercial College of Iceland

The Commercial College of Iceland is a four-year senior high school / college for students 15 years + who have completed the Icelandic elementary school (is. grunnskóli), or grades 1-10. The College has a student population of over one thousand students. The main objectives of the college are to promote the competitiveness of Icelandic business, both internally and internationally, by providing and furthering education in general and business education at secondary and tertiary levels in particular.

**Figure 57** The logo and main building of the Commercial College of Iceland



### Reykjavik University

Reykjavik University is a vibrant international university located at the heart of Reykjavik, the capital of Iceland. Reykjavik University (RU) is Iceland's largest private university and counts about 3,000 students. The university's focus is on research, excellence in teaching, entrepreneurship, law, technology development and co-operation with the active business community. The university's objective is to educate students to become leaders in business, technology and society at large, starting new companies and creating jobs.

**Figure 58** The logo and main entrance of Reykjavik University



## Joining the Iceland Chamber of Commerce

A membership to the Chamber gives companies an opportunity to influence its strategy and to promote their interests in a robust forum. The issues that the Chamber deals with on a daily basis can both concern the business community as a whole and also specific interests of individual member companies. For more information about the role of the Chamber and joining the Chamber contact Ragnar Thorvardarson, Communications Director (ragnar@vi.is). More information about the Chamber can be found [here](#).

Information about the location and opening hours of the ICoC office can be found [here](#).





# Appendices

## Appendix 1: Timeline of the Icelandic Financial Crisis

### 2008

#### September 29

- Government announces takeover of 75% share in Glitnir and EUR 600 m equity injection
- S&P downgrades Glitnir to BBB; Sovereign to A-

#### September 30

- Fitch downgrades sovereign to A-; Landsbanki to BBB;Kaupthing to BBB;Glitnir to BBB-
- Moody's downgrades sovereign to Aa1;Landsbanki to A2;Kaupthing to A1;Glitnir to Baa2

#### October 4-5

- Government evaluates crisis in an attempt to save banking sector.

#### October 6

- Emergency Law Act is introduced and passed by parliament; government guarantees all domestic deposits
- Icelandic FSA seizes control of Landsbanki under terms of emergency law
- S&P downgrades sovereign to BBB

#### October 7

- Assets of Landsbanki seized by UK authorities;Landsbanki Luxembourg goes into administration
- FSA seizes control of Glitnir under terms of emergency law
- Central Bank extends EUR 500 m loan to Kaupthing; announces intentions to negotiate EUR 4 bn loan with Russian Government
- Central Bank announces exchange rate peg and starts by selling EUR 6 m. at ISKEUR 131
- Fitch downgrades sovereign to BBB-;Landsbanki to B;Glitnir to B
- S&P downgrades Glitnir to CCC

### October 8

- Central Bank announces intention to maintain currency peg; later announces that peg is not sustainable and has been abandoned.
- Swedish Central Bank extends SEK 5 bn loan to Kaupthing Sweden
- British authorities put Kaupthing Edge and Kaupthing Singer & Friedlander into administration
- British PM threatens to sue Icelandic Government to claim guarantee for Icesave deposits
- Icelandic PM states that sale of Landsbanki assets will be used to refund Icesave depositors
- Fitch downgrades sovereign to BBB-; Landsbanki to D; Kaupthing to CCC; Glitnir to D
- Moody's downgrades sovereign to A1 and puts on review for further downgrade; Kaupthing to Baa3; Glitnir to Caa2
- Board of Kaupthing requests FSA to assume control of bank

### October 9

- Dutch finance minister threatens to sue Icelandic Government over Icesave deposit guarantee; British PM reiterates threats
- Fitch downgrades Kaupthing to CC
- Moody's downgrades Kaupthing to Caa2
- S&P downgrades Glitnir to D

### October 10

- Dutch delegation arrives in Reykjavik; initiates talks with treasury department about Icesave
- Central Bank announces limits on currency outflow; low amounts for travel and import restricted to necessities, companies must apply for currency to the CBI

### October 11

- British delegation initiates talks with treasury department about Icesave deposits
- Accord signed with Dutch Government on loan to guarantee a refund of Icesave deposits
- Outlines of an accord with British Government on loan to guarantee refund of Icesave deposits

### October 14

- Central Bank delegation starts talks in Moscow with Russian Finance Ministry on loan to Iceland
- Central Bank draws on swap facility arrangements with Denmark and Norway, each by EUR 200 m.
- Moody's confirms sovereign credit rating issued on October 8 (A1)

### October 15

- Central Bank lowers policy rate by 350 bp to 12%
- Central Bank introduces auction system to meet demand for foreign currency, resulting in an allocation of EUR 25m. at a ISKEUR rate of 150.
- Fitch issues credit update for sovereign debt holding rating steady at BBB- on negative watch.
- Iceland and Russia agree to continue discussions on a possible loan.
- New Glitnir starts operations with ISK 110 bn in capital



**October 16**

- Central Bank announces that it guarantees that all payments will reach ultimate beneficiaries' accounts with local banks in an attempt to revitalize payment system.

**October 22**

- New Kaupthing starts operations with capital of ISK 75 bn
- Norwegian delegation arrives in Iceland to gather information about the the situation.

**October 24**

- Government announces an agreement ad referendum with an IMF mission of USD 2 bn stand-by-facility programme.
- Government formally requests assistance from the Nordic countries, the ECB and the FED.
- Delegation from the US Treasury Department arrives in Reykjavik.

**October 27**

- High-level Nordic committee established to present proposals for Nordic assistance to Iceland in cooperation with the IMF.

**October 28**

- Central Bank raises policy rate by 600 bp to 18%.
- Faroe Islands pledge DKK 300 million loan for Iceland.

**November 19**

- The Icelandic Government enters into a program with the IMF which approves a two-year SDR 1.4 billion (about US\$2.1 billion) Stand-By Arrangement to support the country's program to restore confidence and stabilize the economy.

**November 28**

- New foreign exchange regulation is implemented

**2009****January 2**

- OMX Iceland 15 index replaced with a new index, the OMXI6.
- Mr. Geir H. Haarde, Prime minister at the time, announces that national elections will be held in May 2009.
- Coalition government of Independence Party and Social Democratic Alliance comes to an end.
- New government formed - a coalition of the Social Democratic Alliance and Left-Green Movement. The coalition is backed up by Progressive Party.
- Election date set for April 25th 2009.

**February**

- Parliament passes new act on Central Bank, subsequently Mr. Svein Harald Øygard is appointed interim Governor of the bank and Mr. Arnór Sighvatsson is appointed interim Deputy Governor.

**April 4 2009**

- Parliament approved amendments to the Act on Foreign currency

#### April 24 2009

- National elections for Parliament, in the elections the Social Democrats and Left-Greens get majority of seats in the Parliament.
- Coalition Government of the two parties continued.

#### June 2009

- Local and central governments, Confederation of Employers and Confederation of Employees sign The Stability Pact

#### June 26 2009

- Prime minister appoints Mr. Már Guðmundsson as new Governor of Central Bank, for a five year term, and Mr. Arnór Sighvatsson as Deputy Governor, for a four year term.

#### July 16 2009

- Parliament votes in favor of applying for membership to the EU.

#### July 17 2009

- Iceland's application for the EU submitted to the Swedish Government, which holds EU presidency.

#### July 20 2009

- Agreement announced on the initial capitalization of the new banks.

#### August 2009

- Laws passed on the Icelandic Banking Agency

#### August 5 2009

- Central bank introduces Capital Account Liberalization Strategy – First step implemented November 1st.

#### August 28 2009

- IceSave - Parliament passes an Act authorizing a state guarantee for the loans granted by the Government of the UK and the Netherlands to the Depositors' and Investors' Guarantee Fund of Iceland

#### September 2 2009

- IceSave – President of Iceland signs IceSave act with a special reference to preconditions set by the Parliament.

#### October 2009

- Rules on foreign exchange tightened to hinder parties being able to exchange ISK abroad and import them at a more favorable exchange rate.

#### October 15 2009

- Resolution Committee of Glitnir acquires 95% of the share capital in Islandsbanki against 5% held by the Government

#### October 18 2009

- IceSave – Re-negotiations concluded with Governments of the UK and Netherlands

#### October 22 2009

- Answers to EU Commission questionnaire formally presented to Olli Rehn, the EU Commissioner for Enlargement



**October 28 2009**

- IMF's Executive Board approves first review of the Economic Recovery Program for Iceland
- Local and central governments, Confederation of Employers and Confederation of Employees sign an extension to The Stability Pact.

**November 2 2009**

- Minister of Foreign Affairs, Mr. Ossur Skarphedinsson, appoints Ambassador Mr. Stefan Haukur Johannesson to serve as Iceland's Chief negotiator in EU negotiations

**November 5 2009**

- Monetary Policy Committee (MPC) lowers both the deposit and loan rates to 11% and 9%.

**December 2009**

- Representatives from the IMF visit Iceland to undertake discussions for second review

**December 1 2009**

- Resolution Committee of Kaupthing acquires 87% of common equity in Arion Bank against 13% held by the Government

**December 10 2009**

- Monetary Policy Committee (MPC) lowers both the deposit and loan rates to 10% and 8.5%.

**December 16 2009**

- Final agreement announced between Ministry of Finance and the Resolution Committee of Landsbanki Íslands hf. The government acquires 81% of the share capital in Landsbanki (NBI hf.) against 19% held by the Resolution Committee of Landsbanki Íslands hf.

**December 30 2009**

- IceSave – New law passed in the Parliament on conditions of the October re-negotiations

**2010****January 2010**

- FSA authorizes ISB holding ehf on behalf of creditors of Glitnir to own a qualifying holding in Íslandsbanki. Similarly the FSA authorizes Kaupskil ehf. on behalf of creditors of Kaupthing to acquire a qualifying holding in Arion Bank.

**January 5 2010**

- IceSave - President of Iceland, Ólafur Ragnar Grímsson, declines to sign law passed on December 30th. Law will be put under national referendum as soon as possible.

**January 19 2010**

- Minister of Justice, Ragna Árnadóttir, sets a date on national referendum. The referendum is set for March 6 2010.

**March 6 2010**

- A national referendum was held to authorize the Treasury to guarantee the Icesave deposits. The guarantee was rejected with 98% of valid votes.

#### April 12 2010

- The Parliamentary Special Investigation Commission (SIC) published a report on the background and causes of the Icelandic financial crisis.

#### April 14 2010

- The volcanic glacier Eyjafjallajökull erupted. The eruption caused severe disruptions in air traffic across Europe and dramatically reduced the number of visitors to Iceland during the summer.

#### April 16 2010

- The IMF approved the second review of Iceland's economic programme. This made a third part of the IMF loans available as well as loan facilities from the Nordic countries and Poland

#### April 22 2010

- The FSA took over Byr Savings Bank and Keflavik Savings Bank, following unsuccessful negotiations with creditors. Both institutions became state-owned.

#### May 18 2010

- The Central Bank of Iceland concluded an agreement with the Banque centrale du Luxembourg (BCL) and the liquidator of Landsbanki Luxembourg S.A., concerning the purchase of all outstanding Avens B.V. bonds. The Central bank sold the bonds to domestic pension funds on May 31st. The total nominal value of the bonds is 90.2 b.kr.. The transaction has a positive overall effect on the Icelandic economy since it reduces both total debt and net debt by over 3½% of GDP and the foreign exchange balance of the Treasury and the Central Bank improves by the equivalent of 5½% of GDP.

#### May 26 2010

- The EFTA Surveillance Authority (ESA) declared that, in its opinion, Iceland was obliged to guarantee the Icesave deposits in the amount of EUR 20,000 per account.

#### June 9 2010

- The People's Bank of China and the Central Bank of Iceland signed a bilateral currency swap agreement, amounting to ISK 66 billion.

#### June 17 2010

- Iceland received candidate status for a membership of the EU. Ten days later, the accession negotiations with the European Union were formally opened.

#### September 19 2010

- The Central Bank sold a 99.89% stake in the Danish bank FIH, which it had accepted as a collateral for a las-resort loan to Kaupthing Bank in October 2008 in the amount of 500 million euros. The sale price was about 670 million euros.

## 2011

#### January 11 2011

- The IMF approved the fourth review of the economic program with Iceland.

#### March 25 2011

- A report was introduced by the Central Bank of Iceland and the ministry of economic affairs that contains a new strategy for liberalization of capital controls.

**April 6 2011**

- The first formal meeting of the new Constitutional Council took place.

**April 9 2011**

- A second national referendum is held on the Icesave issue, this time to vote on the Lee Buchheit agreement. The agreement was rejected with 40% of voters voting for the agreement and 59% voting against it.

**April 12 2011**

- Lars Christensen, Chief Analyst of Danske Bank, states that a substantial output gap exists in the Icelandic economy and the Icelandic Krona would strengthen substantially in the coming years. He expects an output balance to be reached around mid-year 2014.

**May 5 2011**

- Collective wage agreements signed.

**May 21 2011**

- Eruption in Grimsvotn volcano started

**May 23 2011**

- The Central Bank of Iceland offered to purchase Icelandic krónur against cash payment in foreign currency. This was the first auction of many aimed at lifting the capital controls. See [Chapter 16](#).

**May 28 2011**

- The eruption in Grimsvotn volcano comes to an end.

**June 9 2011**

- Iceland issued a bond in the amount of USD 1 billion. The issued is the first in foreign currency since the banking collapse. See [Chapter 18.5](#).

**June 10 2011**

- The EFTA Surveillance Authority (ESA) concluded that Iceland is obliged to ensure payment of the minimum compensation (EUR 20.000) to Icesave depositors in the UK and Netherlands, according to the Deposit Guarantee Directive.

**July 29 2011**

- The constitutional council handed over a bill for a new constitution to the Speaker of Althingi.

**August 26 2011**

- The Executive Board of the IMF completed and approved today the sixth and final review of Iceland's Economic Recovery Programme.

**September 19 2011**

- Althingi, the Icelandic parliament, enacted legislation regarding capital accounts proposed by the Minister of Economic Affairs. The legislation is a step towards the normalization of Icelandic capital markets following the breakdown of the Icelandic banking system and introduction of capital controls in October 2008.

**October 27 2011**

- IMF announces international conference on lessons, challenges of economic crisis. Icelandic authorities and the IMF co-hosted a high-level conference in Reykjavik on October 27 2011, to review Iceland's achievements and examine the challenges that still lie ahead.

#### November 11 2011

- Arni Pall Arnason, Minister of Economic Affairs in Iceland, introduced a new Economic Programme on Thursday, 10 November.

#### November 29 2011

- The Government of Iceland agreed on a proposal for a parliamentary resolution on foreign investment. The proposal emphasizes the importance of investment in the Icelandic economy and calls for transparent administration regarding foreign investment and clear and unambiguous regulations concerning the subject.

## 2012

#### January 4 2012

- Last tranche of Nordic loans disbursed to Iceland. The bilateral loan facilities negotiated between the Nordic countries and Poland, on the one hand, and Iceland, on the other, in connection with authorities' IMF-supported economic programme, amount to a total of EUR 1.930 million.

#### January 20 2012

- New Minister of Finance. Mrs. Oddny G. Hardardottir, is Iceland's new Minister of Finance. She was appointed on the 31st of December 2011 and is the first woman in Iceland to hold this position.

#### February 2 2012

- The Ministry of Economic Affairs has handed in a Pre-Accession Economic Programme to the EU Commission. The report is a part of Iceland's accession process and sets out Iceland's main economic priorities until 2014 in four main chapters.

#### March 15 2012

- In March, the Treasury of Iceland and the Central bank of Iceland will prepay loans from the IMF and the Nordic countries in the amount of ISK 116 billion.

#### March 19 2012

- The Parliament has approved two amendments to the capital controls regime in an attempt to halt increasing circumvention through the bond market and possible negative effects of large capital flows originating from the winding-up process of the failed Icelandic banks.

#### Related content

A Chronicles of Economic Events from 2002 until May 2009 can be found [here](#).

Economic and monetary chronicle from April to September 2009 can be found [here](#).

Economic and monetary chronicle from January until March 2010 can be found [here](#).

Economic and monetary chronicle from April until September 2010 can be found [here](#).

Economic and Monetary Chronicle from october 2008 to March 2011 can be found [here](#).

## Appendix 2: More on the Emergency Bank Act

As previously mentioned the Icelandic parliament passed on October 6<sup>th</sup> a new law, allowing the Financial Supervisory Authority (FSA) to take over the operations of the

banks in unusual and extraordinary circumstances in order to limit damage or the risk of damage in the financial markets. One of the provisions approved in the new Emergency Bank Act, is that deposits are to be considered a priority claim on the bank's estates. This was done in order to secure the interests of depositors in the foreign branches. Ideally, a bank's assets will be worth enough to cover all or most outstanding deposits.

These unusual and extraordinary circumstances are stipulated further in art. 1 ph. 2. This list of circumstances is however not exhaustive; the FSA can thus, in other circumstances, apply its authority given by the law as long as the board of the FSA approves. The Central bank, which monitors liquidity status of financial institutions, appoints one member to the FSA board. The Central bank therefore has first hand information about the status of financial institutions and probable FSA actions in that regard.

The FSA has, on basis of this new law, taken over Iceland's three biggest banks and the procedure has been as follows:

1. The boards were dismissed
2. Special Resolution Committees were appointed to take over board activities and management
3. New companies were founded around the old banks domestic operations
4. The FSA decides on disposal of assets and liabilities of the old banks to the new companies
5. The Government, the Resolution Committees and the new banks came to an agreement on capitalization of the new banks and compensation to creditors of the old banks.
6. The Resolution Committee of Glitnir, on behalf of its creditors, decided to acquire 95% of the new bank, Islandsbanki.
7. The Resolution Committee of Kaupthing, on behalf of its creditors, decided to acquire 87% of the new bank, Arion Bank (previously known as New Kaupthing). The government will hold a 13% share in Arion bank.
8. NBI bank, built on the domestic operations of Landsbankinn, will be owned by the Government.
9. In January 2010 the FSA authorized Kaupskil ehf., on behalf of the creditors of Kaupthing, to acquire a qualifying holding in Arion Bank hf. Similarly the FSA authorized ISB Holding ehf. on behalf of the creditors of Glitnir, to own a qualifying holding in Islandsbanki See [here](#).

Competition authority to receive broader powers to break up dominant firms. See [here](#).

An overview of the reforms in the financial sector since October 2008 until April 2010 can be found [here](#). See [Chapter 12](#).

Information on the number of investigations and progress of those investigations can be found [here](#)

## Appendix 3: Q&A About Foreign Exchange Matters

The Central Bank of Iceland has published questions and answers about the recent changes in the Foreign Exchange Act of 1992 and the Bank's new Rules on Foreign Exchange. See [here](#). For more information on the rules on foreign exchange see [here](#).

## Appendix 4: New Act on the Central Bank of Iceland

Act no. 5/2009 amending the Act on the Central Bank of Iceland, no. 36/2001, was passed by Parliament in late February. The new Act provides for one Governor and one Deputy Governor within the CBI instead of a Board of Governors. Decisions on applying the CBI's monetary policy instruments will henceforth be taken by a Monetary Policy Committee. In other respects, the Bank's direction will be in the hands of the Governor.

According to the new law, the Board of Governors of the CBI has been abolished, together with the positions of the three Governors currently sitting on the Board, including the position of Chairman of the Board of Governors.

Pursuant to the new law, the Prime Minister appointed Mr. Svein Harald Øygard to act as interim Governor and Mr. Arnór Sighvatsson, the Bank's Chief Economist, to act as interim Deputy Governor. The interim Governor and Deputy Governor would hold these positions until appointments had been made by the Prime Minister on the basis of advertisements, in accordance with the provisions of the Act.

Information on Svein Harald Øygard can be found [here](#).

### Information on the Current CBI Governor

On 26<sup>th</sup> of June the Prime Minister appointed Mr. Már Guðmundsson as the new Governor of the CBI, for a term of five years, and Mr. Arnór Sighvatsson as Deputy Governor, for a term of four years. The Governor appointed on 15<sup>th</sup> of September Mr. Þórarinn G. Pétursson as the Chief Economist of the CBI. Information about the CBI's new Governors' and new Chief Economist can be found [here](#) and [here](#).

The Monetary Policy Committee of the CBI has published reports on their activities. They can be found [here](#).

Information on the decision by the MPC can be found [here](#). Monetary policy instruments and transmission mechanism see [here](#) and [here](#).

## Appendix 5: The IMF Loan Package and Other Financing

On November 19<sup>th</sup> the IMF approved Iceland's request for a two year stand-by arrangement. Iceland will receive USD 2.1 billion from the IMF. Additional loans of up to USD 3 billion have been secured from Denmark, Finland, Norway, Sweden, and Poland. These loans are based on Iceland's agreement with IMF. The Faroe Islands have announced that they would lend Iceland USD 50 million. The loans main purpose is to buttress Iceland's liquid foreign exchange reserves, and by doing so increasing the economy's credibility and its capabilities to address possible capital outflow, and protect the ISK, ones the currency restrictions have been lifted.

As a part of the 1<sup>st</sup> review of the IMF program the first tranche of Nordic loans was disbursed to Iceland on December 21<sup>st</sup> 2009. The first tranche amounted to 300 million euro's. See [here](#).

See information about the latest IMF review's in [Chapter 14](#).



For information on the IMF stabilization program and the progress being made, please refer to the [IMF's website](#) and for the most recent publications on Iceland from the IMF please refer to the section on Iceland, see [here](#).

#### **a) The IMF loan**

On 19<sup>th</sup> of November the Executive Board of the IMF approved a two-year SDR 1.4 billion (about US\$2.1 billion) Stand-By Arrangement for Iceland.

The approval made SDR 560 million (about US\$827 million) immediately available and the remainder is available in eight equal installments of SDR 105 million (about US\$155 million), subject to quarterly reviews. Iceland has already drawn the initial \$827 million and was able to draw the first of eight installments after the 1<sup>st</sup> Review of the IMF Economic Program was approved by IMF's Executive Board.

Further information on the IMF loan can be found [here](#), [here](#) and [here](#).

#### **b) The Nordic Loans**

In July 2009 the Nordic countries agreed to loan Iceland in total of 1.775 billion Euros, which is equivalent to 2.5 billion US dollars or 317 billion ISK. The loan agreements with Denmark, Finland, and Sweden are between the Icelandic Government and the governments concerned, while the agreement with Norway is between the two countries' central banks. The loans will be disbursed in four equal tranches tied to the International Monetary Fund's reviews of the Icelandic economic program.

The loans will be disbursed in Euros with an overall maturity of 12 years, with installment payments of principal deferred for the first five years during which time interest will be paid quarterly. At the end of the five-year period, the principal amount will be repaid in equal quarterly installments for the remainder of the loan period. The loans will bear variable (floating) interest based on three-month EURIBOR rates, plus a 2.75 per cent premium.

Further information on the Nordic loans can be found [here](#).

As a part of the 1<sup>st</sup> review of the IMF program the first tranche of Nordic loans was disbursed to Iceland on December 21<sup>st</sup> 2009. The first tranche amounted to 300 million euro's. See [here](#).

#### **c) The Polish Loan**

In October 2009 The Republic of Poland agreed to lend the Republic of Iceland 200 million US dollars (USD). The loan's overall maturity of 12 years, with a grace period of five years. The loan will be disbursed in three equal tranches tied to the second, third and fourth reviews of Iceland's IMF program, with the payment of each tranche conditional on the approval of the respective review.

The loan will be denominated and disbursed in Polish z<sup>3</sup>oty (PLN). The net cost to the borrower will consist only of an interest margin to be paid simultaneously with interest payments on the Polish Treasury Bonds issued by the Polish Treasury. This interest margin will be 2% per annum until 31 December 2015 and 1.3% per annum thereafter. The loan will be repaid in four installments coinciding with the maturity dates of the selected Polish Treasury Bonds, in October 2015, 2017 and 2019, and in September 2022.

Further information on the loan from Poland can be found [here](#).

#### d) The Faroe Island Loan

A loan agreement was signed between the Government of the Faroe Islands and the Republic of Iceland in March 2009. Under the agreement, the Government of the Faroe Islands will lend the Republic of Iceland 300 million Danish kroner. The loan was the first bilateral loan of this type extended to Iceland.

Further information on the loan from the Faroe Islands can be found [here](#)

#### c) The Russian Loan

The Russian Government indicated in November 2008 its willingness to lend up to 500 million dollars. The loan agreement negotiations have ended.

#### d) The Chinese Currency Swap

On June 9<sup>th</sup> 2010 the People's Bank of China and the Central Bank of Iceland signed a bilateral currency swap agreement. The amount of the agreement is 3.5billion CNY/66billion ISK. The agreement has 3 year maturity and can be extended after both parties agree. This agreement is independent of the IMF program that Iceland is a part of. See [Chapter 16](#).

## Appendix 6: More Information on the IMF Program

After the first review of the IMF program leading up to the Icesave referendum the Prime Minister of Iceland urged the IMF to continue the Economic Program in a press release regardless of the planned national referendum on the Icesave Act. See [here](#)

Mr. Strauss-Kahn, Managing director of the IMF, answered a couple of questions in January 2010 on Iceland and the delay of the 2<sup>nd</sup> review. See [here](#)

The second review was scheduled in early spring 2010. Some discussions between Icelandic ministers and IMF took place before the second review in late March. See [here](#)

An IMF staff Report that was written leading up to the Second Review under the IMF program. The report states that,

*"Indications are growing that Iceland's recession, while deep, will be less severe than expected. Program policies have contributed to this, and all relevant performance criteria for the second review have been met. A recovery is still expected to commence in 2010, but it will face headwinds from the private sector debt overhang and from fiscal consolidation." See the full report [here](#).*

In a statement following the July leading up to the 3<sup>rd</sup> review the fund concluded that:

*"The program has been delivering results. The recession has been shallower than expected, inflation has come down, external imbalances have unwound, and the krona has stabilized. Public finances have been strengthened and the framework for banking supervision and regulation has been reformed. The successes to date can be built upon with continued resolve and timely policy implementation."*

## Appendix 7: Macroeconomic Forecasts and Other Data Sources

DataMarket.com is a data portal that provides access to statistics and structured data from over 30 public and private sector organizations. This makes the data accessible in a single place enabling users to search, visualize and compare data from different data sources. Time series can be linked to news events and any selected data can be downloaded in a format suitable for use elsewhere. See [here](#).

[Statistics Iceland](#) is the center for official statistics in Iceland.

For further information on macroeconomic forecasts, please review:

- Central Bank of Iceland, [Monetary Bulletin](#), four issues per year
- Statistics Iceland, Economic Forecast for 2011-2016 from June can be found [here](#). (Previously conducted at the Ministry of Finance) an earlier version from June 2010 can be found [here](#) and [here](#). (mostly in Icelandic)
- OECD Economic Outlook, November 2011, see [here](#).
- An overview of economic indicators of the Central Bank can be found [here](#)
- [Report on Financial Stability](#), latest publication in June 2011
- [Inflation forecast](#) by the Central bank. See also the latest Monetary bulletin.
- The Economy of Iceland -The Central bank of Iceland issues a brief introduction to the economy of Iceland, historical information and latest economic developments called [The Economy of Iceland](#). The latest publication is from October 2010.
- Annual report of the Central bank and monthly economic indicators can be found [here](#) and [here](#)
- [Key economic figures](#) from Statistics Iceland

### Other Publications and Economic Forecasts

Below you can find more publications in English:

- Confederation of Icelandic employers published [Iceland's economic situation](#) in autumn 2010.
- The former minister of Economic Affairs, Dr. Gylfi Magnússon held a lecture in early April named The Icelandic Economy and Outlook. These slides are a good source of information on the economic environment in Iceland. The slides can be found [here](#).
- Mr. Magnússon also held another lecture, The Icelandic Economy: Recovering From a Very Hard Landing by see [here](#). In that lecture he covers the background of the crisis leading up to the collapse, the first signs of trouble, the collapse and the recovery.
- Statistics Iceland, Economic Forecast from June 2010 can be found [here](#)
- OECD Economic policy reforms: [Going for growth](#) in March 2011. See [here](#) for the April 2011 version.
- OECD [Economic Survey](#), September 2009.
- The Ministry of finance issued an Economic Outlook in the years between 2002 and 2009 that can be found [here](#). The Economic Outlook is now out of publication.
- The ministry also issued weekly web releases from 2009 until September 2009. See [here](#).

The Ministry of Finance published a Macroeconomic forecast for 2009-2014 in the fall of 2009. A few highlights of the report are listed below. The report in its entirety can be

found [here](#) (Note the outlook has improved since the release of this report in the fall of 2009)

Information on current Credit ratings of Iceland can be found [here](#) and [here](#)

More information on the monetary policy of the central bank and their current stance can be found in the Monetary Bulletin. See [here](#).

Keldan.com provides data on the financial market and up to date stock prices and other indices. See [here](#).

Information on investment opportunities and how to do business in Iceland can be found [here](#) and [here](#).

## Appendix 8: Icesave Timeline

1. On August 28<sup>th</sup> 2009 the Icelandic parliament, Althingi signs a law authorizing a state guarantee for the loans granted by the Governments of the United Kingdom and the Netherlands to the Depositors' and Investors' Guarantee Fund of Iceland. The law was signed with certain preconditions.
2. The president of Iceland decided to sign the Act on 2 September 2009, with a special written reference to the preconditions set by the Althingi.
3. In light of the pre-conditions the Icelandic Government had to re-negotiate with the Governments of the United Kingdom and the Netherlands. The re-negotiations process was concluded on 18<sup>th</sup> of October 2009 with the Governments of the United Kingdom and the Netherlands accepting the principal points of the conditions set by the Parliament.
4. Since the agreement is not identical to the law passed in August a new law needed to be passed. After several weeks of discussions a new law was passed on December 30<sup>th</sup> 2009.
5. On January 5<sup>th</sup> 2010 the President of Iceland declined to sign the law passed on December 30<sup>th</sup>. According to the constitution the law remains in force but is put under a national referendum.
6. The government appoints a negotiation committee to hold talks with the Britain and Netherlands. No agreement was made before the referendum.
7. Referendum was held on March 6<sup>th</sup>. Only 1,5% voted in favor of passing the bill. The December Icesave Act was therefore repealed and the Act passed on August 28<sup>th</sup> 2009 will continue to be in force, recognizing that the government of Iceland acknowledges their obligations to the Governments of the UK and the Netherlands.
8. Informal talks took place from March 2010 until late August 2010 when informal negotiations started. See [Chapter 12](#).
9. Formal talks were held in early September 2010.
10. The negotiating committees of Iceland, the UK and the Netherlands reached an agreement in early December 2010. The new deal is expected to cost the Icelandic authorities between 32 billion ISK.
11. The agreement was passed in Althingi in February.
12. The president referred the bill to a referendum in late February.
13. The Second Icesave referendum was held on April 9<sup>th</sup>. Around 60% voted against the law. The act was therefore repealed.

14. The EFTA Surveillance Authority (ESA) concluded on June 10<sup>th</sup> 2011 that Iceland is obliged to ensure payment of the minimum compensation (EUR 20,000) to Icesave depositors in the United Kingdom and the Netherlands, according to the Deposit Guarantee Directive.

## Appendix 9: Icesave Issue - Background Material

### Adapted from an Earlier Version of this Report

In a press release regarding the decision of the president in January 2010 to decline to sign the Icesave act the Government of Iceland emphasized that it remains fully committed to implementing the bilateral loan agreements with the UK and the Netherlands and thus the state guarantee provided for by the law. The Government views the loan agreements with the UK and the Netherlands as an integral part of Iceland's economic program. The Government economic recovery plan developed in cooperation with and supported by the International Monetary Fund and with financing from the IMF and governments of the Nordic countries and Poland, remains in effect. The press release can be found [here](#).

The Icelandic Minister of Finance conferred with his Nordic counterparts explaining the situation that arose following the denial of the President in January 2010. The parties discussed the impact and repercussions this could have on the continuation of disbursements and the implementation of the loan agreements which are in place between Iceland and the Nordic countries, which are a key factor in Iceland's economic recovery program agreed with the IMF.

The prime minister of Iceland wrote an article in the UK Observer explaining the commitment of the Icelandic government to honoring its obligations.

Another interview with the PM following the decision can be found [here](#)

The Ministry of foreign Affairs has published background information and some basic facts about the Icesave debate. See [here](#) and [here](#)

The president was in an interview with Bloomberg business news network on January 7<sup>th</sup> 2010 where he explains the implications of his decision and his view on the impact on the credit rating of Iceland. See [here](#).

Following are a couple of articles written by Icelandic economist on the Icesave dispute that were written before the referendum. They contain useful information and statistics. See [here](#) and [here](#).

## Appendix 10: Impact of Icesave on Credit Ratings

### January until March 2010

Following the decision of the president in January 2010 to decline to sign the Icesave act the credit rating of Iceland was lowered by Fitch ratings to BB+/BBB+; with a negative outlook. The lower credit rating does however not impact the ability or the cost of borrowing for Icelandic authorities since it is funded by the IMF and other loans from Nordic countries. Therefore the ratings have minimal effect on the cost of funding for the Icelandic Authorities. However, the decision could have some impact on Icelandic firms, in the short run, if the uncertainty surrounding the issue is not resolved.

Other rating agencies put Iceland on a watch list with negative outlook. Like was mentioned before this has little practical significance for Iceland since it is funded by the IMF program and political lending from Nordic nations. Standard & Poor's placed Iceland on a watch list after the decision not to sign. See [here](#) and also again in February [here](#).

On March 31<sup>st</sup> 2010 Standard and Poor's confirmed the credit rating of Icelandic authorities in foreign currency but lowered it in domestic currency. See information on the decision [here](#) and a new report by Standard and Poor's on Iceland [here](#).

#### Credit ratings on the rise after the 2<sup>nd</sup> IMF review – April until August

Moody's raised the outlook for Iceland from negative to stable on April 24<sup>th</sup> 2010 shortly after the IMF had concluded the 2nd review of the economic program. Moody's states in a press release that the change of outlook was driven by the improvement in Iceland's external liquidity due to the restoration of financing from the IMF and Nordic governments. "The successful passage of the IMF review and re-instatement of the Nordic credit line ensures that Iceland's external liquidity is now secure" says Kenneth Orchard, Vice-President/Senior Credit Officer in Moody's Sovereign Risk Group. "The resumption of official financial inflows into the country should also boost confidence and support the ongoing economic recovery." See the full press release [here](#).

On July 29<sup>th</sup> 2010 Moody's changed the rating outlook for Iceland's Baa3 local and foreign currency government bond ratings to negative from stable. See [here](#).

On November 18<sup>th</sup> 2010 the Japanese rating agency R&I announced today that it had downgraded the Republic of Iceland's foreign currency rating to BB+ from BBB-. See [here](#).

Information on Iceland's CDS spread can be found [here](#).

Information on current Credit ratings of Iceland can be found [here](#) and [here](#).

See [Figure 41](#) for an overview of the current credit ratings of Iceland.

## Appendix 11: Supreme Court Decision on the Foreign Currency Loans

Quite a number of Icelandic companies and households had, before the collapse, ISK loans denominated in foreign currency where the principal was linked to a "basket" of foreign currency. The main reason was high domestic interest rates compared to the Eurozone, Japan and Switzerland etc. Due to the currency crisis, following the banking and economic crisis, the ISK fell by roughly 55% in only one year resulting in doubling the principal of currency linked loans.

These loans have been debated heavily in recent years. On Wednesday June 16<sup>th</sup> 2010 the Supreme Court issued verdicts in two court cases pertaining to the question of whether it is legal to index car leasing payments in ISK to changes in exchange rates of foreign currency. The Court found that it was illegal to index payments in ISK in this manner. The court did not issue any guidelines on whether the interest rate on the loans in question should hold or not. Therefore, another case went to trial to determine what interest rate should apply.



### Guidelines from the Central Bank

On June 30<sup>th</sup> 2010 the FSA and the CBI decided to issue guidelines to financial institutions due to non-binding clauses linking loans to the exchange rate. The basis of the guidelines was that loans should be recalculated based on the lowest interest rate of the CBI at each point in time. The guidelines in their entirety can be found [here](#) and [here](#).

The guidelines were based on the above-specified supervisory bodies' considered opinion that there was no legal or substantive rationale for the maintenance of the previous interest rates (which were determined with reference to foreign interbank rates) after the portion of loan principal bearing such interest had been uncoupled from the exchange rate of the currency concerned by means of the Supreme Court ruling.

Figure 59 *The Supreme Court of Iceland*



Image Source: Unknown

### District and Supreme Court Rulings

On July 23<sup>rd</sup> 2010 the District Court ruled that the lowest non-indexed rate from the CBI should apply. The verdict was appealed to the Supreme Court, as was known prior to the verdict. The Supreme Court of Iceland pronounced on September 16<sup>th</sup> 2010 that interest should be calculated on unlawfully foreign-denominated automobile loans in accordance with the interest rates published by the CBI.

### Legislation Following the Ruling

In view of this outcome, the Ministry of Economic Affairs introduced legislation aimed at ensuring a fair resolution for borrowers and taxpayers. The legislation stated that the Supreme Court's ruling would apply to all automobile loans and real estate mortgages which were linked to the exchange rates of foreign currencies. It was estimated that the banking sector would not need an equity injection due to the legislation. See [here](#). The law was passed on December 18<sup>th</sup> 2010. The law can be found [here](#) (only in Icelandic). The legislation did not cover corporate loans.

### Applies also to corporate loans

On June 9<sup>th</sup> 2011 the Supreme Court concluded that the legislation should also cover corporate loans. The case in question regarded the Motormax bankruptcy estate which filed a lawsuit against Landsbankinn due to a loan they claimed to be ISK linked to foreign currency but not a foreign loan. The Supreme Court conclusion is thought of many to be precedential for further lawsuit.

### New Supreme Court Ruling - paid interest cannot be revoked

On February 15<sup>th</sup> the Supreme Court ruled that is illegal to recalculate retroactively interest on foreign currency loans even though the loan has been ruled as illegal indexation, if the debtor has serviced the the loan fully and has received a valid receipt for past payments. (See [here](#), [here](#) and [here](#) only in Icelandic). In the ruling the right of debtor to assume that each past payment at due date is a full and irrevocable payment of interest cannot be overruled by other legislation. Despite many uncertainties and potential more legal cases related to the Supreme Court ruling, the Icelandic banks reserved in the 4<sup>th</sup> quarter of 2011, some 64 bn. ISK to cover costs resulting from this ruling (see [here](#), only in Icelandic). This allocation to reserves is well within the excess equity buffer of the Icelandic banks (see [here](#)).





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