



## Annual Report 2010

# ANNUAL REPORT 2010

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*Supervisory Board and senior officers of the Central Bank of Iceland (photo taken 29 March 2011). From left: Friðrik Már Baldursson; Hildur Traustadóttir; Anna Ólafsdóttir Björnsson; Már Guðmundsson, Governor; Ragnar Árnason; Lára V. Júlíusdóttir, Chairman of the Supervisory Board; Ingibjörg Ingvadóttir; Arnór Sighvatsson, Deputy Governor; Björn Herbert Guðbjörnsson, and Jón Þ. Sigurgeirsson, Secretary of the Supervisory Board. Further information about the Supervisory Board and senior management of the Central Bank of Iceland can be found on page 32 of this Annual Report.*

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- \* Preliminary or estimated data.
- 0 Less than half of the unit used.
- Nil.
- ... Not available.
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# I Objectives and policy

As is stated in the Act on the Central Bank of Iceland (Act no. 36/2001, with subsequent amendments), the principal objective of monetary policy is to promote price stability. By agreement with the Minister of Economic Affairs, the Bank is authorised to declare a numerical inflation target. The inflation target is defined in a joint declaration issued by the Icelandic Government and the Central Bank of Iceland on 27 March 2001 as a 2½% rise in the price of goods and services over the previous 12 months (as measured by the consumer price index).<sup>1</sup> The Central Bank Act grants the Bank full independence to implement monetary policy so as to achieve this objective; however, it also states that the Bank shall contribute to the implementation of the Government's economic policy unless it considers that policy inconsistent with its own objective of promoting price stability. Moreover, the Act states that the Bank shall undertake such tasks as are consistent with its role as a central bank, such as maintaining foreign reserves and promoting an efficient and secure financial system, including payment systems domestically and with foreign countries. In other words, the Bank shall address tasks concerning financial stability. The Act also clarifies provisions on accountability, transparency of monetary policy, and the Bank's activities in general.<sup>2</sup>

Because of the extraordinary circumstances that developed after the banks' collapse in the fall of 2008, exchange rate stability became one of the key factors in the monetary policy devised jointly by the Government, the Central Bank, and the International Monetary Fund (IMF). Under the conditions that have reigned in the recent term, exchange rate stability contributes to stable price levels and inflation expectations, in accordance with monetary policy objectives, and it protects highly leveraged Icelandic households and businesses from increased debt due to exchange rate and price level movements. In this way, exchange rate-centred monetary policy also promotes overall financial stability.

## Monetary policy

Monetary policy implementation is based on the Central Bank's inflation forecast, prepared over a horizon of three years. The forecast is published in the Bank's *Monetary Bulletin*, which was issued four times in 2010. *Monetary Bulletin* includes an in-depth analysis of economic and monetary developments and prospects as well as the Bank's forecast.

The most recent amendment to the Central Bank Act, in 2009, provided for a five-member Monetary Policy Committee (MPC) whose task is to take decisions on the application of monetary policy instruments. In this context, the Bank's monetary policy instruments are its

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1. The declaration was published in *Monetary Bulletin* 2001/2 and on the Bank's website. Minor changes were made to it in November 2005.  
2. The Bank's tasks and activities are further described in various sections of the present report.

interest rate decisions, transactions with credit institutions other than loans of last resort, decisions on reserve requirements, and foreign exchange market transactions. The Committee has adopted rules of procedure that have been approved by the Bank's Supervisory Board.<sup>3</sup> The Governor is the chair of the Monetary Policy Committee, which also includes the Deputy Governor, a senior Central Bank executive in the field of monetary policy formulation, and two other economic and monetary experts appointed by the Minister of Economic Affairs.

In 2010 there were eight interest rate decision dates, four of which were also publication dates for *Monetary Bulletin*. Interest rate decision dates are announced in advance; however, the Committee is authorised to change the announced dates or add additional ones.

### **Financial stability**

The Central Bank attempts to maintain a constant, clear overview of the position of credit institutions and financial markets, and in its twice-yearly *Financial Stability* report, it publishes a detailed analysis of factors relating to financial stability. In addition, the Central Bank promotes an efficient and secure financial system by ensuring that Icelandic payment and settlement systems operate in line with internationally recognised standards.

As authorised by law, the Central Bank has set rules on minimum liquidity of credit undertakings and on their foreign exchange balance. The Bank carries out transactions with credit institutions, both receiving deposits from them and granting them loans. In special circumstances, when the Central Bank deems it necessary in order to preserve confidence in the domestic financial system, it is authorised by law to issue guarantees to credit institutions experiencing liquidity difficulties.

### **Foreign exchange reserves, foreign borrowing, and currency issues**

The Central Bank invests the nation's foreign exchange reserves. The reserves are intended to enhance security in transactions between Iceland – particularly the State and parties with a State guarantee – and other countries, and they are handled in accordance with special rules set by the Governor and confirmed by the Supervisory Board, covering topics such as investment and security. The Central Bank is authorised to borrow funds in order to reinforce the foreign exchange reserves and to participate in international co-operation, in part for this purpose. The Bank is also authorised by law to act as an advisor to the Government on matters pertaining to foreign exchange, including foreign borrowings.

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3. The Rules of Procedure for the Monetary Policy Committee can be found on the Central Bank website.

## II Monetary policy

According to the Act on the Central Bank of Iceland, the principal objective of monetary policy is to promote price stability. This objective is further described in the joint declaration issued by the Bank and the Icelandic Government on 27 March 2001 as an inflation target of 2½%. Since the financial crisis struck Iceland so forcefully in 2008, the main task of monetary policy has been to promote exchange rate stability in accordance with the joint economic policy formulated by the Government, the Central Bank, and the International Monetary Fund. Among the focuses of that policy has been to protect private sector balance sheets from further shock during the economic restructuring and rebuilding phase. Furthermore, a rising exchange rate has contributed towards bringing inflation into line with the inflation target. As economic structuring progresses, however, the inflation outlook has regained its importance in monetary policy decisions.

### Interest rate, exchange rate, and inflation developments

The Central Bank of Iceland Monetary Policy Committee (MPC) continued to reduce interest rates throughout 2010. At the beginning of the year, the deposit rate (current account rate) was 8.5%, and the maximum rate on certificates of deposit (CDs) was 9.75%. Since the financial crisis struck, these two rates have been the major determinants of short-term interest rates.<sup>1</sup> At the same time, the Bank's collateralised lending rate was 10.0%. Following the MPC's December 2010 interest rate decision, the deposit rate was down to 3.5%, the maximum rate on 28-day CDs was 4.25%, and the collateralised lending rate was 4.5%. Also at the December meeting, the Committee narrowed the interest rate corridor by 1.0 percentage point, to 2.0 percentage points, with the aim of reducing volatility in short-term market rates and bringing overnight lending rates in the interbank market closer to the centre of the corridor (see Charts II-1 and II-2).

In terms of the trade-weighted exchange rate index (TWI), the króna appreciated by nearly 12% over the course of the year, including nearly 17% against the euro and 8.5% against the US dollar (see Chart II-3). The Central Bank commenced regular purchases of foreign currency on 31 August 2010. By the end of the year, it had bought a total of 27 million euros. Apart from these regular transactions, the Central Bank bought foreign currency on four occasions, purchasing the equivalent of 168 million euros between 25 August 2010 and the end of the year.

Broad-based restrictions on movement of capital to and from Iceland were imposed in November 2008. Without these capital controls, the Central Bank would probably have had to maintain considerably higher interest rates. Following the November 2010 interest rate decision, the Governor issued a statement on the capital

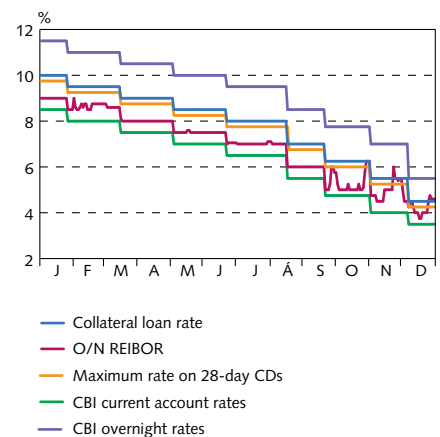
Table II-1 Central Bank of Iceland interest rates 2010 (%)

Date	Current account	28-day CDs (max)	7-day collateral	Over-night lending rate
8 Dec.	3.50	4.25	4.50	5.50
5 Nov.	4.00	5.25	5.50	7.00
22 Sep.	4.75	6.00	6.25	7.75
18 Aug.	5.50	6.75	7.00	8.50
23 June	6.50	7.75	8.00	9.50
5 May	7.00	8.25	8.50	10.00
17 March	7.50	8.75	9.00	10.50
27 Jan.	8.00	9.25	9.50	11.00

Chart II-1

Central Bank of Iceland interest rates and short-term market interest rates

Daily data 1 January - 31 December 2010

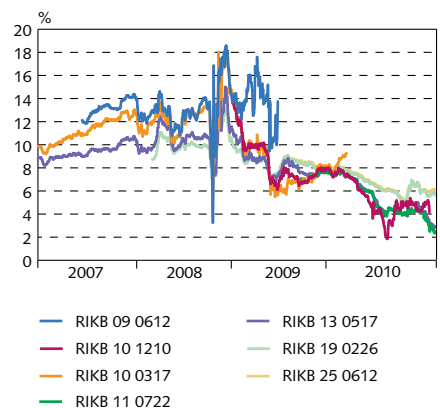


Source: Central Bank of Iceland.

Chart II-2

Long-term nominal Treasury bond yields

Daily data 3 January 2007 - 30 December 2010



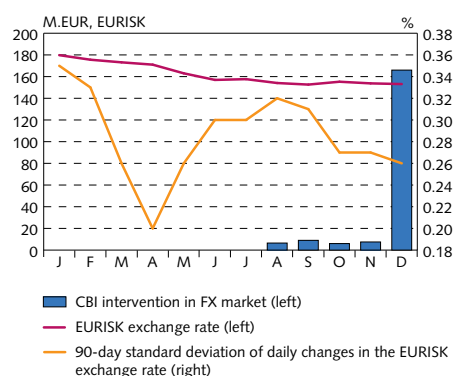
Source: Central Bank of Iceland.

1. The Central Bank interest rates that are most important in determining short-term market rates may vary. For a long period, the seven-day collateralised lending rate was the main determinant of market rates, but since early 2009 deposit rates (current account rates) and the rates on 28-day CDs have been more important factors in interest rate formation. For further discussion, see *Monetary Bulletin* 2009/4, pp. 7-8 and 21-23.

Chart II-3

EURISK exchange rate, exchange rate fluctuations and CBI intervention in the FX market

January - December 2010



Source: Central Bank of Iceland.

controls, including an announcement that the August 2009 capital account liberalisation strategy would be revised in view of experience and changed circumstances. The Governor also stated that no fundamental changes would be made in the current Rules on Foreign Exchange until March 2011 at the earliest, unless specific measures proved necessary in order to prepare for comprehensive removal of restrictions on capital outflows.

The appreciation of the króna, waning inflation expectations, and spare capacity in the economy helped to bring inflation down to target in 2010. Inflation measured 6.6% at the beginning of the year and rose to 8.5% in March, but had fallen to 2.5% by year-end (see Chart II-4). If the transitory effects of consumption tax increases are excluded, as is generally done in connection with monetary policy decisions, inflation measured 1.7% at the end of the year.

### Monetary policy decisions and the rationale behind them

In Iceland, the Central Bank is obliged by law to publish reports on its monetary policy; on monetary, exchange rate, and foreign exchange developments; and on its measures in these areas. In its quarterly *Monetary Bulletin*, the Bank reports on the economic and monetary outlook. *Monetary Bulletin* is also issued in Icelandic under the title *Peningamál*.

The Act on the Central Bank of Iceland requires that the Bank's Monetary Policy Committee make public the minutes of its meetings and that it explain its decisions and the rationale behind them. The MPC publishes the minutes of its meetings two weeks after each interest rate decision is announced. The minutes contain the Committee's assessment of the status and outlook in economic and monetary matters and the members' reasons for their votes.

The Central Bank Act also stipulates that the MPC must report to Parliament on its activities twice a year and that the contents of the report must be discussed at a joint meeting of the Parliamentary Economics and Tax Committee, Budget Committee, and Commerce Committee. The Governor appeared before these committees on 26 February and 12 November.

To pursue forward-looking monetary policy, a central bank needs models for assessing the economic outlook, especially inflation. A considerable share of research at the Central Bank of Iceland is devoted to this task. At the beginning of 2006, the Bank's economists began using a quarterly macroeconomic model (QMM) that illustrates the main channels for monetary policy transmission. While the QMM is constantly under development, also in progress is the development of a new dynamic stochastic general equilibrium (DSGE) model, which is more suitable for economic policy simulations and will be used alongside the QMM.

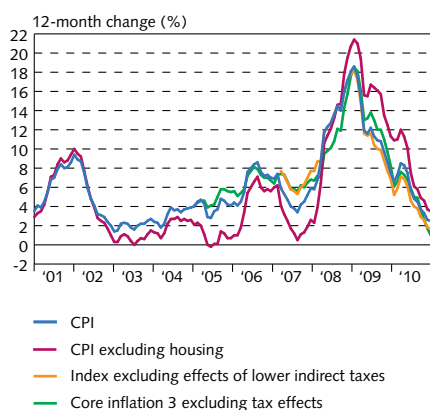
One means of enhancing transparency is to make the QMM and its database accessible on the Bank's website.

### The Monetary Policy Committee and its decisions

According to the amended Central Bank Act, which entered into force on 27 February 2009, a monetary policy committee shall take deci-

Chart II-4

Inflation: various measurements



Source: Statistics Iceland.

sions on the application of the Bank's monetary policy instruments, which include decisions on interest rates, specified transactions with credit institutions, determination of reserve requirements, and foreign exchange market transactions intended to influence the exchange rate of the króna.

The Monetary Policy Committee is chaired by Governor Már Guðmundsson. Other members are Deputy Governor Arnór Sighvatsson, Chief Economist Thórarinn G. Pétursson, Professor Anne Sibert of Birkbeck College in the UK, and Professor Gylfi Zoëga of the University of Iceland.

### Interest rate decisions in 2010

The Central Bank Act requires that the MPC meet at least eight times each year. Eight meetings were held during the year. The Committee's decisions were as follows:

*27 January:* The Governor proposed that the Bank's interest rates be lowered by 0.5 percentage points. Arnór Sighvatsson and Gylfi Zoëga voted in favour of the proposal, while Thórarinn G. Pétursson and Anne Sibert voted against it. Thórarinn G. Pétursson wanted to lower interest rates by 0.25 percentage points, and Anne Sibert wanted to keep them unchanged.

*17 March:* The Governor proposed that the Bank's interest rates be lowered by 0.5 percentage points. The proposal was approved unanimously, although three Committee members would have preferred a different decision: Gylfi Zoëga would have preferred lowering interest rates by 1.0 percentage point, Thórarinn G. Pétursson would have preferred to lower interest rates by 0.25 percentage points, and Anne Sibert would have preferred to keep them unchanged. All agreed, however, that the difference was small enough that they were willing to vote in favour of the Governor's proposal.

*5 May:* The Governor proposed that the Bank's interest rates be lowered by 0.5 percentage points. The proposal was approved unanimously, although two Committee members would have preferred a different decision: Gylfi Zoëga would have preferred to lower interest rates by 1.0 percentage point, and the Governor would have preferred to lower them by 0.75 percentage points, but as this proposal did not meet with approval from the majority of the Committee, the Governor proposed instead that rates be lowered by 0.5 percentage points.

*22 June:* The Governor proposed that the Bank's interest rates be lowered by 0.5 percentage points. The proposal was approved unanimously, although two Committee members would have preferred a different decision: Gylfi Zoëga would have preferred to lower interest rates by 0.75 percentage points, and Anne Sibert would have preferred to lower interest rates by 0.25 percentage points. However, both were of the opinion that the difference was small enough that they were willing to vote in favour of the Governor's proposal.

*18 August:* The Governor proposed that the Bank's interest rates be lowered by 1.0 percentage point. The proposal was approved unanimously. Anne Sibert was not in attendance.

*22 September:* The Governor proposed that the Bank's interest rates be lowered by 0.75 percentage points. The proposal was approved unanimously, although two Committee members would have preferred a different decision: Gylfi Zoëga would have preferred to lower interest rates by 1.0 percentage point, and Anne Sibert would have preferred to lower interest rates by 0.5 percentage points. However, both were of the opinion that the difference was small enough that they were willing to vote in favour of the Governor's proposal.

*3 November:* The Governor proposed that the Bank's interest rates be lowered by 0.75 percentage points. The proposal was approved unanimously, although one Committee member would have preferred a different decision: Gylfi Zoëga would have preferred to lower interest rates by 1.0 percentage point. He considered the difference small enough, however, to vote in favour of the Governor's proposal.

*8 December:* The Governor proposed that the interest rate corridor be narrowed by 1.0 percentage point, to 2.0 percentage points. Arnór Sighvatsson, Gylfi Zoëga, and Thórarinn G. Pétursson were in agreement, but Anne Sibert saw no need to narrow the corridor. Following the Committee's decision to narrow the interest rate corridor, the Governor proposed that the deposit rate be lowered by 0.5 percentage points, that the seven-day collateralised lending rate and the maximum rate on 28-day CDs be lowered by 1.0 percentage point each, and that the overnight lending rate be lowered by 1.5 percentage points. Anne Sibert, Arnór Sighvatsson, and Gylfi Zoëga voted in favour of the proposal, although Anne Sibert and Arnór Sighvatsson would have preferred a different decision: Arnór Sighvatsson would have preferred to lower all Central Bank interest rates by 0.25 percentage points less, and Anne Sibert would have preferred to lower the seven-day collateralised lending rate by 0.5 percentage points less. However, both were of the opinion that the difference was small enough that they were willing to vote in favour of the Governor's proposal. Thórarinn G. Pétursson voted against the Governor's proposal, wanting to lower interest rates by 0.25 percentage points less than the proposal allowed for.





## III Financial stability

One of the Central Bank of Iceland's legally mandated roles is to promote an active and secure financial system, including domestic and cross-border payment intermediation. A healthy financial system is a prerequisite for positive economic developments and effective monetary policy. The Central Bank places emphasis on assessing financial system risk, including financial institutions' liquidity risk and settlement problems in payment and settlement systems. It also promotes the efficiency and positive development of the financial system.

### Financial companies

#### Restructuring the banking system

As in 2009, reconstructing and strengthening the financial system after the crisis was a priority in 2010. Output growth depends on the existence of a sound and effective banking system. The reconstruction of the banking system is well underway, and its current operations focus primarily on services to domestic firms, institutions, and households.

In 2010, the Central Bank concluded contractual agreements concerning the debt of five savings banks that did not meet minimum capital adequacy requirements in the wake of the banking collapse. The savings banks concerned are Sparisjóður Bolungarvíkur, Sparisjóður Norðfjarðar, Sparisjóður Svarfdæla, Sparisjóður Vestmannaeyja, and Sparisjóður Þórshafnar og nágrennis. In addition, Sparisjóður Suðurlingeyinga and Sparisjóður Höfðhverfinga paid their debts to the Central Bank. After restructuring, recovery of claims against the savings banks was far below the amount of appropriated deposits. Claims written off amounted to 4,763 m.kr., whereas only 3,982 m.kr. were received in satisfaction of the claims: 1,735 m.kr. in guarantee capital shares, 450 m.kr. in subordinated loans, 1,184 m.kr. in contractual loans, and 613 m.kr. in cash. During the restructuring process, the Central Bank acquired a large part of the savings banks' guarantee capital. The guarantee capital shares were transferred to Icelandic State Financial Investments, which administers the holding on behalf of the State.

#### Financial Stability reports 2010

The Central Bank published two *Financial Stability* reports in 2010, in June and November. According to *Financial Stability 2010/2*, the Icelandic financial system is working through a variety of problems, particularly those stemming from poor asset quality and the fact that financial institutions' funding was protected by the capital controls and the Government's blanket deposit guarantee. Another factor discussed was the limited activity in key financial markets, making the markets in question less able to carry out their role of distributing risk and channelling equity and credit. On the other hand, monetary policy and the Government's economic programme supported the króna

in 2010, reducing inflation and strengthening public sector finances. Work continued in the public sector framework throughout 2010, as well as in supervision and payment system infrastructure.

### Supervision and regulatory instruments

A milestone was reached in Basel on 12 September when a meeting of the central bank governors and directors of financial supervisory bodies (the Group of Central Bank Governors and Heads of Supervision (GHOS)) from member countries of the Basel Committee on Banking Supervision ratified new international guidelines on banking institutions' capital adequacy ratios. The group also agreed to implement new references for banks' liquidity and maximum debt ratio. The new guidelines, called Basel III, will take effect in the next few years.

Work remains to be done to address the flaws in the structure and tools used to preserve financial stability. In this context, the Minister of Economic Affairs has proposed that the Act on the Central Bank of Iceland and the Act on Official Supervision of Financial Activities be reviewed.

The Rules on Foreign Exchange Balance were amended in 2010, and the new rules took effect on 1 January 2011. One of the most important changes is that the permissible open foreign exchange position in individual currencies has been reduced from 20% to 15%, and the permissible total foreign exchange balance has been lowered from 30% to 15%. Due to the circumstances that developed after Iceland's banks failed, however, temporary provisions were added so as to allow the Bank to authorise financial institutions to maintain a separate positive or negative foreign exchange balance temporarily. When applying for such authorisation, financial institutions must present a dated timetable showing how they intend to bring their foreign exchange balance back within the limits provided for in the Rules. Exemptions will not be granted beyond 1 January 2013.

In the final months of the year, the Financial Supervisory Authority and the Central Bank worked together to formulate proposals for collaboration between the two institutions on assessments of systemic risk in the financial system, reciprocal exchange of information, and joint databases. These efforts culminated in a new co-operation agreement publicised on 6 January 2011.

### Payment systems

#### The Icelandic Banks' Data Centre and Fjölgreiðslumiðlun hf.

For several decades, financial institutions have collaborated on the joint operation of payment intermediation and information technology (IT) infrastructure, not least as regards the Icelandic Banks' Data Centre (RB) and Fjölgreiðslumiðlun (FGM). Since RB's foundation, its operations have been based on a collaboration agreement, and its activities have been viewed as a part of its owners' infrastructure. The Central Bank of Iceland has been one of RB's owners from its inception. In many ways, this structure has been sound and economical, and it proved its value during the financial crisis. Streamlining IT matters was under discussion by the owners of RB and FGM in 2010. On 30 April 2010, Arion Bank, Íslandsbanki, NBI, the Icelandic Savings

Banks' Association, and the Central Bank of Iceland signed a statement of plans for changes in collaboration on payment intermediation and IT. Further work was then done towards implementing these changes, and on 15 November, the owners of the companies signed a framework agreement outlining the main elements of the changes, which were as follows:

- RB would be converted to a public limited company. The owners would be the same as before, with the exception of the Central Bank of Iceland, which would withdraw from the owner group. The change entailed making the new company independent of its owners.
- The system and related payment intermediation functions would be separated from other RB services and transferred to FGM.
- The Central Bank of Iceland would acquire FGM in full. FGM would be given a new name, Greiðsluveitan hf., and would operate under the aegis of the Central Bank, so as to separate the ownership and management of important core infrastructure from users in a competitive market. This would be infrastructure to which all financial institutions with the prescribed licences would need access in order to operate in the Icelandic financial market. The infrastructure in question includes the following systems: Central Bank of Iceland RTGS system, netting system, RÁS system, payment card authorisation system, payables pool and Birtingur, and SWIFT Alliance.

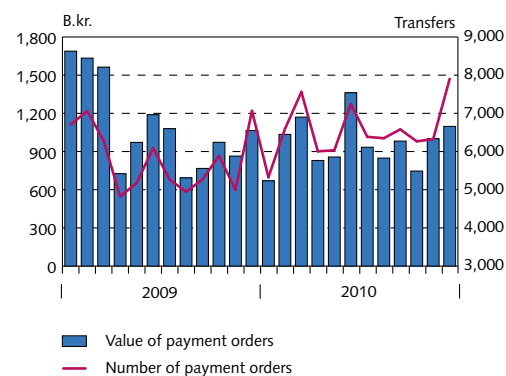
The above changes were then confirmed with contractual agreements between parties to individual systems on 15 December 2010. The changes were made subject to the approval of the Competition Authority, which required some modifications of specific competition-related aspects of Greiðsluveitan's operations. These matters were resolved between the parties, and the Competition Authority then approved the merger of the Central Bank of Iceland and Greiðsluveitan hf. (previously FGM). According to the Competition Act, the Central Bank of Iceland's takeover of Greiðsluveitan is the equivalent of a merger. Thereafter, the operational form was changed from hf. (public limited company) to ehf. (private limited company), new Articles of Association were drafted for the company, and the number of board members was reduced from five to three. Members of the company board are independent of the systems' users.

Emphasis will be placed on separation of Greiðsluveitan infrastructure and systems from other core operations of the Central Bank of Iceland, as the company fulfils a special service role for the Icelandic financial market and the users of the systems (the financial institutions) support the operation of this infrastructure. In this context, for example, it is important that Greiðsluveitan's operations be as transparent as possible.

### Real-Time Gross Settlement (RTGS) system

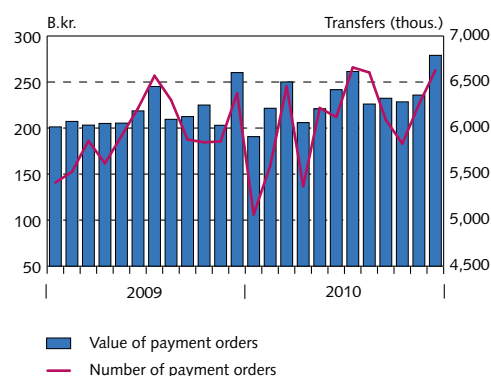
As of 31 December 2010, direct participants in the RTGS system were Arion Bank hf., Byr hf., Clearstream, the Housing Financing Fund (HFF), Íslandsbanki hf., MP Bank hf., NBI hf., and Saga Investment

Chart III-1  
RTGS system turnover  
2009-2010



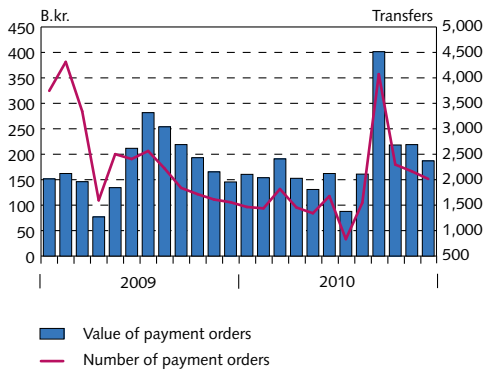
Source: Central Bank of Iceland.

Chart III-2  
Netting system turnover  
2009-2010



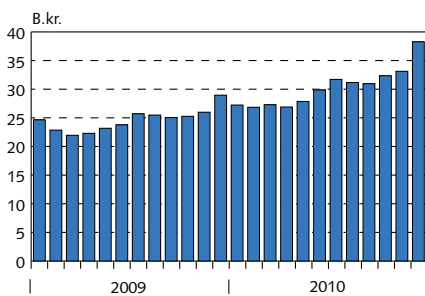
Source: Central Bank of Iceland.

Chart III-3  
Securities settlement system turnover  
2009-2010



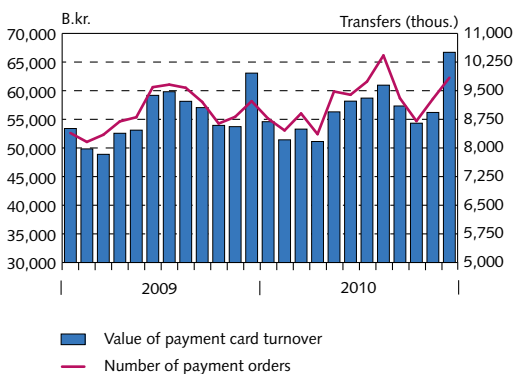
Source: Central Bank of Iceland

Chart III-4  
Notes and coin in circulation  
2009-2010



Source: Central Bank of Iceland.

Chart III-5  
Payment card turnover  
2009-2010



Source: Central Bank of Iceland.

Bank hf. In addition, the securities settlement system and the netting system settle transactions in the RTGS system. One party applied for system membership in the autumn of 2010. The application was approved, and preparation is underway for that party's participation. RTGS system activity amounted to 78,557 transactions (outgoing) with a total value of 11,533 b.kr. The number of transactions rose by 13% year-on-year, while turnover contracted by 13% at the same time.

### Netting system

Direct participants in the netting system at year-end 2010 were Arion Bank hf., Byr hf. (with two settlement accounts), the Housing Financing Fund, Íslandsbanki hf., MP Bank hf., NBI hf., and the Central Bank of Iceland. System activity was up 2% year-on-year in 2010, to 72,874,000 transactions with a total value of 2,794 b.kr.

### Securities settlement system

As of 31 December 2010, participants in the securities settlement system were Arion Bank hf., Byr hf., Clearstream, Íslandsbanki hf., MP Bank hf., NBI hf., and Saga Investment Bank hf.

Securities settlement activity totalled 2,225 b.kr. and 22,120 transactions in 2010, a drop of 25% year-on-year, in the third consecutive year of declining activity. Off-exchange trading fell off slightly, from 50,869 transactions in 2009 to 50,280 in 2010.

### Payment instruments

At the end of 2010, notes and coin in circulation outside the Central Bank amounted to 38.3 b.kr., up by 34% from year-end 2009. Of that total, 35.9 b.kr. was in banknotes and 2.4 b.kr. in coin, and 5,000 kr. banknotes accounted for the greatest value, at 31.4 b.kr.

Payment card turnover rose by about 3% year-on-year, to nearly 111 million transactions with a total value of 679 b.kr. Of that total, debit cards accounted for 373 b.kr. and credit cards for 306 b.kr.

### Cross-border payment intermediation

Cross-border payment intermediation returned to normal in 2010. Icelandic financial institutions have resumed their own payment intermediation activities and business connections, and the Central Bank of Iceland's involvement was negligible by the end of the year. Payments sent to parties overseas are handled by commercial banks and savings banks, but from time to time payments are routed to those parties through the Central Bank.

## IV Foreign reserves

The Central Bank of Iceland invests the nation's foreign exchange reserves. Accordingly, the Governor lays down rules of procedure on management of the reserves, and the rules are approved by the Supervisory Board. Foreign reserves comprise the Central Bank's foreign securities holdings, deposits in foreign banks and money market funds, gold, Special Drawing Rights (the Central Bank's holdings with the International Monetary Fund, denominated in SDRs), and the reserve position at the International Monetary Fund (IMF).

According to the rules of procedure, funds may be deposited in international financial institutions and invested in money market funds and listed securities issued by entities in member countries of the Organisation for Economic Co-operation and Development (OECD). Issuers can be sovereigns, local governments, state enterprises, international organisations and financial institutions. A minimum rating of A+/A1/A1 from recognised rating agencies (Moody's/S&P/Fitch) is required for long-term securities. Short-term securities require minimum ratings of A-1/P-1/F-1, respectively, from the same agencies. The same demands are made towards deposit-taking institutions. According to the rules, the bulk of the reserves are invested in securities with a lifetime of more than one year, but a share of the reserves must be held in demand deposits. The average duration of securities and deposits in foreign reserves may not exceed five years. The Bank's gold reserves amounted to just over 64,000 ounces at the end of 2010. The gold is held in custody at the Bank of England.

In 2010, the Treasury received the second and third tranche of the loan facility under the Stand-By Arrangement with the IMF, in the amount of 210 million SDRs. In addition, the Central Bank and the Treasury received loan facilities amounting to 587.5 million euros from Denmark, Sweden, Finland, and Norges Bank, in connection with the Stand-By Arrangement. Concurrent with this, the Treasury received the first tranche of a loan from Poland, in the amount of 210 million Polish zlotys. Still undrawn are credit lines from the IMF, in the amount of 525 million SDRs, and the Nordic countries, in the total amount of 887.5 million euros. A credit line in the amount of 420 million Polish zlotys is also unutilised. The bulk of the Avens agreement, which amounted to 549 million euros, has already been settled with Iceland's pension funds.

During the year, the Central Bank had access to repurchase transactions with the Bank for International Settlements in the amount of 400 million US dollars.

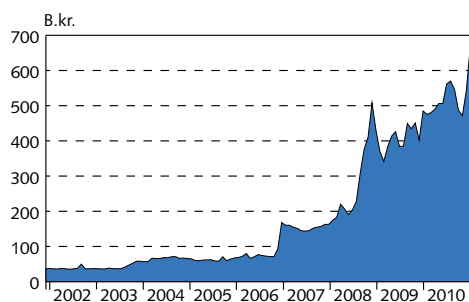
As of year-end 2010, the Central Bank of Iceland's foreign exchange reserves totalled 665 b.kr., after having increased by 180 b.kr. during the year. The expansion of the reserves is due primarily to the above-mentioned loans from the IMF and the Nordic countries; deposits from the estates of the old banks; transactions with Icelandic pension funds (the Avens agreement); and foreign exchange transactions with Icelandic banks, for the purpose of reducing their foreign

Table IV-1 Return on investment in Central Bank foreign reserves

	2006	2007	2008	2009	2010
<i>US dollar (USD)</i>					
Interest income (%)	4.06%	4.34%	3.17%	2.71%	2.25%
Price gain/loss (%)	0.01%	2.74%	4.21%	-0.37%	2.04%
Total return on securities (%)	4.07%	7.08%	7.38%	2.34%	4.29%
Duration at year-end	2.09	2.4	2.12	2.51	2.635
MSCI 1- to 3-yr index (%) <sup>1</sup>	3.95%	7.34%	6.70%	0.77%	2.39%
Duration at year-end	1.70	1.66	1.77	1.91	1.86
MSCI 3- to 5-yr index (%) <sup>1</sup>	3.50%	9.83%	12.21%	-0.76%	5.77%
Duration at year-end	3.52	3.62	3.84	3.84	3.79
Time deposits (%)	4.93%	5.09%	1.97%	0.16%	0.16%
LIBOR (annual average) (%)	4.96%	5.10%	2.27%	0.17%	0.17%
<i>Euro (EUR)</i>					
Interest income (%)	3.67%	4.27%	4.37%	3.33%	1.94%
Price gain/loss (%)	-2.55%	-1.84%	1.59%	2.38%	0.54%
Total return on securities (%)	1.12%	2.42%	5.96%	5.71%	2.48%
Duration at year-end	3.52	2.96	2.5	1.81	1.37
MSCI 1- to 3-yr index (%) <sup>1</sup>	1.80%	3.83%	6.94%	4.16%	0.92%
Duration at year-end	1.81	1.70	1.78	1.84	1.87
MSCI 3- to 5-yr index (%) <sup>1</sup>	0.62%	3.37%	8.76%	5.51%	1.56%
Duration at year-end	3.56	3.56	3.61	3.70	3.74
Time deposits (%)	2.82%	3.86%	4.08%	0.41%	0.31%
LIBOR (annual average) (%)	2.83%	3.87%	3.87%	0.63%	0.32%
<i>Pound sterling (GBP)</i>					
Interest income (%)	5.01%	5.51%	4.51%	3.28%	2.70%
Price gain/loss (%)	-2.86%	0.68%	4.41%	0.84%	1.21%
Total return on securities (%)	2.15%	6.18%	8.92%	4.12%	3.91%
Duration at year-end	2.22	2.23	2.07	2.66	2.504
MSCI 1- to 3-yr index (%) <sup>1</sup>	3.07%	7.48%	9.18%	3.27%	2.72%
Duration at year-end	1.79	1.75	1.92	1.72	1.57
MSCI 3- to 5-yr index (%) <sup>1</sup>	1.48%	7.54%	11.80%	3.31%	5.87%
Duration at year-end	3.38	3.42	3.36	3.68	3.67
Time deposits (%)	4.70%	5.58%	4.71%	0.35%	0.47%
LIBOR (annual average) (%)	4.66%	5.58%	4.74%	0.62%	0.48%

1. For 2007 and 2009, returns according to indices reflect the Bloomberg/EFFAS Government Bond Index.

Chart IV-1  
Foreign reserves  
31 December 2001 - 31 December 2010



Source: Central Bank of Iceland.

currency mismatches. The main outflows from the foreign exchange reserves were due to prepayment of a foreign Treasury loan in the amount of 225 million euros and buybacks of foreign Treasury bonds in the amount of 379 million euros.

The currency composition of the foreign exchange reserves is adjusted with the aim of minimising fluctuations in foreign-denominated assets net of foreign-denominated liabilities. The currency composition of this net holding, or the Central Bank's foreign exchange balance, is reviewed regularly and confirmed in the rules of procedure governing the foreign exchange reserves. According to these rules, the foreign exchange balance should be distributed as follows: US dollars 35%, euros 45%, pounds sterling 15%, and yen 5%.

### Currency-by-currency investment of the foreign reserves

Table IV-1 shows the return on investment of major currencies comprising the foreign reserves in recent years. The MSCI Sovereign Bond Index is used as a benchmark in measuring investment performance of bond portfolios during the period 2005-2006, while the Bloomberg/EFFAS Government bond index is used for 2007-2010, as the MSCI Sovereign Bond Index is no longer updated and has been supplanted by the EFFAS index. From mid-2008 onwards, the Central Bank has placed particular emphasis on safe investment of its liquid assets and has directed its transactions in greater measure towards the central banks in Europe and the US instead of using the interbank market. This increased caution is due to instability in foreign financial markets.

The bond portfolios in the foreign exchange reserves have been managed in accordance with Board of Governors' Decision no. 1019, using indices developed by Lehman Brothers and Barclays. Table IV-2 gives a comparison between the bond portfolio yield and the indices, which are now maintained by Barclays. In 2010, the bond portfolio outperformed the reference indices in euros and US dollars but performed more poorly in pounds sterling.

Table IV-2 Comparison between portfolio returns and Lehman benchmark indices

	Returns 2010
US dollar	4.29%
Lehman Brothers/Barclays benchmark	3.64%
<i>Difference</i>	0.654%
Euro	2.48%
Lehman Brothers/Barclays benchmark	2.18%
<i>Difference</i>	0.304%
Pound sterling	3.91%
Lehman Brothers/Barclays benchmark	4.41%
<i>Difference</i>	0.498%







## V Treasury debt management

### **Agreement on Treasury debt management**

The Central Bank of Iceland administers domestic and foreign borrowings and debt management for the Treasury as the representative of the Ministry of Finance. An agreement between the Bank and the Ministry provides for division of tasks and decision-making authority. The Central Bank is entrusted with overseeing the Treasury's foreign borrowings and administering auctions, buybacks, and redemption of Treasury securities, as well as preparing primary dealer agreements and administering securities lending to primary dealers. The Central Bank of Iceland carries out risk management and debt management according to Treasury portfolio management criteria set by the Ministry of Finance. The Bank is also responsible for regular disclosure of information on Government debt affairs to the market and the Ministry of Finance and maintains the websites [www.bonds.is](http://www.bonds.is) and [www.lanasysla.is](http://www.lanasysla.is). The above-mentioned agreement entrusts the Bank with communications and disclosure of information on the Icelandic economy to foreign credit rating agencies and credit institutions, in addition to tasks related to Government guarantees and relending, such as administration of Government guarantees and the assessment of the Treasury's risk due to such guarantees. The Bank submits statements on Government guarantees to the Ministry, handles processing of guarantees, and collects the pertinent fees. The Central Bank also issues bonds for relending.

### **Domestic debt management**

At the beginning of 2010, the Central Bank, on behalf of the Treasury, published its *Government Debt Management Prospect* for the year. According to the *Prospect*, Treasury bonds were to be issued for a total of 170 b.kr. in 2010 in order to fund the Treasury's operational deficit and the debt maturing during the year. Two series of Treasury bonds matured in 2010. On 17 March, RIKB 10 0317 matured for 71 b.kr. nominal value, and on 10 December, RIKB 10 1210 matured in the nominal amount of 60 b.kr. In all, Treasury bonds matured in the nominal amount of 131 b.kr. Treasury bond issuance net of redemption totalled 62 b.kr. during the year.

Announced in the *Prospect* was the issuance of a new two-year nominal Treasury bond series, with proposed sales set at 50 b.kr. Also announced was the issuance of a new five- to six-year nominal Treasury bond series, with planned sales of 20 b.kr. The Treasury had not sold indexed bonds in conventional auctions for a number of years. As the issuance of nominal Treasury bonds increased, the weight of indexed marketable bonds in the portfolio steadily declined to about 3% by year-end 2009. In view of expanded Treasury activity in the credit market and the declining supply of indexed bonds, it was considered important that the Treasury meet the demand for such bonds. The Treasury therefore announced the issuance of a new 10-year indexed bond with the intention of selling 50 b.kr. in the series. This

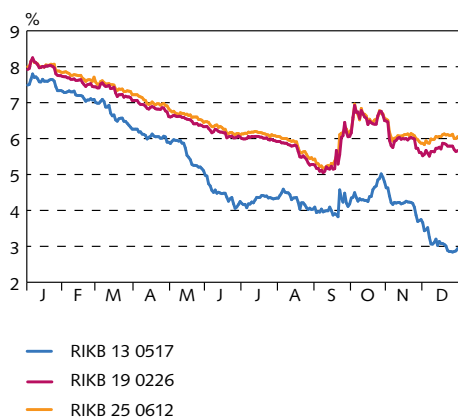
Table V-1 Sales and redemptions of Treasury bonds, nominal value in ISK millions

	2010
RIKB 10 0317	-70,583
RIKB 10 1210	-59,744
RIKB 11 0722	44,484
RIKB 12 0824	30,000
RIKB 16 1013	21,631
RIKB 19 0226	15,341
RIKB 21 0414	50,631
RIKB 25 0612	30,868
<i>Total; i.e., sales net of redemptions</i>	<i>62,628</i>

Chart V-1

## Government bond yields

Daily data 1 January - 31 December 2010

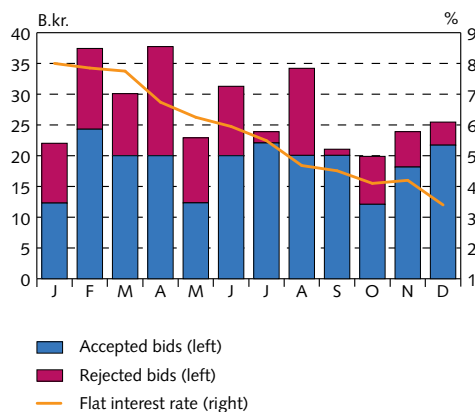


Source: NASDAQ OMX.

Chart V-2

## Treasury bill auctions and interest 2010

January - December 2010



Source: Government Debt Management.

was the Treasury's first indexed market issue since 1995. The remaining 50 b.kr. were to be used for further expansion of RIKB 11 and RIKB 25, which were originally issued in 2009.

In response to market demand and in order to lengthen the maturity profile of the Treasury portfolio, changes to the issuance calendar were announced in April. It was decided to issue Treasury bonds for 20 b.kr. and reduce Treasury bill issuance accordingly. It was also decided to change the composition of Treasury issuance by reducing the new two-year series from 50 b.kr. to 30 b.kr., expanding RIKB 11 by up to 15 b.kr. and expanding RIKB 19 and RIKB 25 by up to 25 b.kr. Quick perusal shows that most of these plans materialised. Table V-1 shows sales and redemptions of Treasury bonds, by series, in 2010.

As inflation declined and the Central Bank of Iceland policy interest rate was lowered, the interest rate terms offered to the Treasury in auctions declined as well. The yield on accepted bids in auctions of two-year nominal Treasury bonds, for example, fell from 7.3% to 2.4% in 2010. Yields on longer bonds also declined considerably. Chart V-1 illustrates developments in bond yields in the secondary market, which reflect the terms offered to the Treasury in auctions.

The Central Bank also oversees auctions of Treasury bills on behalf of the Treasury. Such auctions are held once a month. In 2010, four-month bills were offered in these auctions. Total sales of Treasury bills amounted to 223 b.kr. nominal value, or just under 19 b.kr. per month. Table V-2 shows interest rate terms and participation in Treasury bill auctions.

Table V-2 Treasury foreign debt (amounts in ISK millions)

## Bilateral loans

	Loan facility Currency	Amount Amount	Amount utilised	Amount unutilised	Loan facility ISK	Amount utilised ISK	Amount unutilised ISK
Denmark	EUR	480	240	240	73,973	36,987	36,987
Finland	EUR	320	160	160	49,316	24,658	24,658
Sweden	EUR	495	248	248	76,285	38,220	38,220
Poland	PLN	630	210	420	23,871	7,957	15,914
Faeroe Isl.	DKK	300	300	0	6,209	6,209	0
<i>Total</i>					<i>229,654</i>	<i>114,030</i>	<i>115,778</i>

## Marketable bonds

	Maturity	Currency	Original amount	Buyback/ Instalment	Year-end balance	Year-end balance ISK
Eurobond (MTN)	2011	EUR	1,000	362	638	98,429
Eurobond (MTN)	2012	EUR	250	42	208	32,066
Eurobond (MTN)	2014	USD	200	0	200	23,064
Bonds	2016	GBP	30	2	28	5,063
Eurobond (MTN)	2025	EUR	402	29	373	57,451
<i>Total</i>						<i>216,073</i>

## Syndicated loans

	Maturity	Currency	Original amount	Buyback/ Instalment	Year-end balance	Year-end balance ISK
Eurobond (MTN)	2011	EUR	300	225	75	11,535
<i>Total external Treasury debt</i>						<i>341,638</i>

Interest rates in the auctions fell substantially during the year. At the beginning of the year, the Treasury obtained four-month funding at 8%, whereas in the December auction it accepted bids on 21 b.kr. in four-month bills at 3.4%. The difference is equivalent to 283 m.kr., based on 19 b.kr. in four-month issuance. Given that Treasury bill sales amounted to 223 b.kr. in 2010, this computes to a savings of 3.4 b.kr. in funding costs. Interest expense is the Treasury's largest expenditure item. In 2010, the Treasury paid 73.8 b.kr. in interest.

### Foreign debt management

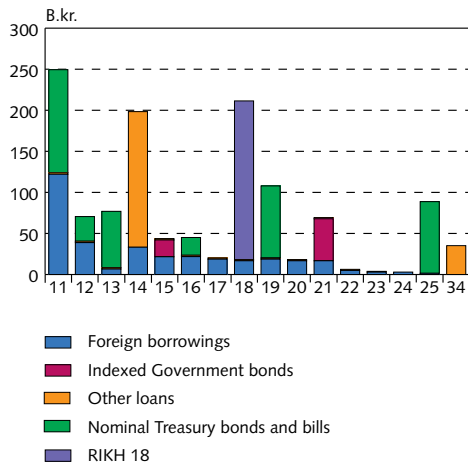
The Treasury's foreign debt totalled 342 b.kr. at year-end 2010. This debt can be divided into three categories: bilateral loans, foreign market loans, and syndicated loans. No foreign loans matured in 2010; however, marketable Treasury bonds for over 400 million euros were repurchased during the year, as is discussed in greater detail below. The Treasury issued a 400 million euro bond for the purchase of Avens B.V. It also drew part of a 1,295 million euro bilateral loan from the Nordic countries, or 887.5 million euros, and one-third of a bilateral loan from Poland, or 210 million Polish zlotys of a total of 630 million.

Bilateral loans are extended by the governments of Denmark, the Faeroe Islands, Finland, Poland, and Sweden, in connection with the Government's IMF programme. The loan facilities total 230 b.kr. and will be paid out in tranches. The Treasury has drawn half of this amount, or 114 b.kr., and has used the funds to strengthen the Central Bank of Iceland's foreign exchange reserves. As is shown in Table V-2, the Treasury had unutilised loan facilities in the amount of 116 b.kr. as of year-end 2010. The loans are to be repaid over a seven-year period, beginning in 2014.

Outstanding foreign bonds totalled 216 b.kr. as of year-end 2010. Table V-2 shows a list of the bonds and their balance at the end of the year. Maturing in December 2011 is a bond originally in the amount of 1,000 million euros. During the year, the Treasury bought 362 million euros out of the series at a discount in the secondary market, and 638 million euros are still outstanding. Next year, the Treasury is planning bond issuance abroad. The funds acquired will be used to refinance marketable bonds and the above-specified bilateral loans, which are to be repaid between 2014 and 2021. By year-end 2010, 42 million euros of a 250 million euro Treasury bond maturing in 2012 had been bought back, leaving an outstanding nominal balance of 208 million euros. A new marketable bond in the amount of 402 million euros was issued in 2010 because of the Treasury's purchase of Avens B.V. The bond matures in 2025, and instalments are distributed over the lifetime of the debt.

In addition to the bonds, the Treasury has one outstanding syndicated loan whose original amount was 300 million euros. The loan was taken in the fall of 2008 through the intermediation of Bayerische Landesbank, which served as lead arranger. It matures at the end of September 2011. In December 2010, the Treasury paid 225 million euros of the nominal value of the loan, leaving an outstanding balance of 75 million euros, or 11 b.kr., at the end of the year.

Chart V-3  
Maturity profile, Government loans  
31 December 2010



Source: Government Debt Management.

### Euro Medium-Term Note Programme (EMTN)

The framework agreement establishing the Euro Medium-Term Note (EMTN) Programme was first signed in 2001. The agreement is administered by Citibank and provides for both public and private issues. It was most recently renewed in the summer of 2008, and the ceiling is now 5 billion euros. As is shown in table V-2, four bond issues totalling 1.4 billion euros are currently outstanding under the programme.

### Government guarantees and relending

Government guarantees are provided for in Act no. 121/1997. The Treasury may not undertake a guarantee unless authorised by law. Because of the risk to the Treasury, collateral must be provided that is deemed satisfactory by the State Guarantee Fund, which is authorised by law to supervise Government guarantees, keep track of the operations of entities that have received Government guarantees, and maintain a register of obligations backed by Government guarantees.

The bulk of Government guarantees are due to the Treasury's holdings in the Housing Financing Fund and Landsvirkjun. These parties' borrowings are not handled through the State Guarantee Fund in the same way as those of parties outside the public sector that request Government guarantees for specified loans. However, parties that enjoy Government guarantees due to Government ownership are required to obtain the Minister of Finance's approval of the terms and conditions for loans they intend to take abroad.

### Sovereign credit rating of the Republic of Iceland

The main agencies that assign the Treasury a credit rating are Moody's Investors Service, Fitch Ratings, and Standard & Poor's. The Central Bank of Iceland communicates regularly with these agencies on behalf of the Government. Rating agencies have significant influence on lending terms in the global credit markets, and an entity's credit rating is, among other things, an indicator of the terms it will enjoy as a borrower. Iceland's sovereign credit rating suffered greatly from the banks' failure in 2008.

At year-end 2010, Moody's rating was Baa3 for long-term foreign and domestic obligations, and P-3 for short-term obligations. These are considered investment-grade ratings. The outlook for the ratings was negative at the end of the year, although it had been changed to stable for a short time in April. According to Moody's, the change back to negative in July was due to the Icesave dispute and the Supreme Court judgments on the illegality of exchange rate-linked loans.

At the beginning of the year, Fitch Ratings downgraded Iceland's sovereign credit rating for long-term obligations in foreign and local currency from BBB- to BB+ and downgraded its rating for short-term obligations in foreign currency from F3 to B, with negative implications. Both changes represent a downgrade from investment grade to speculative grade. In its statement, Fitch attributed the downgrade to the president of Iceland's decision to refer the Icesave agreements to a national referendum. No other changes were made by Fitch Ratings during the year.

Table V-3 Ministry of Finance debt management criteria

	Reference	Balance 31 Dec 2010
Non-indexed loans	60-80%	66%
Indexed loans	20-40%	28%
Foreign borrowing	0-20%	6%

Source: Ministry of Finance.

Iceland's year-end sovereign credit ratings from Standard & Poor's were BBB- and BBB for long-term obligations in foreign and local currency, respectively, and A-3 for short-term obligations in foreign and local currency. The ratings were placed on CreditWatch negative in January, due largely to uncertainty in the wake of the president's decision not to sign the Icesave Act. The ratings for foreign-currency obligations remained unchanged during the year, but those for local-currency obligations were downgraded by one notch in March, from BBB+ to BBB for long-term obligations in local currency and from A-2 to A-3 for short-term obligations in local currency. The outlook was changed to negative. The ratings from Standard & Poor's are investment-grade.





## VI International cooperation

The Central Bank of Iceland has extensive responsibilities and obligations in the field of international finance. The Bank cooperates closely with other central banks and international economic and monetary organisations.

### **International Monetary Fund**

The Central Bank represents Iceland at the International Monetary Fund (IMF). The Icelandic Government and the IMF have collaborated extensively during the past year. Three IMF missions visited Iceland in connection with the macroeconomic programme prepared by the IMF and the Government. In addition to these visits, the IMF assisted the Icelandic authorities with public sector finances, foreign exchange reserves, liquidity management, and capital controls. A total of three missions visited Iceland to render technical assistance. Two reviews of the economic programme under the Stand-By Arrangement were approved by the Executive Board of the Fund. The second review was approved on 16 April 2010, and at the request of the Icelandic Government, it was agreed to extend the IMF Stand-by Arrangement by three months, or until 30 August 2011. Disbursements will be adjusted to reflect this change. The extension was requested because of delays in implementing and reviewing the programme in 2009. The third review was approved by the Executive Board on 29 September, releasing the fourth tranche of the loan facility from the Fund, in the amount of SDR 105 million. The IMF mission met with the Icelandic authorities in November in connection with the fourth review, which was approved on 10 January 2011. By the end of the 2010, SDR 875 million, or 158 b.kr., had been drawn on the IMF loan facilities, and a total of 150 b.kr. had been drawn on the loan facilities granted simultaneously by the Faeroe Islands, Poland, and the Nordic countries. All reports related to the economic programme and the IMF Stand-By Arrangement are published on the Central Bank website.

Central Bank Governor Már Guðmundsson was Iceland's representative to the Board of Governors of the IMF. Iceland cooperates with the Nordic and Baltic countries through a Constituency at the IMF, and they jointly elect an Executive Director as one of the Fund's 24 Executive Board members. In 2010, the Constituency's permanent representative on the IMF Executive Board in Washington was Per Callesen from Denmark. The Nordic-Baltic Constituency's representative to the IMF Monetary and Finance Committee was Bank of Finland Governor Erkki Liikanen, but at the Annual Meeting, the Constituency was represented by Norwegian Minister of Finance Sigbjørn Johnsen. The meetings of the IMF Monetary and Finance Committee (IMFC) were held at the Fund's headquarters in Washington, DC, in April and October. In connection with the meetings, the Central Bank of Iceland published on its website the Nordic-Baltic Constituency Office's reports to the IMF on the main activities of the Fund and its Executive Board. The joint Nordic-Baltic speeches presented to the IMFC and at the IMF Annual Meeting were also published.

**The Bank for International Settlements (BIS)**

The Central Bank is a shareholder in the Bank for International Settlements (BIS) in Basel, Switzerland, which is an important consultative forum for central banks, as well as an information and research institution in the field of monetary policy and financial stability. The Governor and other Central Bank staff members participate regularly in work carried out by BIS.

**Organisation for Economic Co-operation and Development (OECD)**

During the year, Central Bank representatives participated in the work of various OECD committees and groups, including the Economic Policy Committee, Working Party 1, the Committee on Financial Markets, and an expert committee on government debt management. OECD experts come to Iceland on a regular basis to keep abreast of economic developments, and they issue frequent reports setting forth the Organisation's opinion of economic affairs in the country.

**Co-operation with other central banks**

During the year, the Central Bank of Iceland engaged in a variety of tasks in co-operation with other central banks. The central banks in the Nordic region have long enjoyed close collaboration. The Bank also works regularly with the European Central Bank and other central banks in Europe, including increased co-operation with those in the Baltic countries. It also co-operated with the Banque centrale du Luxembourg on the purchase of the Avens bonds, as well as with the National Bank of Poland. Furthermore, the Bank signed a bilateral currency swap agreement with the People's Bank of China.

**Other financial institutions**

The Central Bank cooperates with a large number of foreign financial institutions in connection with the management of its foreign exchange reserves, Treasury foreign debt, and other topics related to its operations.





## VII Special projects

### **Central Bank of Iceland Holding Company ehf. (ESÍ)**

After Iceland's banks collapsed in the autumn of 2008, the Central Bank acquired sizeable claims against domestic financial institutions. The claims are backed by collateral of various types. Some of them were transferred to the Treasury after the banks failed, and the Central Bank advised the Government on their treatment. Most of 2009 was dedicated to preparing and filing claims against the estates of the failed financial institutions, and the actual asset management phase began in 2010.

At the end of 2009, these assets were transferred to a separate subsidiary of the Central Bank, a holding company called the Central Bank of Iceland Holding Company ehf. (ESÍ). Another Central Bank subsidiary, Sölvhóll ehf., is an operating company whose role is to maximise the value of the assets in the holding company (ESÍ) and divest them when market conditions permit, subject to the approval of the ESÍ board. This arrangement provides the Bank with an effective means of separating the operations and assets related to the crash from its conventional activities.

At year-end 2010, ESÍ's balance sheet totalled 395 b.kr., or 30% of the Central Bank's total balance sheet. ESÍ's assets had declined by 96 b.kr. since year-end 2009, or just under 20%, primarily because debt to the Central Bank was paid down as a result of asset recovery. The company's pre-tax profit totalled 2.1 b.kr.

### **Capital Controls Surveillance Unit**

The Central Bank of Iceland's Capital Controls Surveillance Unit (CCSU) was formally established as a separate department within the Bank in September 2009. The CCSU's main tasks in 2010 were to carry out general monitoring of the Foreign Exchange Act and the Rules on Foreign Exchange, investigate alleged violations of the Rules, process and take decisions on applications for exemptions from the Rules, review and revise the Rules, and provide instructions and information to individuals and legal entities.

In June, Act no. 78/2010 entered into force, amending the Foreign Exchange Act, no. 87/1992, and the Customs Act, no. 88/2005. The new Act authorises the Central Bank to investigate alleged violations of the Foreign Exchange Act and the Rules on Foreign Exchange, whereas this authority previously rested with the Financial Supervisory Authority. The Act guarantees the Central Bank the courses of action and authorisations necessary to investigate such cases. These include the authorisation to compile data for investigations of alleged violations, the authorisation to take statements related to such investigations, the power to impose administrative fines on individuals and legal entities for violations and, as appropriate, the obligation to refer major violations to the economic crime department of the National Commissioner of the Icelandic Police. A further change made with the June 2010 amendments is that the Central Bank's decisions on

exemptions from the Rules on Foreign Exchange may no longer be appealed to the Ministry of Economic Affairs; however, they may be referred to the courts, as are other administrative decisions.

The Rules on Foreign Exchange must be reviewed within six months of their effective date. The current Rules, no. 370/2010, were reissued in October 2010.

During the year, a large volume of monitoring and research cases were handled by the CCSU. In the first half of the year, while the Central Bank was still required to notify the Financial Supervisory Authority of violations of the Rules on Foreign Exchange, a total of six cases were referred there. For the remainder of the year, after the statutory amendments entered into force, the Central Bank referred four cases to the economic crime department.

The CCSU received 762 requests for exemptions from the Rules on Foreign Exchange in 2010. Of that total, 431 were approved, 178 were rejected, and 28 were rejected in part. The remaining 83 were handled by other means, withdrawn, or handled by instruction. At the end of the year, 42 exemption requests were pending final processing.

Registered new investment based on Article 13 of the Rules on Foreign Exchange totalled approximately 13.5 b.kr. in 117 cases during 2010.

#### **National Festival Fund**

The National Festival Fund operated for its 33rd year in 2010. It was decided to allocate 35 m.kr. to 59 applicants during 2010, the last year in which general allocations were made from the Fund.



## VIII Accounts and organisation

### Central Bank accounting principles

According to Article 32 of the Act on the Central Bank of Iceland, no. 36/2001, with subsequent amendments, the preparation of the Bank's annual accounts "shall comply with laws, rules and good account practice. The Minister shall set detailed rules on the accounting principles and preparation of the annual accounts." The current rules were set in 2005. The financial statements for 2010 are based on the same principles as in 2009; however, minor changes have been made in the presentation of individual items. These changes are explained in the notes to the financial statements, which appear later in this *Annual Report*.

### Operating results and balance sheet

According to its profit and loss account, the Central Bank of Iceland recorded a net loss of 13,499 m.kr. in 2010, compared with a profit of 500 m.kr. in the previous year. Excluding exchange rate gain and loss, the Central Bank recorded a loss of 5,697 m.kr. in 2010, compared with a loss of 2,523 m.kr. the year before. Table VIII-1 illustrates the changes in the principal items of the Bank's profit and loss account.

There will be no transfer to the Treasury for 2010, as the Bank recorded an operating loss of 5,697 m.kr. before adjusting for exchange rate differences. Exchange rate losses for 2010 totalled 6,933 m.kr., as the Icelandic króna appreciated by just under 12% during the year.

As the table shows, the Bank's earnings declined by 13,999 m.kr. from the previous year. Net interest income fell by 2,469 m.kr., due primarily to the 4,822 m.kr. decline in net interest income from domestic assets, whereas net interest income on foreign assets increased by 2,353 m.kr. year-on-year. The greatest change in net interest income from domestic assets was due to interest income from indexed securities, which declined by 22,728 m.kr. year-on-year due to lower interest rates and to inflation effects, as well as to a 13,668 m.kr. increase in interest paid to the Treasury. Other operating income was down by 1,954 m.kr., owing primarily to the revaluation of foreign securities, which have declined by 2,571 m.kr. due to falling market values. The Bank's operating expenses declined between years, largely because of increased expenses for expert consultancy in 2009, following the collapse of the banks. The Bank's assets totalled 1,326 b.kr. at year-end 2010, as opposed to 1,178 b.kr. at the end of 2009. Foreign assets in the foreign exchange reserves rose by 180 b.kr. during the year. The real increase in the reserves was financed with borrowed funds, including loans from the IMF and the Nordic countries, which totalled 37.4 b.kr. and 112.0 b.kr., respectively, at year-end exchange rates. The loans from the Nordic countries are disbursed both to the Treasury, which deposits the funds to its accounts with the Central Bank, and to the Central Bank itself. Foreign liabilities rose by 77 b.kr., due to a 30 b.kr. increase in non-residents' deposits and 47 b.kr. in new borrowings to expand the foreign exchange reserves.

Table VIII-1 Profit and loss account highlights

(Figures in ISK millions)	2010	2009	Change
Performance for the year	(13,499)	500	(13,999)
<i>Changes specify as follows:</i>			
Net interest income	12,760	15,229	(2,469)
Other revenues	4,870	6,824	(1,954)
Operating expenses	2,047	2,502	(455)
Loan impairment	21,280	22,073	(793)
Transfer to the Treasury	0	0	0
Exchange rate difference	(6,933)	3,023	(9,956)
Income tax	(869)	0	(869)
Performance for the year (as above)	(13,499)	500	(13,999)

**Table VIII-2 Balance sheet highlights**

(Figures in ISK millions)	2010	2009	Change
Equity:	69	83	-13
Changes specify as follows:			
Assets			
Foreign assets in reserves	665	485	180
Loans to banks and financial institutions	379	523	-143
Treasury	172	165	6
Other assets	110	5	105
Liabilities:			
Foreign debt	-281	-204	-77
Banknotes and coin	-38	-29	-9
Deposits, banks and financial institutions	-207	-169	-37
FX deposits, banks and financial institutions	-282	-229	-53
Deposits, Treasury	-427	-447	20
Other liabilities	-23	-18	-5
Equity (as above)	69	83	-13

Foreign-denominated deposits owned by deposit institutions and financial institutions increased by 53 b.kr. year-on-year, with most of the increase in time deposits.

Loans due and payable declined by 389 b.kr. year-on-year, as a result of repayment and restructuring.

At year-end 2010, the Bank's foreign assets constituted 50% of its total assets. At year-end 2009, the Bank's foreign assets accounted for 41% of total assets. The Central Bank's annual accounts are presented later in this report, together with detailed explanatory notes on individual items.

### Supervisory Board

The Central Bank Act, no. 36/2001, stipulates that there shall be seven members of the Supervisory Board. In 2010, members of the Supervisory Board were Chairman Lára V. Júlíusdóttir, Ragnar Arnalds, Björn Herbert Guðbjörnsson, Hildur Traustadóttir, Ragnar Árnason, Katrín Olga Jóhannesdóttir, and Daniel Gros.

### Governor and Deputy Governor

During the year, Már Guðmundsson served as Governor of the Central Bank, and Arnór Sighvatsson served as Deputy Governor. Mr. Guðmundsson was appointed for a term of five years, effective 20 August 2009, and Mr. Sighvatsson was appointed for a term of four years, effective 1 July 2009.

### Central Bank organisation

The Bank's activities take place in six main departments. The General Secretariat is separate from the Bank's main departments. It provides general office and administrative service to the Governors, oversees public relations and information disclosure for the Bank, and supervises the publication of the Bank's *Annual Report* and website. The General Secretariat also handles regular communications with international credit rating agencies, the International Monetary Fund, and foreign financial institutions (apart from financial transactions). The Legal Services staff prepare a wide range of contractual agreements for the Bank, as well as preparing legal documents and debt instruments and participating in the preparation of laws, regulations, and legal opinions. The Library and Collection Department is a part of the General Secretariat. It carries out library operations, as well as overseeing the Central Bank and National Museum numismatic collection.

The Capital Controls Surveillance Unit (CCSU) is a new department answering directly to the Governor. The CCSU's function is to ensure compliance with regulatory instruments on foreign exchange. The unit also participates in amending rules, publishing guidelines, and interpretation of such instruments. In addition, the CCSU processes requests for exemptions from the Rules on Foreign Exchange and is authorised to investigate alleged violations of the Foreign Exchange Act and the Rules on Foreign Exchange.

The International and Market Operations Department oversees domestic money markets and currency markets, as well as transactions with domestic financial institutions. It also manages the Bank's

foreign reserves and oversees government debt affairs, as well as Treasury guarantees and relending. The Department also oversees communications with the foreign financial institutions with which the Central Bank and the Treasury interact.

The Finance Department oversees the financial information for the Bank and its subsidiaries, as well as overseeing the bookkeeping for the National Festival Gift from Norway and the Greenland Fund, which is administered by the Bank. It also handles the redemption of Treasury bonds and administers Treasury foreign borrowing. Furthermore, it administers the Bank's SWIFT system, as well as overseeing payments for the Bank, the Treasury, and State enterprises. It also handles the operation of the Bank's payment systems. The Department's activities are divided into two units: Accounting and Back Office.

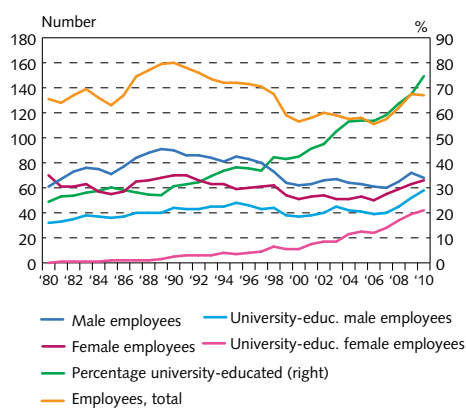
The Financial Stability Department's activities centre on the stability and effectiveness of financial institutions and markets. Its operations are divided into three units related to financial stability: Financial Systems, Payment Systems, and Contingency. The Cashier's Unit also belongs to the Financial Stability Department. The Financial Systems Unit carries out analyses of financial institutions and the structure of the financial system, as well as supervising the Central Bank's precautionary rules. The Payment Systems Unit oversees the most important payment and settlement systems, sets policy for system development, lends support to market solutions, and handles operations, as well as overseeing payment systems. The Contingency Unit handles the development and preparation of stress tests and contingency-related projects. The Cashier's Unit carries out the issuance and handling of notes and coin. The Financial Stability Department publishes an annual report entitled *Financial Stability*.

The Economics Department carries out economic and monetary research, prepares macroeconomic and inflation forecasts, participates in formulating policy in currency and monetary matters, and analyses developments in domestic and foreign economic and monetary affairs, including the macroeconomic elements of financial stability. The Department oversees the issuance of various Bank publications, including *Economic Indicators*, *Monetary Bulletin*, *Working Papers*, *Economic Affairs*, and *Economy of Iceland*. The Department comprises two units: the Analysis and Publications Unit and the Research and Forecasting Unit.

The Operations Department handles security, procurement, budgeting, expenditure control, and the operation and administration of the Bank's real estate and equipment. The Department also handles human resources and payroll affairs, as well as a variety of in-house services. Operations is also responsible for the Bank's archives.

The Statistics and IT Department handles the compilation, entry, and processing of statistical data that the Central Bank compiles for its work. It also operates the Bank's computer systems and databases. The Bank collects information on a regular basis about the domestic credit market, balance of payments, and external position of the economy. Most institutions and companies operating in the domestic credit market report monthly on balance sheet items. They are also obliged to provide the Central Bank with information about interest

Chart VIII-1  
Central Bank of Iceland employees  
1980-2010



Source: Central Bank of Iceland.

rate changes as soon as such changes are made. The balance of payments and external position are calculated on a quarterly basis. These data form the basis for the Bank's assessment of important aspects of monetary developments and for regular dissemination of statistical information, both in its publications and on the Statistics pages of its website. All statistical data are also available in English. The Statistics and IT Department is divided into five units: Financial Institutions, Balance of Payments, Markets, Software, and Service.

### Human resources

Considerable changes took place in Central Bank staffing during 2010. A total of 29 employees left the Bank, retired, or took a leave of absence, and 25 new staff members were hired, whereas the number of summer employees was similar to previous years. Eight staff members retired: Karl G. Smith, Operations, after over 54 years of service; Árni Þórðarson, Finance, after 41 years; Alf H. Pedersen, Finance, after 40 years; Jóhann G. Friðjónsson, Operations, after 24 years; Gunnlaugur Magnússon, Operations, after 23 years; Ólafía Egilsdóttir, Operations, after over 21 years; Þorsteinn Þorvaldsson, Operations, after 13 years; and Hannes Ólafsson Nyman, Operations, after 10 years.

Erla Guðmundsdóttir was appointed temporary Deputy Director of Finance and head of Accounting. Lilja Dögg Alfreðsdóttir, Deputy Director of the General Secretariat, took a temporary leave of absence to work for the International Monetary Fund. The Capital Controls Surveillance Unit increased its staff by six, while the Economics Department recruited four new employees and the General Secretariat one. The staff of the Operations Department was reduced by 12, largely due to the outsourcing of the Bank's security services.

In 2010, the senior management of the Central Bank of Iceland decided to entrust Securitas with the Bank's security services and part of the custodial duties. The operation of the Bank's Security unit was thus discontinued. Of the eight employees in the unit, four left the Bank's employ and the other four retired. One member of the maintenance staff left the Bank.

At year-end 2010, the Bank's staff numbered 134 persons (excluding employees in cleaning services), 67 males and 67 females. The number of full-time equivalent positions was 129.1. Seven employees were in part-time posts equivalent to 5.1 positions, and the Icelandic Banks' Data Centre was responsible for three of the six positions in the joint cafeteria and maintenance it shares with the Central Bank.

As of year-end 2010, employees of the Bank's subsidiaries were 13, including 10 employed by Greiðsluveitan ehf. and three by Sölvhóll ehf.

### Wage agreements

Most Central Bank employees are members of the Federation of Bank Employees (SSF) and are paid salaries according to its wage agreements. SSF wage agreements expired at year-end 2010, and contractual negotiations are currently underway.

**Equal opportunities policy**

The Board of Governors first confirmed the Bank's equal opportunities strategy in 1996. An equal opportunities committee has been active since that time. The equal opportunities strategy has been reviewed regularly, most recently in 2007. The Bank's equal opportunities policy was confirmed at that time.

## Central Bank of Iceland 31 December 2010

### Supervisory Board

#### *Principal members*

Lára V. Júlíusdóttir, Chairman  
 Ragnar Arnalds, Deputy Chairman  
 Björn Herbert Guðbjörnsson  
 Hildur Traustadóttir  
 Ragnar Árnason  
 Katrín Olga Jóhannesdóttir  
 Daniel Gros

#### *Alternates*

Margrét Kristmannsdóttir  
 Anna Ólafsdóttir Björnsson  
 Sigrún Elsa Smáradóttir (elected 21 October 2010)  
 Guðrún Ágústa Guðmundsdóttir  
 Birgir Þór Runólfsson  
 Ingibjörg Ingvadóttir  
 Friðrik Már Baldursson

### Governor

Már Guðmundsson

### Deputy Governor

Arnór Sighvatsson

#### *Principal Officers*

International and Market

Operations Department: Sigurður Sturla Pálsson, Director

Finance Department: Kristín Hannesdóttir, Director

Financial Stability Department: Tryggvi Pálsson, Director

Economics Department: Þórarinn G. Pétursson,  
 Chief Economist

Legal Services: Sigríður Logadóttir, Chief Attorney

Operations Department: Ingvar A. Sigfússon, Director

General Secretariat: Jón Þ. Sigurgeirsson, Director

Statistics and IT Department: Tómas Örn Kristinsson, Director

Capital Controls Surveillance Unit: Ingibjörg Guðbjartsdóttir, Head  
 Þuríður Árnadóttir, Acting Head



## Employees

### GENERAL SECRETARIAT

Bára Brynjólfssdóttir  
Björn Gunnar Ólafsson  
Hrafnhildur Ýr Bernharðsdóttir  
Jón Þorvarður Sigurgeirsson  
Ragnheiður Jónsdóttir  
Stefán Jóhann Stefánsson  
Þorsteinn Þorgeirsson

### Legal Services

Ragnar Árni Sigurðarson  
Sigfús Gauti Þórðarson  
Sigríður Logadóttir

### Capital Controls Surveillance Unit

Einar Örn Þorvaldsson  
Freyja Vilborg Þórarinsdóttir  
Guðjón Viðar Valdimarsson  
Guðmundur Sigbergsson  
Hilmar Vilberg Gylfason  
Hreiðar Eiríksson  
Ingibjörg Guðbjartsdóttir  
Jón Karlsson  
Pétur Steinn Pétursson

### Library and Collection

Anton Holt  
Guðbjörg Þórarinsdóttir  
Magný Gyða Ellertsdóttir  
Sigurborg Brynja Ólafsdóttir  
Sigurþór Sigurðsson  
Valborg Stefánsdóttir

### INTERNATIONAL AND MARKET OPERATIONS DEPARTMENT

Anna Karen Arnarsdóttir  
Auður Gústafsdóttir  
Bergur Barðason  
Björgvin Sighvatsson  
Freyr Hermannsson  
Gerður Ísberg  
Hafsteinn Hafsteinsson  
Halldór Sveinn Kristinsson  
Hallgrímur Ólafsson  
Helga Rún Helgadóttir  
Kjartan Hauksson  
Oddgeir Gunnarsson  
Sigurður Freyr Magnússon  
Sigurður Sturla Pálsson  
Sigurður Thoroddsen  
Viðar Rúnar Geirsson

### ACCOUNTING DEPARTMENT

Anna Sveins Árnadóttir  
Arndís Leifsdóttir  
Berglind Ósk Björgvinsdóttir  
Erla Guðmundsdóttir  
Guðrún Elín Herberthsdóttir

Hafdís Helgadóttir  
Halldóra Konráðsdóttir  
Helga Guðrún Lárusdóttir  
Ísólfrur Sigurðsson  
Jónína Guðbjartsdóttir  
Kristín Hannesdóttir  
Margrét Einarsdóttir  
Oddný Lára Eiríksdóttir  
Oddrún Jónasdóttir

### FINANCIAL STABILITY DEPARTMENT

Aðalbjörg Jóhanna Helgadóttir  
Bryndís Ásbjarnardóttir  
Eggert Þröstur Þórarinsson  
Elín Kristjana Sighvatsdóttir  
Guðmundur Kristján Tómasson  
Harpa Jónsdóttir  
Jónas Þórðarson  
Páll Kolka Ísberg  
Tryggvi Pálsson

### Cashier's Unit

Auður Gísladóttir  
Ingveldur S. Kristjánsdóttir  
Jóhanna Pétursdóttir  
Kolbrún Jóhannsdóttir  
Kristján Guðmundsson  
Sigríður Ketilsdóttir  
Stefán Arnarson

### ECONOMICS DEPARTMENT

Ásgeir Danielsson  
Bjarni Geir Einarsson  
Guðjón Emilsson  
Guðrún Yrsa Richter  
Gunnar Gunnarsson  
Helga Guðmundsdóttir  
Hörður Garðarsson  
Jósef Sigurðsson  
Karen Áslaug Vignisdóttir  
Lilja Guðrún Jóhannsdóttir  
Magnús Fjalar Guðmundsson  
Marías Halldór Gestsson  
Markús K. Möller  
Ólafur Garðar Halldórsson  
Ólafur Örn Klemensson  
Rannveig S. Sigurðardóttir  
Regína Bjarnadóttir  
Rósa Björk Sveinsdóttir  
Svava Jóhanna Haraldsdóttir  
Þórarinn Gunnar Pétursson

### OPERATIONS DEPARTMENT

Birna Kristín Jónsdóttir  
Eva Benediktsdóttir  
Ingvar Alfreð Sigfússon  
Kristín Gunnarsdóttir  
Þórður Gautason

### Maintenance and Janitorial Services

Bogey Hreiðarsdóttir  
Guðný Harpa Hallgrímsdóttir  
Hildur Hrönn Hreiðarsdóttir  
Karítas Kristín Ísaksdóttir  
Marteinn Jóhannesson  
Olga Aðalbjörg Björnsdóttir  
Ragnheiður Elva Rúnarsdóttir  
Rita Sigurðardóttir  
Sigurlaug Jósepsdóttir  
Sólveig Kristinsdóttir

### Cafeteria

Guðlaug Erla Ingólfssdóttir  
Guðrún Sigríður Guðmundsdóttir  
Janthuan Uansa-Ard  
Sigríður Laufey Gunnarsdóttir  
Sigurberg Jónsson

### Design and Printing

Sigríður María Jónsdóttir  
Sigurborg Steingrimsdóttir  
Sveinn Auðunn Blöndal

### Secretaries

Hrafnhildur Georgsdóttir  
Klara Jóhannsdóttir  
Þórey Þórarinsdóttir

### Archives

Eva Sóley Sigurðardóttir  
Guðrún Sigmarsdóttir  
Hilmar Gunnþór Garðarsson  
Sveinbjörg Rut Helgadóttir

### Transport

Garðar Halldórsson

### STATISTICS AND IT DEPARTMENT

Arnar Freyr Guðmundsson  
Bryndís Pétursdóttir  
Einar Örn Ólafsson  
Eva Hjördís Bjarnadóttir  
Fjóla Agnarsdóttir  
Guðmundur Harðarson  
Gylfi Vilberg Árnason  
Hrönn Helgadóttir  
Jakob Gunnarsson  
Karl Jóhann Magnússon  
Lárus Jóhannesson  
Lilja Anna Gunnarsdóttir  
Margrét Sigríður Guðjónsdóttir  
Mark Townley  
Pétur Örn Sigurðsson  
Ríkarður Bergstað Ríkarðsson  
Steinar Örn Erlendsson  
Svava Óskarsdóttir  
Tómas Örn Kristinsson  
Tryggvi Eyvindsson  
Örn Jónasson





CONSOLIDATED  
ANNUAL ACCOUNTS 2010



## *Independent Auditor's Report*

*To the Governor and the Supervisory Board of the Central Bank of Iceland*

We have audited the accompanying Consolidated Annual Accounts of the Central Bank of Iceland for the year 2010, which comprise a report from the Supervisory Board and the Governors, Profit and Loss Account, Balance Sheet, Statement of Cash Flows, summary of significant accounting policies, and other explanatory notes.

### *Management's responsibility for the Consolidated Annual Accounts*

Management is responsible for the preparation and fair presentation of these Consolidated Annual Accounts in accordance with generally accepted accounting principles in Iceland and the Icelandic Annual Accounts Act. This responsibility includes designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of Consolidated Annual Accounts that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### *Auditor's responsibility*

Our responsibility is to express an opinion on these Consolidated Annual Accounts based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Consolidated Annual Accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Consolidated Annual Accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Annual Accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Annual Accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Consolidated Annual Accounts.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the Consolidated Annual Accounts give a true and fair view of the financial position of the Central Bank of Iceland as of 31 December 2010, and of its operations and its cash flows for the year then ended, in accordance with generally accepted accounting principles in Iceland applied on a consistent basis.

Kópavogur, 29 March 2011

Deloitte hf.

Benóni Torfi Eggertsson  
State-Authorised Public Accountant

Jón Rafn Ragnarsson  
State-Authorised Public Accountant

## Confirmation by the management of the Central Bank of Iceland

The Supervisory Board and Governor of the Central Bank of Iceland hereby confirm the Bank's Annual Accounts for the year 2010 with their signatures.

Reykjavík, 29 March 2011

### Supervisory Board

*Ragnar Arnalds  
Hildur Traustadóttir  
Friðrik Már Baldursson*

*Lára V. Júlíusdóttir  
Chairman*

*Björn Herbert Guðbjörnsson  
Ragnar Árnason  
Ingibjörg Ingvadóttir*

### Confirmation by the Governor

*Már Guðmundsson*

## Confirmation by the Minister of Economic Affairs

With reference to the statements of the auditor, the Supervisory Board and the Governor, the Annual Accounts are hereby ratified.

Reykjavík, 30 March 2011

*Árni Páll Árnason*

## Profit and Loss Account for the Year 2010

	Notes	2010	2009
<b>Interest income</b>			
From domestic assets .....	20	37,958,088	67,165,053
From foreign assets .....	20	11,125,305	9,340,025
		<u>49,083,393</u>	<u>76,505,078</u>
<b>Interest expense</b>			
From domestic liabilities .....	20	27,783,299	50,642,966
From foreign liabilities .....	20	8,540,466	10,633,445
		<u>36,323,765</u>	<u>61,276,411</u>
<b>Net interest income</b>		<b>12,759,628</b>	<b>15,228,667</b>
<b>Other operating revenues</b>			
Service revenues .....		380,656	445,089
Service expense .....		(249,087)	(253,789)
Revenues from shareholdings .....		137,185	55,554
Revaluation of foreign securities and loans .....		975,851	3,547,100
Revaluation of gold .....		2,564,501	1,668,139
Exchange rate gains on foreign exchange transactions ..		727,842	1,361,499
Gains on system sales .....		186,760	0
Revaluation of Greiðsluveitan .....		146,625	0
		<u>4,870,333</u>	<u>6,823,593</u>
<b>Net operating revenues</b>		<b>17,629,961</b>	<b>22,052,260</b>
<b>Other operating expense</b>			
Wages and salaries and related expenses .....	13, 14	1,316,123	1,324,140
Other operating expenses .....		642,847	872,061
Expense due to banknotes and coin .....		9,886	211,494
Depreciation of fixed assets .....	7	78,642	94,335
		<u>2,047,498</u>	<u>2,502,030</u>
Impairment of claims .....		21,279,537	22,073,493
<b>Total operating expenses</b> .....		<b>23,327,035</b>	<b>24,575,523</b>
<b>Loss for the year excluding transfer</b>		<b>(5,697,074)</b>	<b>(2,523,264)</b>
Transfer to the Treasury .....		0	0
<b>Loss without exchange rate difference</b>		<b>(5,697,074)</b>	<b>(2,523,264)</b>
Exchange rate difference .....	17	(6,933,007)	3,023,442
<b>Pre-tax (loss) profit for the year</b> .....		<b>(12,630,081)</b>	<b>500,178</b>
Income tax 18% .....		(868,785)	0
<b>(Loss) profit for the year</b> .....		<b>(13,498,866)</b>	<b>500,178</b>

Amounts are in ISK thousands

## Balance Sheet 31 December 2010

ASSETS	Notes	2010	2009
<b>Foreign assets</b>			
Bank deposits .....		433,260,412	241,054,034
Gold .....	6	10,426,358	8,663,849
Securities .....	6, 22	217,821,305	231,573,927
FX balance with the International Monetary Fund .....	8	3,321,985	3,648,662
Other foreign assets apart from foreign reserves .....		1,689,602	190,046
Foreign assets		<u>666,519,662</u>	<u>485,130,518</u>
<b>Domestic assets</b>			
<i>Deposit money banks</i>			
Collateralised loans and overnight loans .....		41,819,956	10,949,172
Foreign loans to banks .....		0	3,076,555
Other foreign-denominated claims .....		103,224,534	8,120,917
Other claims .....		121,112,038	6,722,016
Deposits .....		304,272	0
		<u>266,460,800</u>	<u>28,868,660</u>
<i>Other financial institutions</i>			
Listed securities .....		11,039,789	3,132,781
Past-due collateralised loans and overnight loans .....	4	101,951,118	328,411,553
Foreign-denominated loans due and payable .....	4	0	162,202,466
		<u>112,990,907</u>	<u>493,746,800</u>
<i>National Treasury</i>			
Securities due to takeover of collateralised loans .....	4	164,388,390	161,141,869
Foreign securities .....		6,136,176	4,256,573
Income tax credit balance .....		1,200,000	0
		<u>171,724,566</u>	<u>165,398,442</u>
<i>Other parties</i>			
Miscellaneous accounts .....		2,157,493	132,975
Securities .....		9,782	50,514
Other foreign-denominated claims .....		81,745,582	0
Other claims .....		19,230,793	0
		<u>103,143,650</u>	<u>183,489</u>
<i>Fixed operational assets</i>			
Real estate and liquid assets .....	7	4,997,336	4,754,354
Domestic assets		<u>659,317,259</u>	<u>692,951,743</u>
Total assets .....		<u><u>1,325,836,921</u></u>	<u><u>1,178,082,262</u></u>
Assets not included in the Balance Sheet .....	16		



## Balance Sheet 31 December 2010

### LIABILITIES AND EQUITY

	Notes	2010	2009
<b>Foreign liabilities</b>			
Deposits of non-residents .....		67,004,034	36,752,068
Foreign long-term loans .....	9	36,915,859	14,570,280
Counterpart to IMF .....	8	19,970,516	21,970,839
Loan from IMF .....	8	156,322,258	130,695,818
<b>Foreign debt</b>		<b>280,212,667</b>	<b>203,989,005</b>
<b>Domestic liabilities</b>			
Banknotes and coin .....		38,269,479	28,957,678
<i>Deposit money banks</i>			
Current accounts .....		55,659,624	87,607,042
Certificates of deposit .....		60,957,470	36,359,094
FX accounts .....		8,157,241	20,615,131
Swap agreements .....		48,588,986	9,408,543
		<b>173,363,321</b>	<b>153,989,810</b>
<i>Other financial institutions</i>			
Current accounts .....		36,915,984	35,412,352
Certificates of deposit .....		4,505,298	668,738
Time deposits, FX .....		252,978,772	153,141,635
FX accounts .....		20,374,207	54,869,981
		<b>314,774,261</b>	<b>244,092,705</b>
<i>Treasury and Government institutions</i>			
Treasury, current accounts .....		130,050,348	166,050,140
Treasury, time deposits .....	12	0	6,672,821
FX accounts .....		175,842,255	49,129,190
Foreign-denominated bonds .....	12	106,328,359	179,997,675
Treasury borrowings for expansion of FX reserves .....	12	11,000,011	44,537,142
Government institutions, current accounts .....		1,426,680	281,500
Income tax obligation .....		9,070	0
Other liabilities .....		2,448,258	0
		<b>427,104,981</b>	<b>446,668,468</b>
<i>Other liabilities</i>			
Miscellaneous parties .....		22,410,832	17,157,002
Pension obligations .....	11	322,222	349,569
		<b>22,733,054</b>	<b>17,506,571</b>
<b>Domestic liabilities</b>		<b>976,245,096</b>	<b>891,215,234</b>
<b>Equity</b>			
Guarantee capital .....	15	57,501,000	57,501,000
Revaluation of real estate and liquid assets .....	15	4,554,388	4,606,855
Other equity .....	15	7,323,770	20,770,169
<b>Equity</b>		<b>69,379,158</b>	<b>82,878,024</b>
<b>Liabilities and equity .....</b>		<b>1,325,836,921</b>	<b>1,178,082,262</b>

Amounts are in ISK thousands

## Statement of Cash Flows 2010

OPERATING ACTIVITIES:	2010	2009
(Loss) profit for the year .....	(13,498,866)	500,178
<i>Operating items not involving cash:</i>		
Depreciation of fixed assets .....	78,642	94,335
Exchange rate differences on assets and liabilities .....	(27,868,907)	12,193,771
Exchange rate differences on cash position .....	28,512,530	(15,217,213)
Various valuation changes, assets and liabilities .....	(16,956,535)	(29,402,674)
Loans written off .....	18,172,738	22,073,493
Capital shares written off .....	3,106,800	0
Income tax credit .....	(1,199,586)	0
<i>Change in operating assets and liabilities</i> .....	3,756,863	(45,327,513)
From operating activities	<u>(5,896,322)</u>	<u>(55,085,622)</u>
 <b>INVESTMENT ACTIVITIES:</b>		
Collateralised loans and overnight loans (increase), decrease .....	(30,892,332)	130,457,221
Foreign-denominated loans to domestic parties .....	(1,470,518)	(7,493,275)
Purchase price of property and equipment .....	(25,886)	(24,677)
Securities purchased .....	(59,848,119)	(4,256,573)
Instalments on securities, etc. ....	86,332,795	272,341
Securities purchased in foreign reserves .....	(99,051,514)	(64,428,800)
Securities sold in foreign reserves .....	77,485,490	59,723,019
Share capital increase and subsidiaries' share capital increase ...	(188,240)	0
Investment tax, subsidiaries .....	(1,424,573)	0
Total investing activities	<u>(29,082,897)</u>	<u>114,249,256</u>
 <b>FINANCING ACTIVITIES:</b>		
Banknotes and coin in circulation, increase .....	9,311,800	4,521,240
Loan from IMF .....	38,930,335	39,608,619
Loans taken from Nordic central banks .....	25,009,110	(67,743,880)
Other loans taken .....	6,739,897	(47,437,513)
Certificates of deposit, increase (decrease) .....	28,483,775	(146,313,900)
Treasury time deposits (decrease) .....	(6,500,000)	(9,300,000)
Contributed capital .....	(32,643,000)	0
Foreign currency deposits, increase (decrease) .....	107,480,036	153,544,018
Increase (decrease) in deposits, DMBs .....	(30,197,579)	26,947,240
Increase (decrease) in deposits, other .....	5,591,544	8,787,359
Increase (decrease) in deposits, central government .....	102,164,719	(3,249,644)
Total financing activities	<u>254,360,637</u>	<u>(40,636,460)</u>
 <b>CHANGES IN CASH POSITION:</b>		
Foreign bank deposits, increase (decrease) .....	220,718,909	18,527,174
Exchange rate differences on bank deposits .....	(28,512,530)	15,217,213
Foreign deposit balance at beginning of year .....	241,054,034	207,309,648
Foreign deposit balance at year-end .....	<u>433,260,412</u>	<u>241,054,034</u>

## Notes to the financial statements for the year 2010

1. The annual financial statements have been prepared in accordance with the Annual Accounts Act, no. 3/2006, the Act on Financial Undertakings, no. 161/2002, and the Rules on the Central Bank of Iceland's Accounting and Annual Accounts, no. 1088/2005.
  - The Annual Accounts for the group include those of the parent company and its subsidiaries. Subsidiaries are companies controlled by the group. Control exists when the parent company has decision-making power concerning the operations and financial management of the subsidiaries. Among the objectives of consolidated financial reporting is to publish only income, expenses, assets, and liabilities vis-à-vis external parties; therefore, internal transactions are netted out in preparing the financial statements.
  - Assets and liabilities in foreign currency are presented in Icelandic currency using the mid-exchange rate as of year-end 2010. Revenues and expenses in foreign currency are converted using the exchange rate on the transaction date. Exchange rate gains/losses are recognised in the profit and loss account.
  - Indexed assets and liabilities are entered with accrued indexation as of year-end 2010, using the index value of January 2011, which reflects year-end 2010 price levels. Indexation is recognised in the profit and loss account, with interest.
  - Securities in the Bank's foreign exchange reserves are entered at market price in US dollars, and valuation changes are entered in the profit and loss account. Valuation changes are the difference between market value and book value of securities, and the premium or discount on the date of purchase is distributed over the lifetime of the securities on a straight-line basis, providing an effective interest rate.
  - Revenues are entered when earned, irrespective of whether collection has taken place. Expenses are also entered when incurred, irrespective of whether they have been paid. Furthermore, valuation changes in securities are entered in the profit and loss account, irrespective of whether the securities have been redeemed.
  - The statement of cash flows shows movements in the conventional categories in such a statement; however, the cash balance is defined based on foreign deposits.
  - Equity securities are entered at cost price, as the equities owned by the Bank have not been traded on the market.
  - Seigniorage is expensed when the costs are incurred.
  - Fixed operational assets were capitalised in 2005 based on the appraised value at the end of that year. Assets are listed among fixed operational assets when it is likely that the economic benefits of the asset concerned will be useful to the group and when it is possible

### Accounting principles

## Shareholdings in associated companies

to estimate the cost due to the asset in a reliable manner. Fixed operational assets are recognised using either the cost-price method or the revaluation method. According to the cost-price method, fixed tangible assets are entered at original cost price less accumulated depreciation and impairment. The cost price of fixed operational assets consists of the purchase price and all direct costs relating to putting the asset into revenue-generating condition. The revaluation method uses fair value on the date the fixed operational assets are revalued, less depreciation and impairment.

- Gold in the Bank's foreign exchange reserves is entered at market price in US dollars, and valuation changes are entered in the profit and loss account.

2. Shareholdings in the Bank for International Settlements (BIS) are entered at cost price. At year-end 2010, the number of shares was 1,070 and the value of each share was SDR 5,000. This holding is entered under the item Foreign Assets/Assets not included in foreign reserves. The book value as of year-end 2010 was 184.5 m.kr., and the nominal value was 261.8 m.kr. (SDR 1.3 million). Payment has been remitted for 25% of each SDR 5,000 share, or SDR 1,250 for each share. The Bank is obliged to remit the remaining 75% upon demand.

## Subsidiaries

<i>Name of subsidiary</i>	<i>Location</i>	<i>Ownership share</i>	<i>Nominal value, m.kr.</i>	<i>Primary activities</i>
Sölvhóll ehf.	Iceland	100%	1,000,000	Operating company
CBI Holding Company	Iceland	100%	1,000,000	Holding company
Greiðsluveitan ehf.	Iceland	100%	20,000,000	Payment system operations

## Eignasafn Seðlabanka Íslands ehf. and Sölvhóll ehf.

3.
  4. Until 2008, the Bank had not sustained any losses due to credit risk. In the wake of the banking collapse of 2008-2009, however, it has become clear that the Bank has sustained some losses due to unsecured collateral for collateralised loans that were deemed sound at the time the loans were granted. In view of this, the Treasury, as the owner of the Bank, purchased securities with a book value of 345 b.kr. at year-end 2008. It paid for them with an indexed five-year debt instrument in the amount of 270 b.kr., and 75 b.kr. were written off at the same time. At year-end 2009, it was decided that the Central Bank would buy back the assets in question and then sell them to a separate subsidiary owned by the Bank and bearing the name Central Bank of Iceland Holding Company ehf. (ESÍ). Another Central Bank subsidiary, Sölvhóll ehf., is an operating company whose role will be to maximise the value of the assets in the holding company (ESÍ) and divest them when market conditions permit, subject to the approval of the ESÍ board. This arrangement provides the Bank with an effective means of separating the operations and assets related to the crash from its conventional activities.

*Changes in the Treasury debt instrument are itemised as follows:*  
(ISK thousands)

	2010	2009	2008
Balance at beginning of year .....	161,142	270,005	0
Principal .....	146,651	270,005	0
Purchases during the year.....			270,005
Indexation.....	16,726	23,303	0
Accrued interest .....	1,009	1,833	0
Payment.....		(134,000)	0
Balance at year-end .....	<u>164,388</u>	<u>161,142</u>	<u>270,005</u>

*Collateralised loans due and payable are itemised as follows:*

	2010	2009	2008
Balance at beginning of year .....	490,614	333,491	0
Collateralised loans due and payable during the year .....	0	117,270	678,496
Collateralised loans purchased from the Treasury .....	0	134,000	0
Book value of collateralised loans sold to the Treasury .....	0	0	(95,102)
Appropriation of assets .....	(264,931)	0	0
Collateralised loans written off .....	(16,517)	(22,073)	(249,903)
Instalm. and exch. rate differential .....	<u>(107,215)</u>	<u>(72,074)</u>	<u>0</u>
Balance at year-end .....	<u>101,951</u>	<u>490,614</u>	<u>333,491</u>

5. On 15 November 2010, the owners of the Icelandic Banks' Data Centre (RB) and Fjölgreiðslumiðlun hf. (FGM) signed a framework agreement concerning a new structure for core and support systems pertaining to domestic payment intermediation. Among other things, the framework agreement stipulated that RB's operational form would change from a collaborative forum to a limited liability company, that the Central Bank would sell its stake in RB and acquire FGM in full, and that ownership of the part of RB's software solutions most closely connected with payment intermediation would be transferred to FGM.

These changes were formally confirmed on 15 December 2010 with the signing of an agreement between the owners of RB and FGM (banks, savings banks, payment card companies, and the Central Bank). With Decision no. 2/2011, dated 28 January 2011, the Competition Authority approved the merger of the Central Bank and FGM (the Bank's takeover of FGM'S operations is the equivalent of a merger in the sense of the Competition Act). The name of the company has now been changed to Greiðsluveitan, and the operational form has been changed from a public limited company (hf.) to a private limited company (ehf.), as the Central Bank of Iceland is the sole owner.

Greiðsluveitan ehf. now owns and is responsible for the operation of the following payment intermediation systems: the RTGS system, the netting system, the RÁS system, the payables pool, Birtingur, and the SWIFT Alliance system. No changes will occur in the technical operation of the systems, which will continue to be run by RB on the basis of an operational and service agreement between Greiðsluveitan and RB.

Greiðsluveitan ehf.

## Foreign assets and gold

6. As of year-end 2010, the Bank's foreign assets totalled 667 b.kr., as opposed to 485 b.kr. at year-end 2009. Included in this balance are the Bank's holdings in gold, which totalled 63,785.1 ounces. The gold is entered at market value as of year-end 2010, when the ounce was valued at USD 1420.78, the equivalent of 163,461 kr. Thus the Bank's holdings in gold were valued at 10.4 b.kr. as of year-end 2010.

*Holdings of gold are itemised as follows:*

	2010	2009
Balance at beginning of year .....	8,663,849	6,652,894
Revaluation .....	2,564,501	1,668,139
Price differential .....	(801,992)	342,816
Balance at year-end .....	<u>10,426,358</u>	<u>8,663,849</u>

- During the year, returns on securities, including interest income and price changes, and on bank deposits in each currency in the Bank's foreign exchange reserves, were as follows:

	Securities	Bank deposits
US dollars (USD) .....	4.29%	0.16%
Euros (EUR) .....	2.48%	0.31%
Pounds sterling (GBP) .....	3.91%	0.47%
<i>Securities are itemised as follows:</i>		
	2010	2009
Balance at beginning of year .....	231,573,927	211,855,297
Purchases during the year .....	99,051,514	64,428,800
Sold and collected during the year .....	(78,209,704)	(59,723,019)
Revaluation .....	(2,330,758)	3,553,889
Price differential .....	(32,263,674)	11,458,960
Balance at year-end .....	<u>217,821,305</u>	<u>231,573,927</u>

## Fixed assets

7. Fixed operational assets were capitalised in 2005 based on the appraised value at the end of that year. Assets are listed among fixed operational assets when it is likely that the economic benefits of the asset concerned will be useful to the group and when it is possible to estimate the cost due to the asset in a reliable manner. Fixed operational assets are recognised using either the cost-price method or the revaluation method. According to the cost-price method, fixed operational assets are entered at original cost price less accumulated depreciation and impairment. The cost price of fixed operational assets consists of the purchase price and all direct costs relating to putting the asset into revenue-generating condition. The revaluation method uses fair value on the date the fixed operational assets are revalued, less depreciation and impairment.
- Fixed operational assets as of year-end 2010 are itemised as follows (amounts in ISK thousands):

	<i>Land</i>	<i>Real estate</i>	<i>Liquid assets</i>	<i>Collections</i>	<i>Total</i>
<i>Cost price and valuation</i>					
Cost price at beginning of year 2009 .....	0	90,976	72,314	8,126	171,416
Valuation at beginning of year 2009 .....	24,000	4,575,331	181,945	237,000	5,018,275
<i>Total at beginning of year 2009</i>	24,000	4,666,307	254,259	245,126	5,189,692
Capitalised during the year .....	0	0	30,877	0	30,877
Sold (cost price) .....	0	0	(8,890)	0	(8,890)
Cost price at beginning of year 2010 .....	0	90,976	103,191	8,126	202,293
Valuation at beginning of year 2010 .....	24,000	4,575,331	173,055	237,000	5,009,385
<i>Total at beginning of year 2010</i>	24,000	4,666,307	276,246	245,126	5,211,679
Transferred during the year due to merger ..	0	0	671,108	0	671,108
Capitalised during the year .....	0	0	25,886	0	25,886
Sales and disp. during the year (cost price)...	0	0	(13,214)	0	(13,214)
Sold (valuation) .....	0	0	(140,329)	0	(140,329)
Cost price at year-end 2010 .....	0	90,976	786,971	8,126	886,073
Valuation at year-end 2010 .....	24,000	4,575,331	32,726	237,000	4,869,057
<i>Total at year-end 2010</i>	24,000	4,666,307	819,697	245,126	5,755,130
<i>Depreciation</i>					
Cost price at beginning of year 2009 .....	0	1,679	29,631	0	31,311
Valuation at beginning of year 2009 .....	0	194,551	142,107	0	336,657
<i>Total at beginning of year 2009</i>	0	196,230	171,738	0	367,968
Depreciation for the year at cost price .....	0	892	22,592	0	23,484
Depreciation for the year at valuation price ..	0	49,003	21,848	0	70,851
Sold (cost price) .....	0	0	(4,978)	0	(4,978)
Cost price at beginning of year 2010 .....	0	2,572	52,223	0	54,795
Valuation at beginning of year 2010 .....	0	243,554	158,976	0	402,530
<i>Total at beginning of year 2010</i>	0	246,126	211,199	0	457,325
Transferred due to merger .....	0	0	375,370	0	375,370
Depreciation for the year at cost price .....	0	951	25,224	0	26,175
Depreciation for the year at valuation price ..	0	48,944	3,523	0	52,467
Sales and disp. during the year (cost price)...	0	0	(13,214)	0	(13,214)
Sold (valuation) .....	0	0	(140,329)	0	(140,329)
Cost price at year-end 2010 .....	0	3,523	439,603	0	443,126
Valuation at year-end 2010 .....	0	292,498	22,170	0	314,668
<i>Total at year-end 2010</i>	0	296,021	461,773	0	757,794
<i>Book value</i>					
Book value at beginning of year 2009 .....	24,000	4,470,077	82,521	245,126	4,821,724
Book value at beginning of year 2010 .....	24,000	4,420,181	65,046	245,126	4,754,354
Book value at year-end 2010 .....	24,000	4,370,286	357,924	245,126	4,997,336
Depreciation percentages .....	0%	1-3%	10-33%	0%	
Estimated utilisation period .....		33-80 years	3-10 years		

8. Iceland's quota with the International Monetary Fund (IMF) totalled SDR 117.6 million at year-end 2010. One-fourth (¼) of the quota was paid for with gold and Icelandic krónur. The Bank's foreign exchange balance with the Fund totalled SDR 18.7 million, which is the difference between the quota and the Fund's ISK deposits with the Bank; cf. the table below. The Bank's borrowings in the form of Fund allocations in SDR totalled SDR 112.2 million. Then the Bank received the third and fourth tranches of the IMF loan, each of which amounts to SDR 105 million. Amounts are in millions.

#### International Monetary Fund

Assets	In millions	
	SDR	ISK
Central Bank of Iceland quota .....	117.6	20,922.2
IMF deposit with Central Bank of Iceland .....	(98.9)	(17,601.6)
Central Bank's FX balance with IMF .....	18.7	3,320.6
Accrued interest on FX balance .....	0.0	1.4
Central Bank's deposit balance with IMF .....	73.5	13,078.5
	<u>92.2</u>	<u>16,400.5</u>
<i>Liabilities</i>		
	SDR	ISK
Counterpart to IMF allocations .....	112.2	19,958.0
IMF current account with the Central Bank .....	0.0	0.3
Accrued interest on SDR allocation .....	0.1	12.2
Borrowed from IMF during the year .....	875.0	155,671.3
Accrued interest on IMF loan .....	3.7	651.0
	<u>991.0</u>	<u>176,293.0</u>

- Disbursements from the IMF in connection with the Stand-By Arrangement are eight in number: the first tranche totalled SDR 560 million, the next four tranches are SDR 105 million each; and the last three tranches are SDR 140 million each. The total IMF loan facility in connection with the Stand-By Arrangement amounts to an estimated SDR 1,400 million. Disbursements were made on the following dates: first tranche, 19 November 2008; second tranche, 30 October 2009; third tranche, 20 April 2010; and fourth tranche, 1 December 2010. As of year-end 2010, a total of SDR 875 million had been drawn on the total IMF loan facility. A further SDR 735 million are available for future disbursement.

#### Foreign debt

#### Position vis-à-vis financial institutions

#### Pension obligations

9. On 21 December 2009, the first tranche of the loan from the Nordic countries was disbursed to Iceland in connection with the Stand-By Arrangement. The second tranche was disbursed on 28 June 2010. The total amounts to 887 million euros, of which the Central Bank of Iceland borrowed 240 million euros, or approximately 36.9 b.kr., from Norges Bank at the year-end 2010 exchange rate.
10. Credit institutions that are participants in the Central Bank RTGS system submit collateral for payments through the system. That collateral takes the form of securities. The collateral amount corresponds to the credit institutions' authorised intraday overdraft limit in the RTGS system.
  - At year-end 2010, RTGS system collateral securities had a total market value of 19.37 b.kr.
  - Credit institutions submit collateral to be held in custody at the Central Bank of Iceland in return for their collateralised loans in accordance with Rules no. 997/2004.
11. According to actuarial assessments, the Central Bank of Iceland's obligations due to pension payments to former governors' and their spouses and the director of the National Economic Institute, of which the Bank bore half the operational expense, totalled 322.2 m.kr. as of year-end 2010. Payments related to these to-



talled 51.2 m.kr. in 2010 and reduce the previously entered obligation. Increases in the Bank's obligations, after accounting for payments, totalled 23.9 m.kr. in 2010 and are charged.

*Changes in tax liability during the year are as follows:*

	2010	2009
Pension obligations at beginning of year . . . .	349,569	347,218
Paid due to retirement . . . . .	(51,207)	(49,878)
Increase during the year . . . . .	23,860	52,229
Pension obligations at year-end . . . . .	<u>322,222</u>	<u>349,569</u>

12. The transfer to the Treasury, pursuant to Article 34 of the Act on the Central Bank of Iceland, no. 36/2001, is calculated as 2/3 of the profit on its net profit (excluding exchange rate loss or gain) during the year if equity (excluding revaluation) exceeds 2.25% of outstanding loans and domestic securities holdings in the credit system at the end of the year; otherwise, the transfer shall equal 1/3. Because the Bank's equity was below this limit at year-end 2010, payment should have been calculated as 1/3 of profits; however, the Bank incurred a loss in 2010, and there will be no transfer to the Treasury for the year.

- The Bank took a long-term loan from the Treasury in late 2006 in order to expand its foreign exchange reserves. The Treasury sold bonds abroad and reloaned the proceeds, in the amount of 1 billion euros, to the Bank. The Central Bank, on behalf of the Treasury, has repurchased a portion of the bonds, and the outstanding balance of the loan was 639 million euros as of year-end 2010. The nominal interest rate on the loan is 3.75%, and the bonds sold at an effective rate of 3.88%. The maturity date of the loan is 1 December 2011, and interest is paid annually on 1 December.
- The Bank also borrowed funds from the Treasury in late 2008 in order to expand its foreign exchange reserves. The Treasury borrowed funds from Bayerische Landesbank in the amount of 300 million euros. The loan was taken in late September and matures at the end of September 2011, and interest is paid at the end of March and September. The Central Bank, on behalf of the Treasury, has repurchased a portion of the loan. The loan to the Bank is in Icelandic krónur, and its book value, with accrued interest, was 11 b.kr. as of year-end 2010. The loan bears the same interest as DMBs' current accounts. Borrowing costs were borne by the Treasury.
- The Bank also borrowed funds from the Treasury in late 2010 in order to expand its foreign exchange reserves. The Treasury borrowed 205 million euros from the Polish government. The book value of the debt, including accrued interest, was 8 b.kr. at year-end 2010.
- Central government deposits with the Central Bank totalled 427 b.kr. at year-end 2010, as compared with 447 b.kr. at end-2009, a decrease of 20 b.kr. New foreign loans were taken in the amount of 8 b.kr., and a time deposit in the amount of 6.5 b.kr. was paid. Furthermore, a loan amounting to 90 b.kr. was paid, and krónur in the amount of 79 b.kr. were brought into Iceland in connec-

## National Treasury

tion with the Avens agreement. Other changes are explained by exchange rate differences and valuation changes.

### Salaries and payroll costs

#### 13. Total salaries and payroll costs specify as follows (in ISK thousands):

	2010	2009
Wages and salaries .....	1,046,445	1,048,976
Payroll costs .....	245,817	222,935
Contribution to pension obligations .....	23,860	52,229
	<u>1,316,123</u>	<u>1,324,140</u>
Number of positions at year end .....	147	127

### Salaries and compensation of senior management

#### 14. In 2010, total remuneration to governors and the Supervisory Board amounted to 31.20 m.kr. The Governor is not remunerated for participation in boards and committees jointly operated by institutions in the financial market or to which the Central Bank of Iceland appoints a representative by law. Total remuneration to governors and the Supervisory Board in 2010 specify as follows (in ISK millions):

	2010	2009
<i>Governors</i>		
Davíð Oddsson .....		16.1
Eiríkur Guðnason .....		23.5
Ingimundur Friðriksson .....		18.7
Svein Harald Öygard .....		15.5
Már Guðmundsson .....	18.7	7.4
<i>Supervisory Board</i>		
Halldór Blöndal .....		0.7
Lára V. Júlíusdóttir .....	3.0	2.4
Other Superv. Board members and alternates	9.5	10.8
	<u>31.2</u>	<u>95.1</u>

### Itemisation of equity and developments in the Bank's profit

#### 15. In the past five years, the Bank's equity has changed as follows (in ISK millions):

Equity	2010	2009	2008	2007	2006
Equity at beg. of yr. (excl. revaluation)	78,271	77,386	86,012	43,236	31,379
Capital contribution	0	0	0	44,000	0
Net profit (loss) bef. transfer and exch. rate diff.	(5,697)	(2,523)	(227,509)	7,013	48
Coll. loans reclaimed from Treasury	0	0	174,903	0	0
Transfer to Treasury	0	0		(2,338)	(16)
Write-offs, revalued assets	52	384	0	0	0
Exch. rate diff., gain (loss)	(6,933)	3,023	43,980	(5,899)	11,825
Calcul. inc. tax, subs.	(869)	0	0	0	0
Equity at year-end (excl. revaluation)	64,825	78,271	77,386	86,012	43,236
Revaluation of assets	4,607	4,991	4,991	4,991	4,991
Depreciation	(52)	(384)	0	0	0
Equity at year-end	<u>69,379</u>	<u>82,878</u>	<u>82,377</u>	<u>91,003</u>	<u>48,227</u>
<i>Stock figures/ratios at year-end (in ISK millions):</i>					
Total assets	1,325.8	1,178.1	1,187.4	476.8	321.8
Equity (excl. asset revaluation)	64.8	77.9	77.4	86.0	43.2
Equity / Total assets	4.9%	6.6%	6.5%	18.0%	13.4%

16. The Central Bank of Iceland is obliged to pay for a subscription for capital shares to the Bank for International Settlements upon request. 25% of the subscription has already been paid. The 75% share could be due for payment and totals 785 m.kr.

- At year-end 2010, the Central Bank had negotiated access to loan facilities from foreign financial institutions in the form of securities repurchase agreements, in the amount of 400 million US dollars, or 46 b.kr. The Bank had not utilised that credit line by the end of 2010.

17. The exchange rate loss for 2010 totalled 6.9 b.kr., as opposed to a gain of 3.0 b.kr. in 2009. The exchange rate revaluation is calculated based on the following items (in ISK thousands):

	2010	2009
Gold .....	(801,992)	342,816
International Monetary Fund (IMF) .....	1,438,917	12,371
Foreign bank deposits .....	(28,512,530)	15,217,213
Foreign securities holdings .....	(32,263,674)	11,478,886
Foreign short-term debt .....	14,262,579	(14,210,481)
Foreign loans, FX accounts .....	38,943,693	(9,817,364)
Total exchange rate difference	<u>(6,933,007)</u>	<u>3,023,442</u>

18. The Central Bank of Iceland is a public institution that, by law, has a specific role focusing primarily on monetary policy, via its interest rate decisions and the investment of the nation's foreign exchange reserves. Risk in its operations is therefore of a different type than in the operation of other financial institutions, although the same terminology is used. The Bank's primary risks are interest rate risk, foreign exchange risk, credit risk, and liquidity risk. The following is a discussion of those risks. In addition, the Bank operates under operational risk, which is the risk of human error or the failure of internal processes and systems. Operational risk is managed by the Bank's employees on a day-to-day basis, and every effort is made to implement monitoring and procedures that minimise this risk.

19. Interest rate risk is the risk of loss due to changes in interest rate terms. The Bank's policy in investing in foreign securities focuses mainly on investing in liquid securities issued by sound, reliable issuers. However, returns are also considered. Until now, the Bank has not actively managed the reserves; securities are generally collected at maturity. The value of the assets is closely monitored, however, and they are sold if there is the slightest risk of default. The Bank does not use derivatives to manage its interest rate risk on foreign investments in securities, deposits, or foreign debt, nor does it use derivatives for its domestic assets and liabilities. Returns on domestic assets in the form of collateralised loans are determined by the policy interest rate at any given time. Interest on the deposits of the commercial banks and the Treasury is determined with reference to the policy rate.

## Guarantees and off-balance sheet commitments

## Exchange rate revaluation

## Risk management

## Interest rate risk

## Net interest income

20. Net interest income totalled 12.8 b.kr. in 2010, as opposed to 15.2 b.kr. in the prior year.

<i>Net interest income from domestic assets and liabilities</i>		
	2010	2009
Overnight loans .....	131,905	1,197,680
Collateralised loans .....	1,497,751	4,382,477
Certificates of deposit .....	(5,066,426)	(10,358,526)
Current accounts .....	(7,114,347)	(12,365,245)
Treasury current accounts .....	(12,984,895)	(26,653,035)
Marketable securities .....	3,035,865	694,411
Index-linked securities .....	10,971,653	33,700,355
Foreign exchange accounts .....	(909,286)	(67,870)
Other domestic assets .....	20,612,569	25,991,841
	<u>10,174,789</u>	<u>16,522,087</u>
<i>Net interest income from foreign assets and liabilities</i>		
	2010	2009
Balance with IMF .....	(284,373)	(253,606)
Foreign bank accounts .....	1,377,642	607,138
Foreign securities holdings .....	9,693,957	8,642,722
Foreign loans .....	(9,454,771)	(10,203,952)
Other foreign assets .....	1,252,385	(85,722)
	<u>2,584,839</u>	<u>(1,293,420)</u>

## Foreign exchange risk

21. Foreign exchange risk is the risk of loss due to changes in currency exchange rates. Until the present time, the Bank has not used derivatives to manage foreign exchange risk. The composition of the foreign exchange reserves is based on the proportions of Iceland's external trade, in which the euro weighs heaviest. The Bank's assets and liabilities subject to foreign exchange risk specify as follows at year-end 2010 (all figures in ISK millions):

<i>Currencies in financial assets and liabilities 2009</i>						
	EUR	USD	GBP	Other cur- SDR	rencies	Total
<i>Assets:</i>						
Bank deposits .....	78,663	49,124	37,763	18,160	57,344	241,054
Gold .....		8,664				8,664
Securities .....	194,488	28,091	8,994			231,573
FX balance with IMF ..				3,649		3,649
Loans credit inst., etc. .	169,261	526	3,911		4,148	177,846
	<u>442,412</u>	<u>86,405</u>	<u>50,668</u>	<u>21,809</u>	<u>61,492</u>	<u>662,786</u>
<i>Liabilities:</i>						
Foreign deposits .....	2,034				34,717	36,751
Loan from IMF .....				152,667		152,667
Foreign exch. accounts	145,982	39,684	36,190		55,901	277,757
FX reserve expansion. .	194,568					194,568
	<u>342,584</u>	<u>39,684</u>	<u>36,190</u>	<u>152,667</u>	<u>90,618</u>	<u>661,743</u>
Net ISK assets	<u>99,829</u>	<u>46,721</u>	<u>14,478</u>	<u>(130,858)</u>	<u>(29,126)</u>	<u>1,043</u>
Equity at year-end .....						82,878

<i>Currencies in financial assets and liabilities 2010</i>						
	<i>EUR</i>	<i>USD</i>	<i>GBP</i>	<i>SDR</i>	<i>Other currencies</i>	<i>Total</i>
<i>Assets:</i>						
Bank deposits .....	182,787	75,312	83,951	13,079	78,132	433,260
Gold .....		10,426				10,426
Securities .....	161,682	37,066	11,152		7,922	217,822
FX balance with IMF ..				3,322		3,322
Other assets .....	42,126	48,513	6,975		95,732	193,346
	<u>386,595</u>	<u>171,317</u>	<u>102,078</u>	<u>16,401</u>	<u>181,786</u>	<u>858,176</u>
<i>Liabilities:</i>						
Foreign deposits .....	475				61	536
Loan from IMF .....				176,293		176,293
Foreign exch. accounts	264,054	55,059	77,145		68,682	464,940
FX reserve expansion ..	135,255				7,989	143,244
	<u>399,784</u>	<u>55,059</u>	<u>77,145</u>	<u>176,293</u>	<u>76,732</u>	<u>785,013</u>
Net ISK assets .....	(13,189)	116,258	24,933	(159,892)	105,054	73,163
Equity at year-end .....						69,379

22. Credit risk is the risk that claims in the Bank's asset portfolio will be lost due to deterioration of the debtor's financial position, rendering the debtor unable to fulfil its obligations vis-à-vis the Bank. Until 2008, the Bank had not sustained any losses due to credit risk. In the wake of the banking collapse of 2008-2009, however, it has become clear that the Bank has sustained some losses due to unsecured collateral for collateral loans that were deemed sound at the time the loans were granted.

## Credit risk

### *Credit risk of assets in the FX reserves, by credit rating: (Figures in ISK millions)*

	<i>Rating</i>	<i>Year-end 2009</i>	<i>Ratio</i>
Foreign bank deposits .....	AAA	241,054	49.71%
Foreign securities holdings, GBP ..	AAA	9,365	1.93%
Foreign securities holdings, USD ..	AAA	21,152	4.36%
Foreign securities holdings, EUR ..	AAA	132,362	27.29%
Foreign securities holdings, EUR ..	AA	50,816	10.48%
Foreign securities holdings, EUR ..	A	7,812	1.61%
Other assets in reserves .....	AAA	12,314	2.54%
Foreign securities, EUR, w/o credit rating .....		10,067	2.08%
Total financial assets in reserves		<u>484,941</u>	<u>100.0%</u>

### *Credit risk of assets in the FX reserves, by credit rating: (Figures in ISK millions)*

	<i>Rating</i>	<i>Year-end 2010</i>	<i>Ratio</i>
Foreign bank deposits .....	AAA	433,260	65.16%
Foreign securities holdings, GBP ..	AAA	9,739	1.46%
Foreign securities holdings, GBP ..	AA	539	0.08%
Foreign securities holdings, USD ..	AAA	33,720	5.07%
Foreign securities holdings, EUR ..	AAA	119,854	18.03%
Foreign securities holdings, EUR ..	AA	34,754	5.23%
Foreign securities holdings, EUR ..	A	5,549	0.83%
Foreign securities holdings, PLN ..	A	94	0.01%
Other assets in reserves .....	AAA	13,748	2.07%
Foreign securities, EUR, w/o credit rating .....		13,666	2.06%
Total financial assets in reserves		<u>664,924</u>	<u>100.0%</u>

## Liquidity risk

23. Liquidity risk is the risk of being unable to fulfil payment obligations in the short term. It also includes the risk of having to sell financial assets at a price below fair value. The following table specifies assets and liabilities by maturity. In the first column are assets and liabilities without a maturity date or those intended for lasting use. The table shows the difference based on foreign and domestic maturities. Figures are in ISK millions.

<i>Outstanding balance of financial assets and liabilities 2009</i>							
	<i>No specified Matured maturity date</i>	<i>Within 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>	
<i>Foreign assets</i>							
Bank deposits .....	148,782	92,273					241,055
Gold .....	23	8,641					8,664
Securities .....		235,831					235,831
FX balance with the IMF .....	3,649						3,649
Non-reserve assets .....	184	3,077	8,121	6			11,388
Past-due loans .....	162,202						162,202
	<u>162,202</u>	<u>152,638</u>	<u>339,820</u>	<u>8,121</u>	<u>6</u>	<u>0</u>	<u>662,787</u>
<i>Foreign debt</i>							
Short-term loans and deposits .....		314,508					314,508
Loan from IMF .....	21,971			130,697			152,667
Loan for expansion of reserves .....				179,998	14,570		194,568
	<u>0</u>	<u>21,971</u>	<u>314,508</u>	<u>0</u>	<u>310,695</u>	<u>14,570</u>	<u>661,743</u>
Foreign maturity gap	<u>162,202</u>	<u>130,668</u>	<u>21,056</u>	<u>8,121</u>	<u>(310,688)</u>	<u>(14,570)</u>	<u>1,044</u>
<i>Domestic assets</i>							
Collateralised loans .....		10,949					10,949
Past-due collateralised loans .....	328,412						328,412
Marketable securities .....				186	2,946		3,132
Treasury, securities .....		6,722	183				6,905
Treasury, securities .....				161,142			161,142
Real estate and liquid assets .....	4,754						4,754
	<u>328,412</u>	<u>4,754</u>	<u>17,671</u>	<u>183</u>	<u>161,328</u>	<u>2,946</u>	<u>515,295</u>
<i>Domestic liabilities</i>							
Banknotes and coin .....	28,958						28,958
Current accounts .....	123,019						123,019
Certificates of deposit .....	37,028						37,028
Treasury, current accounts .....	166,050						166,050
Treasury, time deposits .....			6,673	44,537			51,210
Treasury, current accounts .....	282						282
Miscellaneous parties .....		17					17
Pension obligations .....			50	200	100		350
Equity .....	82,878						82,878
	<u>0</u>	<u>111,836</u>	<u>326,396</u>	<u>6,723</u>	<u>44,737</u>	<u>100</u>	<u>489,792</u>
Domestic maturity gap .....	<u>328,412</u>	<u>(107,081)</u>	<u>(308,725)</u>	<u>(6,539)</u>	<u>116,591</u>	<u>2,847</u>	<u>25,505</u>
Foreign maturity gap .....	<u>162,202</u>	<u>130,668</u>	<u>21,056</u>	<u>8,121</u>	<u>(310,688)</u>	<u>(14,570)</u>	<u>1,044</u>
Total balance .....	<u>490,614</u>	<u>23,587</u>	<u>(287,669)</u>	<u>1,582</u>	<u>(194,097)</u>	<u>(11,723)</u>	<u>26,549</u>

<i>Outstanding balance of financial assets and liabilities 2010</i>							
	<i>No specified Matured maturity date</i>	<i>Within 3 months</i>	<i>3 to 12 months</i>	<i>1 to 5 years</i>	<i>Over 5 years</i>	<i>Total</i>	
<i>Foreign assets</i>							
Bank deposits .....	225,825	207,436					433,261
Gold .....	28	10,399					10,427
Securities .....		217,821					217,821
FX balance with the IMF .....	3,322						3,322
Non-reserve assets .....	184		1,505				1,689
Past-due loans .....							0
	0	229,359	435,655	1,505	0	0	666,520
<i>Foreign debt</i>							
Short-term loans and deposits .....	67,004						67,004
Loan from IMF .....	19,971			156,322			176,293
Loan for expansion of reserves .....					36,916		36,916
	0	86,975	0	0	156,322	36,916	280,213
Foreign maturity gap .....	0	142,385	435,655	1,505	(156,322)	(36,916)	386,307
<i>Domestic assets</i>							
Collateralised loans .....			41,820				41,820
Past-due collateralised loans .....	101,951						101,951
Marketable securities .....				872	10,168		11,040
Miscellaneous parties .....	19,231	2,462	39,484	266,598	10		327,785
Treasury, securities .....		6,136		164,388			170,524
Real estate and liquid assets .....		4,997					4,997
	121,182	13,594	81,304	0	431,858	10,178	658,116
<i>Domestic liabilities</i>							
Banknotes and coin .....	38,269						38,269
Current accounts .....	92,576						92,576
Certificates of deposit .....			65,463				65,463
Treasury, current accounts .....	130,050						130,050
Treasury, time deposits .....	183,999			117,328			301,328
Treasury, current accounts .....	1,427						1,427
Miscellaneous parties .....	22,411	252,979	2,433	48,174			325,996
Pension obligations .....			50	200	72		322
Equity .....	69,379						69,379
	0	538,112	318,442	119,811	48,373	72	1,024,810
Domestic maturity gap .....	121,182	(524,517)	(237,138)	(119,811)	383,485	10,106	(366,694)
Foreign maturity gap .....	0	142,385	435,655	1,505	(156,322)	(36,916)	386,307
Total balance .....	121,182	(382,133)	198,517	(118,306)	227,163	(26,810)	19,613

*Instalments on long-term debt are itemised as follows:*

Instalments 2011 .....	119,811
Instalments 2012 .....	59,660
Instalments 2013 .....	73,673
Instalments 2014 .....	47,209
Instalments 2015 .....	14,518
Later .....	9,635
Total long-term debt .....	324,507





## APPENDICES



## Establishment of the Central Bank of Iceland - background

The Central Bank of Iceland's 2011 Annual General Meeting, held on 7 April, marked the 50th anniversary of its operations. Below are some of the highlights from the Bank's founding and history.

### Background

- The first banknotes were issued in Iceland when the National Bank of Iceland (Landsbanki Íslands) commenced operation in 1886. The national Treasury's contribution to the bank amounted to ten thousand krónur. In addition, the bank was allocated 500,000 krónur in banknotes printed at the behest of the national Government.
- The Bank of Iceland (Íslandsbanki hf.) was established in 1903 and had the exclusive right to issue banknotes for 30 years, while Landsbanki continued to use the banknotes issued by the national Treasury.
- The two banks operated until 1927, each with several branches, and played a major role in the transformation of Iceland's economy and labour market in the 20th century. Both banks were, in effect, commercial banks.
- Discussions of the establishment of a national bank with exclusive right to issue banknotes ended with the approval of the Act on Landsbanki Íslands, which functioned as both central bank and commercial bank. Landsbanki operated three divisions from 1927 onwards: the central bank, the savings bank, and the collateral division. Íslandsbanki's activities declined sharply, until it was dissolved in 1930, whereupon the Fisheries' Bank of Iceland (Útvegsbanki Íslands hf.) was established on its operational foundation.
- During the period 1927-1957, Landsbanki Íslands' central banking activities became more and more extensive. All business conducted by banks, savings banks, the national Treasury, and Government institutions was carried out with the central bank division, as were all foreign exchange transactions. Proposals concerning the establishment of an independent central bank were still presented, but no action was taken until 1957, when Landsbanki was divided into two separate units, the central bank and the commercial bank, with separate senior management appointed for each. The final separation had not yet taken place, however, as the two banks had a joint supervisory board.
- The ties between the two banks were finally severed with the passage of legislation on an independent central bank, Act no. 10 of 29 March 1961. The bank was given the name Central Bank of Iceland and took over all of the rights and responsibilities previously pertaining to the central bank division of Landsbanki. The Central Bank commenced operation on 7 April 1961.

## Highlights from the history of the Central Bank

- 1961 The Central Bank of Iceland is formally established on 29 March. Operation commences on 7 April. The Bank's staff numbers 61 at the end of the first operational year. The Central Bank operates both the State Guarantee Fund and the Fisheries' Lending Fund. The Bank handles banking supervision and grants production credit.
- 1962 The Bank is explicitly authorised to engage in foreign borrowings for the State.
- 1966 The Central Bank of Iceland issues its first series of banknotes.
- 1967 The Bank is granted exclusive rights to issue both banknotes and coin (was previously authorised only to issue banknotes).
- 1969 The Central Bank of Iceland's first coin series is issued.
- 1974 Monthly economic indicators first published.
- 1977 Bank employees are granted the legal right to negotiate.
- 1979 Act no. 13/1979 is passed and indexation of financial obligations to the Credit Term Index is adopted.
- 1981 Currency change – value of the króna multiplied by 100. The Central Bank issues its second banknote series. The Central Bank of Iceland's second coin series is issued.
- 1985 Iceland Stock Exchange is established with the support of the Central Bank.
- 1986 New Central Bank Act passed – interest rate regulation abolished. President Vigdís Finnbogadóttir lays the cornerstone for the Central Bank building at Kalkofnsvegur 1.
- 1987 Central Bank building at Kalkofnsvegur brought into use. Total floor area is 13,000 m<sup>2</sup> on seven floors, with the ground floor and basement, and including the annex. The building has housed other institutions in addition to the Central Bank. The Icelandic Banks' Data Centre has maintained offices there, and the National Economic Institute was formerly located there, as was the Industrial Development Fund.
- 1989 Exchange rate pegged – National Reconciliation.
- 1990 Central Bank employees number 160.
- 1992 Minister of Finance and Central Bank reach an agreement to the effect that the Treasury will meet its financial need in the capital markets; direct lending from the Central Bank will be restricted to a specified maximum in 1992 and then discontinued.
- 1993 Foreign exchange market established; tolerance limits for exchange rate set at  $\pm 2.25\%$ . Issuance of third banknote series begins.
- 1995 Exchange rate tolerance limits expanded to  $\pm 6\%$ .
- 1999 Bank Inspectorate and Insurance Inspectorate merge to form the Financial Supervisory Authority. Central Bank withdraws from banking supervision activity. Publication of Monetary Bulletin commences.
- 2000 Exchange rate tolerance limits expanded to  $\pm 9\%$ .
- 2001 Inflation target adopted and exchange rate tolerance limits abandoned. New comprehensive legislation on the Central Bank of Iceland passed.

- 2005 Publication of *Financial Stability* commences.
- 2006 Central Bank employees number 111.
- 2008 Iceland's three largest commercial banks relinquish their operating licences to the Financial Supervisory Authority due to operational difficulties. Over 90% of Iceland's banking system collapses in the banking crisis. Capital controls reinstated.
- 2009 Amendments to the Act on the Central Bank of Iceland passed. The amended Act provides for one Governor and one Deputy Governor instead of the three-member Board of Governors. The Monetary Policy Committee is established to take decisions on the policy interest rate.
- 2011 The Central Bank of Iceland celebrates its 50th anniversary on 7 April 2011. Employees numbered 134 at the beginning of the year.

## Governors

- The Central Bank was initially led by a three-member Board of Governors. Jóhannes Nordal is the longest-serving Governor to date, with a tenure of 32 years (1961-1993), including 29 years (1964-1993) as Chairman of the Board of Governors. The first Chairman of the Board of Governors was Jón G. Maríasson. In 2009, the Act on the Central Bank of Iceland was amended to provide for one Governor and one Deputy Governor. The current Governor of the Central Bank is Már Guðmundsson, who was appointed on 20 August 2009. The Deputy Governor, Arnór Sighvatsson, was appointed on 1 July 2009.

## Governors of the Central Bank:

Jóhannes Nordal 1961-1993  
 Jón G. Maríasson 1961-1967  
 Vilhjálmur Þór 1961-1964  
 Sigtryggur Klemensson 1966-1971  
 Davíð Ólafsson 1967-1986  
 Svanbjörn Frímannsson 1971-1973  
 Guðmundur Hjartarson 1974-1984  
 Tómas Árnason 1985-1993  
 Geir Hallgrímsson 1986-1990  
 Birgir Ísleifur Gunnarsson 1991-2005  
 Jón Sigurðsson 1993-1994  
 Eiríkur Guðnason 1994-2009  
 Steingrímur Hermannsson 1994-1998  
 Finnur Ingólfsson 2000-2002  
 Ingimundur Friðriksson 2002-2003  
 Jón Sigurðsson 2003-2006  
 Davíð Oddsson 2005-2009  
 Ingimundur Friðriksson 2006-2009  
 Svein Harald Øygard 2009-2009  
 Már Guðmundsson 2009-

## Supervisory Board

- Originally, the Central Bank of Iceland Supervisory Board comprised five members who were chosen by proportional election by Parliament. In 2001, the Board was expanded to include seven members. The primary role of the Board has been to supervise the Bank's operations, take decisions on major projects, and hire the Bank's auditors. The first Chairman of the Supervisory Board was Member of Parliament Birgir Kjaran. The current Chairman is Lára V. Júlíusdóttir.

## Chairmen of the Supervisory Board:

Birgir Kjaran 1961-1973  
Ragnar Ólafsson 1973-1976  
Jón Skaftason 1977-1979  
Ingi R. Helgason 1979-1980  
Halldór Ásgrímsson 1981-1983  
Sverrir Júlíusson 1983-1984  
Jónas G. Rafnar 1985-1986  
Ólafur B. Thors 1986-1990  
Ágúst Einarsson 1990-1994  
Pröstur Ólafsson 1994-1998  
Ólafur G. Einarsson 1998-2006  
Helgi S. Guðmundsson 2006-2007  
Halldór Blöndal 2007-2009  
Lára V. Júlíusdóttir 2009 -

## Press releases from the Central Bank of Iceland 2010

Nr.	1	27 January 2010	MPC decision on interest rates
	–	2 27 January 2010	Statement of the Central Bank of Iceland Monetary Policy Committee: Central Bank rates lowered
	–	3 1 March 2010	Balance of payments in the fourth quarter of 2009 and the external position
	–	4 17 March 2010	Central Bank rates lowered
	–	5 17 March 2010	Statement of the Central Bank of Iceland Monetary Policy Committee: Central Bank rates lowered
	–	6 25 March 2010	The Central Bank purchases Treasury bonds
	–	7 10 April 2010	Letter of Condolence – the death of the Governor of the National Bank of Poland
	–	8 3 May 2010	Amended Rules on Foreign Exchange
	–	9 5 May 2010	MPC decision on interest rates
	–	10 5 May 2010	Statement of the Central Bank of Iceland Monetary Policy Committee: Central Bank rates lowered
	–	11 19 May 2010	Central Bank of Iceland, Banque centrale du Luxembourg and the liquidator of Landsbanki Luxembourg S.A. sign an agreement in Luxembourg
	–	12 28 May 2010	The Central Bank of Iceland signs an agreement concerning the Avens B.V. Eurobonds
	–	13 31 May 2010	Pension funds purchase Treasury's HFF bonds to strengthen FX reserves
	–	14 3 June 2010	Balance of payments in the first quarter of 2010 and the external position
	–	15 9 June 2010	The People's Bank of China and the Central Bank of Iceland sign a bilateral currency swap agreement
	–	16 9 June 2010	Balance of payments and the external position revised in 2009 and first quarter of 2010
	–	17 22 June 2010	Treasury buys back EUR bonds and currency reserves reinforced
	–	18 23 June 2010	MPC decision on interest rates
	–	19 23 June 2010	Statement of the Central Bank of Iceland Monetary Policy Committee: Central Bank lowers rates
	–	20 30 June 2010	Financial Supervisory Authority and Central Bank of Iceland issue guidelines to financial undertakings
	–	21 16 August 2010	Ministries, Central Bank and Financial Supervisory Authority sign Agreement on Financial Stability and Preparedness
	–	22 17 August 2010	Nordic and Baltic Ministries, Central Banks and Supervisory Authorities sign Agreement on Financial Stability
	–	23 18 August 2010	Central Bank rates lowered
	–	24 18 August 2010	Statement of the Central Bank of Iceland Monetary Policy Committee: Central Bank lowers interest rates
	–	25 25 August 2010	Balance of payments in the second quarter of 2010 and the external position
	–	26 19 September 2010	FIH to be sold to a consortium of ATP, PTA, Folksam and CPDyvig
	–	27 22 September 2010	Central Bank rates lowered
	–	28 22 September 2010	Statement of the Central Bank of Iceland Monetary Policy Committee: Central Bank lowers interest rates
	–	29 1 November 2010	Rules on Foreign Exchange
	–	30 3 November 2010	Central Bank rates lowered
		31 3 November 2010	Statement of the Central Bank of Iceland Monetary Policy Committee: Central Bank interest rates lowered
	–	32 3 November 2010	Statement on capital controls

- 33 2 December 2010 Balance of payments in the third quarter of 2010 and the external position
- 34 8 December 2010 Central Bank interest rates lowered
- 35 8 December 2010 Statement of the Central Bank of Iceland Monetary Policy Committee:  
Central Bank interest rates lowered
- 36 20 December 2010 Monetary policy after capital controls
- 37 29 December 2010 Banking system: balance sheet summaries 2008-2010
- 38 30 December 2010 Negotiations on savings bank debt concluded



## Publications by the Central Bank of Iceland in 2010

### *In English:*

*Annual Report 2009*

*Financial Stability 2010*, two issues

*Monetary Bulletin 2010*, four issues

*Economic Indicators 2010*, nine issues

*Economy of Iceland*

Central Bank of Iceland Working Papers No. 48, New Perspectives on Depreciation Shocks as a Source of Business Cycle Fluctuations, by Francesco Furlanetto and Martin Seneca (July 2010).

Central Bank of Iceland Working Papers No. 49, Investment-specific technology shocks and consumption, by Francesco Furlanetto and Martin Seneca (July 2010).

Central Bank of Iceland Working Papers No. 50, A DSGE model for Iceland, by Martin Seneca (September 2010).

Central Bank of Iceland Working Papers No. 51, Weathering the financial storm: The importance of fundamentals and flexibility, by Thorvardur Tjörvi Ólafsson and Thórarinn G. Pétursson (October 2010).

Central Bank of Iceland Working Papers No. 52, Longevity, Growth and Intergenerational Equity – The Deterministic Case, by Torben M. Andersen and Marías H. Gestsson (October 2010).

### *In Icelandic:*

*Ársskýrsla 2009*

*Fjármálastöðugleiki 2010*, two issues

*Peningamál 2010*, four issues

*Hagvísar 2010*, nine issues

*Economy of Iceland*.

Central Bank of Iceland Working Papers No. 48, New Perspectives on Depreciation Shocks as a Source of Business Cycle Fluctuations, eftir Fransesco Furlanetto og Martin Seneca (July 2010).

Central Bank of Iceland Working Papers No. 49, Investment specific technology shocks and consumption, eftir Fransesco Furlanetto og Martin Seneca (July 2010).

Central Bank of Iceland Working Papers No. 50, A DSGE model for Iceland, eftir Martin Seneca (September 2010).

Central Bank of Iceland Working Papers No. 51, Weathering the financial storm: The importance of fundamentals and flexibility, eftir Þorvarð Tjörva Ólafsson og Þórarinn G. Pétursson (October 2010).

Central Bank of Iceland Working Papers No.52, Longevity, Growth and Intergenerational Equity – The Deterministic Case, eftir Torben M. Andersen og Marías H. Gestsson (October 2010)..

All of these publications are also posted on the Central Bank of Iceland website.



## Speeches 2010

Below is a list of speeches given by the Governor and other senior Central Bank officers in 2010. The list contains only those speeches that are available in English. In many instances, the text can be found on the Central Bank website. Speeches and lectures were given in Reykjavík unless otherwise specified.

### *Governor Már Guðmundsson:*

The financial crisis in Iceland and the fault lines in cross-border banking. FIBE conference in Bergen, Norway. 27.1.2010.

The fault lines in cross-border banking: Lessons from the Icelandic case. A speech at a SUERF-conference in Vienna, Austria. 12.2.2010.

Speech at the Bank's Annual General Meeting. 25.3.2010.

Up from the depths? Speech at the Annual General Meeting of the Federation of Icelandic Fish Processing Plants. 7.10.2010.

The Icelandic economy two years after the crash. Speech at the Annual Meeting of the Icelandic-American Chamber of Commerce. 19.10.2010.

On the economic situation and outlook and on monetary policy. Speech at a breakfast meeting of the Icelandic Chamber of Commerce. 25.11.2010.

Lessons from the financial crisis in Iceland. Speech at a seminar of the Institute for Monetary and Financial Stability, House of Finance, Goethe University, Frankfurt, Germany. 3.12.2010.

Monetary frameworks after the financial crisis. Speech at a workshop on monetary issues in Würzburg, Germany. 6.12.2010.

### *Deputy Governor Arnór Sighvatsson:*

Shedding the shackles of capital controls. Speech at a meeting of Icelandic Securities. 7.10.2010.

Iceland's financial disaster and its fiscal impact. Speech at a conference on systemic risks, University of Warwick, England. 8.4.2010.

### *Chief Economist Þórarinn G. Pétursson*

Lecture on investigation of the financial crisis at the conference The Euro Area and the Financial Crisis, Bratislava, Slovakia. 6.-8.9.2010.

Speech on the rise and fall of the Icelandic economy and the outlook for the future, for guests at Lehigh University, Bethlehem, Pennsylvania, USA. 14.5.2010.

Lecture on economic policy tasks in Iceland, at a work meeting at the Bank for International Settlements, Basel, Switzerland. 19.2.2010.

Speech on the status of Icelandic economic affairs and the path to economic recovery, at an international conference on energy affairs held by Capacent Glacier. 5.2.2010.

### *Tryggvi Pálsson, Director, Financial Stability Department:*

Coping with a banking crisis – Rise, fall and rebirth of the Icelandic banking system. Speech at the second International Workshop on Managing Financial Instability in Capitalist Economies. 25.9.2010.

In addition, Central Bank staff and senior management have given a number of presentations and written number of articles related to the Bank's operations. Among these are presentations for various financial institutions and student groups.

## Economic and monetary chronicle 2010

### January 2010

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

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

On 5 January, rating agency Fitch Ratings announced a downgrade of Iceland's sovereign credit ratings for local and foreign currency obligations. Iceland's long-term foreign and local currency ratings were lowered to BB+ and BBB+, and the short-term foreign currency rating was changed to B. The country ceiling was lowered from BBB- to BB+. In its press release, Fitch stated that the downgrade was due to the president of Iceland's decision not to sign the Icesave Act.

On 6 January, rating agency Moody's announced that it was keeping Iceland's sovereign rating unchanged for the present, in spite of the president's refusal to sign the Icesave guarantee legislation. The agency considered it likely that domestic political instability and external pressure to resolve the Icesave dispute would result. Both were considered likely to damage Iceland's credit rating.

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

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

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

On 12 January, Fitch Ratings followed its 5 January decision with a report stating that the lack of resolution in the Icesave dispute, economic instability, and a weaker fiscal debt position could result in a downgrade.

On 22 January, the Financial Supervisory Authority (FME) authorised Landskil ehf. to own a qualifying holding in NBI hf. on behalf of Landsbanki Íslands hf. The permission was granted following a contractual agreement with Landsbanki Íslands hf. and the Icelandic Ministry of Finance, dated 15 December 2009, stipulating, *inter alia*, that Landsbanki Íslands hf. was authorised to acquire an 18.7% holding in NBI hf., upon fulfilling specified conditions.

On 27 January, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.5 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 8.0%; maximum rates on 28-day certificates of deposit (CDs), to 9.25%; seven-day collateralised loans, to 9.5%; and overnight loans, to 11.0%.

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

On 29 January, rating agency Standard and Poor's announced an unchanged rating for the Republic of Iceland but indicated that the rating would remain on CreditWatch negative due to uncertainty about external financing, capital account liberalisation, and the status of the Icesave dispute.

### **February 2010**

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

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

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

On 25 February, Parliament passed Act no. 11/2010 amending the Act on Forced Sale, so that until 1 August 2010, a debtor can, upon filing an application, have the forced sale of his or her own residence deferred for up to three months. The amendment took effect the same day. Previously, the Act contained a provision deferring forced sale of residential housing through 28 February.

On 26 February, rating agency Moody's expressed its concerns about the downward pressure that the stalemate in the Icesave dispute placed on Iceland's Baa3 credit rating. No changes in the credit rating were announced.

### March 2010

On 4 March, Parliament passed Act no. 13/2010 amending the Act on Public Limited Companies. The amendment restricts the role of the Chairman of the Board, thereby eliminating the position of Acting Chairman of the Board. Explicit provisions on gender equality in the boards of companies were also passed into law.

On 4 March, the Financial Supervisory Authority confirmed joint financial institution rules on corporate financial restructuring. The Financial Supervisory Authority was assigned the task of confirming supervised entities' rules on debt restructuring and amending the terms and conditions of bonds and loan agreements that could lead to debt cancellation or other concessions for companies. This was done with Act no. 107/2009 on measures to assist individuals, households, and businesses due to extraordinary circumstances in the financial market.

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

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

On 8 March, Standard & Poor's issued a statement to the effect that the rejection of the Icesave Act in the national referendum would not have any immediate effect on Iceland's sovereign credit rating.

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

On 17 March, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.5 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 7.5%; maximum rates on 28-day certificates of deposit (CDs), to 8.75%; seven-day collateralised loans, to 9.0%; and overnight loans, to 10.5%.

On 22 March, Parliament passed Act no. 17/2010 prohibiting the air mechanics' strike that had begun at midnight the previous night. The term of the wage agreement that expired on 31 October 2009 was extended through the end of November 2010.

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

On 25 March, Parliament passed Act no. 23/2010 amending the Income Tax Act, which authorises the Director of Internal Revenue to demand that the assets of parties suspected of major violations of tax reporting rules be frozen, if it is considered that there is a significant risk of large-scale default in tax payments.

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

On 30 March, rating agency Standard & Poor's affirmed the Republic of Iceland's sovereign credit ratings for long- and short-term obligations in foreign currency at BBB-/A-3. The ratings for long- and short-term obligations in local currency were downgraded from BBB+/A-2 to BBB/A-3. The ratings were removed from CreditWatch status, where they had been with negative implications since 5 January 2010. The outlook remained negative.

On 30 March, Standard & Poor's issued its annual report on Iceland, stating that the country had strong economic fundamentals and that the outlook for foreign credit financing was good, but that it could prove difficult to lift the capital controls.

#### **April 2010**

On 6 April, Moody's changed the outlook on Iceland's sovereign credit rating from stable to negative. Moody's cited uncertainty about foreign credit financing as the main reason for the change.

On 12 April, the Parliamentary Special Investigation Commission (SIC) report on the background and causes of the collapse of the Icelandic banks in 2008 was published, both in printed form and on the website of the Parliament of Iceland.

On 13 April, the Financial Supervisory Authority granted Alfa Securities hf. a licence to operate as a securities undertaking pursuant to Article 4, Paragraph 1, Subparagraph 5 of the Act on Financial Undertakings, no. 161/2002.

On 14 April, the volcanic glacier Eyjafjallajökull erupted, after a smaller eruption on Fimmvörðuháls, east of the glacier, had been underway since 20 March. The Eyjafjallajökull eruption caused severe disturbances in air traffic in Iceland and across Europe and dramatically reduced the number of visitors to Iceland well into the summer. The eruption had largely subsided by mid-May.



On 16 April, the Executive Committee of the International Monetary Fund (IMF) approved the second review of Iceland's economic programme. At the request of the Icelandic Government, the Fund agreed to extend Iceland's Stand-By Arrangement by three months, until end-August 2010, due to delays in programme reviews. Upon approval by the Executive Board, the third tranche of the IMF loan facility, SDR 105 million, became available. This tranche of the facility is equivalent to 160 million US dollars, or about 20 b.kr. Also released were loan facilities from the Nordic countries and Poland, in the amount of 85 b.kr.

On 22 April, the Financial Supervisory Authority (FME) took over the operations of Byr Savings Bank and Keflavík Savings Bank upon requests by the two banks' boards of directors, following unsuccessful negotiations with creditors. In the Financial Supervisory Authority's decision on the disposal of the savings banks' assets and liabilities, it is stated that Byr's assets and deposits were transferred to a new commercial bank, Byr hf., and that Keflavík Savings Bank's assets and liabilities had been transferred to a new savings bank, SpKef Savings Bank. Both institutions are wholly owned by the State.

On 23 April, Parliament passed Act no. 31/2010 amending the Act on Bankruptcy, Etc., no. 21/1991. According to the amended Act, the deadline for cancellation of measures entered into by a bankrupt individual or entity shall be four years prior to the reference date, so as to ensure that it will be possible to conclude matters emerging in the wake of the banks' collapse without running the risk that interests will not be protected due to workload and time constraints.

On 23 April, Moody's changed its outlook for the Republic of Iceland's sovereign debt from negative to stable. Iceland's rating remained Baa3 for domestic and foreign long-term obligations and P-3 for short-term obligations. The change was attributable to the Treasury's improved liquidity position following the second review of the economic programme of the Government and the IMF.

On 23 April, the Financial Supervisory Authority authorised KEA svf. to own a qualifying holding in Sparisjóður Höfðhverfinga.

On 27 April, Moody's issued its annual report on Iceland, stating that economic stability had been achieved but that fiscal restraint and weak investment would probably prolong the economic slump through 2010.

On 30 April, the Central Bank of Iceland amended its Rules on Foreign Exchange. The amendments clarified the Rules, reduced the maximum amount of foreign currency that can be purchased for travel, and changed specified exemptions so as to remove all doubt about the legality of offshore transactions.

### **May 2010**

On 5 May, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.5 percentage

points. The deposit rate (current account rate) was lowered to 7.0% and the maximum bid rate for 28-day certificates of deposit (CDs) to 8.25%. The seven-day collateralised lending rate was lowered to 8.5% and the overnight lending rate to 10.0%.

On 19 May, the Central Bank of Iceland, the Banque centrale du Luxembourg (BCL), and the liquidator of Landsbanki Luxembourg entered into an agreement concerning the Bank's purchase of 98% of outstanding Avens B.V. bonds. The bonds were owned by Landsbanki and pledged to the BCL as collateral for a liquidity facility provided in 2008. The Bank was granted full control of the assets of Avens, the largest single owner of króna-denominated assets outside Iceland, with about 120 b.kr., or one-fourth of all non-residents' króna-denominated holdings at the time the transaction was concluded.

On 26 May, the EFTA Surveillance Authority (ESA) sent a letter of formal notice stating that, in its opinion, the Icelandic authorities were obliged to set up a deposit insurance scheme guaranteeing deposits in the amount stipulated by Directive no. EC 94/19/EC on Deposit-Guarantee Schemes, or roughly 20,000 euros.

On 28 May, the Central Bank of Iceland, on behalf of the Treasury, negotiated the purchase of just over 2% of issued Avens B.V. eurobonds. With this transaction, the Treasury became the owner of all of the company's issued euro-denominated bonds (it had previously finalised the purchase of 98% of outstanding bonds with an agreement concluded in Luxembourg on 19 May).

On 30 May, the Treasury sold to Housing Financing Fund bonds with a nominal value of 90 b.kr. 26 pension funds, which the Treasury had acquired upon the banks' collapse and through purchases from the Banque centrale du Luxembourg. The pension funds bought the bonds at a yield of 7.2%, financing the purchase by selling foreign assets. The sale reduced the Government's net foreign-denominated debt, which had grown due to the funding of the above-mentioned agreement concluded in Luxembourg. It also expanded the Central Bank's foreign exchange reserves by about 82 b.kr.

#### June 2010

On 1 June, Parliament passed Act no. 49/2010 amending the Act on Stamp Fees, no 36/1978, and the Act on Treasury (Additional Revenue) Act, no. 88/1991. The amendments authorise a temporary exemption from stamp fees upon refinancing of motor vehicle loans and expand the exemptions from payment of registration fees for refinancing of individuals' mortgages and motor vehicle loans.

On 9 June, the People's Bank of China and the Central Bank of Iceland signed a bilateral currency swap agreement. The amount of the agreement is 66 b.kr., or 3.5 billion Chinese yuan. The agreement remains valid for three years and may be extended subject to the approval of both parties.

On 9 June, the Financial Supervisory Authority's application for International Organization of Securities Commissions (IOSCO) membership was approved. The membership allows the Financial Supervisory Authority to exchange information on securities transactions with most other nations, within the framework of existing legislation.

On 10 June, a new Act on Insurance Activities, no. 56/2010, entered into force, supplanting the previous Act on Insurance Activities, no. 60/1994. The Act applies to direct insurance in the areas of liability insurance and personal insurance, as well as any type of reinsurance. Supervision of such insurance remains in the hands of the Financial Supervisory Authority.

On 10 June, Parliament passed Act no. 60/2010 amending the Act on Bankruptcy, Etc., with the aim of improving the legal position of debtors. Among other provisions, the amended Act allows the debtor to continue living in his or her residential property for a period of time during bankruptcy proceedings or after forced sale. According to other new provisions, if a property is sold via forced sale at a normal market price, the difference is calculated to the benefit of the debtor.

On 10 June, Parliament passed Act no. 70/2010 amending the Act on Unemployment Insurance, no. 54/2006, and the Act on Rent Subsidy Allowances, no. 138/1997. The amendments extend the right to proportional benefits against part-time employment until year-end 2010; furthermore, income from third-pillar pension funds does not curtail unemployment benefits (retroactive to 1 March 2009), and the implementation of the Act shall take account of international obligations. According to the amendments to the Act on Rent Subsidy Allowances, income from third-pillar pension funds does not reduce benefits.

On 11 June, Parliament passed the Mortgage Rights Act, no. 67/2010, authorising financial undertakings to grant mortgage rights in connection with the Financial Supervisory Authority's disposal of assets and liabilities due to extraordinary circumstances in the financial markets. The Act was passed in order to facilitate settlement between the old and new banks.

On 12 June, Parliament passed Act no. 75/2010 amending the Act on Financial Undertakings. The amendments tighten rules and increase surveillance in a number of ways: the Financial Supervisory Authority is granted increased powers, financial institutions are required to hold a special register of large borrowers, the conditions upon which a financial institution may own its own shares are narrowed and clarified, financial institutions are prohibited from granting loans against collateral in their own shares or guarantee capital shares, conditions for loans to specific related parties are tightened, and rules on large exposures are tightened, as are rules on incentive programmes, bonus schemes, and termination agreements.

On 14 June, Parliament passed Act no. 78/2010 amending the Foreign Exchange Act, no. 87/1992, and the Customs Act, no. 88/2005. The amendments assign the Central Bank of Iceland sole jurisdiction over investigations and fines in connection with surveillance of the Foreign Exchange Act and the Rules on Foreign Exchange.

On 15 June, Parliament passed Act no. 95/2010 amending the Act on Execution, no. 90/1989, and the Act on Bankruptcy, Etc., no. 21/1991. The amendments entail, among other things, making composition of creditors a more effective measure for debtors, as well as expanding the conditions for enforcement of unsuccessful distraint and bankruptcy proceedings.

On 15 June, Parliament passed the Act on Concessions for New Investment in Iceland, no. 99/2010. The aim of the Act is to stimulate and promote investment in business operations in Iceland by specifying in the law, in a transparent manner, what authorisation the State and municipal governments have to grant defined concessions to investment projects, so as to depart from the previous arrangement of concluding separate investment contracts for individual projects on the basis of special legislation approved by Parliament.

On 16 June, Parliament passed Act no. 92/2010 amending the Income Tax Act, no. 90/2003, with regard to concessions for renovation and maintenance of real estate. In levying income tax in 2011 and 2012, it is permissible to deduct 50% of the amount paid for labour (net of value-added tax) carried out in 2010 and 2011, up to a maximum of 200,000 kr. for individuals and 300,000 kr. for couples and jointly taxed parties, for maintenance of residential and vacation property for personal use.

On 16 June, the Supreme Court of Iceland handed down judgments in two exchange rate linkage cases focusing on the legality of exchange rate-linked motor vehicle loans. The Supreme Court concluded that the agreements in question were indeed loan agreements and not motor vehicle agreements, and that the loan in question was a loan in Icelandic krónur and not a loan in foreign currency. Furthermore, the Court concluded that linking the principal of the loan to foreign currency exchange rates was in contravention of the Act on Interest and Price Indexation. The judgments set precedent for the interpretation of exchange rate-linked loan agreements; however, they did not answer the question of how to apply interest to those agreements.

On 22 June, the Republic of Iceland redeemed eurobonds maturing in 2011 and 2012, following a public auction. The nominal value of the purchase was 160 million euros for the first bond and 32 million euros for the latter. It was also decided to draw on the bilateral loan facilities negotiated with Denmark, Finland, Norway, Poland, and Sweden, in connection with the economic programme of the Icelandic Government and the International Monetary Fund. The total amount, 639 million euros, was added to the Central Bank of Iceland foreign exchange reserves.

On 23 June, the Monetary Policy Committee of the Central Bank decided to lower the collateralised loan rate by 0.5 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 6.5%; maximum rates on 28-day certificates of deposit (CDs), to 7.75%; seven-day collateralised loans, to 8.0%; and overnight loans, to 9.5%.

On 24 June, Parliament passed the Act on the Debtors' Ombudsman, no. 100/2010, establishing the separate office of the Debtors' Ombudsman, whose task is to assist individuals, free of charge, in gaining an overview of their financial status and seeking solutions to financial problems. The Debtors' Ombudsman's role is to act as an intermediary in interactions and contractual agreements with creditors, and to implement debt mitigation. It also receives communications from debtors, protects their interests, and takes action if debtors' rights are encroached upon. Furthermore, it provides comprehensive advice and instruction on household finance.

On 24 June, Parliament passed the Act on Debt Mitigation for Individuals, no. 101/2010. The objective of the Act is to enable individuals in severe financial difficulties to restructure their finances and establish a balance between their debt and their capacity to pay, so that the debtor can realistically fulfil his obligations for the foreseeable future.

On 24 June, Parliament passed Act no. 102/2010 amending the Act on Temporary Mitigation of Residential Mortgage Payments, no. 50/2009, establishing as permanent the measures set forth in the original Act.

On 24 June, Parliament passed the Act on Temporary Measures for Individuals with Two Residential Properties, no. 103/2010. According to the Act, an individual who pays mortgages on two properties because of purchasing a property for residential use can request that one of the properties be transferred to the holder of collateral. The Act remains in force from 1 August 2010 until year-end 2011.

On 24 June, Parliament passed Act no. 104/2010, temporarily amending the Income Tax Act, no. 90/2003, as regards taxation of cancelled debt for corporations, self-employed persons, and individuals, with consideration of the extraordinary circumstances currently reigning. According to the Act, it will temporarily be permissible, upon fulfilment of specific conditions, to report only a specified percentage of the cancelled debt as taxable income.

On 30 June, the Central Bank of Iceland and the Financial Supervisory Authority issued guidelines based on the Supreme Court of Iceland judgments on exchange rate-linked loans. This was done because of the uncertainty that developed concerning the scope and terms of the agreements falling under the judgments. This uncertainty was considered to undermine stability in the financial markets and the financial system as a whole. The guidelines instructed financial institutions to

calculate loans based on interest rates determined by the Central Bank of Iceland, with reference to the lowest interest rate on new indexed or nominal loans instead of the foreign interest rate reference.

### July 2010

On 6 July, the Prime Minister, Minister of Finance, Minister of Economic Affairs, Governor of the Central Bank, and Director of the Financial Supervisory Authority signed an agreement on the appointment of a Financial Stability Committee. The agreement and the work of the committee are based on the 2006 agreement on financial stability and contingency, between the pertinent ministries and institutions. The members of the committee represent the Ministry of Economic Affairs, Prime Minister's Office, Ministry of Finance, Financial Supervisory Authority, and Central Bank of Iceland. The representative of the Ministry of Economic Affairs steers the committee's activities.

On 7 July, the Government announced a campaign to increase employment. Reimbursements of value-added tax due to labour carried out on residential and vacation property were raised from 60% to 100%. A deduction from the income tax base of up to 200,000 kr. for individuals and 300,000 kr. for couples is granted for maintenance of residential real estate.

On 7 July, the Parliamentary Ombudsman sent the Central Bank of Iceland and the Financial Supervisory Authority identical queries concerning the 30 June guidelines issued in the wake of the Supreme Court judgments on exchange rate-linked loan agreements. The queries presented detailed questions in several numbered items, and the deadline for response was 16 July. After having received a one-week extension of the deadline due to workload and the scope of the query, the Central Bank of Iceland responded on 23 July, as did the Financial Supervisory Authority.

On 12 July, the International Monetary Fund report on changes to the Icelandic tax system was published. The report was prepared for the Ministry of Finance, which sought guidelines on possible improvements with reference to output growth and efficiency, as well as the need to meet an increased need for revenue amounting to 1-2% of GDP over the medium term. The report praises the Icelandic tax system in general and proposes ways on increased revenues. The proposals are based in large part on bringing in revenues through individual income tax and value-added tax but also mention increases in corporate income tax, financial income tax, and fuel taxes.

On 13 July, the Financial Supervisory Authority appointed an interim board of directors for Avant hf. at the company's request, on the basis of Article 100(a) of the Act on Financial Undertakings, no. 161/2002; cf. Article 4 of Act no. 44/2009.

On 16 July, the total allowable catch (TAC) for the fishing year beginning on 1 September 2010 was announced. The permissible cod quota

was raised by 10,000 tonnes, in line with recommendations, while the TAC for haddock and saithe was reduced, although less than was recommended. Restrictions on ocean shrimp fishing were removed.

On 29 July, Moody's changed its outlook for Iceland's sovereign credit rating on foreign and domestic obligations from stable to negative.

### **August 2010**

On 16 August, the Financial Supervisory Authority approved the Central Bank of Iceland Holding Company ehf.'s (ESÍ) application for permission to own a qualifying holding in the insurance company Sjóvá-Almennar hf. (SA tryggingar). The Central Bank of Iceland Holding Company ehf. is wholly owned by the Central Bank of Iceland. Other SA tryggingar shareholders are Íslandsbanki hf., with 9.3% of share capital, and SAT Holding Company hf., with the equivalent of 17.67% of share capital.

On 17 August, a cross-border collaboration agreement between the Nordic and Baltic countries took effect. The aim of the agreement is to ensure financial stability and a coordinated response to financial shocks affecting more than one country. The agreement is not legally binding but allows for enhanced cooperation and coordinated response, including improved information disclosure between institutions.

On 18 August, the Monetary Policy Committee of the Central Bank decided to lower the collateral loan rate by 1.0 percentage point. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 5.5%; maximum rates on 28-day certificates of deposit (CDs), to 6.75%; seven-day collateralised loans, to 7.0%; and overnight loans, to 8.5%.

On 31 August, the Central Bank began purchasing foreign currency from market makers in the interbank foreign exchange market. The aim of the purchase is to expand the Bank's non-borrowed reserves. The Central Bank decided to buy 500 thousand euros, on Tuesday of each week, from each market maker.

On 31 August, the Financial Supervisory Authority revoked the operating licences of SPRON Securities and the operating company Reks-trarfélag SPRON hf. In both instances, the companies themselves had relinquished their licences.

### **September 2010**

On 14 September, the Financial Supervisory Authority sent a circular to credit institutions on the treatment of operational, private, and financing leases. The circular included the following instructions to credit institutions: "Until a final ruling has been rendered on whether operational, private, and financing leases fall within the scope of Chapter VI of the Act on Interest and Price Indexation and whether such agreements contain non-binding exchange rate linkage clauses, such contracts shall be treated in the same manner as the discussed lease-purchase agreements from the credit institutions in question. In

other words, they shall be treated in accordance with the 30 June 2010 guidelines issued by the Financial Supervisory Authority and the Central Bank of Iceland, which can be found on the Financial Supervisory Authority's website."

On 16 September, the Supreme Court of Iceland handed down a judgment in a case in which the treatment of the balance of an exchange rate-linked motor vehicle loan falling under the scope of the 16 June judgment was in dispute. The Supreme Court concluded that, in calculating the balance due, the foreign interest rate specified in the contract should not prevail, as the premises for that interest rate no longer applied once exchange rate linkage had been deemed unlawful. Instead, the interest on the loan should be based on the lowest non-indexed interest rate published by the Central Bank of Iceland. The judgment set precedent for the treatment of other exchange rate-linked loan agreements.

On 17 September, a report by a special committee appointed by the Prime Minister was published. The committee expressed the opinion that there were no clear legal flaws in the agreement concerning Magma Energy Sweden's purchase of shares in HS Orka. Other possible legal interpretation of the connection between the buyer and the parent company could lead to another interpretation, however.

On 19 September, the Central Bank sold a 99.89% stake in Danish bank FIH, which the Central Bank accepted as collateral for a last-resort loan granted to Kaupthing Bank in October 2008, in the amount of 500 million euros. The sale price was 5 billion Danish kroner (approximately 103 b.kr., or 670 million euros). The purchase is linked to the performance of FIH until 2014.

On 20 September, Moody's Investors Service issued an opinion on the Supreme Court's 16 September decision on exchange rate-linked loans. The agency was of the opinion that the judgment reduced uncertainty but did not affect Iceland's sovereign credit rating.

On 20 September, the Financial Supervisory Authority granted ALM Fjármálaráðgjöf hf. a licence to operate as a securities undertaking pursuant to Article 4, Paragraph 1, Subparagraph 5 of the Act on Financial Undertakings, no. 161/2002.

On 21 September, the Financial Supervisory Authority authorised Annex ehf. to own a qualifying holding of up to 50% in ARM Securities hf., cf. Chapter VI of the Act on Financial Undertakings, no. 161/2002.

On 22 September, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.75 percentage points. The deposit rate (current account rate) was lowered to 4.75% and the maximum bid rate for 28-day certificates of deposit (CDs) to 6.0%. The seven-day collateralised lending rate was lowered to 6.25% and the overnight lending rate to 7.75%.



On 23 September, the Financial Supervisory Authority granted Virðing hf. increased authorisation to operate as a securities company. The company's operating licence was reissued to take account of this.

On 29 September, the Executive Committee of the International Monetary Fund (IMF) approved the third of seven reviews of Iceland's economic programme. Upon approval by the Executive Board, the fourth tranche of the IMF loan facility, SDR 105 million, became available. This tranche of the facility is equivalent to 162 million US dollars, or just under 19 b.kr. It is expected that, with the approval of the review, bilateral loan financing from the Nordic countries (444 million euros) and Poland (210 million zlotys, or 71 million US dollars) will also become available. The IMF Executive Board also carried out its regular discussion of the conditions and prospects in the Icelandic economy.

### October 2010

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

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

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

On 15 October, the Financial Supervisory Authority authorised Arion Bank hf. to own a qualifying holding in Valitor hf. Arion Bank hf. requested permission to increase its qualifying holding in Valitor hf. indirectly, through its holding in Valitor Holding hf., cf. Article 40 of the Act on Financial Undertakings. The Financial Supervisory Authority

considers Arion Bank eligible to own and administer the holding, partly because of Valitor hf.'s sound and reliable operations. On 12 October, the Financial Supervisory Authority had authorised Arion Bank to own a stake of over 50% in Valitor hf.

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

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

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

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

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

#### **November 2010**

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

On 1 November, Moody's Investors Service issued a press release stating that the continued negative outlook for Iceland's sovereign credit rating reflected uncertainty in economic affairs and in the financial system.

On 3 November, the Monetary Policy Committee of the Central Bank of Iceland decided to lower the Bank's interest rates by 0.75 percentage points. Interest rates were lowered to the following amounts: interest on deposit institutions' current accounts, to 4.0%; maximum

rates on 28-day certificates of deposit (CDs), to 5.25%; seven-day collateralised loans, to 5.5%; and overnight loans, to 7.0%.

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

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

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

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

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

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

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

#### **December 2010**

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

On 3 December, the Government announced an agreement with credit institutions and pension funds concerning measures to assist distressed households. Distressed borrowers with over-leveraged assets are offered the opportunity to reduce their outstanding debt to 110% of the value of the asset concerned. The original debt service burden must be at least 20% of the income tax base plus investment income. Collateralised debt could be reduced by as much as 4 m.kr. for individuals and 7 m.kr. for couples or single parents. A much more detailed appraisal of assets and capacity to pay must be carried out if a larger write-down is needed, up to a maximum of 15 m.kr. for individuals and 30 m.kr. for couples and single parents. Changes were also made to problem debt restructuring measures so that they would benefit a larger number of households. Over 2 b.kr. would be allocated to the maintenance of a special increase in mortgage interest allowances that was implemented in 2009-2010. A new temporary measure would then be created to pay down interest expense due to residential housing. Lenders will also attempt to reach all households that are in arrears and offer them satisfactory solutions before 1 May 2011. In connection with the agreement on debt problems, the Government declared that it would reduce the linkage between pension benefits and social security benefits and that the tax-free threshold for pensioners would be raised in stages during the period 2013-2015.

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

On 8 December, the Monetary Policy Committee of the Central Bank of Iceland decided to narrow the Bank's interest rate corridor by 1.0 percentage point. Interest on deposit institutions' current accounts was reduced by 0.5 percentage points, to 3.5%. The maximum rate on 28-day CDs and the interest on seven-day collateralised loans were reduced by 1.0 percentage point each, to 4.25% and 4.5%, respectively. The overnight lending rate was lowered by 1.5 percentage

points, to 5.5%. According to the MPC statement, the objective of the changes was to reduce volatility in short-term rates and move the overnight lending rate closer to the centre of the corridor.

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

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

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

On 16 December, the National Budget for 2011 was approved by Parliament. Revenues are estimated at 472 b.kr., expenditures at 510 b.kr., and the deficit at 37 b.kr. The surplus before interest income and expense is estimated at 15 b.kr. Revenues are estimated to decline by 1% from the increased 2010 National Budget due to lower sales revenues and the transfer of revenue bases to municipalities. Tax revenues are estimated to rise by 3%, even though the transfer of revenues for the affairs of the disabled to municipalities will cause a 2.4% reduction. Expenditures are projected to decrease by 9%, including 1.6% due to the transfer of the affairs of the disabled.

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

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

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

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

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

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

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

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

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

On 18 December, Parliament passed Act no. 151/2010 amending the Act on Interest and Price Indexation; the Act on Measures to Assist Individuals, Households, and Businesses due to Extraordinary Circumstances in the Financial Markets; and the Act on the Debtors' Ombudsman. The amendments were intended to reduce the uncertainty that developed in the wake of the Supreme Court judgments

on exchange rate-linked loans, as regards the legality of contractual agreements covering a wide range of short- and long-term financing. The objectives were to ensure, to the extent possible, that comparable cases would receive comparable treatment, and to ensure legal security in the settlement of loan agreements with non-binding exchange rate linkage clauses.

On 18 December, Parliament passed Act no. 153/2010, amending legislation on unemployment benefits. For those who lost their jobs after end-April 2008, the period of entitlement to benefits was lengthened from three years to four, and the authorisation to pay benefits commensurate with a reduction in employment percentage was extended by six months, until 30 June 2011. The requirement concerning reduced employment was tightened from 20% to 30% of a full-time position.

On 18 December, Parliament passed Act no. 155/2010, imposing a special tax on financial institutions in the amount of 0.041% of a base equal to total liabilities less deposits covered by the Depositors' and Investors' Guarantee Fund. Financial institutions that owe less than 5 b.kr. are exempt from the tax.

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

On 18 December, Parliament passed Act no. 163/2010 amending the Value-Added Tax Act, so as to enable monitoring and follow-up by the tax authorities, to clarify provisions on tax deductions for exported electronic services, including data centre services, to discontinue rebates for indoor heating while extending authorisations for special rebates due to distance coaches and construction work done on residential housing until year-end 2011.

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

On 18 December, Parliament passed Act no. 165/2010, amending various pieces of tax legislation. Chief among them were i) the trans-

fer of local tax revenues to municipalities due to the transfer of the affairs of the disabled; ii) the authorisation for companies to distribute the tax base due to cancelled debt over the years 2010-2014 and to pay the outstanding balance over five years; iii) the expansion of authorisations to defer or cancel businesses' tax debt; iv) the cancellation of the equity securities discount on individuals' income tax, in view of comments from EFTA, and increased authorisations for tax deductions for innovation companies; v) amendments to the statutory framework for tax investigations, so as to expedite case handling.

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

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

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

Near the end of the year, the Central Bank purchased foreign currency for 24.6 b.kr. (160 million euros), as well as negotiating forward con-



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



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Table 1 Selected Central Bank interest rates

	Bank's current accounts	Non-indexed certificates of deposit, 90-day	Required deposits, nominal terms	O/N loans discount rates	Yield on collateral loan auctions	Collateral loans (nominal rate)	Yield on certificates of deposit, 7-day	28-day certificates of deposit (max. rate)
11 May 2004	3.00	5.00	4.30	7.90	5.50	.	.	.
8 June 2004	3.25	5.25	4.50	8.00	5.75	.	.	.
6 July 2004	3.75	5.75	5.00	8.25	6.25	.	.	.
21 September 2004	4.25	6.25	5.50	8.75	6.75	.	.	.
1 November 2004	5.00	6.75	6.00	9.25	7.25	.	.	.
10 December 2004	6.25	7.75	7.25	10.25	8.25	.	.	.
21 February 2005	6.75	8.25	7.75	10.75	8.75	.	.	.
29 March 2005	7.25	8.50	8.00	10.75	9.00	.	.	.
7 June 2005	8.00	9.35	8.75	11.00	9.50	.	9.35	.
4 October 2005	8.75	10.10	9.50	11.75	10.25	.	10.10	.
11 December 2005	9.00	10.35	9.75	12.00	10.50	.	10.35	.
1 February 2006	9.25	10.25	10.00	12.25	10.75	.	10.60	.
1 April 2006	10.00	11.00	10.75	13.00	11.50	.	11.35	.
21 May 2006	10.75	11.75	11.50	13.75	12.25	.	12.10	.
11 June 2006	11.50	.	12.00	14.25	13.00	.	12.85	.
21 August 2006	12.00	.	12.25	14.50	13.50	.	13.35	.
21 September 2006	12.50	.	12.75	15.00	14.00	.	13.85	.
21 December 2006	12.75	.	13.00	15.25	14.25	.	14.10	.
20 June 2007	12.75	.	13.00	15.25	14.25	.	14.10	.
21 July 2007	12.75	.	13.00	15.25	.	13.30	13.20	.
1 November 2007	13.25	.	13.25	15.25	.	13.75	13.65	.
25 March 2008	14.50	.	14.50	16.50	.	15.00	14.75	.
10 April 2008	15.00	.	15.00	16.50	.	15.50	15.25	.
15 October 2008	11.50	.	11.50	14.00	.	12.00	11.75	.
28 October 2008	17.50	.	17.50	20.00	.	18.00	17.75	.
18 December 2008	15.00	.	15.00	22.00	.	18.00	15.25	.
19 March 2009	14.00	.	14.00	21.00	.	17.00	14.25	.
8 April 2009	12.50	.	12.50	19.50	.	15.50	12.75	.
7 May 2009	9.50	.	9.50	17.00	.	13.00	9.75	.
4 June 2009	9.50	.	9.50	16.00	.	12.00	9.75	.
24 September 2009	9.50	.	9.50	14.50	.	12.00	9.75	9.5–10 <sup>1</sup>
5 November 2009	9.00	.	9.00	13.00	.	11.00	.	9.5–10.25 <sup>1</sup>
10 December 2009	8.50	.	8.50	11.50	.	10.00	.	9.75
27 January 2010	8.00	.	8.00	11.00	.	9.50	.	9.25
17 March 2010	7.50	.	7.50	10.50	.	9.00	.	8.75
5 May 2010	7.00	.	7.00	10.00	.	8.50	.	8.25
23 June 2010	6.50	.	6.50	9.50	.	8.00	.	7.75
18 August 2010	5.50	.	5.50	8.50	.	7.00	.	6.75
22 September 2010	4.75	.	4.75	7.75	.	6.25	.	6.00
3 November 2010	4.00	.	4.00	7.00	.	5.50	.	5.25
8 December 2010	3.50	.	3.50	5.50	.	4.50	.	4.25
<i>Time-weighted average</i>								
2002	5.50	7.80	7.00	10.70	8.40	.	.	.
2003	2.80	4.80	4.10	7.70	5.30	.	.	.
2004	3.65	5.59	4.88	8.28	6.09	.	.	.
2005	7.69	8.85	8.50	11.02	9.35	.	9.70	.
2006	11.00	10.63	11.52	13.77	12.50	.	12.35	.
2007	12.83	.	13.04	15.25	14.25	.	14.10	.
2008	14.80	.	14.80	16.82	.	15.40	15.08	.
2009	11.04	.	11.04	17.16	.	13.68	.	.
2010	6.31	.	6.28	9.25	.	7.78	.	7.53

1. Shows minimum and maximum rates on 28-day certificate of deposits.

Table 2 Exchange rate indices

	Official exchange rate <sup>1</sup> 31 Dec. 1991 = 100	Narrow trade index <sup>2</sup> 31 Dec. 1991 = 100	Average exchange rate index <sup>3</sup> 31 Dec. 1994 = 100			Real exchange rate <sup>4</sup> 2000 = 100				
			Based on		Based on		Based on		Based on	
			Average	Based on import weights	Based on export weights	Index	%-change <sup>5</sup>	Index	%-change <sup>5</sup>	
1996	116.2	.	99.0	100.0	98.1	91.3	0.3	88.9	1.1	
1997	114.7	.	97.7	98.3	97.2	92.2	1.0	90.4	1.6	
1998	112.8	.	96.2	96.7	95.7	93.8	1.8	92.8	2.7	
1999	112.6	108.8	96.0	96.5	95.6	96.3	2.6	96.8	4.3	
2000	112.7	107.7	96.1	96.3	95.7	100.0	3.9	100.0	3.3	
2001	135.4	128.7	115.4	115.1	115.3	87.3	-12.7	86.7	-13.3	
2002	131.4	125.7	112.0	111.7	112.0	91.7	5.1	90.8	4.7	
2003	123.5	120.2	105.3	104.8	105.4	96.0	4.7	95.9	5.6	
2004	121.0	118.9	103.1	102.4	103.5	98.0	2.0	93.1	-2.9	
2005	108.6	106.9	92.6	91.9	93.0	111.4	13.7	104.8	12.6	
2006	121.3	119.5	103.4	102.6	104.0	104.2	-6.4	102.2	-2.5	
2007	118.3	117.6	100.9	99.9	101.5	108.6	4.2	110.6	8.2	
2008	166.4	166.8	141.9	140.9	142.4	85.5	-21.2	85.7	-22.5	
2009	216.1	223.3	190.9	189.9	191.3	70.0	-18.2	63.8	-25.5	
2010	.	216.3	185.0	184.4	185.0	74.5	6.4	72.1	13.0	

1. The index shows the average exchange rate of foreign currencies against the Icelandic króna for each period. From 6 September 1995, the trade-weighted basket (goods and services) of 16 currencies replaced the former basket of US dollar (18%), ECU (76%) and Japanese yen (6%). 2. The index has been recalculated so that, 2 January 2009, it was assigned a value equivalent to that of the now-discontinued Exchange Rate Index. 3. The index shows the average exchange rate of foreign currencies against the Icelandic króna for each period. Weights are based on trade in goods and services. 4. Based on quarterly information on prices (consumer prices), wages, employment and output in main trading partner countries. 5. Year-on-year.

Table 3 Notes and coin in circulation by denomination

	2006		2007		2008		2009		2010	
	ISK thousands	%	ISK thousands	%	ISK thousands	%	ISK thousands	%	ISK thousands	%
<i>Notes:</i>										
5,000 kr.	8,787,500	69.5	9,597,500	70.3	18,000,000	80.8	22,445,000	84.1	31,402,500	87.4
2,000 kr.	350,000	2.8	398,000	2.9	617,000	2.8	504,000	1.9	618,000	1.7
1,000 kr.	2,475,000	19.6	2,669,000	19.5	2,696,500	12.1	2,776,000	10.4	2,896,500	8.1
500 kr.	905,000	7.2	989,500	7.2	952,750	4.3	957,000	3.6	994,500	2.8
100 kr.	95,550	0.8	.	.	.	.	.	.	.	.
50 kr.	11,825	0.1	.	.	.	.	.	.	.	.
10 kr.	11,050	0.1	.	.	.	.	.	.	.	.
Total	12,635,925	100.0	13,654,000	100.0	22,266,250	100.0	26,682,000	100.0	35,911,500	100.0
<i>Coin:</i>										
100 kr.	1,006,180	53.6	1,188,600	57.1	1,256,600	57.9	1,318,600	57.9	1,359,600	57.7
50 kr.	392,590	20.9	374,890	18.0	373,640	17.2	392,390	17.2	412,390	17.5
10 kr.	314,080	16.8	342,370	16.5	359,520	16.6	377,620	16.6	392,920	16.7
5 kr.	82,480	4.4	89,434	4.3	92,434	4.3	95,434	4.2	97,934	4.2
1 kr.	81,247	4.3	86,132	4.1	87,994	4.1	91,634	4.0	95,134	4.0
Total	1,876,576	100.0	2,081,426	100.0	2,170,188	100.0	2,275,678	100.0	2,357,978	100.0

Table 4 Accounts of the Central Bank<sup>1</sup>

<i>M.kr. at year-end</i>	2004	2005	2006	2007	2008	2009	2010
Net foreign exchange reserves	65,567	67,356	167,975	163,486	190,567	303,112	406,194
Domestic items, net <sup>2</sup>	-27,009	-19,904	-108,457	4,361	220,378	-65,295	-195,247
Claims on Treasury and Gov't. institutions, net	-17,782	-75,916	-211,036	-211,177	-133,241	-281,270	-254,123
Claims on other financial institutions	8,993	11,902	28,547	50,102	16,423	3,133	3,004
Claims on deposit money banks	31,771	77,772	119,863	258,165	466,540	28,869	90,037
Other claims	84	189	499	131	117	490,665	391,617
Deposits of other financial institutions	-13,681	-145	-131	-1,425	-14,242	-189,223	-314,774
Other items, net	-36,394	-33,706	-46,199	-91,434	-115,219	-117,468	-111,007
Reserves of deposit money banks	29,415	36,952	48,047	155,418	390,593	212,093	176,282
Certificates of deposits	4,404	2,294	1,777	-	167,600	29,702	60,957
Other claims	-	-	-	-	16,519	9,409	47,903
Cash and liquid reserves	25,012	34,658	46,269	155,418	206,474	172,983	67,422
Notes and coin in circulation	9,143	10,500	11,471	12,429	20,352	25,725	34,665
Base money	34,151	45,158	57,741	167,847	115,054	116,565	93,929
Deposits in deposit money banks	22,519	31,956	43,228	152,112	90,618	87,607	55,660
Notes and coin	11,632	13,202	14,513	15,735	24,436	28,958	38,269

1. Further breakdown in Table 10. 2. Deposits are marked as negative (-).

Table 5 Summary of the accounts of deposit money banks<sup>1</sup>

M.kr. at year-end	2004	2005	2006	2007	2008	2009	2010
<i>Assets:</i>							
Domestic assets, total	1,606,052	2,445,068	3,314,826	4,977,887	3,560,256	2,674,308	2,496,270
Cash and cash balances with Central Bank	29,413	36,906	47,359	163,798	206,586	132,705	115,332
Receivables on domestic institutions	89,757	105,362	196,396	209,168	188,140	161,874	76,001
Domestic credit	1,431,579	2,205,912	2,969,617	3,827,402	2,200,999	2,106,151	2,081,978
Lending <sup>2</sup>	1,123,510	1,701,808	2,407,176	3,148,054	1,940,352	1,658,034	1,688,087
Redeemed liabilities	329	468	276	134	828	2,468	2,256
Overdrafts	141,548	171,976	198,986	214,527	132,574	141,209	149,965
Bills	5,051	5,648	4,762	11,248	35,743	1,666	980
Nominal bonds	145,004	201,797	329,420	517,150	191,579	241,043	337,070
Indexed bonds	340,650	658,406	780,351	844,956	512,690	489,250	522,299
Foreign currency-linked bonds	490,928	659,988	1,077,672	1,518,618	1,233,423	924,694	862,120
Foreign currency-linked overdrafts	...	3,526	15,710	41,421	55,511	30,590	32,079
Provisions <sup>3</sup>	...	...	...	...	-221,998	-172,886	-218,683
Leasing contracts	18,739	18,909	28,380	38,126	30,368	26,285	28,330
Debt instruments	195,604	256,788	275,620	388,628	187,816	410,690	353,847
Treasury bills	2,440	5,248	2,770	3,401	1,764	2,647	723
Equities	91,287	223,158	255,670	252,593	42,464	11,142	11,713
Derivatives	...	...	...	266,126	90,461	14,078	1,508
Share in associates	11,159	28,892	21,125	23,352	11,487	12,868	7,345
Share in affiliated undertakings	44,143	67,996	80,329	188,610	213,816	106,606	86,426
Other assets	...	...	...	299,431	648,768	140,026	127,679
Foreign assets, total <sup>4</sup>	633,492	1,488,256	3,031,477	4,721,174	623,973	281,854	287,764
Foreign credit and equities	237,430	723,831	1,284,133	2,867,835	393,285	131,354	136,348
Foreign lending	190,455	500,953	817,046	1,996,874	322,674	87,195	89,837
Marketable bonds and bills	4,554	71,165	227,456	576,504	28,786	40,134	43,404
Equities	42,421	151,713	239,631	294,457	41,825	4,026	3,107
Foreign receivables	...	...	...	788,952	25,131	73,403	93,481
Derivatives	...	...	...	134,180	1,524	962	23
Share in associates	315	1,168	1,714	76,560	-	-	1,554
Share in affiliated undertakings	118,088	205,190	329,305	560,542	138,744	25,523	3,000
Other assets	277,659	558,067	1,416,326	293,106	65,289	50,612	53,358
Assets, total	2,239,544	3,933,324	6,346,303	9,699,061	4,184,230	2,956,162	2,784,033
<i>Liabilities:</i>							
Domestic liabilities, total	785,108	1,137,043	1,545,990	2,552,524	3,083,620	2,334,955	2,134,935
Central Bank facilities	31,822	77,766	120,388	281,360	358,916	12,997	41,919
Deposits of residents, total	524,686	647,001	774,714	1,217,856	1,604,159	1,580,825	1,411,884
Current accounts	130,811	161,435	184,425	351,059	492,711	450,351	419,988
Current accounts in foreign currency	...	850	15,651	47,310	29,540	37,837	41,177
Money market rate accounts	...	...	...	173,076	109,537	190,901	128,118
Sight deposits	56,358	66,296	80,031	111,144	372,798	360,044	341,539
Indexed deposits	145,352	145,513	148,061	114,572	255,554	227,133	213,436
Holiday pay accounts	...	...	...	6,809	7,492	6,745	6,737
Supplementary pension deposits	20,188	28,448	31,713	36,850	62,302	74,057	80,769
Other time deposits	126,210	179,540	243,310	250,592	106,928	95,966	93,446
Foreign currency accounts	45,768	64,920	71,523	126,444	167,298	137,792	86,675
Deposits from credit institutions	...	...	...	110,570	171,038	172,741	148,892
Bond issue	95,689	146,243	252,498	409,489	87,238	19,643	8,418
Subordinated loans	25,080	30,392	30,668	39,991	31,066	33,208	48,938
Direct borrowing	72,359	130,997	188,684	234,257	552,492	434,162	401,663
Derivatives	...	...	...	51,154	5,520	2,251	1,267
Other liabilities	35,471	104,644	179,038	207,847	273,191	79,128	71,954
Foreign liabilities, total <sup>4</sup>	1,212,415	2,391,125	4,234,096	6,224,485	731,539	311,467	203,375
Deposits from foreign credit institutions	...	...	...	388,858	203,429	180,259	160,489



Table 5 Summary of the accounts of deposit money banks (cont.)<sup>1</sup>

M.kr. at year-end	2004	2005	2006	2007	2008	2009	2010
Deposits from foreign parties, other than credit institutions	14,501	52,069	364,595	1,297,271	103,706	80,729	41,942
Derivatives	...	...	...	125,841	11,564	-	807
Bond issue	896,934	1,842,123	2,814,959	2,496,270	-	-	-
Subordinated loans	71,980	151,125	360,588	418,388	17,046	-	-
Direct borrowing	229,000	345,808	693,954	1,493,533	395,787	50,340	-
Other foreign liabilities	...	...	...	4,325	8	140	137
Total equity and minority interest	242,021	405,156	566,217	922,051	369,070	309,740	445,724
Total liabilities and equity	2,239,544	3,933,324	6,346,303	9,699,061	4,184,230	2,956,162	2,784,033

1. The latest data are preliminary. The data only represent DMBs that are operating at each time. 2. In these figures, the loans of Arion Bank hf., Íslandsbanki hf., and NBI hf. are assessed at purchase value; that is, the price at which these parties purchased the loan portfolio from Kaupthing Bank hf., Giltinir Bank hf., and Landsbanki Íslands hf. The purchase value is the amount that is expected to be collected on the loans. The value of the loan portfolio therefore does not reflect customers' debt position. The loan portfolios are revalued on a regular basis, and could lead to an increase or decrease in the value of specific loans. 3. The CBI is currently working on coordinating the presentation of value assessment and provision. The data are therefore subject to change until more a reliable valuation becomes available. 4. Foreign party means that the counterpart is non-resident, according to the Foreign Exchange Act, no. 87/1992.

Note: See Central Bank of Iceland Statistics pages, [www.sedlabanki.is](http://www.sedlabanki.is).

Table 6 Summary of the accounts of the banking system<sup>1</sup>

M.kr. at year-end	2004	2005	2006	2007	2008	2009	2010
Foreign assets, total <sup>2</sup>	699,201	1,555,761	3,199,547	4,884,759	1,053,464	766,985	955,703
Foreign credit and equities	276,488	766,533	1,405,600	3,006,157	607,562	365,907	359,526
Other foreign assets	422,713	789,228	1,793,948	1,878,602	445,902	401,078	596,177
Foreign liabilities, total <sup>2</sup>	1,214,118	2,392,759	4,235,969	6,226,198	973,521	515,456	491,845
Foreign bond issue	896,934	1,842,123	2,814,959	2,496,270	-	-	-
Other foreign liabilities	317,184	550,636	1,421,010	3,729,928	973,521	515,456	491,845
Domestic assets, total	1,646,933	2,539,857	3,468,598	4,854,382	3,568,716	3,142,170	2,914,296
Domestic credit <sup>3</sup>	1,472,376	2,295,586	3,118,026	3,877,504	2,487,428	2,274,682	2,255,557
Treasury and Government institutions	45,911	18,380	24,855	6,610	273,784	168,353	173,372
Municipalities	13,420	10,600	11,828	11,645	10,392	10,585	18,363
Non-bank financial companies	195,754	212,173	281,719	131,126	34,598	24,365	25,362
Companies	851,174	872,519	1,137,030	1,316,380	1,175,330	1,106,060	1,118,187
Households	305,840	544,418	707,531	836,672	568,118	490,459	529,502
Holding companies	...	443,509	719,829	928,020	411,723	217,976	235,284
Other	60,277	193,986	235,233	647,051	235,481	429,769	374,170
Provisions <sup>4</sup>	...	...	...	...	-221,998	-172,886	-218,683
Derivatives	...	...	...	266,126	90,461	14,078	1,508
Share in associates	11,159	28,892	21,125	23,352	11,487	12,868	7,345
Share in affiliated undertakings	44,143	67,996	80,329	188,610	213,816	106,606	86,426
Other domestic assets	119,254	147,383	249,118	498,791	765,525	733,936	563,459
Broad money and bonds (M4)	629,521	803,746	1,037,629	1,639,774	1,711,749	1,626,192	1,454,967
Domestic bond issue	95,689	146,243	252,498	409,489	87,238	19,643	8,418
Broad money (M3)	533,832	657,503	785,131	1,230,285	1,624,511	1,606,550	1,446,549
Time deposits	291,753	353,501	423,084	581,899	541,813	594,802	522,505
Money and sight deposits (M2)	242,079	304,002	362,047	648,385	1,082,699	1,011,747	924,043
Sight deposits	102,125	131,216	150,498	237,588	540,097	497,835	428,213
Money supply (M1)	139,953	172,786	211,549	410,797	542,602	513,912	495,830
Demand deposits	130,811	162,286	200,077	398,369	522,250	488,187	461,166
Notes and coin in circulation	9,142	10,500	11,472	12,429	20,352	25,725	34,665
Other domestic borrowing	72,359	130,997	199,480	4,148	402,633	396,621	389,577

1. The latest data are preliminary. The data only represent DMBs that are operating at each time. 2. In these figures, the loans of Arion Bank hf., Íslandsbanki hf., and NBI hf. are assessed at purchase value; that is, the price at which these parties purchased the loan portfolio from Kaupthing Bank hf., Giltinir Bank hf., and Landsbanki Íslands hf. The purchase value is the amount that is expected to be collected on the loans. The value of the loan portfolio therefore does not reflect customers' debt position. The loan portfolios are revalued on a regular basis, and could lead to an increase or decrease in the value of specific loans. 3. The CBI is currently working on coordinating the presentation of value assessment and provision. The data are therefore subject to change until a more reliable valuation becomes available. 4. Foreign party means that the counterpart is a non-resident according to the Foreign Exchange Act, no. 87/1992.

Table 7 Liquidity and reserve ratios in %<sup>1</sup>

<i>Effective as of:</i>	<i>Reserve requirement ratio</i>	<i>Effective as of:</i>	<i>Reserve requirement ratio</i>
1 June 1979	28.0	1 January 1992	7.0
17 April 1985	18.0	1 November 1992	6.0
1 March 1987	13.0	1 December 1992	5.0
1 August 1988	12.0	1 November 1993	4.0 (2.5) <sup>2</sup>
1 March 1989	11.0	21 May 1998	4.0 (1.5) <sup>2</sup>
1 May 1990	10.0	21 March 2003	3.0 (1.0) <sup>2</sup>
1 June 1990	7.0	21 December 2003	2.0 (0.0) <sup>3</sup>
31 October 1991	6.0		

1. Percentage of bank total deposits as of 1 June 1979, of domestic disposable funds as of 1 March 1989, and of all disposable funds as of 21 May 1988. 2. Figure in parentheses refers to the reserve ratio for bond issues and time deposits. 3. Figure in parentheses refers to the reserve ratio for deposits and bond issues with an original maturity of more than two years, and securities eligible as collateral for transactions with the Central Bank.

Table 8 Main interest rates announced pursuant to Article 10, Paragraph 2 and Temporary Provision III of the Act on Interest and Price Indexation, no. 38/2001

<i>General interest rates, rates on damage claims, and penalty interest, in % per annum</i>			
	<i>General interest on non-indexed loans</i>	<i>General interest on indexed loans</i>	<i>Interest on damage claims</i>
1 January 2010	8.50	4.80	5.70
1 February	8.50	4.80	5.70
1 March	8.50	4.80	5.70
1 April	8.50	4.80	5.70
1 May	8.50	4.80	5.70
1 June	8.25	4.80	5.50
1 July	8.25	4.80	5.50
1 August	7.75	4.80	5.20
1 September	7.75	4.80	5.20
1 October	6.75	4.80	4.50
1 November	6.30	4.80	4.20
1 December	5.75	4.70	3.85
Average 2009	14.00	5.58	9.39
Average 2010	7.78	4.79	5.20

Table 9 Selected annual nominal yields of deposit money banks and penalty rates in % per annum

	<i>Non-indexed loans<sup>1</sup></i>		<i>New (long) indexed securities<sup>2</sup></i>		<i>Penalty rates</i>		<i>Credit terms index, 12-month change<sup>3</sup></i>
	<i>Nominal</i>	<i>Real</i>	<i>Nominal</i>	<i>Real</i>	<i>Nominal</i>	<i>Real</i>	
1995	11.9	10.1	10.5	8.7	14.6	12.8	1.6
1996	12.8	10.5	11.1	8.9	15.8	13.5	2.1
1997	13.3	11.1	11.2	9.0	16.3	14.0	2.0
1998	13.2	11.8	10.1	8.8	16.5	15.1	1.3
1999	14.1	8.0	14.7	8.6	17.3	11.1	5.6
2000	17.4	12.7	14.1	9.5	22.0	17.2	4.2
2001	18.8	9.4	19.7	10.2	23.7	13.9	8.6
2002	16.0	13.7	12.3	10.1	21.3	18.9	2.0
2003	12.4	9.4	12.0	9.1	17.3	14.2	2.7
2004	12.6	8.3	10.5	6.3	17.3	12.9	3.9
2005	15.3	10.7	10.3	5.9	20.3	15.5	4.2
2006	18.6	10.9	13.4	6.1	22.5	14.6	6.9
2007	20.2	13.5	12.9	6.6	25.0	18.0	5.9
2008	21.6	4.5	24.7	7.1	25.8	8.1	16.4
2009	20.2	10.6	15.7	6.5	21.2	11.6	8.6
2010	15.4	12.5	11.5	8.7	15.1	12.2	2.6

1. Weighted average of DMBs' interest rates. Based on two due dates per year. 2. Weighted average of DMBs' interest rates. 3. January to January.

Table 10 Balance Sheet of the Central Bank of Iceland

M.kr.	End of year					
	2004	2005	2006	2007	2008	2009
<b>Assets:</b>	<b>106,590</b>	<b>162,294</b>	<b>321,842</b>	<b>476,859</b>	<b>1,187,460</b>	<b>1,178,082</b>
<i>Foreign assets</i>	65,709	67,506	168,070	163,585	429,491	485,131
Foreign deposit	23,171	21,049	41,650	19,338	207,257	222,894
Gold	1,707	2,074	2,934	3,305	6,653	8,664
Foreign securities	39,058	42,702	121,467	138,322	211,855	231,574
Foreign assets apart from reserves	-	-	-	787	211	190
Special drawing rights with the IMF	8	3	8	11	53	18,161
IMF reserve position	1,765	1,678	2,010	1,823	3,462	3,649
<i>Domestic assets</i>	40,881	94,789	153,772	313,273	757,969	692,952
<i>Deposit money banks</i>	31,771	77,772	119,863	258,165	466,540	28,869
Other claims	-	-	-	-	231,024	6,722
Collateral	31,771	77,772	119,863	258,165	72,352	9,249
Overnight loans	-	-	-	-	37,982	1,700
Other claims in foreign currency	-	-	-	-	125,181	11,197
<i>Other financial institutions</i>	8,993	11,902	28,547	50,102	16,423	3,133
Listed securities	3,232	1,832	1,473	1,447	2,757	3,133
Collateral	5,762	10,070	27,074	44,554	13,666	-
Overnight loans	-	-	-	4,102	-	-
<i>Central government</i>	32	-	-	-	270,005	165,398
Listed securities	32	-	-	-	-	-
Bonds receivable	-	-	-	-	270,005	165,398
<i>Other sectors</i>	84	189	499	131	117	490,665
<i>Real estate and other assets</i>	-	4,527	4,479	4,520	4,470	4,420
<i>Other assets</i>	-	399	385	356	413	467
<b>Liabilities and capital:</b>	<b>106,590</b>	<b>162,294</b>	<b>321,842</b>	<b>476,859</b>	<b>1,187,460</b>	<b>1,178,082</b>
<i>Foreign liabilities</i>	1,703	1,634	1,873	1,712	241,982	203,989
Short-term	142	150	95	100	134,403	36,752
Long-term	-	-	-	-	104,521	145,266
IMF SDR allocation	1,561	1,484	1,779	1,613	3,058	21,970
IMF deposits	-	-	-	-	-	1
<i>Domestic liabilities</i>	70,689	124,291	271,633	384,143	863,100	891,215
<i>Notes and coin</i>	11,632	13,202	14,513	15,735	24,436	28,958
<i>Deposit money banks</i>	26,926	34,250	45,006	152,112	386,509	208,860
Sight deposits	22,519	31,956	43,228	152,112	90,618	87,607
Time deposits	-	-	-	-	-	6,657
Certificates of deposit	4,404	2,294	1,777	-	167,600	29,702
Other claims	-	-	-	-	16,519	9,409
Sight deposits in foreign currency	-	-	-	-	111,771	75,485
Insurance accounts	3	-	-	-	-	-
<i>Other financial institutions</i>	13,681	145	131	1,425	14,242	189,223
Sight deposits	13,681	145	131	1,425	4,415	35,412
Time deposits	-	-	-	-	-	669
Certificates of deposit	-	-	-	-	9,827	-
Sight deposits in foreign currency	-	-	-	-	-	-
Time deposits in foreign currency	-	-	-	-	-	153,142
<i>Central Government</i>	17,815	75,916	211,036	211,177	403,246	446,668
Treasury current account	16,257	33,573	80,110	93,971	168,723	166,050
Government institutions	519	371	605	536	895	282
Treasury's sight deposits in foreign currency	1,039	9,113	97,235	89,855	2,376	49,129
Treasury's time deposits in foreign currency	-	-	-	-	169,404	179,998
Time deposits	-	32,859	33,085	26,815	61,849	51,210
<i>Other liabilities</i>	636	778	948	3,694	34,666	17,507
<b>Capital and reserves</b>	<b>34,198</b>	<b>36,370</b>	<b>48,336</b>	<b>91,003</b>	<b>82,378</b>	<b>82,878</b>

## End of month 2010

January	February	March	April	May	June	July	August	Sept.	Oct.	Nov.	Dec.
1,176,537	1,185,030	1,192,081	1,208,568	1,211,072	1,246,323	1,249,280	1,207,615	1,185,987	1,124,718	1,206,741	1,328,240
475,233	480,333	490,060	506,447	506,297	562,745	570,966	547,245	488,104	472,771	543,428	666,436
213,692	223,941	234,237	232,759	229,111	313,464	326,055	306,496	249,668	236,484	314,431	420,098
8,805	9,071	9,116	9,603	9,946	10,113	8,985	9,613	9,462	9,721	10,376	10,426
230,444	225,209	224,857	242,396	246,683	218,629	216,029	211,304	209,799	207,432	200,266	217,821
184	184	184	184	184	993	948	950	903	895	928	1,690
18,409	18,259	18,041	17,909	16,838	16,024	15,536	15,479	14,980	14,954	14,086	13,079
3,698	3,668	3,625	3,596	3,535	3,521	3,413	3,402	3,292	3,286	3,340	3,322
701,303	704,697	702,021	702,121	704,775	683,578	678,314	660,370	697,883	651,947	663,312	661,804
26,516	29,033	26,445	26,179	38,895	31,919	27,892	26,959	63,494	62,799	75,058	90,037
6,702	6,702	6,722	6,722	6,722	6,722	6,722	6,722	6,722	6,334	6,194	-
7,972	11,118	8,085	8,697	10,943	15,920	12,276	11,398	48,267	48,116	58,149	40,825
1,100	1,207	2,638	2,008	1,366	995	995	995	995	995	8,037	995
10,742	10,007	9,000	8,751	19,863	8,282	7,899	7,844	7,510	7,353	2,678	48,217
3,140	3,103	3,129	2,698	2,752	3,101	3,102	3,097	3,707	3,017	2,949	3,004
3,140	3,103	3,129	2,698	2,752	3,101	3,102	3,097	3,077	3,017	2,949	3,004
-	-	-	-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	630	-	-	-
175,916	178,784	180,571	183,596	182,880	164,595	163,345	168,269	169,068	169,614	169,971	170,525
-	-	-	-	-	-	-	-	-	-	-	-
175,916	178,784	180,571	183,596	182,880	164,595	163,345	168,269	169,068	169,614	169,971	170,525
490,896	488,900	487,083	484,850	474,730	479,077	479,089	456,835	456,471	411,492	409,901	391,617
4,754	4,754	4,754	4,754	4,420	4,395	4,395	4,395	4,395	4,395	4,395	4,370
81	122	39	44	1,097	491	490	815	747	630	1,039	2,252
1,176,537	1,185,030	1,192,081	1,208,568	1,211,072	1,246,323	1,249,280	1,207,615	1,185,987	1,124,718	1,206,741	1,328,240
206,149	201,974	206,001	217,952	211,406	238,298	245,066	239,879	241,216	240,449	236,088	280,213
36,544	34,069	40,413	33,201	31,114	33,553	45,170	41,791	47,808	46,897	40,899	67,004
147,335	145,817	143,763	163,096	159,018	183,561	179,358	177,624	173,604	173,783	175,093	193,238
22,271	22,088	21,824	21,655	21,273	21,184	20,538	20,463	19,804	19,769	20,095	19,971
-	-	-	-	-	-	-	-	-	-	-	-
887,349	902,201	905,044	912,998	916,789	928,096	920,907	888,050	863,894	803,494	896,960	978,648
27,235	26,848	27,289	26,893	27,861	29,869	31,714	31,164	30,959	32,347	33,128	38,269
196,941	166,676	243,366	187,589	200,533	190,779	187,834	159,668	156,884	131,262	148,628	172,678
51,138	47,848	84,949	49,020	58,345	57,644	53,976	47,912	41,093	26,807	48,249	55,660
-	-	-	-	-	-	-	-	-	-	-	-
64,516	42,293	68,519	86,128	78,176	76,415	77,373	62,515	59,387	64,517	61,465	60,957
7,827	7,003	6,897	7,643	20,719	6,236	5,824	5,837	5,516	5,315	-	47,903
73,460	69,532	83,001	44,798	43,293	50,484	50,662	43,404	50,888	34,623	38,914	8,157
-	-	-	-	-	-	-	-	-	-	-	-
192,657	210,896	211,128	254,934	251,259	274,499	283,842	278,824	200,481	184,683	218,601	314,774
35,325	40,510	40,542	43,939	36,640	38,946	37,690	47,045	38,776	27,917	35,394	36,916
-	-	-	-	-	-	-	-	-	-	-	-
1,673	1,321	400	400	3,700	8,922	13,503	10,622	-	-	-	4,505
-	-	-	-	-	-	-	-	-	-	-	20,374
155,659	169,065	170,186	210,595	210,918	226,631	232,650	221,156	161,705	156,766	183,207	252,979
448,079	472,204	393,283	408,123	402,625	400,483	374,305	393,305	406,267	418,989	469,130	424,648
168,375	195,844	119,890	137,455	144,552	140,894	120,848	143,957	162,607	174,036	182,881	130,050
608	1,423	2,041	2,311	2,389	1,401	1,668	1,186	866	1,406	1,198	1,427
48,723	47,804	46,880	46,199	43,509	105,281	105,067	102,982	97,871	98,274	140,175	175,842
178,932	175,387	174,301	171,817	161,520	101,955	102,160	100,387	101,399	101,572	101,019	106,328
51,441	51,746	50,171	50,342	50,655	50,952	44,562	44,793	43,524	43,702	43,856	11,000
22,437	25,577	29,978	35,459	34,511	32,467	43,212	25,089	69,303	36,212	27,473	28,279
83,038	80,855	81,036	77,618	82,878	79,929	83,307	79,686	80,878	80,774	73,693	69,379

