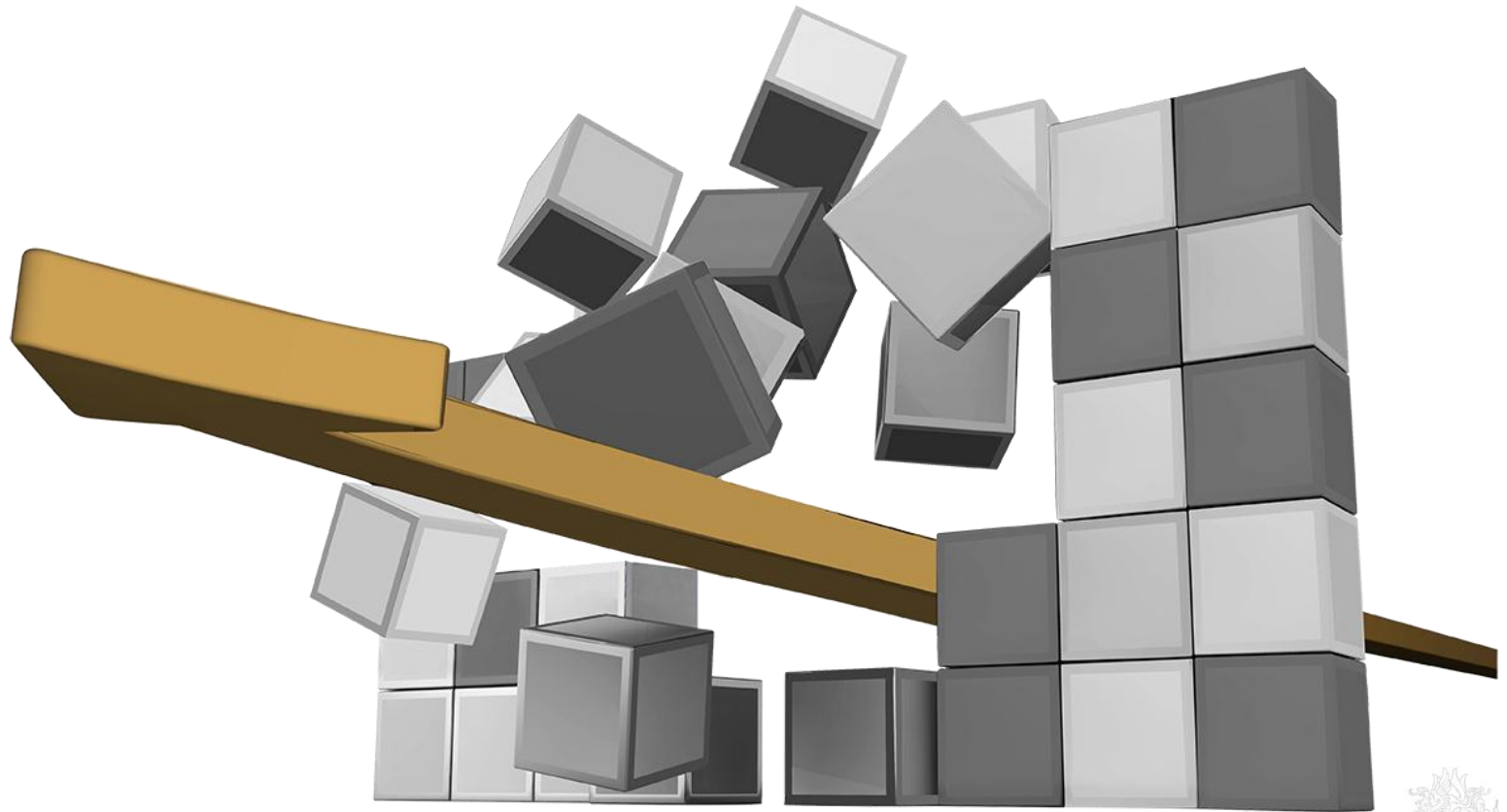


CAPITAL ACCOUNT LIBERALISATION

The authorities' liberalisation strategy, assessment of estates' exemption requests, and analysis of their impact



Comprehensive liberalisation strategy: On 8 June 2015, the authorities presented a three-pronged approach to capital account liberalisation, based on a comprehensive strategy in response to problems that jeopardise stability.

Liberalisation strategy based on protecting the public interest

01

- Stability conditions or a tax on the failed banks' estates
-

02

- Reinvestment in long-term marketable bonds and currency auctions
-

03

- Expanded authorisations for residents to undertake foreign saving and investment.

The capital controls will be lifted without direct impact on the exchange rate of the ISK. Parts of the strategy have already been launched.

Liberalisation is a vital task in terms of the Government's duty to protect the interests of Icelandic society.

All of the key provisions of the liberalisation strategy have now been confirmed.



Stability conditions and other measures relating to liberalisation amount to

856

billion krónur



The stability conditions solve the problem in a comprehensive way: They address in a clear-cut manner the balance of payments effects of settling the estates – they amount to a total of 856 b.kr.

Total scope of the measures

856

billion krónur

Payments to the government

491

billion krónur

Reimbursement of credit facilities

74

billion krónur

Long-term banking system funding

226

billion krónur

Positive impact on
foreign exchange reserves

41

billion krónur

Positive impact on Iceland's IIP

360

billion krónur



The stability conditions solve the problem in a comprehensive way

The stability conditions solve the balance of payments problem, open up access to long-term foreign financing, and provide for reimbursement of facilities to the Government.

01	ISK assets	Stability contribution
02	Domestic FX assets	Long-term funding of financial system
03	Foreign assets	Reimbursements and distributions

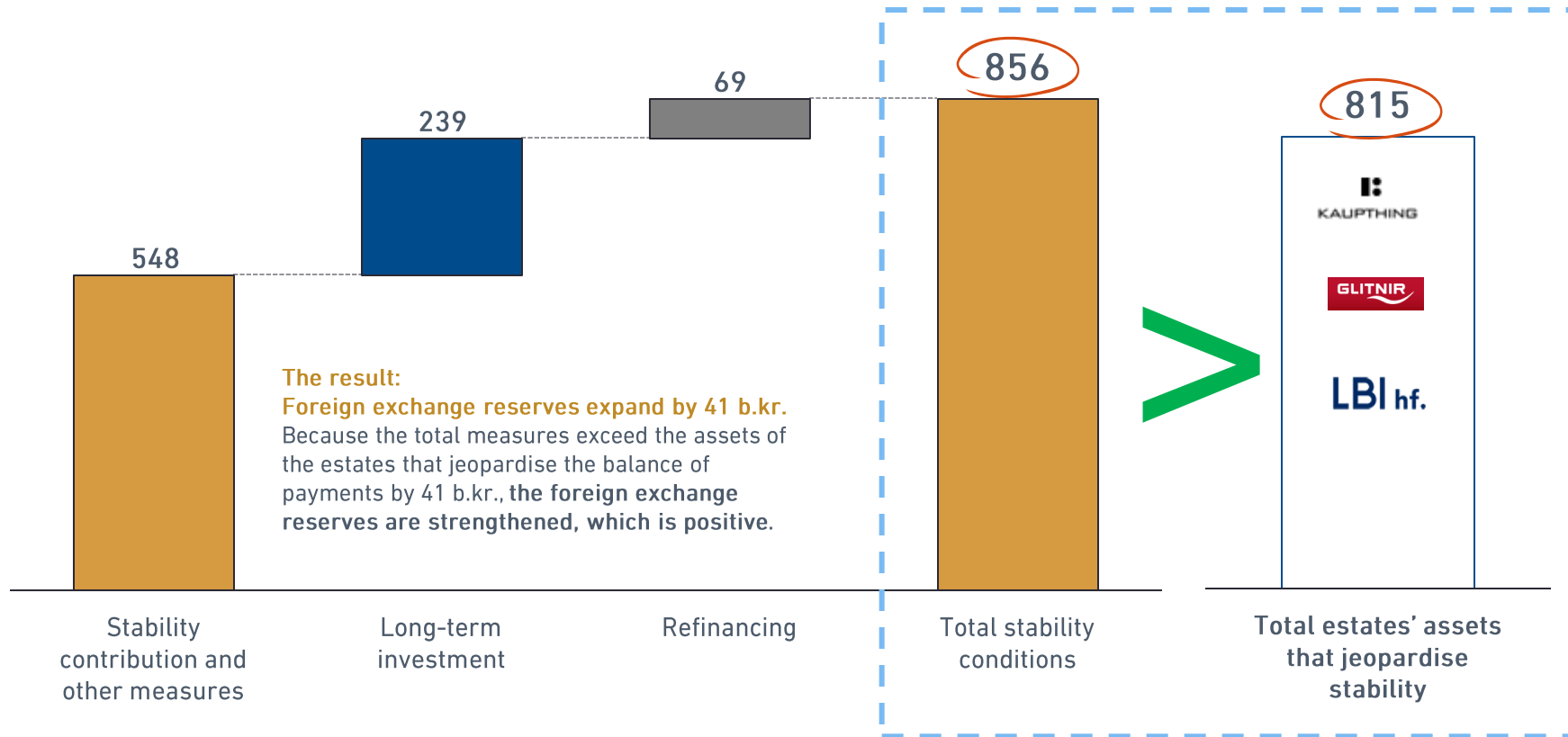




The result: Comprehensive measures relating to the stability conditions total 856 b.kr., which solve the problem in its entirety

Chart: Comprehensive measures by the authorities address all aspects of the problem entailed in the domestic assets held by the estates.

In ISK billions



● The solution ● The problem ●

If the problem escalates, the stability contribution will increase.

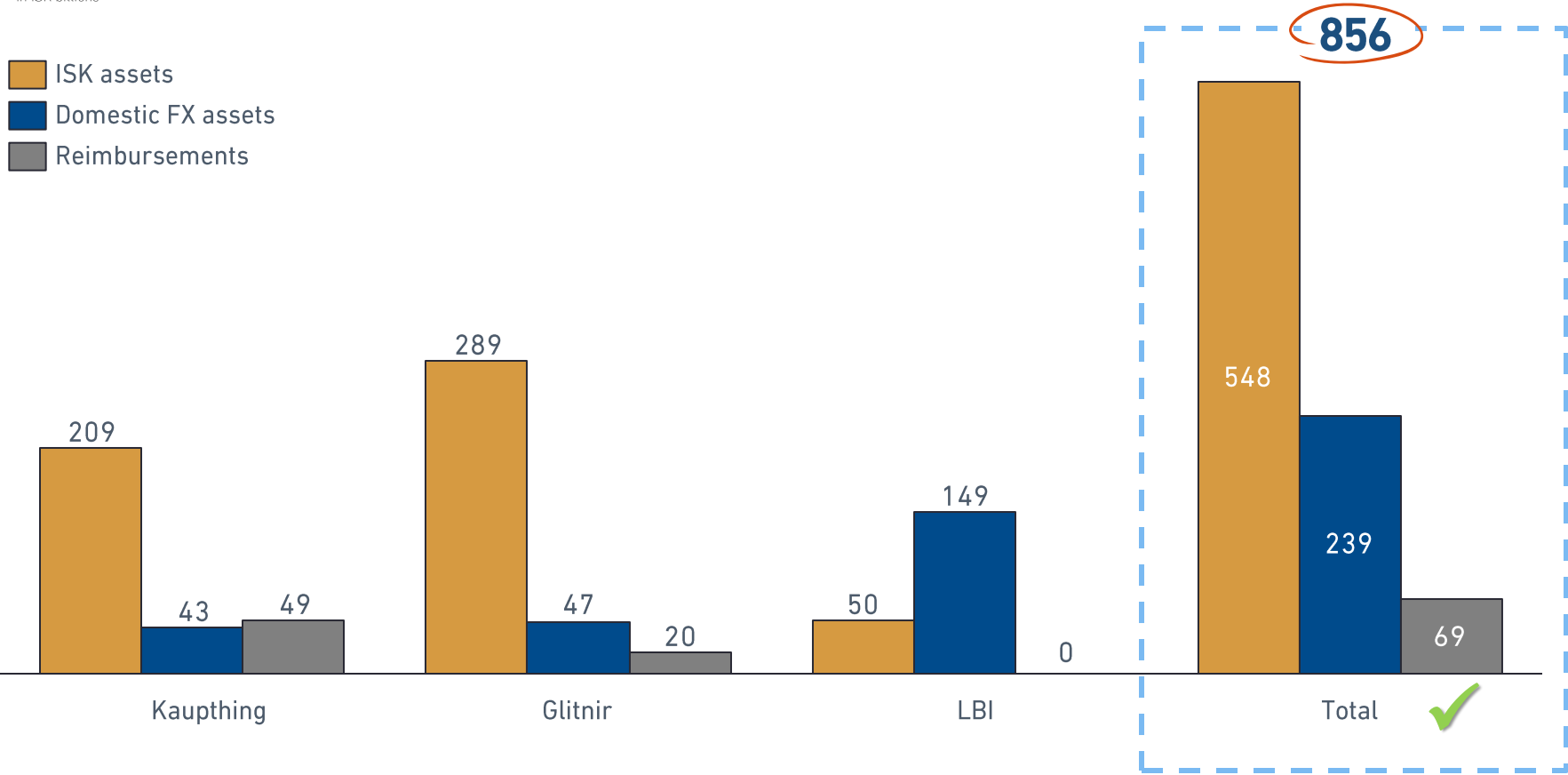




The result: Comprehensive measures relating to the stability conditions total 856 b.kr., which solve the problem in its entirety

Chart: Comprehensive measures by the authorities address all aspects of the problem entailed in the domestic assets held by the failed banks' estates.

In ISK billions



If the problem escalates, the stability contribution will increase.



Upon liberalisation, four objectives will be achieved: neutrality vis-à-vis the ISK exchange rate, long-term banking system funding, expansion of the foreign reserves, and elimination of balance of payments risks stemming from legal disputes

01

- Settlement of the estates will not have a negative impact on the exchange rate
-

02

- Banking system's foreign funding is lengthened and access to global markets eased, reducing refinancing risk and enhancing exchange rate stability
-

03

- Non-borrowed Central Bank reserves expand by 41 b.kr.
-

04

- It is certain that disputes concerning tax issues do not entail further capital outflows, which would otherwise exceed 60 b.kr.

- **Stability conditions and other liberalisation-related measures total 856 b.kr., which solves the balance of payments problem**



Measures vis-à-vis estates total 856 b.kr. but will increase if the value of transferred assets rises later on

01

• Stability contribution* 491 to 599** billion krónur

• Other measures 57 billion krónur

02

• Long-term investments 239 billion krónur

03

• Reimbursements 69 billion krónur

Total measures

856 to 964 billion krónur

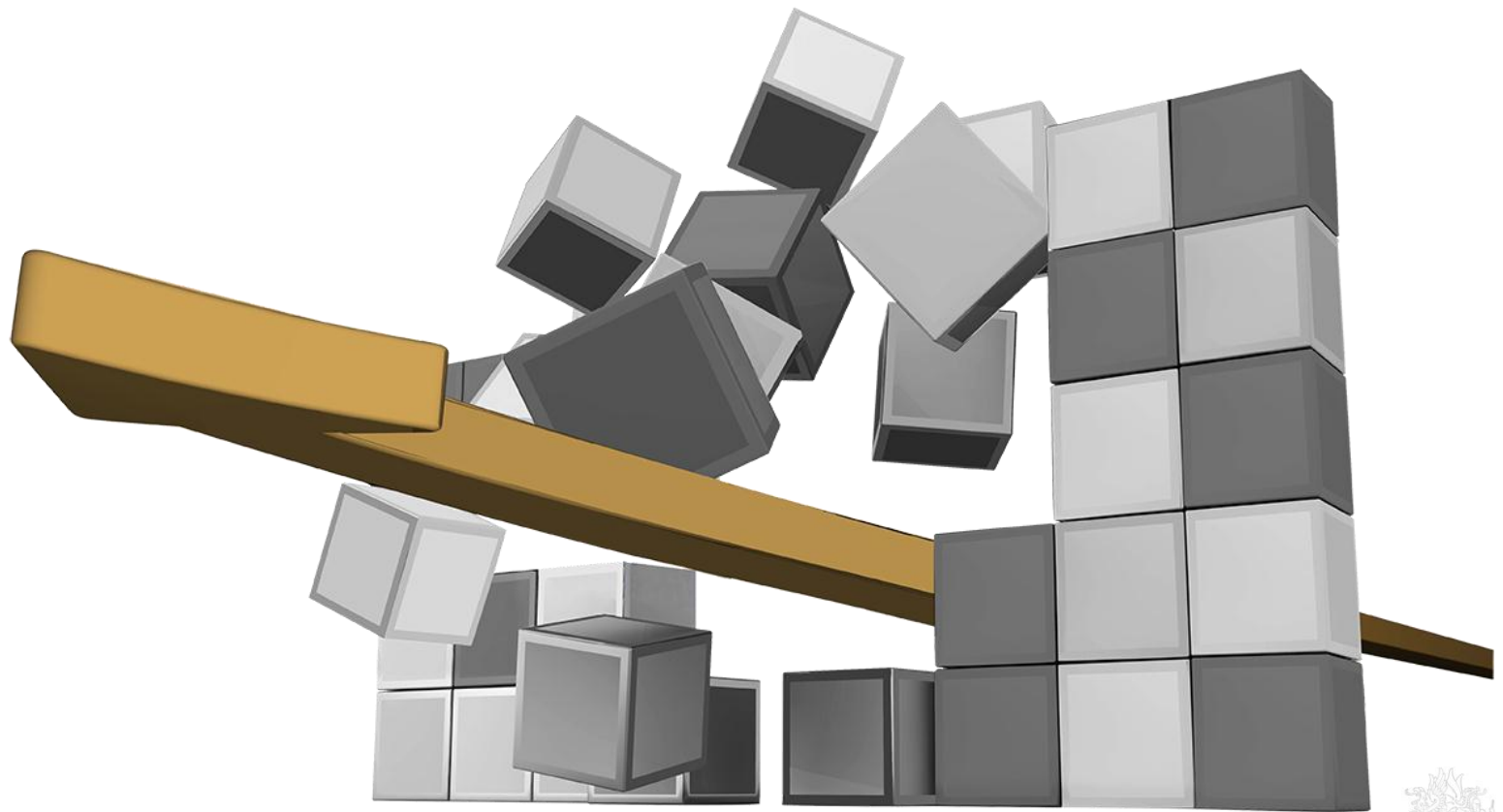
* Taxes for 2015, direct contribution to the State and through ESÍ

** Same premises as in Central Bank report



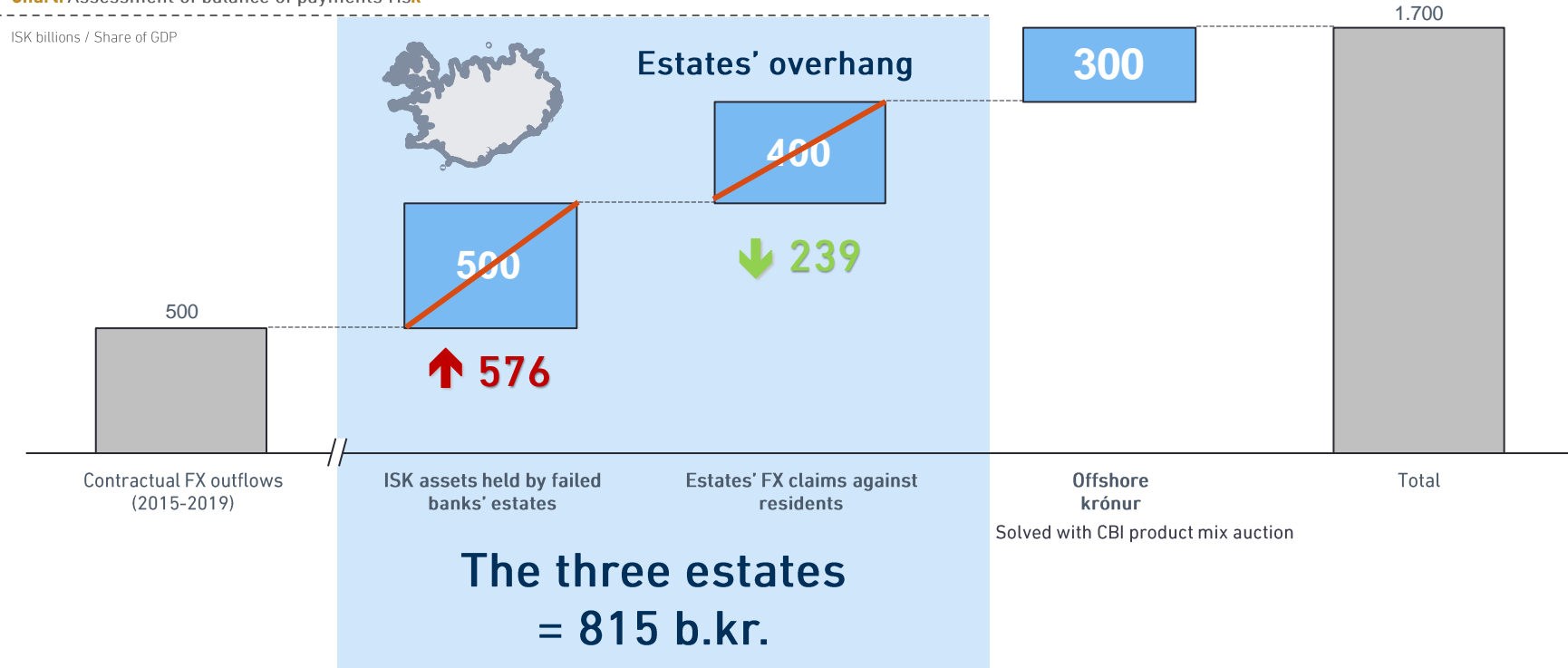
BACKGROUND AND CONTEXT

Liberalisation strategy has adhered to a clear main theme centring on a comprehensive solution to the problem



Review: Iceland does not have enough foreign currency to release an overhang amounting to ISK 1,200 billion, which derives from the failed banks' estates and the stock of offshore krónur. The authorities' solution is directed at three elements.

Chart: Assessment of balance of payments risk



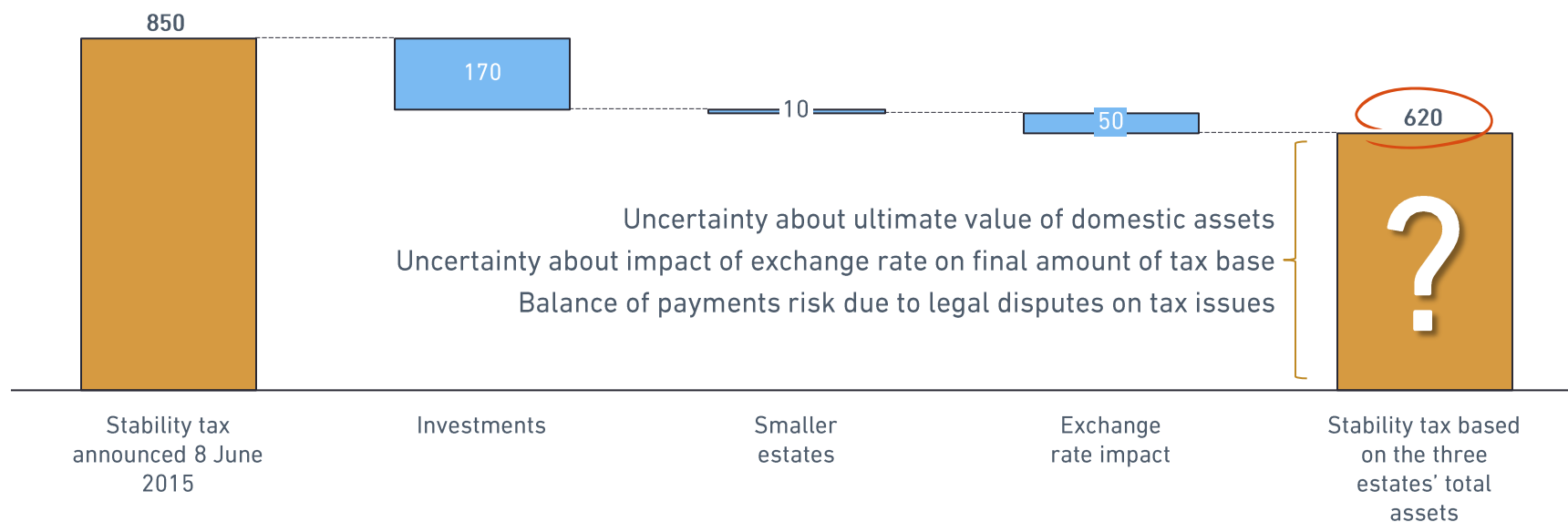
Because of the rise in the value of the estates' domestic ISK-denominated assets, the problem centring on those assets has increased from 500 b.kr. to 576 b.kr.; however, the problem centring on domestic foreign-denominated assets has decreased from 400 b.kr. to 239 b.kr. because of the appreciation of the króna and the planned distribution to priority creditors of LBI hf.

The problem stemming from the three estates totals 815 b.kr; it was 900 b.kr.



The stability conditions solve the problem in a comprehensive way. Because of the appreciation of the króna, the tax on the three estates would now be 50 b.kr. less than when it was announced in June.

- The stability contribution will take account of future changes in the value of the estates' domestic assets. It neutralises this future increase in value through voluntary measures based on a clear framework set by the authorities. **The stability contribution addresses current and future problems deriving from the failed banks' estates and is a voluntary measure.**
- The stability tax includes the pricing of future risk attached to the increase in the value of the estates' domestic assets. It will be levied on total assets as of end-2015 (the tax base). There is uncertainty about the future value of domestic assets and the ultimate size of the tax base.
 - This uncertainty is reflected, among other things, in the fact that potential income from it has already declined significantly, even though domestic ISK assets have risen in value.



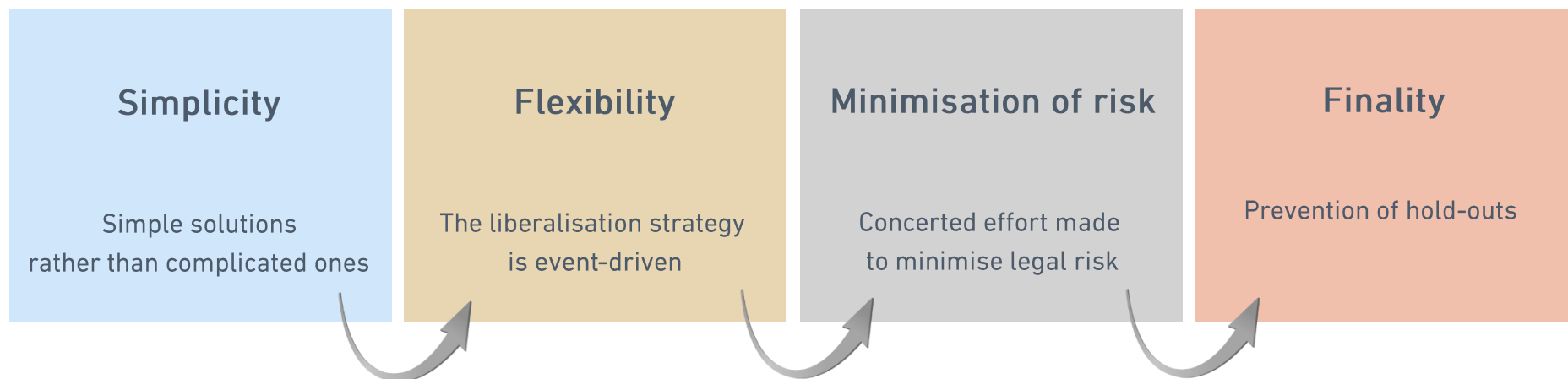
The authorities have presented a comprehensive liberalisation plan that puts top priority on the public interest and is based on transparency and recognised methodology.

- The authorities' solution is in compliance with law and international obligations and is non-discriminatory.
- It is conducive to enabling the exchange rate of the ISK to reflect the real economy after liberalisation.
- The authorities select measures that take less time, are simpler, and minimise legal risk rather than more complicated options, and individual measures are compatible with the comprehensive solution.
- The liberalisation process protects the interests of households and businesses, as it is based on the requirement that the real economy may not absorb more adjustment than it already has.



The fundamental principle has been to observe proportionality, transparency, and non-discrimination in lifting the capital controls.

To observe proportionality, transparency, and non-discrimination during the process.



- To provide information to stakeholders in a transparent way during the process.
 - Enabling them to make an informed assessment of their economic and financial position.
 - Leading their expectations towards orderly, sequenced liberalisation of controls.



Statutory amendments: Proposals for various statutory amendments relating to the liberalisation strategy are now before Parliament (1/2)



The authorities have facilitated the estates' composition agreements with statutory amendments as provided for in the liberalisation strategy; cf. Act no. 59/2015, among others. The purpose was to simplify the rules and create legal certainty.

•The estates have worked towards concluding composition agreements with an eye to fulfilling the stability conditions with the support of an overwhelming majority of creditors. The bill of legislation passed as Act no. 59/2015 mentions several unusual characteristics of the winding-up of the banks' estates: among other things, that the number of creditors that have declared claims is unprecedented and runs to tens of thousands. The claims vary greatly in size. Declared claims run to several thousand billion krónur.

•It is clear that some of the issues involved have never before been provisions the Icelandic courts. Because of the immense scope and complexity of the cases and the short time available to the estates for preparation of their composition agreements, there is the risk of dramatically increased strain on the Icelandic judicial system.

It has been decided to respond to this and grant the courts increased scope by adding a temporary provision to the stability tax legislation. The estates that have received:

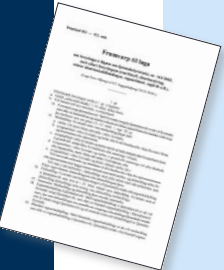
- (i) before year-end: a composition agreement approved by a creditors' meeting.
- (ii) before year-end: have filed a written petition for the confirmation of a composition agreement before a District Court Judge are exempt from the stability tax.
- (iii) after year-end: the final court confirmation of the composition is received before 15 March 2016 will fall outside the scope of the tax liability.



Statutory amendments: Proposals for various statutory amendments relating to the liberalisation strategy are now before Parliament (2/2)



- Other statutory amendments are made in order to neutralise decisions on the structure and contents of the estates' composition agreements:

- 
- Amendment to provisions on withholding tax so that bonds issued in connection with the estates' settlement will be available for settlement in international settlement systems.
 - Provision authorising the simplification of the creditors' register and a clarifying provision concerning when winding-up proceedings are considered concluded.
 - Provision reiterating that the obligation to pay the bank levy is cancelled when winding-up proceedings are concluded with an approved composition agreement.
 - Extension of the temporary provision in tax legislation authorising the conversion of claims to share capital.
 - The minimum proportion for approval of the composition proposal by amounts has been reduced, owing to the unusual nature of bank insolvency; that is, the intention is not to resume operations but to wind up the asset portfolio.
 - Ensured that delivery of shares in a private limited liability company is considered proper fulfilment of the composition agreement.



Fundamental objectives: The authorities' guiding principles in liberalisation were to ensure non-discrimination and finality in settling the estates.

- To solve Iceland's balance of payments problem so that it would be possible to lift the controls without undue risk to macroeconomic and financial stability.
- To implement solutions that safeguard short- and long-term stability and are sustainable in the long run.
- To limit risk to Iceland's Government finances, foreign exchange reserves, and credit ratings and to avoid socialising private sector risks or debts.
- To promote Icelandic firms' access to international markets.
- To ensure that the exchange rate of the Icelandic króna reflects the real economy and not private entities' past problems.
- To honour Iceland's international obligations and Constitutional provisions concerning non-discrimination.



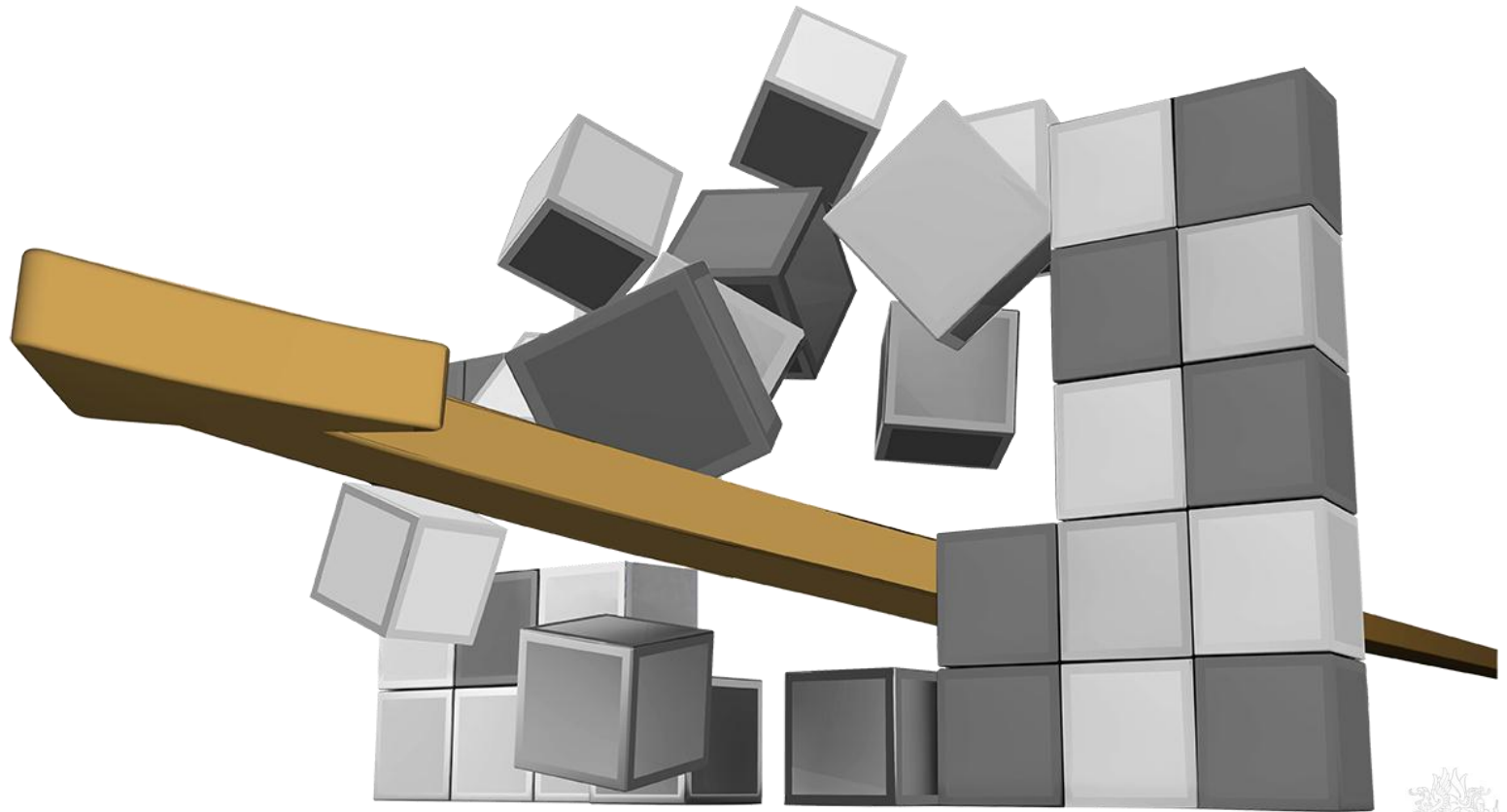
Lifting the capital controls is the most important element in the Government's economic plan
Settling the estates is the largest single factor in liberalisation

- The failed banks' estates are the largest single hindrance to liberalisation of the controls.
- The three estates have agreed to the authorities' stability conditions and have prepared measures that ensure monetary, exchange rate, and financial stability.
- All of the estates' ISK assets are disposed of so that they will not affect the foreign exchange market or the ISK exchange rate.



THE STABILITY CONDITIONS

The stability conditions solve the problem in a comprehensive way, and the positive impact of the liberalisation strategy have already begun to emerge



The stability conditions were announced on 8 June 2015: The estates must satisfy the stability conditions in full in order to conclude composition agreements

The stability conditions are three in number:

01

- A stability contribution that neutralises the negative impact of settlement on the ISK exchange rate and the foreign exchange reserves.
-

02

- The estates fund the banking system with long-term investments.
-

03

- The authorities receive reimbursement of the foreign-denominated credit facilities granted upon the establishment of the new banks in 2009.

The settlement of the estates will take place without adverse effects on the exchange rate of the Icelandic króna.



The authorities' solution: positive effects already emerging

The capital account liberalisation strategy has been well received by the market and has contributed to increased foreign investment in Iceland.

01

- Iceland's sovereign credit ratings have improved
-

02

- New foreign investment has increased and bond yields have fallen
-

03

- The Central Bank's foreign exchange reserves have expanded
-

04

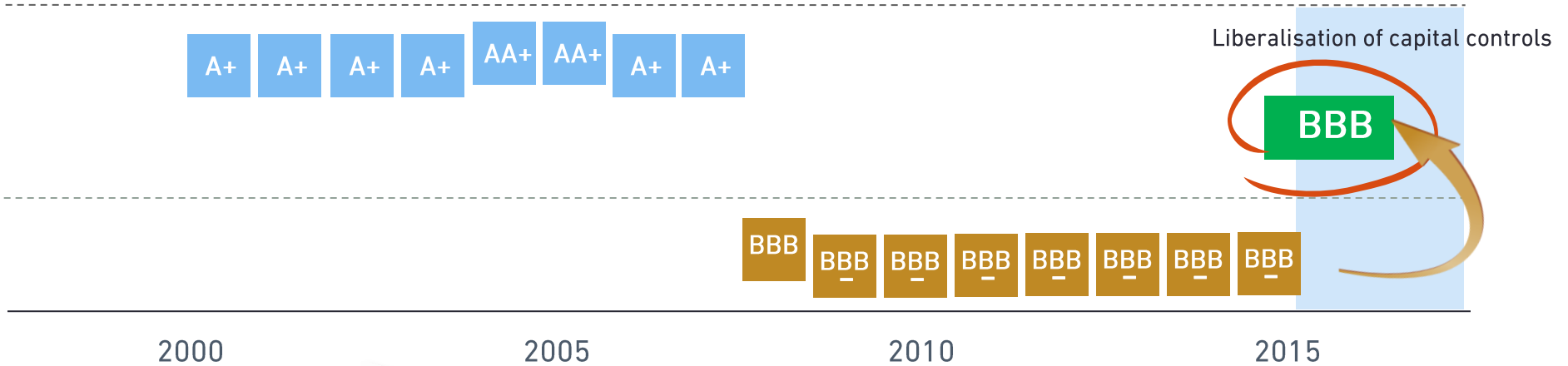
- The dispute between the DIGF and the British and Dutch has been concluded

The authorities' plan is credible – words and deeds coincide.



Iceland's sovereign credit rating rose following the announcement of the liberalisation strategy

Chart: Iceland's sovereign credit rating for foreign obligations according to Standard & Poor's



STANDARD & POOR'S

Standard & Poor's, Research Update, July 17, 2015
 The upgrade reflects what we view as credible government proposals that ... enable the eventual lifting of capital controls, which have been in place since the 2008 banking crisis.

MOODY'S

The upgrade reflects the following key drivers:

Initiation of a careful process of capital account liberalization that is expected to reduce the country's external vulnerabilities, while protecting economic and financial stability.

Expectation of further improvement in the government's gross and net debt position over the next three to four years,

Improvements to macro-prudential and micro-prudential regulation.

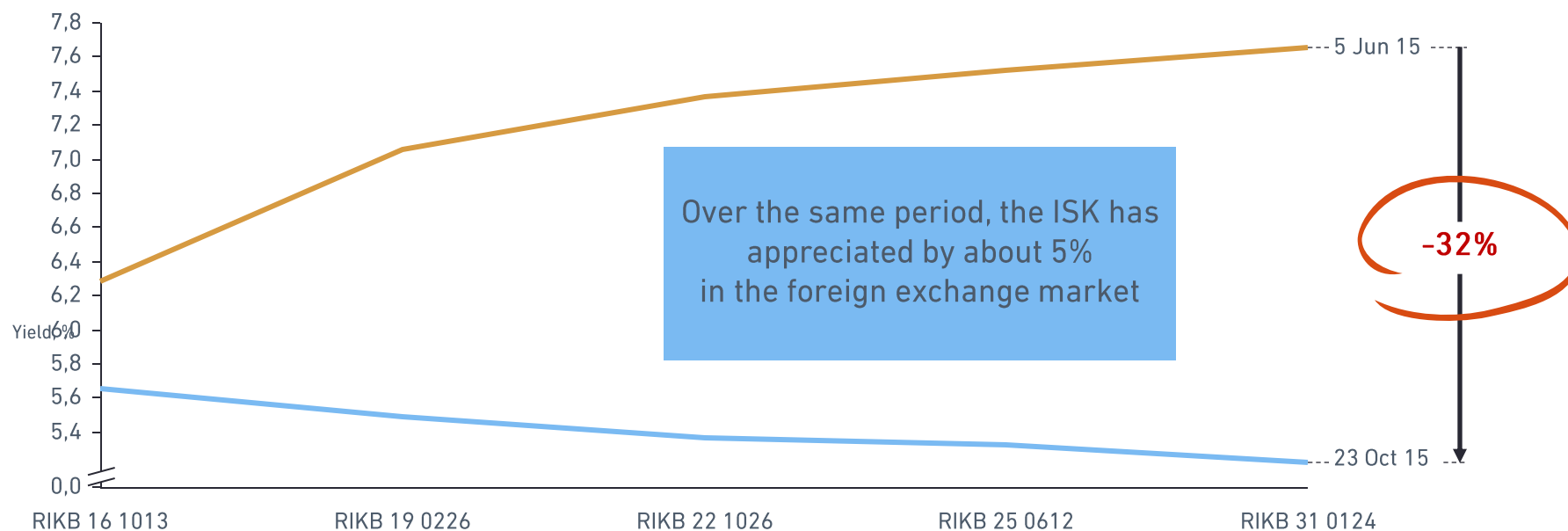
FitchRatings

Fitch
 "The main driver of Iceland's BBB+ rating is the presentation of a detailed strategy for the liberalisation of capital controls. Fitch believes that the plan is credible and will allow for the lifting of capital controls without generating undue balance of payments pressure."



The credibility of the strategy can be seen in developments in market interest rates, as yields on nominal Treasury bonds have fallen markedly since 8 June.

- Yields on long nominal Treasury bonds have fallen by more than 2 percentage points in just over four months. Since 8 June, non-residents have invested for nearly 40 b.kr. in Treasury bonds, and yields have fallen due to increased confidence in Government finances.



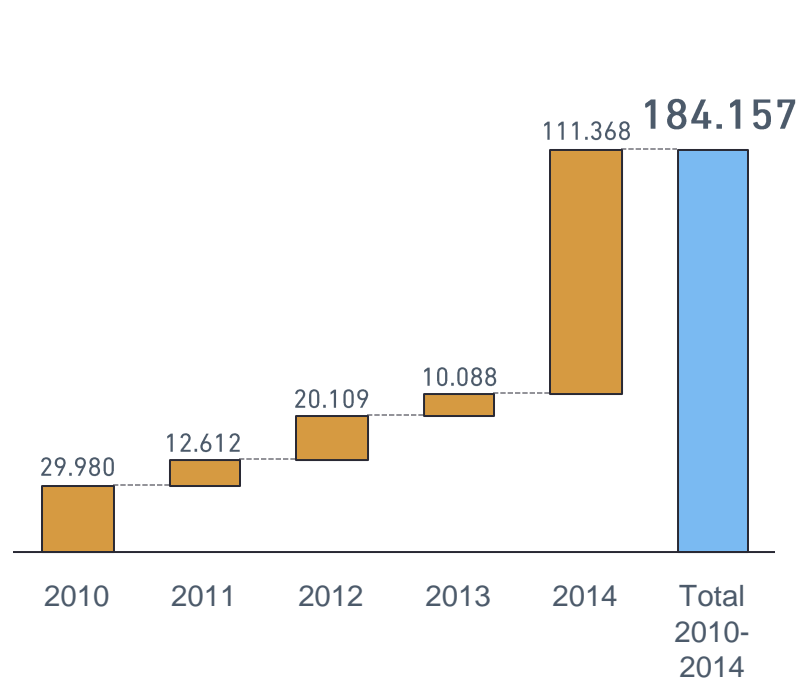
- The liberalisation strategy has therefore contributed to lower interest rates, which should support lower rates for households and firms.



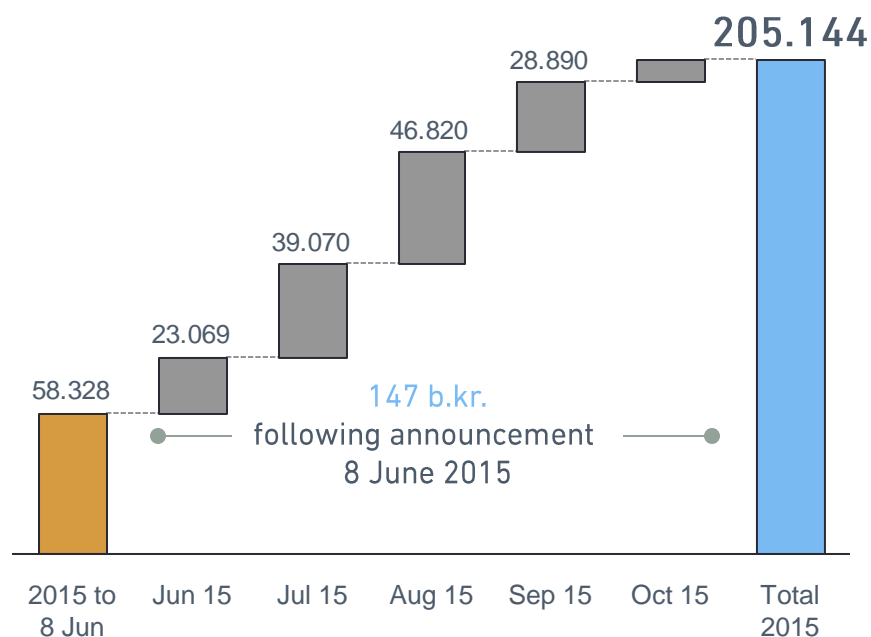
The credibility of the liberalisation strategy has been confirmed by foreign currency inflows following the announcement on 8 June 2015

- The Central Bank's FX market purchases in 2015 exceed by 12% its accumulated net purchases over the five-year period from 2010 to 2014.

5 yr
Net purchases



2015
FX purchases in the market



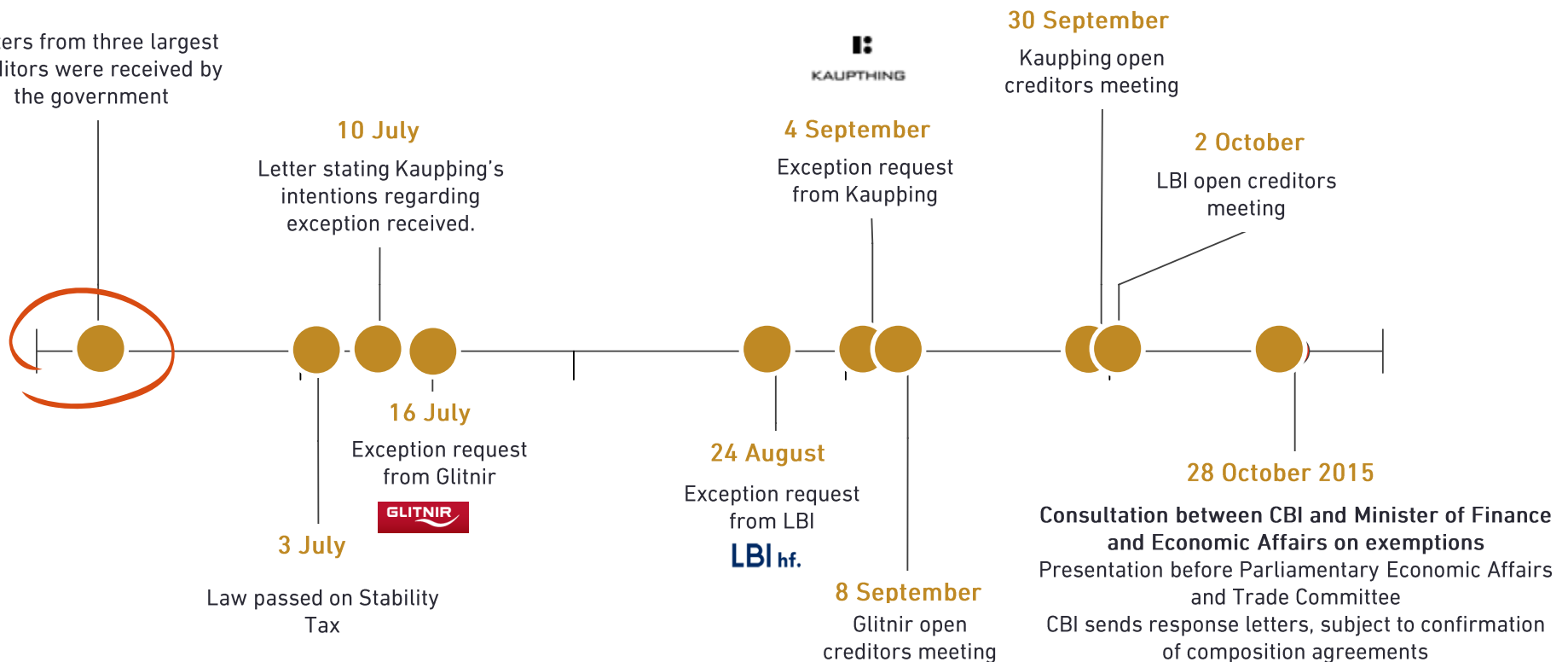
Work on liberalisation has proceeded according to the authorities' strategy. The matter is now in the hands of the estates and the Icelandic courts.

With response letters from the Central Bank, the matter is now in the hands of creditors, on the one hand, and the courts, on the other.

8 June 2015

Capital Liberalisation Presentation

Letters from three largest creditors were received by the government



The next steps will be in the hands of the creditors and the courts

- With response letters from the CBI and prior consultation with the Minister of Finance and Economic Affairs, the matter is in the hands of creditors. When the creditors have approved the composition proposals, the matter is in the hands of the courts.

Capital account liberalisation – the next steps vis-à-vis the estates

Creditors

- Creditors' meetings called for vote on composition proposals [October/November]
- Creditors' meetings to vote on composition proposals [November]

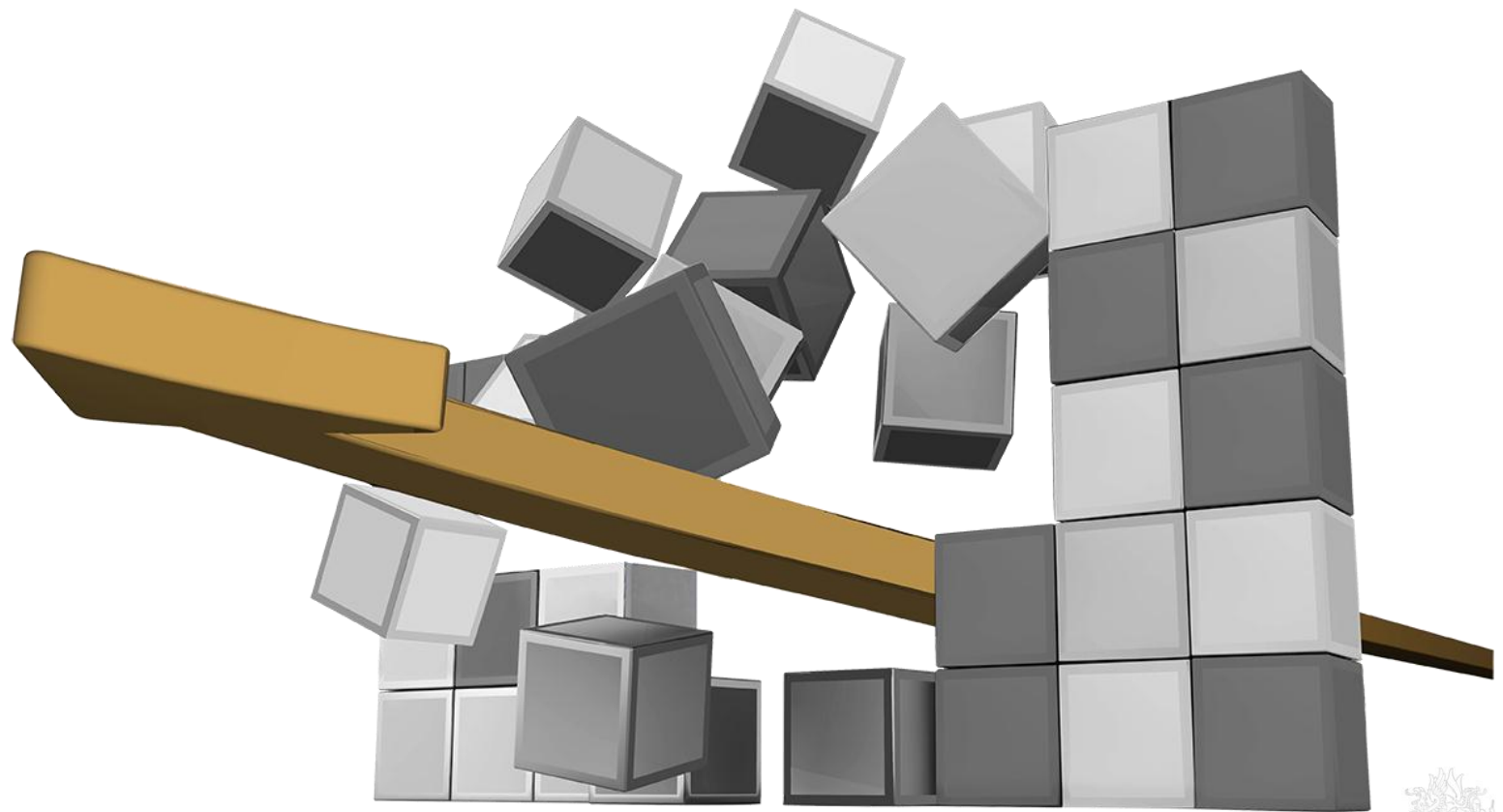
Icelandic courts (from November)

- Petition to District Court for confirmation of composition proposals
- Announcement of hearing for confirmation of composition agreement
- Confirmation hearing before District Court
- District Court decision
- Deadline for appeal to Supreme Court
- Deadline for filing of briefs to Supreme Court
- Supreme Court Judgment
- Final confirmation of composition agreements
- Composition process complete



ANALYSIS OF SOLUTION TO THREEFOLD PROBLEM

Analysis of the status of the estates and further interpretation of stability conditions



Estates' domestic assets entail balance of payments risk

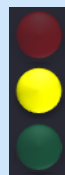
The asset profile would entail balance of payments risk if the assets were allowed to flow out of Iceland unrestricted upon liberalisation. The problem is therefore threefold.



**Domestic
ISK assets
(ISK)**

Balance of payments problem

Stability
contribution and
other measures



**Domestic
FX assets
(ISK/FX)**

Balance of payments risk

Long-term
investments
and other measures



**Foreign
assets
(FX)**


No balance of payments risk

Refinancing
and distributions to creditors



Estates' domestic assets entail balance of payments risk

The asset profile would entail balance of payments risk if the assets were allowed to flow out of Iceland unrestricted upon liberalisation. The problem is therefore threefold.




**Domestic
ISK assets
(ISK)**

Balance of payments problem



**Domestic
FX assets
(ISK/FX)**

Balance of payments risk



**Foreign
assets
(FX)**

No balance of payments risk

Stability
contribution and
other measures

Long-term
investments
and other measures

Refinancing
and distributions to
creditors



ISK: With stability contributions, net outflows due to the estates' ISK assets will be curtailed sufficiently



**Domestic
ISK assets
(ISK)**

Balance of payments problem

576
billion krónur

Domestic ISK assets (ISK)

The solution: Stability contribution and other measures

- Transfer of assets
- cash sweep provision
- Bond issuance offsetting shares in the banks
- Profit-sharing agreement due to ownership of the banks
- ESÍ recoveries
- Domestic operating expenses
- Public levies and taxes, particularly the bank levy
- 576 b.kr. recovered from the Glitnir, LBI, and Kaupthing estates

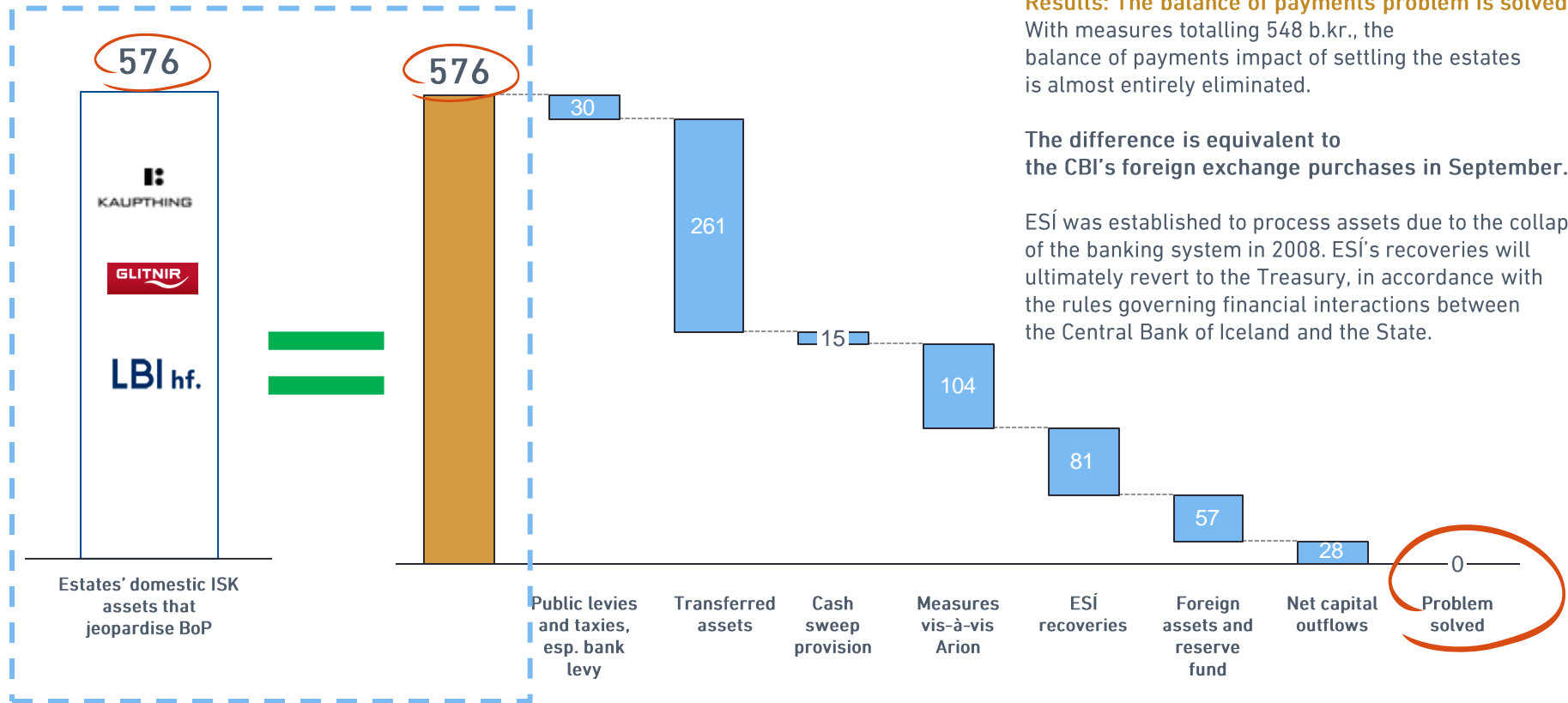




Domestic ISK assets: The total problem, 576 b.kr., is resolved with the measures described below

Chart: Comprehensive measures by the authorities address all aspects of the problem entailed in the domestic ISK assets held by the estates.

In ISK billions



Results: The balance of payments problem is solved.
 With measures totalling 548 b.kr., the balance of payments impact of settling the estates is almost entirely eliminated.

The difference is equivalent to the CBI's foreign exchange purchases in September.

ESÍ was established to process assets due to the collapse of the banking system in 2008. ESÍ's recoveries will ultimately revert to the Treasury, in accordance with the rules governing financial interactions between the Central Bank of Iceland and the State.

● The problem ●

● The solution ●



Estates' domestic assets entail balance of payments risk

The asset profile would entail balance of payments risk if the assets were allowed to flow out of Iceland unrestricted upon liberalisation. The problem is therefore threefold.



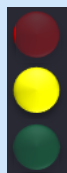
Stability contribution and other measures

Long-term investments and other measures

Refinancing and distributions to creditors



ISK/FX: With investments, banking system funding is ensured, access to market funding is facilitated, and long-term resilience is fostered



Domestic FX assets (ISK/FX)

Balance of payments risk

239
billion krónur

Domestic FX assets (ISK/FX)

The solution: Banking system funding and other measures

- Deposits with domestic financial institutions invested in standard long-term international bonds.
- Landsbankinn is already funded by LBI. This funding is not standard and collateralised. With conversion rights, Landsbankinn has the option of converting the bond to conventional unsecured international funding.
- Individual assets will fall under cash sweep provision (unsecured recoveries from residents will be swept).

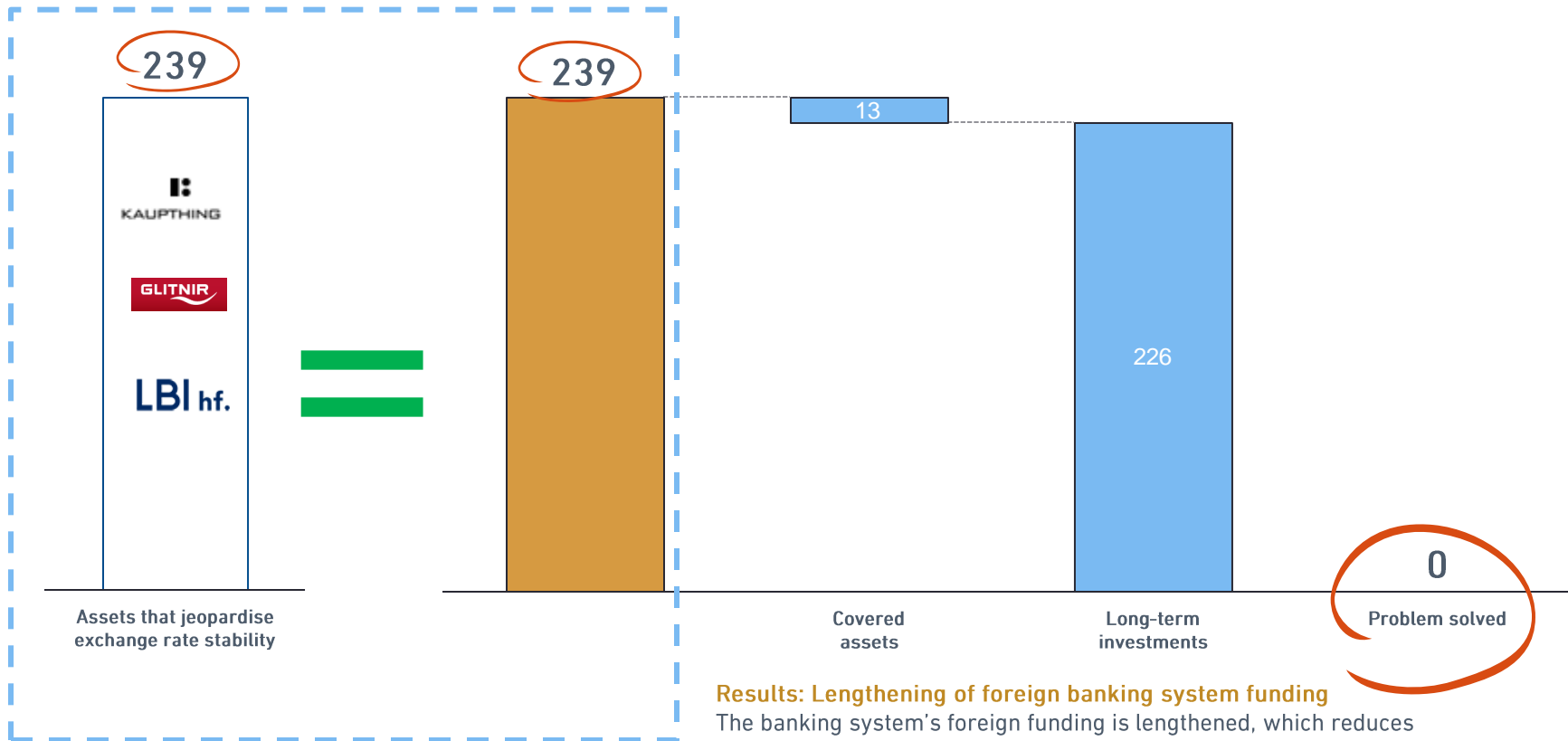




Domestic FX assets: The total problem, 239 b.kr., is resolved with lengthening of loans and measures described below.

Chart: Comprehensive measures by the authorities address all aspects of the problem entailed in the domestic FX assets held by the estates.

In ISK billions



Results: Lengthening of foreign banking system funding

The banking system's foreign funding is lengthened, which reduces refinancing risk and enhances exchange rate stability.

The measure is neutral vis-à-vis the foreign exchange market.

● The problem ●

● The solution ●



Estates' domestic assets entail balance of payments risk

The asset profile would entail balance of payments risk if the assets were allowed to flow out of Iceland unrestricted upon liberalisation. The problem is therefore threefold.



Stability contribution and other measures

Long-term investments and other measures

Refinancing and distributions to creditors



FX: The estates pay for and acquire the authorities' facilities, using foreign currency



**Foreign
assets
(FX)**

No balance of payments risk

69
billion krónur

Domestic FX assets (FX)

The solution: Refinancing and distributions to creditors

- During the restructuring of the banking system in 2009, the authorities contributed capital denominated in krónur. The obligation was in foreign currency.
- The will estates pay for and acquire these facilities from the authorities, using foreign currency. The investment totals 74 b.kr.
- In other respects, the estates' foreign currency will be distributed to all creditors, residents and non-residents.
- Deposits totalling 5 b.kr. are withdrawn from the CBI and used for long-term commercial bank funding.
- These 69 b.kr. are for disposal due to the estates' domestic FX assets.

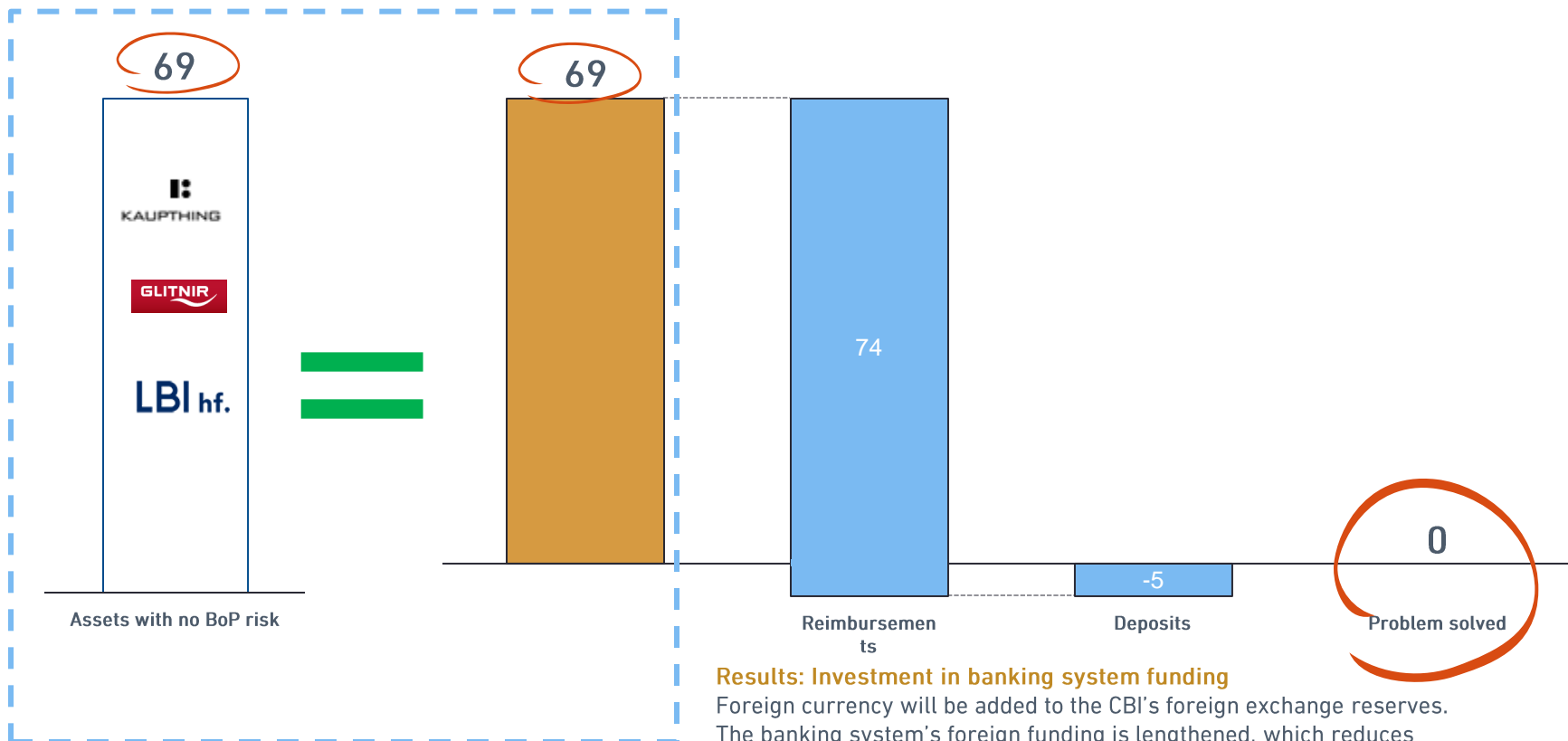




FX: With investments, banking system funding is ensured, access to global market funding is facilitated, and long-term resilience is fostered

Chart: Comprehensive measures by the authorities address all aspects of the problem entailed in the domestic FX assets held by the estates.

In ISK billions



Results: Investment in banking system funding

Foreign currency will be added to the CBI's foreign exchange reserves. The banking system's foreign funding is lengthened, which reduces refinancing risk and enhances exchange rate stability. The measure is neutral vis-à-vis the foreign exchange market.

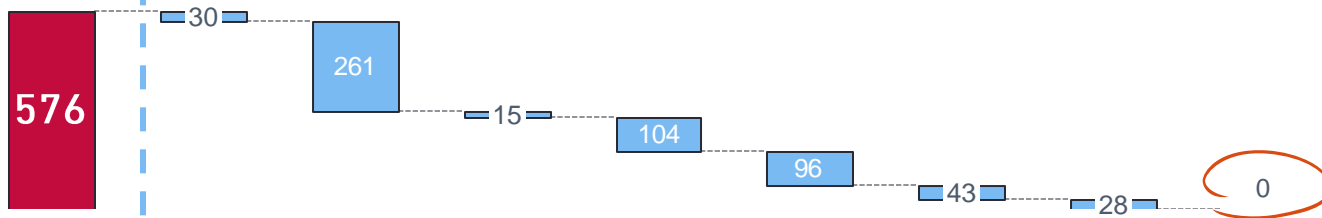
● The problem ●


● The solution ●

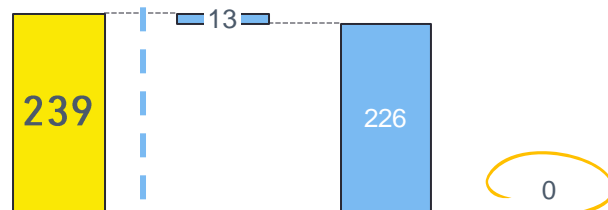


Summary: 856 b.kr. total measures vis-à-vis the estates ensure in a comprehensive way that there will be no impact on Iceland's balance of payments

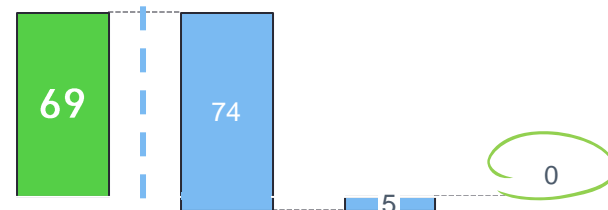

Domestic ISK assets (ISK)
 Balance of payments problem




Domestic FX assets (ISK/FX)
 Balance of payments risk




Foreign assets (FX)
 No balance of payments risk

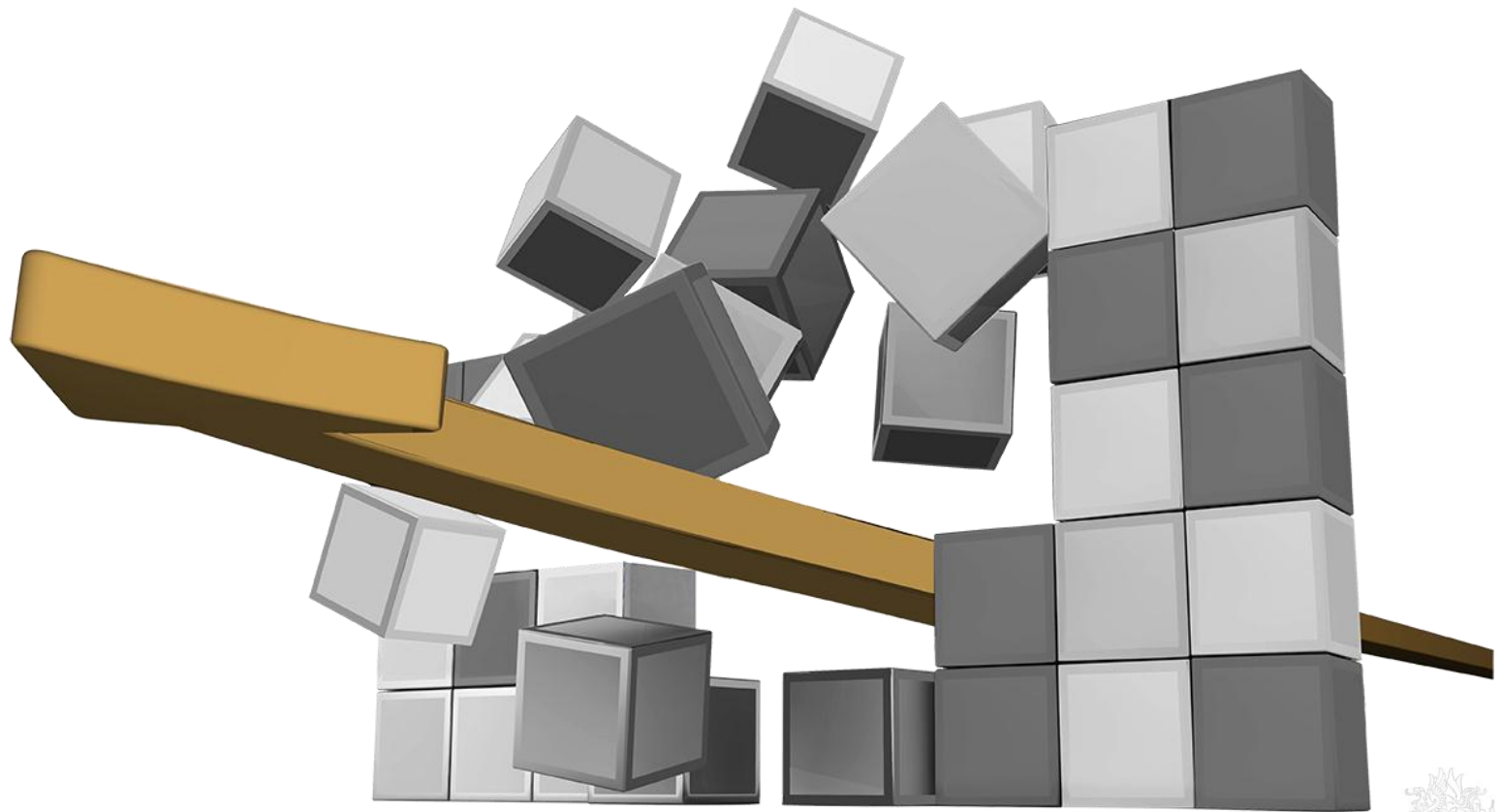


= 856 b.kr. in total measures



STRUCTURE OF THE STABILITY CONDITIONS

The stability conditions solve the problem in a comprehensive way



The stability conditions solve the problem in a comprehensive way

The stability conditions solve the balance of payments problem, open up access to long-term foreign financing, and provide for reimbursement of facilities to the Government.

01	ISK assets	Stability contribution
02	Domestic FX assets	Long-term funding of financial system
03	Foreign assets	Reimbursements and distributions



01

The stability conditions are three in number, and the estates must satisfy them in full. The stability contribution comprises four items.

Stability conditions



Transfer of assets

Cash sweep provision

Bonds due to the banks

Profit-sharing agreement

Deposits converted to bonds

Debt refinancing

- Transfer of cash, domestic assets and claims to the State of claims where nominal value is well in excess of book value.

- With a cash sweep provision that covers claims and other entitlements that cannot be transferred directly to the State.

- Kaupthing issues a bond to the Government for the sale of its holding in Arion Bank.

- Agreement based on Arion Bank's total performance, and yield on agreements reverts to the State.

- FX deposits used for investment in standard long-term bond funding.

- Repayment of the FX loans granted by the Treasury and the Central Bank to the new banks; the original facilities were in ISK.

01

Stability contribution

02

Lengthening

03

Refinancing



The stability contribution concerning ISK assets is in four parts

01

ISK assets

Stability contribution

01

- The estates transfer assets; i.e., cash, claims against residents, holdings in domestic companies, including the holding in Íslandsbanki.

02

- Cash sweep provision ensuring that the authorities receive all yields on assets that cannot be transferred.

03

- With the issue of a bond and profit-sharing agreements concerning holdings in Arion Bank, the State receives the vast majority of the sale value of the bank.

04

- ESÍ's recoveries on the three estates ultimately revert to the Treasury.

02

Domestic FX assets

Long-term funding of financial system

03

Foreign assets

Reimbursement to the authorities and distributions



Summary: The stability conditions solve the problem in a comprehensive way ^(1/3)

The stability conditions solve the balance of payments problem, open up access to long-term foreign financing, and provide for reimbursement of facilities to the Government.

01	ISK assets	Stability contribution
02	Domestic FX assets	Long-term funding of financial system
03	Foreign assets	Reimbursements and distributions



01

Stability contribution: Transfer of assets

- The estates' ISK assets pose a problem with respect to the balance of payments.
- The estates own claims against residents with a nominal value of 292 b.kr., as opposed to a book value of 68 b.kr. Such claims could rise sharply in value, therefore increasing capital outflows if no action is taken. Such claims are transferred to the authorities in order to minimise the balance of payments risk further ahead.
- Transferring the assets minimises future risk to the balance of payments. The problem and the solution therefore go hand-in-hand.
 - If the asset values prove higher than previously estimated, the stability contribution is higher, and the problem is similarly larger than previously estimated.
 - If asset values prove less than previously estimated, the stability contribution is lower, and the problem is similarly smaller than previously estimated.
- Deposits, Treasury bonds, loans and other claims, and shares in domestic firms are examples of assets that will be transferred.





Stability contribution: Cash sweep provision

- It is neither possible nor desirable to transfer all assets.
- The estates will be subject to cash sweep provision. Behind this are assets that cannot be transferred, which have a book value of 15 b.kr. but a nominal value of 513 b.kr. When their value is realised and the estate receives cash, it will revert to the authorities on the basis of the cash sweep provision.
- Examples of such assets are various rights and entitlements, reserve funds for disputed claims, assets that are partly domestic and partly foreign, and domestic operating expenses.
 - If reserve funds due to dispute claims or costs are not exhausted, the remaining balance will revert to the authorities as part of the stability contribution.



01

Stability contribution: The cash sweep provision ensure that disputes concerning tax issues do not entail further capital outflows, which would otherwise exceed 60 b.kr.

- Only two possible scenarios, neither of which entails balance of payments risk

A

- **Scenario I:** The Icelandic State wins legal disputes.
 - Results: Taxes and other revenues revert to the Treasury.



B

- **Scenario II:** The Icelandic State loses legal disputes.
 - Results: The cash sweep provision takes back taxable entities' profit.



- Court cases and disputes due to the estates' tax payments in recent years fall under the cash sweep provision, which ensure that the results are neutral vis-à-vis the balance of payments.
- Uncertainty is thereby eliminated.
- **The cash sweep provision ensure finality with respect to tax disputes.**



01

Stability contribution: Special cash sweep provision related to domestic assets recovered wholly or partly in foreign currency

- Such assets are not transferred but fall under the cash sweep provision.

A

- **Foreign currency:** Recovered due to underlying sale of foreign asset.
 - Results: Authorisation to distribute payments to creditors.



B

- **Foreign currency:** Due to payments deriving from debtors' foreign-denominated income.
 - Results: Converted to long-term funding.



C

- **Domestic currency:** Recoveries due to payments or sale of assets in ISK.
 - Results: cash sweep provision guarantee transfer of recoveries to the State.



- By placing domestic assets with foreign recoveries under conditional cash sweep provision, it is ensured that recoveries not received with the sale of underlying foreign assets do not affect the FX market. Ensures finality.





Stability contribution: Glitnir transfers its holding in Íslandsbanki

Íslandsbanki will be wholly owned by the State with the transfer of Glitnir's holding in the bank

- Íslandsbanki has earned 136 b.kr. in profit since 2009.
- Dividend payments for the past three years total 16 b.kr. Uncertainty about the impact of Íslandsbanki's growth and dividend policy on the balance of payments is eliminated with the transfer of the bank to the State.
- Thereafter, the Government will formulate policy as the owner of the bank. If the Government decides to sell the bank, it will be done in a professional and transparent way, assuring equal treatment of all parties.
- Possible payment of a special dividend on aggregate profits to the Government





Stability contribution: Balance of payments risk due to Arion Bank is minimised with bond issue, profit-sharing agreements, and conditions

- Kaupthing is responsible for selling its holding in Arion Bank and has three years to do it.
- Kaupthing issues a bond to the Government. The bond is backed by Kaupthing assets and bears 5.5% interest. When the holding in Arion Bank is sold, the proceeds shall be paid towards the bond principal.
- No one knows what the future holds. The new banks have grown enormously since their establishment. This is why their value is not a constant figure. This risk is minimised with a profit-sharing agreement that takes account of the **sale value** of Arion Bank and rises in line with the sale price of the bank.
- Further conditions will also be imposed, and the authorities will have a supervisor within Kaupthing to monitor the sale process.



Summary: The stability conditions solve the problem in a comprehensive way ^(2/3)

The stability conditions solve the balance of payments problem, open up access to long-term foreign financing, and provide for reimbursement of facilities to the Government.

01	ISK assets	Stability contribution
02	Domestic FX assets	Long-term funding of financial system
03	Foreign assets	Reimbursements and distributions



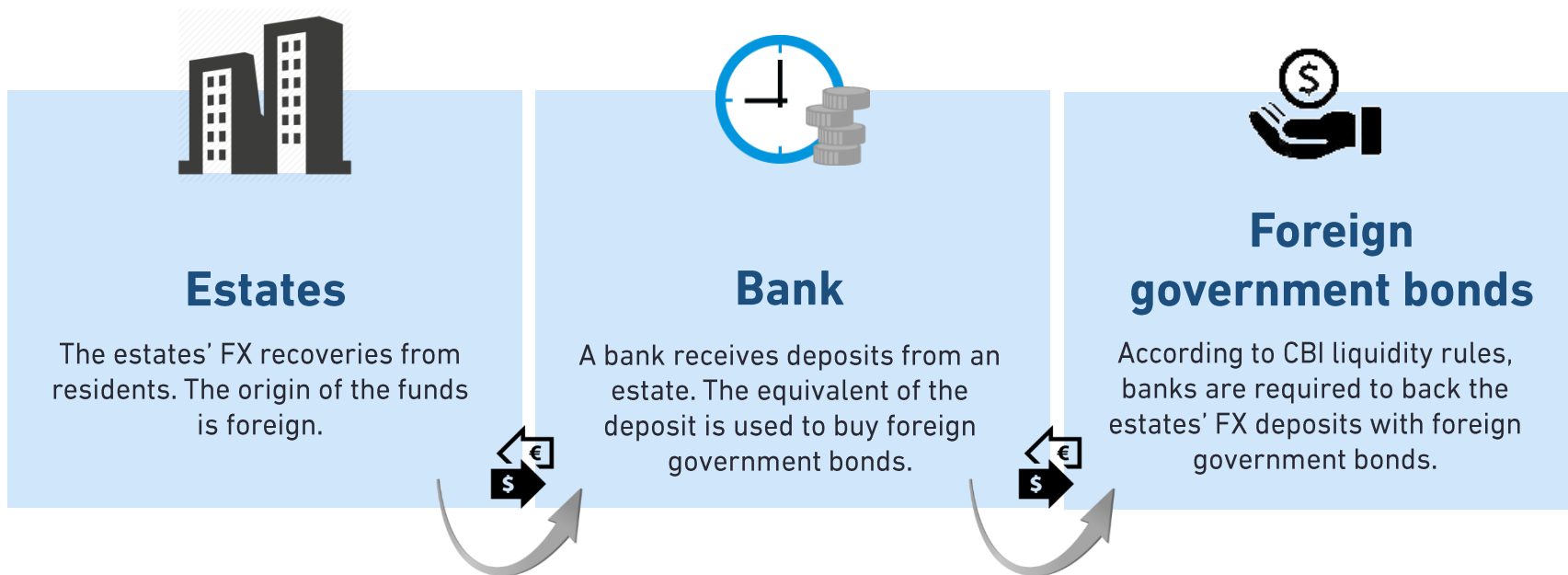


Long-term investments: Opens up banks' and large firms' access to foreign markets

- Banks' and large firms' access to international capital markets is one of the preconditions for liberalisation. This has been stated in previous liberalisation strategies, among other things.
- On the basis of CBI liquidity rules, the estates' FX deposits with domestic banks are fully secured, so that outflows from them will not affect the ISK exchange rate.
- Instead of allowing these FX deposits to exit immediately, they are tied up for as long a period of time as necessary. Providing long-term FX funding for the banking system aligns creditors' interests with the domestic economy's interests as regards health bank operations.



On the basis of CBI liquidity rules, the estates' FX deposits with domestic banks are fully backed with foreign government bonds. Therefore, they do not affect the ISK exchange rate.





Long-term investments: With conversion rights and restructuring in 2014, Landsbankinn is guaranteed the possibility of normal long-term funding

- As part of the authorities' stability conditions, Landsbankinn is now entitled to convert its current funding to a standard international bond (EMTN), which facilitates its access to global credit markets.
- Since its establishment, the new Landsbankinn has been funded in foreign currency by LBI hf. (the old Landsbanki Íslands). In 2014, the bond was restructured so as to reduce the domestic economy's balance of payments risk.
 - The bond is backed by the bank's assets and is subject to various conditions and encumbrances.
- This is an important element in the reconstruction of the financial system. Banks have access to long-term foreign credit.
- This measure takes the "training wheels" off the financial system.



Summary: The stability conditions solve the problem in a comprehensive way ^(3/3)

The stability conditions solve the balance of payments problem, open up access to long-term foreign financing, and provide for reimbursement of facilities to the Government.

01	ISK assets	Stability contribution
02	Domestic FX assets	Long-term funding of financial system
03	Foreign assets	Reimbursements and distributions





Reimbursements: The Treasury and Central Bank receive reimbursements of the foreign-denominated capital they contributed to the new banks upon their establishment in 2009.

- Upon the establishment of the new banks, the authorities contributed substantial capital in krónur, subject to the requirement that it be reimbursed in foreign currency in order to correct the foreign currency mismatches between the banks' assets and liabilities.
- At present, a total of 74 b.kr. remains, which will be repaid in foreign currency.
- The Treasury owns a subordinated bond issued by Íslandsbanki in foreign currency in the amount of 20 b.kr., which Glitnir will refinance.
- The Central Bank owns a senior unsecured foreign bond issued by Arion Bank in the amount of 54 b.kr., which Kaupthing will refinance.
- Deposits in the amount of 5 b.kr. will be withdrawn from the Central Bank and converted to long-term funding for the commercial banks. The foreign exchange reserves will be reduced by that amount.
- These measures will expand the foreign exchange reserves by 69 b.kr.

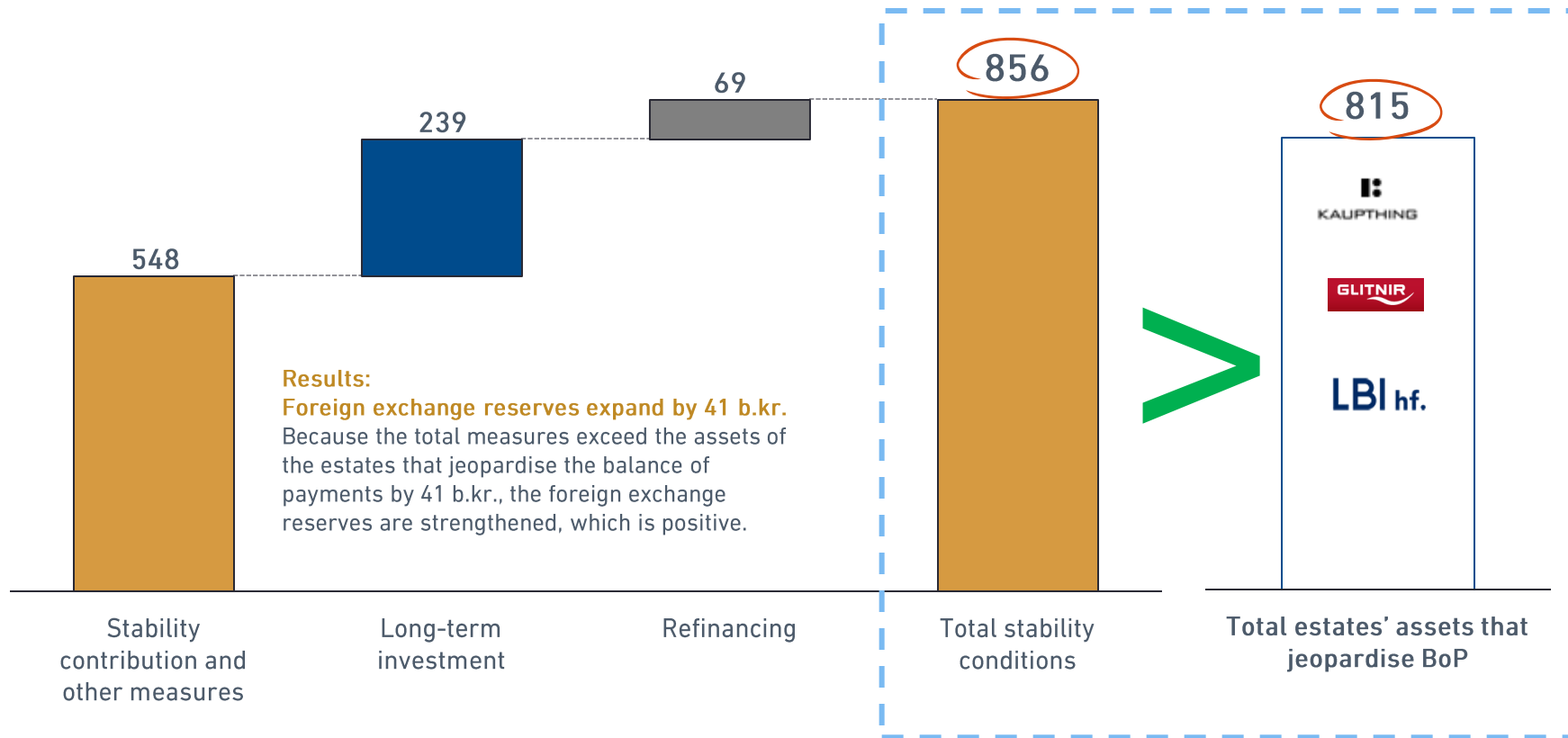




The result: Comprehensive measures relating to the stability conditions total 856 b.kr., which solve the problem in its entirety

Chart: Comprehensive measures by the authorities address all aspects of the problem entailed in the domestic assets held by the estates.

In ISK billions



The solution

The problem

If the problem escalates, the stability contribution will increase.



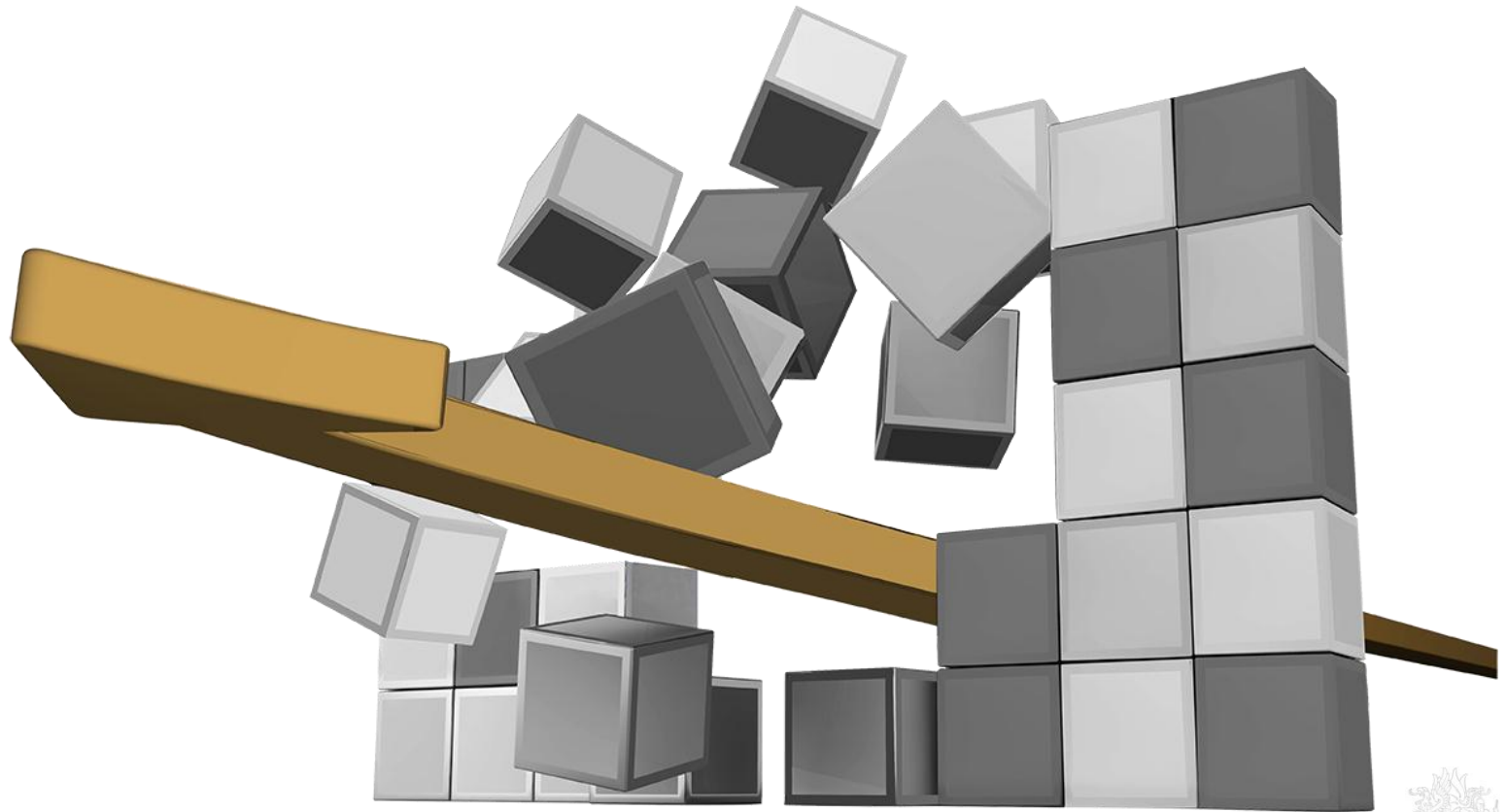
The stability conditions: The Treasury's legal risk is minimised, as the financial institutions in winding-up proceedings irrevocably release the authorities from lawsuits or other legal proceedings.

- The estates and creditors relinquish and abandon all claims, including potential financial claims, vis-à-vis the Icelandic authorities in connection with events taking place prior to the confirmation of composition agreements.
- The winding-up boards, on behalf of the financial institutions in winding-up proceedings, and the creditors present declarations stating that the companies and their estates and creditors irrevocably release the Icelandic authorities from any type of liability and any type of claim, to the maximum extent allowed by law.
- The above-mentioned declarations affect everything pertaining to the winding-up process, the existence of the capital controls, the stability conditions, the conferral of exemptions, and the planned composition agreements.



OVERALL IMPACT OF STABILITY CONDITIONS

Impact of stability conditions and breakdown by estate



Measures vis-à-vis estates total 856 b.kr. but will increase if the value of transferred assets rises later on

01

• Stability contribution* 491 to 599** billion krónur

• Other measures 57 billion krónur

02

• Long-term investments 239 billion krónur

03

• Reimbursements 69 billion krónur

Total measures

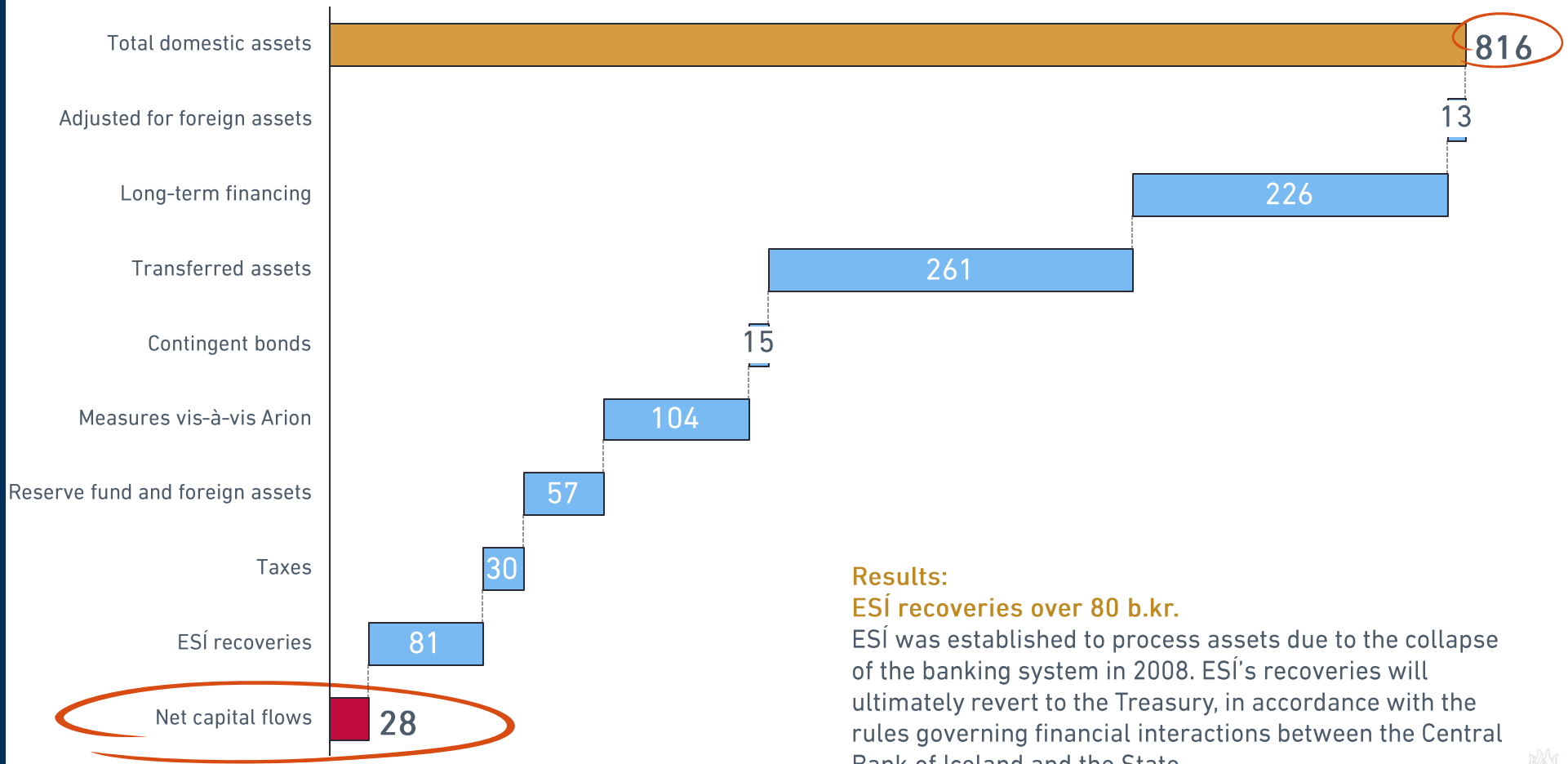
856 to 964 billion krónur

* Taxes for 2015, direct contribution to the State and through ESÍ

** Same premises as in Central Bank report



Total impact: Balance of payments impact of settling the estates is negative by 28 b.kr.



Results:

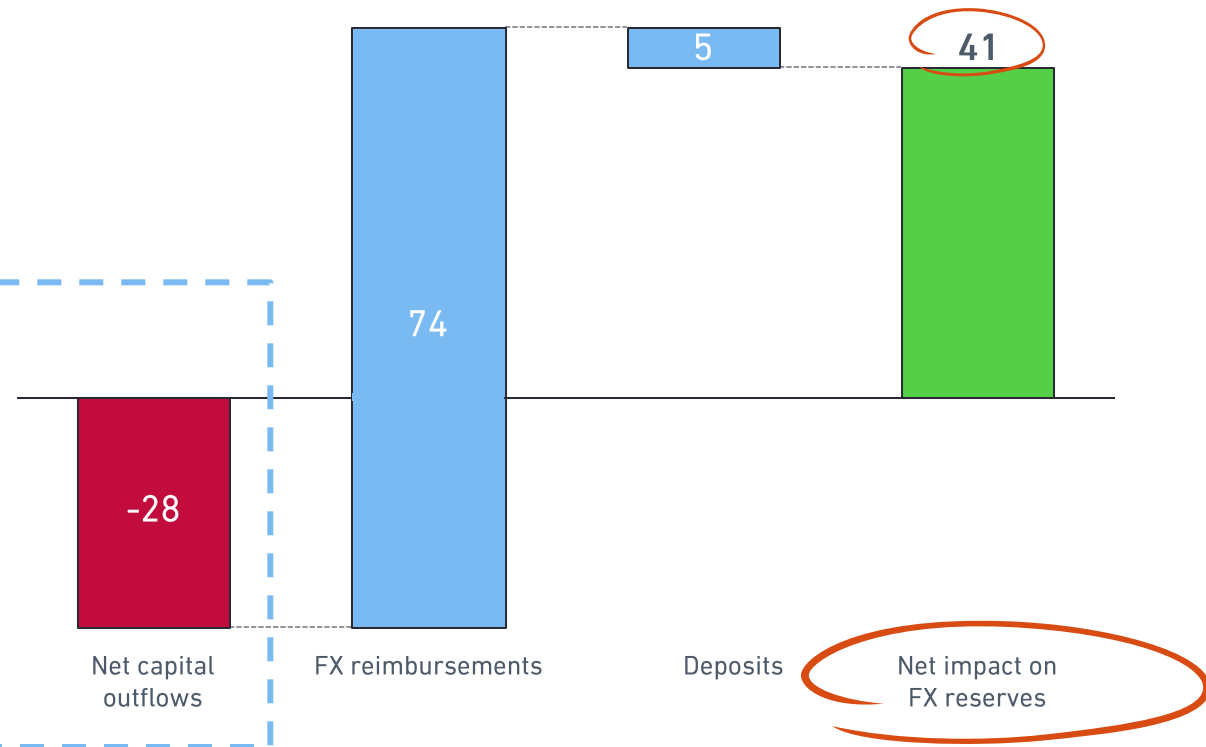
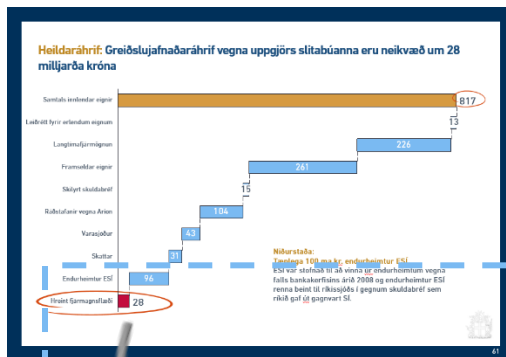
ESÍ recoveries over 80 b.kr.

ESÍ was established to process assets due to the collapse of the banking system in 2008. ESÍ's recoveries will ultimately revert to the Treasury, in accordance with the rules governing financial interactions between the Central Bank of Iceland and the State.



Total impact:

Foreign exchange reserves will expand by 41 b.kr. because of the settlement of the estates



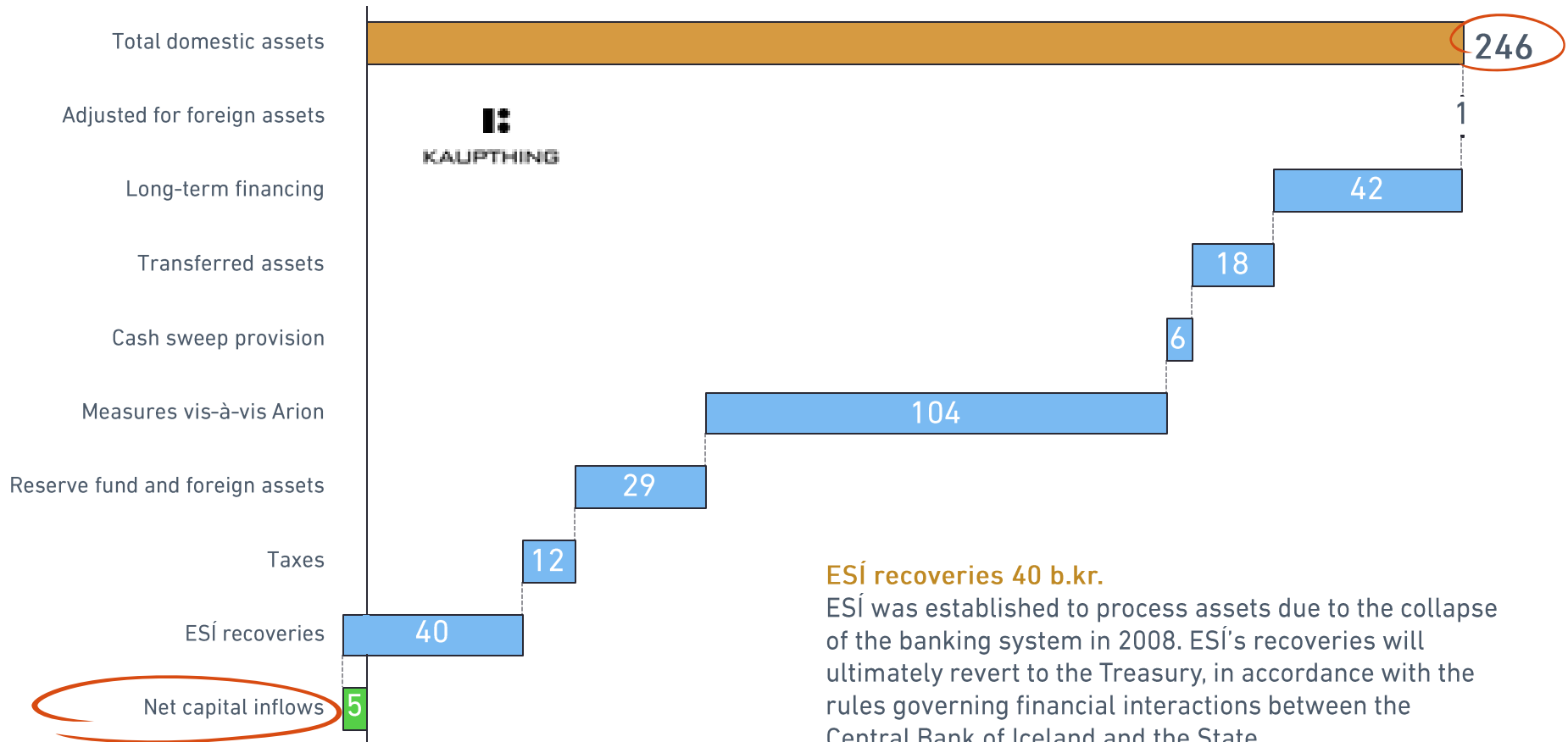
- FX reimbursements from the estates ensure that, upon disposal vis-à-vis the estates in connection with the stability conditions, the Central Bank's foreign exchange reserves will expand by 41 b.kr.



Measures vis-à-vis Kaupthing



Total impact due to Kaupthing: 246 b.kr. disposal does not affect the balance of payments and strengthens the foreign exchange reserves by 5 b.kr. (3/3)



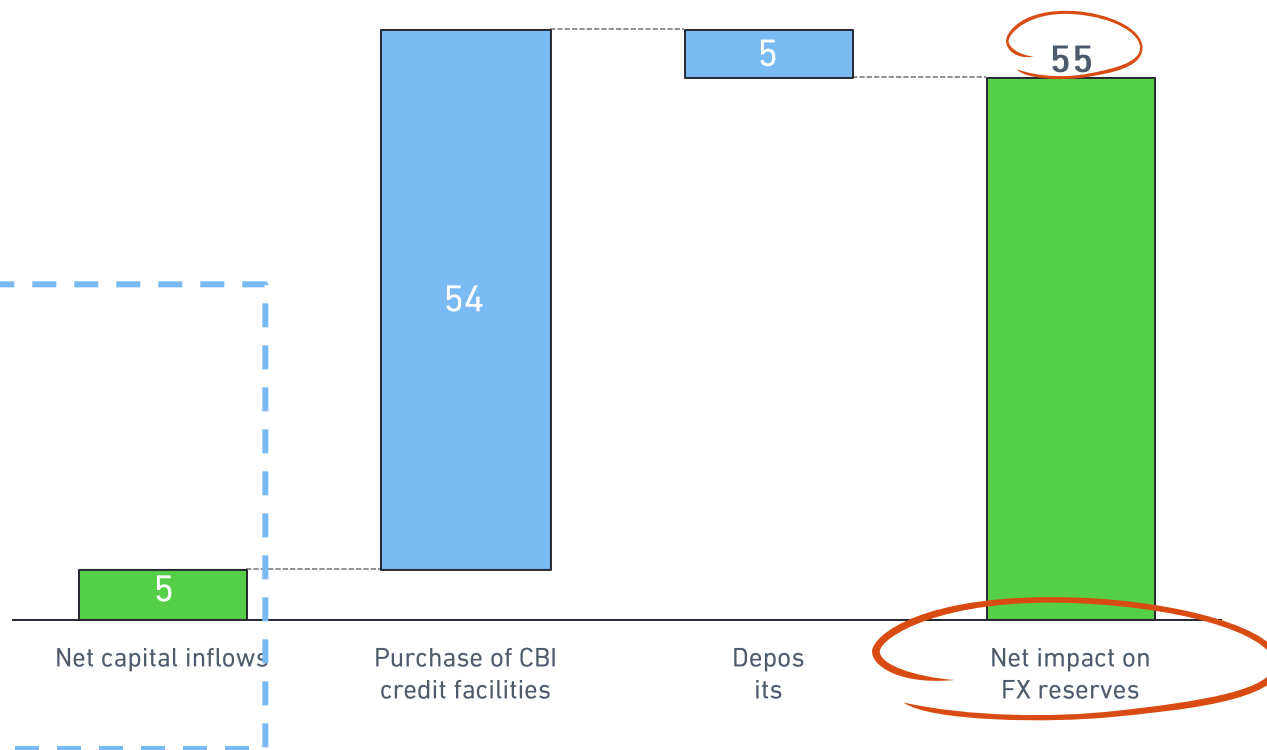
ESÍ recoveries 40 b.kr.

ESÍ was established to process assets due to the collapse of the banking system in 2008. ESÍ's recoveries will ultimately revert to the Treasury, in accordance with the rules governing financial interactions between the Central Bank of Iceland and the State.

- Total measures vis-à-vis Kaupthing exceed by 5 b.kr. the domestic Kaupthing assets that threaten the balance of payments. The difference will be allocated to the Central Bank's foreign exchange reserves.



Total impact due to Kaupthing: Foreign exchange reserves expand by 55 b.kr. (2/3)



- Kaupthing pays for and acquires the CBI's foreign credit facilities to Arion Bank in the amount of 54 b.kr., and Kaupthing's 5 b.kr. deposit with the CBI is transferred to Arion Bank and is converted to a long-term investment. The CBI's foreign exchange reserves are strengthened by 55 b.kr. due to these actions and measures relating to Kaupthing.



Total impact due to Kaupthing: Further description of individual measures relating to the estate ^(3/3)



• Kaupthing hf. measures according to stability conditions:

01 The transfer of liquid funds and assets totals 4 b.kr. book value; the nominal value of transferred claims is 75 b.kr. Kaupthing transfers foreign-denominated assets with a book value of 14 b.kr. and a nominal value of 42 b.kr. Contingent cash sweep assets, such as those due to disputes and other non-transferable assets, total 6 b.kr. book value and 295 b.kr. nominal value. Operating expenses and reserve funds total 7 b.kr. in Icelandic currency and, if overestimated, will be part of the stability contribution.

02 Kaupthing will issue a collateralised bond in the amount of 84 b.kr. to the Government guarantees the Government a share in the profit due to the operation and any type of sale of Arion Bank hf. Assuming that the bank is sold at its estimated book value at year-end 2015, the State's holding in Arion Bank hf. is 20 b.kr. plus a share in future dividend payments until the time of sale (could rise or fall).

03 Kaupthing guarantees Arion Bank hf. long-term foreign funding with an internationally recognised bond issue in an amount equivalent to 42 b.kr.

04 Kaupthing pays the Government the equivalent of 54 b.kr. in foreign currency for the reimbursement of the facilities granted to Arion Bank hf. Funding converted to an internationally recognised bond issue.

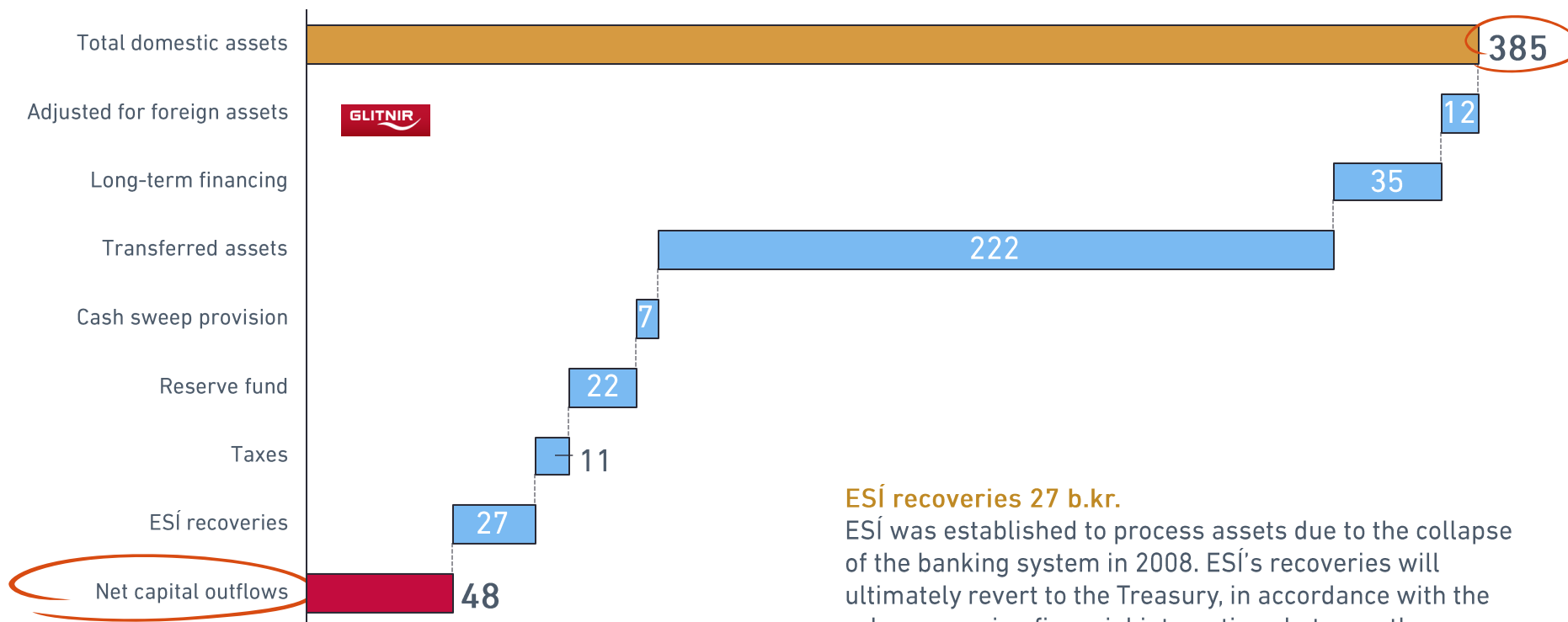
Kaupthing pays just under 12 b.kr. in tax. Balance of payments risk due to legal disputes on tax issues is eliminated with the cash sweep provision.



Measures vis-à-vis Glitnir



Total impact due to Glitnir: 336 b.kr. total measures leads to a 48 b.kr. negative impact on the balance of payments ^(1/3)



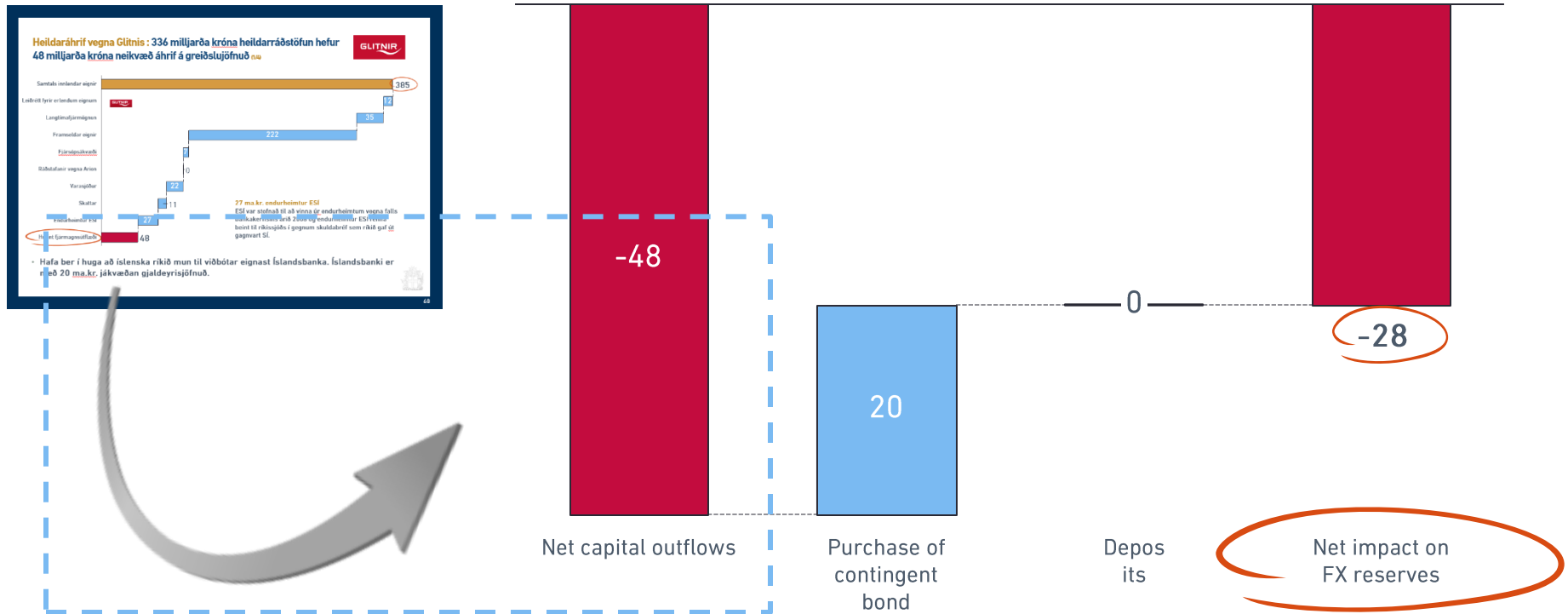
ESÍ recoveries 27 b.kr.

ESÍ was established to process assets due to the collapse of the banking system in 2008. ESÍ's recoveries will ultimately revert to the Treasury, in accordance with the rules governing financial interactions between the Central Bank of Iceland and the State.

- It should be borne in mind that the Icelandic Government will also acquire Íslandsbanki. According to its H1/2015 accounts, Íslandsbanki has a 22 b.kr. positive foreign exchange balance.



Total impact due to Glitnir: Impact of Glitnir on the CBI foreign exchange reserves is negative in the amount of 28 b.kr. (2/3)



- It should be borne in mind that the Icelandic Government will also acquire Íslandsbanki. According to its H1/2015 accounts, Íslandsbanki has a 22 b.kr. positive foreign exchange balance.



Total impact due to Glitnir: Further description of measures vis-à-vis the estate (3/3)



- Glitnir hf. measures according to stability conditions:

01 The transfer of liquid funds and assets totals 37 b.kr. book value; the nominal value of transferred claims is 85 b.kr. Glitnir will also transfer all shares in ISB Holding ehf., which owns 95% of shares in Íslandsbanki hf., an asset with a book value of 185 b.kr. at year-end 2015.

02 Contingent cash sweep assets, such as those due to disputes and other non-transferable assets, total 7 b.kr. book value and 46 b.kr. nominal value. Operating expenses and reserve funds total 8 b.kr. in Icelandic currency and, if overestimated, will be part of the stability contribution.

03 Glitnir guarantees Íslandsbanki hf. long-term foreign funding with an internationally recognised bond issue in an amount equivalent to 35 b.kr.

04 Glitnir pays the Government the equivalent of 20 b.kr. in foreign currency for the reimbursement of the facilities granted to Íslandsbanki hf.

Glitnir pays 11 b.kr. in tax. Balance of payments risk due to legal disputes on tax issues is eliminated with the cash sweep provision.



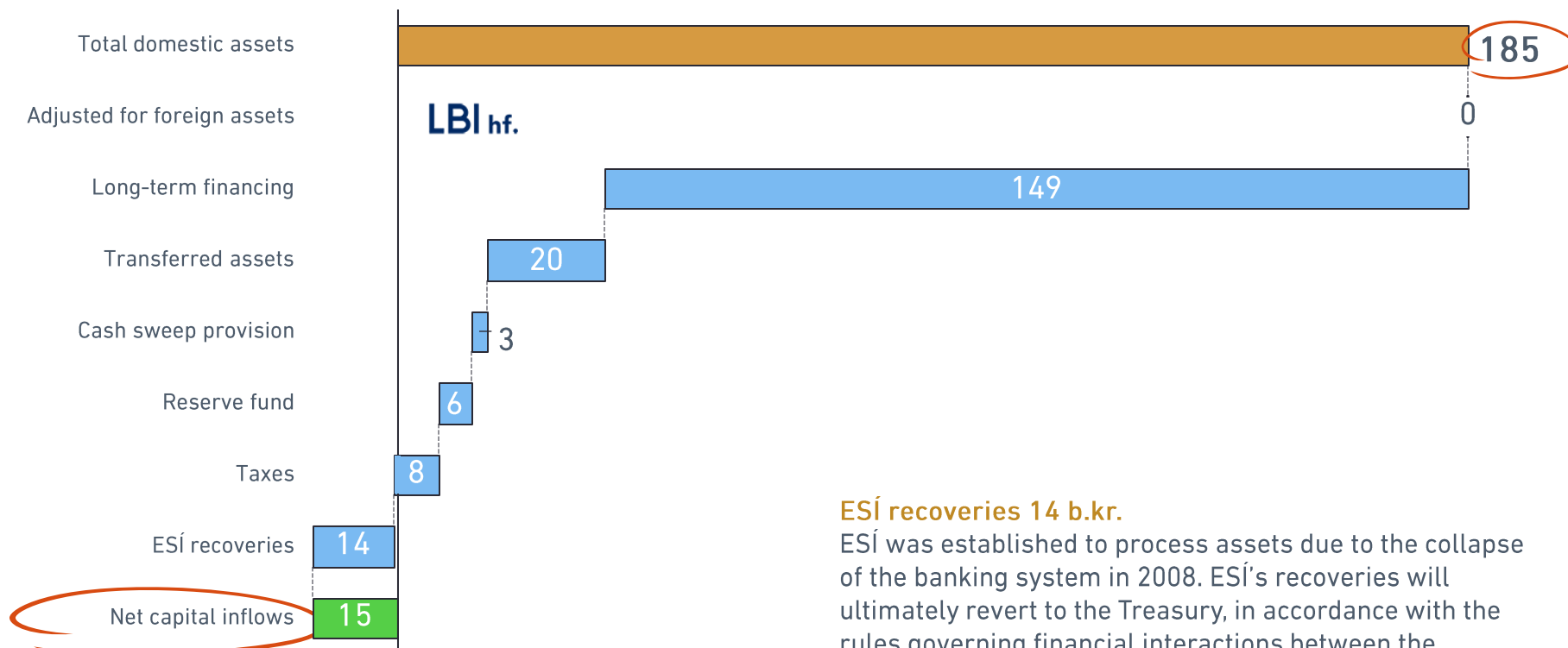
Measures vis-à-vis LBI

LBI hf.



Total impact due to LBI: 200 b.kr. total disposal leads to a 15 b.kr. positive impact on the balance of payments ^(1/3)

LBI hf.



ESÍ recoveries 14 b.kr.

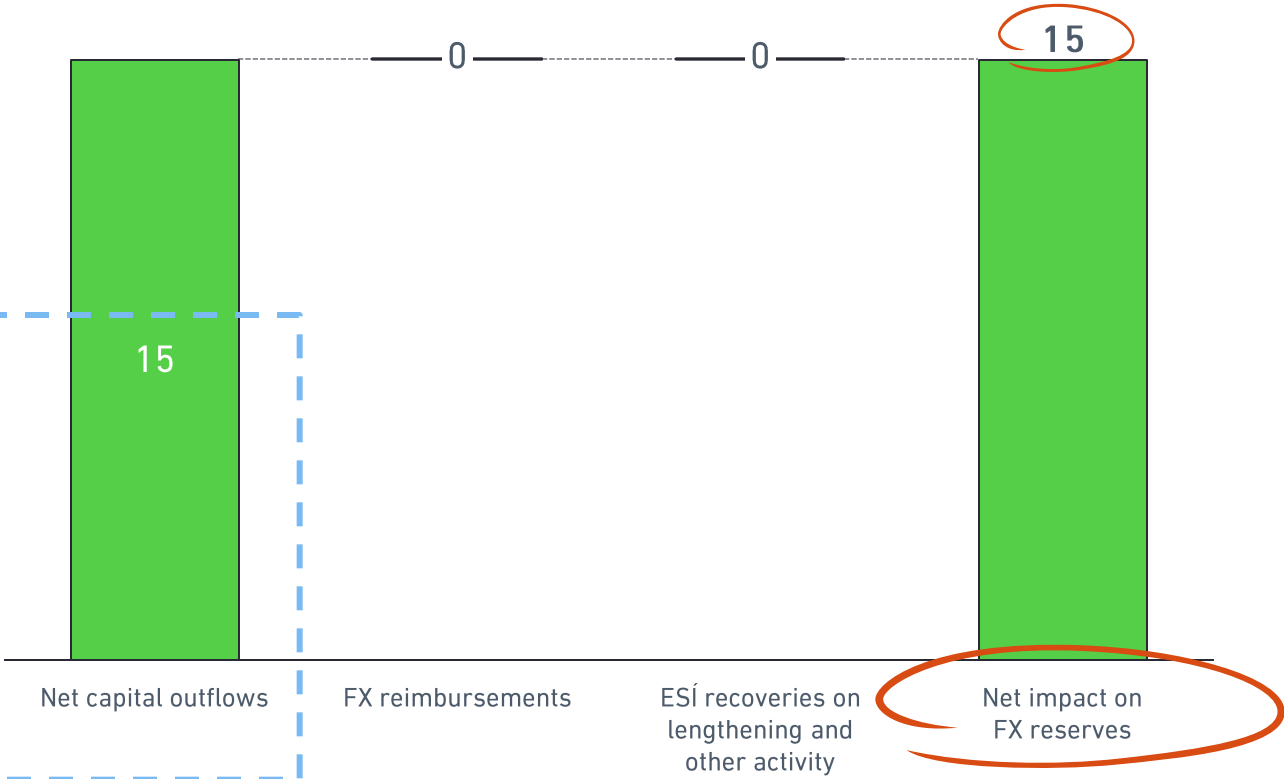
ESÍ was established to process assets due to the collapse of the banking system in 2008. ESÍ's recoveries will ultimately revert to the Treasury, in accordance with the rules governing financial interactions between the Central Bank of Iceland and the State.

- Total measures vis-à-vis LBI exceed by 15 b.kr. the domestic LBI assets that threaten the balance of payments. The difference will be allocated to the Central Bank's foreign exchange reserves.



Total impact due to LBI: 200 b.kr. disposal *** and strengthens the foreign exchange reserves by 15 b.kr. (2/3)

LBI hf.



- Total measures vis-à-vis LBI exceed by 15 b.kr. the domestic LBI assets that threaten the balance of payments. The difference will be used to expand the foreign exchange reserves as payments are received on the Landsbankinn bond.



Total impact due to LBI: Further description of measures vis-à-vis the estate (3/3)

LBI hf.

- LBI hf. measures according to stability conditions:

01 The transfer of liquid funds and assets totals 20 b.kr. book value; the nominal value of transferred claims is 90 b.kr. Contingent cash sweep assets, such as those due to disputes and other non-transferable assets, total 3 b.kr. book value and 172 b.kr. nominal value. Operating expenses and reserve funds total 6 b.kr. and, if overestimated, will be part of the stability contribution.

02 LBI guarantees Landsbanki Íslands hf. long-term foreign funding and issues conversion rights to Landsbanki Íslands, which gives the bank the unilateral right to convert outstanding collateralised bonds to standard international bond funding.

LBI pays 8 b.kr. in tax. Balance of payments risk due to legal disputes on tax issues is eliminated with the cash sweep provision.



Total measures vis-à-vis the estates

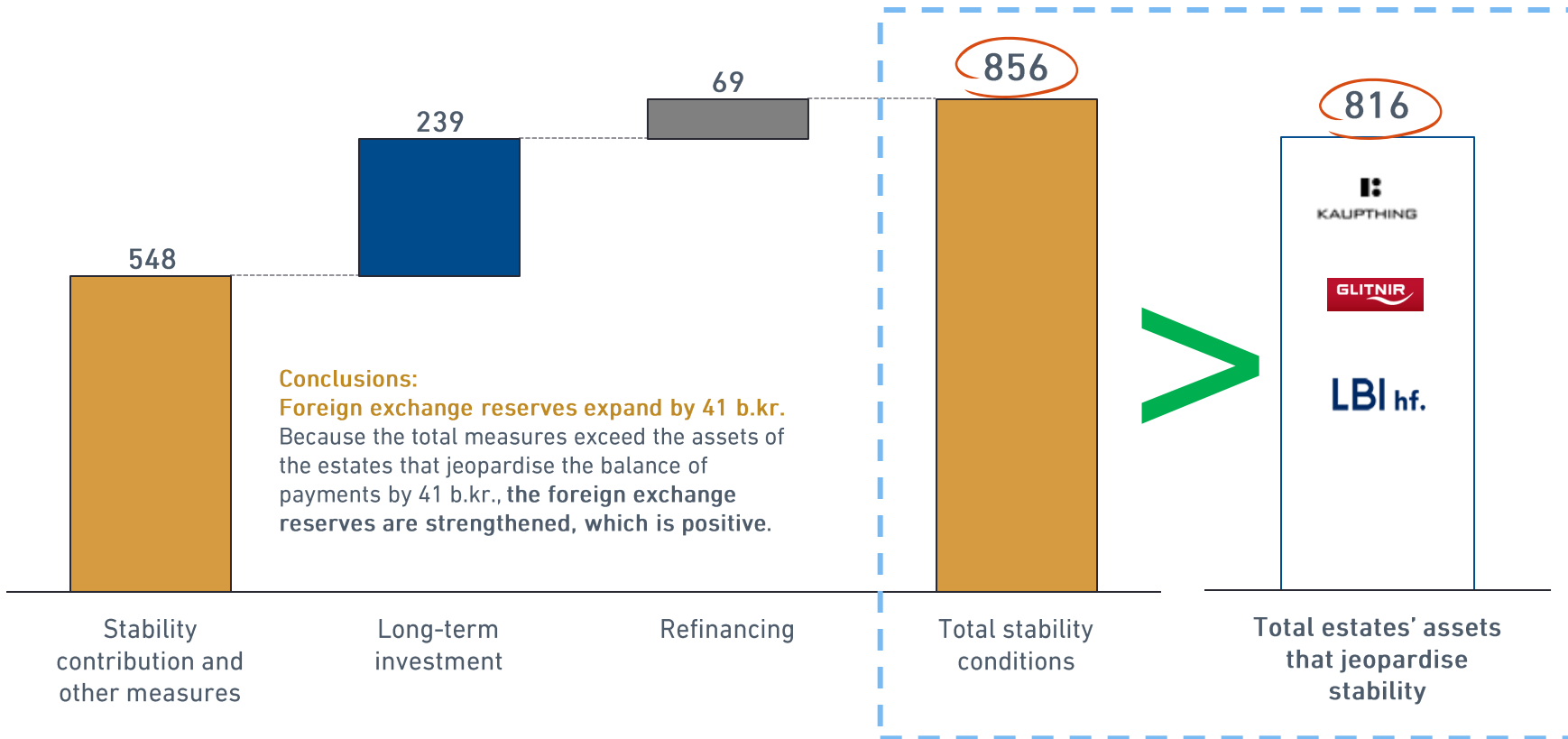




The result: Comprehensive measures relating to the stability conditions total 856 b.kr., which solve the problem in its entirety

Chart: Comprehensive measures by the authorities address all aspects of the problem entailed in the domestic assets held by the estates.

In ISK billions



● ————— The solution ————— ● ● ————— The problem ————— ●

If the problem escalates, the stability contribution will increase.

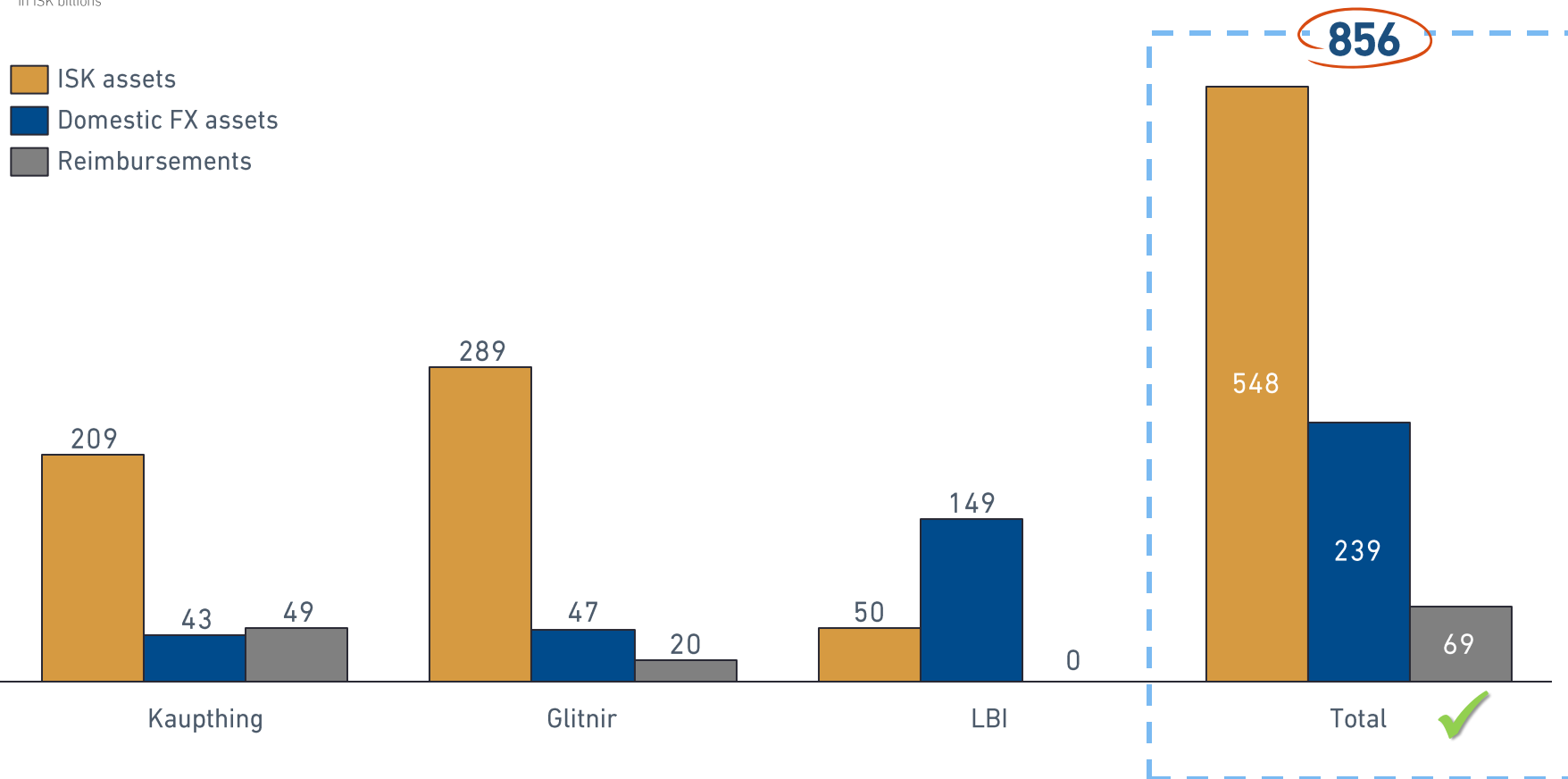




The result: Comprehensive measures relating to the stability conditions total 856 b.kr., which solve the problem in its entirety

Chart: Comprehensive measures by the authorities address all aspects of the problem entailed in the domestic assets held by the failed banks' estates.

In ISK billions



If the problem escalates, the stability contribution will increase.



Upon liberalisation, four objectives will be achieved: neutrality vis-à-vis the ISK exchange rate, long-term banking system funding, expansion of the foreign reserves, and elimination of balance of payments risks stemming from legal disputes

01

- Settlement of the estates will not have a negative impact on the exchange rate
-

02

- Banking system's foreign funding is lengthened and access to global markets eased, reducing refinancing risk and enhancing exchange rate stability
-

03

- Non-borrowed Central Bank reserves expand by 41 b.kr.
-

04

- It is certain that disputes concerning tax issues do not entail further capital outflows, which would otherwise exceed 60 b.kr.

- **Stability conditions and other liberalisation-related measures total 856 b.kr., which solves the problem.**



The stability conditions solve the problem in a comprehensive way: They address in a clear-cut manner the balance of payments effects of settling the estates – they amount to a total of 856 b.kr.

Total scope of the measures

856

billion krónur

Payments to the Government

491

billion krónur

Reimbursement of credit facilities

74

billion krónur

Long-term banking system funding

226

billion krónur

Positive impact
on foreign exchange reserves

41

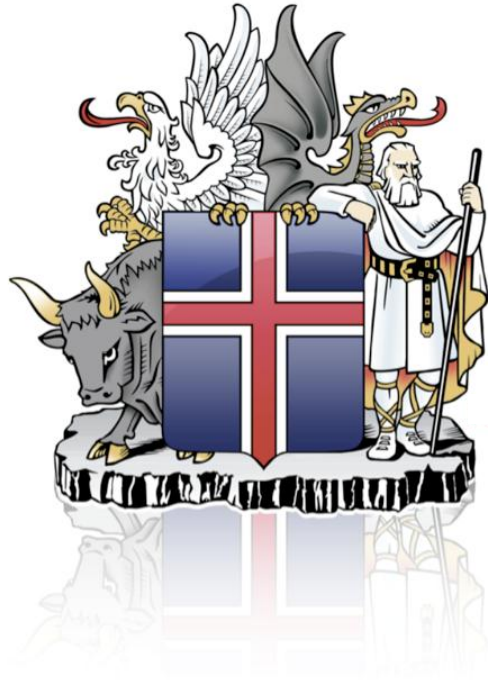
billion krónur

Positive impact on Iceland's IIP

360

billion krónur





Appendix: Prelude to liberalisation of capital controls ^(1/3)

- In the Government's policy statement of 22 May 2013, it is stated that one of the most important tasks will be to work towards the removal of the capital controls, which distort asset prices and do harm to Iceland's competitive position.
- It is also stated that Iceland's economic position must be analysed and a liberalisation strategy created with reference to the importance of the balance of payments for the country and its people. In particular, the framework of the foreign exchange market must be strengthened for the long term, and it must be ensured that the settlement of the failed banks' estates does not jeopardise economic stability. The authorities' strategy was introduced on 8 June 2015.
- The strategy takes account of previous strategies from 5 August 2011 and 25 March 2011, international guidelines on liberalisation of capital controls issued by the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD), and other international obligations undertaken by the Icelandic Government.



Appendix: Objectives and results – context ^(2/3)

- The objectives of the strategy are clear. The strategy provides for conditional measures. The timing of the measures depends on their impact on economical and financial stability.
- There is a logical connection between the strategy and the interests it is designed to protect and further. It will not be tolerated that the nation continue to live in uncertainty about long-term economic stability because of problems lying in the past. A necessary and indispensable part of the authorities' measures is to ensure that Iceland's foreign exchange balance does not deteriorate.
- This protects the interests of the general public and preserves the stability of the domestic economy.
- From the above, it is clear that the capital account liberalisation strategy and the measures related to it actually centre on fundamental aspects of Iceland's economic policy.



Appendix: On the contents of this presentation (3/3)

- Because of the planned composition agreements with creditors and the conclusion of winding-up proceedings, the winding-up boards of Kaupthing hf., Glitnir hf., and LBI hf. (hereinafter referred to as the estates) have requested that the Central Bank of Iceland grant them exemptions from the Foreign Exchange Act. Exemptions cannot be granted from the Act unless it is ensured that monetary, exchange rate, and financial stability will not be jeopardised. In order to ensure that the settlement of the estates does not cause instability, it is necessary to adopt countervailing measures in order to mitigate the adverse impact on the balance of payments as a result of distributions of domestic assets to foreign creditors. According to the Foreign Exchange Act, exemptions are only granted following consultation with the Minister of Finance and Economic Affairs, subject to the Minister's prior presentation of the economic impact of the exemption to the Parliamentary Economic and Trade Committee.
- This presentation applies only to the aforementioned estates. The presentation contains information on the measures that the estates have chosen to take so as to fulfil the authorities' stability conditions, and on the impact of the said measures on the balance of payments and the Central Bank of Iceland's foreign exchange reserves. The stability conditions were presented as a part of the authorities' capital account liberalisation strategy on 8 June 2015.





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In all instances, the text of bills of legislation on the capital account liberalisation strategy shall apply.

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Monetary amounts have been rounded in order to simplify the presentation.