TO THE JOINT COMMITTEE OF THE EEA AGREEMENT

NOTIFICATION
of protective measures
under Article 43 of the EEA Agreement

1. INTRODUCTION

1.1.1 The Government of Iceland hereby presents a notification according to Article 45 of the EEA Agreement of protective measures under Article 43 of the Agreement. The notification concerns measures that the Government introduces against the background of the current financial crisis. The measures are required by the situation of the Icelandic currency, the króna.

1.1.2 The measures entail restrictions on the free movement of capital and are therefore notified to the Joint Committee in accordance with the aforementioned provisions.

1.1.3 Below the applicable provisions shall be recalled under heading 2. The background for the measures is set out under heading 3. The details of the measures are set out under heading 4.

1.1.4 The measures are undertaken to ensure that there will not be cross-border capital flow to the detriment of the currency that could undermine the economic package introduced by the Government to the International Monetary Fund.

2. THE RELEVANT PROVISIONS

2.1.1 The relevant provisions are in particular:

2.1.2 Article 40 EEA provides for free movement of capital in accordance with Directive 88/361. The provision does not find any exact parallel in the EC Treaty as the EEA Agreement came about during the EC's transition from the original Treaty provisions on free movement of capital to the regime that the Economic and Monetary Union would entail.

2.1.3 Article 43 EEA provides for restrictive measures that States may take on macro-economic grounds. The provisions of Article 43 EEA are parallel to provisions of the original EC Treaty, namely to provisions of Articles 70, 73, 107 and 108. Article 43(4) EEA finds its parallel in the current EC Treaty in Article 119(1).

2.1.4 Article 43 provides:

1. Where differences between the exchange rules of EC Member States and EFTA States could lead persons resident in one of these States to use the freer transfer facilities within the territory of the Contracting Parties which are provided for in Article 40 in order to evade the

rules of one of these States concerning the movement of capital to or from third countries, the Contracting Party concerned may take appropriate measures to overcome these difficulties.
2. If movements of capital lead to disturbances in the functioning of the capital market in any EC Member State or EFTA State, the Contracting Party concerned may take protective measures in the field of capital movements.
3. If the competent authorities of a Contracting Party make an alteration in the rate of exchange which seriously distorts conditions of competition, the other Contracting Parties may take, for a strictly limited period, the necessary measures in order to counter the consequences of such alteration.
4. Where an EC Member State or an EFTA State is in difficulties, or is seriously threatened with difficulties, as regards its balance of payments either as a result of an overall disequilibrium in its balance of payments, or as a result of the type of currency at its disposal, and where such difficulties are liable in particular to jeopardize the functioning of this Agreement, the Contracting Party concerned may take protective measures.

2.1.5 Articles 44 and 45 EEA contain the procedural provisions necessary to translate the provisions of Article 43 EEA into practice.

2.1.6 Articles 44 and 45 EEA provide:

Article 44
The Community, on the one hand, and the EFTA States, on the other, shall apply their internal procedures, as provided for in Protocol 18, to implement the provisions of Article 43.

Article 45
1. Decisions, opinions and recommendations related to the measures laid down in Article 43 shall be notified to the EEA Joint Committee.
2. All measures shall be the subject of prior consultations and exchange of information within the EEA Joint Committee.
3. In the situation referred to in Article 43(2), the Contracting Party concerned may, however, on the grounds of secrecy and urgency take the measures, where this proves necessary, without prior consultations and exchange of information.
4. In the situation referred to in Article 43(4), where a sudden crisis in the balance of payments occurs and the procedures set out in paragraph 2 cannot be followed, the Contracting Party concerned may, as a precaution, take the necessary protective measures. Such measures must cause the least possible disturbance in the functioning of this Agreement and must not be wider in scope than is strictly necessary to remedy the sudden difficulties which have arisen.
5. When measures are taken in accordance with paragraphs 3 and 4, notice thereof shall be given at the latest by the date of their entry into force, and the exchange of information and consultations as well as the notifications referred to in paragraph 1 shall take place as soon as possible thereafter.

2.1.7 Article 45(3) to (5) EEA are modelled upon Articles 73(2) and 109 of the original EC Treaty. The parallel provisions of the actual EC Treaty to Article 45(4) and (5) EEA are to be found in Article 120(1) and (2).

2.1.8 Protocol 18 EEA, referred to in Article 44 EEA, stipulates the following:

For the Community, the procedures to be followed for the implementation of Article 43 of the Agreement are set out in the Treaty establishing the European Economic Community.

For the EFTA States, the procedures are set out in the agreement on a Standing Committee of the EFTA States and will cover the following elements:
- An EFTA State which intends to take measures in accordance with Article 43 of the Agreement shall in good time give notice thereof to the Standing Committee of the EFTA States.

- However, in case of secrecy or urgency, notice shall be given to the other EFTA States and to the Standing Committee of the EFTA States at the latest by the date of entry into force of the measures.
- The Standing Committee of the EFTA States shall examine the situation and deliver an opinion regarding the introduction of the measures. It shall keep the situation under review and may at any time make, by majority vote, recommendations regarding the possible amendment, suspension or abolition of the measures introduced or regarding any other measures to assist the EFTA State concerned to overcome its difficulties.

3. BACKGROUND

3.1.1 Iceland's economy has been facing a banking crisis of extraordinary proportions which led to the collapse of Iceland's three main banks, accounting for around 85 percent of the banking system. This precipitated an abrupt adjustment in key asset prices, while the onshore foreign exchange market dried up, and external payment systems have been severely disrupted. The economy is heading for a deep recession, a sharp rise in the fiscal deficit, and a dramatic surge in public sector debt—by about 80 percent of GDP—reflecting an unprecedented high fiscal cost of restructuring the banking system.

3.1.2 The situation prompted the Icelandic Government to seek the assistance of the International Monetary Fund (IMF). The Executive Board of the IMF approved Iceland's request for a two year stand-by arrangement on 19 November 2008. Iceland will receive USD 2.1 bn. from the IMF. Additional loans of up to USD 3 bn. have been secured from Denmark, Finland, Norway, Sweden, Russia and Poland. The Faroe Islands have furthermore announced that they will lend Iceland USD 50 million.

3.1.3 In response to the challenges, the authorities' program, supported by a stand-by arrangement and substantial access to IMF resources, has three key objectives: (i) to stabilize the exchange rate, (ii) to develop a comprehensive and collaborative strategy for bank restructuring, and (iii) to ensure medium-term fiscal sustainability.

3.1.4 The immediate priority is to stabilize the Icelandic króna and set the stage for a gradual appreciation. During the run-up to the banking crisis, the króna depreciated precipitously, culminating, when the banks collapsed, in the shut-down of the on-shore foreign exchange market and a further sharp depreciation in the off-shore market. The depreciation and the attendant surge in inflation have severely strained household and corporate balance sheets because of the high share of foreign currency denominated and inflation-indexed debt.

3.1.5 The funds made available through the IMF will be used to support the currency. To this end, the program includes an appropriately tight monetary policy and restrictions on capital flows in the near term. This is considered to be necessary to prevent situations from arising in which the position of the currency will become untenable.

4. THE MEASURES

4.1.1 The measures made available to the Central Bank in an Act passed by Althingi today are the following:

"Notwithstanding the provisions of Article 2 of the Act and Article 9 of the Act on Investment by Non-residents in Business Enterprises, the Central Bank of Iceland is authorised, until 30 November 2010, to adopt rules, subject to the agreement of the Minister of Business Affairs, which restrict or temporarily suspend any or all of the following categories of capital movements and related foreign exchange transactions, if the Bank considers that such movements of capital to and from the country would cause serious and significant instability in exchange rates and monetary issues:

1. Transactions with and the issue of securities, units in securities funds and investment funds, money-market instruments and other transferable financial instruments.

2. Deposits into and withdrawals from accounts with depositary institutions.

3. Lending, borrowing and issue of guarantees not related to international trade in goods and services.

4. Import and export of securities and domestic and foreign currency.

5. Forward transactions, derivative transactions, trade in options, currency swaps and interest rate swaps, and other related foreign exchange transactions, in which the Icelandic króna is one of the denominated currencies.

6. Presents and grants and other capital movements corresponding to those listed in paragraph 1 to 5.

The Central Bank of Iceland is authorised, subject to the agreement of the Minister of Business Affairs, to adopt rules obliging domestic parties to surrender foreign currency acquired by the sale of goods and services or by other means.

The provisions of Article 7 of the Act shall apply to the authorisations of the Central Bank of Iceland to grant exemptions from the rules established pursuant to paragraph 1. No fee shall be collected for the granting of such exemptions.

Rules according to paragraph 1 and 2 shall be published in the B Series of the Official Gazette and shall be reviewed at least every six months following their publication.

Penalties and administrative fines due to infringement of this provision shall be as stipulated in Article 15 (a) to (d), Article 16, and Article 16 (a) and (b)."

4.1.2 As can be seen, the Central Bank will be authorised to put in place restrictions to the free movement of capital on grounds of serious and exceptional exchange-rate and monetary instability. The measures taken will be in accordance with the principle of proportionality and thus, will not go beyond what the situation objectively requires.

4.1.3 Due to the urgency of the matter the Icelandic Government has to make use of the procedure permitted under Article 45(5) of the EEA Agreement, where notice shall be given to the Joint Committee at the latest by the date of entry into force of the measures.

4.1.4 The full text of the measures, both the bill of law presented to the Parliament and subsequent rules adopted by the Central Bank, will be provided in English as soon as possible.

5. CONCLUSION

5.1.1 Against this background, the Joint Committee is invited to proceed in accordance with Article 45 of the EEA Agreement.

5.1.2 The Icelandic Government is available to supply any additional information requested and to have consultations on the direct measures taken. The Government will furthermore keep the Joint Committee informed of further developments regarding the matter.

Reykjavik on 28 November 2008