The Icelandic financial system

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1. General structure of the financial system

(i) The Icelandic financial system

The financial markets in Iceland have been in rapid transition during the last decade. A process of liberalisation and legislative reform has created conditions in which market forces play an increasing role. The Basle standard for rules on capital adequacy of commercial and savings banks was implemented at the beginning of 1993. In connection with the European Economic Area (EEA) Agreement,[1] new legislation was enacted in 1993, including acts governing the operations of commercial and savings banks, other credit institutions, securities transactions, mutual funds and the Iceland Stock Exchange. A new Foreign Exchange Act entered into force in November 1992. The general impact of this legislation has been twofold. First, stricter rules have been adopted to ensure the economic health of banks and other financial institutions, including rules on the minimum capital ratio and exposure to risk. Banking supervision, which is in the hands of the central bank, has been strengthened at the same time. Secondly, the new legislation is a step in the deregulation process that has been under way for some time, with the most important changes being the abolition in 1986 of centralised control over interest rates and the liberalisation of capital movements, which was completed at the beginning of 1995.

With the deregulation of markets, there has been a rapid increase in the issuance of new bonds and other financial instruments. The Government, banks and other financial institutions have become active in this market. Financial institutions have also started to offer public financial services not previously available in Iceland. The relative importance of the

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1 An agreement between the member countries of the EU and EFTA (excluding Switzerland) on the free movement of goods, services, capital and labour.

Table 1
Gross assets of financial institutions
In billions of krónur, at end of year

	1980	1985	1990	1993	1994	1995	Average annual growth in % 1985–95
Commercial banks . .	5.8	61.8	183.8	214.6	212.4	212.1	13.1
Savings banks	0.7	7.0	32.8	50.1	45.7	52.1	22.3
Savings departments of coops.	0.1	0.7	2.0	2.0	2.2	2.3	12.5
Insurance companies .	0.9	7.0	23.3	38.3	41.6	44.5	20.3
Pension funds	2.1	28.5	128.2	208.8	234.2	262.6	24.8
Investment credit funds	3.1	40.4	151.8	237.2	254.9	268.3	20.8
Leasing companies . .	..	0.1	10.0	13.1	13.2	11.0	60.0
Mutual funds (open-end)	..	0.4	13.6	12.5	17.0	14.8	43.5
Mutual funds (closed-end)	..	..	1.5	1.7	2.4	4.3	78.6*
Memorandum item:							
Credit terms index . . .	*197*	*1337*	*2952*	*3347*	*3384*	*3442*	*9.9*

* 1986–1995.

various institutions making up the financial system in Iceland is shown in Table 1.

Commercial and savings banks (Table 2)

There are four commercial banks in Iceland, of which two are state-owned (Landsbanki Íslands and Búnaðabanki Íslands) and two are privately owned (Íslandsbanki hf. and Sparisjóðabanki Íslands hf.). Three of the commercial banks conduct the full range of traditional banking business. The fourth, Sparisjóðabanki Íslands hf., is owned by the 29 savings banks in Iceland and functions on their behalf as their central banking institution. The savings banks are generally private institutions with local operations and they perform most traditional banking operations. In addition to commercial and savings banks there are two other types of deposit-taking institutions, namely the savings departments of cooperatives (with deposits of I.kr. 2.3 billion at the end of 1995) and the Post Giro

Table 2

Commercial and savings banks' assets, deposits and domestic securities issues

In billions of krónur, at end of 1995

	Total assets	Deposits	Securities issues	Market share in % in terms of deposits
Landsbanki Íslands .	102.0	60.8	10.1	36
Íslandsbanki hf. . . .	54.9	35.9	4.5	22
Búnaðarbanki Íslands	48.1	34.9	1.6	21
Sparisjóðabanki Íslands hf.	7.0	0.0	0.0	0
Savings banks	52.1	34.8	7.6	21
Total	264.1	166.4	23.8	100

(I.kr. 0.5 billion at the end of 1995). Deposit-taking institutions are referred to as Deposit Money Banks (DMBs).

Other specialised banks (Table 3)

There are 13 investment credit funds (ICFs) in Iceland, most of them being public entities. ICFs play an important role in the Icelandic financial system with regard to long-term financing. Three of the ICFs provide housing finance, while others channel credit to the various business sectors of the economy. In recent years, there has been a structural change in the financing of the ICFs. They have increased their public issuance of bonds on the domestic market and reduced the use of foreign funds and borrowing from other financial institutions. The share of bond issuance in their financing at present is 37%, with that of domestic loans 31%, foreign loans 15% and own capital 17%.

Leasing companies

There are three leasing companies in Iceland at present, the first having been established in 1985. Their growth was rapid in the first few years of operation. Growth has since slowed down, mainly because of relatively low investment in Iceland. Recently the leasing companies have diversified their activities to some extent by granting loans in addition to making conventional leasing contracts.

Table 3
Investment credit funds' credits and securities issues
In billions of krónur, at end of 1995

	Credits	Domestic securities issues
State Housing Funds	184.9	84.8
Fisheries Investment Fund	23.4	0.7
Industrial Loan Fund	16.4	4.1
Agricultural Loan Fund	9.8	3.4
Other ICFs	28.7	6.0
Total	263.2	99.0

Institutional investors

There are currently 67 pension funds in Iceland. Their number has decreased in recent years owing to mergers. The funds receive payments from employers and employees and are the most important source of long-term finance in the country. The pension funds invest mainly in bonds issued by the Government and the ICFs, but also in bonds issued by other financial institutions, municipalities and companies and to some extent in shares. They also extend credit to members. Recent changes in foreign exchange regulations opened access for the pension funds to invest in foreign securities.

There are eleven closed-end mutual funds and seven open-end mutual funds in operation in Iceland, none of which existed prior to 1985. The closed-end funds are limited liability companies that are quoted on the Iceland Stock Exchange. The open-end funds are operated in 31 divisions.

There are now 19 insurance companies operating in Iceland. Four of them are life insurance companies and represent only 4% of the total assets of Icelandic insurance companies. One reason for the small share of life insurance is probably the employees' compulsory membership of pension funds. About half of insurance companies' portfolio consists of marketable securities, which make insurance companies fairly big players in the Icelandic securities market. In terms of total assets the two (largest) companies have a market share of more than 50%, which indicates that the other insurance companies are rather small.

The securities market

The market for securities has expanded gradually in Iceland. In 1964 the Government started to issue indexed savings bonds. In the 1970s, a secondary market for these bonds began to develop. The Iceland Stock Exchange commenced operations in 1986. In recent years, there has been an increase in the variety and volume of financial instruments that the Government, municipalities, financial institutions and companies have offered on the market (see Table 4). The bond market has continued to develop, money and equity markets have emerged and Treasury bills, notes and bonds are now auctioned regularly.

Offshore institutions

No incentives are offered to financial institutions to conduct offshore business in Iceland. The measures taken to insulate the domestic market from *illegal* offshore transactions are presumably the same as in neighbouring countries. Money laundering, for example, is forbidden by law and the supervisory body (the Bank Inspectorate of the Central Bank) has made an effort to educate financial sector agents in this respect.

(ii) The central bank

The Central Bank of Iceland was established in 1961. Previously central bank functions were carried out by Landsbanki Íslands, a state-owned commercial bank. The functions of the central bank include the conduct of monetary policy consistent with the goal of maintaining low inflation, the supervision of financial institutions and the management of the country's foreign exchange reserves. Its balance sheet at the end of 1995 is shown in Table 5.

The Bank is an active participant in the domestic money markets, dealing in Treasury bills. The Treasury and several government institutions have their bank accounts with the central bank, which acts as banker, economic adviser and fiscal agent to the Government. Until a few years ago the Treasury had unlimited access to a short-term overdraft facility with the Bank. In June 1992 an agreement on central bank credit accommodation was reached between the Bank and the Minister of Finance, requiring the Treasury to meet its borrowing needs in the financial market. In addition, the Treasury began to sell its bills and bonds at regular auctions conducted by the National Debt Management Agency. As

Table 4

Market capitalisation of selected market securities

In billions of krónur, at end of year

	1988	1990	1991	1992	1993	1994	1995
Government savings bonds	19.7	38.2	46.6	53.2	64.0	72.5	78.0
Treasury bills	0.7	8.1	8.3	15.5	17.5	14.6	15.5
Government notes	..	..	..	..	2.1	5.6	6.6
Bank bonds and bills	8.9	17.5	19.2	20.6	22.7	22.3	23.8
Housing bonds[1]	..	5.8	22.6	37.0	54.7	72.5	84.8
Bonds of other ICFs	1.6	2.3	2.9	3.9	6.6	9.2	14.3
Bonds of other government funds	..	6.8	7.9	5.7	4.2	2.7	2.7
Mutual fund units (open-end)	5.7	13.2	11.1	9.0	12.1	16.2	14.5
Bonds of leasing companies	1.6	2.5	3.3	4.1	5.4	6.1	4.9
Shares[2]	5.5	33.5	40.4	36.2	35.1	45.9	65.3

[1] Housing bonds and State Housing Fund bonds. [2] Market value of shares quoted on the Iceland Stock Exchange and the OTC market.

Table 5

The balance sheet of the central bank at 31st December 1995

In billions of krónur

Assets	60.9	**Liabilities & Capital**	60.9
Foreign-currency-denominated		Foreign-currency-denominated	
External	33.2	External	20.4
Domestic	1.4	Domestic	4.5
Claims on DMBs	*1.2*	*DMBs' deposits*	*1.4*
Claims on ICFs	*0.0*	*ICFs' deposits*	*0.6*
Claims on others	*0.1*	*Public sector deposits*	*2.5*
Local-currency-denominated		Local-currency-denominated	
Claims on DMBs	4.2	DMBs' required deposits	6.3
		DMBs' free deposits	1.7
Claims on ICFs	3.3	Repos to DMBs	0.0
		ICFs' deposits	1.2
Claims on public sector	18.5	Currency	6.0
		Public sector deposits	3.6
Other assets	0.3	Other liabilities	2.2
		Net capital position	15.0

a consequence, yields on Treasuries are no longer decided by the Government but rather by market forces. The central bank conducts active business with commercial and savings banks as lender of last resort, clearing agent for cheques and provider of liquidity. During the last decade banks' direct access to central bank accommodation has been reduced.

(iii) Major changes in commercial banks' balance-sheet items over the last 14 years

Table 6 shows considerable changes in some items of the balance sheet of the commercial banks between 1980 and 1994. As a percentage of GDP, banks' total assets have increased substantially. New items have appeared, such as bonds sold to the public and Treasury bills, while others have disappeared, such as produce loans rediscounted by the central bank. In fact the central bank numbers have decreased considerably in the balance sheet of the commercial banks.

Some items not shown in Table 6 have also been changing. For instance, banks have been quite inventive in creating new types of deposit accounts. The proportion of total credits granted to the public and household sectors has increased, while that of lending to the business sector has decreased. In GDP terms, however, bank loans to the business sector have increased. Loans granted by banks usually carry variable rates of interest.

(iv) Index-linked and foreign currency items in banks' balance sheets

Table 6 shows that foreign-currency-linked assets represent about one-fifth of total assets. The proportion on the liabilities side is quite similar. These percentage shares are virtually unchanged over the period, but measured as a ratio of GDP foreign assets and liabilities have increased somewhat.

Table 6 also shows the shift towards indexation that has taken place in the Icelandic economy, with approximately one-third of the balance sheet being indexed at the end of 1994, compared with almost nil in 1980. This confirms that indexation has played a big role in the financial sector in Iceland. With inflation coming down, an effort is now being made to reduce the use of indexation on bank deposits and short-term instruments.

Table 6
Commercial banks' balance sheet*

At end of year	Billions of krónur 1994	As a % of total assets 1980	As a % of total assets 1994	As a % of GDP 1980	As a % of GDP 1994
Assets:					
Cash	0.4	0.4	0.2	0.1	0.1
Treasury bills	1.6	0.0	0.8	0.0	0.4
Central bank	9.2	17.9	4.5	6.4	2.1
of which: required reserves	5.8	13.2	2.8	4.7	1.3
Foreign assets	7.4	2.8	3.6	1.0	1.7
Credit and investment	162.5	70.6	79.0	25.2	37.5
Other assets	24.6	8.3	12.0	3.0	5.7
Total assets	205.7	100.0	100.0	35.7	47.5
of which: foreign-currency-linked	45.4	22.5	22.1	8.1	10.5
indexed	76.9	3.3	37.4	1.2	17.7
Liabilities:					
Total deposits	129.1	55.2	62.8	19.7	29.8
Bonds	16.7	0.0	8.1	0.0	3.8
Central Bank	2.4	17.0	1.2	6.1	0.6
of which: redisc. produce loans	0.0	15.5	0.0	5.5	0.0
Foreign liabilities	31.1	19.2	15.1	6.9	7.2
Other liabilities	12.1	2.1	5.9	0.8	2.8
Capital and reserves	14.3	6.5	7.0	2.3	3.3
Total liabilities & capital	205.7	100.0	100.0	35.7	47.5
of which: foreign-currency-linked	43.2	21.0	21.0	7.5	10.0
indexed	64.8	0.5	31.5	0.2	15.0

* Excluding the savings banks' bank.

(v) The payment and settlement system[2]

The banks, together with the central bank, operate a clearing system through the Banks' Data Centre. The Centre facilitates the clearing of cheques and the flow of payments, including giro payments. The same clearing system functions both as an interbank circuit and as a retail clearing system. The net results from the daily clearing are settled on the participants' current accounts with the central bank the same day. Cross-border payments are carried out almost exclusively via the S.W.I.F.T.

[2] For more information, see the report on Payment Systems in Iceland, BIS, Basle, May 1995, prepared by the Central Bank of Iceland and the Committee on Payment and Settlement Systems of the central banks of the Group of Ten countries.

network and correspondent banking relations. The banks, including the central bank, are all S.W.I.F.T. members connected via the Banks' Data Centre.

2. The general framework of monetary policy

The degree of independence of the Central Bank of Iceland cannot be easily defined.[3] The Bank has independence in setting its own interest rates, but the use of some of its instruments is subject to government consent, the most important being reserve requirements. The Bank pursues its monetary policy by indirect means through market operations, primarily in the money market and the interbank market in foreign exchange. In addition, the Bank has been a market-maker in long-term government bonds, a role it, however, stopped playing in February 1996 (see below). Finally, the Bank acts as the borrowing agent for the Republic of Iceland in the international capital markets.

Current central bank legislation stipulates several, to some extent contradictory, goals for monetary policy. However, the goal of price stability has become through consensus the main objective of monetary policy. In December 1989, the exchange rate of the króna was fixed against a basket of currencies in order to provide a nominal anchor and to ensure disciplined economic policy formulation and implementation. Through careful monetary policy, relatively well-contained fiscal policy and moderate wage behaviour the economy was stabilised and inflation, which for a long time far exceeded the OECD average, fell to low single digits. In fact, by 1994 it had fallen to 1.5%, the lowest rate recorded among the OECD countries. The inflation rate in 1995 was 1.7%, and 1996 should see a similar performance.

A stable exchange rate is the intermediate target of monetary policy. Since 1989 the exchange rate has had to be lowered twice, first in the wake of the turbulence in international currency markets in late 1992,

[3] According to the methodology used by Starck (1992), which is adopted from Swinburne and Castello-Branco (1991), the Central Bank of Iceland ranks between the Bank of Japan and the Bank of England in its degree of independence. The method is based on gauging the following attributes on a certain scale: the mandate of the central bank to formulate and implement monetary policy, its goals, the terms of appointment of its directors and governors, its independence in deciding its own budget and its obligations to report to the Government and the public. The measure is rough and should only be interpreted as giving broad indications.

Table 7
Domestic debt of the Treasury
In billions of krónur, at end of year

	1988	1990	1991	1992	1993	1994	1995
Indexed savings bonds . .	19.7	38.2	46.6	53.2	64.0	71.3	74.2
ECU-linked savings bonds	0.0	0.0	0.0	0.0	0.0	1.1	3.8
Government notes . . .	..	..	..	..	2.1	5.6	6.6
Treasury bills	0.7	8.1	8.3	15.5	17.5	14.6	15.5
Overdraft at the Central bank	9.0	1.5	6.3	0.0	0.0	0.0	0.0
Total	29.4	47.8	61.2	68.7	83.6	92.6	100.1

which led to a significant deterioration in Iceland's terms of trade, and then in mid-1993 in response to a prospective deterioration of the real economy resulting from quite a sharp reduction in allowable fish catches for conservation reasons. Since mid-1993, the exchange rate has fluctuated very modestly around its central rate. In September 1995 the fluctuation band was widened from ± 2.25% to ± 6%.

The main operating targets of monetary policy are short-term interest rates. The instruments used by the Bank are its own interest rates (discount rate, repo rates and money market intervention rates) and the access that banks are granted to central bank financing.

Table 8
Central bank and commercial bank shares in government borrowing
In percentages

Year	Central bank	Commercial banks	Other	Total
1980	45	11	44	100
1985	24	5	71	100
1991	10	23	67	100
1992	2	21	77	100
1993	4	22	74	100
1994	11	16	73	100
1995	9	15	76	100

The National Debt Management Agency acts as the Government's agent in the management of the public debt. According to the Agency's legislation it is charged with overseeing borrowing and debt management functions of the Treasury, both domestic and foreign, and government guarantees. However, under a special agreement the central bank is responsible for the execution of foreign borrowing for the Treasury. As Tables 7 and 8 show, the Icelandic Government borrows on both foreign and domestic financial markets. On the domestic market regular auctions are held for Treasury bills (with maturities of 3, 6 and 12 months), government notes (3 and 5 years) and indexed government bonds (10 and 20 years).

On the foreign market most of the public debt is funded. The floating foreign debt includes the borrowings through the Euro Commercial Paper Programme, which Iceland established as long ago as 1985. The Republic of Iceland has a long-term rating of A+ and A1 from Standard & Poor's and Moody's, respectively, and a short-term rating of A1+/P1.

Table 8 shows the proportion of central bank and commercial bank claims on the Government in recent years. The rise in the central bank's claims in 1994 is exceptional, and is explained by the increase in the Bank's holdings of marketable government bonds as a result of its effort to maintain moderate interest rates on the domestic market.

3. Monetary policy instruments and implementation

Instruments

The main instruments used to implement monetary policy are: central bank interest rates, bond and money market operations, intervention in the foreign exchange market, central bank credit facilities for financial institutions, reserve requirements and a minimum liquidity ratio. In the early 1990s, a new policy on the central bank's accommodation for the Treasury was formulated. The Treasury now has to fully meet its borrowing needs in the financial market, and not through overdrafts with the central bank. This policy has been instrumental in the development of the Icelandic money market. Interest rates on government securities are fully set by the market, and they now play a bigger role in the determination of general domestic interest rates. Through market operations, the ability of the central bank to influence short-term interest rates has been strengthened.

(i) Reserve requirements

Deposit Money Banks are subject to both reserve requirements and rules on a minimum liquidity ratio. The reserve requirement can be fulfilled only via deposits in blocked accounts with the central bank. The base for the reserve requirement includes not only deposits but also DMBs' bond issuance and other domestic liabilities. The amount that needs to be held on deposit in the required reserve accounts is adjusted by the central bank (with an entry on the current account of the institution in question) during the third week of each month so as to reach the specified minimum percentage of the base as of the end of the previous month. Since November 1993 the required reserve ratio has been lower for time deposits and outstanding bonds than for other liabilities. Prior to that no differentiation was made with regard to the type of liabilities. Marginal reserve ratios were applied in the 1960s and 1970s, but they have no relevance except when the (average) reserve ratio is being raised. Deposits on the required reserve account with the central bank have always been remunerated. Required reserves currently carry interest rates of 3½% in addition to being fully indexed.

The minimum liquidity ratio is a secondary requirement that is fulfilled by holdings of cash, Treasury bills and free reserves as measured by an average during each month.

Table 9 shows that required reserve ratios have been reduced sharply over the last decade. At the same time, banks' and the Treasury's access to central bank financing has also been reduced.

(ii) Credit ceilings

The central bank does not impose ceilings on credits extended by financial institutions. Credit ceilings were applied in the 1970s and early 1980s, the last year being 1986.

(iii) Interest rates

Financial institutions can freely set all their interest rates. One exception is that the central bank determines the so-called penalty interest rates

Table 9

Liquidity and reserve requirement ratios

In percentages

Effective as of:	Minimum liquidity ratio	Required reserve ratio
1st June 1979	..	28.0
17th April 1985	..	18.0
1st March 1987	7.0	13.0
1st July 1987	7.5	13.0
1st August 1987	8.0	13.0
1st August 1988	9.0	12.0
1st January 1989	10.0	12.0
1st March 1989	10.0	11.0
1st April 1989	9.0	11.0
1st May 1990	11.0	10.0
1st June 1990	12.0	7.0
31st October 1991	12.0	6.0
1st January 1992	12.0	7.0
1st November 1992	12.0	6.0
1st December 1992	12.0	5.0
1st November 1993	10.0	4.0 (2.5)*
23rd September 1996	12.0	4.0 (2.5)*

* Figure in parentheses refers to the reserve ratio for time deposits and bond issues.

according to a certain formula specified by law. Penalty rates are applied on overdue payments. At the time of writing it is probable that the planned near-term amendments of the Interest Rates Act (No. 25/1987) will abolish the regulation on penalty rates. There are no indications that interest rates are set by an agreement among financial institutions; such collusion is strictly forbidden by law. The large market share of a small number of banks may nevertheless have led to oligopolistic behaviour in the setting of bank rates. An overview of interest rates is presented in Tables 10 and 11.

(iv) Limits on discount and other credit facilities

The central bank provides the economy with liquidity through (a) the purchase of foreign exchange, (b) the purchase of Treasury bills and government bonds, and (c) by granting financial institutions some access to central bank financing. The last channel includes limited discount facilities at low interest rates and repurchase agreements (repos) at predeter-

Table 10

Selected interest rates in Iceland as at 21st October 1996

Percentage rates per annum

Central Bank	
Deposits	
Current account	2.7
CB's notes, 90-day	5.7
Treasury bills, 10-day reverse repos	5.9
Required reserves (indexed terms)	3.5
Credits	
Discount rate	6.0
Treasury bills, 10-day repo	6.9
Money market	
CB's offer rate on 90-day Treasury bills, secondary market	7.05
CB's bid rate on 90-day Treasury bills, secondary market	7.12
Primary market for 90-day Treasury bills	7.12
Interbank rate for overnight loans	8.00
Primary market for 90-day bank bills	6.20
Bank deposits	
General savings accounts	0.8
Special sight saving accounts	3.5
Two-year indexed accounts	4.5
Bond market	
Indexed rates	
Offer rate on 5-year government bonds	5.38
Bid rate on 5-year government bonds	5.46
Market-maker bid rate on housing bonds	5.64
Bank loans	8.90
Non-indexed rates	
Offer rate on 5-year government notes	8.98
Bid rate on 5-year government notes	9.08
Bank loans, non-indexed	12.50

mined interest rates which are slightly higher than the discount rate. Treasury bills are the most common instrument in repos with the DMBs. There is no formal limit. The maturity in each case is ten days. The central bank has also granted limited repo facilities to securities houses which have assumed the role of market-makers in government bonds, in which

Table 11

Selected interest rates at deposit money banks

Annual averages

	General savings accounts		Time deposits[1]		Bills of exchange 60-day		General non-indexed secured loans		Indexed securities		Penalty rates		Inflation rate[2]
	N	R	N	R	N	R	N	R	N	R	N	R	
1960	8.7	2.0	9.4	2.6	11.1	4.2	10.7	3.8	.	.	.	.	6.6
1961	7.0	–6.5	8.0	–5.6	9.5	–4.3	9.5	–4.3	.	.	.	.	14.4
1962	7.0	–0.9	8.0	0.0	9.5	1.4	9.5	1.4	.	.	.	.	8.0
1963	7.0	–6.4	8.0	–5.5	9.5	–4.2	9.5	–4.2	.	.	.	.	14.3
1964	7.0	–4.3	8.0	–3.4	9.5	–2.1	9.5	–2.1	.	.	.	.	11.8
1965	6.0	–6.1	7.0	–5.2	8.4	–4.0	9.0	–3.5	.	.	12.0	–0.8	12.9
1966	7.0	–1.2	8.0	–0.3	9.5	1.1	10.0	1.6	.	.	12.0	3.4	8.3
1967	7.0	2.5	8.0	3.4	9.5	4.9	10.0	5.4	.	.	12.0	7.3	4.4
1968	7.0	–8.0	8.0	–7.1	9.5	–5.8	9.2	–6.1	.	.	12.0	–3.7	16.3
1969	7.0	–12.2	8.0	–11.3	9.5	–10.1	9.2	–10.3	.	.	12.0	–8.0	21.8
1970	7.0	–8.8	8.0	–7.9	9.5	–6.6	9.2	–6.9	.	.	12.0	–4.5	17.3
1971	7.0	3.9	8.0	4.9	9.5	6.3	9.2	6.0	.	.	12.0	8.7	3.0
1972	7.0	–7.2	8.0	–6.3	9.5	–5.0	9.2	–5.3	.	.	12.0	–2.9	15.3
1973	8.3	–17.3	9.7	–16.3	10.9	–15.3	12.1	–14.4	.	.	16.0	–11.5	31.0
1974	10.8	–28.1	12.3	–27.1	14.4	–25.8	15.9	–24.8	.	.	20.8	–21.6	54.1
1975	13.0	–19.9	14.5	–18.8	17.6	–16.6	18.8	–15.7	.	.	24.0	–12.1	41.0
1976	13.0	–12.5	14.5	–11.3	18.2	–8.4	19.5	–7.4	.	.	24.7	–3.4	29.1
1977	13.3	–15.0	24.0	–7.0	19.2	–10.6	20.7	–9.5	.	.	32.5	–0.6	33.3
1978	18.6	–19.2	31.6	–10.4	26.6	–13.8	27.2	–13.4	.	.	36.0	–7.4	46.8
1979	22.8	–20.6	35.5	–12.4	29.1	–16.5	30.9	–15.4	.	.	45.0	–6.3	54.7
1980	33.3	–12.6	45.0	–5.0	40.0	–8.3	39.9	–8.3	56.1	2.3	55.8	2.1	52.6

case such bonds serve as the underlying securities and the maturity is 30 days. The central bank provides no privileged credit for private or public borrowers. Until 1985, however, the Bank applied preferential rates when rediscounting loans which the banks had granted to certain business sectors.

(v) Money market transactions

In addition to the interest rates on the above-mentioned credit facilities, the central bank influences short-term interest rates through its transac-

Table 11 (cont.)

Selected interest rates at deposit money banks

Annual averages

	General savings accounts		Time deposits[1]		Bills of exchange 60-day		General non-indexed secured loans		Indexed securities		Penalty rates		Inflation rate[2]
	N	R	N	R	N	R	N	R	N	R	N	R	
1981 . .	34.4	– 8.9	45.9	–1.2	39.8	– 5.3	45.1	– 1.7	51.3	2.5	55.3	5.2	47.6
1982 . .	35.3	–15.7	61.8	0.8	40.4	–12.5	45.4	– 9.4	65.2	2.9	58.0	–1.6	60.5
1983 . .	38.7	–20.0	74.7	0.7	44.6	–16.6	48.8	–14.2	78.6	3.0	58.2	–8.8	73.4
1984 . .	16.1	– 2.4	22.7	3.2	23.2	3.6	23.0	3.4	25.4	5.5	31.5	10.6	18.9
1985 . .	22.7	– 9.5	39.4	2.8	36.0	0.3	32.5	– 2.3	42.4	5.0	44.0	6.2	35.6
1986 . .	11.5	– 2.8	18.0	2.9	20.3	4.9	19.6	4.3	20.5	5.1	30.5	13.8	14.7
1987 . .	13.3	– 7.3	26.1	3.2	28.7	5.3	27.9	4.7	31.6	7.7	35.9	11.2	22.2
1988 . .	16.7	– 2.0	23.6	3.8	34.0	12.5	33.2	11.8	30.1	9.2	43.9	20.8	19.1
1989 . .	11.2	– 8.6	25.1	2.9	29.4	6.4	29.5	6.5	31.1	7.8	35.9	11.8	21.6
1990 . .	3.7	– 3.2	13.6	6.0	17.0	9.2	17.1	9.3	15.7	8.0	26.0	17.6	7.1
1991 . .	4.8	– 2.7	15.3	7.1	19.0	10.5	18.4	10.0	17.5	9.2	25.0	16.1	7.6
1992 . .	1.2	– 0.4	8.2	6.5	13.3	11.6	13.5	11.8	11.0	9.3	19.5	17.7	1.6
1993 . .	0.8	– 2.1	9.4	6.2	15.1	11.8	14.8	11.5	12.4	9.1	17.7	14.3	3.0
1994 . .	0.5	– 0.7	6.1	4.8	11.9	10.5	10.9	9.5	9.3	7.9	14.2	12.8	1.3
1995 . .	0.6	– 1.0	7.1	5.4	14.5	12.7	11.9	10.1	10.4	8.7	14.6	12.8	1.6

Notes: N = Nominal yield in percent per annum.
R = Real yield in percent per annum (yield in excess of changes in credit terms index).

[1] Period 1960–1976: 6-month savings books. Period 1977–1981: 12-month non-indexed time deposits. Period 1982–1989: 6-month indexed accounts. Period 1990–1993: 15 to 30-month indexed accounts. Period 1994–1995: 48 to 60-month indexed accounts. [2] Changes in credit terms index from the beginning to the end of each year.

tions in the money market, specifically the market for Treasury bills. The Bank places non-competitive bids at auctions of Treasury bills and offers two-way prices on the secondary market for such bills. This market is the most important channel for the Bank in terms of traded volume, both for outright purchases of Treasury bills and for the sale of such bills. The DMBs make use of this market to adjust their most liquid reserves and to maximise their earnings on liquidity. The central bank offers the DMBs reverse repos of Treasury bills at predetermined interest rates. Also available to the DMBs are certain central bank notes, but usually these play a negligible role. The Bank would only make the notes attractive if for some reason Treasury bills were to lose their importance for the conduct of monetary policy.

The above-mentioned transactions of the central bank are seen as a way of influencing interest rates, but at the same time the Bank is either providing or absorbing liquidity. The Bank does not make a clear distinction between these two roles. By monitoring several monetary aggregates, the Bank makes its decisions about its bid and offer yields in the secondary market. Changes in the yields are often based on a judgement that the direction of the flow of liquidity should change.

4. External convertibility and the foreign exchange market

(i) Capital movements

In recent years the rules and regulations governing inward and outward capital transactions in Iceland have been liberalised. The current legislation on foreign direct investment dates back to 1991. At the beginning of 1994 long-term portfolio investments were completely deregulated, and restrictions on short-term movements were eased. At the beginning of 1995 the remaining restrictions on short-term movements were abolished.

Today there are no limits on capital movements to and from Iceland for residents. Most of the earlier restrictions on direct investment in Iceland by non-residents have also been removed. Some restrictions remain, however, the most important being that foreigners cannot hold an equity stake in fishing or fish processing firms, either directly or indirectly. The same applies to power generation and distribution companies. Moreover, holdings of non-residents in commercial aviation companies is restricted to 49% and in domestic incorporated commercial banks to 25%. Other than this, the direct investment climate is liberal, and despite the restrictions on foreign ownership of domestic banks, for example, foreign banks can operate branches in Iceland. It is important to note that for all investments in the financial markets in Iceland no restrictions whatsoever apply on the repatriation of capital, interest or dividends.

(ii) Exchange rate regime

Stability of the nominal exchange rate vis-à-vis a trade-weighted basket of currencies is an intermediate target of monetary policy. There is a fluctuation band of +/–6% around the central rate. The basket is revised annually to correspond to the actual weights of foreign trade in the preceding year.

(iii) Foreign exchange intervention and official foreign exchange reserves

The central bank intervenes in the foreign exchange market by buying or selling krónur, usually at fixing meetings but also on the interbank market outside the meetings. The Bank intervenes so as to prevent the currency index from moving too far from the central rate.

To be able to maintain the exchange rate at the desired level the central bank needs sufficient foreign reserves. Since the fixed exchange rate policy was adopted, the reserves have been fully adequate. Government foreign borrowing has sometimes been helpful in supporting the reserve position, especially when the business sector started to reduce its foreign indebtedness. However, government foreign borrowing is not used in any systematic way to regulate official reserves. In the event of a short-term downturn in reserves, the central bank has access to some credit lines abroad. The Bank has set a lower limit for the reserves as well a higher limit beyond which they should not move.

(iv) The foreign exchange market in Iceland

Fixing meetings, with participants from the four commercial banks and the central bank, are held each day at 10.45 a.m. at the central bank. Most interbank transactions take place at these meetings but continuous trading during the day over the telephone is also possible. Information on such transactions is immediately reported to the central bank, which in turn reports a new value for the currency rate index. The prices quoted at the fixing meeting are the basis for the official exchange rate, which the central bank publishes daily. The banks are free to decide on their buying and selling rates to customers and change these rates in the course of the day.

5. Financial market development

(i) Money market

The Treasury started to auction Treasury bills only three years ago. Prior to that Treasury bills were only sold on tap at a price decided by the Ministry of Finance. These bills were tailor-made in the sense that the investor decided the amount and maturity, so that they were badly suited to serve as instruments for secondary market trading. Under the new system the bills are standardised 3, 6 and 12-month bills. They have been listed on the Iceland Stock Exchange and are now the basis for the money market, the largest financial market in Iceland in terms of traded volume. The central bank is a market-maker in Treasury bills, and commercial and savings banks are the most common traders with this instrument.

It is perhaps surprising that secondary market trading of standardised Treasury bills began so late in the whole process of financial market development in Iceland. The main reason is the fact that the Treasury had almost unlimited access to a central bank overdraft until agreement was reached in June 1992 to close this facility and let the Treasury meet its short-term financing needs through regular auctions of short-term paper. This agreement is undoubtedly one of the most important changes in the framework for monetary policy implementation in recent years. All direct lending by the central bank to the Treasury has ceased, except that the central bank can make non-competitive bids at the auctions of Treasury bills. It is the decision of the central bank whether and to what degree it does so. Its possibilities to influence short-term nominal interest rates are, therefore, no longer restricted by any form of automatic direct lending to the Treasury.

As a result of this agreement a significant and effective money market developed in less than two years. As an indication of the speed of the development of the money market it may be mentioned that the Treasury sold I.kr. 44 billion of short-term paper through auctions in 1995, compared to I.kr. 10 billion in 1992 and nothing in 1991. At the same time, the turnover of this paper on the organised secondary market increased from nothing in 1991 to I.kr. 48 billion in 1995.

Certainly it would have been appropriate to start the deregulation of interest rates by auctioning Treasury bills and developing a secondary market for them. Thus the commercial banks would have been able to

Table 12
Interbank market for overnight and other short-term loans
Annual averages, in billions of krónur

1990	1.6
1991	2.2
1992	1.6
1993	1.9
1994	0.8
1995	0.7

adjust their lending rates to money market conditions in addition to their own liquidity situation.

An interbank market for overnight loans is operated over the telephone. The players are the four commercial banks. A bank in need of liquidity calls another bank and asks for a loan. If they come to an agreement the lender moves some of its free central bank reserves to the central bank account of the borrower simply by faxing the instruction to the central bank. At maturity, usually the day after, the borrowing bank sends another fax instructing the central bank to execute a transaction in the opposite direction. Thus the central bank receives immediate information on what is happening in this market and is able to distribute the relevant statistics regularly. Volumes traded on this market are rather low (see Table 12), partly because all banks have had ample liquidity in the last two years. Once the market starts expanding more strongly, it is likely that more automation will be used. Interbank interest rates do not play an important role in the conduct of monetary policy.

As already indicated, both primary and secondary markets in securities issued by the Treasury exist. The commercial and savings banks issue bills which are tailor made and usually not traded on a secondary market. A primary market also exists for units of money market mutual funds. Table 13 presents some statistics on short-term instruments in the money market.

(ii) Bond market

At times of high inflation and regulated interest rates, bond issuance did not play a major role in Iceland, except for government bonds, which

Table 13
Market capitalisation of selected short-term instruments
In billions of krónur, at end of year

	1987	1990	1991	1992	1993	1994	1995
Short-term instruments, total (A)	1.0	10.9	10.9	19.5	22.5	18.1	21.0
Treasury bills	1.0	8.1	8.3	15.5	17.5	14.6	15.5
Bank bills	..	1.0	1.7	3.1	3.4	1.7	4.1
Money market mutual fund units	..	1.8	0.9	0.9	1.6	1.8	1.4
Memorandum item:							
Deposits of DMBs (B)	69.4	126.7	145.2	150.4	159.8	163.3	169.2
(A) as a percentage of (B)	1.4	8.6	7.5	13.0	13.8	11.1	12.4

since 1964 were the only instruments that could be indexed.[4] Government savings bonds are fixed interest securities issued in Icelandic krónur. Most of them are indexed, i.e. linked to the consumer price index, but SDR and ECU-linked bonds have also been issued. The following government bonds have been available on the primary market in 1996: 10 and 20-year indexed bonds, 3 and 5-year non-indexed bonds. At the end of 1995 the Ministry of Finance stopped selling 5-year indexed bonds and started to issue 5-year non-indexed bonds. This step was taken to reduce the use of price indexation in short and medium-term financial obligations in Iceland. Stocks of government bonds in recent years are shown in Table 14.

The lack of instruments explains the earlier slow development of the secondary market. The indexation of debt instruments from other issuers and deregulation of interest rates changed this environment. The Iceland Stock Exchange was established in 1985 and trading started in 1986. By that time the stock of government bonds issued domestically had already reached a considerable amount, and these were the only instruments traded on the Iceland Stock Exchange for the first few years. New bond issuance has increased dramatically. In addition to government bonds and

[4] The extensive practice of indexation of financial obligations in Iceland is one of the main characteristics of the domestic financial market. Certain loans, deposits and debt securities sold on the market are linked to the CPI so that changes in the index instantaneously alter the amount of the financial obligation in question.

Table 14

Stock of government bonds on the domestic market

	1988	1990	1991	1992	1993	1994	1995
	In billions of krónur, at end of year						
Government bonds & notes .	19.7	38.2	46.6	53.2	66.1	78.0	84.6
Indexed savings bonds	19.7	38.2	46.6	53.2	64.0	71.3	74.2
SDR/ECU-linked savings bonds	0.0	0.0	0.0	0.0	0.0	1.1	3.8
Government notes (3 years)	..	..	..	..	2.1	5.6	6.6
Government-guaranteed housing bonds	..	5.8	22.6	37.0	54.7	72.5	84.8
Total	19.7	44.0	69.2	90.2	120.8	150.5	169.4
	As a percentage of GDP						
Government bonds & notes .	7.7	10.5	11.7	13.3	16.1	18.0	18.6
Government & housing bonds	7.7	12.1	17.4	22.6	29.4	34.7	37.2

the government-guaranteed bonds issued for the housing finance system, municipalities, financial institutions and private companies issue bonds on the domestic market. In many cases these issues are privately placed and not sold in a public offering. In other cases these issues are listed on the Iceland Stock Exchange, but it seems that secondary trading only takes place in government and government-guaranteed bonds. Nevertheless, the bond market is providing the authorities with continuous information and is also playing an important role in raising capital.

On 21st February 1996, the Central Bank of Iceland relinquished its role as a market-maker for long-term government bonds. To ensure liquidity in the market, the central bank concluded an agreement with three securities houses according to which they assumed the responsibility of market-makers in the secondary market. The central bank handed over a part of its stock of government bonds to the securities houses in order to facilitate market-making and to finance their operations. The reason for this has been the Bank's view that its market-making role in the long-term market should be diminished as markets develop. As the long-term market has deepened it has become clear that the central bank is not able to control interest rates in that market and that efforts to do so could compromise other monetary policy targets. The new system has operated successfully. Spreads have narrowed and the volume of trade has increased.

Mutual funds are obliged to place 90% of their disposable funds in securities listed on an official stock exchange. They are also obliged to maintain at least 4% of their assets in government securities. Their holdings have far exceeded this obligation. In the past, both pension funds and commercial banks were obliged to invest in certain domestic securities. This regulation has been lifted.

(iii) Equity market

Secondary market equity trading does not have a very long tradition in Iceland. Limited liability companies have of course existed for many years, but they have often sought new share capital through rights issues and not

Table 15

Turnover and market capitalisation of securities listed on the Iceland Stock Exchange

	Securities market						Money market
	Total	Govt. bonds	Housing bonds	Govt. notes	Shares	Other bonds	Treasury bills
	Turnover in billions of krónur						
1987 . . .	0.2	0.2	0.0	..	..	..	..
1991 . . .	2.4	1.7	0.7	..	0.0	0.0	..
1992 . . .	5.9	4.3	0.6	0.9	0.1	0.0	1.0
1993 . . .	22.3	14.0	2.9	4.5	1.0	0.0	53.3
1994 . . .	22.2	9.4	7.6	3.8	1.3	0.0	64.3
1995 . . .	22.6	9.3	2.5	7.8	2.9	0.1	48.3
1996[1] . .	28.6	12.1	2.6	9.0	4.9	0.0	70.8
	Market capitalisation in billions of krónur, at end of period						
1987 . . .	12.2	11.2	..	..	..	1.0	..
1991 . . .	69.9	43.8	18.3	..	1.6	6.2	..
1992 . . .	106.0	51.6	31.1	1.9	14.6	6.8	6.8
1993 . . .	152.5	65.4	55.3	2.1	19.1	10.6	17.7
1994 . . .	204.3	72.7	69.7	5.6	33.0	23.3	17.1
1995 . . .	239.8	76.5	79.5	6.1	47.0	30.7	16.5
1996[2] . .	288.3	58.6	96.8	10.0	85.4	37.6	15.9

[1] January–October. [2] As at 31st October.

Table 16
Shares listed on the Iceland Stock Exchange

	1991	1992	1993	1994	1995	1996*
Turnover/market capitalisation (%)	0.3	1.0	5.0	4.1	6.1	5.9
Market capitalisation/GDP (%)	0.4	3.7	4.6	7.6	10.3	17.2
Number of companies listed	2.0	11.0	17.0	24.0	27.0	32.0
Changes in share index (ICEX) (%)	7.0	–10.0	–17.0	24.0	35.0	59.0

* As at 31st October.

on the public market. The lack of a public market for equities in the past can best be explained by the fact that Icelandic financial markets were underdeveloped and by a lack of enthusiasm of companies for going public. In some cases secondary market trading has been restricted by company resolutions. The Iceland Stock Exchange had been in operation for five years when the first shares were listed. Here a significant change has taken place, and now 32 companies have had their shares listed on the

Table 17
Public issues of equity, privatisation and secondary market turnover
In billions of krónur

	1991	1992	1993	1994	1995	1996*
Primary market						
Public issues	3.7	1.3	0.9	1.9	2.9	10.3
of which:						
equity funds	0.9	0.2	0.5	0.7	1.3	3.5
privatisation	0.0	0.0	0.0	0.3	0.2	1.1
Other privatisation	0.0	0.5	0.7	0.0	0.0	0.0
Secondary market						
Icelandic Stock Exchange	0.0	0.1	1.0	1.3	2.9	5.0
OTC	..	0.4	0.4	0.6	0.8	1.6
Total	3.7	2.3	3.0	3.8	6.6	17.0

* As at 15th November.

Exchange with a market capitalisation of currently I.kr. 93 billion (see Tables 15 and 16). Trading in shares in the trading system of the Exchange is limited, as can been seen from the tables, but it should be noted that some trading also takes place outside the trading system. Figures show that the turnover in equity trading in 1996 may increase significantly from last year.

In 1992, the largest brokers in Iceland started operating an over-the-counter (OTC) market for non-listed shares, and the Exchange allowed its members to utilise the Exchange's trading and information system for trading in this market. Currently there are 32 companies on the OTC market, with a market capitalisation of about I.kr. 30 billion. Shares of about half of the companies are regularly traded on the OTC market. Some companies have recently moved from the OTC market to the Stock Exchange.

Table 17 shows that the supply of new equity (public offerings and privatisation) was I.kr. 3.7 billion in 1991, but since then the figure has fallen. This may be explained by several factors. Plans for further privatisation have not been implemented. In 1993 earnings of companies were low and some companies postponed the issue of equity. In 1994 some companies were attracted to the bond market rather than the equity market because of falling interest rates. In 1995 and 1996 the demand for equity has been high; this has led to new issues of equity on the primary market, increased turnover on the secondary market and higher prices.

The importance of the equity market in Iceland is growing. It has made it easier for companies to raise risk capital from the public (see Table 18 for a sectoral breakdown of listed companies). The disclosure rules imposed by the Stock Exchange on listed companies have educated investors to the importance of adequate information when making investment decisions. The investment opportunities have certainly existed, as is indicated by the fact that the index of stock prices registered by the Exchange rose by 35% in 1995 and has risen by 59% in the first ten months of 1996.

(iv) The role of the central bank in fostering the development of the financial market

The Central Bank of Iceland has played a major role in the development of financial markets in Iceland. The Bank has actively participated in the

Table 18
Companies listed on the Iceland Stock Exchange

	Number	Total assets	Capital at book value	Share capital, nominal	Market capitali-sation	Capital ratio	Debt/ equity ratio
		31/12/95	31/12/95	31/12/95	25/07/96	31/12/95	
		in millions of krónur					
Communications .	2	30,854	11,089	3,683	17,989	0.36	1.78
Fish processing . .	8	26,171	9,075	4,701	18,685	0.35	1.88
Banking	1	54,900	4,899	3,879	6,400	0.09	10.21
Oil distribution . .	3	18,137	8,496	1,923	11,661	0.47	1.13
Closed-end investment funds .	7	7,375	6,758	4,016	6,363	0.92	0.09
Industry and others	9	14,896	5,637	1,400	6,163	0.38	1.64
Total	31	152,334	45,954	19,601	67,162	0.34	1.94

liberalisation and modernisation of the Icelandic financial market. It established the Iceland Stock Exchange in cooperation with banks and securities houses and has supported the Exchange in various ways, including by providing a location for its offices. But the Exchange is growing fast and is now able to cover its operational costs without any direct support from the central bank. Table 15 shows that turnover on the Exchange has grown rapidly in recent years, both of bonds and money market instruments and of equities.

The Bank has acted as a market-maker on the Exchange for long and short-term government securities, which has speeded up the development of both bond and money markets. In connection with this task the Bank has sometimes run into conflicts between the conduct of monetary policy on one hand and the need to have a liquid market for government securities on the other. This is particularly true for the bond market. At times the Bank invested considerable amounts in long-term bonds so as to steer long-term interest rates to levels it deemed appropriate.

The central bank enables commercial and savings banks to use an effective clearing system since cheques and interbank transactions are cleared over current accounts with the central bank.

(v) The role of derivative instruments

Derivative instruments in the foreign exchange market are playing an increasing role, since the commercial banks recently started to offer forward and swap contracts to their customers. Some securities houses have started to offer currency options over-the-counter.

6. Banks: regulation and supervision

(i) Supervision of financial institutions

The central bank is responsible for supervising the activities of commercial and savings banks, leasing companies, securities brokers, securities firms and mutual funds (open-end), and all other credit institutions as defined by Act No. 123/1993. Furthermore, the central bank supervises the annual accounts and the audit of pension funds. Thus its field of surveillance covers the whole range of financial institutions except insurance companies, closed-end mutual funds and the state-owned Building Fund. These functions are vested in the Bank Inspectorate, a department within the central bank. The main role of the Bank Inspectorate is to ensure that the activities of the above-mentioned institutions and firms are conducted in accordance with the relevant laws and regulations, and that they are sound in other respects. These institutions and firms are obliged to provide all the information considered necessary by the Inspectorate. The Insurance Supervisory Authority oversees insurance companies in Iceland.

(ii) Banking sector regulations and supervisory practices

Because of Iceland's participation in the European Economic Area, the Icelandic legislation and regulations regarding banks and other financial institutions have recently been adapted to the various regulations and directives in force in the European Union. The current rules on capital adequacy which came into effect in 1993 are based on Basle guidelines (with a minimum capital ratio of 8%). According to rules which the central bank has imposed, commercial and savings banks are obliged to keep the difference between foreign exchange assets and liabilities within a certain level (20% of capital and reserves). The same is true for indexed assets and liabilities.

Table 19
Deposit insurance schemes

	1991	1992	1993	1994	1995
	In billions of krónur, at end of year				
Commercial banks insurance fund	1.1	1.3	1.4	1.5	1.7
Savings banks insurance fund	0.2	0.3	0.3	0.4	0.5*
Total	1.3	1.6	1.8	1.9	2.2
Commercial banks deposits	118.1	121.3	128.6	129.1	131.7
Savings banks deposits	24.7	26.9	29.3	31.6	34.8
Total	142.8	148.2	157.9	160.7	166.5
	As a percentage of deposits				
Commercial banks insurance fund	0.9	1.1	1.1	1.1	1.3
Savings banks insurance fund	0.7	0.9	1.1	1.3	1.4
Total insurance funds	0.9	1.1	1.1	1.2	1.3

* Provisional.

The main task of the Bank Inspectorate, as defined in the current Central Bank Act, is to supervise the operations of those institutions which are subject to its supervision in order to ensure that they adhere to the relevant laws and regulations and remain sound in other respects. Inspection takes place either on site or on the basis of written information on particular aspects of operations and assets or liabilities according to individual circumstances. Most of the institutions subject to monitoring by the Bank Inspectorate are required to submit periodic reports on their operations and the composition of assets and liabilities. The results of the investigations of the Bank Inspectorate are presented in letters or reports to the institutions in question. Findings that give cause for concern are reported to the Minister of Commerce.

(iii) Deposit insurance schemes

Iceland has two deposit insurance schemes, one for the commercial banks and another for the savings banks (see Table 19). In recent years the commercial and savings banks have contributed an amount equal to 0.15% of their deposits annually to these schemes. The present law stipulates that the commercial banks' insurance fund is a government entity, while the savings banks own their insurance fund. According to a provisional Act, the two schemes will be merged in the near future.

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