Summary of the Glitnir Report 'An Outline of a Resolution'

The report was requested by the Winding Up Board of Glitnir and outlines the possibilities for the estate to pay out to creditors without adversely affecting the balance of payment situation in Iceland.

As with other sovereign states with their own currency, it is apparent that Iceland has two options to deal with the banking crisis – 'printing' power and 'taxing' power. Taxing power to re-capitalise the country's banks is vested with the Treasury and Parliament.

Following the collapse of the main banks and also the country's use of quantitative easing, a transfer problem has developed in Iceland. As stated in the report, this is the challenge associated with transferring large sums from one currency area to another through the capital account without causing a large deviation in the exchange rate from an economic perspective.

The financial system has an excess of liquidity which is to exit through the currency market. Therefore, there is a risk is that the ISK will suffer **sudden and large depreciation** if the currency market is liberalised by the Government through the lifting of capital controls.

The report states that the solution to the transfer problem lies within taking money out of circulation as well as changing bank funding from short term deposits into longer term instruments.

Originally the Government considered **bankruptcy** to be the best option in the winding up process because the interpretation of the Icelandic Bankruptcy law meant that all claims from any bankrupt company in Iceland would have to be paid in ISK. However, this interpretation was not supported by the Icelandic courts in a recent ruling by Iceland's Supreme Court in ***Kaupthing v Aresbank SA*** on 10 November 2014. The ruling stated that although all claims should be calculated in ISK there is **no obligation to settle the claims in ISK**.

Exit taxes – due to the size of the 'overhang' in the **Icelandic Central Bank** ("**ICB**") reserves, the report rules this out as a stand-alone measure to lift capital controls. It is stated that because of the small reserves, an exit tax would need to be **very high** and this would give little incentive for offshore holders of ISK to exit.

The report states that there are two ways for a foreign investor to liquidate their domestic assets: one is to exit through the local currency market, the other is to sell the assets off-shore to some other foreign investor and thereby transfer ownership. The report states that, in the authors' opinion, the successful solution to the transfer problem lies within the following five conditions:-

1. *"Payments from the estates must be capital account neutral.*

2. *The disposal or allocation of ISK assets from the estates must not endanger financial stability nor create future balance of payments disturbance.*

3. *Currency transactions following payments from the estates must take place separately from the official currency market.*

4. *There can be no hold-outs after payments have been made which could await their time until the capital controls have been lifted.*

5. *The fulfilment of the four conditions above must not entail legal risk for the Icelandic government in order to ensure that claims on the estates will not be converted into claims on Icelandic tax payers."*

The capital structure of the new banks, in particular their dependence on short term deposits, makes them vulnerable to the lifting of capital controls. It is therefore important to reduce the role of short term funding to some degree before lifting the controls.

The report concludes that the objective of the emergency legislation of limiting the socialization of losses has been mostly reached and that instead the losses have been borne by the unsecured creditors of the failed banks, both by giving depositors priority and by taxation of their assets.

It is 3-4 years since the conditions were put in place for a pay-out to creditors. Despite this, Icelandic authorities have yet to put forward clear conditions to the estates as to how the transfer problems associated with the payments to creditors should be addressed.