

Bill of Legislation

amending Act No. 36/2001, on the Central Bank of Iceland (Submitted to the 136th Legislative Session of the *Althingi* 2008-2009)

Article 1

The second sentence of the first paragraph of Art. 20 of the Act shall read as follows: The Supervisory Board of the Central Bank of Iceland shall, upon receiving the proposals of the Governor of the Central Bank, approve procedures for preservation of its foreign currency reserves, cf. Art. 28.

Article 2

The second sentence of Art. 22 of the Act shall be replaced by two new sentences, which shall read as follows: Decisions on applying the Central Bank's monetary policy control mechanisms shall be taken by the Monetary Policy Committee, cf. Art. 24. In other respects, the Bank's direction shall be in the hands of the Governor.

Article 3

Art. 23 of the Act shall read as follows:

The Prime Minister shall appoint the Governor of the Central Bank for a seven-year term after the position has been advertised. A governor must have completed a master's degree in economics and have extensive experience and expertise in monetary issues. The same person may only be appointed Governor of the Central Bank twice. The Governor of the Central Bank shall be responsible for the Bank's operations and shall be authorised to take decisions in all questions not entrusted to others by this Act.

In the Governor's absence the Prime Minister may appoint a temporary replacement Governor in his or her stead.

The Governor of the Central Bank shall set rules on employees' authorisations to oblige the Bank with their signatures, which shall be subject to the endorsement of the Bank's Supervisory Board, cf. Article 28.

Article 4

Art. 24 of the Act shall read as follows:

Decisions on applying the Central Bank's monetary policy control mechanisms shall be taken by the Monetary Policy Committee. In this context, the Bank's monetary policy control mechanisms include decisions on interest rates, transactions with credit institutions other than those listed in the second paragraph of Art. 7, a decision on reserve requirements as provided for in Art. 11, and currency market transactions as provided for in Art. 18, intended to influence the ISK exchange rate. Decisions by the Monetary Policy Committee must be based on the Bank's objectives and a thorough assessment of the current situation of and outlook for the economy and monetary issues.

The Monetary Policy Committee shall be comprised of the Governor of the Central Bank, two of the Bank's executives responsible for formulating and implementing monetary policy and two monetary policy experts appointed by the Governor for a three-year term, after obtaining the endorsement of the Prime

Minister. The Governor of the Central Bank shall also chair its Monetary Policy Committee. The Monetary Policy Committee shall have a quorum if four of its five members attend a Committee meeting. Decisions by the Monetary Policy Committee shall be taken by a simple majority of votes; in the case of a tie, the Chairman shall cast the deciding vote. The Monetary Policy Committee shall meet at least eight times each year. In addition, the Monetary Policy Committee may meet if its Chairman or three members of the Committee so request. The Monetary Policy Committee shall adopt rules concerning its work, subject to the endorsement of the Bank's Supervisory Board, concerning the preparation of, rationale for, and presentation of its monetary policy decisions. Decisions by the Monetary Policy Committee, and the premises upon which they are based, shall be explained publicly. The Monetary Policy Committee may, however, decide not to account for decisions on currency market transactions, as provided for in Art. 18.

Article 5

Art. 25 of the Act shall read as follows:

The Governor of the Central Bank of Iceland may not sit on the Board of Directors of an institution or commercial enterprise outside the Bank, nor otherwise participate in commercial operations except as required by law or in the case of an institution or commercial enterprise in which the Bank is involved. Should a dispute arise concerning the application of this provision, the Prime Minister shall decide the issue.

The Governor of the Central Bank of Iceland shall set rules, subject to the endorsement of the Supervisory Board, concerning the participation of other Central Bank employees on the Boards of institutions and commercial enterprises, cf. Art. 28.

Article 6

The second paragraph of Art. 27 of the Act shall read as follows:

The Governor of the Central Bank shall attend meetings of its Supervisory Board with the right to speak and make motions. The Governor shall, however, recuse him- or herself if the Supervisory Board so decides.

Article 7

The following changes shall be made to Article 28 of the Act:

- a. The words "Board of Governors" in the second sentence shall be replaced by: The Governor of the Central Bank.
- b. The words "Board of Governors" in sub-paragraph a) shall be replaced by: Governor of the Central Bank.
- c. The word "Governors" in sub-paragraph b) shall be replaced by: Governor and members of the Monetary Policy Committee who are not salaried employees of the Central Bank of Iceland.
- d. The words "Board of Governors" in sub-paragraph d) shall be replaced by: Monetary Policy Committee.
- e. Two new sub-paragraphs shall be added, sub-paragraphs e) and f), which shall read as follows:
 - e. Supervise the implementation of rules concerning the work and working practices of the Monetary Policy Committee.

- f. Approve the selection of executives for the Monetary Policy Committee, upon receiving the proposal of the Governor of the Central Bank.
- f. The words “Board of Governors” in sub-paragraphs e), j), l), m) and n) shall be replaced by: Governor of the Central Bank.

Article 8

The words “Board of Governors” in the first sentence of the second paragraph of Art. 33 of the Act shall be replaced by: Governor of the Central Bank.

Article 9

The following changes shall be made to Article 35 of the Act:

- a. The words “Board of Governors” in the first paragraph shall be replaced by: Governor of the Central Bank.
- b. The words “Board of Governors” in the second paragraph shall be replaced by: Governor of the Central Bank.

Article 10

The following changes shall be made to Article 37 of the Act:

- a. The words “Board of Governors” in the first sentence of the second paragraph shall be replaced by: Governor of the Central Bank.
- b. The words “Board of Governors” in the second sentence of the third paragraph shall be replaced by: Governor of the Central Bank.

Article 11

This Act shall enter into force immediately.

Article 12

Amendments to Act No. 87/1998,

on Official Supervision of Financial Activities; as subsequently amended

The following changes shall be made to Article 15 of the Act:

- a. The words “Board of Governors of the Central Bank” in the second paragraph shall be replaced by: Governor of the Central Bank.
- b. The words “Board of Governors of the Central Bank” in the fourth paragraph shall be replaced by: Governor of the Central Bank.

Temporary Provisions

I.

Notwithstanding the provisions of Art. 26 of the Act, *Althingi* shall, as soon as practicable following the entry into force of this Act, elect a Supervisory Board and alternates for the Central Bank of Iceland. As of that same time, the mandates of those persons currently sitting on the Supervisory Board shall be nullified.

II.

Upon the entry into force of this Act, the Board of Governors of the Central Bank shall be abolished, together with the positions of the three Governors currently sitting on the Board, including the position of Chairman of the Board of Governors. The Prime Minister shall, as soon as practicable, in an advertisement invite applications for the new position of Governor of the Central Bank of Iceland, as provided for by

this Act. Until the appointment of a Governor of the Central Bank of Iceland has been made, pursuant to the advertisement, the Prime Minister shall designate a person fulfilling the conditions of this Act to serve as Governor of the Central Bank in the interim.

Explanatory Notes on this Draft Legislation

This Bill proposes making changes to the administrative structure of the Central Bank of Iceland. The changes are intended to ensure that the Bank has a qualified senior management, thereby ensuring professional and objective decision-making concerning the application of the Bank's monetary policy control mechanisms.

Two principal substantive changes are proposed in the Bill. Firstly, it proposes to abolish the Board of Governors of the Central Bank of Iceland, and thereby the positions of the three Governors who currently sit on the Board, including the position of the Chairman of the Board of Governors. The Board of Governors will be replaced by a single, professional Governor who will direct the Bank's operations. The Governor of the Central Bank shall be appointed following advertisement of the position; applicants for the position must have completed a master's degree in economics and possess extensive experience and knowledge of monetary issues. Secondly, the Bill proposes to establish a Monetary Policy Committee within the Bank, with the task of taking decisions on the application of the Bank's monetary policy control mechanisms.

The need for major restructuring and renewal at the senior management level of the Central Bank of Iceland is clear following the shocks which have beset the national economy and, concurrently, the Bank itself in recent months. In recent years the Central Bank of Iceland has suffered substantial setbacks in connection with financial market developments, both in Iceland and abroad, and as yet no final solution is visible as to how the Bank's operations and the state's monetary policy can be placed on a solid foundation once more. The changes proposed in this Bill are, in the estimation of the government, a basic pre-requisite if the Central Bank of Iceland is to once more be regarded with the confidence necessary in this connection. Monetary policy decisions are primarily a professional question, requiring expertise in macroeconomics and monetary economics specifically. This has been accepted by central banks throughout the world, and is clearly evident in the fact that the majority of the world's central bank governors are qualified economists. Political considerations, which often appear to have been a major factor in appointments to the Board of Governors of the Central Bank of Iceland, are inconsistent with the requisite professional expertise and conducive to eroding confidence in the Bank. The qualifications stipulated for appointment as Governor of the Central Bank of Iceland, and the legal obligation to advertise applications for the position, are intended to preclude the possibility of such considerations taking precedence in the appointment of Governor.

Notes on individual Articles of the Bill

On Articles 1 and 2

These Articles effect changes to the wording of the Act in accordance with the substance of Art. 3 of the Bill and the main proposal that the Board of Governors be abolished and replaced by a new professional Governor of the Central Bank.

On Article 2

In accordance with Art. 4 of the Bill, this Article specifies that decisions on the application of the Central Bank's monetary policy control mechanisms are to be taken by a Monetary Policy Committee, cf. Article 24 of the Act.

On Article 3

The Article proposes that the Prime Minister appoint the Governor of the Central Bank for a seven-year term following advertisement of the position. Appointment to the position shall be made in accordance with general rules on appointments to public office. They provide for the appointment of the person most qualified to fulfil the position, based on the relevant objective considerations; in addition, applicants must have completed a master's degree in economics and possess extensive experience and expertise in monetary issues. According to the provision, the same person can be appointed Governor only twice, which is the same as the rule currently applicable to appointments to the Board of Governors of the Central Bank of Iceland.

As in the current Act, provisions of Acts on the rights and obligations of public officials are expected to continue to apply in all respects concerning the Governor of the Central Bank, while at the same time the exception made in the current Act, to the effect that the provisions of the Acts do not apply to reappointment as Governor, is removed. Just how this exception is to be understood, has not been considered fully evident, and it was therefore deemed proper to eliminate it so that the general rules of Acts on public officials shall apply upon reappointment following the end of the first term of appointment; as indicated in the provision, each Governor may fulfil the position for a maximum of two terms.

According to this provision, the Governor of the Central Bank is responsible for the Bank's operations and authorised to take decisions in all questions not entrusted to others by the Act. The provision also specifies that, in the absence of the Governor, the Prime Minister may appoint a temporary replacement as Governor.

Finally, the provision proposes that the Governor of the Central Bank set rules on the authorisations of Bank employees to oblige the bank with their signatures, which shall be subject to the approval of the Supervisory Board, cf. Article 28.

On Article 4

This Article proposes that a special Monetary Policy Committee be set up within the Central Bank, entrusted with taking decisions on the application of the Bank's monetary policy control mechanisms, which are in this context its interest rate decisions, transactions with credit institutions other than those listed in the second paragraph of Art. 7 of the Act, a decision on reserve requirements as provided for in Art. 11 of the Act, and currency market transactions as provided for in Art. 18 of the Act, which are intended to influence the ISK exchange rate. Decisions by the Monetary Policy Committee are to be based on the Bank's objectives and a thorough assessment of the current situation of and outlook for the economy and monetary issues. The provision is aimed at further reinforcing the professional expertise underlying monetary policy decisions by the Central Bank of Iceland.

The Monetary Policy Committee proposed is to be comprised of the Governor of the Central Bank, two of the Bank's executives responsible for formulating and implementing monetary policy and two monetary policy experts appointed by the Governor for a three-year term, after obtaining the endorsement of the Prime

Minister. The Governor of the Central Bank shall also chair its Monetary Policy Committee. It is deemed proper to have more than one person involved in decisions to be taken by the Monetary Policy Committee, since monetary policy decisions generally involve varying points of view as to the economic situation and developments. Monetary Policy Committees of this sort are therefore commonplace in central banks in other countries, with the objective of improving the quality of decisions taken on applying the banks' monetary policy control mechanisms. The Governor of the Central Bank is to be able to appoint external specialists, both in Iceland or from abroad, to the Monetary Policy Committee, which could likely add to the credibility of monetary policy. According to this provision, the Monetary Policy Committee has a quorum if four of its five members are in attendance at a Committee meeting. Decisions by the Monetary Policy Committee shall be taken by a simple majority of votes; in the case of a tie, the Chairman shall cast the deciding vote. Finally, provision is made for Committee meetings, the adoption of rules concerning its work and obligations to publicly account for the Committee's decisions.

On Articles 5-10

These Articles effect changes to the wording of the Act in accordance with the substance of Articles 3 and 4 of the Bill.

On Article 11

The provision proposes that the Act, if adopted, shall enter into force immediately.

On Article 12

The provision proposes changes to the wording of Art. 15 of the Act on Official Supervision of Financial Activities, in accordance with the changes proposed in Art. 3 of the Bill.

On Temporary Provision I

The provision proposes that, notwithstanding the provisions of Art. 26 of the Act, *Althingi* shall, as soon as practicable following the entry into force of this Act, elect a Supervisory Board and alternates for the Central Bank of Iceland. In such case, the mandates of those persons currently sitting on the Supervisory Board shall be nullified as of that same time. The election of a new Supervisory Board is intended to contribute to rebuilding confidence in the Central Bank of Iceland, both at home and abroad.

On Temporary Provision II

The provision confirms that, upon the entry into force of the Act, the Board of Governors of the Central Bank of Iceland shall be abolished, together with the positions of the three Governors currently on the Board, including the position of the Chairman of the Board of Governors; the provisions of Art. 34 of the Act on the Rights and Obligations of State Employees, shall apply to the termination of their employment. Following the entry into force of the Act, the Prime Minister shall, as soon as practicable, advertise for applications to the new position of Governor of the Central Bank, as provided for by the Act. Until the appointment of a Governor of the Central Bank of Iceland has been made, pursuant to the advertisement, it is proposed

that the Prime Minister designate a person fulfilling the conditions of this Act to serve as Governor of the Central Bank in the interim.