

RULES

on Facilities with the Central Bank for Institutions Subject to Minimum Reserve Requirements

The following Rules apply to facilities with the Central Bank for institutions maintaining reserve accounts with it in accordance with Rules to that effect:

Article 1

Current accounts and reserve accounts

Interest on current accounts is calculated at overnight rates in accordance with the Central Bank's interest rate announcements and entered in the accounts at the end of the year. The first day of interest for in-payments and out-payments is the day of transaction unless otherwise agreed. The Bank may change the terms of current accounts without notice.

Interest on required reserves is calculated at overnight rates. Remuneration on the average reserve account balance, which corresponds to the monthly minimum reserve requirement, is made in accordance with the Central Bank's interest rate announcements and entered in the accounts on a monthly basis, while reserves in excess of that amount are remunerated at the rate of interest payable on current accounts in accordance with paragraph 1 above, which is entered at the end of the year.

A current account may not be overdrawn. If an unauthorised overdraft has nonetheless been made, e.g. in respect of a payment system settlement, the credit institution concerned shall settle it immediately with an overnight loan from the Central Bank, cf. Article 4, and have the loan validated for interest payments on the day that the overdraft is deemed to have been formed, which will constitute the first day of interest payment. A charge of 0.01% per day shall be paid for such a validation. The credit institution concerned shall request such a facility no later than 10:30 a.m. on the first normal business day after the overdraft is formed. As collateral for the overnight loan, the credit institution shall present securities which are eligible for repo transactions in accordance with Article 3. These securities shall be in the custody of the Central Bank.

Article 2

Certificates of deposit

The Central Bank sells 14-day and 90-day certificates of deposit as the Board of Governors may decide at any time. Central Bank certificates of deposit with a maturity of 14 days are sold at auctions which are announced specifically.

Certificates of deposit with a maturity of 90 days are sold at the buyer's request, but the Central Bank may cease their sale at any time without notice. These certificates of deposit bear fixed interest that is paid on maturity. Applications to purchase them shall be submitted to the Central Bank's Monetary Department and will be cleared the same day if received before 15:00. On days when the Central Bank and Deposit Money Banks (DMBs) are closed to the public at 12:00, applications to purchase shall be received 11:30.

Article 3

Repurchase agreements

The Central Bank normally holds weekly auctions of repurchase agreements (repos) every Tuesday. Maturity of repos is 14 days. If the Bank and DMBs are closed to the public on the Tuesday, the auction will take place on the following business day, and the maturity

will be correspondingly shorter. If the Bank and DMBs are closed to the public on the due date, this will be moved to the following business day, and the maturity will be correspondingly longer.

In each instance the Central Bank will notify participants of the auction terms no later than 10:00 on the Monday, including whether the Bank intends to offer or bid for securities. In appropriate cases, 14-day Central Bank certificates of deposit may also be offered for sale. If the Bank and DMBs are closed to the public on the Monday, the Bank will announce the auction terms after 16:00 on the last business day before the day of the auction. Auctions will either be in a fixed-price format, i.e. with the yield set in advance, or in the form of a price auction, where the yield is determined on the basis of the bids received.

Securities that are eligible as collateral for Central Bank repo agreements are Central Bank of Iceland certificates of deposit, electronically registered Treasury bonds, Treasury bills, Treasury notes, and bonds issued in Icelandic currency which fulfil the following conditions:

1. The market value of the issue in the bond class is greater than 3 b.kr. and confirmation is available that this amount has been sold.
2. The issuer has been rated by Standard & Poor's, Moody's or Fitch, with a long-term credit rating of A- or better from Standard & Poor's and Fitch and A3 or better from Moody's.
3. Securities with a government guarantee are evaluated as if issued by the Treasury.
4. Securities are subject market making on Iceland Stock Exchange or a comparable institution.
5. The securities do not represent subordinated debt and issuers may not use their own issues in transactions with the Central Bank.
6. Classes which are eligible for repo transactions under Rules No. 510 of June 28, 2001 will continue to be eligible for repo transactions where applicable.
7. Securities shall normally be selected on the principle that they do not mature before the end of the period of the agreement.

If securities mature during the period of the agreement and the seller requests to have them returned to his custody, he shall present new eligible securities with an assessed value at least equal to that of the matured securities.

Completion of a repo transaction or the sale of 14-day Central Bank certificates of deposit shall take place on the day of auction. If the Central Bank has not received securities of which it is the buyer by 15:00 on that day, it may cancel the transaction.

When yields are determined on the basis of bids from credit institutions, the lowest yield accepted by the Central Bank shall apply in the case of repo purchases and the highest yield in the case of repo sales or sales of Central Bank certificates of deposit (the "Dutch auction" procedure).

On the basis of yields on accepted bids, the percentage prepaid interest rate shall be computed to two decimal points for use in interest rate calculations. If F is the prepaid interest rate, A the yield, d the number of days from the day of purchase to maturity inclusive, a circumflex (^) represents the power, an asterisk (*) multiplication and a slash (/) division, the following equation applies:

$$F = [1 - 1/(1+A/100)^{(d/360)}] * 36000/d$$

The Central Bank and presenters of accepted bids must make a separate agreement in each instance, stating among other things:

- a) A description of the securities used in transactions. This should include the name of the securities, date to maturity and initial and final trading price, cf. below. Final price refers to the repayment, i.e. the amount that the seller pays the buyer on the day of repayment. The initial price is the final price less prepaid interest. The final price is the market price of the securities discounted at a rate determined by the date to maturity of the securities. The discount (haircut) from market price will be:
- 2% for securities with a date to maturity of less than one year.
 - 5% for securities with a date to maturity of 1 to 5 years.
 - 7% for securities with a date to maturity exceeding 5 years.
- No haircut shall be applied when the Central Bank is the seller of the securities. Market price refers to the price in the last trade on Iceland Stock Exchange on the last trading day before the auction, irrespective of whether the Bank is the buyer or seller. If no such price is available, the lowest offer for the day shall apply.
- b) A provision entitling the buyer of the securities to sell them on his own account if their repurchase is not honoured on the final day of the facility.
- c) A provision that the securities may be in the custody of either the Central Bank or the seller, provided that the Central Bank agrees to their custody being supervised by an external auditor.

Article 4

Overnight loans

The Central Bank provides credit institutions with overnight loans against pledges which are to be applied for on a separate form. The same securities are eligible for overnight loans as those in repo agreements, cf. Article 3, paragraph 3. However, the amount of outstanding overnight loans shall never exceed ninety percent of the market value of the pledged securities under Article 3, paragraph 8. A request for an overnight loan shall be received by the Monetary Department before 17:15, and the pledge shall be finalised before 17:45, if the facility is to be made available the same day. On days when the Central Bank and DMBs close to the public at 12:00, applications for overnight loans shall be received by 11:30 and the pledge finalised by 12:00. Interest on overnight loans is prepaid. The term of the agreement is one day. If the Bank and DMBs are closed to the public on the due date, the term will be extended until the following business day. The Central Bank debits the borrower's current account at the Central Bank for the amount due on the overnight loan, provided there is an adequate balance to cover it at that time. If the balance is insufficient, the borrower is obliged to take the appropriate measures to secure repayment of the overnight loan. The Central Bank may also take custody of a sufficient amount of eligible securities as collateral for an overnight loan which has been taken, until full repayment of the loan has been secured. Pledges for an overnight loan which is validated for charging of interest on the day when the overdraft is deemed to have been formed, and for unnetted payment settlements, shall be in the custody of the Bank for a minimum of one day. Credit institutions which have access to overnight loans shall be notified in advance of the terms on them. The Central Bank may change the terms of overnight loans or restrict credit institutions' access to them without notice.

Article 5

Procedures

If the Bank and DMBs are closed to the public on the regular due date for debt service, this shall be moved to the following day. Loan agreements may provide for corresponding different durations of the interest period.

As a broad principle, in-payments into current accounts with the Central Bank shall not be validated for payment of interest on a different day from that on which they are made. Such validations shall only be made in order to correct discrepancies, i.e. in the event of an error in the entry by the Central Bank or to close a negative position which may have been formed on a DMB's current account with the Bank, cf. Article 1, paragraph 3 above.

The general interest rate rule for facilities with the Central Bank is actual days/360.

Article 6

Notification

Credit institutions may notify the Central Bank of the financial details covered in these Rules by fax, provided that it is signed by employees who have the authority to bind the relevant institution, cf. Article 39, item 7 of Act No. 113/1996 on Commercial Banks and Savings Banks, as amended, cf. also the lists of such employees together with their specimen signatures. The Central Bank insists that a credit institution shall confirm by secure means, e.g. by telephone, when a notification is sent by fax. The same rule applies to the Bank's notifications to credit institutions.

A credit institution which has not made a list of employees who have the authority to bind it, cf. the aforementioned Act on Commercial Banks and Savings Banks, shall specifically confirm to the Central Bank the signatures of the relevant employees.

Article 7.

Exclusion from facilities

The Central Bank may exclude a credit institution from further facilities in accordance with these Rules, without notice, if it fails to comply with their provisions.

Article 8

Entry into force, etc.

These Rules, which are set on the basis of Articles 6 and 7 of Act No. 36/2001, enter into force on July 1, 2002. At the same time Rules No. 115 from February 13, 2001, on Facilities with the Central Bank for Institutions Subject to Minimum Reserve Requirements, with amendment No. 161/2002, are abrogated.

Notwithstanding the provisions of paragraph 1, the provisions of Article 3 of these Rules, on the eligibility of securities as collateral for repurchase agreements and overnight loans, enter into force as of June 1, 2002.

Reykjavík, May 29, 2002

Central Bank of Iceland,

Birgir Ísleifur Gunnarsson

Eiríkur Guðnason

Finnur Ingólfsson