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From: ragnheidur.elfa.thorsteinsdottir@utn.stjr.is

Sent: Wednesday, November 30, 2005 3:48 PM

To: MARKT MORTGAGE-CONSULTATION

Subject: Remarks from the Government of Iceland on the Green Paper on Mortgage Credit in the EU

Please find enclosed remarks from the Government of Iceland on the Green Paper on Mortgage Credit in the EU.

Regards,

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Subject: Remarks from the Government of Iceland on the Green Paper on Mortgage Credit in the EU –COM(2005) 327 final.

With reference to the Green Paper on Mortgage Credit in the EU, Iceland appreciates being given this opportunity to give comments on the current document. Iceland is following with interest the development of the Green paper. In order to contribute to the discussion taking place, Iceland considers it appropriate to send a brief description of the main features of the Icelandic mortgage market. Further information will be provided if necessary.

Public policy in regard to the Icelandic housing market has been aimed at making private housing affordable to as big a proportion of the public as possible. This has resulted in a high percentage of privately owned housing and a comparatively small share of rented accommodation. Close to 70 percent of total Icelandic household debt is related to housing and therefore collateralized, and almost 90 percent consists of price-indexed loans. Taking into account pension fund assets, which are composed of a tax-financed public pension scheme, mandatory funded occupational pension

schemes and voluntary pension saving with tax incentives, the net worth of Icelandic households has increased and is broadly in line with the G-7 countries. Reflecting the large share of mortgages in household debt, owner-occupied dwellings remain the largest assets, or some 35 percent of total assets.

Iceland's economy was in the eighties characterised by high and fluctuating inflation. As a result lending to both owner-occupied and rented housing was partly index-linked from the mid 1970s, and since 1981 all this lending has been indexed. The system has worked well and is still in use although inflation has been moderate in recent years.

The Housing Act, No. 44/1998, as amended, describes the goals of the public housing policy in Article 1:

"The purpose of this Act is to promote, through the granting of loans and organisation of matters relating to housing, that Icelanders will enjoy security and equal rights as regards housing, and that funds are provided in the specific purpose of increasing people's chances of acquiring or renting housing on manageable terms."

The Housing Financing Fund (HFF) was created in 1999 on the basis of the Housing Act. The fund is owned by the State, it is exempt from corporate tax, it does not pay dividends to its owner, and its bonds carry a Government guarantee. The HFF is accountable to the Minister of Social Affairs but it is financially independent and subject to supervision by the Financial Supervisory Authority. All residents of Iceland, without regard to nationality, have a right to obtain a loan under the conditions defined in the Housing Act and regulations based on that Act. All terms and conditions regarding HFF lending apply equally to all applicants.

In July 2004, the HFF significantly reformed the way it finances mortgage lending. Individuals can now get cash mortgages at market yields, plus a stipulated interest margin of 60 basis points, financed by the issuance of HFF bonds directly to the international capital markets. HFF bonds are indexed annuity bonds, with installments twice a year, and with maturities of 10, 20, 30 and 40 years. They remain open until maturity, and are listed on ICEX and issued in Euroclear.

The Icelandic banking system's access to international capital markets has increased significantly in the last few years. In particular the three largest commercial banks, which are rated by international rating agencies, have started to expand their operations internationally. Through promotion and sales of Icelandic bonds to foreign investors, in partnership with other financial market players, the banks' access to international capital markets has improved significantly.

The increased international borrowing by commercial banks has, in turn,

increased their opportunities to enter the domestic mortgage market on competitive terms. Commercial banks started to offer housing financing services by the end of 2003. In the autumn of 2004, they started offering mortgages at better interest rates than had been available until then, at fixed real interest rates and with maturities of 25 or 40 years. The mortgages offered by the commercial banks are not confined to house purchases or construction, but can also be used toward refinancing previous mortgages or for mortgage equity withdrawal.

In addition to the commercial banks and the HFF, there are also some 24 savings bank, almost 40 pension funds, five investment banks, four investment funds, and two leasing companies currently operating in the Icelandic credit market.

The Icelandic secondary bond market consists of Government bonds and bills, HFF housing bonds and HFF-bonds, and other bonds and bills issued by other Government agencies, private firms and institutions, including banks. An active marketmaking program on the stock exchange now ensures sufficient liquidity for benchmark Government bonds and the various key housing bonds. The bond market is dominated by indexed bonds. Most issues with maturities exceeding five years are linked to the CPI.

The role of the HFF is currently under review, in light of the sharp increase in the market share of Icelandic commercial banks in the private housing financing market since 2004. Increased competition in the housing financing market has also stimulated a debate on whether there is a need for more regulation in the housing financing market to protect consumers. The green paper on Mortgage Credit in the EU is a welcome input into that debate.

Finally, the Icelandic Government will continue to take an active interest in the European Union's work on mortgage credit and is willing to share views and experiences with the Union. To this end, Iceland emphasises its willingness to participate in any upcoming debate and work on whether there is a need for EU intervention, in the housing finance market.

Yours sincerely,

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Chargé d'Affaires a.i.