REASONED OPINION

delivered in accordance with Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice concerning Iceland’s breach of Article 40 of the Agreement on the European Economic Area by maintaining in force a ban on the exchange rate indexation of loans in Icelandic króna
1 Introduction

According to Icelandic law, the exchange rate indexation of loans in Icelandic króna ("ISK") is prohibited. Following two complaints relating to the ban on exchange rate indexation of loans in ISK, the EFTA Surveillance Authority ("the Authority") has assessed the compatibility of these rules with Article 40 (free movement of capital) of the Agreement on the European Economic Area ("EEA").

2 Correspondence

In a letter dated 15 November 2010 (event no. 577289), the Authority informed the Icelandic Government that it had received a complaint against Iceland regarding an alleged breach of Article 40 of the EEA Agreement for maintaining in force a ban on exchange rate indexation of loans in ISK. In that letter, the Authority invited Iceland to provide further information regarding the case.

In an e-mail of 27 January 2011, the Icelandic Government asked for an extended time limit to reply to the above letter until 15 February 2011.

By letter of 1 February 2011 (event no. 585026), the Authority informed the Icelandic Government that it had received a new complaint concerning the ban on exchange rate indexation of loans in ISK. In that letter, the Authority invited Iceland to provide additional information regarding the case.

In an e-mail of 14 February 2011, the Icelandic Government asked for an extended time limit to submit the requested information. The Authority granted the requested extension of the time limit in an e-mail of 15 February 2011 (event no. 587292).

On 5 April 2011, the Icelandic Government stated that an answer would be forthcoming around mid May 2011. The case was discussed at the package meeting in Reykjavik on 7 June 2011.

The Icelandic Government finally replied to the above-mentioned letters in a letter dated 21 June 2011.

On 19 April 2012, the Authority issued a letter of formal notice to Iceland (event no. 585210) for failing to comply with its obligation under Article 40 EEA by maintaining in force a ban on the exchange rate indexation of loans in ISK.

The case was discussed at the package meeting in Reykjavik on 7 June 2012. At that meeting the representatives of the Icelandic Government asked for an extension of the time limit to submit observations in the case until 19 August 2012. The Authority granted the requested extension in a follow-up letter to the meeting, dated 5 July 2012 (event no. 638743).

Iceland replied to the letter of formal notice by letter of 17 August 2012.
3 Relevant national law

3.1 Act No 38/2001 on Interest and Price Indexation

Act No 38/2001 on Interest and Price Indexation (lög nr. 38/2001 um vexti og verðtryggingu ("Act No 38/2001")) applies to any kind of reimbursement for loans and price indexation of loans in Iceland.

Chapter VI of the Act (Articles 13-16) concerns the price indexation of savings and loans and applies to obligations concerning savings and loans in ISK according to Article 13 of the Act.

Article 13 of Act No 38/2001 reads as follows:

"The provisions of this Chapter shall apply to obligations concerning savings and loans in Icelandic krömur (ISK) where the debtor promises to pay money and it has been agreed or stipulated that the payments should be price-indexed. Price indexation as referred to in this Chapter shall mean changes in line with a domestic price index. Authorisation for price indexation shall be as provided for in Article 14 of this Act unless otherwise provided for by law.

Derivative agreements do not fall within the scope of this Chapter."

According to Article 14(1) of Act No 38/2001, savings and loans may be price indexed if the basis of the price indexation is the consumer price index as calculated by Statistics Iceland in accordance with the law applicable to the index and published monthly in the Legal Gazette.

Furthermore, it is stated in Article 14(2) of Act No 38/2001 that a loan agreement may be based on a share price index, domestic or foreign, or a collection of such indices which do not measure changes to general price levels.

Act No 38/2001 does not expressly refer to exchange rate indexation of loans in ISK. However, in the previous Act on Interest No 25/1987, the concept of "exchange rate indexation" was considered to be part of the concept of "price indexation". In the preparatory works to Act No 38/2001 it is stated that exchange rate indexation of loans shall not be permitted anymore.

In two rulings of 16 June 2010, the Supreme Court of Iceland confirmed that since Act No 38/2001 does not provide a legal basis for the granting of exchange rate indexed loans in ISK, the granting of such loans is not legal. Those two rulings concerned the granting of exchange rate indexed loans to two individuals. In its ruling of 14 February 2011, the Supreme Court of Iceland ruled that the prohibition of the granting of exchange rate indexed loans in ISK also applies to legal persons.

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1 Translation taken from the website of the Ministry of Economic Affairs (now the Ministry of Finance and Economic Affairs).
2 Supreme Court rulings No 92/2010 and No 153/2010.
3 Supreme Court ruling No 603/2010.
3.2 Act No 87/1992 on Foreign Exchange

On 28 November 2008, Iceland introduced currency controls by Act No 134/2008 amending the Foreign Exchange Act No 87/1992 (lög 134/2008 um breytingu á lögum nr. 87/1992 um gjaldeyrismál ("Act No 87/1992")). In conjunction with those amendments to Act No 87/1992, the Icelandic Government sent notifications dated 28 November 2008 to the EEA Joint Committee and the Standing Committee of the EFTA States according to the procedure permitted under Article 45(3) EEA and Article 1(2) of Protocol 2 of the Agreement on a Standing Committee. Act No 87/1992 has been amended several times since the currency controls were introduced by Act No 134/2008. The most recent notification of protective measures from Iceland to the Joint Committee is from 12 March 2013.

Article 13g of Act No 87/1992 concerns borrowing and lending. According to Article 13g(1) of the Act, the borrowing and lending between residents and non-residents for purposes other than cross-border trading in goods and services is, as a general rule, prohibited unless such borrowing and lending is between companies within the same group.

According to Article 13n of Act No 87/1992, several parties are exempted from some or all of the provisions of the Act. According to Article 13n(7) of the Act, commercial banks, savings banks and credit institutions operating under the supervision of the Financial Supervisory Authority, are authorized to engage in spot, forward, and swap transactions with foreign currency. Furthermore, such institutions are exempt from the provisions of Articles 13g, 13h and 13i of the Act. Consequently, commercial banks, savings banks and credit institutions operating under the supervision of the Icelandic Financial Supervisory Authority, are not subject to the general ban under Article 13g on the borrowing and lending between residents and non-residents.

4 Relevant EEA law

Article 40 EEA reads:

"Within the framework of the provisions of this Agreement, there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in EC Member States or EFTA States and no discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested. Annex XII contains the provisions necessary to implement this Article."

Article 1 of the Capital Movements Directive⁴ states that "Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States. To facilitate application of this Directive, capital movements shall be classified in accordance with the Nomenclature in Annex I." That non-exhaustive Nomenclature has, according to case law, an indicative value for the purposes of defining the notion of capital movements.⁵

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The opening words of the Nomenclature read as follows:

"In this Nomenclature, capital movements are classified according to the economic nature of the assets and liabilities they concern, denominated either in national currency or in foreign exchange."

The capital movements listed in this Nomenclature are taken to cover:

[...]

- operations to repay credits or loans.

According to the explanatory notes in Directive 88/361/EEC, financial loans and credits (listed in Sections VII and VIII of Annex I to the Nomenclature) include "Financing of every kind granted by financial institutions, including financing related to commercial transactions or to the provision of services in which no resident is participating." Furthermore, the category also includes "mortgage loans, consumer credit and financial leasing, as well as back-up facilities and other note-issuance facilities."

5 The Authority’s Assessment

5.1 Existence of a restriction on the free movement of capital

As a preliminary remark, the Authority notes that although there is a general ban in Article 13g of Act No 87/1992 on borrowing and lending between residents and non-residents, Icelandic financial institutions are not restricted in being granted loans from foreign undertakings since they are, according to Article 13n(7) of the Act, exempted from the ban in Article 13g of the Foreign Exchange Act. The currency controls do, therefore, not restrict Icelandic financial institutions in financing themselves in foreign currencies.

Turning to the issue of the existence of a restriction, the Court of Justice of the European Union ("The Court of Justice") and the EFTA Court have repeatedly held that national rules which are liable to impede the free movement of capital and to dissuade investors in other EEA States from exercising that freedom must be regarded as restrictions within the meaning of Article 63 TFEU/Article 40 EEA.6

In the complaints it is alleged that the ban on exchange rate indexation of loans in Iceland has the effect of making it less attractive for Icelandic financial institutions to finance themselves in other currencies than ISK. Such a restriction will, in turn, affect potential foreign lenders.

In Trummer and Mayer7 the Court of Justice concluded that the free movement of capital precluded the application of national rules that required a mortgage securing a debt payable in the currency of another Member State to be registered in the national currency. The Court of Justice emphasised that such rules would have the effect of weakening the

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link between the debt to be secured (payable in the currency of another Member State) and the mortgage. This rule would therefore reduce the attractiveness and effectiveness of such a security. As a consequence the rules are liable to dissuade parties from denominating a debt in the currency of another Member State and thus deprive them of a right which constitutes a component element of the free movement of capital. 8

With reference to Trummer and Mayer the Court of Justice, in Westdeutsche Landesbank Girozentrale, again confirmed that the provision on free movement of capital “was to be construed as precluding the application of national rules such as those at issue in the main proceedings, requiring a mortgage securing a debt payable in the currency of another Member State to be registered in the national currency”. 9

The transaction of granting and taking loans can fall under the scope of capital movements, regardless of whether the loan is denominated in the national currency or in a foreign currency. 10 An exchange rate indexed loan is not a loan granted in foreign currency but a loan granted in ISK. Such a loan is, however, indexed to the value of certain other foreign currencies. It was common in Iceland to grant exchange rate indexed loans in so-called “currency baskets” i.e. the loans were indexed to the value of certain foreign currencies such as USD, EUR, CHF and JPY. It varied between loan agreements which currencies were involved and the percentage of each currency in the “currency baskets” differed between agreements as well.

Although exchange rate indexed loans were granted in ISK, such loans were inevitably linked to the value of other currencies. In order to reflect the risk of granting such loans in ISK, Icelandic financial institutions would therefore probably seek to finance the loans in foreign currencies.

In its letter of formal notice from 19 April 2012, the Authority came to the conclusion that a total ban on the granting of exchange rate indexed loans in ISK, such as laid down in Act No 38/2001, will dissuade Icelandic financial institutions from financing their loans in other currencies than the national currency and therefore constitutes a restriction to the free movement of capital as provided for under Article 40 EEA. This was the Authority’s conclusion regardless of Iceland’s allegation that it was not aware of any providers of capital from other EEA States that had seen their capital movements hindered as a result of the ban on exchange rate indexation of loans in ISK. The Authority considers that this has no impact on the restrictive nature of the ban on exchange rate indexation of loans in ISK. It is settled case-law that there is no requirement to establish actual effects of a provision which has a potential restrictive effect on the fundamental freedoms. 11 Moreover, the fact that many of the agreements coming within the scope of the ban might lack the cross-border element necessary to trigger the application of Article 40 EEA is not relevant for the purposes of these infringement proceedings. It follows from the above that the restriction of the free movement of capital identified by the Authority concerns Icelandic financial institutions that are being dissuaded from financing their loans in other currencies than the national currency. Such a restriction will primarily affect the

8 C-222/97 Trummer and Mayer, cited above, paragraphs 26-28.
relationship between the Icelandic financial institutions and their (potential) lenders in other EEA States.

In its reply to the Authority’s letter of formal notice from 17 August 2012, Iceland maintains its position that the ban on the granting of exchange rate indexed loans in ISK will not dissuade Icelandic financial institutions from financing their loans in other currencies than the national currency thus constituting a restriction to the free movement of capital as provided for under Article 40 EEA. Iceland’s arguments in this regard can be divided into two: First, Iceland claims that the total ban on the granting of exchange rate indexed loans in ISK does not restrict the free movement of capital since there are no restrictions in force on the granting of loans in foreign currencies. Second, Iceland claims that there is not necessarily a direct link between the banks’ lending in certain currencies and their financing in the same currencies.

5.1.1 Foreign exchange loans

Iceland has explained that even though it is prohibited to grant exchange rate indexed loans in Iceland there are no statutory restrictions on the granting of loans in foreign currency. Therefore, Icelandic banks can offer such loan agreements to individuals and companies.

In its letter of 17 August 2012, Iceland refers to Trummer and Mayer\(^\text{12}\) and states that it disagrees with the Authority that this case is relevant for the assessment of the Icelandic ban due to the different facts and circumstances of the cases since foreign currency loans are lawful in Iceland while there was a total ban on the registration of mortgages in foreign currencies in Trummer and Mayer.

When preparing the reply to the letter of formal notice, the Icelandic Government requested information from the Central Bank of Iceland on whether the ban on granting exchange rate indexed loans in ISK affects the banks’ funding methods.

In its letter of 29 June 2012, the Central Bank of Iceland gives an overview of the nature of the loans that the Icelandic banks have granted. According to the information from the Central Bank, around 2/3 of the commercial banks’ loans in Iceland are to companies and 1/3 to private households. An insignificant share of household debt and about 55% of corporate debt is in foreign currency. As a result, some 35% of the commercial banks’ total loans are in foreign currency. In addition, Icelandic banks have also granted loans in foreign currencies to foreign companies and foreign subsidiaries of domestic companies.

5.1.2 The financing of exchange rate indexed loans

Apart from basing its position in the case on the assumption that there is no restriction on the free movement of capital because Iceland allows the granting of loans in foreign currencies, Iceland objects to the Authority’s conclusion that the Icelandic financial institutions would seek to finance the exchange rate indexed loans in the currencies that the loans were indexed to, in order to reflect the risk of granting such loans in ISK.

According to the explanations in Iceland’s letter of 17 August 2012, loans granted in certain currencies or indexed to the value of certain currencies are not necessarily financed in the same currencies. However, according to the explanations in Iceland’s letter, the risk

\(^{12}\) C-222/97 Trummer and Mayer, cited above.
of such loans is mitigated by the financing in foreign currencies even though it is not the same currencies.

In its letter Iceland states that "...in Iceland as in Norway, Austria, Cyprus and a number of other countries, financial supervisors have set rules governing the foreign exchange risk that financial undertakings are permitted to take on. These are referred to as foreign exchange balance rules. These rules place limits on the open position in foreign currencies; that is, they attempt to control the accumulation of foreign exchange risk on credit institutions' balance sheets. Icelandic financial undertakings sought out foreign credit and deposits abroad, primarily in pounds sterling, euros, and US dollars, and then lent that money to domestic borrowers via exchange rate-linked or foreign loans that were mainly in Japanese yen (JPY) and Swiss francs (CHF). To a large extent, the loans were not funded in the currencies in which they were disbursed. This however did not create an open foreign exchange position in the credit institutions' accounts...".

Iceland claims that the ban on granting exchange rate indexed loans does not dissuade Icelandic financial institutions from financing themselves in foreign currency since there exists no direct link between the granting of such loans and the financing in the relevant currencies. In this context Iceland explains that the exchange rate indexed loans were not necessarily funded in the same currencies as the loan agreements were indexed to. Most agreements concerned loans indexed to the value of JPY and CHF but the banks mainly financed themselves in GBP, EUR, and USD.

5.1.3 The Authority observations on Iceland’s reply

The Authority is of the opinion, that the arguments presented by Iceland do not alter its conclusion that the exchange indexation ban is a restriction under Article 40 EEA. In that respect the Authority refers to the arguments set out in Section 5.1 above. Furthermore, the Authority would like to note the following.

The Authority recalls, that in order to be in breach of the free movement of capital it is sufficient that the national measure has a potential effect on the free movement of capital. A ban on the granting of exchange rate indexed loans may have a potential effect on the banks when it comes to financing themselves in foreign currencies and the Authority fails to see that Iceland attempted to demonstrate that it was excluded that the index loan ban could have such a potential effect. The fact that the Icelandic banks might not necessarily have financed themselves in same currencies as the loans were indexed to does not detract from the finding that there exists at least a potential restrictive effect.

Moreover, in the view of the Authority a total ban such as the one at stake in this case can, in principle, not be regarded as having a too indirect or too uncertain effect on the free movement of capital to be classified as an obstacle to that freedom.

The fact that it is allowed to grant loans in foreign currency is, as such, not crucial for the assessment of whether it can constitute a restriction. In the view of the Authority, the fact that it may be possible for contracting parties to draft their agreements differently in order to evade the scope of the ban cannot remove the ban from the ambit of Article 40 EEA. Moreover, even though the granting of foreign currency loans has been a common practice in Iceland it is still the Authority’s position that it is not determinative for the assessment.

13 See e.g. E-1/00 State Debt Management Agency v Islandsbanki FBA, cited above, paragraph 28.
14 See e.g. C-577/10 Commission v Belgium [2012], not yet reported, paragraph 42.
of the restrictive nature of the ban on exchange rate indexation of loans. In this context the Authority also recalls that any restrictions on the fundamental freedoms, however minor they might be are prohibited unless they are justified.

In light of the above, the Authority maintains its conclusion that the ban on exchange rate indexation of loans in ISK constitutes a restriction to the free movement of capital as provided for in Article 40 EEA.

5.2 Justifications

In its letter dated 21 June 2011, the Icelandic Government argues that the objectives of protecting individual persons as well as the society in general against the risk presented by loans in ISK with indexation linked to foreign currency, are valid justifications for a restriction under Article 40 EEA. The prohibition of such loans is appropriate and necessary as there are no other measures that could effectively achieve the objectives sought. The Icelandic Government finally recalls the ruling of the Court of Justice in the *Alpine Investments* case where it was held that a prohibition of cold calling in the financial sector was justified and proportionate. In the opinion of the Icelandic Government, cold calling is minor compared to the risks that loans with indexation linked to foreign currency pose to individual persons and society.

National measures liable to hinder or make less attractive the exercise of the four fundamental freedoms may be in conformity with EEA law if they fulfil the conditions of being applied in a non-discriminatory manner, justified by imperative requirements in the general interest, suitable to attain the objective which they pursue and not going beyond what is necessary in order to attain the objective.

Contracts with exchange rate indexation of loans may involve risk for consumers, since consumers usually have their income in the national currency and are therefore not prepared to react to fluctuation in the value of other currencies. Furthermore, consumers might not have the ability to assess the risk involved in such contracts.

Therefore, the Authority does not contest that the aim of protecting consumers can serve as a justification ground when it comes to restrictions on offering certain high risk financial products to individuals. A total ban on the granting of such loans can, however, not be seen as a proportionate measure to protect that aim. Iceland could introduce other less restrictive measures to protect consumers from the risk that exchange rate indexed loans may involve. Such measures could include informing the consumers in an adequate and clear manner about the risks involved before contracting a loan with an exchange rate indexation, or possibly granting the consumers a right to retract, within a certain time period, from a signed loan contract.

In this context, the Authority wishes to point out that, in general, rules aiming at ensuring consumer protection relate to, *inter alia*, the advertising and marketing of credit products,

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15 See e.g. C-112/05 *Commission v Germany* [2007] ECR I-8995, paragraph 53.
adequate and transparent pre-contractual information about offers and related risks, as well as thorough creditworthiness assessments.\textsuperscript{19}

It should further be noticed that Article 14(2) of Act No 38/2001 provides that loan agreements may be indexed to both domestic and foreign stock price indices. The Court of Justice has held that “it must be recalled that national legislation is appropriate for ensuring attainment of the objective pursued only if it genuinely reflects a concern to attain it in a consistent and systematic manner”.\textsuperscript{20} The Icelandic Government has not presented the Authority with any information indicating that, given the possible fluctuations of such indices, allowing this type of indexation entails significantly less risks for consumers than exchange rate indexation. Therefore, the Authority considers that in any event the Icelandic legislation is inconsistent with regard to the pursuit of the objective of consumer protection.

The conclusion above, that the Icelandic legislation is not compatible with the principle of proportionality applies \textit{a fortiori} with regard to its application to legal persons. Contrary to the situation relating to consumers, legal persons have the necessary means and resources to be able to adequately assess any risks involved when considering contracting a loan with an exchange rate indexation.

FOR THESE REASONS,

THE EFTA SURVEILLANCE AUTHORITY,

pursuant to the first paragraph of Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, and after having given Iceland the opportunity of submitting its observations,

HEREBY DELIVERS THE FOLLOWING REASONED OPINION

that by maintaining in force a total ban on the granting of exchange rate indexed loans in ISK, Iceland has failed to fulfil its obligation arising from Article 40 of the Agreement on the European Economic Area.

Pursuant to the second paragraph of Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, the EFTA Surveillance Authority requires Iceland to take the measures necessary to comply with this reasoned opinion within \textit{two months} following notification thereof.

Done at Brussels, 22 May 2013
For the EFTA Surveillance Authority

\begin{flushright}
Sabine Monauni-Tomördy  
College Member
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Xavier Lewis  
Director
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\textsuperscript{20} Case C-169/07 Hartlauer [2009] ECR I-1721, paragraph 55. See also Case C-500/06 Corporación Dermoestéticas [2008] ECR I-5785, paragraph 39.