

Agreement between the Ministry of Finance and Central Bank of Iceland on Treasury debt management

1. Foundation of the Agreement

Under Article 1 of Act No. 43/1990 on the National Debt Management Agency, the National Debt Management Agency shall, on behalf of the Minister of Finance, handle domestic and international borrowing by the Treasury and State institutions, the issue and sale of Treasury bonds in the domestic market and other debt management for the Treasury as well as relending and State guarantees.

Article 9 of the same Act states that the Central Bank of Iceland may be contracted to manage implementation of foreign debt, State guarantees and relending, and other tasks assigned to the National Debt Management Agency, as deemed economical.

On the basis of the above authorisation in law, the Central Bank is assigned under this Agreement to manage implementation of domestic and foreign debt along with other functions specified in it.

2. Purpose of the Agreement

The purpose of this Agreement is to contribute to cost-effective and quality debt management for the Treasury on the basis of the Ministry of Finance's debt strategy. This entails minimising the central government's foreign and domestic interest and financial expense by seeking cost-effective sources of finance in Iceland and other countries for the Treasury. Exchange rate risk, interest rate risk and price risk on account of Treasury debt shall be spread as effectively as possible and the Treasury's risk reduced on account of guarantees and relending kept to a minimum.

3. Division of tasks between parties to the Agreement

Responsibility for management of central government debt is vested in the Ministry of Finance. The Ministry of Finance handles Treasury bond issuance, amortisation of central government borrowing and Treasury liquidity management. Furthermore, the Ministry sets references for the required yield on accepted bids in auctions of Treasury instruments and decides the structure of individual debt issues, their maturity and properties, buybacks and/or swaps and other matters covered in this Agreement.

The Central Bank of Iceland handles implementation of borrowing and debt management as the Ministry of Finance's agent and in accordance with procedures set by it.

The Central Bank is responsible for ensuring that borrowing and debt management are consistent with the strategy drawn up by the Ministry.

4. Functions covered by this Agreement:

The Central Bank of Iceland handles issuance of the Treasury's marketable securities in Iceland and internationally, builds up markets for Treasury instruments and

the Republic of Iceland's creditworthiness in international capital markets, and acts in an advisory capacity to the Ministry of Finance in relation to these tasks.

4.1. Management of domestic instruments

4.1.1. Supervision and implementation of auctions

The Central Bank prepares and undertakes auctions and buybacks of Treasury instrument auctions in accordance with the estimated government borrowing requirement. A representative of the Ministry of Finance is present at the opening of auctions and decides which bids are accepted in accordance with procedures. On behalf of the Ministry of Finance, the Central Bank announces the results of auctions to OMX and the media. The Central Bank also prepares prospectuses of Treasury benchmark issues and their listing on OMX and the Icelandic Securities Depository.

4.1.2. Buybacks and redemption of Treasury instruments

The Central Bank handles buybacks of Treasury instruments in accordance with plans made by the Ministry of Finance to expedite debt amortisation or to restructure issues. The Central Bank shall also redeem Treasury marketable securities in accordance with their terms.

4.1.3. Primary dealer agreements and repurchase agreements

The Central Bank makes agreements with market participants on issues of Treasury instruments and market making in the secondary market, subject to the approval of the Ministry of Finance. The purpose of these agreements is to strengthen Treasury access to credit and to enhance price formation for Treasury instruments in the secondary market. Furthermore, the Central Bank provides short-term facilities to primary dealers, secured with eligible collateral, in order to support market making. The Central Bank is responsible for implementation of these agreements. Expenses and fees in connection with primary dealer agreements are paid by the Ministry of Finance.

4.1.4. Settlement and accounting

The Central Bank handles settlement and documentation relating to the sale and redemption of Treasury instruments and securities lending arrangements. The material and form in which information is documented and delivered to the government accounting system shall be approved by the State Accounting Office.

4.1.5. Secondary market

The Central Bank shall seek to ensure that an active secondary market is in place for domestic Treasury instruments.

4.2. Management of foreign borrowing

4.2.1. Communication of information on the situation in international capital markets

The Central Bank monitors the situation in international capital markets and informs the Ministry of Finance on a regular basis.

4.2.2. Relations with rating agencies and foreign credit institutions

The Central Bank handles relations with international rating agencies. It also communicates information on the Icelandic economy to foreign credit institutions.

4.2.3. Foreign borrowing, swaps and short-term borrowing

The Central Bank manages foreign borrowing by the Treasury, its interest rate and currency swaps and maintenance of foreign short-term borrowing, along with other foreign borrowing by the Treasury in accordance with decisions made by the Ministry of Finance at any given time.

4.2.4. Accounting and amortisation

The Central Bank shall handle accounting and amortisation of the Treasury's foreign borrowing, in consultation with the State Accounting Office.

4.3. State guarantees and relending

The Central Bank administrates State guarantees and evaluates the risk that they entail to the Treasury. The Bank provides the Ministry with opinions on State guarantees, issues them in accordance with ministerial decisions and collects fees for them.

The Central Bank handles issuance of bonds for on-lending, while the State Accounting Office handles their disbursement and collection. The Central Bank monitors the development of individual guarantees and their total stock, and evaluates the risk they entail to the Treasury and the need to write them off. Furthermore, the Central Bank administrates redemption of claims on the Treasury on account of guarantees that it has undertaken, along with their collection.

State guarantees are governed by the provisions of Act No. 121/1997 on State Guarantees, cf. Regulation No. 237/1998 on State Guarantees, the State Guarantee Fund and Treasury Relending. Provisions include specification of fees for guarantees issued and handling charges.

The Central Bank maintains a register of guarantees issued on which the levying of guarantee fees is also based, and the Ministry of Finance grants the Central Bank access to the Treasury's credit accounting system for this purpose. Settlement of handling charges and guarantee fees is subject to State Accounting Office rules.

4.4. Communication of information

4.4.1. Communication to market participants

The Central Bank, on behalf of the Ministry of Finance, communicates information on the Treasury's domestic and foreign loan stock to market participants on a regular basis, and publishes information on auction days and planned volume of for the year on the basis of the government's estimated borrowing requirement. The Central Bank also handles communications with OMX and the Icelandic Securities Depository and issue press releases on planned auctions, their results and other matters concerning Treasury borrowing. All information shall be prepared by the Central Bank but published in the name of the Ministry of Finance.

Central Bank information involving Treasury debt management shall be published independently of other Central Bank publications or announcements.

The Central Bank shall hold regular meetings with market participants.

4.4.2. Communication of information to the Ministry of Finance

The Central Bank shall submit quarterly reports on the implementation of the Treasury's domestic and foreign borrowing in accordance with Treasury debt management benchmarks set by the Ministry of Finance. A more detailed report shall be submitted annually to the Ministry covering the main aspects of borrowing by the Treasury and by holders of Treasury guarantees.

At its discretion the Ministry of Finance may request other information and reports on the implementation of this Agreement.

4.4.3. Supervision and maintenance of website

The Central Bank shall supervise, maintain and update the website www.bonds.is.

4.5. Risk and liquidity management

The Central Bank of Iceland manages risks and liquidity in accordance with Treasury portfolio management benchmarks set by the Ministry of Finance. The benchmarks are based on minimising the Treasury's borrowing costs within an acceptable degree of exposure from its debt, guarantees and relending.

5. Contractual payments

For the service provided under this Agreement, the Ministry of Finance pays the Central Bank 75 m.kr. per year. One-twelfth of this sum shall be paid monthly against an invoice from the Central Bank and payment for a given month shall be rendered on the first business day of the following month, commencing on November 1, 2007.

The contractual amount shall be adjusted at the beginning of each year, commencing January 2009. Accordingly, 50% of the contractual amount (i.e. 37.5 m.kr.), shall be adjusted to reflect changes in the consumer price index from January to January (but in January 2009 based on changes in the consumer price index from September 2007

to January 2009) from an index base of 273.1, and 50% of the contractual amount (i.e. 37.5 m.kr.), shall be adjusted to reflect changes in the wage index from November to November (but in January 2009 based on changes in the wage index from July 2007 to November 2008) from an index base of 319.8.

Contractual payments cover all expenses on account of the project as specified in this Agreement, including salaries and payroll taxes, all facilities and necessary resources to provide the service, travel expenses, fees for access to information systems, and connection and membership fees for OMX and the Icelandic Securities Depository.

The Treasury pays the cost of primary dealer fees for market making and receives income from handling fees and issued repurchase agreements.

6. Consultative committee on debt management

The Minister of Finance appoints a consultative committee on Treasury debt management comprised of representatives of the Ministry and others nominated by the Central Bank of Iceland.

The committee shall serve as a forum for the exchange of views on the position of and outlook for capital markets, and on the Treasury's domestic and foreign borrowing and borrowing plans. The committee shall also promote reforms in the domestic credit market as it deems appropriate.

The committee presents proposals to the Ministry of Finance on the format and arrangements for individual bond issues and their maturity and volume, market making arrangements and auction arrangements. Furthermore, the committee proposes benchmarks for risk management of the Treasury's domestic and foreign debt portfolio. It discusses and passes proposals for Treasury issuance programmes in domestic and international markets and Treasury operations in credit markets. The programme specifies the volume of issuance for the year, issue dates and planned borrowing actions over the year. The plan shall be ratified by the Ministry of Finance and then announced to market participants.

Committee meetings shall be held quarterly or more frequently if deemed necessary.

7. Entry into force, duration, review and revocation

This Agreement enters into force as of October 2007 for an indefinite period. On signature of the Agreement, the agreement between the parties dated September 18, 2001, on specified tasks for the Treasury, ceases to apply.

Either party may request a review of the Agreement at any time over its duration. If such discussions result in consensus on amending this Agreement, the review process shall be expedited as far as possible.

The Agreement may be revoked by either party with six months' notice.

Reykjavík, September 4, 2007

Ministry of Finance

Central Bank of Iceland