BILL AMENDING THE HOUSING ACT, NO. 44/ 1998, AS LATER **Amended**

(Submitted to Parliament during the 130th legislative session, 2003-2004)

Article 1
Article 2 of the Act shall be amended as follows:
a. The definition of "General loans" shall be as follows: *General loans* shall be loans granted by the Housing Financing Fund for purchase, construction or renovation of residential housing against the delivery of a borrower's mortgage.
b. The definition of "Mortgage Instruments" shall be deleted.
c. The definition of "Housing Bonds" shall be replaced by the following: *Financing Bonds* shall be marketable debt instruments issued in the name of the Housing Financing Fund (HFF Bonds), or have been issued in the name of the State Housing Fund or the Workers' Housing Fund (housing bonds or residence bonds) in connection with their lending and financing.
d. The definition of "Residence Bonds" shall be replaced by the following: *HFF Bonds* shall be marketable debt instruments issued in the name of the Housing Financing Fund and sold by the Fund in the general market for financing its lending activities.
e: The following definition shall be inserted in the proper alphabetical order: *Borrowers' Mortgages* shall be debt instruments owned by the Housing Financing Fund, issued by the purchaser or owner of residential housing and secured by mortgage upon such housing.
f: In the definition of "Supplementary Loans", the words "subordinated to the mortgage instrument" shall be deleted.

Article 2
The words "Housing Financing Fund" in Article 4, the first sentence of the first paragraph, shall be followed by the words "which shall provide loans for purchase, construction and renovation of residential housing in Iceland".

Article 3
The words "trade in housing bonds" in Article 9, the first paragraph, of the Act shall be replaced by: "trade in debt instruments issued by the Fund".

Article 4
The following amendments shall be made to Article 10 of the Act:
a. Point 2 shall read as follows: "By issue and sale of HFF bonds and by borrowing as provided for in the Budget Act at any particular time."
b. Point 3 shall read as follows: "By service charges as provided for in Article 49."

Article 5
The following amendments shall be made to Article 11 of the Act:
a. The title of the Article shall be: *Management of Assets and Liabilities.*
b. The second paragraph shall read as follows: The board of the Housing Financing Fund may, having obtained the approval of the Minister for Social Affairs, conclude agreements with credit institutions on customer service and collection of loans or individual categories of loans.
c. The following two paragraphs shall be added to the Article:
The Housing Financing Fund shall keep its revenues and expenses in balance, and shall make advance plans in this regard. The Fund shall establish a risk management system for this purpose.
The Housing Financing Fund may conduct trade in its own financing bonds and other securities. Having obtained the opinion of the board of the Housing Financing Fund, the Minister shall, by Regulation, issue provisions on the Fund's risk management and its trade in securities.

Article 6
The words "this Act" in Article 15, point 1, shall be followed by: Renovation.

Article 7

Article 17 of the Act shall, with its title, read as follows:

Separation of Loan Categories

The Housing Financing Fund shall keep separate financial records for its various loan categories, and shall issue the classes of marketable property bonds in its name with the terms and conditions laid down in this Act or in an administrative Regulation.

Article 8

The title of Section VI of the Act shall be: **General Loans – HFF Bonds**

Article 9

Article 18 of the Act shall read as follows:

The conditions for approval by the Housing Financing Fund of an application for a loan shall be governed by reference standards issued by the Fund's board concerning the degree of security provided by real estate mortgages and each debtor's payment ability. The Fund may refuse to extend a loan if such conditions have not been fulfilled.

When a decision is taken on each loan application, an evaluation shall have taken place of the following:

1. The degree of security provided by the real property mortgaged for each particular debt.
2. The debtor's payment ability.

The board of the Housing Financing Fund shall, with the approval of the Minister for Social Affairs, conclude agreements with commercial banks or other entities for evaluation of the factors referred to in the first paragraph.

Article 10

Article 19 of the Act shall be amended as follows:

a. The title of the Article shall be: *Borrowers' Mortgages.*

b. The first paragraph shall read as follows: Loans extended by the Housing Financing Fund shall be paid out in cash. Before a loan is paid out, the borrower shall issue a borrower's mortgage instrument and have it officially recorded. Each borrower's mortgage shall be price-indexed by the consumer price index, cf. the Consumer Price Index Act, and shall bear interest as provided for in Article 21.

c. The words "Mortgage instruments and housing bonds may be exchanged for an amount of" shall be replaced by the words: "A loan extended against a borrower's mortgage instrument may amount".

d. The words "the mortgage instrument" in the second sentence of the second paragraph shall be replaced by: The borrowers' mortgage.

e. The words "the mortgage instruments that the Housing Bonds Department" in the third sentence of the second paragraph shall be replaced by: Borrowers' mortgages, which the Housing Financing Fund.

Article 11

Article 21 of the Act shall read as follows:

Subject to the provisions of Article 48, general loans shall be extended for a period of up to 40 years. By Regulation, the Minister shall specify the period of maturity of each class of loan in further detail.

Borrowers' mortgages shall bear interest and be price-indexed as from the date when the Housing Financing Fund approves the lending.

The board of the Housing Financing Fund shall determine the interest rate of borrowers' mortgages with a view to the costs of financing in regular issues of HFF bonds and financing costs due to loans paid up as referred to in Article 23, the second paragraph, plus interest addition as referred to in Article 28.

Interest rates shall remain unchanged throughout the entire loan period. Transfer of mortgages from one property to another shall be allowed. Provisions shall be issued by Regulation laying down when, and under what conditions, such transfer can take place.

12. gr.

Article 22 of the Act as later amended, and its title, shall read as follows:

HFF Bonds

HFF bonds shall be issued by the Housing Financing Fund.

HFF bonds shall be issued in electronic form, cf. the Act on Electronic Ownership Registration of Securities, No. 131/ 1997.

Article 13

Article 23 of the Act, and its title, shall read as follows:

Repayment of Loans

The Housing Financing Fund shall collect the instalments and interest payments on Borrowers' mortgages and use the monies thus collected to repay its financing bonds. The debtors of borrowers' mortgages shall be free to pay extra instalments on their debts or to pay their debts in full prior to maturity.

The Minister may, under special circumstances and having obtained the opinion of the board of the Housing Financing Fund, decide that extra instalments and full payment of borrowers' mortgages shall only be allowed against the payment of a fee designed to compensate for the difference between the prepayment value of a borrower's mortgage and the market value of a comparable HFF bond. A mentioning of this possibility shall be made in the terms of each borrower's mortgage.

Article 14

Article 24 of the Act, and its title, shall read as follows:

Payment Terms for Borrowers' Mortgages

Borrowers' mortgage instruments shall be issued in classes. The board of the Housing Financing Fund shall make proposals to the Minister of Social Affairs concerning interest rates, price indexation terms, repayment terms and maturity periods for each class.

Article 15

Article 25 of the Act, and its title, shall read as follows:

Financing bonds due for payment

Claims for repayment of principal and interest on financing bonds due for payment shall cease to be enforceable if not made within ten years from the due date. Financing bonds shall not bear interest and shall not be price-indexed after each due date**.** Financing bonds may be invalidated in accordance with the provisions of generally applicable legislation.

Article 16

Article 26 of the Act, and its title, shall read as follows:

Trade in Securities

HFF bonds shall be accessible for the securities market, for example at a securities exchange. The Housing Financing Fund may establish a primary dealer system for trade in HFF bonds.

Against security, the Housing Financing Fund may lend securities to a primary dealer in order to facilitate the formation of a market price.

Article 17

Article 27 of the Act, as later amended, shall read as follows:

The Financial Supervisory Authority shall control that the Housing Financing Fund conducts its activities, in particular as regards issues of HFF bonds and the Fund's financial status, in conformity with the provisions of this Act and any Regulations issued on its basis. This shall be governed by the Act on Official Supervision of Financial Services, as applicable.

In addition to the control exercised according to the first paragraph, the Financial Supervisory Authority shall exercise control of trade in financing bonds in the secondary market on the basis of the Securities Trading Act and the Securities Funds Act.

Article 18

Article 28 of the Act shall read as follows:
The Housing Financing Fund may claim an interest addition to cover its operating expenses, estimated losses of outstanding loans, and its interest risk. The Minister for Social Affairs, having obtained the proposals of the board of the Housing Financing Fund, shall determine the level of this interest addition.

Article 19

Article 29 of the Act shall read as follows:
The Minister for Social Affairs may, by Regulation, issue provisions in further detail on lending by the Housing Financing Fund, trading methods and arrangements, and the issue of HFF bonds.

Article 20

The words "mortgage instruments" in Article 31, the seventh paragraph, shall be replaced by: Borrowers' mortgages.

Article 21

...

Article 22

Entry into Effect, and Conflict of Laws

Subject to Temporary Provision I, this Act shall enter into effect 1 July 2004.

Temporary Provisions

I

In the period from 1st July 2004 to 15th September 2004, the Housing Financing Fund shall exchange mortgage instruments exchangeable for housing bonds of Classes 1 and 2 2001, for ready money. The owner shall receive the nominal value of each instrument, plus accrued interest and price adjustments, less the lending fee. All loans within the housing bond system that have not been finally paid out prior to 1 July 2004 shall be handled as provided for in Part VI of the Act.
Notwithstanding the provisions of Article 22, the Housing Financing Fund may commence the issue and sale of HFF bonds 15th April 2004. As from that date, the Housing Financing Fund may invite the owners of housing bonds and residence bonds to exchange them for HFF bonds. The Board of the Housing Financing Fund shall lay down the terms of such exchange and announce this on a suitable notice.

II

The Housing Financing Fund shall take over all rights and duties of the Housing Bonds Department provided for in laws and regulations. Mortgage instruments that could be exchanged for housing bonds shall, subject however to the first paragraph of Temporary Provision I, retain their validity.
The validity of the housing and residence bonds issued previously in the name of the Housing Financing Fund, the State Housing Fund, or the Workers' Housing Fund on account of their lending and financing activities, shall remain unaltered. The terms of any bonds already issued shall remain in effect until the end of the loan period. The same shall apply to the various classes of housing bonds.
The Housing Financing Fund may convert housing bonds of older classes issued in paper form to electronic form, in accordance with the Act on Electronic Registration of Securities, No. 131/1997.

III.

The Housing Financing Fund shall collect instalments and interest on purchased mortgage instruments that have been exchanged for housing bonds, and use the monies thus collected for repayment of housing bonds as determined by lot, or for relending.
Debtors of mortgage instruments exchanged for housing bonds may pay extra instalments on their debts or pay them up in full prior to maturity. In order to provide for an even cash flow following such repayments, issued housing bonds may be redeemed by lot, cf. the first paragraph, or purchased on the market when repurchase offers are made to the public. The Housing Financing Fund may remove from its accounts the housing bonds that may come into its ownership.
Drawing of housing bonds shall be supervised by the Sheriff. As regards electronically registered housing bonds, repayment within the relevant class shall be made in even proportion.

Explanatory Notes accompanying this Bill

The purpose of the Housing Act, No. 44/ 1988, is to promote, by extension of loans and by organisational means, security and equality among the population as regards housing, and to promote appropriation of funds in order to increase for the public the possibility of owning or renting residential housing on manageable terms.

The Government's Policy Declaration of 23 May 2003 states that reorganisation within the housing market will be continued in conformity with the aims concerning the Housing Financing Fund. The credit proportion of general housing loans would be progressively increased during the election term to up to 90% of a property's value, subject to a certain maximum. Jointly with this increase it was also deemed necessary to make some amendments to the issue of securities by the Housing Financing Fund, which would be conducive to strengthen their price formation in the general market. Following the laying down of this policy the Minister for Social Affairs instituted an executive and consultative group to supervise this work. The group decided to wait for the conclusions of a committee appointed by the Minister for Finance 28th March 2001 for examining the formal and organisational aspects of the Housing Financing Fund's issue of securities for the purpose of augmenting their market status still further. The Committee submitted its proposals in October 2003, and its conclusions are attached in an Attachment to this Bill. The Minister for Social Affairs subsequently introduced to the Government, on 31st December 2003, the plans for reorganisation of the Housing Financing Fund's issue of securities, which are elaborated in further detail in this Bill.

The Committee on reorganisation of the Housing Financing Fund's issues of securities was in its time charged with examining the co-ordination of securities issues by the HFF and the State Treasury to provide for a reasonable temporal continuity as regards accrual of interest, taking into account instruments with as well as without price adjustment provisions. The Committee was also to make proposals on reorganisation of older classes of housing bonds and residence bonds, and to examine the possibilities for issues in a form different from that used until now, for example by the issue of a single type of security instead of two types, and by discontinuing the arrangement of drawing housing bonds by lot. It was necessary to ensure that any such changes would affect cash flow within the housing credit system to the least possible extent. The Committee was also to examine the possibilities of the State Treasury's withdrawal from the price-indexed market, concentrating instead on issues of securities not price-indexed.

The Committee states in its report that government bonds and government guaranteed bonds constitute the basis of price formation for securities in most countries with developed capital markets. The risk of lending to governments is generally regarded as negligible, and, in addition, state treasuries are generally capable of maintaining securities classes of adequate volumes and of ensuring adequate turnover. It is important that securities are, as regards formal and organisational aspects, suited to fulfil these roles in the most feasible manner. The State Treasury has reorganised its securities issues and sales organisation in order to promote price formation.

The HFF's securities issues are of considerable scope, and guaranteed by the Government, which should, other things being equal, result in similar market terms. This has however not happened, for reasons stated as including that housing bond terms cause an uncertainty in the market on account of the drawing arrangement and the possibility of extra draws, and that the classes of securities were for a considerable time many in number and small in volume. Since 1996 the HFF has, however, issued large benchmark issues of securities, which have attained a certain market status. The arrangement governing repayment of housing bonds is explained by certain historical facts and was, in its time, reasonable in the light of the circumstances, but these premises have now been altered for reasons including changes in the market environment and the introduction of electronic securities registration.

The Purposes of this Bill

The purposes of the Bill now submitted are to provide for the population, through the HFF, more economical housing loans by means of less expensive financing in the general credit market. This objective is to be attained by a reorganisation of the HFF's securities issues, thus making financing more cost-effective, trimming off the chief defects of the present issue arrangement and creating a basis for a reliable price formation in the primary and secondary markets for HFF bonds

These amendments are designed to improve the situation of the Fund's debtors, both by a reduction in financing costs and by reducing the risks that real property transactions involve. The housing bond system is a complicated one, as exemplified by the arrangement involving exchanges of debt instruments and the price calculations when mortgage instruments are exchanged for housing bonds. Assignment of mortgage instruments has also created problems, as evidenced by recent examples. Housing bond discounts have been determined by the return requirements of investors. Such discounts have given rise to considerable risks in real property transactions, which have been borne by the purchasers. With the change to the system proposed in this Bill involving the granting of housing loans in cash, it is expected that the effects of discounts when selling securities will be eliminated in the forms experienced until now. As proposed, the loans will be extended in cash, bearing interest in accordance with the return demand made at each particular time.

The Bill aims to increase the saleability of HFF bonds in the securities market, which is likely to result in a reduction of the return demands made by investors. If this happens, the HFF will be able to reduce the interest rate of its loans to the borrowers. It may therefore be expected that the changes will reduce the borrowers' financing costs and the HFF's management costs. The new arrangement of securities issues by the HFF should also be suited to facilitate the planned increase of the credit proportion to 90%.

A Single Type of Security

It is proposed in the Bill that the HHF will, instead of issuing securities of two types as done until now, i.e. housing bonds and residence bonds, only issue a single type of security. In conformity with the committee report it is proposed that the bonds issued will be referred to as HFF bonds, thus referring to the purpose of their issue as well as to their issuer.

The Form and Issue of HFF Bonds

It is proposed that HFF bonds will be price-indexed and payable in the form of annuities in four instalments each year. Payment in the form of annuities is known all over the world for debt instruments, and should therefore be compatible with all systems in use today for trade in securities. The plan is to issue HFF bonds in classes that are few in number and remain open throughout their lifetime, thus being of large volume and marketable internationally. A single fund is to carry unlimited liability for the HFF bonds, but financing of the different loan categories will be segregated in its accounts.

Borrowers' Mortgages

In preparing this Bill, the new term Borrower's Mortgage was selected in place of the term "mortgage instrument exchangeable for housing bonds" following consultation with the HFF and representatives of the Association of Real Estate Brokers, and the definition was also changed. It seems necessary to adopt a new name, borrower's mortgage, as a means of making a distinction from mortgage instruments exchangeable for housing bonds issued by the HFF. This is in order to avoid confusion between these two kinds of securities.

Reorganisation of former issues

In order to reorganise former issues by the HFF and to make HFF bonds marketable sooner, the owners of housing bonds and residence bonds will be invited to exchange them for HFF bonds. It is also proposed that the exchanges of housing bonds and residence bonds for HFF bonds will take place by means of public exchange offers. This would be done on the basis of market terms, taking the issuer's risks into account. It is proposed that the further details of such public exchange offers, such as timing, number, frequency, and the selection of the housing and residence bond classes each such offer is to relate to, will be determined in consultation with the participants in the market and the foreign investment bank whose assistance the HFF will solicit for carrying out the bond exchanges.

Market Making and Sale of Property Bonds

It is proposed that for property bonds a primary dealer system will be instituted, involving a purchase commitment when the new classes of securities are first offered for sale, and market making. It is proposed that the HFF will be authorised to grant securities loans to the primary dealer in order to facilitate market making. It is expected that the HFF bonds will be registered in a foreign clearing house, if possible, or that their suitability for registration will be ensured by other means.

Changes to Lending by the HFF

In place of the HFF delivering the borrowers market securities against their delivery of a mortgage instrument as now practiced within the housing bond system, HFF bonds would be offered for sale in the market, the borrowers receiving the proceeds from the borrowers' mortgages (the mortgage instruments) in cash.

The credit terms would be determined with a view to the HFF's total financing costs. This refers to, on the one hand, interest terms determined by the outcome of public offers for sale of HFF bonds, and, on the other, the terms for financing payment of the loans received by the HFF. The determination of interest rates will be based on the weighted average of these two factors, taking into account the Fund's benefits from efficient risk management. On this the Fund would impose an addition, such as now practiced when the HFF extends loans in cash and sells housing bonds. Thus, it is envisaged by this new arrangement that interest on the loans extended by the HFF will be determined following each public offer, and that interest will consequently differ from one period to another.

Risk Management

According to the Bill, the HFF is not empowered to redeem property bonds as its own debts are paid up, which is an aspect of the policy to make the property bonds more marketable. The committee on reorganisation of the HFF's securities issues proposed a reaction to this difficulty by imposing on a debtor who exercised his right of prepayment the duty to pay in full the interest difference ensuing from his payment of the entire loan prior to final maturity. This involves however various disadvantages; it places purchasers of residential housing in a difficult situation, it may cause the mortgages resting upon a real property to impede its sale, and it is conducive to weaken the competitive position of banks as regards lending for purchase of real property. The Bill therefore envisages that as a general rule, the HFF's general determination of interest rate will be made with a view to the effects of prepayments on its financing costs. This means that interest will be determined as a weighted average of the public offer interest rates and the interest rates of paid-up loans, plus the Fund's own interest addition. Thus, the costs due to prepaid loans will be distributed over new loans.

This method is seen as the one to be generally applicable; however, it is deemed necessary to provide for the Fund's possibilities to refuse prepayments unless a fee is paid to compensate for the difference between the prepayment value of a borrower's mortgage and the market terms applicable to comparable HFF bonds, under unforeseen circumstances when prepayments might threaten the Fund's position. This possibility would only be exercised as an emergency measure when other measures to defend the Fund's equity position do not suffice. It is envisaged that the Minister's involvement would be necessary. In such a situation the right of a borrower to make prepayments of mortgages will be restricted, allowing prepayment of a borrower's mortgage (mortgage instrument) only against the payment of a fee that could become equal to the difference between the market value of a comparable HFF bond and the mortgage (refer further to Article 13 of the Bill and the Notes to that Article).

It is also necessary for the HFF to be authorised to conduct securities transactions and to employ the traditional methods of risk management with a view to risk distribution.

Risk Assessment
The proposals now made affect to some degree the balance that has been maintained in the HFF's lending and borrowing cash flows. Issues of some classes of different periods for financing loans of other periods will increase the Fund's interest risks, and it therefore proposed that in order to meet this risk, a particular interest addition will be imposed on the interest rate payable by the borrower. This addition would have to be reassessed regularly with a view to planned issues, lending plans, and other risks faced by the Fund.

Conflict of Laws
In the housing bond system now in effect, applicants can, in cases of new constructions, defer acceptance for up to five years. This Bill proposes that a separation will be effected between the housing bond system and the new credit system by not paying out any housing bonds as from when the new system enters into effect. Instead, the HFF will purchase the mortgage instruments the exchange of which for housing bonds has been approved, and pay for them in cash. It is therefore proposed that from 1st July 2004 to 15th September 2004, the HFF will only exchange for cash mortgage instruments exchangeable for housing bonds of classes 1 or 2 of the year 2001. Those housing bond classes will be closed 15th September 2004. Until that date, the creditor receives the nominal value of the instrument plus accrued interest and price adjustments, less the lending fee. All loans within the housing bond system not finally paid out prior to 1 July 2004 will therefore be handled according to the new system.
It is also proposed that the HFF will be empowered to issue and sell HFF bonds for some time before lending according to the new Act commences, in order to provide for the financing of its loans. It is proposed that this will be allowed as from 15th April 2004. In this way, the bonds will be in general circulation and will have formed an independent market price before financing of loans commences. In order to provide for increased marketability of the property bonds the board of the HFF will be authorised to invite the owners of housing bonds and residence bonds to exchange them for property bonds, thus increasing the volume of the property bond classes. This authorisation will also be in effect as from 15th April 2004.

Notes to the Individual Articles of the Bill

On Article 1

The Article proposes changes to the substance of the definitions of general loans and supplementary loans. Mortgage instruments are replaced by borrowers' mortgages, and the wording of the definition is changed. It was deemed necessary to adopt a new name in order to make a distinction from the mortgage instruments issued by the HFF that are exchangeable for housing bonds. Definitions of the terms housing bonds and residence bonds are deleted. Definitions of HFF bonds and financing bonds are added. It is also proposed that a provision to the effect that a supplementary loan shall be immediately subordinated to the mortgage instrument will be deleted, as this is actually not demanded in practice.

On Article 2

The Article is amended to prevent any doubt that the lending activities of the HFF are limited to residential housing in Iceland.

On Article 3

No explanations are needed to this Article.

On Article 4

It is proposed that points 2 and 3 of the Article, relating to the HFF's financing by means of the sale of housing bonds and residence bonds, will be abolished, to be replaced by a new point relating to the issue of HFF bonds. It is also considered reasonable to add service charges to this enumeration, the determination of which is governed by Article 49 of the Act.

On Article 5

It is proposed that the provision on the HFF's duty to conclude agreements with credit institutions on customer service and collection of loans will be abolished. This would be replaced by a provision enabling it to do so, which is in better conformity with current practice.
The Article provides for a duty on the part of the HFF to institute a risk management system, and the Fund is enabled, in conformity with current views relating to risk management, to conduct securities transactions for limiting its risks.

On Article 6

It is proposed that the word "renovation" be inserted in point 1 of the first paragraph. This is in conformity with current practice, cf. the Regulation on Housing Bonds and Trade in Housing Bonds.

On Article 7

It is proposed that the provisions on a separate Housing Bonds Department be abolished. This is replaced by a provision on segregation of loan classes in the HFF's records. Points 2 and 3 of the Article concerning exchanges of housing bonds and mortgage instruments and the sale of housing bonds in the market are abolished.

On Article 8

It is proposed that the title of Part VI will be changed on account of the introduction of HFF bonds.

On Article 9

It is proposed that the reference to the Housing Bonds Department will be replaced by the Housing Financing Fund, and that the provision on housing bonds exchangeable for mortgage instruments be deleted.

On Article 10

It is proposed in the first paragraph that a provision be enacted to the effect that borrowers' mortgages shall be paid out in cash, this being the designation given the new type of mortgage, cf. the notes to Article 1. These will replace the mortgage instruments exchangeable for housing bonds.

On Article 11

This Article places the first day of interest and the basic index of the loan as close as possible to the date when the HFF approves the lending. As the first day of interest must be known before a borrower's mortgage is officially recorded, this is determined as the date of approval, it being expected that the borrower's mortgage instrument will be ready for delivery to the borrower in the same day.

The third paragraph provides how the board of the HFF is to lay down the interest rate of extended loans. The principal rule is that such interest will be determined with a view to the fund's costs of financing, composed of the one hand of the outcome of public offers of HFF bonds, and on the other of the interest terms of paid-up housing loans. In this way a significant interest difference between financing costs and the interest on extended loans will be distributed over new loans, preventing danger to the Fund.

The fifth paragraph adds a clear provision allowing transfer of mortgages. This is also permitted in the Regulation on Housing Bonds and Trade in Housing Bonds now in effect.

On Article 12

As issues of housing bonds will be discontinued, it is proposed that the provisions on draws and extra draws will be moved to the Temporary Provisions. In other respects this Article concerns the form of property bonds and their issue as electronic securities.

On Article 13

In the new system, the Fund is not empowered to redeem housing bonds as its own debts are paid up. The general rule that borrowers may pay up their debts without any particular charge will remain in effect. The risk this involves for the Fund will be reflected in its interest rate determinations according to Article 21, the third paragraph, and in its interest addition according to Article 28. The fund will also manage its finances actively in order to minimise the risks this may present.

It is nevertheless necessary, for safety's sake, to provide for the Fund's possibilities to refuse prepayments unless a fee is paid to compensate, partially or totally, for the difference between the prepayment value of a borrower's mortgage and the market value of comparable HFF bonds. It is expected that this authorisation will only be exercised when prepayments, as a result of unforeseen circumstances, increase to the extent of threatening the Fund's position. This possibility would only be exercised as an emergency measure, when traditional risk management methods and the Fund's scope for determination of interest rates do not suffice to protect it. It is expected that such an action would require the Minister's involvement.

On Article 14

It is proposed that the classes of HFF bonds will remain open throughout the loan period, and consequently that the present provision to the effect that a proposal must be made for the total amount of each class will be abolished. It is also proposed that the duty of the Central Bank to provide its opinion will be abolished, as such provision of counsel does not harmonise with its role as defined in the Central Bank Act.

On Article 15

It is proposed that the Article be amended to apply to HFF bonds, housing bonds and residence bonds.

On Article 16

It is proposed that the HFF will be enabled to register HFF bonds at a securities exchange, but no longer having the duty to do so, as imposed by the law now in effect. The securities exchange in question will decide what securities are registered there, and will issue minimum requirements in this regard. As mortgage instruments will no longer be exchanged for housing bonds, an amendment must be made to the second paragraph. A provision is added authorising the HFF to establish a primary dealer system and to grant securities loans to primary dealers for promoting the formation of a market price, thus facilitating market making. A primary dealer system for HFF bonds would involve a purchasing duty on the part of the primary dealer when new classes are first offered for sale, and market making, and the primary dealers would also be the only parties that could make offers to purchase HFF bonds when they are first sold. Securities loans to primary dealers would take place by the HFF being allowed to lend them HFF bonds of a particular class, the primary dealer securing their payment by pledging HFF bonds of another class. Thus this arrangement does not bring about an increase in issues of HFF bonds, but ensures that they can always be offered with a view to market demand, thus promoting a reasonable volume of trade and the formation of a market price.

On Article 17

It is proposed that the control exercised by the Financial Supervisory Authority as provided for in the first and second paragraphs be expanded to cover the activities of the HFF in their entirety, in particular as regards issues of marketable debt instruments, instead of being limited to the Housing Bond Department as until now. It is also proposed that the provision of Article 27, the third paragraph, of the Act as now in effect, concerning the role of the Central Bank of Iceland as regards secondary market trading in housing bonds, will be abolished. This amendment is in conformity with the proposals of the Committee on reorganisation of the HFF's securities issues, referred to above.

On Article 18

It is proposed that in determining an interest addition, account may be taken of the Fund's interest risks. This amendment is in conformity with the proposals of the Committee on reorganisation of the HFF's securities issues. This provides for the Fund a greater freedom of reaction to risks due to prepayments, for lessening the likelihood of having to demand a fee from the borrowers on account of prepayments as permitted in Article 13 of the Bill.

On Article 19

No explanations are needed to this Article.

On Article 20

No explanations are needed to this Article.

On Article 21

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On Article 22

No explanations are needed to this Article.

On the Temporary Provisions

Temporary Provision I provides for a separation between the housing bond system and the new credit system, stopping the paying out of housing bonds as from the date the new system takes effect. For this reason it is necessary to permit the HFF to purchase the mortgage instruments the exchange of which for housing bonds has been approved, and to pay for them in cash. In the housing bond system now in effect, applicants are allowed to accept final service in up to five years time in cases of new constructions. Therefore, in order to forestall uncertainty among prospective borrowers, it is necessary to provide for the manner in which those persons may have their applications finally decided on when housing bonds service is no longer provided.

As regards the substance of the second paragraph, it is deemed necessary to permit the HFF to issue and sell HFF bonds for some time before lending is commenced under the new system, in order to secure financing of its loans. In this way the instruments will have been placed in circulation and have started to form an independent market price before financing of the loans is commenced. For increasing the marketability of the HFF bonds, the board of the HFF is permitted to offer the owners of housing bonds and residence bonds an exchange of those bonds for HFF bonds, thus increasing the volume of the HFF bond classes. This authorisation will be effective as from the time when the Fund is expected to be able commence its issues of property bonds. This promotes an increase in the volume of the property bond classes, bringing about an increase in trade and a more definite interest formation in the market.

It is assumed in Temporary Provision II that housing bonds will remain marketable debt instruments and fully valid negotiable documents until paid up in full or exchanged for HFF bonds. It is necessary to provide in a temporary provision that the HFF overtakes the rights and duties of the Housing Bonds Department, as that department will no longer exist. The HFF's rights and duties on account of issued housing bonds will remain unaltered. It is also proposed that the Fund's permission to convert older classes of housing bonds to electronic form will remain in effect.

It is envisaged in Temporary Provision III that mortgage instruments exchanged for housing bonds will continue to be collected in the same way as until now. It is also envisaged that as a general rule, repayment of housing bonds will continue unaltered, both as regards regular draws and the permission for extra draws in cases of imbalance in the HFF's cash flow, and that the HFF will be allowed to use prepayments for relending. In the second paragraph the HFF is permitted to remove from its accounts any housing bonds it may acquire, whether acquisition takes place by redemption or by purchase. The HFF has until now had to enter as assets any housing bonds purchased when public repurchase offers are made, and to remove them when those bonds are drawn; however, in light of the fact that the Fund is not expected to place those bonds on the general market again, it is reasonable to permit it not to make such entries to assets and to remove them instead from the debit side of its balance sheet.