



FUNDARGERÐ

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Minutes of the Financial Stability Committee meeting

February 2024 (20th meeting)

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The Financial Stability Committee (FSN) of the Central Bank of Iceland takes decisions on the application of the Bank's financial stability policy instruments. Financial stability means that the financial system is equipped to withstand shocks to the economy and financial markets, to mediate credit and payments, and to diversify risks appropriately. The Committee is tasked with assessing the current situation and outlook for the financial system, systemic risk, and financial stability; defining the measures necessary to ensure financial stability; and deciding which entities, infrastructure components, or markets shall be considered systemically important. When warranted, the FSN may make recommendations to the appropriate Governmental authorities concerning the measures needed to strengthen and preserve financial stability. In general, the Committee publishes the minutes of its meetings within four weeks of the meeting concerned. The minutes include information on the Committee's decisions, the rationale on which they are based, and its assessment of financial stability.

At its meeting on 21 February 2024, the Committee discussed the extraordinary circumstances prevailing in the town of Grindavík, as residency in the town was prohibited due to the ongoing volcanic activity in the area. The Committee was given a presentation on the size of the residential community in Grindavík, the potential impact of Government support measures on the housing market in general, and the possible attendant systemic risk.

Financial Stability Committee decisions

Borrower-based measures

The meeting began with a presentation given to the Committee on a bill of legislation on the purchase by the Government of residential housing in Grindavík. The main aim of the bill is to protect Grindavík residents' financial position and welfare by giving residents the option of selling their homes for 95% of the fire insurance value to a State-owned asset management company. These actions were taken in light of the declaration of a state of emergency in Grindavík by Iceland's Civil Protection Department during the run-up to the 10 November 2023 eruption and its decision that the town be evacuated. As a result, Grindavík residents had to leave their homes at short notice, and it is highly uncertain whether the town will be inhabitable in the near future. Furthermore, commercial activities had by and large been discontinued in the town, with the result that many residents had suffered a substantial loss of income and were dependent on Government support.

It emerged that most of the roughly 1,200 households in Grindavík had loan-to-value ratios between 35% and 45%. Loans issued to Grindavík residents by the banks and the pension funds comprised a very small share of their loan portfolio, or 0.9% of the total portfolio. It is expected that most Grindavík residents will choose to settle in near-lying communities, boosting demand for housing on the Reykjanes peninsula and pushing prices higher.

In view of these extraordinary circumstances, the FSN considered it appropriate to grant owners of property in Grindavík increased scope within the current borrower-based measures for the purchase of new homes. According to current rules on debt service burdens, lenders also had some latitude to respond to

extraordinary circumstances; i.e., that 5% of issued mortgage loans could exceed the maximum debt service-to-income ratio. Because of the highly unusual circumstances in Grindavík and the temporary income losses suffered by the town's residents, the Committee considered it appropriate to give lenders additional scope to assist households with a legal address in Grindavík as of November 2023, by granting them a special exemption. Furthermore, it was also important to ensure that Grindavík residents had the opportunity to acquire comparable housing, even in communities where property prices were higher than in Grindavík. In view of this, it was deemed appropriate to expand the rules on loan-to-value ratios.

The Committee was of the view that the extraordinary circumstances prevailing in Grindavík – i.e., the temporary loss of income and the permanent loss of housing – created conditions beyond the scope of borrower-based measures, the goal of which was to safeguard borrowers' resilience. These borrowers' situation was in many respects comparable to that of first-time buyers, and borrower-based measures for Grindavík residents should therefore reflect those applying to first-time buyers.

FSN members were of the view that providing such increased scope for Grindavík residents was unlikely to have a discernible impact on lenders' resilience and therefore should not materially affect financial stability.

Following the discussion, the Governor proposed that, for individuals who owned residential property in Grindavík on 10 November 2023, the maximum debt service-to-income (DSTI) ratio be set at 40% and the maximum loan-to-value (LTV) ratio at 85% in connection with their next home purchase. All Committee members voted in favour of the Governor's proposal and approved a temporary provision to this effect, which would be added to the relevant rules on borrower-based measures, with an expiry date of 1 March 2027.

At the end of the meeting, the Committee approved a statement for publication on the morning of 16 February 2024.

The following Committee members were in attendance:

Ásgeir Jónsson, Governor and Chair of the Committee

Gunnar Jakobsson, Deputy Governor for Financial Stability

Rannveig Sigurdardóttir, Deputy Governor for Monetary Policy, Central Bank of Iceland

Björk Sigurgísladóttir, Deputy Governor for Financial Supervision

Axel Hall, external Committee member

Bryndís Ásbjarnardóttir, external Committee member

Haukur C. Benediktsson, Director of the Financial Stability Department at the Central Bank; Guðrún Sóley Gunnarsdóttir, Deputy Director of the General Secretariat; Kristjana Jónsdóttir, lawyer with the General Secretariat; Einar Jón Erlingsson, specialist with the Financial Stability Department; and Ása Dröfn Óladóttir, specialist with the Financial Stability Department were present for the entire meeting.

Rósa Björk Sveinsdóttir wrote the minutes.