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Where does Iceland go from here?

Björgólfur Thor Björgólfsson - The Iceland crisis seen from inside.

Ladies and gentlemen.

First of all I want to thank Börsen for inviting me to this symposium. This is the first time that I address the Iceland crisis of 2008 and the evolution of Iceland's finance and economy from 2003 – 2008 in a speech or a lecture but that does not mean that I have been shying away from the public debate on the issue - far from it.

For over a year I have operated a website in Icelandic covering all my activities in Iceland from 2002 and published a great number of documents that shed a light upon what really went on in the areas that concerned me. There I have also published detailed comments on all issues raised in a report by the Parliamentary Investigation Committee that relate to me or my companies. I accept some of the criticism directed towards me but strongly challenge other. In addition I have written newspapers articles where I briefly explain my views and where I apologized to the public of Iceland for not having done enough to prevent harmful consequences of the rise and fall of the Icelandic banking system. Following a settlement with all my creditors last year I was interviewed in Iceland where I responded to various questions on this topic. So it is safe to say that my view of the short saga of the expansion of the Icelandic financial sector some years ago is no secret. But now, after all this time, I want to make it clear that this is one of the very last time I will comment in

general terms on the fall of the Icelandic banks. Enough is enough. We better move on. This is in fact the key issue for Iceland – move on and not let the past imprison the future.

The fundamental question must be: What went wrong?

The big picture has emerged quite clearly. I subscribe to the view of Kaarlo Jannari, former head of the Finnish FSA, who was commissioned in 2009 by IMF and the Icelandic government to assess the regulatory framework and supervisory practices in Iceland. His summary was brief: “Bad banking, bad policy and bad luck.” His views have been supported by the likes of the most recognised critic of the Iceland banking expansion at the time, Lars Christensen of Danske Bank, who you will hear from later on today. He has said that the Icelandic banks took too great risk, the authorities failed in governing and Icelanders were unlucky.

From purely financial and economical point of view it is simple to say that the banks had become too big already in 2005 / 2006. Some would even go so far to suggest that in the light of the draught on the international financial markets the following two years the banks did not have a great chance of surviving. Detailed account provided by two economist from the Ludwig von Mises Institute – Mr. Bagus and Mr. Howden, in the book Deep Freeze, show that because of loan maturity mismatching and the currency mismatching of the Icelandic krona following the rapid expansion of the banks it is difficult to see how the banks from then on could avoid what happened.

However. This is pure hindsight. In order to be able to learn from this experience we need to be honest in analysing and defining what it was we did see and based our decisions on and even more importantly what we did not see at the

time of events but we all seem to see now. Again let's stick to the larger picture.

First of all - no one was in the position or equipped to see how much in total the Icelandic banks did lend to a very small group of Icelandic business people. This is vital as Jannari pointed out in his report. The extent of the international operations of the Icelandic banks gave a reason to believe that the importance of international clients was much greater than is really was. This was a bit of a Catch 22 situation.

Secondly - we did not see how the expansion of the individual banks in Iceland was weakening the financial system as a whole. The banks were much too big for such a small economy. It is interesting to see that it was not only the investors or the bankers who did not comprehend the exaggerated proportions. Even though in 2008 a number of economists did point a finger at the dangers that were evident— inflated housing price, trade deficit and growing expenditure of the government, nearly all of them overestimated the strength of the financial system as a whole – fully funded pension system, no governmental debts, high GDP per capita, high level of education, traditions of hard working, etc. We realised the weaknesses but we thought that we had means of defence. I – as nearly everyone else in the banking sector shared this view. As the former PM of UK, Gordon Brown, pointed out in his book *"Beyond the Crash"* the individual bankers were the least likely to comprehend the overall situation. Their view was overshadowed by their specific interest and situation.

Thirdly, we did not realise how much the expansion of the Icelandic banks was caused by the surplus of money on the

international financial markets in 2003-2006 and how much the false measurement of wealth in Iceland created by the manipulation of the Icelandic krona by the authorities, did skew the reality we all shared.

Fourthly, we did not comprehend the weaknesses in the structures of the newly created open global financial systems – i.e. depositors guarantee funds which became the centre of attention in the so-called Icesave-dispute.

Dear guests.

In addition to identifying where Iceland or Icelandic bankers went wrong or did not comprehend what was really going on, I want to become more personal and address what I – in hindsight, of course, feel as I should have seen:

1. I should have seen that the major parameters were wrong. The measurement of wealth in Iceland was false. The authorities manipulated the Icelandic krona – made it much too strong which meant that prices in Iceland were far behind real prices. Money was cheap, but it was all an illusion. It was hot air into the bubble. It was an epidemic, and an extremely contagious one. The old fishing nation went wild, overfishing in the capital markets. In the end the crash of the currency was a much heavier blow for the Icelandic public than the crash of the banks. And I should have known, I should have seen this, but I was one of those taken ill. When the party was over the hangover was enormous. Unfortunately, the behaviour after the crash was the same as before – the same herd mentality: Everyone running in the same direction, shouting the same accusations.

2. The privatization process in 2002 was frail and weak and became politically infected. Firstly - it was wrong to privatize both state banks at the same time. If 2-3 years had passed from the privatization of Landsbanki until it was Búnaðarbanki's turn, the competition would have been healthier and the government would have gotten a higher price for the latter bank. Secondly – the government should have requested more equity, to guarantee financially stronger buyers. The government did neither. Why? My answer is that after I and my then business partners showed the initiative and approached the authorities and suggested the possibility of buying Landsbanki, as we had foreign capital, it was seen as a good thing to privatize the banks. And we fit the biggest criteria, being essentially foreign investors. What happened then was that others began to force themselves into the process and corrupting it. They had no equity, let alone foreign capital. In order to keep important parties happy the government decided to sell both banks at the same time and keep the equity requirements low in order to keep the gate open for those political allies that did not have any money but could borrow it, due to political connections. The sale of Landsbanki became the blueprint for the sale of Búnaðarbanki.

It is not accurate to say that I didn't see the dangerous signs at the time. I did have moral objections that I stated publicly, I wanted to abandon the process and I should have walked away when I saw the deal was being rigged for the alleged buyers of Bunadarbanki. But I didn't listen to my inner voice and that was the biggest mistake of my life. So the political cronies got their bank and started to inflate their shares in order to raise the money to pay for the bank. The ensuing competition was overheated from the start and resulted in the banks growing way too fast.

And by the way: I have again and again proved with ample documentation how we paid for Landsbanki in full. But there are still those, even within the government itself, that claim otherwise. The state got paid in full, but even now, after my settlement of debt with all my creditors, this lie is in some places accepted as a fact.

3. What I should have seen was that the business environment was incestuous. All the Icelandic banks were too dependent on a few groups of Icelandic business people. Despite international operations the pool of biggest debtors was too small. The banks got bigger but the diversification of risk did not increase enough – the risk was too concentrated. I was one of those debtors, but I had real assets. Others took out loans with little or even no collateral, which is absurd! The phenomenal extent of all the virtual business around me was not evident until after the crash. And by the way: How come the big players are not bankrupt? Only three leading business men have had to file for bankruptcy following the crash: My two former business partners in Landsbanki and one manager with Baugur Group. That's it. No one else, not a single one of all those who were heavily in debt to Kaupping, Glitnir and Landsbanki, only these three. Why? Is this normal? It is not like those who took part in the virtual business dealings, selling assets to each other at inflated prices, have been able to settle their staggering debt.

The same few groups could also through collaboration or competition easily affect key financial parameters such as stock prices, currency etc. Markets were easily driven upwards. The Iceland Stock Exchange was operated by a handful of companies mostly working on behalf of some 30 to 40 strong and active investors. This

is – of course, an innate problem because of the small size of the Icelandic population.

4. I should have recognized the lack of infrastructure and the need for systematic change. That is still a big challenge. Business people in Iceland today moan about the government, claiming that the left wing coalition will have to go, in order to resurrect business. Right or wrong – this is not a solution in itself. It doesn't matter which party rules, left or right, we need real systematic changes, massive strengthening of the infrastructure that will take years.

In the beginning, I told you I had published detailed comments on all issues raised in a report by the Parliamentary Investigation Committee that relate to me or my companies. I accept some of the criticism directed towards me but challenge other. None of the opinionated people who rant and rave about the fall of the banks and the crisis have refuted a word of what I said publicly, - in interviews, on my website or elsewhere. I expected and would have appreciated a rational and fair debate on these issues, but now I know it will never be. The same goes for the Icesave debate. In a TV interview in October 2008 I claimed that Landsbanki's assets would fully cover the claims from depositors of the on-line savings accounts. That statement was met with scepticism, to say the least and I was called a liar, but now it has turned out that I was right. Icesave was never the monster it was made out to be. The debate was distorted and wrongful, as has been the case with so many aspects of the financial crash. We need to learn from that, and move on.

Ladies and gentlemen!

We are here to address the question “Where does Iceland go from here?” I do not see myself as any authority on Iceland of today. However, I want to raise the following issues:

First of all we should remember that Iceland was knocked out the in first minute of the first round of its fight with the international financial crisis of 2008. Other small and medium size nations had more rounds but were anyway brutally beaten. Still it remains to be seen how Iceland will do in long terms compared to other nations that were hit by the crash.

Having said that it looks to me that many of the present problems were created by the reaction to the crash and the social and political crisis Iceland went through in the winter of 2008-2009. Many important decisions taken by the Icelandic authorities in last three years have been justified by unique circumstances of the past – not by general and universal principals of present, past and future. In this respect I want to mention a few things:

- The attempt by the present government to save the savings banks is turning out to be far more costly for the state’s coffers than the fall of the banks.
- Enormous political energy in the last two years has been wasted. Instead of dealing with real problems the politicians and the media divided the nation into two camps with a debate on the Icesave-dispute Iceland has with UK and Netherlands. Twice the president called for a national referendum. The public thought that the decisions could either result in Iceland becoming the equivalent of North Korea or Paradise on earth while the

essence of the whole debate was always the question of the quality of the assets that were backing up the Internet account deposits. The ability of Icelandic politicians and the media to focus on matters with little relevance while the significant ones pass by unnoticed is a constant surprise to me.

- I also want to mention that the government's tax policy has for instance been criticised for slowing down the economy and the prospect of recovery.
- The government has not paved at all any route for foreign investment.
- Some of Iceland's biggest companies – start-up companies based on human resources that grew up in Iceland and managed to extend its operations overseas, have left the country. When they become an international company, they leave. Why don't we succeed in keeping them in Iceland, like Denmark still holds on to its big business?

I have been living away from Iceland for more than twenty years and I look at it from the outside. I find it so important that Iceland and Icelanders focus on what they are and what they can be, not what they desperately want to be.

Iceland, a nation of only 320 thousand people, needs to realize what it is and is not – what it can do and cannot do. It will be difficult to create infrastructures compared with the Scandinavian nations or other larger nations on the continent of Europe. On its own – Iceland, as a society, will find it hard to provide its people the services, the opportunities, the security, – that citizens of larger states can expect. That is why Iceland needs to redefine its stand in relation to the globalization of industry, trade, service

and finance. Being small is fine – embrace it and find the opportunities it brings. Broadly speaking there are two principal options:

- First one is to minimize the risk and rewards by adjusting its structures to international organization such as the European Union.
- The second one is to face the risk involved in depending on its own structures such as the currency, ISK, when the economy is totally dependent on global markets and foreign export income. It needs to prepare properly for the blows it will receive.

The globalisation of the financial markets is a work in progress. The crash of 2008 and the crisis of 2008 till present day is the first one that really deserves the name “global financial crisis”. Despite attempts by G8, G20, EU, WTO, IMF and all the leaders of the world the globalisation is still a walk in the dark. Iceland needs to find out if it will find some traveling partners or if it wants to find its own path. Iceland needs to realize its own limits. Limits do not need to be a bad thing, as long as Icelanders focus on being all they can be, instead of all they want to be. In global context, Iceland is a village. Life can be great in the village, but it will never be exactly the same as life in a metropolis. I suspect many are now waiting to strike oil in the territorial waters of Iceland, so they can go back to 2007. But who wants to, really?

On a parting note, I would like to mention that a specially appointed prosecutor and the legal system in Iceland is currently dealing with events leading to the crash in 2008. I hope that within 3 years we will see to what extent this incestuous environment was caused by illegal practises. It is

vital that those who broke the law will be brought to justice. We will never restore faith if that fails. We have to draw a clear line between those who played by the rules with real assets and those who sucked up capital via virtual business.

Ladies and gentlemen,

We cannot change what has happened. We have to live and learn. In Iceland, I abandoned my rule of being a small fish in a big pond and became a big fish in a small pond. That was a mistake and I am determined never to repeat it. I do still have business interests in Iceland and I will continue to nourish those companies. I have learned my lesson well and I hope the current crisis will be the stepping stone necessary for Iceland to reach a healthier and more balanced economic environment, where rules and principles will be followed for the greater good of all.

Iceland has shown that its people are at best when challenged by adversaries. Political disputes will go on – the debate on what went wrong will continue, but I am certain that Icelandic people will find a way to a prosperous future.