

Reykjavík, 24 April 2023

TO THE PRESIDENT AND THE MEMBERS OF THE EFTA COURT

WRITTEN OBSERVATIONS

Submitted cf. Article 97 of the Rules of Procedure and Article 20 of the Statute, by

ÍSLANDBANKI HF.

Represented by Áslaug Árnadóttir, supreme court attorney, acting as legal counsel for Íslandsbanki hf.

in EFTA Court Case No E – 1/23

Elva Dögg Sverrisdóttir and Ólafur Viggó Sigurðsson v Íslandsbanki hf.

in which the Reykjanes District Court has requested that the EFTA Court gives an advisory opinion pursuant to Article 34 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice on one question regarding the interpretation of Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property and of Directive 2008/48/EC on credit agreements for consumers.

I.

INTRODUCTION

1. By order of 1 February 2023 the Reykjanes District Court requested the EFTA Court to give an Advisory Opinion pursuant to Article 34 of the Surveillance and Court Agreement. The action before the District Court has been brought by Elva Dögg Sverrisdóttir and Ólafur Viggó Sigurðsson (hereinafter the Plaintiffs) against Íslandsbanki hf. (hereinafter the Defendant).
2. The Plaintiffs obtained a non-indexed mortgage loan with variable interest rate from the Defendant by issuing a mortgage bond on 21 January 2021. The Plaintiffs lodged an application before the District Court of Reykjanes challenging the interest-rate adjustments applying to the loan. They submitted that the changes were at were in breach of the provisions of the Consumer Property Mortgage Act No. 118/2016 and should be annulled based on Article 36 and Article 36 c of Act No. 7/1936 on Contracts, Agency and Void Legal Instruments and the Defendant be ordered to repay them 84.418 ISK with penalty interest and legal costs.
3. To rule on the dispute, the Reykjanes District Court decided to refer the following question to the EFTA Court:
 1. *Is it compatible with Directive 2014/17/EU (see, in particular, Article 24 thereof) and, as appropriate, with Article 10(2)(f) of Directive 2008/48/EC (cf. recital 19 of Directive 2014/17/EU), that the terms of a consumer property mortgage with variable interest state that adjustments of the borrowing rate will take account of factors including operating costs and other unforeseen costs?*
4. Below in Section II the Defendant briefly sets out the relevant factual background to the case. In Section III the mortgage loans market in Iceland is explained. In Section IV relevant provisions of EEA law will be set out, and the relevant provisions of national law and regulations will be set out in Section V. Discussions on the referred question are set out in Section VI, and finally, conclusions are set out in Section VII.

II.

FACTS

5. Through the years the Plaintiffs have obtained several loans with variable interest rate from the Defendant. In late 2020 the Plaintiffs requested a credit score evaluation from the Defendant. On 11 January 2021 the Defendant provided them with the standard consumer credit information form related to a possible loan. In the form it is clearly stated that the interest rate is variable and that changes in interest rate are *inter alia* based on changes in the bank's financing costs, the operating costs of the bank, public levies and/or other unforeseen costs, the key interest rate of the Central Bank of Iceland, changes in the consumer price index etc. It was further stated that the ratio of each of those factors is variable and will *inter alia* be defined by decisions of public

entities and market conditions at each time. Changes in the interest rate will be based on an evaluation of all these factors together or individually. If any of those factors have changed when the interest rate is evaluated it can lead to changes of the interest rate, so that the rate is raised or lowered.

6. In the standard consumer credit information form it is further stated that from a loan of the amount of 57.610.000 ISK the Plaintiffs, based on the current interest rate, must pay 105.544.316 ISK or 1,83 ISK for each 1 ISK borrowed. It is also stated that due to the variable interest rate the expected borrowing costs are only set forth as examples and may change. Furthermore, it is stated that the Annual Percentage Rate of Charge (APR) is calculated based on the current interest rate. Because of the variable interest rate the actual APR can be different from the APR displayed in the form. If, for example, the interest rate becomes 9,50% the APR could increase to 9,94%. It is also clearly stated that due to the change in interest rate the regular payments can be higher or lower than the given examples project. The Plaintiffs also received a standard information leaflet from the Consumer Agency.
7. After the Plaintiffs received the standard consumer credit information, they applied for two loans from the Defendant. And on 21 January 2021 they issued a mortgage bond, taking a non-indexed mortgage loan with variable interest rate from the Defendant of the amount of 57.610.000 ISK. At the issuance of the bond the interest rate was 3,40%. The duration of the loan was 40 years.
8. In Article 1 of the terms of the bond it is clearly stated that the debt is to be repaid with equal payments of interest and instalments, however as the interest rate is variable the lender reserves the right to recalculate the loan at every adjustment of the interest rate and/or adjustment of the terms based on changes in circumstance and that instalments will take account of the interest rate as it is on the date on which the recalculation was based. It is clearly stated that interest rate adjustments can result in an increase or a decrease of each instalment and consequently impact the total amount repaid.
9. Article 2 of the terms of the bond states that a variable non-indexed mortgage interest rate applies to the loan, as determined at any given time, and published in the index chart of the Defendant. It is stated that adjustments of the interest rate are *inter alia* based on changes in the bank's financing costs, the operating costs of the bank, public levies and/or other unforeseen costs, the key interest rate of the Central Bank of Iceland, changes in the consumer price index etc. It is further stated that decisions on changes in interest rates are taken by a committee of the bank. The committee primarily looks at the development of the above-mentioned factors and assesses if changes call for changes in the interest rate. Then it is stated that the ratio of each of those factors is variable and will *inter alia* be defined by decisions of public entities and market conditions at each time. Changes in the interest rate will be based on an evaluation of all the factors together or individually. If any of those factors have

changed when the interest rate is evaluated it can lead to changes of the interest rate, so that the rate is raised or lowered.

10. The terms regarding how the issuer is to be informed of changes of the interest rate are also set out in Article 2 of the terms. It is stated that by signing the bond, the issuer confirms that it is sufficient that the lender gives notice of changes in the borrowing rate with reference to the banks interest rate table which is available at the bank's website and/or the issuer's online bank if the changes are correlated with a change in a reference rate, key interest rate or index. The issuer shall be informed of changes of the borrowing rate based on other factors than changes in a reference rate, key interest rate or index with 30 days' notice.
11. The parties to the contract can, however, agree in the credit agreement that the information referred to in paragraph 1 is to be given to the consumer periodically where the change in the borrowing rate and the new benchmark is made publicly available by appropriate means, the information concerning the new benchmark is kept available in the premises of the creditor and communicated personally to the consumer together with the amount of new periodic instalments.
12. In Article 6 of the terms of the bond it is stated that the issuer can repay the credit, in full or partially, at any time, without extra costs.
13. At the same time the Plaintiffs issued another bond of the amount of 3.290.000 ISK. The interest rate was variable and the same terms on changes in the interest rate applied to both loans.
14. In accordance with the terms of the mortgage bond the Defendant informed the Plaintiffs on 30 May 2021 of an upcoming change in the interest rate. In the letter the Plaintiffs were informed that the interest rate would be raised from 3,40% to 3,65%. On 5 September 2021 the Plaintiffs were informed of an increase in the interest rate from 3,65% to 3,80%. Finally, the Defendant informed the Plaintiffs on 22 October 2021 of an increase in the interest rate from 3,80% to 3,95%. On all occasions the Plaintiffs received an updated payment schedule as well as a reference to the text of the mortgage bond on interest rate changes and an update on where the Plaintiffs could get further information regarding the loan.

III.

MORTGAGE LOANS IN ICELAND

15. For many decades almost all mortgage loans in Iceland were price indexed, meaning that the principal of the loan was adjusted monthly in accordance with the development of the consumer price index (CPI) The borrower thus accepted the risk of inflation and in return could obtain lower interest rates. The background for the widespread use of CPI linked loans to households and companies can be attributed to historically high and volatile inflation in Iceland for long periods during the twentieth

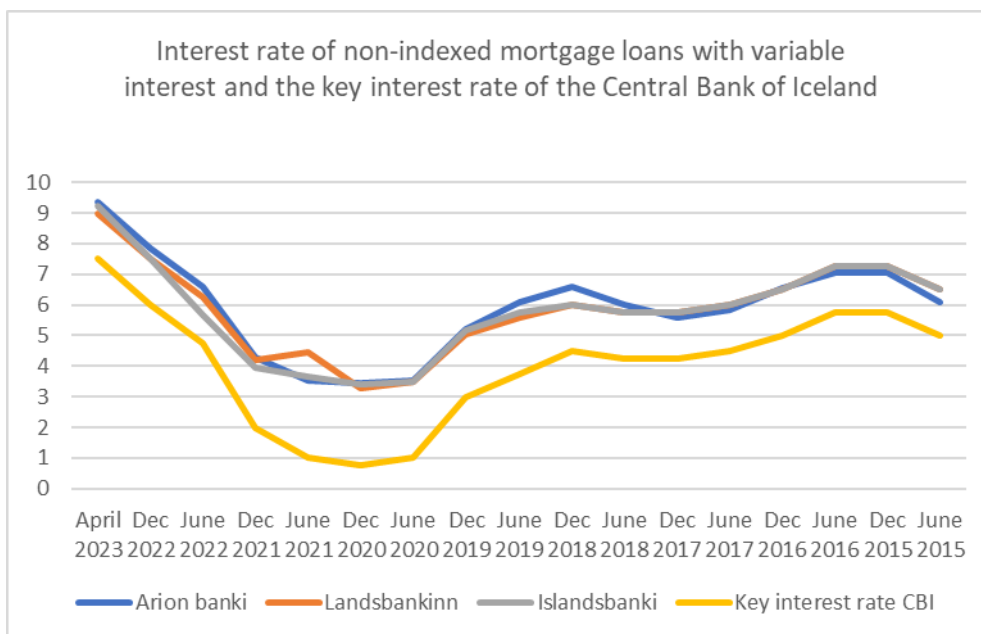
century. There were periods of rising prices in the 1950's and 1960's, but inflation really took off in the early 1970's and peaked in 1983, when it reached 100% (on an annual basis) in mid-year. In the late 1980's the economy cooled off somewhat. Although inflation has been much lower since 1990, it is still higher and more volatile than in most West European countries.

16. The demand for non-indexed mortgage loans increased in Iceland in the years after the 2008 financial crisis, mostly due to lower interest rates and increased inflation. From January 2010 until December 2013 the market share for non-indexed mortgage loans went from 4% to 27% of all mortgage loans. From 2013 until early 2019 non-indexed mortgage loans continued to be around 27-31% of all mortgage loans in Iceland.
17. Non-indexed loans almost always bear higher interest than indexed loans as the lender must include an allowance for expected inflation and a risk margin for uncertainty. The risk factor rises as the uncertainty of the development of inflation increases. The increase of interest rate due to uncertainty of the development of inflation is not necessary when it comes to indexed loans due to the different sharing of risk.
18. The number of non-indexed loans has increased noticeably in the last few years. In January 2020 non-indexed mortgage loans with variable interest rates were 18,48% of all mortgage loans and non-indexed mortgage loans with fixed interest were 12,27% of all mortgage loans in Iceland. According to statistics from the Central Bank of Iceland indexed mortgage loans with variable interest rates were 17,76% of all mortgage loans in Iceland in December 2022. At the same time indexed loans with fixed interest rates were 25,41% of all mortgage loans, non-indexed mortgage loans with variable interest rates were 27,49% of all mortgage loans and 29,34% of all mortgage loans.¹
19. Although the three main banks in Iceland have different terms as regards changes in the interest rates, the interest rate applied to non-indexed loans with variable interests has developed in a very similar way through the years as can be seen in the table below, and in overviews of changes in interest rates of the three large banks in Annex II. The table also shows the development of the key interest rate (policy rate) of the Central bank of Iceland. The key interest rate that the Central Bank offers to credit institutions that is the primary driver of market rates and a manifestation of the monetary policy which is intended to affect borrowing and saving rates.²

¹ See the Central Bank of Iceland:

<https://www.cb.is/publications/publications/publication/2023/03/15/Financial-Stability-2023-1/>

² See the Central Bank of Iceland: <https://www.cb.is/other/key-interest-rate/>



IV.

RELEVANT PROVISIONS OF EEA LAW

20. The relevant provisions of EEA law are mainly to be found in three directives. Firstly, in Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 on credit agreements for consumers relating to residential immovable property (Mortgage Credit Directive).

21. Recital 19 of the Mortgage Credit Directive reads:

For reasons of legal certainty, the Union legal framework in the area of credit agreements relating to residential immovable property should be consistent with and complementary to other Union acts, particularly in the areas of consumer protection and prudential supervision. Certain essential definitions including the definition of ‘consumer’, and ‘durable medium’, as well as key concepts used in standard information to designate the financial characteristics of the credit, including ‘total amount payable by the consumer’ and ‘borrowing rate’ should be in line with those set out in Directive 2008/48/EC so that the same terminology refers to the same type of facts irrespective of whether the credit is a consumer credit or a credit relating to residential immovable property. Member States should therefore ensure, in the transposition of this Directive, that there is consistency of application and interpretation in relation to those essential definitions and key concepts.

22. Recital 67 of the Mortgage Credit Directive reads:

It is important to ensure that sufficient transparency exists to provide clarity for consumers on the nature of the commitments made in the interests of preserving financial stability and on where there is flexibility during the term of the credit agreement. Consumers should be provided with information concerning the borrowing rate during the contractual relationship as well as at the pre-contractual stage. Member States should be able to maintain or introduce restrictions or prohibitions on unilateral changes to the borrowing rate by the creditor. Member States should be able to provide that where the borrowing rate changes the consumer is entitled to receive an updated amortisation table.

23. Paragraph 1 and point (e) of Article 13 of the Mortgage Credit Directive states:

Member States shall ensure that clear and comprehensible general information about credit agreements is made available by creditors or, where applicable, by tied credit intermediaries or their appointed representatives at all times on paper or on another durable medium or in electronic form. In addition, Member States may provide that general information is made available by non-tied credit intermediaries.

Such general information shall include at least the following:

(e) types of available borrowing rate, indicating whether fixed or variable or both, with a short description of the characteristics of a fixed and variable rate, including related implications for the consumer;

24. Article 24 of the Mortgage Credit Directive states:

Where the credit agreement is a variable rate credit, Member States shall ensure that:

(a) any indexes or reference rates used to calculate the borrowing rate are clear, accessible, objective and verifiable by the parties to the credit agreement and the competent authorities; and

(b) historical records of indexes for calculating the borrowing rates are maintained either by the providers of these indexes or the creditors.

25. Paragraphs 1 and 2 of Article 27 of the Mortgage Credit Directive read:

Member States shall ensure that the creditor informs the consumer of any change in the borrowing rate, on paper or another durable medium, before the change takes effect. The information shall at least state the amount of the payments to be made after the new borrowing rate takes effect and, in cases where the number or frequency of the payments changes, particulars thereof.

However, the Member States may allow the parties to agree in the credit agreement that the information referred to in paragraph 1 is to be given to the consumer

periodically where the change in the borrowing rate is correlated with a change in a reference rate, the new reference rate is made publicly available by appropriate means and the information concerning the new reference rate is kept available in the premises of the creditor and communicated personally to the consumer together with the amount of new periodic instalments.

26. Secondly, relevant provisions of EEA law are in Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC on credit agreements for consumers (Consumer Credit Directive).

27. Paragraph 1 and point a of Paragraph 2 of Article 2 of the Consumer Credit Directive, read:

1. This Directive shall apply to credit agreements.

2. This Directive shall not apply to the following:

(a) credit agreements which are secured either by a mortgage or by another comparable security commonly used in a Member State on immovable property or secured by a right related to immovable property;

28. Point (f) of Paragraph 2 of Article 10 of the Consumer Credit Directive states:

The credit agreement shall specify in a clear and concise manner:

(f) the borrowing rate, the conditions governing the application of that rate and, where available, any index or reference rate applicable to the initial borrowing rate, as well as the periods, conditions and procedures for changing the borrowing rate and, if different borrowing rates apply in different circumstances, the abovementioned information in respect of all the applicable rates;

29. Thirdly, Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts is also relevant (Unfair Contract Terms Directive).

30. Article 3 of the Unfair Contract Terms Directive provides:

1. A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.

2. A term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, particularly in the context of a pre-formulated standard contract.

The fact that certain aspects of a term or one specific term have been individually negotiated shall not exclude the application of this Article to the rest of a contract if

an overall assessment of the contract indicates that it is nevertheless a pre-formulated standard contract.

Where any seller or supplier claims that a standard term has been individually negotiated, the burden of proof in this respect shall be incumbent on him.

3. The Annex shall contain an indicative and non-exhaustive list of the terms which may be regarded as unfair.

31. Article 4 of the Unfair Contract Terms Directive states:

1. Without prejudice to Article 7, the unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.

2. Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language.

32. Article 5 of the Unfair Contract Terms Directive reads:

In the case of contracts where all or certain terms offered to the consumer are in writing, these terms must always be drafted in plain, intelligible language. Where there is doubt about the meaning of a term, the interpretation most favourable to the consumer shall prevail. This rule on interpretation shall not apply in the context of the procedures laid down in Article 7(2).

33. Article 6(1) of the Unfair Contract Terms Directive reads:

Member States shall lay down that unfair terms used in a contract concluded with a consumer by a seller or supplier shall, as provided for under their national law, not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms.

34. The Annex to Directive 93/13/EEC contains an indicative and non-exhaustive list of the terms which may be regarded as unfair. The Annex was not implemented into Icelandic law, as it was only considered indicative.³

V.

RELEVANT PROVISIONS OF NATIONAL LAW

Act No. 118/2016 on Consumer Property Mortgage

35. The Mortgage Credit Directive was transposed into Icelandic law by Act No. 118/2016 on Consumer Property Mortgage.

³ See the preamble to Act No. 14/1995, amending Act No. 7/1936. Available in Icelandic at: <http://www.althingi.is/altext/118/s/0102.html>

36. Paragraph 1 Article 12 states that the creditor shall ensure that the consumer always has access to clear and comprehensible information on available credit, on paper or another durable medium or in electronic form. The information shall *inter alia* include information on the type of interest rate where it is specified if interest rates are fixed or variable or both, together with an illustrative example and a short description on the characteristics of fixed and variable interest rates and their significance for the consumer. The conditions and procedure for adjusting interest rates shall be set out.

37. Paragraph 1 of Article 34 states:

If a property mortgage agreement contains a provision stating that reference values, indexes or reference index rates are to be used for determining variable interest rates, the creditor may only use reference values, indexes or reference interest rates that are clear, accessible, objective and verifiable, both by the parties to the agreement and by the Consumers' Agency (Neytendastofa). If a decision on the adjustment of the interest rate is not based on a reference value, index or reference interest rate, then the mortgage credit agreement shall state the conditions and procedure for adjustment of the interest rate.

38. Paragraphs 1 and 2 of Article 35 read:

The consumer must be informed of all changes in the borrowing rate, on paper or another durable medium, before the change takes effect. The information shall at least state the amount of the payments to be made after the new borrowing rate takes effect and, in cases where the number or frequency of the payments changes, particulars thereof. As a general rule, the consumer must be informed of changes 30 days in advance.

The parties to the contract can, however, agree in the credit agreement that the information referred to in paragraph 1 is to be given to the consumer periodically where the change in the borrowing rate is correlated with a change in a reference rate, key interest rate or index and the new benchmark is made publicly available by appropriate means, the information concerning the new benchmark is kept available in the premises of the creditor and communicated personally to the consumer together with the amount of new periodic instalments.

Act No. 33/2013 on Consumer Credit

39. The Consumer Credit Directive was incorporated into Icelandic law by the Consumer Credit Act No 33/2013.

40. Point f of Paragraph 4 of Article 7 reads:

The information shall contain the following:

f. the borrowing rate, the conditions for its application and, if appropriate, any index or reference interest rate that may affect the initial borrowing rate, and also the period, conditions, and procedure for changing the borrowing rate; if various borrowing rates apply under various circumstances, the aforementioned information shall be provided on them all, ...

Act No. 7/1936 on Contracts, Agency and Void Legal Instruments.

41. Directive 93/13/EEC was transposed into Icelandic law by Act No. 14/1995, adding four articles (Articles 36(a) – 36(d)) to Act No. 7/1936 on Contracts, Agency and Void Legal Instruments. Further, changes were made to the wording of Article 36. The method of implementation was the result of Nordic co-operation, and the Icelandic provisions are almost identical to the provisions implemented in Norway and Denmark.

42. Article 36 of Act No. 7/1936 states:

A contract may be set aside, in full or in part, or amended if it would be considered unfair or contrary to good business practices to invoke the contract, subject, however, to Article 36(c). The same applies to other legal instruments.

Any assessment pursuant to paragraph 1 shall take account of the substance of the contract, the position of the parties to the contract, the circumstances of the making of the contract and subsequent circumstances.

43. Article 36(c) of Act No. 7/1936 states:

The provisions of Article 36 apply to contracts pursuant to paragraph 1 of Article 36, but with the changes resulting from paragraphs 2 and 3.

In assessing whether a contract pursuant to paragraph 1 is unfair, account should be taken of the factors and circumstances referred to in paragraph 2 of Article 36, including the terms of other linked contracts. However, no account shall be taken of circumstances that arose subsequently, to the disadvantage of the consumer.

A contract is unfair if it is contrary to good business practices and materially distorts the balance between the rights and obligations of the contracting parties, to the disadvantage of the consumer. If a term of this kind is set aside, in full or in part, or amended, the contract shall, at the request of the consumer, remain valid in other respects without change if it can be performed without the term.

VI.

DISCUSSION ON THE QUESTION RAISED BY THE COURT

44. The question referred by the Reykjanes District Court reads as follows:

Is it compatible with Directive 2014/17/EU (see, in particular, Article 24 thereof) and, as appropriate, with Article 10(2)(f) of Directive 2008/48/EC (cf. recital 19 of Directive 2014/17/EU), that the terms of a consumer property mortgage with variable interest state that adjustments of the borrowing rate will take account of factors including operating costs and other unforeseen costs?

45. To answer the question of the referring court it must be determined if Article 24 of the Mortgage Credit Directive and Article 10(2)(f) of the Consumer Credit Directive prohibit Icelandic banks to use terms in mortgage agreements with consumers that allow the bank to take account of factors such as operating costs of the bank and other

unforeseen costs when adjusting the borrowing rate of mortgage loans with variable interest rates.

The Mortgage Credit Directive was not part of EEA law until 1 November 2021

46. Firstly, the Defendant would like to point out that the Mortgage Credit Directive had not been incorporated into the Agreement on the European Economic Area (the EEA Agreement) when Act No. 118/2016 was adopted on 13 October 2016 or when the Plaintiffs issued the bond in question on 21 January 2021.
47. The Directive was incorporated into the EEA Agreement by Decision of the EEA Joint Committee No. 125/2019 of 8 May 2019. Constitutional requirements were lifted by Iceland, Liechtenstein and Norway on 23 September 2021 and the decision entered into force on 1 November 2021.
48. Icelandic courts are obliged to interpret national law in line with Iceland's obligations stemming from the EEA Agreement. As the Mortgage Credit Directive was not a part of the EEA Agreement when the Plaintiffs issued the bond in question the Defendant submits that Icelandic courts are not obliged to interpret Act No. 118/2016 in line with the Mortgage Credit Directive as regards the terms of the bond.

The Consumer Credit Directive does not apply to mortgages

49. Secondly, the Consumer Credit Directive does not apply to the loan agreement in question. It is clear from Article 2(2)(a) that the Directive does not apply to credit agreements which are secured either by a mortgage or by another comparable security commonly used in a Member State on immovable property or secured by a right related to immovable property. It is undisputed that the bond issued by the Plaintiffs is secured by a mortgage.
50. Recital 19 of the Mortgage Credit Directive states, that certain essential definitions and key concepts used in standard information to designate the financial characteristics of the credit, should be in line with those set out in the Consumer Credit Directive. This does not mean that the provisions of Article 10(2)(f) of the Consumer Credit Directive apply to loans that fall outside the scope of the Directive, as the rule set forth in the Article does not meet the criteria to be "essential definitions" or "key concepts used in standard information to designate the financial characteristics of the credit".
51. The Defendant acknowledges that according to case law provisions or concepts taken from EEA law and adopted into domestic legislation should be interpreted uniformly, irrespective of the circumstances in which they apply. (Case E-17/11 *Aresbank S.A.*, para 45 and Case E-25/13 *Gunnar V. Engilbertsson*, para 54).
52. In this case the second sentence of Article 34 (1) of Act No. 118/2016 states that the mortgage credit agreement should explain the conditions and procedures for the

adjustment of the interest rate if the change is not based on a reference interest rate. The wording “conditions and procedures for the adjustment of the interest rate” are the same as in Article 7(4)(f) of the Consumer Credit Act No. 33/2013, which implemented Article 10(2)(f) of the Consumer Credit Directive. In the comments accompanying the bill that was later passed as Act No. 118/2016 it is stated that Article 34(1) is not intended to stop lenders from granting loans with variable interest rates where the changes in interest rates are based on the unilateral decisions of the lender based on *inter alia* the financing costs or operating costs. It is further stated that if a change in the interest rate is based on such factors the lender is obliged to state that clearly and explain the conditions for the adjustment. Then it is stated that the second sentence in Article 34(1) is based on Article 7(4)(f) of the Consumer Credit Act.

53. The Defendant submits that the words in Article 34(1) of Act No. 118/2016 that have its origin in the Consumer Credit Directive do not in any way restrict the use of terms in mortgage credit agreements which allow the lender to adjust the borrowing rate based on other factors than indexes and reference rates.
54. Further, the Defendant submits that the term of Article 2 of the bond in question conforms with the rules set forth in Icelandic law. If the Court is of the opinion that the second sentence of Article 34(1) of Act No. 118/2016 contains provisions or concepts taken from the Consumer Credit Directive, the Defendant submits that the term in Article 2 of the bond is also fully in line with the Directive, as it sets forth both the conditions and procedures for the adjustment of the interest rate.
55. The conditions for the adjustment to the interest rate are explained to be *inter alia*, changes in the bank’s financing costs, the bank’s operating costs, public levies and/or other unforeseen costs, the key interest rate of the Central Bank of Iceland and changes in the consumer price index. Then the procedure for the adjustment to the interest is explained in a clear and concise manner, as it is stated that decisions on changes in interest rates are taken by a committee of the bank. The committee primarily looks at the development of the above-mentioned conditions for adjustment and assesses if changes call for an adjustment of the interest rate. Then it is stated that the ratio of each of those factors is variable and will *inter alia* be defined by decisions of public entities and market conditions at each time. Changes in the interest rate will be based on an evaluation of all the factors together or individually. If any of those factors have changed when the interest rate is evaluated it can lead to changes of the interest rate, so that the rate is raised or lowered. Finally, it is set out how the issuer is to be informed of changes of the interest rate.
56. It is the Economic Committee of the Defendant that takes decisions on changes in interest rates. The committee works for the senior management of the bank. The bank actively monitors the development of interest rates on the market and the bank's financing costs in both ISK and foreign currency. The bank's treasury is responsible

for financing it and managing the bank's balance sheet. A part of that role is to monitor the situation and development (trends) in the capital markets. The bank's treasury works in accordance with the funding policy of the bank and can among other things take notice of market conditions, funding costs and the management of the bank's balance sheet when internal pricing is determined or changes to internal pricing are proposed. Changes in the bank's external interest rates to customers can only be made in accordance with the terms that apply to the relevant interest rate. Suggestions of changes of the external interest rates are made by the bank's business units to the bank's Economic Committee. The main factors behind such proposals are stated in the proposals to the committee, and normally address changes in financing costs, operating costs, public levies, changes in the key interest rate of the Central Bank of Iceland or other factors, or the interaction of two or more factors, and the importance of each factor, considering the terms that apply to the interest rate in question. The Economic Committee then reviews the proposals and takes decisions regarding changes in interest rates. The determining factors behind each decision are recorded in the minutes of the committee's meetings.

Article 24 of the Mortgage Credit Directive

57. In essence the referring court asks if it is compatible with Article 24 of the Mortgage Credit Directive that adjustments of the borrowing rate of a mortgage loan with variable interest will take account of factors including operating costs and other unforeseen costs. This is exactly what the variable rate is intended to reflect and enable the bank to offer rates with minimum allowance for risk due to unforeseen events, to the benefit of the borrower. That way the customer will not have to pay for risks which may never materialise.
58. Article 24 of the Directive states that where the credit agreement is a variable rate credit, Member States shall ensure that any indexes or reference rates used to calculate the borrowing rate are clear, accessible, objective and verifiable by the parties to the credit agreement and the competent authorities; and that historical records of indexes for calculating the borrowing rates are maintained either by the providers of these indexes or the creditors.
59. The Defendant submits that Article 24 of the Directive does not apply to the disputed bond as the adjustments of the index rate in the bond are based on an internal decision of the Defendant and are not based on an index or a reference rate.
60. The terms "index" or "reference rate" are not defined in neither the Mortgage Credit Directive nor the Consumer Credit Directive. Therefore, the Defendant submits that the terms must be used in accordance with the common understanding of the terms within the financial sector and in other EEA law. The terms "index" and "interest rate benchmark" are defined in regulation 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (the Benchmark

Regulation). “Index” is defined as meaning any figure: (a) that is published or made available to the public; (b) that is regularly determined: (i) entirely or partially by the application of a formula or any other method of calculation, or by an assessment; and (ii) on the basis of the value of one or more underlying assets or prices, including estimated prices, actual or estimated interest rates, quotes and committed quotes, or other value surveys. The term “interest rate benchmark” is defined to mean a benchmark which for the purposes of point (1)(b)(ii) above is determined on the basis of a rate at which banks may lend to, or borrow from, other banks, or agents other than banks, in the money market.

61. The main elements of “indexes” og “reference rates” are that they are clear, objective, and accessible to the public and therefore verifiable. Further, they are set by a third party, that is not a party to the contract in question and therefore neither of the parties of the contract has control over the changes made to the index or the reference rate. A good example is the Euro Interbank Offered Rate (Euribor), five in total, which are based on the interest rates at which a panel of European banks borrow funds from one another. In the calculation, the highest and lowest 15% of all the quotes collected are eliminated. The remaining rates will be averaged and rounded to three decimal places. Euribor is determined and published daily.
62. The terms of Article 2 of the bond in question show that adjustments of the index rate are not directly linked to an index or a reference rate. The adjustments are decided unilaterally by the Defendant in a process that has been described above. The index rate of the Defendant for non-indexed mortgage loans with variable interest does not meet the criteria of an index or a reference rate, as it is decided unilaterally by one party of the loan agreement and is not published by anyone other than the Defendant. Further, the changes are not determined by any one factor, but rather by many different factors.
63. The Defendant submits that the Mortgage Credit Directive does not prevent Member States from allowing lenders to offer loans with a variable rate where adjustments to the interest rate are based on internal decisions of the lender.
64. This can be seen from Recital 67 of the Mortgage Credit Directive where it is stated that: *“Member States should be able to maintain or introduce restrictions or prohibitions on unilateral changes to the borrowing rate by the creditor. Member States should be able to provide that where the borrowing rate changes the consumer is entitled to receive an updated amortisation table.”* This language simply allows for the Member States to impose restrictions on lending practices as they deem fit but does not address the nature of such restrictions.
65. Article 27 of the Directive also envisages that lenders can change the borrowing rate with reference to other factors than indexes or reference rates. Paragraph 1 imposes the duty on the creditor to inform the consumer of any change in the borrowing rate on paper or another durable medium, before the change takes effect. In Paragraph 2 it is

stated that the Member States can allow the parties to agree in the credit agreement that the information on changes in borrowing rates is to be given to the consumer periodically where the change in the borrowing rate is correlated with a change in a reference rate, the new reference rate is made publicly available by appropriate means and the information concerning the new reference rate is kept available in the premises of the creditor and communicated personally to the consumer together with the amount of new periodic instalments.

The rules of both Paragraphs 1 and 2 were implemented into Article 35 of Act No. 118/2016. According to Paragraph 1 of the Article the lender must inform the consumer of changes in the borrowing rate that are based on other factors than changes in a reference rate, key interest rate or index with 30 days' notice. The documents of the case show that the Defendant has informed the Plaintiffs of all changes in the borrowing rate 30 days in advance, in line with Article 35 of Act No. 118/2016.

66. Based on all of the above, the Defendant submits that the term in Article 2 of the debated bond regarding the adjustment of interests is in line with EEA law.

Consumer protection by EEA law

67. The Defendant submits that Icelandic legislation, that allows for lenders to offer consumers mortgage loans with variable interest where adjustments of the index rate are not directly linked to an index or a reference rate, is in line with EEA law.

68. The Defendant further submits that the aim of the Mortgage Credit Directive is to require creditors to provide adequate information to consumers to allow them to assess whether the loan offer of the creditor is suitable for the consumer in question and to allow consumers to compare different loan offers from creditors.

69. Before taking out the loan, the Plaintiffs received the standard consumer credit information form and all information that the Mortgage Credit Act requires the Defendant to give consumers, as discussed above.

70. The Plaintiffs could freely choose from many types of loans, including indexed loans with fixed interest and non-indexed loans with fixed interest. After being given adequate information the Plaintiffs elected a mortgage loan with a variable interest rate, with the base interest rate of 3,40%. At the time the interest rate of the Defendant for a non-indexed mortgage loan with fixed interest for the first five years was 4,4%. The different rates reflect different allocation of risk, those electing higher degree of certainty pay higher rates and vice versa.

71. If the Plaintiffs think that the terms of the mortgage loan are unfair, they can, as they have done, file a case before the national courts and claim that the debated term in the bond is unfair and should be declared null and void. They can base their arguments on Act No. 7/1936 on Contracts, Agency and Void Legal Instruments, which incorporates

the Unfair Contract Terms Directive into Icelandic law. It follows from case law, that it is the role of the national court to determine whether the debated term in the bond issued by the Plaintiffs is unfair. It is also for the national court to establish whether the term was explicitly and comprehensively described to the consumer (Case E-25/13 *Gunnar V. Engilbertsson*, para 146 and 162-163).

VII.

CONCLUSION

72. For the reasons set out above, the Defendant submits that the question referred by the Order of the Reykjanes District Court, dated 1 February 2023, should be answered as follows:

1. *Directive 2014/17/EU Article 24 and Directive 2008/48/EF Article 10(2)(f) do not restrict lenders from using terms in consumer mortgage loans with variable interest where the adjustments of the borrowing rate take into account factors including operating costs and other unforeseen costs.*

On behalf of Íslandsbanki hf.

Áslaug Árnadóttir
supreme court attorney

List of Annexes:

- I. A memorandum from Íslandsbanki hf. regarding adjustments in the interest rate of mortgage loans to consumers with variable interest.
- II. Interest rate changes of Íslandsbanki hf., Landsbankinn hf. and Arion banki hf.
- III. Changes to the key interest rate of the Central Bank of Iceland.