

How Did the Icelandic Criminal Justice System Respond to the Banking Collapse in 2008?

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Abstract:

The Icelandic banking collapse in 2008 constituted the largest banking collapse in history relative to economic size and made Iceland the biggest casualty of the Great Recession. In fact Iceland's crisis has been called "the greatest financial crisis ever" by the eminent US economist Paul Krugman.

How did the Icelandic criminal justice system respond? Have any of the bankers or public officials been convicted for any criminal wrongdoings? If so, for what kind of crime?

A new prison legislation was passed earlier this year in Iceland. Finally, this bill will be examined to assess whether Iceland is moving towards more punitive control measures or if lenient measures are becoming more pronounced than before.

Size of the Icelandic banking collapse

Iceland's main banks collapsed in October of 2008 in a span of a few days and were subsequently taken into public ownership. This turmoil came as a surprise to the public because the banks were thought to be well-financed and generating high returns in the summer prior to their downfall. The banks had risen from being small utility institutions in the late 1990's to join the ranks of the world's top three hundred banks only a decade later. They have since joined a much less glorious league. Iceland's banking crisis in 2008 has been called the „greatest financial crisis ever“ by the distinguished economist Paul Krugman (2010).

Causes of the banking collapse in Iceland in 2008

After the downfall of the banks, Icelanders understandably debated the cause of the collapse: whether and how Icelandic officials and the business community failed, and how much impact outside factors played in the crisis (Gunnlaugsson, 2015). In December of 2008, the Icelandic parliament set up a so called *Truth Commission*, charged with investigating the causes of the banking collapse and identifying those individuals responsible, in either pursuing financial wrongdoing or allowing it to happen under their supervision.

Finally in April of 2010, the report was published. This was a 2,300 page report in nine volumes, based on interviews with almost 150 key actors, and a thorough review of documents from the financial system, for which the commission had been granted full access. Any suspicions that the final report would be a whitewash or cover-up were quickly dispelled. If we ever thought the report would be a government cover-up, it definitely did not turn out that way. The report is wide-ranging and detailed and has been described by a local news analyst as probably the most important document in the history of Iceland.

The content of the report included damning revelations exposing deep failings in the financial system, with senior politicians, regulators, and bankers all believed to be at fault due to mistakes or negligence. The deepest criticisms were reserved for the three largest banks. These banks, which had in a few years ballooned to become ten times bigger than the national economy, were said to have been effectively taken over by some of their majority shareholders. What is more, the banks' now-apparent financial vulnerability had deliberately been hidden from the public eye: all of the banks had been involved in a web of cross-holdings spun by the owners and linked parties. This group was, to say the least, favourably treated by the banks it part-owned and had been granted loans with a value of close to one-third of the equity of the banks by early 2008. Thus, rules about large risk exposures were not followed and it was difficult to see how the interests of the banks had been protected ("How Iceland's banking flaws brought down the country's economy," 2010).

Put in short the following factors contributed to the banking collapse in Iceland:

- **Bad state supervision**
 - A weak regulatory system – "Don't you see the party going on" Minister of Finance responding to a criticism of the local economy in 2006 in Parliament.
- **Bad banking practices**
 - Manipulative owners
 - Closely connected owners and CEO's
 - Corrupt corporate culture
 - Incentive schemes and risky bonus systems
- **Bad luck**

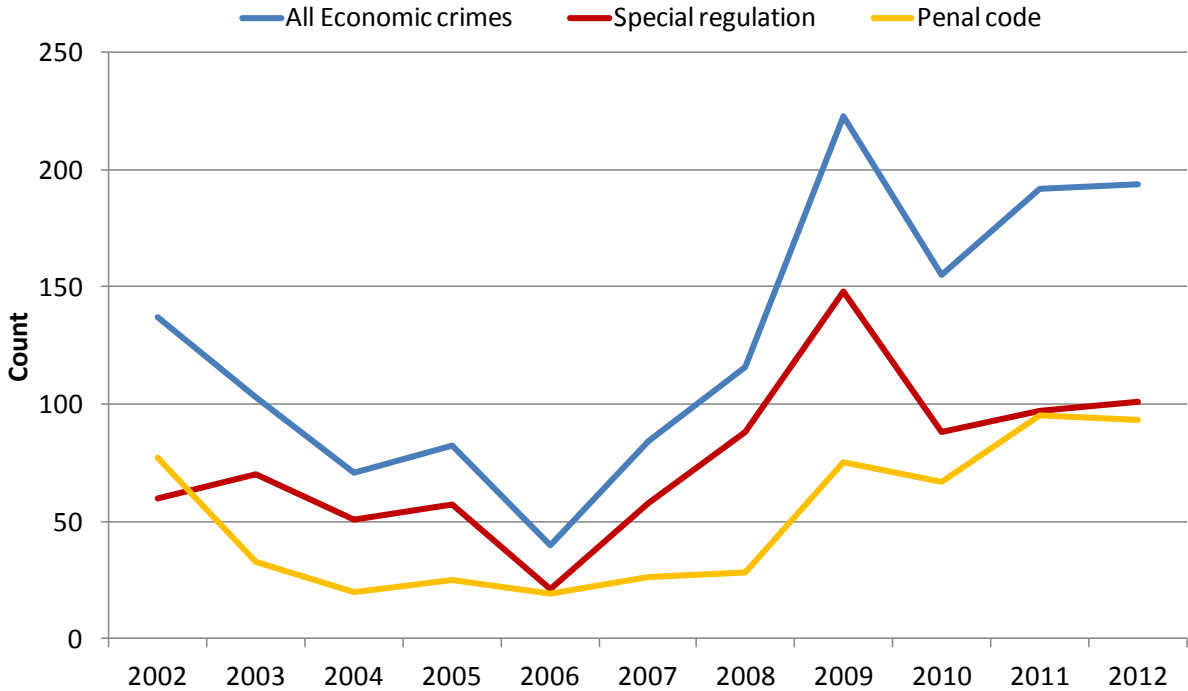
- Global financial crunch
- Yet Icelandic banking collapse inevitable regardless of global economic tornado

Was a Crime Committed?

A number of cases have been under criminal investigation involving the owners of the banks and their CEOs since the crash in 2008. Close to twenty had already been sentenced to prison in November of 2016 and a few still face criminal indictments and eventual court outcome. For this purpose, the Icelandic parliament had in early 2009 set up a Special Prosecutor to investigate criminal acts of the banks leading up to the crisis. In 2010-2012, the special prosecutor had a staff of about 100 employees and a case load of close to two hundred cases. More than forty banking executives had been criminally indicted by 2014 and a few convicted but some were awaiting final legal outcome in the Supreme Court.

To put the size of the Special Prosecutor in perspective per capita population estimates, the figure in 2012 is equivalent to if the US government set up a special prosecutor office investigating Wall Street criminal acts with a staff of about 100 thousand employees and a case load of about two hundred thousand cases. With the result that about forty thousand individuals had already been indicted for criminal wrongdoings! This shows us how seriously local authorities have taken their role in unravelling possible criminal offenses up to the crisis and how aggressively the Special Prosecutor in Iceland has approached his task. Most of his cases have involved mandate fraud, market manipulation, insider trading, and fraudulent loans (Gunnlaugsson, 2012).

Graph: Number of economic crimes in Iceland 2002-2012



Public expectations in Iceland

This author conducted a public attitude survey with the Social Sciences Research Institute in 2012, where we asked a population sample of Icelandic citizens older than 18 years old what they expected to come out of the special prosecutor efforts.

About 67 percent of the respondents believed that nothing would come out of his investigations – that no prosecutions or convictions would follow his massive investigations. Thus a major public disbelief in this effort was detected – perhaps because investigations seemed to have taken a long time without any prosecutions taking place at the time – and a disbelief that the rich and powerful bankers be convicted ending up behind bars.

What actually came out of the Special Prosecutor’s investigations?

In February of 2015 the Supreme Court of Iceland handed out their first decision on the banking collapse cases stemming from the Special Prosecutor. A total of four bank directors and bank owners received stiff prison sentences for their conduct – ranging 4-5 1/2 year unconditional prison sentences. And since then a total of about 20 bankers have been

convicted and sent to prison with a punishment ranging from 3-5 years in prison. Types of crime: Mandate fraud, market manipulation, insider trading, and fraudulent loans.

Close-Up: The Al Thani Case

- **The indictments:**

- The former CEO and the Chairman of the Board of Kaupthing Bank were indicted along with the CEO of Kaupthing Luxembourg and one of the biggest owners of Kaupthing.

- **The charges:**

- Market manipulation and fraudulent loans

- Made to look like Sheikh Mouhammed Al Thani from Qatar was buying 5% of all shares in Kaupthing in September of 2008 when in fact the purchase was fully financed by the bank itself and half of the money came through a firm owned by a big shareholder, who took no risk at all.

- **The defence methods:**

- Started attacking the prosecutor of the case and the SPO – „they do not understand banking“.

- Delaying the process of investigation and the court proceedings.

- Defence lawyers decided to quit – delaying the process for six months.

The Criminal Court Outcome in the Al-Thani Case

- Found guilty by the City District Court and the Supreme Court in February of 2015:

- CEO of the bank – 5 ½ years unconditional prison sentence

- Chairman of the board – 4 years

- CEO of Kaupthing Luxembourg – 4 ½ years

- Big shareholder – 4 ½ years

The Supreme Court: „More serious crime than any previous economic crime case“.

The Al-Thani Case Aftermath

- Convicts attempted to get their case reopened – unsuccessfully – later submitted their case to the Human Rights Court in Strasbourg for mistrial which in part has been granted.
- Many articles and interviews in the local media with those convicted and their family members claiming the following:
 - „*The Supreme Court misunderstood the case*“
- Made numerous complaints because of decisions made by Prison Authorities during serving their sentence:
 - Articles and interviews: „*These men are not dangerous and should not be in prison*“
 - New Prison law in March of 2016: After having served one year in an open prison, they were transferred to a half-way home earlier after passage of the new bill, and will in November soon serve their sentence by electronic monitoring.
- TV - interview of convicts while still in prison:
 - „*not convicted by real law*“
 - „*my only regret is believing in the justice system*“

Criminal Court Outcome of Banking Collapse So Far

- A total of 20 cases have been processed through the court system
 - 64 indictments (a number of individuals more than once)
 - Types of the cases:
 - Majority involving mandate fraud and market manipulation
 - Supreme Court decisions:

- 10 guilty verdicts – 5 district court decisions overturned
 - 6 currently in process
 - 2 not guilty verdicts
 - 2 guilty verdicts in district court not appealed
- More than 20 bankers have been sentenced to unconditional prison.
 - Stipulating a total of 63 years in prison, ranging from 1-5 years each.

Epilogue

- Many of the convicted bankers do not see or admit they did anything wrong:
 - „We are not the problem“
 - „The problem is the judicial system“
- The future?
 - More market regulation needed – stricter banking rules have already been enacted. Capital controls in place since collapse and expected to be fully lifted by this year's end.
 - Still many cases in court (as of November 2016).

New Iceland Prison Legislation in 2016

- Many positive changes towards leniency
- Possibility of community service has been increased – those who receive a sentence of 12 months unconditional prison or less can now apply for serving their sentence by community service – instead of 9 months previously.
- Family leave possible for two days when you are serving a long prison sentence.
- Earlier prison release to a half-way house and then later to electronic surveillance is now possible.

- Possibility of an earlier release from prison after serving one-third of a prison sentence if offense is committed by a 21 year or a younger offender – similar to Finland.

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