

Anomie and Timing

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Abstract

Anomie is a concept referring to chaos in a society where solidarity and conventional organization, particularly that relating to criteria and values, have weakened and been replaced by lawlessness. Anomie refers to a social situation that occurs when changes are so swift and the social situation in its wake becomes so alien that codes of conduct and values, which the general public has been accustomed to, lose their context in respect of the social reality. The author of this article is of the opinion that institutional anomie occurs when society's institutions, directly or indirectly, acknowledge principal changes in the construction of law, customs and practices, subsequently resulting in social chaos. Manifestations of anomie can be creative constructions of law and creative accounting. This article will illustrate that the privatization of the Icelandic commercial banks has several characteristics of anomie. When the financial system was privatized a process of anomie began in the society, ending upon the collapse of the financial system.

Keywords: Construction of law, creative accounting, imbalance, institutional anomie, privatization

1.0 Introduction

The concept *anomie* was initially used by the French sociologist, Émile Durkheim, in one of his essays about the division of duties in the society, i.e. "De la division du travail social", which was published in 1893. He actually also used it in another context in his essay on suicide, "Le Suicide", published in 1897. There Durkheim addressed various prevalence of suicide according to different churches, referring to how Reformation was accompanied by chaos with ancient views being rejected without being replaced by integral views and codes of ethics that have, nevertheless, developed from the time of Reformation until current times (Durkheim, 1952/1897).

- Hence, anomie is a concept referring to chaos in a society where solidarity and conventional organization, particularly that relating to criteria and values, having weakened and been replaced by lawlessness.
- Anomie refers to a social situation that occurs when changes are so swift and the social situation in its wake becomes so alien that codes of conduct and values, which the general public has been accustomed to, lose their context in respect of the social reality.

Major social changes, be they due to extensive prosperity caused by economic reasons, high rate of employment and easy access to resources, or caused by recession in production and the collapse of prices and assets, may result in a situation where law and morals no longer prevail. Generally acknowledged codes of conduct and conventions, the norms, lose their value and respect, and are not abided. Nothing replaces them. This results in a situation where anomie prevails and codes of conduct become unclear.

The author of this article is of the opinion that *institutional anomie* occurs when society's institutions, i.e. the authorities, the supervisory institutions and the courts, directly or indirectly, acknowledge principal changes in the construction of law (interpretation of law), customs and practices, subsequently resulting in social chaos!

Acknowledgement of principal changes may occur in various ways:

- By institutions literally rejecting old and generally accepted values and practices.
- By the community's institutions humiliating and silencing those who deem that new customs and practices result in undesirable conduct with unforeseeable consequences for the whole population.

- By the institutions acknowledging new and alien interpretation of conduct without fully considering the possible repercussions.
- By institutions remaining inactive when creative construction of law and accounting appear in the interaction between units and individuals in the community.

Durkheim was of the opinion that greed is totally independent from any biological limits. Therefore Durkheim found it necessary to implement rules for the financial system in order for the financial system not overriding the community's other elements (Durkheim, 1952/1897). Capital accumulation in the form of bank balances is subject to relatively small limitations with respect to space and safekeeping.

- **One manifestation of anomie is creative construction of law.** Creative construction of law with respect to legislation for the financial market refers to rules being interpreted according to the needs of a financial undertaking. This may result in increasing its activities and profitability, however, may also increase the risks in its operations.
- **Another manifestation of anomie is creative accounting.** Creative accounting refers to accounting being carried out with the purpose and objectives as intended by management rather than abiding by law and good accounting practices. The accounting of Icelandic financial undertakings before the collapse ignored, for example, the nature of lending; instead focused on the format where the guarantees were shares in the undertakings themselves. Their equity capital was overestimated, as well as the lending where the guarantees were shares or founding shares in other financial undertakings. Loans to holding companies with underlying holding (collateral) of shares in banks are subordinated loans to the relevant banks. When a margin call is made a remaining claim materializes in the underlying company. Thereby Article 85 of the Act on Financial Undertakings becomes active, i.e. that a loan that is secured with own shares requires a 100% equity capital commitment. Thereby a system risk occurs in the financial system, which cannot be read in the banks' accounting. System risk refers to how one specific transaction may cause a chain-reaction throughout the entire financial system, eventually resulting in weakening the financial system - it even collapses.

This article will illustrate that the privatization of the Icelandic commercial banks has several characteristics of anomie. During the privatization process various old values were abandoned. Legislation was interpreted in a liberal manner, to say the least, and the financial undertakings' accounting was rather focused on format than on the content and nature of the financial transactions.

2.0 Development of Legislation about the Financial Markets in Iceland

The financial market is subject to certain principles. This is in fact acknowledged in that through legislation the legislator has implemented more detailed rules of the game on the financial market than in commerce in general. Very strict legislation applies to financial undertakings. It has developed in tune with the activities on the market and is based on experience and need. Hence, it applies in particular to the accepted and known, however, less so to innovation. In this respect the community must rely on professionalism, responsibility and caution prevailing in commercial operations.

In their activities and business, the banks and other financial undertakings must abide by the various rules of law and instructions set forth by the authorities. These rules are not least intended to safeguard the interests of those doing business with the banks, i.e. both those depositing money and those borrowing money. The first-mentioned rarely have much opportunity to monitor or obtain information about the disposition by the bank or the financial undertaking of their money, i.e. which has been received either as deposit or loan. The owner of a savings account who deposits his money at a bank is extending a loan to the bank. This loan is without guarantees; instead the owner of the savings account must be able to rely on the bank requiring fully valid guarantees when using the depositor's money in its lending activities.

Financial undertakings, in the widest interpretation of the words, i.e. banks, savings funds, stock brokerages, insurance companies and pension funds, are units that are linked to public interest. Act no. 79/2008 on Chartered Accountants, contains special requirements about the independence of the auditors of such units. Additionally, these units are subject to special supervision by the Financial Supervisory Authority - Iceland.

A directive, dating back to February 9th, 1798 for improving legal security in lending activities is still valid in Iceland. This is a part of a very old tradition and falls well under the umbrella of Durkheim's theories in the opinion of sociologists.

It should also be mentioned that among the oldest current law, which is of considerable significance in civil law contracts, is the act on bank drafts and acts number 93 and 94/1934 on checking accounts, both based on similar legislation in Scandinavia at this point in time. Both types of financial instruments, bank drafts and checks, are subject to stringent conditions of format, and all case law focusing on these laws is based on this stringent format.

The website of Financial Supervisory Authority lists 30 laws that apply to the financial market, the oldest one dating back to 1991. Most of these laws are adoption of EU directives on grounds of the EEA Agreement, i.e. cf. Act no. 2/1993. The Financial Supervisory Authority’s list, however, is short of the Act Respecting Public Limited Companies no. 2/1995, because financial undertakings shall be operated as public limited companies and the rules of law on public limited companies shall apply to savings banks that are not operated as public limited companies. It is interesting to note that the Supreme Court has only rendered judgments in nine cases during the period 1999 through 2008 where the Act on Public Limited Companies was put to the test.

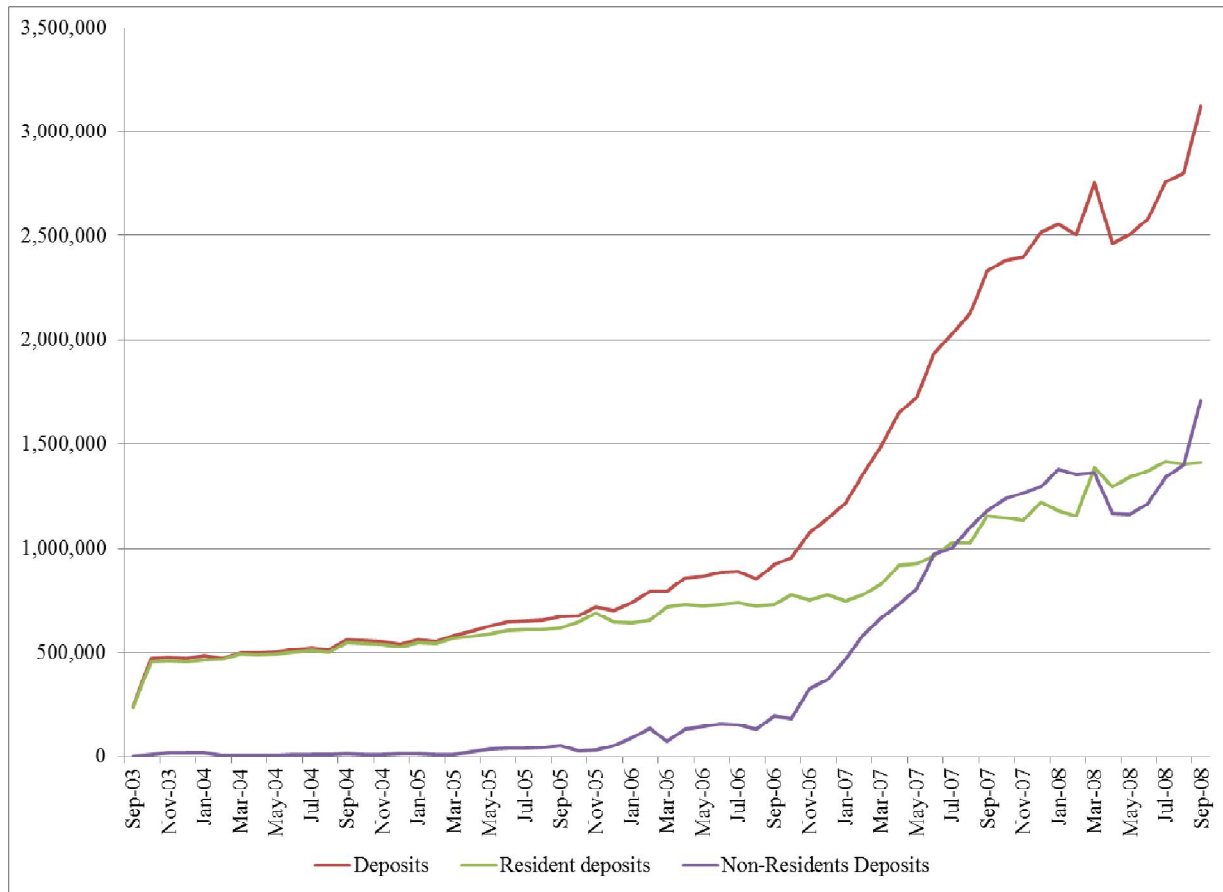


Figure 1: Deposits at Banks and Savings Banks (Central Bank of Iceland, 2008a)

The financial market in Iceland grew considerably in size during the years from 1998 to 2008. The banks increased lending to their domestic customers, they started lending to foreign customers (figure 1), and they established branches and subsidiaries abroad, as well as the banks beginning to collect deposits abroad through their subsidiaries there. Examples of this are primarily the *Icesave* savings accounts of Landsbanki Íslands HF in the UK and the Netherlands, where the deposits grew very quickly. The deposits abroad increased by about EUR 2.1 billion (Central Bank of Iceland, 2008a), i.e. from the end of June 2008 until the end of September 2008, which is about the amount discussed in the negotiations of the Icelandic authorities with the authorities in the UK and the Netherlands.

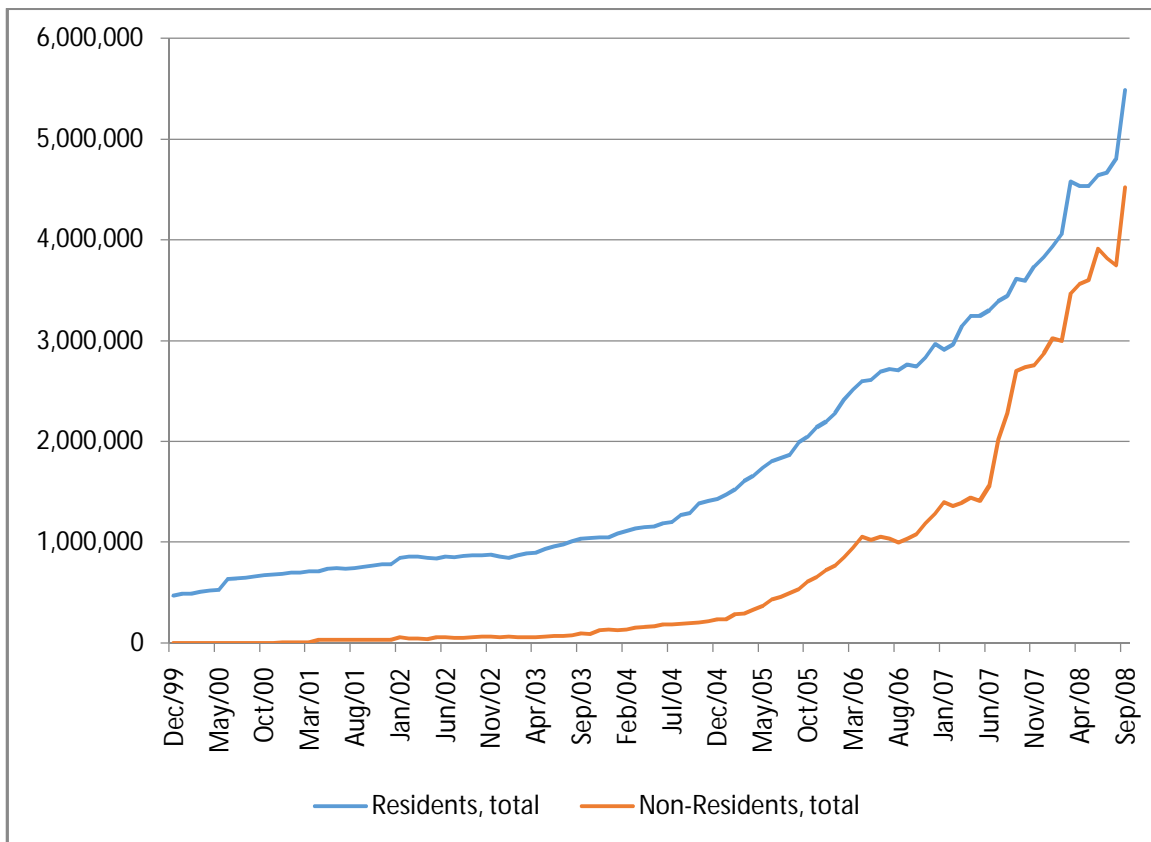


Figure 2: Lending in the Banking System. Development of loans to Residents and Non-Residents in the Domestic Part of the Banking System in ISK Thousands (Central Bank of Iceland, 2008b)

During the period referred to in figures 2 and 3, two state-owned banks were turned into public liability companies, i.e. Landsbanki Íslands (the National Bank) and Búnadarbanki Íslands (the Agricultural Bank), and investment funds were merged into the FBA Investment Bank, i.e. the Fisheries Loan Fund of Iceland, the Industrial Development Fund and the Industrial Loan Fund. FBA was subsequently merged with a bank that had materialized from another state-owned bank, i.e. Útvegsbanki Íslands (The Icelandic Fisheries Bank) and three privately-owned banks, i.e. the People's Bank hf, the Industrial Bank of Iceland hf and the Icelandic Bank of Commerce hf. Eventually all the new banks were privatized.

During the period 2003 to 2008 developments occurred which no one had foreseen and no supervisory body concerned itself with, however, there were those who had major interests in this situation. The financial system expanded and the banks' lending increased from a single GDP to five to six fold GDP, nota bene excluding the lending by the subsidiaries abroad.

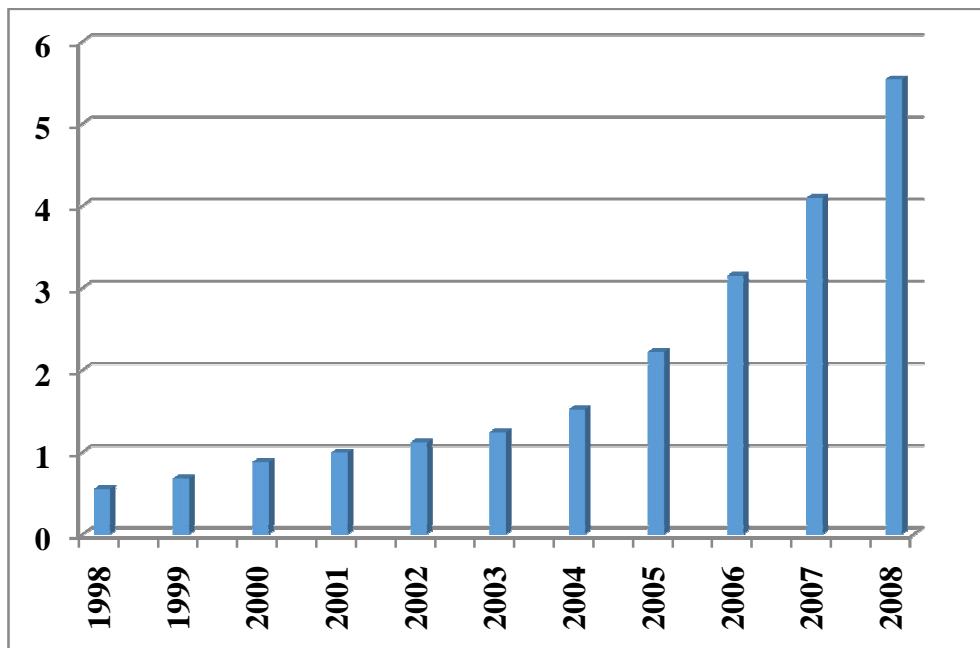


Figure 3: Lending in the Banking System Icelandic Bank Lending Relative to GDP Annual Lending (Central Bank, 2008b)

The last state-owned banks were turned into public limited companies in 1998 and then sold and privatized in 2003. At that point a major lending increase occurred in the banking system, both to domestic and foreign borrowers, individuals and corporations.

It should be kept in mind that the banks were privatized at the same time as the financial system was regulated. There is a common misunderstanding that the laws and regulations about the banking system in Iceland were abolished, or deregulated during the privatization process, because as stated above the EU regulatory framework was formally adopted in Iceland prior to and during the privatization.

On 3 February 2003 the Financial Supervisory Authority entered into a decision on the competence of Samson Holding ehf for holding shares in Landsbanki Íslands hf. The decision's title was as follows:

“Decision cf. Section VI of Act no. 161/2002 on Financial Undertakings regarding evaluation of the competence of Samson Holding ehf to hold an active share in Landsbanki Íslands hf.”

The decision's section titled Decision, item 3, states the following, however, the document had a preamble and description of the case procedure and data gathering:

“In its letters to Samson and in discussions with its owners the Financial Supervisory Authority has placed much emphasis on it being ensured that their holding in the bank, if realized, does not provide them with a position or gains, other than those entailed in the gain by general shareholders from healthy and profitable operations of the bank. Hence, that the company, its owners, related parties or the elected representatives on the bank's board of directors do not enjoy privileges within the bank, for example, business terms, intervention in commercial decisions pertaining to themselves, related companies or the competition, or information about the business of current or pending competitive enterprises.”

Considering the history and the background, one cannot but consider the extent of supervision and follow-up by the public authorities in this context. It must be kept in mind that the government parties channeled the banks into ownership by parties who reflected their cooperation and also reflected the old rule on a “50/50 split” that appears as certainly still having prevailed. It should also be borne in mind that the CEO of the Financial Supervisory Authority was at this time closely linked to one of the government parties. One of the parties purchasing a bank was the then minister of commerce and banking, i.e. at the time of hiring of the Supervisory Authority's CEO. One of the bank directors of the other bank was the secretary general (permanent undersecretary) of the Ministry of Commerce and Banking at this same time.

The CEO of the Financial Supervisory Authority and he were closely linked through personal friendship. The Financial Supervisory Authority's lack of supervision and follow-up must be viewed in light of these facts.

3.0 Balance and Imbalance

Various structural units may be set up in conventional and regulated democratic societies as can be seen, for example, in figure 1. In circumstances as described there institutions safeguard internal balance; each unit providing constraint to the other units through appropriate means and measures.

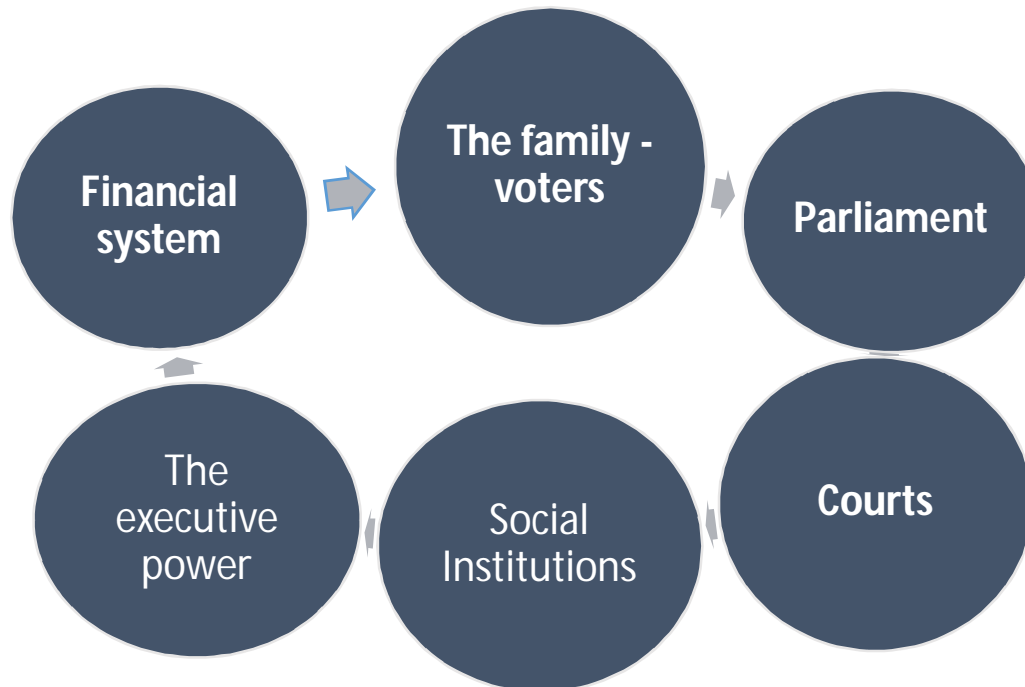


Figure 4: Society in Balance

The financial system has one thing over and above the other institutions that are listed above: the executive power is subject to certain restrictions under the national budget, whereas the financial undertakings have almost unhindered access to capital. Public institutions may not act without authorizations (referred to as authorizations by law), whereas private parties may literally do anything provided it is not prohibited. As stated before the public authorities have set detailed rules for private banks and savings banks that are intended to restrict their maneuvering space, although they, as such, are “private parties”. The financial undertakings that are given the right to receive the savings of the general public and to generate money on the market must accept, however, needing legal authorizations for the business they engage in despite being private entities. Creative construction of law and innovations in their activities must therefore be restricted through effective public supervision and appropriate measures.

One of the things that went dramatically wrong at the banks was their system of remuneration (salaries/bonuses). Management was allocated bonuses from their banks' profits. There were also indications of this in the banks' hospitality allowances (Páll Hreinsson, Sigríður Benediktsdóttir and Tryggvi Gunnarsson, 2010c). This does not include the high grants for various cultural events.

When imbalance materializes as a result of one unit overheating it may be assumed that the Icelandic parliament, Althingi, and the executive power and, as appropriate, the judicial power, would take measures to create balance through law amendments or judicial measures.

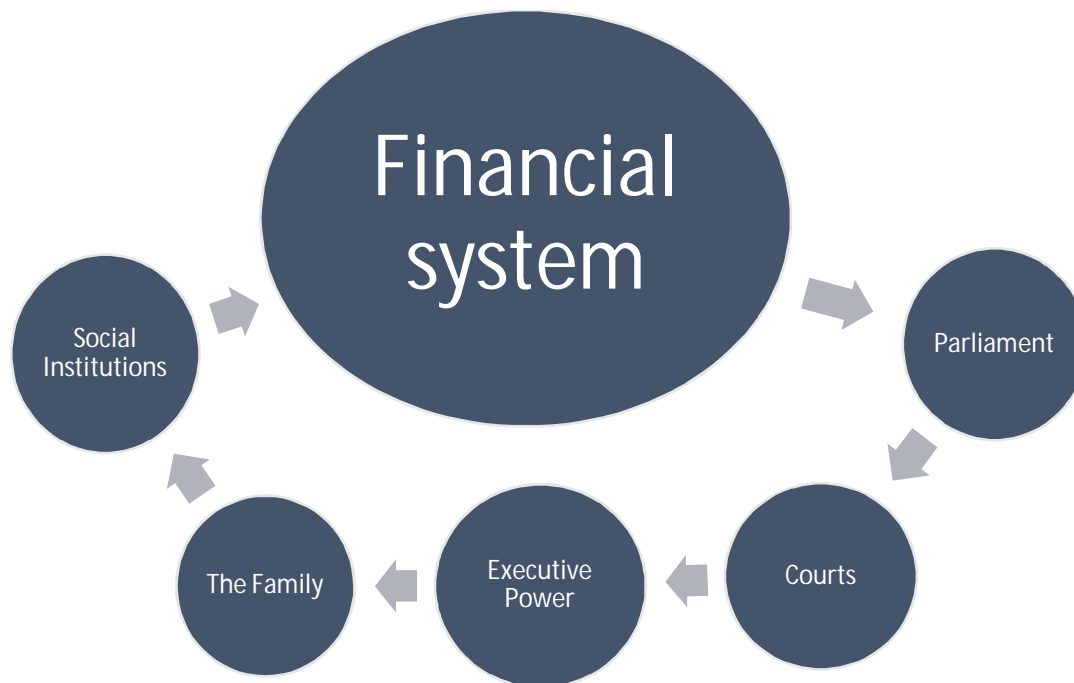


Figure 5: Society Imbalance

When the financial system was privatized a process of anomie began in the society, ending upon the collapse of the financial system. At this time the society went out of balance and the financial system overheated. Not only DID individuals find it as their right to exploit the new “resource” as the banks were seen, but also the state institutions deemed it as both appropriate and normal to do so, for example, academics did not see anything wrong in turning to the banks in their quest for grants. Anomie did not only exist among individuals, but also in the society’s institutions. The politicians were no exception here.

It is appropriate at this point to refer to the coalition platform of the government that came to power after the national elections in 2007, stating the following among other things:

“The changes in the Icelandic economy in recent years are entailed, among other things, in the increased weight of various international service activities, including financial services. The government aims towards ensuring such activities continuing to grow in Iceland and that new fields are explored in competition with other market areas, and towards globally expanding enterprises realizing the benefits from having their headquarters in Iceland” (Páll Hreinsson and others, 2010c, page 78).

The president of the Republic of Iceland and government ministers participated in the promotion efforts of the Icelandic banks way until the middle of 2008. The president of Iceland stated the following in a speech given at a meeting of the Icelandic Society of Historians about the “global expansion”:

“The answer is also entailed in safeguarding the foundations; that the ambitious global expansion team always remains alert; that they do not lose their footing despite their successes: that they continue to appreciate the society that has fostered them and appear with dignity and fairness, not only towards the Icelandic nation but also towards the people of other countries; that they do not forget that the global expansion is in fact based on the history, culture and **moral wisdom** (author’s bold lettering) of the Icelandic people “ Ólafur Ragnar Grímsson, 2006, page 9).

When the financial system of an entire nation collapses to such an extent that over 60% of the banks’ asset portfolios disappears, there can be no doubt that the supervisory bodies have severely failed. Perhaps it is not correct to say that the asset portfolios vanished in a matter of minutes when considering that the activities of the financial undertakings had developed in one direction for some time, finally crashing in October 2008. Judging by the report by Althingi’s Investigative Commission it is not possible to determine there having been any difference in the nature of the causes of the collapse of individual financial undertakings.

The supervisory bodies of financial undertakings are:

- The boards of directors and the executive management of the financial undertakings.
 - No board member or executive manager of the financial enterprises has admitted to any wrong doing.
- The chartered accountants of the financial enterprises.
 - Accounting firms deem that the accounting of the banks was in conformity with international audit procedures and that the audit had been carried out in a satisfactory manner.
- The Icelandic stock exchange and the financial enterprises with respect to market manipulation.
 - The duty to notify held by the Icelandic stock exchange and the financial undertakings and their employees, is clear if suspicion arises on market manipulation. When reading the report by Althingi's Investigative Commission on the trading by Landsbanki, Kaupthing and Glitnir with their own shares one cannot but conclude that these banks engaged in organized market manipulation in order to keep the prices of their shares up (Páll Hreinsson and others, 2010b, page 116). The summary conclusion by the Investigative Commission stated the following among other things: "Referring to the aforementioned, the Investigative Commission deems that there is overwhelming likelihood of the banks' trading with their own shares, which the analysis addressed, was carried out with the purpose of providing misleading information about the demand for the shares, and thus affecting their prices. The extent of such trade was so high that it would not have been possible to continue the purchases except with some sales being made as a counteraction or by flagging publically the accumulated shareholding. In many instances the banks granted loans to selected customers at favorable terms, even without any guarantees, in order to grease the wheels for such sales. Referring to the aforementioned analysis, the Investigative Commission deemed it as clear that it is highly inappropriate for a bank or a financial undertaking being a market maker in trading in its own shares, not to mention also being the lenders in related transactions" (Páll Hreinsson and others, 2010c, page 65). Althingi's Investigative Commission also stated the following in its report, among other things: "The extensive share of holding companies is interesting. Loans to holding companies are not guaranteed by solid operating results; instead various financial instruments constitute the main assets, frequently shares. It may be deemed that a loan to a holding company, which owns shares in a certain company, is similar to a subordinated loan to a public limited company. The reason is that if the said public limited company encounters problems the creditors of the company are paid first, then the shareholders, and thereby the creditors of the holding company. The market risk because of the underlying assets of a holding company to whom a loan is made is therefore extensive unless the asset portfolio of the holding company is much spread or the company is very solid with a high equity ratio. A low equity ratio and a higher ratio of intangible assets of undertakings are among the factors that forecast in a statistically reliable manner a low ratio collection of loans" (Páll Hreinsson and others, 2010a, page 95). It also materialized in testimonies in court in case no. E-4033/2008, i.e. the District Court of Reykjavík, Vilhjálmur Bjarnason versus the board members of Glitnir Bank hf, that the purpose of buying shares from a bank director who was leaving was to prevent the shares from going on the general market, as this would cause their price to drop.
- The Financial Supervisory Authority and the Central Bank
 - These institutions relied on the audit reports that were signed by the international accounting firms. The Financial Supervisory Authority appears not to have carried out on-site inspections in a satisfactory fashion. The following quote is contained in the report by Althingi's Investigative Commission: "Glitnir had a hard time holding on to their compliance officers and there was much personnel turnover at the bank. "Some joked about how he or she, who came in last to work, would be given the compliance-officer title", said a compliance officer of Glitnir, Kristinn Arnar Stefánsson, who started working there in 2007 after having served with the Financial Supervisory Authority and then as a compliance officer at Landsbanki. When he joined the staff of Glitnir, the Financial Supervisory Authority had inspected the compliance activities at Glitnir, giving them a very bad rating, stating the following among other things: "As for the compliance activities, almost all factors examined by the Financial Supervisory Authority received negative comments. The Authority's conclusion is that the implementation of compliance supervision is severely lacking". Additionally, various observations were made regarding the bank's private banking service, its asset management, the handling of complaints, the employees using mobile telephones when talking to customers, just to mention a few examples. Reading the report, it is in fact unbelievable that here is a description of an international bank with an operating license" (Páll Hreinsson and others, 2010c, page 52).

According to the report by Althingi's Investigative Commissioner, it cannot be seen that these observations were ever followed up.

4.0 When was Anomie Perfected?

As addressed above a change occurred on the Icelandic financial market when the state-owned banks were incorporated and with the founding in 1998 of the FBA Investment Bank, and subsequently with their privatization.

The privatization ended in the beginning of 2003. Parallel, senior executives and employees were pushed aside and replaced by a new generation of executives and managers. At the same time the Bank Supervisory Authority was separated from the Central Bank of Iceland with the establishment of the Financial Supervisory Authority – Iceland, where bank supervision and the Insurance Supervisory Authority were merged. These bodies also underwent replacement of their executive teams. The new executives possessed very limited experience of the financial market.

It is commonly known, however, that in our neighboring European countries it is maintained that no one can become the supreme executive of a bank without having extensive experience of the financial market. As a minimum, one must have experienced and survived at least one economic recession with its entire write offs and difficulties, for example, having addressed the problems of fishing companies when the fishing season fails.

Things began to happen on the stock-exchange scene around the middle of September 2003. In the early hours of the morning of 18 September the executives of the undertakings that were registered at the Icelandic stock exchange negotiated the division of ownership of six companies. The total of this transaction was about 42% of the market price of the companies cf. the OMX-15 index (ICE-15) (“Extensive Reorganization of Conglomerates”, 2003). The individuals who had purchased shares in the banks were the leading bodies in these transactions.

The main conclusion of this business transaction was that the ownership of HF. Eimskipafélag Íslands was moved over to Landsbanki Íslands hf, i.e. the company's commercial bank.

The notification to the stock exchange on 26 September 2003 stated the following among other things:

“Name of the notification-duty party: Landsbanki Íslands hf. Address: Austurstraeti 11, Reykjavík”.

Number of shares before trade	506,520,728
Number of shares after trade	525,011,323
Percentage of total share capital before trade	9.83%
Percentage of total share capital after trade	10.19%

The Landsbanki Íslands hf has furthermore entered into a forward agreement on the purchase of ISK 303,403,659 at nominal value, referring to the notification to the stock exchange dated 19 September last. The bank's share after the trade amounts to ISK 828,414,982 at nominal value, or 16.08% of the total share capital. Additionally, the Landsbanki has the mandate to represent votes at a shareholders meeting to be held on 9 October next, totaling 10.41% of the total share capital” (The Nordic Exchange, e.d.)

The largest shareholder of Landsbankinn at this time, Samson Holding Company ehf and the related parties, were among those included in the 10.41% share, which Landsbankinn stated itself as representing on grounds of a mandate. Landsbankinn and its principal owner thus held joint ownership of HF. Eimskipafélag Íslands.

Section IV of Act no. 161/2002 on Financial Undertakings addresses the operating licenses of financial undertakings. The Act's Article 20 discusses the operating licenses in 14 numbered items, as well as in a few other items, all of which describe normal financial activities. The word “risk” appears no less than 55 times in the Act on Financial Undertakings in different contexts, i.e. as the law was in 2008 after having undergone several amendments. Emphasis is placed on the risk management of financial undertakings and on limiting their risks. Financial undertakings are not prepared to shoulder the operating risks of their customers.

The Act's Article 22 states the following regarding actions over default by customers:

“Temporary activities and takeover of assets

Commercial banks, savings banks and credit undertakings may only pursue activities other than those listed in this Chapter on a temporary basis and for the purpose of concluding transactions or reorganizing the activities of customers.”

As stated before Landsbanki Íslands hf was the commercial bank of HF. Eimskipafélag Íslands in September 2003 and had in fact been so since the founding of the steamship company back in 1914. The interaction between a commercial bank and its customer is confidential. It is fair to compare it to the confidentiality between a priest and a parishioner, which is an unregistered relationship, or the confidential relationship between a physician and the patient, which is confidential as provided for in the Hippocrates Oath.

The participation of Landsbanki Íslands hf in the purchase of shares in HF. Eimskipafélag Íslands was in breach of laws and regulations:

- Breach of the registered rules of the Act on Financial Undertakings by interpreting the word “reorganizing” in Article 22 as if this were a general reorganization of the company as opposed to the prerequisite of the bank’s involvement being measures taken on grounds of customer default.
- Breach of the unregistered rules on the confidential relationship between a bank and its customers, as Landsbankinn utilized confidential information of a commercial bank about its customer.
- Additionally, it is appropriate to consider the rule of equality of the Corporate Act when examining the agreement of 28 September 2003, because there were very few shareholders in the shareholding undertakings that entered into decisions on the disposition of the undertakings’ assets to guarantee their private interests.

These same views are contained in two reports and opinions by the Icelandic Competition Authority:

- Decisions by the banks and the authorities on the future of businesses on the competition market. (Icelandic Competition Authority, 2008). Opinion no. 3/2008, dated 12 November 2008.
- Restoration of Icelandic businesses. Fishery achievers or zombies, report. Publication no. 3/2012 (Icelandic Competition Authority, 2012).

The author of this article was a shareholder in H.F. Eimskipafélag Íslands when the said business transactions took place. The author turned to the Financial Supervisory Authority – Iceland in the wake of these transactions, submitting his views as stated above. The Financial Supervisory Authority did nothing in respect of these objections. The author knows that the chairman of the board of H.F. Eimskipafélag Íslands also turned to the Financial Supervisory Authority at this same time, submitting a letter raising objections about these transactions and conduct. The Supervisory Authority never responded to this letter. Hence, in this respect one cannot but think about the old “50/50 split rule” that apparently prevailed and the political relations of the CEO of the Financial Supervisory Authority at the time.

5.0 Conclusion

The trading in shares that took place on 18 September 2003 and the reaction of the supervisory bodies to this trading fall well within the concept of *anomie*. Anomie certainly occurred in Icelandic commerce during 1998-2003. There was also *institutional anomie*, as the supervisory institutions totally failed in their duties when accepting the creative construction of the Act on Financial Undertakings, i.e. in respect of the stringent authorization for taking over the operation of a customer in order to satisfy the claims of a financial undertaking. Furthermore, the rules on the equity capital of financial undertakings were widely interpreted on grounds of the wishes of financial undertakings by fully ignoring the nature of loans that certainly met the conditions of format.

The business transactions on 18 September 2003 and the reaction by the supervisory institutions to complaints over these transactions were clear indicators of the strategy the supervisory bodies were going to follow. This is clearly illustrated by the dramatic and unavoidable collapse of the financial system in October 2008!

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