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Our Ref: MS/JY/32864.1

Your Ref:

19 December 2009

The Budget Committee
Althingi
Austurvollur
150 Reykjavik
Iceland

FAO: Mr Gudbjartur Hannesson

Advice in relation to the Icesave Agreement

STRICTLY CONFIDENTIAL AND LEGALLY PRIVILEGED

Dear Sirs,

INSTRUCTIONS

We refer to our letter to the Budget Committee of the Althingi dated 11 December 2009.

Where we refer to an agreement, the reference is that agreement as amended unless the context requires otherwise. The advice given in this is are given on the basis of the assumptions and reservations detailed in Parts 3 and 4 of Appendix Two of this letter respectively.

We have been asked to provide our views and, as appropriate, to make observations on the following matters:

1. the wording and substance of the Icesave Agreement in particular in light of the interests of the various parties involved. In particular you asked us to provide our advice on the content and the terms of the Icesave Agreement, whether their terms are considered by us to be customary, in light of the terms of comparable agreements of which we are aware and our experience, and whether the agreement reflects that the parties were on equal footing during

the course of the negotiation (see Chapter 1 - Terms of the Icesave Agreement);

2. the impact on the interests of Iceland or Icelandic parties as a result of the position that any potential litigation in the future in the United Kingdom regarding a dispute under the Icesave Agreement is subject to English law and jurisdiction. In particular you have asked us to address whether the contractual provisions, based on such grounds, would result in the legal position of the Icelandic State or Icelandic parties, such as Landsbanki Íslands hf. and its subsidiaries, being weakened and whether the legal position of the British & Dutch State or British & Dutch parties is strengthened (see Chapter 2 - Jurisdictional Issues);

3. the impact of any potential future revision and amendments of the European legislation on deposit guarantee schemes as it was in October 2008 not least regarding any guarantee by a home state, on the content and validity of the Icesave Agreement and the obligations of the Icelandic State or the Icelandic parties under the Icesave Agreement. In particular you asked us to refer to the existing legal obligations of the Icelandic State or Icelandic parties under the European legislation of deposit guarantee schemes and their impact on the Icelandic State or Icelandic parties (see Chapter 3 - European Legislation); and

4. the potential legal repercussions if the final acceptance of the draft bill for a sovereign guarantee for Icesave loans from October 19th 2009, amending Law No. 96/2009 (the "**Icesave Bill**") would be delayed and/or not adopted as Icelandic law by the Icelandic Parliament, Althingi. In particular we have asked us to evaluate, on grounds of such circumstances, the most appropriate way forward for all the relevant parties to bring the Icesave matter to a successful conclusion (see Chapter 4 - Matters to be considered by the Budget Committee of the Althingi).

Please note that certain of these questions overlap and therefore cross-reference between Chapters is necessary to form a full understanding of our advice and to avoid unnecessary repetition.

We have further obtained a note of advice in relation to certain aspects of the matters we have been asked to consider from Matthew Collings QC, which is annexed to this letter in Appendix One. This note provides a summary of the position as we and he perceive it.

This letter addresses matters which are extremely sensitive. Moreover, it refers to the terms of agreements which are themselves confidential between the parties. Careful consideration should be given to the adverse consequences of any disclosure of this document or its contents other than to those to whom it is directly addressed.

BIOGRAPHIES

The advice contained in this letter has been prepared by:

Mike Stubbs – Partner, Mishcon de Reya

Mike, who is a solicitor and a licensed Insolvency Practitioner, acts for office holders, banks, corporations and sovereign countries in difficulty on all aspects of Corporate & Banking Recovery and Insolvency. His work includes business rescue and reconstruction; business and asset disposals and acquisitions; international tracing and recovery of assets, associated litigation and compliance and professional issues. Mike's specialisation is 'problem solving' and as such he has a colourful background in some of the most unusual insolvency and quasi insolvency matters during the last 20 years, in addition to his wide ranging general insolvency practice. Insolvencies on which he has advised include those of Robert Maxwell, Polly Peck International and a number of major insurance company failures.

John Young – Associate, Mishcon de Reya

John Young is a senior solicitor at Mishcon de Reya and acts primarily for corporations. He has particular expertise in complex international transactions, including distressed corporate transactions, and advising on the corporate aspects of litigation. John regularly assists Mike Stubbs on a variety of matters.

Matthew Collings QC – Barrister, Maitland Chambers

Matthew Collings' expertise lies firmly in the areas of company and insolvency litigation and advisory work, in which he has established a strong reputation, and for which he is recommended in *Chambers Global*, *Chambers UK Directory*, and *The Legal 500*. He has appeared in over a hundred reported cases, and has been instructed in connection with most significant corporate and insolvency matters, including recently against the British Government on behalf of the shareholders of Northern Rock.

Rebecca Stubbs – Barrister, Maitland Chambers

Rebecca Stubbs is widely recognized as a leading junior barrister in the field of company and insolvency and restructuring law, with expertise in the fields of banking, financial services and civil fraud and asset recovery. She is recommended in *Chambers UK*, *Chambers Global* and *The UK Legal 500* for company, commercial Chancery litigation and insolvency. She has spent much of the last year advising and appearing for the Administrators of Lehman Brothers (International) Europe, including as to the implementation in the United Kingdom of European directives including MiFID. Rebecca has particularly contributed to the European aspects of this advice.

Biographies of other team members are available on request.

BACKGROUND

In providing our advice it is necessary to consider the background circumstances concerning Landsbanki and the actions of the Icelandic, British and the Dutch Authorities in respect of the Icesave Agreement and Landsbanki. The following contains references to the basic facts as we understand them to be, subject to full investigation and verification.

1. In October 2006, Landsbanki introduced "Icesave", its online savings account, in the United Kingdom, though its London branch ("**Landsbanki London**").

In May 2008 Landsbanki launched Icesave in the Netherlands, though its Amsterdam branch ("**Landsbanki Amsterdam**").

2. The deposits made into Icesave accounts by Landsbanki's customers were covered, for an amount of up to €20,887 per depositor, by TIF. TIF is an Icelandic private foundation established under Icelandic Law No 98/1999 on Deposit and Investor Compensation Scheme ("**Law No 98/1999**") for the execution of the Icelandic Deposit Guarantee Scheme. This was required in order to implement Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes (the "**Directive**"). Subsequently Landsbanki joined FSCS' deposit guarantee scheme to obtain top-up cover for its clients between the level offered by TIF and £35,000 and, at a later date, the maximum level of top-up cover provided by FSCS was increased to £50,000.

3. On or about 31 October 2006 FSCS and TIF entered into a (legally non-binding) Memorandum of Understanding (the "**MOU**") setting out, inter alia, certain principles for the handling of claims for compensation from depositors with deposits at UK branches of certain Icelandic banks.

4. During the spring and summer of 2008 there were ongoing discussions and meetings held between the Icelandic and British Authorities concerning Icesave, and in particular about the bringing of Icesave within the jurisdiction of the United Kingdom, with assets to match. This however did not take place for reasons that are not entirely clear.

5. In September 2008 there were further meetings held between the Icelandic and British Authorities regarding Icesave. We understand that in September 2008 the Icesave accounts in the United Kingdom held approximately £4.8 Billion and the Icesave accounts in the Netherlands held approximately €1.7 Billion in the Netherlands.[1] We further understand that shortly following these meetings the British Authorities began preparing for the actions ultimately taken by them in early October 2008 and referred to below. Clearly these actions would

[1] Report on Banking Regulation and Supervision in Iceland: past, present and future by Mr. Kaarlo Jannari, dated 30 March 2009, page 17.

have taken some time to prepare but it might be fair to observe that other market disturbances were also occupying HM Treasury as well, in particular in relation to the Royal Bank of Scotland.

6. On 6 October 2008 the Althingi adopted Icelandic Law No 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc. (the "**Emergency Act**"). The Emergency Act allowed the Icelandic Financial Services Authority (the "**FME**") to intervene in the operations of the Icelandic banks and take them over, as well as making all deposits of such banks preferred claims in the event of an insolvency. On the same day the online Icesave accounts in the United Kingdom and the Netherlands ceased to function, so that depositors were unable to access their Icesave deposits at Landsbanki.

7. On 7 October 2008 the FME took control of Landsbanki on the basis of the Emergency Act and appointed a Resolution Committee to manage the affairs of Landsbanki. Soon afterwards a dispute emerged between Iceland on one hand and the United Kingdom and the Netherlands on the other hand as to whether Iceland was obligated to guarantee the payment of the minimum compensation of €20,887 required by Law No 98/1999 and the Directive.

8. On 8 October 2008 the UK Authorities imposed the Landsbanki Freezing Order 2008 No 2668 (the "**Freezing Order**"), a Statutory Instrument under the Anti-Terrorism, Crime and Security Act of 2001. The Freezing Order came into force at 10.10am and effectively froze the assets of Landsbanki in the United Kingdom. The reason given for making the Freezing Order was that *"The Treasury believe that action to the detriment of the United Kingdom's economy (or part of it) has been or is likely to be taken by certain persons who are the Government of or resident of a country or territory outside the United Kingdom"*. It is our view that the Freezing Order route was employed because the Banking (Special Provisions) Act of 2008 could not be used, nor could Landsbanki be subject to an insolvency process in the UK by reason of The Credit Institutions (Reorganisation and Winding Up) Regulations 2004, as Landsbanki was an Icelandic legal entity. The Freezing Order had the effect of ring-fencing the assets of Landsbanki in the United Kingdom (so that they

could not be repatriated to Iceland), but allowed Landsbanki London to continue to trade.

9. On 13 October 2008 Mike Stubbs of Mishcon de Reya travelled to Iceland and met with Mrs Greta Ingthorsdottir at the Prime Minister's office. At this meeting Mike Stubbs furnished the Prime Minister's office with copies of the Freezing Order, which they had not previously seen, and discussed a number of pertinent issues, subsequent to which there was correspondence in early 2009 prior to Mishcon de Reya being engaged in March 2009 as mentioned below.

10. On 4 November 2008 FSCS decided to pay out compensation in full to the UK Icesave retail depositors (but not wholesale depositors, who included local councils and charities), in return for an assignment of their claims against Landsbanki in respect of the Icesave accounts to FSCS. The Dutch Central Bank ("**DNB**") decided at a later date to provide compensation for the Dutch Icesave deposits, up to a limit of €100,000. See, here, paragraphs 11-13 of the Opinion of Matthew Collings QC.

11. On 14 November 2008 the Governments of Iceland, the United Kingdom and the Netherlands agreed upon common guidelines as to how to deal with issues arising from the Landsbanki insolvency (the "**Brussels Guidelines**").

12. On 24 February 2009 the Icelandic Finance Minister authorised the creation of a negotiation committee for foreign currency loans for TIF (the "**Icesave Committee**") in accordance with the resolution of the Icelandic Government on the same date and a resolution of the Althingi.

13. On 11 March 2009 Mishcon de Reya was instructed by the Icesave Committee to consider certain aspects of the Icesave situation and to brief the Icelandic Foreign Minister before his meeting with his counterpart in the United Kingdom, David Miliband. On 26 March 2009 Mishcon de Reya presented its initial findings to the Icesave Committee and on 31 March 2009 Mishcon de Reya met with the Icelandic Foreign Minister to brief him on its findings in relation to certain aspects of Icesave.

14. On 5 June 2009 the following documents were entered into and/or exchanged between the following parties:

(i) The UK Loan Agreement;

(ii) The Dutch Loan Agreement;

(iii) The UK Settlement Agreement; and

(iv) The Dutch Side Letter,

the "**5 June Agreements**".

15. On 30 June 2009 the Icelandic Minister of Finance submitted a new Bill to the Althingi regarding the authorisation for the Minister of Finance, on behalf of the State Treasury, to issue a sovereign guarantee of TIF's obligations under the 5 June Agreements (the "**Icesave Bill**"). Subsequently the Bill was amended during deliberations in Althingi and a number of preconditions and reservations (the "**Preconditions**") were put in place for the granting of the sovereign guarantee by Iceland. The Icesave Bill, as amended, provided that for the sovereign guarantee to come into effect all the Preconditions would be required to be presented to the British and Dutch Authorities and accepted by them.

16. On 22 July 2009 Mishcon de Reya wrote a letter to the Budget Committee at their request.

17. On 28 August 2009 the Althingi adopted Icelandic Law No 96/2009 regarding authorization for the Minister of Finance, on behalf of the State Treasury, to issue a guarantee for the fulfilment of the loan agreements granted by the Governments of the UK and the Netherlands to TIF to cover payments to the depositors of Landsbanki (the "**Icesave Law**"). This law was in the form of the Icesave Bill as amended by the Althingi.

18. Shortly afterwards it became clear that the British and the Dutch Governments were not ready, willing or able to agree to all the Preconditions adopted by the Althingi in the Icesave Law, subsequent to which the Icelandic Government

moved to conclude further amendment agreements with the British and the Dutch Governments on 19 October 2009.

19. On Friday 19 October 2009 the following documents were entered into and/or exchanged between the following parties:

(i) the UK AAA;

(ii) the Dutch AAA;

(iii) the UK Settlement Amendment Agreement;

(iv) the UK Currency Side Letter;

(v) the UK General Side Letter;

(vi) the Dutch Currency Side Letter; and

(vii) the Dutch General Side Letter,

the "**19 October Documents**"

20. On 19 October 2009 the Icelandic Minister of Finance submitted a new Bill to the Althingi amending Law No 96/2009 in line with the 5 June Agreements as amended by the 19 October Documents. The Althingi is currently debating this Bill.

21. On 10 December 2009 the Budget Committee of the Althingi appointed Mishcon de Reya to provide advice on the Icesave Agreement.

MISHCON DE REYA'S ADVICE

CHAPTER 1 - TERMS OF THE ICESAVE AGREEMENT

Advice on *"the wording and substance of the Icesave Agreement in particular in light of the interests of the various parties involved. In particular you asked us to provide our advice on the content and the terms of the Icesave Agreement, whether their terms are considered customary in light of the terms of comparable agreements and whether the agreement reflects that the parties were on equal footing during the course of the negotiation"*

Before turning to the documents we have been asked to consider, we explain that we have endeavoured to identify the unusual aspects of the documents, and to engage with the difficulties in construction, interpretation and implementation which we perceive may arise from them.

1. UK Settlement Agreement and associated documents

1.1 *Summary of Purpose*

The UK Settlement Agreement and UK Settlement Amendment Agreement are made between FSCS and TIF, and together set out the terms on which TIF agrees to compensate FSCS for making payments of up to £16,872.99 to depositors with Landsbanki's UK branch, Landsbanki London. The UK Settlement Amendment Agreement was entered into to amend the UK Settlement Agreement in response to the Icesave Law.

1.2 *Summary of provisions*

Recitals A to H: These provisions set out the background to the UK Settlement Agreement, in particular the roles of the parties to it and a brief chronology of the collapse of Landsbanki. Points worthy of particular note are:

(a) Recital E states that in accordance with Article 9 of Law No. 98/1999 TIF has become obligated to pay an amount of up to €20,887 to each depositor of Landsbanki.

(b) Recital G sets out that the parties to the UK Loan Agreement have entered or will enter into that agreement, and that as a consequence HM Treasury will advance funds to TIF which will be used to (i) settle FSCS's claims on TIF arising from the assignment to it of the obligations of TIF to depositors already compensated by FSCS, up to the limit of £16,872.99 per depositor; (ii) allow the settlement by FSCS (on TIF's behalf) of any remaining claims of depositors at Landsbanki London, up to the limit of £16,887.99 per depositor and (iii) make a payment to FSCS in respect of costs incurred and to be incurred by it in the process of managing the compensation of Landsbanki London depositors.

We observe that the Recitals acknowledge that the liabilities of TIF to Landsbanki London depositors are limited to €20,887 (or its Sterling equivalent £16,872.99).

In addition, it should be noted that the Recitals in English law contracts are not normally binding parts of the contract, but set out the background to assist in understanding it.

Clause 1 –FSCS Recovery from TIF of compensation already paid

Clause 1.1: The parties acknowledge that the payments already made by FSCS to Landsbanki London depositors were in accordance with the rules of the UK's depositor protection scheme and were in respect of obligations which TIF had to those depositors. In addition, they acknowledge that up to the "*Refinancing Date*" FSCS may continue to make such payments by drawing money under the loan facility set out in the UK Loan Agreement. The Refinancing Date is a date specified by FSCS falling not more than 30 days after the date on which the *"conditions precedent to Disbursements"* under the UK Loan Agreement have been satisfied. The clause also contains a definition of Refinancing Amount which is the aggregate of all amounts advanced under the UK Loan Agreement.

Clause 1.1 further contains statements that the payments already made were made with TIF's knowledge (albeit there is no reference to TIF's consent).

It is not clear what the *"conditions precedent to Disbursement"* are. The UK Loan Agreement anticipates that a number of draw downs may occur, but this drafting assumes either a single draw down or that there are conditions precedent to first draw down. Neither of these seems to be the case, and the meaning of this wording should be clarified.

Clause 1.2: Acknowledges, as the Recitals did, that TIF and FSCS agree that the maximum amount payable by TIF for or in respect of each deposit at the Landsbanki London branch is €20,887 and that the correct conversion of this sum into Sterling is £16,872.99.

Clause 1.3: Contains an authorisation for FSCS to, on the Refinancing Date, draw down under the UK Loan Agreement an amount equal to the Refinancing Amount plus accrued interest on that amount. The drawn down amount must be applied to repaying FSCS for making the payments to Landsbanki London depositors referred to in clause 1.1, and to repaying the money it borrowed from HM Treasury to do so.

Clause 1.5: TIF agrees that it will not object to the Refinancing Amount as a result of (i) any Landsbanki London depositor not being entitled to be paid the compensation provided to it by FSCS or (ii) FSCS using a different way of calculating compensation payable than TIF would have done. We observe that such a term effectively permits FSCS to decide how much to pay to Landsbanki London depositors, without capping the obligations on TIF and Iceland to the amount properly due under the Icelandic rules. TIF is here potentially assuming liability for sums which it might not otherwise be liable to pay.

Clause 2 – FSCS payment of compensation on behalf of TIF

Clause 2.1: Provides authority for FSCS to make payments on behalf of TIF to Landsbanki London depositors. These payments will be made under FSCS's scheme rules, i.e. not the rules of TIF, which may lead to payments being made which would not have been made had the rules of TIF applied and been adhered to.

Clause 2.2: States that any payments made by FSCS under clause 2.1 will be funded by way of further loans from the facility provided by the UK Loan Agreement. FSCS agrees that it will not draw down any funds from the facility unless it has provided certain administrative information to TIF.

Clause 2.3: Substantially duplicates clause 1.5, save that it applies to draw downs under clause 2.2 rather than rather than the initial Refinancing Amount.

Clause 2.4: Provides that TIF and FSCS can agree mechanisms for TIF to compensate FSCS for the sums FSCS has paid out to Landsbanki London depositors other than those set out in the Settlement Agreement, if they wish. This raises the possibility of the parties to the UK Settlement Agreement, i.e. TIF and FSCS, bilaterally reaching an agreement which could impact upon the sum payable by Iceland under its sovereign guarantee, without reference to, still less requiring the agreement of either the Icelandic Government or the Althingi.

Clause 3 - Payment to FSCS in respect of historic and future costs

In essence this clause provides that TIF will pay FSCS £10,000,000 to cover its costs in handling the compensation of the Landsbanki London depositors and related matters. We have not seen any calculations of how FSCS came to this figure (although we would have expected FSCS to have provided calculations before TIF agreed to this provision) and thus we are not able to advise on whether the sum of £10,000,000 is reasonable in the context of the work done and to be done by FSCS.

Clause 4 – Claims against Landsbanki

This appears to us to be one of the most significant clauses in the network of agreements entered into between TIF/Iceland and FSCS/HM Treasury. In particular it deals with the assignment of claims held by FSCS to TIF and the compensation FSCS will receive in return.

Clause 4.1: States that FSCS may appoint TIF as its agent or representative for the submission and conduct of the claims against Landsbanki and to represent

FSCS in its discussions about recovery of money with Landsbanki and its representatives, but that TIF cannot bind FSCS without its prior written instructions.

It should be noted that the clause only provides that FSCS may appoint TIF. It is not obliged to do so, and as a consequence FSCS may appoint anyone else to represent it. Moreover, even if an appointment is made, TIF would enjoy no autonomy in dealing with the claims made.

Clause 4.2: This clause is amended by the UK Settlement Amendment Agreement. It should be noted that under clause 6.1, unlike most of the remainder of the UK Settlement Agreement, clause 4.2 came into effect when the agreement was executed. Clause 4.2 contains a number of elements which we will address separately:

Undertaking

The initial paragraph of the clause states that FSCS grants the rights referred to below to TIF "*in consideration for TIF's undertaking to reimburse FSCS*" for compensation paid to Landsbanki London depositors by FSCS which was TIF's responsibility under Law No 98/1999.

It is not clear whether the term "*undertaking*" is intended to refer simply to the obligations of TIF imposed by the UK Settlement Agreement itself, or if it is intended to be set out in a separate document. This is important as (a) the wording does not reflect the loan structure under the UK Loan Agreement; and (b) if the "*undertaking*" has not been given then it will assist in any argument that the balance of the clause is not yet binding on TIF.

Assignment

Clause 4.2 states that, in return for the undertaking referred to above FSCS will assign to TIF the lesser of:

(i) £16,872.99; and

(ii) the whole,

of the rights of the Landsbanki London depositors FSCS compensated (which were assigned to FSCS in return). Some terms of this assignment (as amended by the UK Settlement Amendment Agreement) are set out in clauses 4.2 (a) to (d), but these are not expressed to be all of the terms.

The assignments are also expressed to be subject to the UK Loan Agreement coming into effect.

While the drafting is not absolutely clear, it appears that it is expected that further documents will have to be entered into to make this assignment effective. Indeed, certain of the other documents, in particular the Dutch Loan Agreement at clause 3.1.1(c), anticipate that separate deeds of assignment will be required to make this effective, and we understand (albeit we have not had sight of them) that drafts are in circulation.

Terms of assignment

As noted above, clauses 4.2(a) to (d) set out some of the terms on which the assignment of the claims (or parts of the claims) is to take place. Before turning to address a number of key points, we should first observe that there must be a question as to whether Icelandic law strictly applies. Whilst we cannot advise as to the position under Icelandic law of TIF as against depositors, we note that TIF did not, as Icelandic law anticipates and requires, in fact compensate the Landsbanki London depositors. Rather, FSCS has interposed itself and it is, therefore, arguable that Icelandic law is simply inapplicable to the Landsbanki London depositors, for this reason.

Single undivided claim

First, we draw your attention to the words "*assign such proportion of the Assigned Rights as they relate to claims of depositors (being not more than £16.872.99 per depositor)*" at clause 4.2. The purpose of such wording appears to be to repackage the Assigned Rights and to assign only a proportion of the claims to TIF rather than treating each depositor's claim as a single claim.

The treatment of each deposit as a single undivided claim is such a basic principle in law that we can only assume it would also be applicable under Icelandic insolvency law, as the nature of the claim itself does not change towards Landsbanki, no matter what the contractual position between TIF and FSCS. Under English law, it would not be possible to create, out of one single claim against an insolvent estate, two claims (still less two claims with different levels of priority, although the two parties who thereafter "shared" the claim might agree between themselves to divide recoveries other than equally). See, here, paragraph 30 of the Opinion of Matthew Collings QC.

In this regard, we note article 10 of the Law No. 98/1999, which provides that "*[i]n the event that payment is effected from the Fund, the claims made on the relevant Member Company or bankruptcy estate will be taken over by the Fund*". Much like in English law, it appears that TIF takes on the responsibility of pursuing the depositor's entire claim against the insolvent estate, i.e. Landsbanki, so that the entire claim is transferred by the depositor to TIF, which then progresses the claim. No part of the claim is left with the depositor (in this case FSCS, who has stepped into the depositors' shoes), whose rights are now vested in TIF. The benefit of this is that the depositor does not have to make a separate claim for the remaining part of the amount due to him. That is handled by TIF.

It may be that in avoiding the usual scenario that each depositor's single claim is assigned to TIF and instead purporting to effect an assignment only of a stated proportion of the Assigned Rights, FSCS is endeavouring to entrench the notion that the single claim is somehow broken down into two separate and distinct parts under Icelandic law, so that TIF is only taking on a proportion of the claim (rather than the whole, as we understand would be the position under Icelandic law).

Application of recoveries from Landsbanki between TIF and FSCS

The agreement provides in clause 4.2(a) that "*to the extent that, following such assignment, FSCS retains any proportion of the Assigned Rights in respect of any given claim ..., then the proportion of such Assigned Rights which*

assigned to TIF shall, to the fullest extent permitted by applicable law, rank pari passu in all respects with the proportion of such Assigned Rights retained by FSCS".

Icelandic law would appear to us to be the most appropriate law to apply to the winding up of Landsbanki. Directive 2001/24/EC on the reorganisation and winding up of credit institutions (the "**Winding Up Directive**") provides that (whether Landsbanki is subject to "*reorganisation measures*" or "*winding-up proceedings*" (as defined)), the applicable law is that of the home Member State, save as provided for in this directive itself (see articles 3(2) and 10, which, in relation to winding-up proceedings, expressly provides that the law of the home Member State "*shall determine in particular ... (h) the rules governing the distribution of the proceeds of the realisation of assets, the ranking of claims*" and "*(k) who is to bear the costs and expenses incurred in the winding-up proceedings*").

We note, however, that the British Government may accept that, if clause 4.2(a) is inconsistent with the Icelandic law of priorities in a distribution, any attempt to subvert Icelandic priorities of distribution would fail, which is why provision has been made in clause 4.2(b) for a balancing payment to be made in that event. The clause provides "*In the event that, for any reason whatsoever (including, without limitation, any preferential status accorded to TIF under Icelandic law), following the assignment of a proportion of the Assigned Rights in respect of any given claim to TIF, either TIF or FSCS experiences a greater pro rata level of recovery, in respect of such claim, than that experienced by the other, TIF or FSCS (as appropriate) shall, as soon as practicable, make such balancing payment to the other party as is necessary to ensure that each of the Guarantee Fund's and FSCS's pro rata level of recovery in respect of such claim is the same as the others*". In English law, it is permissible to contract out of a pari passu distribution with the express consent of the creditors affected. Clause 4.2(b) recognises that TIF may recover more than would result from a pari passu distribution from Landsbanki, but by clause 4.2(b) TIF agrees that it will address any such disparity.

What impact does this have on the way in which recoveries from Landsbanki would be applied, absent a contractual agreement having been concluded?

It has been suggested to us that the position in Iceland is akin to that which we can confirm was operated by FSCS's predecessor in relation to deposits, the Deposit Protection Board (the "**DPB**") when the Directive was first implemented in the United Kingdom (i.e. at the time when the Icelandic Law 98/1999 was implemented). Under this system, the DPB took any recovery from the insolvent estate to the limit of the guaranteed minimum recovery in priority to the depositor to whom it had paid out that sum. Whilst we do not know by what legal mechanism this result was achieved, and we have not seen the precise legal basis for the assertion that this is the effect of the Icelandic law, if this is the applicable method under Icelandic law, TIF will be considerably off worse off by agreeing to share recoveries pari passu with FSCS rather than standing on a legal right (if it exists) to assert priority to FSCS.

In English law, since 2001 when the FSCS was established, under the Current Loss Allocation Method, FSCS pays compensation of £50,000, takes over the depositor's rights against the bank and pays over recoveries received from the insolvent estate to the depositor unless and until the deposit has been fully repaid. That approach, applied here, would be fundamentally in favour of the depositor (here, FSCS, standing in the shoes of the depositors). It has not been suggested that this is the approach adopted in Icelandic law, and we do not, therefore, consider it further here.

The final approach which has been suggested is that the Icelandic law grants depositors (here, FSCS) a pari passu recovery with TIF from all the amounts that it recovers from Landsbanki. We have not found any express wording to this effect but if this is the case then clause 4.2 merely reflects the general position in Icelandic law. We are not in a position to advise on the effect of Icelandic law, but we observe from the researches we have conducted that there does not appear to be a clear and definitive answer on this point under Icelandic law.

Practical Example

As an example, assume that Icesave had only two UK depositors, Alice (€10,000) and Bob (€50,000), each with an independent claim against Landsbanki. Assume also, for ease of reference, that Law No 98/1999 (and the underlying Directive) caps the amount to be paid by TIF at €20,000 (rather than the €20,887).

Therefore both Alice and Bob are covered by TIF up to the €20,000 cap and TIF would be obligated under the Law No 98/1999 to compensate Alice in full for her deposits, i.e. Alice gets her €10,000 in full from TIF, while TIF is only obligated to compensate Bob up to the €20,000 cap, leaving an amount outstanding from Landsbanki of €30,000 (which is then assigned to, and prosecuted by, TIF). The aggregate obligation of TIF under Law No 98/1999 is therefore €30,000, split between the two separate claims of Alice and Bob.

However, FSCS on its own initiative decides to compensate both Alice and Bob the full amount in their respective Icesave accounts, i.e. Alice gets her €10,000 in full from FSCS, and Bob also get his €50,000 in full, so that FSCS has therefore paid a total of €60,000.

The "*Assigned Rights*" therefore amount to €60,000, being the aggregate amount that FSCS has paid out to both Alice and Bob, while TIF was only obligated under the Law No 98/1999 to cover Alice for €10,000 and Bob up to the €20,000 cap, i.e. a total of €30,000.

Under clause 4.2 FSCS will assign to TIF *"such proportion of the Assigned Rights as relate to claims of depositors ... which TIF was obligated to guarantee under the Icelandic Act No. 98/1999"* i.e. FSCS will only assign €30,000 to TIF, i.e. the proportion that TIF was obligated to pay to Alice and Bob. FSCS will however retain and not assign to TIF, such proportion of the Assigned Rights which TIF was not obliged to guarantee, i.e. the remaining €30,000, which on closer inspection is all owed to Bob and above the €20,000 cap per depositor.

According to clauses 4.2(a) to (d) TIF and FSCS have agreed contractually to rank any recoveries from Landsbanki pari passu and pro-rata (i.e. proportionately to the ratio of the Assigned Rights of FSCS and TIF) with balancing payments in case one party experiences a greater pro-rata level of recovery. In our example above, and applying the contractual clause 4.2, TIF and FSCS would therefore get equal pro-rata shares in any recoveries from Landsbanki i.e. both TIF and FSCS get €30,000 from the total €60,000, being the Assigned Rights.

If we then assume that the recovery ratio from Landsbanki is 50%, then TIF and FSCS would in aggregate recover €30,000 of the €60,000, while the rest would be lost. The critical issue then becomes on how this €30,000 recovered is shared between TIF and FSCS.

In summary, clause 4.2 is less favourable to TIF than the scheme which was previously operated in England by the DPB (under which the DPB (here TIF) would take the first €20,000 in relation to any given depositor (whether assigned to FSCS or not)). It is more favourable to TIF than the system currently operated in England after 2001 by FSCS, where FSCS (here TIF) would not take any recovery in respect of a given depositor until such time as that depositor had made 100% recovery), although as we have said, we understand that there is no suggestion that this system (or its like) has been implemented in Iceland.

(a) If we apply the terms of clause 4.2 to our example of Alice and Bob TIF and FSCS would each get an equal share of the €30,000 recovered from Landsbanki, so TIF would receive €15,000 and FSCS would receive €15,000.

(b) If however we apply the scheme operated by the DPB to our example of Alice and Bob, TIF would first be discharged and receive €25,000 (i.e. €5,000 for Alice and € 20,000 for Bob) and then FSCS would receive €5,000 (i.e. €5,000 for Bob). This is because the recoveries from Landsbanki were only 50% and Alice's deposit was €10,000 while Bob's deposit was €50,000 and TIF would under the DPB scheme get the first €20,000.

Therefore the result of clause 4.2 is that FSCS is getting €10,000 more at the expense of TIF, than would be the case if the DPB scheme rules applied to the agreement without clause 4.2.

Super priority of claims of depositors against Landsbanki

It has been suggested that article 10 of Law No. 98/1999 as amended by article 9 of the Emergency Law No. 125/2009 that the claims of TIF in respect of deposits held at Landsbanki take priority over all those claims listed in Article 112 paragraph 1 of the Law on Bankruptcy, Law No. 216/1991 (the "**Bankruptcy Law**"). That provision states: "*In the case of insolvency, the claim of the Fund shall have priority as provided for in Article 112, Paragraph 1 of the Act on Bankruptcy etc.; otherwise, it is enforceable by execution without prior adjudication or settlement*".

We understand that Chapter XVII of the Bankruptcy Law (comprising articles 109 to 115) provides for the priority ranking of claims against a bankrupt estate. Article 112 paragraph 1, which populates one of the tiers of priority, does not mention claims by TIF. Whilst we are not in a position to advise on Icelandic law, it seems tolerably clear that article 10.3 of the Law No. 98/1999 is intended effectively to add to those classes of debts listed in Article 112, paragraph 1, i.e. to add to the debts enjoying the level of priority enjoyed by the debts there listed claims made by TIF against insolvency estates when standing in the shoes of a depositor whose deposit was unavailable (i.e. TIF having made a payment to that depositor). It would appear to confer equal priority, and not to permit of a construction which would confer super-priority. The result is that the single claim of a depositor against Landsbanki (including a single claim shared between FSCS and TIF) has the priority conferred by Article 112 paragraph 1. That provision does not, it seems to us, have any bearing on the question of priority between FSCS and TIF and thus how those two bodies share in any recoveries from Landsbanki.

Whilst the wording of article 10.3 (as amended by the Emergency Act) is not as clear is it might be, at least in the English translation, it does seem to envisage and provide for the priority which it confers to apply not only to the

€20,887 paid by TIF to the depositor, but to the entire claim which TIF advances in the shoes of any given depositor.

Clause 4.2(c) (as inserted by clause 2.1(e) of the UK Settlement Amendment Agreement) provides that "*If an Icelandic court gives a final and non-appealable judgment which (1) determines that all or part of any claim assigned to TIF, or the rights retained by FSCS, as the case may be, will be entitled to receive distributions in the Landsbanki estate on a preferential basis relative to other claims originating from the same deposits, and (2) is not in conflict with an advisory opinion obtained from the Court of the European Free Economic Trade Area on that preferential status; or the Winding-Up Board of Landsbanki determines that all or part of any claim assigned to TIF or the rights retained by FSCS, as the case may be, will be entitled to receive distributions from the Landsbanki estate on a preferential basis relative to other claims originating from the same deposits but such ruling is not challenged in an Icelandic court by any depositor or creditor and such failure to challenge is not the result of a Change of Icelandic Law made after 5 June 2009 which renders such a challenge more difficult or impossible; then, unless that preferential status results from any Change of Icelandic Law made after 5 June 2009, the obligation described in subparagraphs (b) above for TIF or FSCS, as the case may be, to make balancing payments will not apply*" (emphasis added).

Clause 4.2(c) (as amended) relates to claims made (whether by TIF or FSCS) against the Landsbanki estate. We understand that it has been suggested that clause 4.2(c) was intended to address the issue of how the proceeds of any recovery from Landsbanki's estate will be divided between TIF and FSCS. If that is so, we are concerned that clause 4.2(c) does not, as drafted, achieve that end. The issue anticipated by clause 4.2(c) proceeds on what we consider to be the false premise that there is, in relation to any given depositor, more than one claim (even though FSCS has purported to split the Assigned Rights as though multiple claims might be created). There is therefore a risk that a Court would refuse to engage with the specific question asked in clause 4.2(c) because it mistakenly proceeds on the basis that there is more than one claim.

The question, if it is meaningfully to be pursued, ought to be phrased in terms of inviting the Court to determine whether there is an internal priority within a single claim (i.e. in a competition between FSCS and TIF, does one rank before the other)? On this basis, the scope of clause 4.2(c) is such that the exclusion of the obligation to make balancing payments would arguably not apply even were an Icelandic Court definitively to decide (and the EFTA Court were not to disagree), in TIF's favour, that TIF ranked higher than FSCS (as would be the case in the DPB Scheme).

Even if the question incorrectly, in our view, formulated in clause 4.2(c) were interpreted in the way which Iceland might wish, and assuming that the result of the deliberations of the Icelandic and EFTA Courts favoured TIF, the further problem is that neither Iceland nor HM Treasury is actually a party to the UK Settlement Agreement, raising very serious questions about the extent to which clause 4.2(c) could be relied on by Iceland to reduce its obligations to HM Treasury under the sovereign guarantee which is provided for in the UK Loan Agreement.

Furthermore Clause 3.5 of the UK AAA merely states *"HM Treasury confirms that is aware that the Guarantee Fund may seek a ruling by competent adjudicators on the priority of its claims against the Landsbanki estate over other claims originating from the same deposits."* Since neither the HM Treasury nor Iceland are parties to the UK Settlement Agreement and this clause 4.2(c) the English courts are unlikely to take any note of the legal implications of such outcome as they would simply apply the terms of the UK Loan Agreement independently. Therefore irrespective of any positive outcome for TIF and Iceland before the Icelandic courts and the EFTA Court on this subject, Iceland would still be bound by English law to honour its contractual obligations in full, in particular its irrevocable and unconditional sovereign guarantee, in accordance with the UK Loan Agreement, despite such positive outcome. The effect of this is that clause 4.2(c) of the UK Settlement Agreement and clause 3.5 of the UK AAA have no legal implication or relevance to Iceland and which were drafted to reflect Article 4 of the Icesave Law. The position would, however, be different in relation to

the Dutch Loan Agreement, as, whilst clause 4.2(c) is not reflected in the UK Loan Agreement, it is reflected in clause 3.1.2(a)(iii) of the corresponding Dutch Loan Agreement.

Clause 4.3: Provides that, pending completion of the assignments referred to in clause 4.2 taking place, any "*recoveries*" in respect of the Landsbanki London deposits will be paid to FSCS for distribution as set out above.

It should be noted that this clause does not come into effect until the UK Loan Agreement comes into effect. However, were the UK Loan Agreement to come into effect and FSCS thereafter to drag its heels in assigning the Assigned Rights, in the meanwhile the FSCS could argue that it was entitled to take all recoveries from the Landsbanki insolvent estate.

Clause 4.4: States that any monies in respect of the Landsbanki London deposits received by TIF either before or after the assignment referred to in clause 4.2 will be applied by or on behalf of TIF (i.e. by FSCS) in satisfaction of TIF's obligations under the UK Loan Agreement.

Again it should be noted that this clause does not come into effect until the UK Loan Agreement comes into effect.

Clause 5 - Confidentiality

The Settlement Agreement must be kept confidential and may not (without the consent of the non-disclosing party) be disclosed to any person other than their home state regulator and Governments, professional advisors, as required by law or to the parties to the UK Loan Agreement. It should be noted that this clause is incorporated into the UK Settlement Agreement by reference.

It is arguable that any document in which the terms of the agreement are set out or referred to in any detail cannot be disclosed more widely than amongst those to whom disclosure can be made in accordance with the UK Settlement Agreement or pursuant to operative waivers.

Clause 6 – Entry into force and miscellaneous provisions

Clause 6.1: As noted above, save for clause 4.2 (and the technical clauses 9 to 15) which come into force on execution, nothing in the UK Settlement Agreement comes into force until the Loan Agreement does.

Clause 7 – Liability and Indemnity

Clause 7.1: Contains limitations on TIF's ability to sue FSCS. In essence, unless FSCS has acted in bad faith, TIF cannot sue in relation to FSCS:

(i) drawing down funds under the UK Loan Agreement;

(ii) receiving funds following such draw down; or

(iii) applying those funds as permitted by the UK Loan Agreement and clauses 1, 2 and 3 of the UK Settlement Agreement.

Clause 7.3: It is agreed that FSCS shall not be liable to TIF when it is performing its obligations or exercising its rights under the Settlement Agreement or otherwise, or in pursuing its claims against the Landsbanki estate in connection with the Landsbanki London deposits unless it has acted in bad faith.

Clauses 7.1 and 7.2 are strong protective provisions, and unusual (albeit not wholly unknown) in the context of arrangements where one party performs services for another.

Clause 7.4 Contains an indemnity, granted to FSCS by TIF, which provides that TIF will meet all of FSCS's costs in pursuing its claims against the Landsbanki estate in connection with the Landsbanki London deposits (i) for the benefit of TIF or (ii) in order to realise funds to be applied to reducing the balance under the UK Loan Agreement or otherwise reducing TIF's liability. This indemnity gives FSCS the ability to recover costs from TIF in addition to the £10,000,000 to be paid to it under clause 3. In addition, the £10,000,000 will not reduce TIF's obligation to make payments under this clause.

Clause 8 – Representations and Warranties

Clause 8.1: This clause includes a number of standard representations and warranties by TIF, but it also contains an unusual provision at clause 8.1(a) in which TIF warrants and represents that it will not (without FSCS's prior approval) take any action which could limit FSCS's rights against Landsbanki (or anyone else – including TIF itself) to recover money in relation to the Landsbanki London deposits.

There are significant dangers in this clause, particularly as the *"representation"* wording means that if there is a breach FSCS may be able to rescind the agreement and hence treat it as never having been entered into (subject, of course, to it being possible to return the parties to the status quo ante). A 'representation' in general can even be conveyed verbally, so long as the making of it, by a person with the power to make it, can be proven.

Clause 8.2: Is not a warranty or representation, but does oblige TIF to use its *"best efforts"* to promote the doing of the things required to be done to allow the Settlement Agreement and Loan Agreement to come into force and their provisions to be effective. This would include promoting the approval of the sovereign guarantee in the Loan Agreement to be approved by the Althingi.

Clause 13 – Governing law and jurisdiction

This clause provides that the agreement will be governed by English law, and that the English courts will have jurisdiction. However, FSCS may use any other court system if it chooses (subject to that court accepting jurisdiction).

This provision effectively reiterates that TIF has ceded any advantage which it would have enjoyed under Icelandic law as to the manner in which recoveries from the Landsbanki insolvency would have been applied.

Clause 14 — Waiver of sovereign immunity

TIF waives any sovereign immunity it may have. We understand that TIF does not have sovereign immunity, and therefore this clause has little meaning. However, it should be noted that the qualifications to the similar

clause in the UK Loan Agreement introduced by the UK AAA are not incorporated into this waiver.

2. UK Loan Agreement and connected documents

2.1 *Summary of Purpose*

The UK Loan Agreement, the UK AAA, the UK Currency Side Letter and the UK General Side Letter together set out the terms on which HM Treasury will lend money to TIF to discharge its obligations to the Landsbanki London depositors. Iceland is party to these agreements primarily to provide a sovereign guarantee of TIF's obligations under the Finance Documents. The "**Finance Documents**" currently include the UK Loan Agreement, UK AAA and the UK Currency Side Letter, but not the UK General Side Letter.

The UK AAA, UK Currency Side Letter and UK General Side Letter have been entered into in response to the preconditions set out in the Icesave Law. Clause 3.2 of the UK AAA states that HM Treasury accepts the limitations set out in the Icesave Law to the extent specifically set out in clause 3 of the UK AAA. Not all of the provisions of the Icesave Law have been incorporated, or fully incorporated, into the UK AAA and the two side letters. Iceland and TIF agree to and accept HM Treasury's acceptance and the confirmations and amendments set out in the UK AAA.

2.2 *Summary of provisions*

Background: These recitals set out the background to the Icesave matter. In particular they state that FSCS has paid compensation to the majority of the Landsbanki London depositors and will settle the remaining claims of Landsbanki London depositors on behalf of TIF, and that FSCS will be reimbursed for the cost of doing so, or, for future settlements, provided with the funds to do so, by drawing on the loan facility provided under this agreement.

Clause 1 – Definitions and interpretation

Clause 1 sets out the definitions used in the agreement and certain technical points relating to how the document will be interpreted by the courts. Please note that TIF is referred to in this document as "*the Guarantee Fund*" and HM Treasury as "*the Lender*". However we have continued to refer to TIF and HM Treasury in this letter for consistency.

Clause 2 – The facility

Clause 2.1: The amount of the facility is £2,350,000,000, or such other amount (which may be less or more) as HM Treasury and TIF may agree in writing. The amount can be varied at any time. It should be noted that the amount of the sovereign guarantee is entirely open ended, and that Iceland has effectively been committed to clearing such liabilities as may be agreed by HM Treasury and TIF without requiring Iceland or the Althingi to approve any increase. Interest is payable from the first date on which a Disbursement is made (which is not a date fixed by the agreement itself, with the result that the date cannot be identified from the face of the documents).

"*Disbursements*" or money drawn under the facility may be made (and must, it might be inferred, be used):

(i) to repay money borrowed from HM Treasury by FSCS which have been applied by FSCS to compensate the Landsbanki London depositors up to the limit of £16,872.99 per claim;

(ii) in the settlement by FSCS (on behalf of TIF) of any further Landsbanki London depositors up to that limit; and

(iii) for the payment to FSCS of compensation for its role and certain costs.

Note that HM Treasury is not obliged to ensure that the money is being applied in this manner, which means that HM Treasury would not be liable in the event that FSCS did not so confine its use of the funds (to the extent that either can be liable in any event, given the limitations of liability sought to be achieved, as to which, see below).

Clause 2.2: TIF is the debtor in respect of all money paid out in respect of the loan facility (which is not limited to money paid to Landsbanki London depositors), notwithstanding that only FSCS may serve notices to draw down money under it. It may make such requests in order to make payments necessary or desirable to deal with any of the matters set out above, but it can not draw down after 30 March 2012 or where the draw down would cause the facility limit to be exceeded. For the avoidance of doubt TIF can not make a draw down request.

Clause 2.3: Subject to the satisfaction of certain conditions, including that no Termination Event has occurred or would occur as a result of the proposed Disbursement being made, HM Treasury will transfer the amount being drawn down on the date specified in the notice provided by FSCS. The relevant money is paid directly into FSCS's bank account. TIF may not receive the relevant money into its bank account.

Clause 2.4: HM Treasury must notify TIF and Iceland, as soon as reasonably possible after paying any money to FSCS, of the amount paid over and its impact on the aggregate amount owed by TIF under the facility. However, any failure to do this will not impact on TIF's and Iceland's obligations under the UK Loan Agreement.

Clause 3 - Coming into force

Clause 3.1: The agreement is subject to the satisfaction of certain conditions, which are set out in clause 3 of the UK Loan Agreement and clause 2 of the UK AAA, and will not come into force until these have been satisfied. The majority of these conditions are purely technical, but certain of them have not been satisfied as yet. In particular:

(i) We understand that HM Treasury has not been provided with a final and satisfactory form of legal opinion from Lex Law Firm as to the proper execution and binding nature of the Finance Documents by and on Iceland and TIF (clause 3.1(a)(iv)). We do not know if it has been supplied with the legal opinion required to be provided by the State Attorney of Iceland;

(ii) the Althingi is required to provide to HM Treasury a copy of an Act of the Althingi providing for the unconditional and unreserved authorisation of the Iceland's sovereign guarantee under the UK Loan Agreement (clause 2.1.2(c) UK AAA). Our view is that this probably replaces the obligation to supply the Act referred to in clause 3.1(b) of the UK Loan Agreement, but this is not clear;

(iii) TIF and FSCS must enter into assignments of the Landsbanki London depositors claims in accordance with clause 4.2 of the UK Settlement Agreement. We understand that drafts of these documents have been circulated but they have not been agreed or executed.

As a consequence the UK Loan Agreement is not in force.

The UK Loan Agreement and UK AAA both contain long stop dates which have passed, the one for the UK Loan Agreement (clause 3.2) when the Althingi commenced its 2009 summer recess and the one for the UK AAA (clause 2.3) on 30 November 2009. The passing of these dates permits HM Treasury to serve notices on TIF (with a copy to Iceland) terminating one or both of these agreements. However we understand relevant notices have not been served. It is not possible for TIF or Iceland to terminate either agreement by virtue of the long stop dates having passed.

Clause 4 – Reimbursement

Clause 4.1: TIF is obliged to "*reimburse*" or re-pay HM Treasury for all money advanced by HM Treasury pursuant to the UK Loan Agreement by repaying the aggregate of the amounts advanced under it, together with all compounded interest on those amounts, or the amount outstanding for the time being (the "**Reimbursement**").

Clause 4.2:

Clause 4.2.1: If TIF receives <u>any</u> money in respect of claims of Landsbanki London depositors or otherwise in respect of the insolvency of Landsbanki it must pay that amount to HM Treasury and the Netherlands *"in inverse order*

of maturity" and in proportion to the to the principal amounts then outstanding under the UK Loan Agreement and Dutch Loan Agreement.

While the second element of this is clear, we do not understand the import of *"in inverse order of maturity"*, as the loans are repaid in instalments without reference to when they were first advanced and the Dutch Loan Agreement does not have this wording.

The money paid over is stated to be applied to discharging the Reimbursement, which includes both capital and interest elements, but HM Treasury confirms in the UK General Side Letter that it is intended that any monies so repaid will be applied to the principal and not interest.

The UK General Side Letter further states that:

(i) these provisions are subject to clause 4.2 of the UK Settlement Agreement, and therefore the obligations in this letter do not supersede the obligation to divide up the any money received as outlined above; and

(ii) the reference to *"or otherwise in respect of the insolvency of Landsbanki"* is intended to be so broad in its scope as to catch any receipts by TIF as a consequence of the insolvency of Landsbanki.

Clause 4.2.2: This clause provides that any payment (the actual wording is *"repayment"* but we believe this to be a typographical error) of the Reimbursement after the seventh anniversary of the execution of the UK Loan Agreement (5 June 2016):

(i) must be accompanied by all accrued interest thereon; and

(ii) subject to clause 9.3 shall be applied pro rata to each of the remaining payment instalments.

These provisions mean that, if TIF receives money after 5 June 2009 in respect of the London depositors or the Landsbanki insolvency, it must (subject always to clause 4.2 of the UK Settlement Agreement) pay the whole of that amount to HM Treasury AND contribute an extra amount to pay the accrued

interest on the amount being repaid. It is not clear what the commercial justification for this is.

Clause 4.3 The original wording of this clause has been deleted and replaced by wording set out in clause 3.4 of the UK AAA, which also adds a number of new clauses intended to address points from Article 3 of the Icesave Law.

The new clause 4.3 provides that, subject to the cap on payments by reference to GDP growth referred to in clause 4.3.2, TIF is obliged to repay the outstanding principal amount of the 'Loan' in 32 equal quarterly instalments beginning in 2016. The hiatus before repayments must be made may be considered to be commercially attractive, although the interest rate of 5.55% which is compounded annually should be taken into account when assessing the true financial impact of the arrangements. The repayment dates are 5 June, 5 September, 5 December and 5 March. 'Loan' is not a term defined in this agreement, but it is defined in the Dutch Loan Agreement. The equivalent word in this agreement to 'Loan' in the Dutch Loan Agreement is 'Disbursement' and we suspect that the use of 'Loan' here is an error, and that 'Disbursement' should be used.

Clause 4.3a: If on the day falling 10 Business Days before any date on which a repayment is due (the **"Cap Calculation Date"**) the aggregate amounts paid or payable in the then current calendar year in respect of principal on the Disbursements exceeds 2% (in the case of the year 2016) or 4% (in the case of any other year) of the amount by which Icelandic GDP for that calendar year (as published by the IMF in its most recent World Economic Outlook and expressed in Sterling) exceeds £9,194,000,000 then the provisions of clause 4.3a will have effect. The UK Currency Side Letter provides that, if Iceland or the UK changes its currency and as a result:

(i) Iceland and the UK have the same currency (eg the Euro) on any Cap Calculation Date there will be no currency conversion; and

(ii) Iceland and the UK have different currencies references to Icelandic Kronur and Sterling will be updated to reflect the currencies being used at the

relevant time and exchange rates will be derived from a source reasonably agreed between Iceland and HM Treasury.

If the clause has effect, TIF may (but is not required to) no later than 5 Business Days following the Cap Calculation Date serve a notice on HM Treasury that the amount to be repaid on the relevant repayment date will be reduced to the higher of:

(i) the maximum amount payable under the cap (as outlined above); and

(ii) zero.

For the avoidance of doubt the repayment amount cannot be negative. The amount by which the relevant payment is reduced is then added to the amount due on the next repayment date. However, clause 4.2 is unaffected, with the result that any and all monies received from Landsbanki must be paid over in full irrespective of whether the cap has been reached.

It should be noted that these clauses apply only to the principal amount to be repaid, and not the interest and therefore do not comply with the provisions of Article 3 of the Icesave Law that "*the sovereign guarantee... is subject to a limit on payments*", payments being a phrase which refers, without an express limitation, to both principal and interest.

In addition Article 3 of the Icesave Law required that the cap on disbursements should be 2% in both 2016 and 2023. This is not reflected in the UK Loan Agreement as the 2% cap applies only in 2016 and not in 2023.

Article 3 of the Icesave Law also requires that the level of Icelandic GDP be determined by reference to Eurostat's definition, but the definition of "*Icelandic GDP*" in clause 4.3.1 (a) refers to the IMF's World Economic Outlook.

Clause 4.3b: This clause gives Iceland the option to extend the number of quarters over which repayment can be made from 32 to 56 (so that the last payment date is 5 June 2030) by giving written notice to HM Treasury. In addition, if the full amount of the principal of the 'Loan' remains outstanding

as a result on the cap on payments by reference to GDP growth then TIF is automatically deemed to have given am extension notice and the repayment period will extend to 5 June 2030.

Clause 4.3c: If any part of the principal amount of the 'Loan' is not repaid on or before 5 June 2030 as a result of the operation of the cap on payments by reference to GDP growth, then unless otherwise agreed the unpaid amount will automatically be extended by a further five years, during which period that cap will continue to apply. This clause will operate again if any principal amount is outstanding at the end of that period and so on until the full amount of the principal is repaid.

The provisions of the new clauses 4.3(b) and 4.3(c), together with those of clause 6 (which contains the sovereign guarantee), do not comply with Article 1 of the Icesave Law, which provides that the sovereign guarantee must expire on 5 June 2024. Rather, these clauses permit the sovereign guarantee to be extended to 5 June 2030 and beyond, until all the "*Unpaid Principal*" is repaid. "*Unpaid Principal*" in clause 4.3(c)(1) refers to "*unpaid principal of the Loan*" but does not seem to refer to interest directly, although one can argue it is covered by the term 'Loan'.

These clauses therefore replace Article 3 of the Icesave Law, which required the parties to the UK Loan Agreement and the Dutch Loan Agreement to negotiate as to what would happen subsequently if all of the principal amounts of those loans were not to be repaid by 5 June 2024.

Clause 4.4: This clause gives TIF (or Iceland, pursuant to the UK General Side Letter) the right to make voluntary pre-payments of amounts due under the UK Loan Agreement, but only if:

(i) TIF (or, pursuant to the UK General Side Letter, Iceland) gives at least three Business Days prior written notice of the intent to pre-pay;

(ii) the payment is equal to at least £1,000,000 or if less, the amount by which FSCS has drawn money under the UK Loan Agreement which exceeds

the amount it needs to compensate creditors as specified in certain information supplied to TIF under the UK Settlement Agreement (an "**Excess**"); and

(iii) unless the pre-payment arises from an Excess, at the same time it makes a pre-payment under the Dutch Loan Agreement which is (pro rata) equal to the payment to be made under this clause.

The pre-paid amount must be accompanied by the accrued interest on it, and will be applied to reduce each subsequent repayment instalment pro-rata, and no amount pre-paid can be re-borrowed.

The differences between clause 4 of the UK Loan Agreement and Article 3 of the Icesave Law are such that the debt services obligations of TIF under the agreement are greater than those covered by the sovereign guarantee on the terms set out in Article 3.

Clause 5 – Interest

Clause 5.1: Interest is charged at a fixed rate of 5.55% per annum from the date on which the first payment is made under the UK Loan Agreement. This appears to us to be a high interest rate which is commercially out of kilter with prevailing interest rates. We have not researched the rate at which the British Government is financing its deficit (to put the FSCS in funds to address the situation of the London Landsbanki depositors). See also paragraph 35 of the Opinion of Matthew Collings QC.

Clause 5.2: Prior to the seventh anniversary of the execution of the UK Loan Agreement, interest accruing on the disbursements will be compounded with, and become part of, the principal sum advanced. After the seventh anniversary, TIF must pay all accrued and unpaid interest (save for the amount converted into principal) on the repayment days for the principal amounts.

Clause 5.3: If TIF fails to pay any interest when due, there is a penalty rate of 5.85% payable, and that penalty interest will fall due and be compounded if not repaid on or before the next repayment date.

Clause 6 – Guarantee and Indemnity

This clause provides the sovereign guarantee of the amounts payable by TIF under the Finance Documents and does not comply with Article 1 of the Icesave Law, which states it should be limited to the payment of minimum compensation under TIF's depositor compensation scheme as at 5 June 2016 and interest on that sum. We have not reported on clause 6 in detail as the provisions are mostly technical albeit some, in our view, appear to be drafted more broadly than is customary in our experience. However, it should be noted that:

(i) the sovereign guarantee comes into force on the seventh anniversary of the UK Loan Agreement;

(ii) the sovereign guarantee covers all the Finance Documents, not just the UK Loan Agreement;

(iii) HM Treasury is not required to claim against TIF before issuing proceedings against Iceland; and

(iv) Iceland cannot issue proceedings against TIF until all amounts payable in connection with the Finance Documents have been paid in full.

In addition, under clause 6.9 Iceland undertakes not to take any action which would result in the creditors (or any class of them) of Landsbanki being treated in a manner contrary to generally accepted international or European principles of treatment of creditors in an international winding up. In our view the meaning of this clause is both relatively vague and wide. As a result, in our view, clause 6.9 could potentially provide HM Treasury with leverage against TIF and Iceland when it comes to taking actions and making decisions towards Landsbanki which could in theory impact on the creditors or any single class of creditors. Furthermore, its application towards clause 4.2 of the UK Settlement Agreement is unclear as neither HM Treasury nor Iceland is a party to that agreement.

Save for the provisions of clause 6.9, and the rather critical fact that the person giving the guarantee is a sovereign state, the wording is not materially out of line with market practice with respect to the giving of guarantees. That said, we note paragraph 26 of the Opinion of Matthew Collings QC, attached as Appendix 1, in which he raises the *"fundamental point"* about *"whether it is right to waive [sovereign immunity] at all. It is a matter of Iceland's identity and pride"*. We further touch upon this generic issue in Chapter 4 below.

Clause 7 – Comparability of treatment and equal treatment

Clause 7.1: Is intended to ensure that TIF and/or Iceland does not give a 'better deal' than that under these documents to any other creditor, save for the Netherlands, and that if it does the provisions of the UK Loan Agreement will be changed to give HM Treasury the same treatment or increased security (as appropriate), and to prevent Iceland creating another guarantee scheme.

Provisions of this type are not unusual in distressed lending situations, as this is, in effect.

Clause 7.2: Provides that if TIF, Iceland or any guarantee fund introduced by Iceland and recognised by Iceland for the purposes of the Directive:

(i) pays any Landsbanki depositor (other than a former depositor who became a depositor of the new Landsbanki or a Landsbanki London depositor) more than €20,887; or

(ii) has the funds to do so,

then TIF will pay, or procure that any other relevant guarantee fund pays, to each Landsbanki London depositor an amount equal to the Excess Payment, or where that creditor has received <u>any</u> payment from HM Treasury or FSCS, *"as the case may be"*. The UK General Side Letter includes a paragraph stating that this clause will not be triggered if the excess arises as a result of variations in exchange rates between Euro and Sterling after execution of the UK Loan Agreement.

Clause 7.2 has a number of very serious flaws. In particular:

(i) the clause provides that Landsbanki London depositors shall receive an amount equal to the excess amount paid to the creditor who received (or could have received) the excess amount. There are no provisions to pro rata the payments to the amount of the underlying claim and as a consequence (a) some depositors would be preferred over others, as the excess will be a larger proportion of smaller claims, and (b) it is possible that Landsbanki London depositors could receive more than the amount of their claim (for example, if there was a €10,000 excess payment made and a London depositor had initially had a claim for €25,000 he would receive the guaranteed minimum of €20,887 PLUS the additional €10,000 resulting in a total payment of €31,887 – a gain of €6,887);

(ii) there are no provisions allowing deduction for any amounts already paid to the Landsbanki London depositors (or HM Treasury). Again, therefore, it is possible that they could be paid more than the value of their claim; and

(iii) the clause does not deal with the circumstances where both HM Treasury and FSCS have made payments to the same creditor. It is therefore not clear if the excess amount should be paid to both or them or divided between them in some manner.

Whilst one can see why the UK Government might wish to use a "cudgel" clause to dissuade Iceland from seeking to prefer domestic depositors were the clause at any time to be operative its results would be extraordinary and entirely out of kilter with the provisions of either Icelandic or English law (including insolvency law).

Clause 8 – Responsibility of HM Treasury and FSCS

This clause states that neither HM Treasury nor FSCS will have any responsibility for losses suffered by TIF or Iceland in connection with the UK Loan Agreement, UK Settlement Agreement or otherwise in connection with Landsbanki prior to the date of the UK Loan Agreement.

In our view this clause is very unusual in two respects. First, it means that TIF and Iceland are not able to recover damages from HM Treasury and FSCS if they breach the terms of the UK Loan Agreement or UK Settlement Agreement (and note that this cuts across the provisions of clauses 7.1 and 7.3 of the UK Settlement Agreement which allow claims where there is bad faith). Secondly, since there is no comparable clause in the Dutch Loan Agreement, the broad wording is, in our view, most likely drafted to provide HM Treasury and FSCS broad protection against any claims that Iceland or TIF might have arising from their actions in connection with Landsbanki's insolvency, thereby providing a total waiver of any legal claims surrounding the events that took place around October 2008 and the action of the UK Authorities during that period and subsequently. As a result this clause may have very broad implications over matters that have not yet come to light publicly.

Clause 9 – Payments

This clause is substantially self-explanatory and, in our view, normal in commercial lending agreements. However, it should be noted that all payments must be made in Sterling and in freely available and transferable funds. The former provision is intended to prevent Iceland reducing its liabilities by depreciating its currency and the latter to prevent Iceland paying but then locking up the money so that HM Treasury cannot use it.

Clause 10 – Indemnity

Clause 10 provides a limited number of indemnities to HM Treasury in respect of possible losses arising under the agreement. These indemnities cover risks and costs arising from currency conversions under the documents; losses arising from Termination Events or the breach by TIF or Iceland of their obligations under any Finance Document and maintaining, perfecting or enforcing any of HM Treasury's rights under the Finance Documents.

Clause 11 - Representations and Warranties

This clause contains a limited number of representations and warranties, the concepts behind which relate to capacity and the documents being binding. In our experience these are relatively standard in the context of a loan agreement.

Clause 12 – Termination Events

This clause sets out a list of "*Termination Events*" and provides that if one of these events occurs, HM Treasury can (but is not required to) cancel the facility provided under the UK Loan Agreement, and demand immediate payment of all amounts due under the Facility Documents, including the full amount of the Disbursements. In our experience it is normal to have a clause with this effect, but some of the Termination Events give rise to concern. In particular:

(i) It is a Termination Event under clause 12.1.2 if TIF or Iceland fails to perform any of its obligations under the Finance Documents (no matter how minor and irrespective of any harm caused), and, if the breach is capable of remedy, fails to remedy it to HM Treasury's satisfaction within 10 Business Days of the breach. In our view this is unusual as normally the time to remedy would run from notice from HM Treasury requiring that it be remedied, and any breach would have to be material to trigger an event of default;

(ii) The Termination Events in clause 12.1.5 include a default by Iceland on its External Indebtedness (which isn't remedied within any initial grace period in relation to the relevant borrowing), where the aggregate amount of External Debt which has been defaulted on exceeds £10,000,000 (or its equivalent in other currencies).

External Indebtedness includes present or future borrowing or other debts or obligations which are payable to non-residents of Iceland or bonds or similar instruments at least 25% of the principal amount of which was initially offered to non-residents of Iceland; AND any indebtedness in a currency other than Icelandic Kronur or which is denominated in Kronur but under the terms of which payment can or must be made in or by reference to any other country.

This explicitly includes loans from the IMF and under the Dutch Loan Agreement.

While in our experience it is not uncommon for default provisions such as this to be incorporated into a loan document, the Budget Committee should consider carefully whether Iceland's current financial situation or other acts, omissions or circumstances could result in this Termination Event occurring on or shortly after completion, the result of which would make the full amount of the 'Loan' immediately due and payable;

(iii) It is a Termination Event under clause 12.1.6 if TIF is unable to pay its debts as they fall due, suspends (whether voluntarily or not) making payments of any of its debts or, by reason of actual or anticipated financial difficulties starts negotiating with one or more of its creditors to restructure or reschedule any of its indebtedness. We strongly suspect that at least one, if not more, of these circumstances applies to TIF at present and therefore it appears there may be a Termination Event on the UK Loan Agreement coming into force, and hence that HM Treasury could then demand payment in full immediately (albeit the sovereign guarantee will not have come into force);

(iv) Under clause 12.1.7 the failure by Iceland or TIF to (a) comply with the requirements of the Directive in respect of any Landsbanki depositor in any material way, or (b) to comply with any other law to which it is subject where that non-compliance could materially impair its ability to perform its obligations under the Finance Documents is also a Termination Event.

Clearly the first element of this Termination Event is unique to the current situation and not a normal commercial term. We are concerned, however, as we point out in Chapter 3 (European Legislation), that there is considerable doubt as to the obligations imposed by the Directive and it may be the case that Iceland is already in breach of this obligation, depending on how the Directive is interpreted in due course.

The second element of this Termination Event is based on our experience more customary and applies to both Iceland and TIF. It should be noted, however, that their ability to comply with their obligations could be impaired

by the payment of damages. Care should be taken to ensure the relevant events do not occur.

(v) If, under clause 12.1.8:

(a) TIF's payment obligations under the Finance Documents cease to rank at least pari passu with its present and future obligations to its other creditors; or

(b) the payment obligations of Iceland under the Finance Documents cease to rank at least pari passu with its present and future external indebtedness,

save as required by any law in force on 5 June 2009 (the date of the UK Loan Agreement) then there is a Termination Event. Again the Committee should consider very carefully whether there are any relevant circumstances at this time calling into question the pari passu ranking (which is critical, as we explain in connection with clause 4.2 of the UK Settlement Agreement above, although, as we have noted, neither HM Treasury or Iceland are party to that document).

(vi) Clause 12.1.10 provides for a Termination Event should TIF be dissolved or cease to be, or if any change of Icelandic law occurs (otherwise than as a consequence of implementing European law) which results or will result in TIF not being the sole depositor protection scheme for Landsbanki's depositors pursuant to the Directive. Again in our view this is an unusual provision, as it impinges on Iceland's ability to create a new deposit insurance scheme in Iceland while the 'Loan' is outstanding i.e. for 15 years or longer; and

(vii) The final Termination Event of note is clause 12.1.11 regarding the occurrence of a change of Icelandic law (otherwise than as a consequence of implementing European law) which does or would materially adversely effect the ability of TIF and Iceland to perform their obligations under the Finance Documents. In our view the structure of this clause is unusual, but the basic principle is not. In our view the main point, however, is that whether a

Termination Event has occurred turns on whether a change of Icelandic law (a civil system) has had a materially adverse effect on the Finance Documents. That question falls (here as in relation to all other Termination Events) to be decided by the English courts applying English law (derived, of course, from common law). In our view this is a very strange state of affairs, and one which can accurately be described as far from normal.

Iceland and TIF are required to tell HM Treasury within 10 Business Days of becoming aware of any actual or potential Termination Event – and failure to do so is itself a Termination Event (unless the notice is served within a further 5 Business Days). Therefore the Committee should consider whether any disclosures need to be made on the UK Loan Agreement or the Dutch Loan Agreement before they come into force, with a view to requesting waivers to avoid the British and Dutch Government immediately foreclosing on Iceland.

Clause 16 – Change in circumstances

Clause 16 provides that if there is a significant deterioration in Iceland's ability to sustain its debt (compared to that in the IMF's assessment of 19 November 2008) then HM Treasury and Iceland will meet to discuss the situation and consider what, if any, changes should be made to the UK Loan Agreement (but not any other Finance Document) as a result.

It should be noted that this clause is merely an obligation to meet, and if HM Treasury refused to agree to any changes to the UK Loan Agreement at or after such meeting there would be nothing Iceland could do about it.

Clause 17 – Governing law and jurisdiction

This clause is identical to the equivalent in the UK Settlement Agreement, and the same comments apply here.

Clause 18 - Waiver of sovereign immunity

This clause as drafted contains a complete waiver of the sovereign immunity of Iceland and (to the extent that it has any) TIF. However, in the UK AAA, in order to address certain concerns raised in the Icesave Law, HM Treasury

and FSCS acknowledge that this does not extend to assets of Iceland which enjoy immunity under the *"Vienna Convention"*, any assets which *"are necessary for the proper functioning of Iceland as a sovereign power"* and any assets of the Central Bank of Iceland. There are a number of issues with this statement, in particular that:

(i) the relevant Vienna Convention is not specified, so this qualification may be void for uncertainty although we anticipate that it relates to the Vienna Convention on Diplomatic Relations 1961; and

(ii) it is not clear to us what assets *"are necessary for the proper functioning of Iceland as a sovereign power"* – for example it is likely that this would include military assets, but it is not clear if this would include assets such as state owned companies and real estate for schools or hospitals which are key to the provision of public services, but not to the maintenance of Icelandic sovereignty. In addition *"necessary for the proper functioning of Iceland as a sovereign power"* and *"critical for Iceland to carry out its obligations as a sovereign state in a satisfactory manner"* are not the necessarily the same and the latter wording (from Article 2.2 of the Icesave Law) appears to us to give greater protection to Iceland (albeit it would be preferable to replace "*critical*" with "*necessary*" at the start of the extracted phrase).

In this connection, see also paragraphs 23 to 26 of the Opinion of Matthew Collings QC.

Further points arising in connection with the Icesave Law

Clause 3.3.1 of the UK AAA contains a statement that the parties confirm that the UK Loan Agreement was negotiated in accordance with the Brussels Guidelines as agreed between Iceland, the EU and the respective member states as intended to apply to the negotiation of that agreement. This is intended to confirm compliance of the UK Loan Agreement with the Agreed Guidelines, but it should be noted that merely because the statement was made does not mean that the parties did actually negotiate in accordance with the Agreed Guidelines. The inclusion of this statement reduces (and, we infer,

was specifically intended to reduce) the ability of Iceland to rely on the Agreed Guidelines in any future discussions or dispute in regards to the UK Loan Agreement specifically and the Finance Documents in general.

Clause 3.3.4 of the UK AAA is intended to address the reservation with respect to Iceland's natural resources set out in Article 2.3 of the Icesave Law. Clearly what are "*natural resources*" is open to question as this is not a defined term.

3. Dutch Loan Agreement and connected documents

3.1 *Summary of Purpose*

The Dutch Loan Agreement, Dutch AAA and three Dutch Side Letters are intended to deal with the same matters as the UK Settlement Agreement, UK Loan Agreement and their connected documents. However, they are structured slightly differently and you will note that there is no Dutch Settlement Agreement. Instead some of the matters dealt with in the UK Settlement Agreement are addressed in the Dutch Loan Agreement and the Dutch Side Letter.

Due to the level of similarity between the UK and Dutch documents, we have not in this letter addressed each material clause of the Dutch documents in detail, but instead have concentrated on where the UK and Dutch arrangements differ in material aspects. We have also not commented on changes arising solely from the parties being different, the UK and the Netherlands having different currencies and similar issues.

3.2 *Summary of provisions*

Dutch Loan Agreement

Recitals: The recitals to the Dutch Loan Agreement are rather different to those in the UK Loan Agreement as the Dutch have paid out all (or substantially all) of the Landsbanki Amsterdam depositors, whereas FSCS still has a number of Landsbanki London depositors to pay. This means that there is no need for further loan draw downs by the Netherlands. We have not

addressed changes to the Dutch Loan Agreement as a consequence of this, unless we believe they are material.

Clause 2: The structure of clause 2 of the Dutch Loan Agreement is very different from the UK Loan Agreement, primarily for the reason outlined above.

Clause 2.1:

Clause 2.1.1: States that TIF undertakes to reimburse the Netherlands for:

(i) assigning to TIF the lesser of the balance of any claim it may have against Landsbanki and €20,887;

(ii) DNB paying the Landsbanki Amsterdam depositors the lesser of the balance of their accounts and €20,887; and

(iii) the Netherlands pre-financing the amounts paid out (and any amounts to be paid out by DNB).

Clause 2.1.2: The amount of the reimbursement will be €1,329,242,850.

Clause 2.1.3: The Netherlands waives any claims it may have against TIF or Iceland in relation to DNB's payment of compensation to the Landsbanki Amsterdam creditors, otherwise than pursuant to the Dutch Loan Agreement. There is no similar wording to this in the UK Loan Agreement or UK Settlement Agreement (as amended in each case).

In addition TIF and Iceland waive any claims they may have against the Netherlands or DNB in relation to the payment of compensation to Landsbanki Amsterdam depositors or the non-payment of compensation to any such depositor.

These waivers are not outside the normal range of commercial terms for agreements of this type. It is surprising that there are no corresponding provisions in the UK agreements.

Clause 2.2: Merely confirms that the reimbursement referred to in clause 2.1.2 will be treated as a loan from the Netherlands.

There is no equivalent of clauses 2.2, 2.3 and 2.4 in the UK Loan Agreement.

Clause 3 – Coming into force

Clause 3.1.1: This clause operates in the same manner as the equivalent clause in the UK Loan Agreement, save that there is no Dutch settlement agreement which must be delivered before the agreement comes into force. In addition, the condition relating to the Act of the Althingi required to approve the giving of the sovereign guarantee must be passed and a copy delivered to HM Treasury under the UK Loan Agreement, but only passed with a copy to follow under the Dutch Loan Agreement.

Clause 3.1.2: Clauses 3.1.2(a) and (b) are substantively the same as clause 4.2 of the UK Settlement Agreement, save that in this document it is absolutely clear that separate assignments to TIF of the claims of the Landsbanki Amsterdam depositors are required.

Clause 3.1.2(c) has no equivalent in the UK documents, but is a further waiver of any claims by DNB against Iceland and TIF in relation to its payment of compensation to Landsbanki Amsterdam depositors by DNB.

Clause 3.1.3: This clause substantively reflects the longstop provisions in clause 3.2 of the UK Loan Agreement, save that it does not carve out the claim assignments from the items which must be delivered before the longstop date.

Clause 4 – Repayment

This clause does not include an equivalent of clause 4.1 of the UK Loan Agreement, as the agreement doesn't provide for further money to be drawn under this loan agreement.

Clause 4.1.1: Appears to be intended to work in the same manner as clause 4.2 of the UK Loan Agreement. However, there is a material mismatch between the two documents, which could create problems.

The Dutch Loan Agreement provides that any amounts received from Landsbanki will be divided between HM Treasury and Netherlands pro rata to the amount of principal then outstanding under the UK Loan Agreement and Dutch Loan Agreement. However, as noted above, the UK Loan Agreement provides that the amounts received will be divided between HM Treasury and the Netherlands *"in inverse order of maturity"* and in proportion to the principal amounts then outstanding. These provisions could result in money being apportioned to HM Treasury and the Netherlands differently, and TIF having to pay out more (or less) than the amount received from the Landsbanki estate.

Clauses 4.1.2 and 4.2: Are substantively the same as the equivalent provisions in the UK Settlement Agreement.

Clause 4.3: In essence is the same as the voluntary prepayment provisions in the UK Loan Agreement, save that:

(i) there are no provisions dealing with circumstances where the loan is for more money than is required to meet TIF's obligations has been drawn under loan agreement. This may have occurred under the Dutch Loan Agreement, but is less likely to occur that under the UK Loan Agreement as the Dutch obligations are substantially crystallised. We suspect that the provisions of the Dutch Side Letter are intended to address the same point, albeit with the implications outlined above;

(ii) there is no restriction on monies prepaid under the Dutch Loan Agreement being re-borrowed.

Clause 5 – Interest

This clause operates in substantially the same manner as in the UK Loan Agreement, save that:

(i) interest starts to accrue from 1 January 2009, rather than the date of the relevant agreement; and

(ii) there are no compounding provisions for interest in relation to clause 5.3.

Clause 6 – Guarantee and indemnity

Works in substantially the same manner as clause 6 of the UK Loan Agreement.

Clause 7 – Comparability of treatment and equal treatment

Has substantially the same effect as clause 7 of the UK Loan Agreement.

There is no equivalent of clause 8 of the UK Loan Agreement, but again this is a consequence of there being no provision for multiple draw downs in respect of the loan from the Netherlands.

Clause 8 – Payments

Again, this works in substantively the same manner as the equivalent clause in the UK Loan Agreement (clause 9), save that the Dutch Loan Agreement sets out a specific account to which the money must be paid and the UK Loan Agreement permits the relevant account to be specified.

Clause 9 – Indemnity

Works in substantively the same manner as the equivalent clause in the UK Loan Agreement (clause 10).

Clause 10 – Representations

Is substantively the same as the equivalent clause in the UK Loan Agreement (clause 11), save that the warranties are only given at the date of the Agreement and are not repeated.

Clause 11 – Termination Events

Operates in the same manner as clause 12 of the UK Loan Agreement, save that as a consequence of the loan under this agreement being a single advance a Termination Event leads only to the balance of the loan (and accrued

interest) becoming payable and not the facility being terminated, as this is not relevant.

Clause 12 – Changes

Works in substantially the same manner as clause 13 of the UK Loan Agreement.

Clause 13 - Notices

Save for some minor changes which are not of commercial interest this clause works in substantively the same manner as clause 14 of the UK Loan Agreement.

Clause 14 – Miscellaneous

Has substantially the same effect as clause 15 of the UK Loan Agreement.

Clause 16 - Change of circumstances

Works in substantially the same manner as clause 17 of the UK Loan Agreement.

Clause 16 – Governing law and jurisdiction

This clause omits the wording required for the choice of law provisions to be effective in relation to non-contractual disputes arising from the Dutch Loan Agreement, but otherwise is the same as the choice of law and jurisdiction clause in the UK Loan Agreement.

Dutch AAA

The Dutch AAA is substantively in the same terms as the UK AAA, save that:

(i) clause 3.4(b) of the UK AAA is not reflected as the Dutch Loan Agreement already included the desired wording;

(ii) clause 3.5 of the Dutch AAA substantively reflects the provisions of clause 2.1(e) of the UK Settlement Amendment Agreement, rather than

anything in the UK AAA or Loan Agreement. This is because there is no Dutch settlement agreement.

(iii) clause 4 does not incorporate the waiver of sovereign guarantee in the Dutch Loan Agreement into the Dutch AAA. However, as the agreement amends the Dutch Loan Agreement we do not believe that this will make a significant practical difference in the event of litigation.

Dutch Currency Side Letter and Dutch General Side Letter

The Dutch Currency Side Letter and Dutch General Side Letter are in substantively identical form to their UK equivalents. However it should be noted that clause 3 of the Dutch General Side Letter is slightly different from the UK General Side Letter as the relevant provisions are included, for the UK, in the UK Settlement Agreement and, for the Netherlands, in the Dutch Loan Agreement.

Dutch Side Letter

The Dutch Side Letter deals with two issues; it confirms the amount of compensation which DNB (the Dutch National Bank) and the Netherlands will receive for dealing with the Landsbanki Amsterdam depositors, and also provides a mechanism for assessing whether the correct amount was paid out by DNB.

Clause 2: This clause confirms that the amount to be lent to TIF by the Netherlands is €1,329,850 and that this will be the principal amount of the Loan. This simply reflects clause 2.1.2 of the Dutch Loan Agreement.

Clause 3: Confirms the amount paid out to Landsbanki Amsterdam depositors and that the DNB will receive €7,000,000 as compensation for dealing with those depositors. This contrasts with £10,000,000 to be paid to FSCS pursuant to the UK Settlement Agreement.

Clause 4, 5 and 6: In essence provide a mechanism pursuant to which non-binding audits of the amounts paid out by DNB can be carried out, ideally by the Landsbanki winding up committee but, if they will not disclose their

information, by TIF and Iceland. If the audit is completed by 5 June 2010 AND the amounts actually paid out by DNB differ in aggregate from the amount the audit shows should have been paid out by more than 1% then the parties will "*enter into good faith negotiations*" to decide what to do. The clause requiring negotiations is void under English law as an agreement to agree, and as a consequence the clause has only moral and political force.

These provisions are rather unusual, and ideally the document would include a proper mechanism for adjustment following the audit. However, it may be that this is not achievable in practice and if this is the case then retaining the clause is better than having nothing at all.

4. Equal Footing During Negotiations

We are asked to comment on whether the Icesave Agreement reflects that the parties were on equal footing during the course of the negotiation. Mishcon de Reya was initially advising the Icesave Committee and provided it with various findings, primarily during March and early April 2008. We were not involved in negotiating the 5 June Agreements or the 19 October Agreements and therefore without the factual background of having been there to observe the course of the negotiations we cannot comment.

As to the terms of the Icesave Agreement, we have identified several relevant points which favour one party or the other.

CHAPTER 2 - JURISDICTIONAL ISSUES

Advice on *"the impact on the interests of Iceland or Icelandic parties as a result of the position that any potential litigation in the future in the United Kingdom regarding a dispute under the Icesave Agreement is subject to English law and jurisdiction as opposed to Icelandic law and jurisdiction. In particular you have asked us to address whether the contractual provisions, based on such grounds, would result in the legal position of the Icelandic State or Icelandic parties, such as Landsbanki Íslands hf. and its subsidiaries, being weakened and whether the legal position of the British & Dutch State or British & Dutch parties is strengthened"*

1. Reference to Chapter 1 (Terms of Icesave Agreement)

Please note that the issues raised in question 2 have partly been addressed in Chapter 1 (Terms of Icesave Agreement), in particular we refer you to the discussions regarding clauses 2.1 and 4.2.

2. Choice of English Law

Each constituent element of the Icesave Agreement is expressed to be governed by, and provision is made that it be construed in accordance with, the laws of England.

Landsbanki and its subsidiaries are not parties to the Icesave Agreement. Whilst clause 4.2 of the UK Settlement Agreement provides that FSCS and TIF "*agree*" that the proportion of Assigned Rights assigned by FSCS to TIF "*shall rank pari passu in all respects with the proportion of such Assigned Rights retained by FSCS*", the reorganisation/winding up of insolvent entities in Icelandic insolvency procedures will, we imagine, proceed in accordance with the provisions of Icelandic law. On that basis, we cannot see, on the information available to us and within the scope of the investigation with which we are charged, how the legal position of Landsbanki or its subsidiaries might be weakened directly.

However, and as we have sought to explain above, clause 4 ("*Reimbursement*") of the UK Loan Agreement requires that distributions from Landsbanki received by TIF are to be applied in accordance with the contractual provisions, which are governed by English law. To the extent that those provisions bring about a result which diverges

from how recoveries would normally be applied in Icelandic law they will adversely (and possibly seriously so) impact upon TIF and (to the extent that Iceland is required under the UK Loan Agreement to provide a sovereign guarantee over TIF's obligations) also on the position of the Iceland itself as guarantor.

This is not the result of the choice of law clause itself, but the result of the commercial agreement reached by TIF and the Iceland to repay HM Treasury in respect of the payments which FSCS has made to Landsbanki London depositors.

We are not able to advise on the extent to which the position of the Netherlands might be improved, as this would require a comparative analysis of English and Dutch law, which is beyond our expertise.

3. Would the choice of English Law be upheld?

An English court faced with choice of law provisions in the Icesave Agreement will apply the Rome Convention on the Law Applicable to Contractual Obligations (the "**Rome Convention**"), the rules of which apply under article 1(1) to "*contractual obligations in any situation involving a choice between the laws of different countries*".

The basic principle is that of party autonomy; essentially, that the parties are entitled to agree what is to be the proper law of their contract, and an express choice of law is conclusive in particular under article 3 of the Rome Convention.

We have considered whether this autonomy might be challenged in some way.

Article 3(3) of the Rome Convention provides that where all elements relevant to the situation at the time of the choice are connected with one country only, the choice of law cannot prejudice the application of rules of the law of that country which cannot be derogated from by contract (referred to as "*mandatory rules*"). The article applies to a choice of English law where all the other relevant elements are connected with some other country. It would, we think, be difficult to maintain an argument that any case arising out of the situation which has arisen could be said to have no connection to England.

4. Impact of the Winding Up Directive

The Winding Up Directive provides that (whether Landsbanki is subject to "*reorganisation measures*" or "*winding-up proceedings*" (as defined)), the applicable law is that of the home Member State, save as provided for in the Winding Up Directive itself. In particular we refer to articles 3(2) and 10 of the Winding Up Directive, which, in relation to winding-up proceedings, expressly provides that the law of the home Member State "*shall determine in particular ... (h) the rules governing the distribution of the proceeds of the realisation of assets, the ranking of claims*" and "*(k) who is to bear the costs and expenses incurred in the winding-up proceedings*"). In English law, any attempt to contract out of a pari passu distribution in, say, the winding up of a company, is permissible only with the express consent of the creditors affected or by means of a scheme of arrangement, see British Eagle International Airlines Limited v Compagnie Nationale Air France [1975] 1 WLR 758. We doubt (but cannot, obviously, be certain, as we are not qualified to advise on Icelandic law) that the Icelandic courts could be persuaded, on the basis of the deal done between TIF and FSCS, to require Landsbanki to depart from the Icelandic priorities of distribution. To this extent, clause 4.2(a) may not (depending on Icelandic law) achieve what the FSCS appears to desire, which is to share equally with TIF in recoveries from Landsbanki. However, clause 4.2(b) appears to anticipate that this may be the result. As we have explained, clause 4.2(b) requires TIF to make a balancing payment in the event that it recovers on an advantageous basis over FSCS. Therefore, the network of agreements entered into between TIF and FSCS, and, in particular, clause 4.2(b), reflect and evidence a contractual agreement to treat recoveries in the hands of creditors of Landsbanki in a particular way, and we cannot see that any attack on the choice of law clause can be mounted on this ground.

5. Jurisdiction of the English courts

The Icesave Agreement also provides for the English courts to take exclusive jurisdiction in relation to the Icesave Agreement. As TIF is not a public authority exercising its powers within the meaning of the 2007 Lugano Convention OJ 2007 L 339/3 (as noted in particular in clause 8.1 of the UK Settlement Agreement), jurisdiction is governed by the Lugano Convention, which gives effect to the parties' agreement to confer jurisdiction on the courts of a particular country. It is notable that

in the Icesave Agreement, the Icelandic Embassy in London is appointed as an agent to receive service of process in England.

CHAPTER 3 – EUROPEAN LEGISLATION

Advice on question 3 - "*the impact of any potential future revision and amendments of the European legislation on deposit guarantee schemes as it was in October 2008 not least regarding any guarantee by a home state, on the content and validity of the Icesave Agreement and the obligations of the Icelandic State or the Icelandic parties under the Icesave Agreement. In particular you asked us to refer to the existing legal obligations of the Icelandic State or Icelandic parties under the European legislation of deposit guarantee schemes and their impact on the Icelandic State or Icelandic parties*"

1. Introduction and Background Law

The Directive applies to Iceland as an EEA Member State by reason of the Decision of the European Economic Area Joint Committee No. 18/94 amending Annex IX to the EEA Agreement, and was implemented in Iceland by Law No 98/1999 and Regulation No 120/2000.

By adopting Law No 98/1998, the Icelandic Government legislated for the creation of TIF, which manages a deposit-guarantee scheme ("**DGS**"), which included the mechanism for the management of funds, monitoring of the scheme and a problem-solving mechanism in the event of a funds deficit. Although obligated to do so under Law No 98/1999 TIF is not able to pay to each Icesave depositor, the minimum sum of ECU20,000 stipulated by the Directive (which was converted into €20,887 on the implementation of the Directive by Iceland). The key question therefore is whether, in these circumstances, the Directive requires Iceland to stand behind TIF to this extent by providing a sovereign guarantee.

The only judicial authority available on the issue is the European Court of Justice ("**ECJ**") decision in Case C-222/02, Peter Paul, which is equivocal and therefore does not provide complete clarity on this point.

In Peter Paul the German Bundesgerichtshof asked the ECJ for a preliminary ruling on the question *"Do the provisions of Articles 3 and 7 of Directive 94/19 ... confer on the depositor, in addition to the right to be compensated by a deposit-guarantee scheme up to the amount specified in Article 7(1) ... the more far-reaching right to*

require that the competent authorities avail themselves of the measures mentioned in Article 3(2) to (5) and, if necessary, revoke the credit institution's authorisation", and, if yes, whether that right *"also includes the right to claim compensation for damage resulting from the misconduct of the competent authorities, beyond the amount specified in Article 7(1)"*.

The ECJ interpreted this question as essentially requiring it to determine whether Article 3(2) to (5) of the Directive precluded a national rule to the effect that the functions of the national authority which were responsible for supervising credit institutions are to be fulfilled only in the public interest, under which national law precludes individuals from claiming compensation for damage resulting from defective supervision on the part of that authority. The ECJ was not, therefore, concerned with the question which arises in the present case as to whether the Directive requires that Iceland provides a sovereign guarantee.

In paragraphs 27 to 31 of its judgment, the ECJ explained that *"The purpose of Article 3(2) to (5) of Directive 94/19 is to guarantee to depositors that the credit institution in which they make their deposits belongs to a deposit-guarantee scheme, in order to ensure protection of their right to compensation in the event that their deposits are unavailable, in accordance with the rules laid down in that direction and more specifically in Article 7 thereof."* This phrase is equivocal and we discuss two interpretations of the phrase below:

(i) It is entirely consistent with an interpretation that the obligation on the Member State is simply to ensure (or "*guarantee*" as the ECJ would have it) that a relevant credit institution is a member of a DGS, and that it is for the DGS to ensure protection of the depositor in the event that his deposit is unavailable. This interpretation is supported by the final sentence of paragraph 29 of the judgment, which reads *"Those provisions thus relate only to the introduction and proper functioning of the deposit-guarantee scheme as provided for by Directive 94/19"*. The judgment does however not address what is meant by the words *"proper functioning"* of a DGS. There are a vast range of possibilities for the meaning of *"proper functioning"*, from, at one end of the spectrum, (1) the establishing of a DGS which operates in accordance with the rules pursuant to which it was set up, to, at the other end,

(2) a DGS which is fully capable of meeting all claims made against it. What the phrase *"proper functioning"* therefore means may be informed by the context in which the Directive was made, as to which see below.

(ii) A different, but nevertheless also plausible, interpretation is that the Member State's obligation is to ensure that the depositor receives the stipulated minimum protection i.e. to provide a sovereign guarantee of its DGS. This latter interpretation is supported by the wording used by the ECJ in paragraphs 30 and 31 of the judgment, where the ECJ speak of compensation of depositors being, or having been, *"ensured"*.

In this connection, it is important to note how the ECJ interpreted the 24th recital of the Directive, which provides *"Whereas this Directive may not result in the Member States or their competent authorities being made liable in respect of depositors if they have ensured that one or more schemes guaranteeing deposits or credit institutions themselves and ensuring the compensation or protection of depositors under the conditions prescribed in this Directive have been introduced and officially recognised"*. The language of this Recital 24 is garbled (and the wording in French is slightly different), leaving significant room for doubt as to whether the obligation on a Member State is (1) simply to establish and officially recognise a scheme guaranteeing deposits, or (2) whether the Member State (and not only the scheme) must ensure that the scheme is capable of providing the stated minimum compensation to depositors for example by providing a sovereign guarantee.

It is, at least, arguable that the Member State's (i.e. Iceland's) obligation is solely confined to establishing and recognising a scheme, particularly in the absence of the imposition of an obligation, in the operative parts of the Directive, on the Member State to stand behind the scheme.[2]

Pels Rijcken & Droggleever Fortuijn however maintain, on behalf of the Dutch Government, *that "A member state or its competent authority can not be made liable*

[2] However, even on this analysis, it could not confidently be asserted that Recital 24 excludes state liability in the event that a Member State has failed properly to implement the Directive; rather, the interpretation of the recitals goes to what adequate implementation means, in all of the circumstances. Note that the EFTA Court has accepted that state liability for failure properly to implement a Directive exists in EEA law: see Erla Maria Sveinbjornsdottir, E-9/97. We have not sought to address, in detail, in this document, the constituent elements of this cause of action.

*in respect of deposits, **only if** they have ensured that a deposit-guarantee scheme has been introduced and ensure the compensation of depositors under the conditions prescribed in the Directive"*, i.e. the receipt by the depositor of the harmonized minimum guarantee. That contention rather begs the very question which arises, given the garbled wording of the recital.

In Peter Paul, the ECJ appear to run the various phrases in this convoluted provision together and interpret it as stating that *"the directive may not result in the Member States or their competent authorities being made liable in respect of depositors **if they have ensured the compensation or protection of depositors under the conditions prescribed in the directive**"*.

Consistently with this reading, in answering the question posed in Peter Paul, the ECJ said this: ***"if the compensation of depositors prescribed by Directive 94/19 is ensured**, Article 3(2) to (5) thereof cannot be interpreted as precluding a national rule to the effect that the functions of the national authority responsible for supervising credit institutions are to fulfilled only in the public interest ..."* This statement has been deployed in support by the British and the Dutch position that Member States are obliged to ensure that depositors receive the compensation prescribed in Article 7 ie that the Directive requires a sovereign guarantee from Iceland.

Peter Paul however does not definitively dispose of the question posed in the present case, as a reading of the provisions of the Directive reveals.

2. The scope of the obligations imposed on a Member State by the Directive

The positive mandatory obligations imposed on Iceland by the Directive are contained in the following articles:

(i) Article 3(1) requires that each Member State shall ensure that within its territory one or more deposit-guarantee schemes and introduced and officially recognised.

(ii) Articles 3(2) to (5) impose an obligation on the competent authorities which have issued authorisations to credit institutions to ensure, in cooperation

with the deposit-guarantee scheme, that those institutions comply with their obligations as members of that scheme, and, in the circumstances outlined in article 3(5), to revoke the authorisation of the institution in question.

(iii) Article 4(3) requires that Member States shall ensure that objective and generally applied conditions are established for the membership of branches of credit institutions in other Member States of a host Member State's scheme.

(iv) Article 6(1) requires that Member States shall check that branches established by a credit institution which has its head office outwith the community have cover equivalent to that prescribed in the Directive.

(v) Article 7(6) requires that Member States shall ensure that the depositor's rights to compensation may be the subject of an action by the depositor against the deposit-guarantee scheme.

(vi) Article 9 imposes requirements as to the provision of information and advertising.

(vii) Article 14(1) requires that Member States shall bring into force the laws, regulations and administrative provisions necessary for them to comply with the Directive by 1 July 1995, and article 14(2) requires Member States to communicate to the Commission the texts of the main provisions of national law which they adopt in the field governed by the Directive.

There is however no positive obligation expressly imposed on the Governments of Member States, i.e. Iceland, to guarantee the payment of the harmonised minimum guarantee to each depositor.

Article 7(1) provides that *"Deposit guarantee schemes shall stipulate that the aggregate deposits of each depositor must be covered up to* [€20,887] *in the event of deposits being unavailable"*, and article 10(1) requires that *"Deposit guarantee schemes shall be in a position to pay duly verified claims by depositors in respect of unavailable deposits within three months"*. The 23rd recital (which does not by itself have legal effect, but may assist interpretation of the operative provisions) requires that *"the financing capacity of such schemes must be in proportion to their liabilities"*.

The live question is, therefore, whether a Member State's obligation is (1) merely to organise and recognise a DGS, or (2) whether the obligation goes beyond this, to ensure that depositors in fact do actually receive the stipulated minimum, or (3) whether there is some middle ground (e.g. to ensure that the scheme is capable of providing cover for depositors, which might, for example, give rise to questions about whether TIF was adequately funded, either upfront or by mandating the obtaining of an after-the-event loan, and might turn on a detailed consideration of the banking sector from time to time, and, perhaps, a comparison of the Icelandic scheme to those in operation in other Member States, assessed against the banking sectors in those states, as well as potentially raising difficult issues of waiver and estoppel).

In favour of the interpretation most beneficial to Iceland, that a Member State's obligation is confined only to establishing and recognising a DGS, Iceland might refer to article 4(1) of Directive 97/9/EC on Investor-Compensation Schemes, which provides that *"Member States shall **ensure** that schemes provide for cover of not less than ECU 20,000 for each investor ..."* The wording of this article, in particular the wording *"Member States shall **ensure**"*, leaves no room for doubt as to the obligation of Member States under Directive 97/9/EC, which is to achieve the result that deposits receive the stated minimum return. However, since there is no such similar provision in the Directive that *"Member States shall **ensure**"*, Iceland can argue that the Icelandic State is not obligated to *"**ensure**"*, i.e. in other words guarantee, that TIF pays up to the minimum return under the Directive to each depositor.

In favour of the opposite interpretation most beneficial to the British and the Dutch, i.e. that the Directive specifies that a particular result (i.e. the receipt by each depositor of the stipulated sum of up to [€20,887]) must be achieved, a purposive construction of the Directive (the 16th recital of which speaks of *"the interest of both consumer protection and of the stability of the financial system"*) might be said to require that article 3(1) (which imposes a positive obligation on Member States) must be read together with articles 7(1) and (6) and 10(1), which stipulate what the DGS must achieve. The argument here would be that requiring a Member State to establish a DGS means nothing unless the Member State must also ensure that the DGS is capable of meeting the obligations that are expressly imposed on it by the Directive. This is the approach that the ECJ appears to have taken in Peter Paul.

It should be said that it seems likely that, if the case were tested in the EFTA Court, and were the EFTA Court to take its lead from the ECJ's judgment in Peter Paul, (1) it is likely that it would be insufficient for Iceland simply to assert that it only had to establish and recognise TIF, but that Iceland would also have to justify at least the terms on which TIF was established; and (b) it is possible that the Directive would be interpreted as requiring that a particular result be achieved.

Nevertheless, there is clearly legal and factual uncertainty as to whether the Government of a Member State, i.e. Iceland, has any obligation, to guarantee pay up to the minimum sum to each depositor, when the DGS, i.e. TIF, cannot pay the stipulated minimum.

Certainly, recent comments made by the UK Financial Services Authority (the "**FSA**") appear consistent only with a construction that Member States have no obligation to stand behind a DGS. In a document entitled Financial Risk Outlook 2009, Section A – Financial and Economic Crisis, the FSA explained that *"The insolvency of Landsbanki ... illustrates a weakness in the current European approach to a single market in retail banking. Depositors in one country (or their Government) are vulnerable to the failure of banks in another country if the home country concerned lacks the supervisory resources to ensure bank solvency, or the fiscal resources and willingness to fund bank rescue, and if the deposit insurance cover is low and unfunded."*

3. The applicability of the Directive to a systematic banking failure

The DGSs are based on an insurance concept; many banks contribute for the eventuality that a risk may materialise in respect of one or some of them. However, if the risk materialises in respect of all or most of them, the insurance may simply not cover the entire class in relation to whom the risk has materialised.

Moreover, in the Directive the Commission afforded Member States a high degree of discretion in respect of the funding mechanism underlying each scheme, and permit post-funded schemes. In a post-funded scheme, the scheme relies on its ability to borrow funds and later effectively to "reclaim" those funds from its members. Logic suggests that a post-funded scheme would not be capable of providing any coverage in the event of a systemic melt-down, as there would be no members left to pay funds

into the scheme. That the Directive permits post-funded schemes which by definition could not cope with melt-down tends to support the contention that the Directive is not intended to deal with bank failures of the magnitude experienced by Iceland.

This limitation appears to be widely recognised.

The Commission have explained[3] that most national schemes are capable of dealing with a mid size bank failure, but that a high impact bank failure would exceed the funds of all Depositor Guarantee Schemes in the EU and Norway by a factor of 2 to 22, requiring all DGSs to borrow money to meet their obligations.

A Report by the French Central Bank published in 2000 on deposit guarantee schemes also states that it is *"accepted"* that such schemes *"are neither meant nor able to deal with systemic banking crises".*

On March 3 2008, the Dutch Finance Minister said *"First and foremost, European countries need to take a close look at how the deposit guarantee scheme is organised. It was not designed to deal with a systemic crisis but with the collapse of a single bank."*

On this basis, it may be arguable that the Directive was not intended to protect against the meltdown of all, or a vast majority of, financial institutions in a given Member State. On this analysis, the obligation imposed by the Directive on the Member State should be interpreted in a circumscribed fashion, i.e. effectively to require a Member State to take all reasonable measures to ensure that a DGS should cover in a normal risk scenario. Support for this approach might also be garnered from the 23rd recital, which provides that the financing capacity of schemes must not *"jeopardize the stability of the banking system of the Member State concerned".*

However, this argument is by no means bound to succeed. Against this construction, it should be noted that article 10(2) refers to *"wholly exceptional circumstances"* which render a guarantee scheme unable to comply with its obligations. However, the latitude granted in these circumstances is narrowly circumscribed; such situations justify only a limited extension of time in which to honour claims made on the scheme.

[3] http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm

4. Possible future amendments to the Directive

A future amendment to the Directive requiring a Member State to guarantee the obligations of a DGS would not definitively ascertain whether the Directive in its previous unamended form would have indeed imposed such an obligation or not. The British and Dutch Governments would, no doubt, argue that such an amendment was effected for the avoidance of doubt i.e. for clarity purposes and to align the new directive with the Directive, by reason of the difficulties experienced by Iceland. Iceland would however in this instance wish to contend that the inclusion of an express Member State Sovereign guarantee demonstrated that this was a new requirement. The question therefore as to whether the Directive in force as at October 2008 required Member States to guarantee the obligations of DGSs would remain a live one.

Also any amendment of the Directive would not impact on the terms of the Icesave Agreements which impose a contractual obligation on Iceland to provide a sovereign guarantee irrespective of whether the Directive, or any future directive, so requires.

5. Limitations on this advice

It has also been suggested (by the Governments of Britain and the Netherlands) that the Icelandic Government deprived the Directive and the Icelandic deposit-guarantee scheme of their practical effect by issuing the Emergency Law No. 125/2008 by providing the legal framework to transfer the domestic assets and liabilities of Landsbanki to NBI hf. We have not examined this contention and make no further comment on it at this point.

CHAPTER 4 - MATTERS TO BE CONSIDERED BY THE ALTHINGI

Advice on question 4 - "*the potential legal repercussions if the final acceptance of the draft bill for a sovereign guarantee for Icesave loans from October 19th 2009, amending Law No. 96/2009 (the "**Icesave Bill**") would be delayed and/or not adopted as Icelandic law by the Icelandic Parliament, Althingi. In particular you have asked us to evaluate, on grounds of such circumstances, the most appropriate way forward for all the relevant parties to bring the Icesave matter to a successful conclusion*"

1. Reference to Chapter 1 (Terms of Icesave Agreement)

Please note that the issues raised in question 2 have partly been addressed in Chapter 1 (Terms of Icesave Agreement), in particular we refer you to the discussions regarding clauses 4.2 and 6.1 of the UK Settlement Agreement, clause 3 of the UK Loan Agreement and clause 3 of the Dutch Loan Agreement. See paragraphs 14 to 19 of the Opinion of Matthew Collings QC.

Note, however, that if the Althingi reject the Bill, the UK and Iceland might seek a court ruling seeking to establish that TIF **and** Iceland are liable to repay the money which those Governments have paid to the Landsbanki London Depositors and the Landsbanki Amsterdam Depositors. The terms of any such judgment might be more onerous than the terms of the Icesave Agreements, in that they could, conceivably, require repayment in full, immediately. It could take considerable time to bottom out the outcome of such a claim.

We also observe that a failure to proceed to implement the Icesave Law may have other financial ramifications, including as to the availability of funding from the IMF and related international loans. However, again this is exclusively for the consideration of the Althingi and the Icelandic Government, not ourselves.

2. Assumptions

We make the following assumptions.

(i) Our first assumption is that to accept any agreements in relation to Icesave, the Althingi would seek that the terms of any agreements be (a) clear; (b) politically acceptable; and (c) economically viable (i.e. affordable).

We cannot, of course, comment on what is politically acceptable. This is beyond our brief or knowledge.

As can be seen from our advice above, the present Icesave Agreement is neither clear nor fair. It is also our understanding, though we have not undertaken any independent calculation, that they may also not be affordable. In this context affordability should be considered in terms of both absolute ability to pay and the impact of making payment on Iceland's other commitments and the needs of its people.

We do not know what economic analysis has been undertaken and reviewed in this regard to date. It would certainly be expected that this aspect would be considered in detail as a, or the, key determinant in reaching any final conclusion.

(ii) Our second assumption is that the British and Dutch Governments must have entered into negotiations tacitly accepting those factors as necessary realities in achieving a mutually acceptable and sustainable conclusion.

In fact, from Mishcon de Reya's discussions with Slaughter & May representing HM Treasury earlier this year, we would say that this assumption did appear to be recognised on the part of the British. There was some perception that the Dutch position was possibly less flexible, but this perception may not have been correct.

If our first and second assumptions are correct, then it may reasonably be thought that the present Icesave Agreement, at least certain aspects of it, may be the product of some misunderstanding.

(iii) This does not sit easily with our third assumption, namely that the British and Dutch Governments may view or appear to view the present Icesave Agreement as the final position.

In logic of course, assumptions (ii) and (iii) are mutually inconsistent; but that is not necessarily the case in practice.

3. The way forward

In any event the Althingi would now appear to be confronted with three options:

(i) to accept the Icesave Bill;

(ii) the reject the Icesave Bill; or

(iii) to delay the Icesave Bill.

Logically, choosing option (ii) or option (iii) would be with the intention of seeking to reopen or resume negotiations with the UK and Dutch, with a view to seeking clarification and more mutual satisfaction in a final conclusion of the Icesave matter.

Here we come to a most critical point. If it is the case that the British and/or Dutch Governments are reluctant or unwilling to re-engage in discussion on terms, there could arise a difficult impasse with potential political, diplomatic, economic and/or legal consequences. We are only qualified to comment on the latter, and we do so only very briefly here, as whether or what steps might be taken is plainly highly speculative question. At this point we would merely point out that it is possible that legal proceedings could be taken in principle by either side.

Any court proceedings would take time and are by their nature unpredictable. They are therefore and certainly could here be a double-edged weapon, with potentially unpredictable spin-offs, including satellite litigation. A possible example is indicated at paragraph 10 of the Opinion of Matthew Collings QC.

It would be our lay assumption that neither "side" would wish to seek confrontation. However, and as indicated above, it is also our lay assumption that if on objective analysis, the Icesave Agreement is unaffordable, then it is arguable that from the very outset or at any point subsequently the Icesave Agreement could fall within the Doctrine of Impossibility in English law which could have again have highly unpredictable consequences including the British and Dutch claiming fundamental breach and consequently seeking immediate repayment in full. (See also our discussion above about the prospect that there has already been a termination event which would entitle the British and Dutch to call for immediate repayment in full.)

Of course, this is circular territory in the sense that if at any point Iceland is unable to pay what is due then that would simply be a fact. It is therefore our lay opinion and in this context legal opinion that Iceland must fully consider the financial liabilities being imposed by the Icesave Agreement and its ability to meet its terms. If it is inevitable or if there is objectively viewed a real risk that Iceland will or may default, then as a matter of law also it should properly be considered whether such agreement should be entered into.

It would be logical to suppose that Icelandic formal rejection of the Icesave Agreement would be more likely to result in a confrontational position than reasoned delay. As we have observed above, it would be useful to take time to:

(i) secure legal certainty as to the precise meaning and effect of the terms which are currently "on the table", in light of the uncertainties and inconsistencies between the agreements addressed above; and

(ii) as part of the process of debate, to seek to re-engage and ascertain to what extent there is flexibility to renegotiate with the British and Dutch, in light of the hard economic facts as to Iceland's ability to meet repayments. This could properly be presented (and seen) as re-clarification of points of detail and therefore possibly less contentious and politically sensitive than a flat refusal to proceed or an attempt to re-negotiate from a clean slate. In other words, this could possibly and rightly be presented as a constructive proposal to take matters forward (not backwards) with a view to securing a successful and sustainable conclusion.

We consider it is premature to rehearse our views in this respect prior to consideration of our advice and observations and all other related matters by the Budget Committee. We are also hesitant, without specific and considered instructions from Iceland, to set out our further views in detail and in writing at this point. We consider that oral discussion would be most appropriate at this stage.

We state this for the following reasons:

(i) Focus

If there are to be further discussions and negotiations with the British and Dutch Governments, it appears to us to be vital that such discussions and negotiations be undertaken with a clear objective, agenda and focus. In particular to reach a (i) clear; (ii) politically acceptable and (iii) economically viable (i.e. affordable) conclusion.

(ii) Confidentiality

It is understood and well known that the Icesave matter is one of considerable political, as well as economic, sensitivity in Iceland. As is pointed out in Matthew Collings QC's note, the Icesave matter may also have the capacity to become politically sensitive in the United Kingdom.

However historical precedent would suggest that political heat, publicity and public debate tend not to assist sensitive negotiation. Confidentiality is more often of assistance; and sometimes is essential. We believe confidentiality both in terms of approach and content would be helpful, and possibly essential, to successfully re-engage with the British and Dutch Governments.

(iii) Approach

There are a number of different avenues of approach in re-engaging with the British and Dutch Governments, including:

(a) Government to Government (and if so at what level?)

(b) through lawyers; or

(c) through intermediaries.

It appears to us that the question of the appropriate approach to take can only be addressed in conjunction with the all the relevant issues under consideration as we have indicated above.

If the Budget Committee should wish to consider any of these matters with us further, we would welcome the opportunity to come to Iceland and do so in person. In that event, we consider we would need a waiver of confidentiality from the Icelandic Government to promote open discussion on all matters which may be relevant to full understanding of the Icesave matter.

Yours faithfully,

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APPENDIX ONE

ADVICE OF MATTHEW COLLINGS QC

ICESAVE

NOTE

This Note is intended to summarise what I see as the principal points arising from Mishcon de Reya's and Rebecca Stubbs' extensive research and advice.

The Icesave Agreements

1. On 5 June 2009, two agreements were entered into:

1.1 the Settlement Agreement; and

1.2 the Loan Agreement.

2. On 19 October 2009, these two agreements were supplemented and amended by:

2.1 an Amendment Agreement in respect of the Settlement Agreement; and

2.2 an Acceptance and Amendment Agreement in respect of the Loan Agreement.

3. The agreements need to be read together.

The Issues

4. I regard the immediate issues as being principally the following:

4.1 in respect of the Icesave agreements:

4.1.1 are they in force, and

4.1.2 what are their terms;

4.2 are the terms of the Icesave agreements acceptable;

4.3 in particular, what is their effect on distributions made by the Landsbanki Resolution Committee; and

4.4 the interest rate under the Loan Agreement.

Background

5. For the purpose of this Note, I will proceed on the basis that it is appropriate for TIF to accept and meet compensation of up to €20,887 for each Icesave retail depositor. (I am of course aware that this raises issues under EC law (as applicable in the EEA), political issues concerning Iceland's position in the EEA and on the wider world stage, and very important economic issues.)

6. However, it is the case that TIF, in common with other compensation schemes, was not equipped to deal with major financial turmoil, but only individual minor troubles. FSCS in the UK has had to have massive Government support. There is no specific obligation for Government support, so this engages voluntary assistance, negotiation and compromise.

7. Such compensation is applied on an EEA wide basis, but FSCS in the UK has chosen to be more generous. FSCS limit was around £35,000, but was increased during the financial crisis to £50,000 so as to bolster confidence.

8. If any deposit protection scheme pays compensation, it stands in the shoes of the depositor in the amount for which it compensates that depositor (by way of subrogation or assignment); and the depositor remains in his shoes for the balance. However, the ways in which this is achieved may be different from scheme to scheme and have different implications. It is a matter of contract, but regulatory measures may also impinge.

9. There are two important, and universal, principles to bear in mind, which are linked. First, the question of deposits, and depositor protection, must be considered on a depositor by depositor basis. Secondly, when a distribution is made to creditors of an insolvent company (a dividend, being a proportion of

what they are owed), it is made to each depositor as a creditor individually, in accordance with the amount of their deposit.

10. The very harsh measures which the UK took in October 2008 in respect of Kaupthing, Landsbanki and their UK subsidiaries are well known. A challenge brought by Kaupthing has failed: see The Queen (on the application of Kaupthing Bank hf) v HM Treasury [2009] EWHC 2542 (Admin). That was not a sound challenge, but we can advise further on what would be a good challenge, and one which would cause considerable concern and embarrassment to the UK Government.

11. The Landsbanki Freezing Order created much controversy and resentment; KS&F and Heritable were put into administration; and Transfer Orders were made in respect of the depositors at KS&F and Heritable pursuant to the Banking (Special Provisions) Act 2008.

FSCS Compensation

11.1 As I have said, FSCS compensation provisions have for a long time exceeded €20,887, and they were relatively recently increased to £50,000. It is reasonable to assume that this level was set on the basis that compensation for depositors with larger sums is not required in order to maintain confidence: larger depositors are more sophisticated, and more able to bear losses. The maximum limit could have been raised higher if it was thought desirable or appropriate.

11.2 Nevertheless, the UK Government chose to compensate all UK retail depositors in Icelandic banks to the full extent of their deposits regardless of the new FSCS limit. The Transfer Orders transferred KS&F and Heritable savers to ING, with corresponding FSCS provisions. However, there were about 1,200 retail, and 2,000 small business, customers whose accounts were not so transferred, and for them an ex gratia non-statutory compensation scheme without limit was established, administered by FSCS.

11.3 In the same way, a similarly generous ex gratia non-statutory scheme was established for the many UK retail depositors in Landsbanki's Icesave

product, and FSCS accordingly stood in those depositors' shoes to the full extent of the deposits. It had to be done in this way because the 2008 Act did not apply to Landsbanki.

11.4 The compensation has been criticised. The Transfer Orders recited (as they had to pursuant to Section 2(2)(a) of the 2008 Act) that they were for the purpose of:

"*maintaining the stability of the UK financial system in circumstances where the Treasury considers that there would be a serious threat to its stability*".

A Treasury press release of 8 October 2008 said that the Transfer Orders and the ex gratia compensation schemes were:

"*the right course of action to protect savers, ensure financial stability, and safeguard the interests of the taxpayer*".

However, and notwithstanding the Kaupthing decision, it is hard to see how financial stability would have been threatened by failing to compensate very wealthy depositors in the Icelandic banks: i.e. by not exceeding the £50,000 maximum limit in the way that actually happened. (I would add that the extent to which Icesave depositors were covered by FSCS at all is not clear: Landsbanki was not subject to the UK's financial regulatory system, and only opted to become a "top-up" member of FSCS.)

12. Further criticism came from the potentially unfair exclusion from the ex gratia compensation schemes of other depositors, specifically charities and local authorities. It is reasonable to assume that some smaller charities and local authorities were much more adversely affected than some wealthy retail depositors, yet only the retail depositors were compensated, and in full.

13. The UK's decision to offer compensation above €20,887 is of course its decision. The UK's decision to compensate depositors in excess of the prescribed £50,000 maximum, in questionable circumstances, is likewise its decision.

Are the Icesave Agreements Binding

14. Clause 6.1 of the Settlement Agreement provides that clause 4.2 comes into force on the date of the agreement, but the remainder comes into force only when the Loan Agreement comes into force.

15. This is to accommodate the completion of the assignments in clause 4.2, but those assignments are likewise conditional on the Loan Agreement coming into force. So enforceability is uniform.

16. Clause 3 of the Loan Agreement sets out conditions precedent to it coming into force. These include the Parliament authorising the guarantee given by the state so that no questions of authority or power (ultra vires) arise.

17. The Icesave Law (96/2009) contained provisos and conditions which were not all acceptable to the UK Government. This was then addressed by the Acceptance and Amendment Agreement, by which the UK Government accepted some of the conditions, but not others: hence clause 2.1.3 and the current Icesave bill. The condition precedent in clause 3.1(b) of the Loan Agreement has not been satisfied.

18. Nor, I understand, have the conditions precedent at clause 3.1(a)(iv) or (c): the legal side letter is outstanding, and the assignments are only in draft.

19. The Icesave agreements are not therefore in force or binding, and they may never become so. They will effectively remain subject to Parliamentary approval.

Terms of the Icesave Agreements

20. If the Icesave Agreements become binding, they will be subject to English law.

21. English law in general adopts a restrictive approach to contracts: both as to their sanctity (there being, for example, no requirement of fairness), and interpretation. Any conditions or provisos in Icelandic law will be irrelevant: the agreements will be interpreted and applied in accordance with their terms.

In areas of ambiguity the English courts may look at the factual matrix as an aid to construction, or interpret clauses including necessary implications.

Acceptability of the Terms

22. There are obviously a number of points here, which have been highlighted by Mishcon de Reya and Rebecca Stubbs.

23. But the one which has most startled us is the waiver of sovereign immunity by the Icelandic state in clause 18 of the Loan Agreement. This concerns what action may be taken against Iceland if it is made liable as a result of being a guarantor. The inclusion of this provision at the end of the Loan Agreement is an odd place for it to be. (The waiver of sovereign immunity at clause 14 of the Settlement Agreement is unnecessary, as TIF would not enjoy such immunity; but the inclusion of the clause does further highlight what the UK Government is seeking to achieve.)

24. The waiver not surprisingly prompted Article 2 of the Icesave Law; but this was in turn addressed at clause 3.3.3 of the Acceptance and Amendment Agreement which limited, but did not remove, the waiver of sovereign immunity. (The reference to the Vienna Convention adds little, except confusion, because it is probably impossible to waive immunity in respect of diplomatic assets.)

25. So the position now is that sovereign immunity would be waived, but it is not clear to what extent. This could lead to unfortunate difficulties and arguments. The English courts will observe waivers of sovereign immunity in accordance with the State Immunity Act 1978. Thus colleagues in my Chambers have recently acted for vulture funds seeking to recover sovereign debts against the Congo and Zambia. In the case of the Congo, there was substantial argument about the ownership of a property in London, which the vulture fund was ultimately able to seize and sell. On the other side, we are also acting for Argentina in seeking to prevent the enforcement in the UK of a judgment obtained in New York.

26. I would have thought that there is a more fundamental point than arguing about the extent to which sovereign immunity has been waived, and that is whether it is right to waive it at all. It is a matter of Iceland's identity and pride.

Distribution

27. I refer to the approximate figure of £2.2bn in respect of the aggregate of €20,887 in respect of each Icesave retail deposit.

28. TIF can expect to receive a substantial sum from a distribution from Landsbanki, as a preferred creditor along with other depositors such as the local authorities. The question is: how are the balance of the deposits (i.e. exceeding the €20,887 compensation figure) to be treated?

29. Let us take an example. There is a retail depositor of €40,000. TIF pays him €20,000 and steps into his shoes for that amount. He therefore remains a depositor for €20,000. Landsbanki pays a 50% dividend. What is the debt against which the dividend is payable? Is it the original €40,000, half of which is in the hands of the original depositor? If so, does TIF take the whole €20,000 dividend as a "top slice", or is the dividend split equally as between both? Or, are there now two debts of €20,000, in respect of which the 50% dividend produces €10,000 for each? (FSCS is now standing in the shoes of the original depositor as to the balance.)

30. The answer depends on Icelandic insolvency law and the basis upon which TIF comes to stand in the depositor's shoes in respect of the amount for which it has compensated him (although this is complicated by the fact that, in this case, FSCS has effectively interposed in the whole procedure). However, prima facie there is one debt, the original €40,000, half of which relates to TIF's compensation, and the remainder of which does not. A single dividend is paid in respect of the original debt.

31. Clause 4.2 of the Settlement Agreement seeks to ensure that TIF does not enjoy any form of priority. This of course benefits FSCS because it has

stepped into the shoes of the depositor for the balance of his deposit above €20,887. But it is still the same original deposit.

32. This is not a straightforward issue, and one which needs to be approached with care.

33. **Interest**

34. As I have said, given TIF's position, we are in the sphere of negotiation and compromise. Any compromise needs to be both fair and realistic (i.e. affordable).

35. This applies to all the terms of any compromise, but we have been particularly struck by the rate of interest in the Loan Agreement of 5.55%. This is very high in the current climate and, it is understood, may be very difficult for Iceland financially. It is not clear on what fair or rational basis this rate was arrived at.

36. The details of the Icesave settlement with Iceland were widely reported at the time, and hailed by the UK Government. However the focus was on the £2.2 billion figure, and Iceland's observance of the €20,887 per depositor compensation figure. The detailed terms are less politically sensitive, although the financial implications arising from distributions from Landsbanki may be more so.

MATTHEW COLLINGS QC

Maitland Chambers
Lincoln's Inn

17th December 2009

APPENDIX TWO

Part 1- Definitions

In this letter the following words shall have the following meanings:

"FSCS"	the Financial Services Compensation Scheme Limited;
"Netherlands"	the State of the Netherlands;
"Iceland"	the Republic of Iceland;
"Icesave Agreement"	the loan agreement between TIF and the HM Treasury; the loan agreement between TIF and the Netherlands; the supplemental agreements related to them and the other important documents relating to them enclosed with your letter to Mishcon de Reya of 10 December 2009, which are listed in Appendix One of this letter;
"Landsbanki"	Landsbanki Islands hf;
"TIF"	the Depositors and Investors' Guarantee Fund of Iceland; and
"HM Treasury"	the Commissioners of HM Treasury.

Further definitions are contained in part 2 of this Appendix, and in the body of this letter.

Part 2 – Documents reviewed

1. Unexecuted Loan Agreement between (1) TIF; (2) Iceland and (3) HMT dated 5 June 2009 (the "**UK Loan Agreement**")

2. Unexecuted Loan Agreement between (1) TIF; (2) Iceland and (3) the Netherlands dated 5 June 2009 (the "**Dutch Loan Agreement**")

3. Executed Settlement Agreement between (1) FSCS and (2) TIF dated 5 June 2009 ("**UK Settlement Agreement**")

4. Unexecuted letter from the Netherlands to TIF and Iceland dated 5 June 2009 ("**Dutch Side Letter**")

5. Unexecuted Acceptance and Amendment Agreement relating to the UK Loan Agreement made between (1) TIF; (2) Iceland and (3) HMT dated 19 October 2009 ("**UK AAA**")

6. Unexecuted Acceptance and Amendment Agreement relating to the Dutch Loan Agreement between (1) TIF; (2) Iceland and (3) the Netherlands dated 19 October 2009 ("**Dutch AAA**")

7. Unexecuted Amendment Agreement relating to the UK Settlement Agreement between (1) FSCS and (2) TIF dated 19 October 2009 ("**UK Settlement Amendment Agreement**")

8. Unexecuted letter from HMT to TIF and Iceland relating to the UK Loan Agreement and UK AAA dated 19 October 2009 ("**UK General Side Letter**")

9. Unexecuted letter from HMT to TIF and Ministry of Finance of Iceland relating to the UK Loan Agreement dated 19 October 2009 ("**UK Currency Side Letter**")

10. Unexecuted letter from the Netherlands to TIF and Iceland dated 19 October 2009 relating to the Dutch Loan Agreement and the Dutch AAA

11. Unexecuted letter from the Netherlands to TIF and Iceland dated 19 October 2009 relating to the Dutch Loan Agreement

12. Finance Ministers of Iceland, the United Kingdom and Netherlands joint statement upon introduction of a Bill on Icesave to the Icelandic Parliament Althingi dated 19 October 2009

13. Unexecuted consolidated copy after amendment made by the UK AAA of the UK Loan Agreement

14. Unexecuted conformed copy as amended by the Dutch Amendment Agreement of the Dutch Loan Agreement

15. Unofficial translation dated 21 October 2009 of a Bill amending the Icesave Law

Part 3 – Assumptions

1. Documentation

1.1 The genuineness of all signatures, stamps and seals on documents, the conformity to the originals of all documents supplied to us as copies and the authenticity and completeness of all documents supplied to us.

1.2 Each unexecuted document referred to in this letter (other than documents 13 and 14 which are provided for ease of reference only) has been executed by all the parties to it in the form in which it was provided to us.

1.3 The documents supplied to us accurately record all the terms agreed between the parties thereto and none of those documents has been terminated, modified, superseded or varied otherwise than pursuant to documents supplied to us, and that no obligation thereunder has been waived.

1.4 All documents dated earlier than the date of this letter on which we have expressed reliance remain accurate, complete and in full force and effect (to the extent that they are in effect at all, which is a matter with which we deal below) at the date of this letter.

2. Parties

2.1 Each of the parties to the documents supplied to us had full capacity, right, power and authority to enter into and to exercise its rights and perform its obligations under the documents to which it is a party and each of the documents has been validly authorised, executed and delivered by each of the parties to it.

2.2 All of the obligations set out in each of the documents supplied to us are intended to be legally binding and are legal, valid, binding and enforceable.

2.3 None of the parties to the documents supplied to us (i) is subject to a court injunction or order which affects its performance of its obligations under the

documents to which it is party, or (ii) has entered into any of the documents under duress, undue influence or as a mistake or in connection with money laundering or any other unlawful activity.

3. Other laws

There are no provisions of the laws of any applicable jurisdiction outside England and Wales which would be contravened by the execution and delivery of the Agreements and, insofar as any obligation under the Agreements is to be performed in any jurisdiction outside England and Wales, its performance will not be illegal or contrary to public policy by virtue of the laws of that jurisdiction, save to the extent considered expressly below.

4. Corporate authority

4.1 Each of the Agreements has been entered into for the bona fide commercial reasons and on arm's length terms by each of the parties thereto.

4.2 The signatories to the various Agreements have (to the extent that they purport to bind corporate entities) acted in good faith in the interests of their principal in respect of Agreements.

5. Background

That the facts set out in the Background are correct.

Part 4 – Reservations

1. We note that in our letter to you of 11 December 2009 we reflect your instructions to provide you with a legal opinion on certain matters. Having reviewed the documents and considered the matters you wish us to provide a legal opinion on we have come to the view that we are not able to provide conclusive legal opinions. We have set out in this letter some limited observations on technical legal and drafting matters arising from the documents we have reviewed.

2. We do not and cannot offer any advice in relation to the economic or political implications of entering into the Icesave Agreement or taking the steps

required to bring them into force (or refusing so to do), which is solely a matter for the Government of Iceland and the Althingi. However we have endeavoured to the best of our ability to produce this advice in light of the political and economic context in which it has arisen, so far as we understand the same.

3. We do not accept any liability for any costs, loss or damage which may be sustained by any person as a consequence of entering into or bringing into effect (or refusing to enter into or bring into effect) the Icesave Agreement.

4. Where we consider the "normality" or otherwise of provisions of the Icesave Agreement, this is done on the basis of our experience of advising distressed creditors in commercial transactions. We are unable to advise on what is normal or appropriate in agreements of this nature between Governments, Governmental departments and/or entities closely connected to or under the control of Governments. In addition it is not possible to comment on what is "normal" in the unique circumstances of addressing the consequences of the collapse of Iceland's financial system.

5. In this letter we advise only on the laws of England and Wales (and the laws of the European Union where expressly stated but not otherwise). In particular we do not advise on the laws of Iceland or the Netherlands.

6. In preparing our advice we have relied solely on the documents set out in part two of this Appendix One and the facts surrounding the Icesave matter set out in the Background.

7. In accordance with subsequent instructions from the Althingi we have not advised on the Memorandum of Understanding made between (1) FSCS and (2) TIF dated 31 October 2006.

8. Where obligations are to be performed in a jurisdiction outside England, they may not be enforceable by the English courts to the extent that performance would be illegal or contrary to public policy under the laws of that jurisdiction.

9. An English court may refuse to give effect to any provision in any agreement which (i) purports to require a party to make any contribution to another or to indemnify another person against the costs or expenses of proceedings in the English courts, as it is within the discretion of the English courts to grant rights of contribution or to decide whether and to what extent a party to such proceedings should be awarded costs or expenses incurred by it in connection therewith or (ii) involves the enforcement of foreign revenue or penal or other public laws or (iii) would be inconsistent with English public policy or (iv) is based on subordinate legislation which is ultra vires due to lack of authority to promulgate the same under the European Communities Act 1972.

10. Any provision to the effect that any calculation, determination or certification will be conclusive and binding will not be effective if such calculation, determination or certification is fraudulent, arbitrary or manifestly incorrect, and there could be circumstances in which an English court may regard any calculation, determination or certification as no more than prima facie evidence of the matter calculated, determined or certified.

11. We express no opinion on any provision of the Icesave Agreement which purports to determine the governing law of any claims which are related to the contract but are not claims under the contract (such as tortious claims).

12. We express no opinion on any provision of the Icesave Agreement which provides for the payment of increased interest on overdue amounts or in circumstances of a breach or default; such provisions might be held to be unenforceable on the ground that it is a penalty or to be void under The Late Payment of Commercial Debts (Interest) Act 1998.

13. Claims may be or become barred under the Limitation Acts or may be or become subject to the defences of set-off or counterclaim.

14. An English court will not give effect to an indemnity if it would involve, *inter alia*, a person enjoying the benefit of such indemnity for its own wrongful act.

15. An English court has power to stay an action where it is shown that there is some other forum, having competent jurisdiction, in which the case can be

tried more suitably for the interests of all the parties and the ends of justice, or where staying the action is not inconsistent with the EU Council Regulation no 44/2001 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters as applied by virtue of the Civil Jurisdiction and Judgments Order 2001.

16. Where any person is purportedly vested with a discretion or may determine a matter in its opinion, English law may require that such a discretion is exercised reasonably or that such opinion is based on reasonable grounds.