Draft translation 21 October 2009

Bill

amending Act No 96/2009 regarding authorisation for the Minister of Finance, on behalf of the State Treasury, to issue a state guarantee of the loans granted by the governments of the UK and the Netherlands to the Depositors' and Investors' Guarantee Fund of Iceland to enable it to cover payments to the depositors of Landsbanki Íslands hf.,

(Submitted to Althingi at the 138th legislative session 2009-2010)

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Article 1

Article 1 of the Act shall read as follows:

The Minister of Finance, on behalf of the State Treasury, is authorised to issue a state guarantee in respect of the obligations of the Depositors' and Investors' Guarantee Fund stemming from the loans granted to it by the governments of the UK and the Netherlands, according to agreements dated 5 June 2009, and Acceptance and Amendment Agreements dated 19 October 2009, in order to enable it to pay the minimum compensation, *cf.* Article 10 of Act No 98/1999 on Deposit Guarantees and Investor-Compensation Scheme, to the depositors of Landsbanki Íslands hf. in the UK and the Netherlands. This authorisation is not limited by other provisions of the Act. The guarantee, which according to the loan agreements takes effect on 5 June 2016, is solely determined by the terms of the agreements.

Article 2

Article 2 of the Act and its title shall read as follows:

Legal situation

Nothing in this Act constitutes an admittance that the Icelandic State was under an obligation to guarantee the payment of a minimum compensation to depositors in the UK and Dutch branches of Landsbanki Íslands hf.

In the event that a competent adjudicator concludes, and said conclusion is in accordance with an advisory opinion obtained from the EFTA Court or as the case may be a preliminary ruling obtained from the European Court of Justice, that the Icelandic state was not under an obligation such as referred to in paragraph 1 or that another state party to the EEA Agreement was not under such an obligation in a comparable case, the Minister of Finance shall initiate discussions amongst the parties to the loan agreements, and as the case may be including the European Union and the institutions of the European Economic Area, on the potential implications of such a decision for the loan agreements and the obligations of the state according to them.

Article 3

Articles 3 and 4 shall be deleted.

Article 4

Article 5 of the Act shall read as follows:

In order to monitor and assess the preconditions for revision of the loan agreements, *cf*. their provisions on change in circumstances, the Icelandic government shall take measures to ensure that the IMF will, by 5 June 2015, at the latest, carry out the Article IV review of the status of the national economy, in particular as regards national indebtedness and debt sustainability. In addition, the IMF review should contain an assessment of the changes that have taken place since the IMF review of 19 November 2008.

In assessing the preconditions for the revision of the agreements, the state of the national economy and public finances shall also be taken into account at any given time, as well as an assessment of the outlook, with special consideration given, i.a., to currency issues, foreign exchange trends and balance on current account, economic growth and changes in domestic production, as well as population trends and the employment participation rate.

The decision to request discussions on amendments to the loan agreements, in accordance with the review provisions contained therein, shall be taken with the consent of Althingi. An assessment of whether to request a revision shall be concluded no later than 5 October 2015 and the result shall be submitted to Althingi before the end of 2015.

Article 5

This Act shall enter into force immediately.

Commentary Pertaining to the Bill.

1. Introduction.

When the three major commercial banks collapsed at the beginning of October 2008, significant amounts had been placed in the deposit accounts of Landsbanki Íslands hf., the so-called Icesave accounts, through the bank's branches in the UK and the Netherlands. These funds were unavailable to depositors as of 6 October 2008, but the following day, 7 October 2008, the Financial Supervisory Authority took control of Landsbanki on the basis of the so-called emergency act, i.e. Act No 125/2008 on the treasury disbursements due to unusual financial market circumstances, etc. This lead to a dispute between Iceland on the one hand and the UK and the Netherlands on the other regarding whether the Icelandic state was obligated to guarantee the payment of a minimum compensation to depositors in the branches of Landsbanki in the UK and the Netherlands, the minimum guarantee then amounting to EUR 20,887 for each depositor according to Directive 94/19/EEC of the European Parliament and of the Council on deposit-guarantee schemes.

With the adoption of a parliamentary resolution on 5 December 2008, the government was entrusted with concluding agreements with the relevant authorities regarding deposits in the branches of Icelandic commercial banks within the European Economic Area on the basis of the common guidelines agreed upon by Iceland, the UK and the Netherlands, at the instigation of the European Union, in Brussels on 14 November 2008. These common guidelines have been called the Brussels Guidelines and were based on: (1) recognition by the parties of the legal situation that the Directive on deposit-guarantee schemes was applicable in Iceland in the same way as in the European Union member states; (2) that this recognition would facilitate the swift conclusion of negotiations regarding financial support to Iceland, including with the International Monetary Fund, and that in agreements with Iceland the difficult and unprecedented circumstances in Iceland, and the necessity of finding arrangements that would enable Iceland to restore its financial system and its economy, would be taken into consideration; (3) the continued participation of the institutions of the European Union and the European Economic Area in the negotiating process which would be carried out in consultation with them.

Following negotiations, two loan agreements were signed on 5 June 2009 between the Depositors' and Investors' Guarantee Fund (hereinafter referred to as "the Guarantee Fund" unless otherwise specified) and the Icelandic state on the one hand and the UK and Dutch governments on the other. In addition, a special settlement agreement was concluded between the British Financial Services Compensation Scheme and the Icelandic Guarantee Fund. These loan agreements were meant to conclude the Icesave issue. The agreements would enter into force if legislation was adopted by the time Althingi went on its 2009 summer recess, authorising the Minister of Finance, on behalf of the State Treasury, to issue a guarantee for the fulfilment of the loan agreements to the Guarantee Fund. A bill on the subject was submitted to Althingi on 30 June 2009 but was changed extensively during deliberations in Althingi, cf. in particular Articles 1-4 of Act No 96/2009 regarding an authorisation for the Minister of Finance, on behalf of the State Treasury, to issue a state guarantee of the loans granted by the governments of the UK and the Netherlands to the Depositors' and Investors' Guarantee Fund of Iceland to cover payments to the depositors of Landsbanki Íslands hf. The cited provisions of Act No. 96/2009 entailed that Althingi adopted an authorisation for the Minister, but with a number of reservations in the form of preconditions for the granting of a state guarantee and economic and legal criteria. For the state guarantee to come into effect, the reservations had to be presented to the UK and Dutch authorities and accepted by them, cf. Article 1(2) of Act No 96/2009.

After the entry into force of the Act, the parties to the loan agreements met for a discussion and it soon became apparent that neither the UK nor the Dutch government were ready to wholly agree to the reservations adopted by Althingi. The outcome, after the discussions between the parties to the loan agreements, was to conclude acceptance and amendment agreements and thus harmonise to a great extent the substance of the loan agreements and the reservations stipulated in Articles 1-4 of Act No 96/2009. The government is of the opinion that the essential features of the reservations have been realised. It is deemed that no further headway is to be made and that it is necessary to bring the matter to a close. The final agreements are in the opinion of the government an acceptable solution to one of the most difficult international disputes Iceland has been faced with since gaining independence. In order for the loan agreements to take effect, as amended by the acceptance and amendment agreements, Act No 96/2009 needs to be amended. If these amendments to the Act are not made by 30 November 2009, both the UK and the Dutch government may terminate the agreements.

There are, in fact, three amendment agreements, dated 19 October 2009: Firstly, the agreement between the Netherlands, on the one hand, and the Guarantee Fund and the Icelandic state on the other (*the Dutch acceptance and amendment agreement*); secondly, the agreement between the UK, on the one hand, and the Guarantee Fund and the Icelandic state on the other (*the UK acceptance and amendment agreement*); thirdly, the agreement between the Financial Services Compensation Scheme and the Icelandic Guarantee Fund, which is an amendment to the settlement agreement of 5 June 2009 between the said parties. According to the three aforementioned agreements, the legal status of the Guarantee Fund and the Icelandic state *vis-à-vis* the UK and the Dutch governments changes in the same manner, i.e. the amendments made to the loan agreements of 5 June 2009 are identical in substance.

This bill is submitted for the purpose of harmonising the substance of the loan agreements, as they have been amended by the acceptance and amendment agreements, with the Act which will apply regarding authorisation for the Minister of Finance to issue a state guarantee in regard to the loans that the Guarantee Fund has received from the authorities in the UK and the Netherlands. This is in order to ensure that the state guarantee is unconditional and so that there will be no need for interpretation of the provisions of the agreements with regard to the Act authorising the Minister of Finance to issue a state guarantee to the Guarantee Fund. Pursuant to this, the agreements shall wholly determine the legal status of the parties on the basis of the laws of England. The formulation of Article 1 of the bill is explicit in this regard.

The critical issue in the general comments pertaining to this bill is to explain the difference between the provisions of the existing Act No 96/2009 and the provisions of the loan agreements, as amended by the acceptance and amendment agreements. This task will be clarifed in more detail in the following points:

1. Period of validity of the state guarantee.
2. Recognition of reservations and the relation of the reservations to the state guarantee.
3. Preconditions for the granting of a state guarantee.
4. Economic criteria.
5. Legal criteria regarding the issue whether the state parties to the EEA Agreement shall be held liable *vis-à-vis* depositors as regards a minimum compensation.
6. Legal criteria regarding the distribution of assets from Landsbanki Íslands hf. or its bankruptcy estate upon settlement. After a discussion of the issues above, various issues of contention will be examined more closely. Finally, specific provisions of the bill will be clarified, but first, however, it is necessary to discuss further the background of the case.

2. Background of the case.

2.1 History.

The deposit-taking activities of Landsbanki Íslands hf. in the UK and the Netherlands were carried out in the form of branches, not subsidiaries. Therefore, the provisions of Act No 98/1999 on deposit guarantees and investor-compensation scheme, applied to these activities, as the Act was based on Directive 94/19/EEC of the European Parliament and of the Council on deposit-guarantee schemes. In accordance with the provisions of Article 3 and Article 9(1) of Act No 98/1999, the payment obligation of the Guarantee Fund, including in the case of default, includes the activities of branches of Icelandic banks within the European Economic Area. Soon after the collapse of Landsbanki it became clear that the assets of the Guarantee Fund would only cover a fraction of the amount that the Guarantee Fund might be liable for on account of the minimum compensation for depositors of the Icesave accounts. Having regard to this, i.a., the UK and the Dutch authorities turned to the Icelandic authorities in order to examine how they intended to make sure that the Guarantee Fund would fulfil the obligations stipulated in the Directive.

On 11 October 2008, a document was signed by the Dutch authorities on the one hand, and the Icelandic authorities and the Icelandic Guarantee Fund on the other, on the shared understanding of the parties to the effect that the Icelandic Guarantee Fund would be granted a loan with a state guarantee to compensate every Dutch depositor for their deposits up to EUR 20,887. The loan from the Dutch government to the Guarantee Fund and the Icelandic state was intended for a period of 10 years, carry 6.7% interest, and have a three-year period of no payments. That same day, the Icelandic authorities let it be known that discussions with the UK had gone well and that an agreement with them was also imminent. Discussions between Icelandic and British officials on 23 and 24 October 2008, on the other hand, proved inconclusive.

At this point it was clear that the UK and the Dutch authorities were of the opinion that Iceland would have to support the Guarantee Fund on account of the minimum compensation for depositors; the Icelandic government, on the other hand, maintained that Iceland was not liable for payments to depositors if they exceeded the amount the Guarantee Fund could cover from payments made to the Fund. The position of the Icelandic government was mainly based on the belief that such an obligation was not present since the financial system of the country had all but completely collapsed. While this disagreement remained unsolved, the UK and Dutch authorities decided that they would promise general depositors of the Icesave accounts a refund of their deposits. The UK authorities fully refund such deposits while the Dutch authorities refund each depositor up to EUR 100,000.

At around that time, the negotiating parties of Iceland entrusted the European Union to act as an intermediary in the case. At that point, the Icelandic authorities emphasised that the case should be decided upon by a suitable adjudicator or in a court of law but the negotiating parties of Iceland rejected this. The British and the Dutch based their position in particular on the fact that it would be imprudent to indicate in any way that doubts had been cast on the deposit guarantee scheme that formed the basis of deposit-taking activities in Europe, since the clear validity of the Directive was a prerequisite for depositors to entrust banks with their savings. Legal uncertainty regarding this matter could have unforeseen consequences for the European banking system.

The situation in Iceland in November of 2008 was, in the view of most people, serious, in part because of a shortage of foreign currency. It was presumed that Iceland's request for assistance from the International Monetary Fund (IMF) of 3 November 2008 would not be put on the agenda of the IMF board while the Icesave dispute remained unsolved. Other countries were, at that time, not ready to grant loans to Iceland unless a cooperation program was established between the IMF and Iceland. A few days after the adoption of the Brussels Guidelines, a statement of cooperation between the Icelandic authorities and the IMF was signed, but earlier, on 15 November 2008, i.a. the following sentences had been added to point 9 of the Letter of Intent of the Icelandic government to the IMF: "Under its deposit insurance system Iceland is committed to recognize the obligations to all insured depositors. We do so under the understanding that prefinancing for these claims is available by respective foreign governments and that we as well as these governments are committed to discussions within the coming days with a view to reaching agreement on the precise terms for this prefinancing."

Following the adoption by Althingi on 5 December 2008 of a resolution authorising the government to bring the Icesave matter to a conclusion, a process was initiated that was concluded with agreements on 5 June 2009. For further details regarding this process, see the general comments accompanying the bill that subsequently was adopted as Act No 96/2009 and documentation relating to the preparation and the conclusion of the Icesave loan agreements, *cf.* documents accessible on the website www.island.is.

2.2 Essential features of the Icesave loan agreements of 5 June 2009.

The loan agreements broadly entailed that the Icelandic Guarantee Fund would borrow from the UK and the Dutch authorities sums of up to GBP 2.35 billion and EUR 1.3 billion, respectively, to be repaid over a 15-year period. The Guarantee Fund, a private foundation, took out the loans whereas the State Treasury guaranteed the repayments of the principal amount and interest. The loans were to be repaid in 32 equal instalments during the period 5 June 2016 to 5 June 2024, with a fixed annual interest rate of 5.55% as of 1 January 2009. In exchange for these loans, the claim of each depositor against the estate of Landsbanki Íslands hf. was to be assigned to the Guarantee Fund to meet these loans but the value of the principal amount of each individual claim could not exceed the minimum compensation, i.e. EUR 20,887. According to the provisions of the loan agreements, neither the Guarantee Fund nor the Icelandic State was obliged to make repayments during the first seven years of the loan period, but the Guarantee Fund was, however, to repay the loans with the assets it would receive from its claims against the estate of Landsbanki Íslands hf. These assets of the Guarantee Fund, received by the Fund upon distribution of the assets of Landsbanki Íslands hf., were to be divided between the Dutch and the British funds on a *pro rata* basis, i.e. about 2/3 of the assets were to go towards paying the British loan and 1/3 towards paying the Dutch loan.

Upon concluding the agreements of 5 June 2009, it was undisputed that the claims of the Icelandic Guarantee Fund, the UK and the Netherlands were priority claims against the estate of Landsbanki Íslands hf. and that they originated in the claims of each individual depositor against the bank. A separate settlement agreement between the British Financial Services Compensation Scheme and the Icelandic Guarantee Fund stated that should one party, for

whatever reason, be allocated a greater part of the total deposit than he was proportionally entitled to, the parties should nonetheless allocate the funds between themselves on a *pro rata* basis. The Dutch loan agreement provided for a similar arrangement. This meant that irrespective of how disbursements from the estate of Landsbanki Íslands to these three parties were made, every disbursement from the estate would, as a rule, be allocated according to the proportional relevance of the parties' claims as a whole, i.e. that the Icelandic Guarantee Fund would receive 52% of the disbursements to the parties, whereas the other two parties would receive a total of 48%. This may be further clarified in the following example: The total disbursements from the estate of Landsbanki Íslands to the three parties is ISK 1000 billion. Regardless of how the Winding-up Committee of the bank decides to distribute the assets from the estate, the Icelandic Guarantee Fund will receive a total of ISK 520 billion to repay the debt according to the loan agreements.

While the parliamentary bill, that was subsequently adopted as Act No 96/2009, was still under parliamentary discussion, this understanding of the allocation of assets from the estate of Landsbanki Íslands hf. was publicly criticised by, i.a., Ragnar H. Hall and Hörður Felix Harðarson, advocates to the Supreme Court, and by law professor Eiríkur Tómasson. They were of the opinion that the Icelandic Guarantee Fund should receive the initial EUR 20,887 from the estate as the claim of each depositor was a single claim and the Icelandic Guarantee Fund had, therefore, obtained the legal status of the depositor as regards disbursement of the initial EUR 20,887 from the estate. This line of argument may be clarified with an example comparable to the one above: The total disbursement from the estate of Landsbanki Íslands to the three parties is ISK 1000 billion, of which the value of the principal amount of the combined claims of the Icelandic Guarantee Fund is ISK 700 billion. Since the first 700 billion from the bank's estate would go to the Icelandic Guarantee Fund, those assets would go towards repaying the Fund's loan from the UK and the Netherlands.

As stated in the opinion of the majority of the Budget Committee from 15 August 2009, a number of lawyers believed that the provisions of the loan agreements on this issue were supported by the principles of Icelandic bankruptcy law and, therefore, did not reduce the rights of the Icelandic Guarantee Fund when it came to distribution from the estate of Landsbanki. It was also argued that a different conclusion would probably be contrary to the EEA Agreement, *cf.*, i.a., the view of professor Pierre Mathijsen, dated 28 July 2009, and the views of Andri Árnason, advocate to the Supreme Court, and Helga Melkorka Óttarsdóttir, district court lawyer, dated 10 August 2009; these views are accessible on the website www.island.is.

There is no reason to elaborate further on the content of the agreements and reference is made to a more detailed discussion in the general comments accompanying the bill adopted as Act No 96/2009, the opinion of the majority of the Budget Committee, dated 15 August 2009, and documents accessible on the website www.island.is.

2.3 Althingi's deliberations regarding the bill on the granting of a state guarantee.

A parliamentary bill authorising the Minister of Finance, on behalf of the State Treasury, to issue a state guarantee of the loans granted by the UK and the Netherlands to the Guarantee Fund of Iceland to enable it to cover payments to the depositors of Landsbanki Íslands hf., was submitted in Althingi at the end of June 2009. The bill was accompanied by detailed explanatory comments regarding the background of the issue and the reasons why Iceland should accept this responsibility. Although the Budget Committee of Althingi has custody of the matter, the Foreign Affairs Committee and the Economic and Tax Committee discussed it at great length and submitted their opinions to the Budget Committee at the end of July. These opinions were published together with the opinion of the majority of the Budget Committee. In parallel, the Budget Committee undertook the extensive task of writing reservations to the

acceptance of a state guarantee for the fulfilment of the Icesave agreements. The majority of the Budget Committee submitted its detailed opinion regarding the issue on 15 August 2009 and made substantial amendments to the bill. Further amendments were made to the bill between the second and the third debate but on 2 September 2009 it was finally adopted as Act No 96/2009.

2.4 Presentation of the parliamentary reservations and discussions between parties.

The reservations adopted by Althingi were, in accordance with the provisions of the Act, presented to the UK and the Dutch authorities. That presentation was informal and took place during talks and meetings in the Hague, London and Reykjavík and the Prime Minister of Iceland also sent a letter to his colleagues in the UK and the Netherlands where the position of Althingi was explained and a request for a meeting, if that proved necessary, was made at the highest level of government. The Minister for Foreign Affairs also held meetings with his British and Dutch counterparts in New York and the Minister of Finance met with his counterparts in Istanbul. Early on, the UK and the Dutch authorities expressed their views that the best way forward was to conclude special acceptance and amendment agreements that contained the acceptance of the reservations of Althingi and amendments to the existing loan agreements. This would ensure that the loan agreements remained self-standing and that they were entirely governed by the laws of England, as was intended in the loan agreements of 5 June 2009. Iceland's representatives in these discussions presented the position of the UK and the Dutch authorities to the Budget Committee of Althingi in mid-September of 2009.

Although the British and the Dutch were ready to agree, to a great extent, to the reservations made by Althingi, it became quite clear at the outset that some items would remain unresolved. Furthermore, the representatives of these states considered that the legal status of the parties would have to be very clear so as not to create inconsistency between Act No 96/2009 and the loan agreements. The outcome was to conclude acceptance and amendment agreements to the previous loan agreements, taking into account the reservations pursuant to Act No 96/2009 to the extent agreed upon by the parties. This entails that a bill amending Act No 96/2009 has to be submitted in order to ensure this consistency.

2.5 What options are available for harmonising the Act and the acceptance and amendment agreements?

A number of ways and approaches are available when it comes to harmonising the acceptance and amendment agreements and the legislation that is to apply to the granting of the state guarantee. Having regard to the contents of the acceptance and amendment agreements there were mainly two possible ways to achieve this. On the one hand, it would be possible to amend individual provisions of Act No 96/2009 in order to create consistency between the Act and the agreements. Thus, the structure of the Act would remain unchanged while there would have to be made substantive amendments to individual provisions and those amendments would unavoidably be complicated, i.e., in view of the different approaches regarding the maximum annual payment for each year pursuant to Article 3 of Act No 96/2009 and the provisions of the acceptance and amendment agreements. On the other hand, it would be possible to repeal Articles 1–4 of Act No 96/2009 and grant the Minister new authorisation to issue a state guarantee of the obligations of the Guarantee Fund pursuant to the loan agreements of 5 June 2009, as amended by the acceptance and amendment agreements dated 19 October 2009. This approach is thought to ensure clear consistency but it would require radical changes to the structure of Act No 96/2009. Other approaches, making the reservations in Articles 1–4 of Act No 96/2009 *de facto* ineffective, are also possible, such as passing supplementary provisions to Act No 96/2009 or a supplementary legislation.

After these approaches had been assessed, it was deemed that the most clear and sensible approach would be to propose in this bill that Articles 1-4 of the existing Act No 96/2009 be repealed. It is proposed that these articles be replaced by a new provision authorising the Minister of Finance to issue a state guarantee on account of the obligations of the Depositors' and Investors' Guarantee Fund pursuant to the loan agreements, *cf.* Article 1 of the bill. This entails

that the reservations to the state guarantee will not be a part of Act No 96/2009, but rather that their essential features will be included in the loan agreements of 5 June 2009, as amended by the acceptance and amendment agreements.

At the same time it is proposed that a new Article 2 be added, reaffirming the understanding that the Act does not in any way provide for an admission of an obligation by the Icelandic state to guarantee the payment of a minimum compensation to depositors in the branches of Landsbanki Íslands hf. in the UK and the Netherlands. If certain adjudicators consent to the understanding that Iceland, or a state party to the EEA Agreement in a comparable case, was not bound by this obligation, the Minister of Finance shall initiate discussions with other parties to the loan agreements.

According to Article 3 of the bill, Articles 3 and 4 of the existing Act are repealed whilst Article 4 of the bill proposes that Article 5 of the Act regarding the revision of the loan agreements be reinforced, *cf.* a comment regarding that article that further clarifies it.

3. Differences between the provisions of the acceptance and amendment agreements and the provisions of Act No 96/2009.

3.1 Period of validity of the state guarantee.

The loan agreements of 5 June 2009 were for a period of 15 years and should therefore have been fulfilled by 5 June 2024. The payment of instalments and interest was to begin on 5 June 2016, up to which time the Icelandic Guarantee Fund was to use any distribution of assets from the estate of Landsbanki Íslands hf. to repay the loans. The state guarantee of the Fund's obligations should, according to this, become effective on 5 June 2016 and; thus, Iceland would be required to ensure payments of instalments and interest for each quarter until 5 June 2024, the date on which the loans were to be fully repaid.

According to current Article 3(3) of Act No 96/2009, the state guarantee is limited to the maximum payments from the Treasury and the payment obligation shall never exceed the maximum state guarantee, *cf.* Article 3(5), first sentence. Resulting from Article 3(5), second sentence, the parties to the loan agreements shall enter into negotiations in a timely manner if, at any point, it would seem that the loan amounts, with interest, will not be paid by the end of the loan period due to the maximum limit on payments from the State Treasury. The final part of Article 1(1) of the Act states that the guarantee shall apply until 5 June 2024.

There have been differing opinions as to whether all the remaining balance of the loans should be extinguished entirely if, at the end of the loan period, the loan agreements have not been paid in full due to the aforementioned instructions in Act No 96/2009. The instructions have been interpreted to mean exactly that by some, but it has also been asserted that they only provide for negotiations on the continuation of the matter.

The UK and Dutch authorities stated that the possibility of the loans being extinguished in 2024 based on the provisions of Act 96/2009 was unacceptable. In their view, this had to be changed if the agreements between the parties were to remain valid. In this context, a reference was made to practices regarding international loan agreements, especially those to which sovereign states are parties.

The loan period may end 5 June 2024 if the payments of instalments and interest are within the maximum annual payment referred to in the agreements. If the situation arises where instalments and interest jointly exceed the maximum payment, the principal sum shall increase and the annual debt service burden decrease as a consequence. Nevertheless, annual interest shall always be paid, the interest payment forming a type of floor to counterbalance the maximum payment. This amortisation schedule is broadly in accordance with Article 3(3) to (5) of Act No 96/2009; however, it is now undisputed that the remaining balance of the loans shall never be completely extinguished, even though instalments are not fully paid because of the maximum payment.

In order to facilitate the annual debt service burden, or for other reasons, the Guarantee Fund or the Icelandic state may, at any point in time, unilaterally opt to extend the loan period until 5 June 2030. In that case the same provisions of the agreements will apply to the maximum and minimum annual payments. If the loans are not settled in full by 5 June 2030, the Guarantee Fund or the Icelandic State may extend them for five years at a time.

The aforementioned difference between the provisions of the existing Act No 96/2009 and the provisions of the acceptance and amendment agreements means, in a nutshell, that the loan period shall remain unchanged if the prognosis for economic progress in Iceland is fulfilled; otherwise, the loan period will be extended until 2030 and, if applicable, for five years at a time after that. As a result of the provisions of the acceptance and amendment agreements, the remaining balance of the loans, possibly generated by the maximum payment limit, shall never be extinguished. Therefore, Act No 96/2009 should be amended, with the aim of aligning its contents with the provisions of the loan agreements, as amended by the acceptance and amendment agreements.

3.2 Recognition of reservations and the relation of the reservations to the state guarantee.

Pursuant to Article 1(2) of Act No 96/2009 it is a condition for granting the state guarantee that the UK and Dutch authorities are presented with the reservations to the guarantee and that they agree to them. Furthermore, it is noted that the lenders, according to the loan agreements of 5 June 2009, must recognise that the obligations of the Guarantee Fund are subject to the same reservations as the state guarantee, pursuant to the Act. As already noted, the UK and Dutch authorities were presented with the reservations of Act No 96/2009; however, they did not agree to all of them. As a result of the provisions of the acceptance and amendment agreements, there is a discrepancy between the provisions and Article 1(2) of this Act; therefore, it is proposed that this provision be repealed.

Article 1(3) of Act No 96/2009 states, *inter alia*, that the state guarantee is limited by the reservations expressed in the Act, and that they are an integral part of the state guarantee. As the objective of concluding the acceptance and amendment agreements has been that they, as well as prior loan agreements, stand as an independent source of the legal status of the parties to the agreements, it is proposed that this provision be repealed. When the aforementioned is assessed, it must be taken into consideration that the essential features of the reservations are now found in the agreements themselves instead of being a part of Icelandic legislation. The relevance of the repeal of the above provisions is therefore limited.

3.3 Preconditions for granting a state guarantee.

The preconditions for granting a state guarantee are listed in three points in Article 2 of Act No 96/2009. In the acceptance and amendment agreements, the provisions of Article 2, points 2 and 3, of Act No 96/2009 are met in full, *cf.* paragraphs 3.3.3 and 3.3.4, in the acceptance and amendment agreements with the UK and the Netherlands. With these provisions of the acceptance and amendment agreements there is an assurance beyond a doubt that the sovereign immunity of the Icelandic State is secured in full, as well as the control over the country's natural resources, including the right of the holders of state power in Iceland to determine the utilisation and form of ownership of the natural resources.

With regard to Article 2, point 1, of Act No 96/2009 it is noted in the acceptance and amendment agreements that the loan agreements are made having regard to the Brussels Guidelines, not that these guidelines will be applied in the interpretation of the agreements. In the acceptance and amendment agreements it is also noted that the agreements will be revised in accordance with their prior provisions. The reason for this derogation from Article 2, point 1, is that the laws of England apply to the agreements, and the Brussels Guidelines were not considered sufficiently clear enough to be applied when interpreting the loan agreements as a whole.

The unilateral right of the Guarantee Fund and the Icelandic State to extend the loans and the introduction of a maximum annual payment will sufficiently guarantee the financial position of the Icelandic State and enable it to restore its financial system and its economy. As a result, the loan agreements are even more compatible with the Brussels Guidelines than before and the likelihood is greatly reduced that a revision of the agreements will be required on account of a possibly dire economic situation in Iceland.

3.4 Economic criteria.

In Article 3 of Act 96/2009, five paragraphs contained criteria established to create a certain economic framework for the granting of the state guarantee. The most important paragraphs are paragraphs 3-5, which lay down a maximum annual payment from the State Treasury on account of the state guarantee. This maximum payment may, as noted before, result in the agreements not being settled in full by the end of the loan period, on 5 June 2024. In the acceptance and amendment agreements this has been changed so that the loans shall in every instance be extended if there is still an outstanding balance by the end of the loan period, due to the maximum payment. Furthermore, the acceptance and amendment agreements assume that annual interest of the principal amount of the loans will always be paid, notwithstanding the maximum payment; the negotiating parties of the Icelandic state referred, in that context, to a basic principle of international loan agreements. In the opinion of the negotiating parties of the State and the Guarantee Fund, unpaid interest after 5 June 2016 was not an option. It is considered likely that the maximum payment will cover the interest payments. With regard to the aforementioned factors, it was concluded that as of 5 June 2016 interest would consistently be paid quarterly. In other respects, the criteria in the acceptance and amendment agreements are comparable to those stipulated in Article 3(3) to (5) of Act No 96/2009.

The following table contains the details of Article 3(3) to (5) of Act No 96/2009, on the one hand, and the details of the acceptance and amendment agreements on the other:

Comparison of the maximum payment according to the Act and the acceptance and amendment agreements.

Details of Article 3(3) to (5) of Act No 96/2009	**Details in the acceptance and amendment agreements.**
Annual payments from the State Treasury are limited.	Annual payments of instalments are limited whereas interest must always be paid.
The maximum payment in the period 2017-2023 is based on 6% total increase in economic growth in Iceland. In 2016 and 2024 this maximum payment is 3% in total.	According to the acceptance and amendment agreement with the Netherlands, the GDP in Iceland for 2008 equaled EUR 11,495 billion, and according to the acceptance and amendment agreement with the UK, the GDP in Iceland for 2008 equaled pounds Sterling 9,194 billion. Increase in the GDP in Iceland is based on these figures, where the maximum payments in the period 2017-2023 equals 6% of the total increase in economic growth in Iceland from 2008 to the year of payment. In 2016 this maximum payment is equivalent to a total of 3%, but it will not be applicable in the year when the agreements are expected to be repaid in full, i.e. in 2024, 2030, or later, as the case may be.
The growth in GDP shall be measured in pounds Sterling, with respect to the agreement with Britain, and in euros with respect to the agreement with the Netherlands. The calculation shall be based on the average CBI mid rate of exchange of the GBP and the EUR with respect to the ISK, on a yearly basis, and on an assessment of GDP, according to the Eurostat definition.	When assessing the GDP in Iceland as of 2016, the point of reference shall be the most recent evaluation thereof for the relevant calendar year, according to the IMF's World Economic Outlook. Growth in the GDP of Iceland shall be measured in EUR and GBP, based on the mid rate of exchange of the ISK, based on the average CBI rate of exchange for the period between two different but adjacent cap calculation dates.

Details of Article 3(3) to (5) of Act No 96/2009	Details in the acceptance and amendment agreements.
	The cap calculation date is the date falling ten business days before a repayment date. This means, in other words, that the mid rate of exchange, in EUR and GBP, is contingent upon its development in each quarter. The parties shall negotiate a reference rate of exchange if the Central Bank of Iceland does not, for whatever reason, publish daily the exchange rate of the ISK with respect to other currencies.
If the agreements have not been fulfilled by the end of the loan period as a result of the maximum payment, it is a matter of dispute whether the outstanding balance should be extinguished.	If the maximum payment results in a balance remaining unpaid at the end of the loan period, the loan period is automatically extended.

As the above list suggests, the main difference between the economic criteria in Article 3(3) to (5) of Act No 96/2009 and the criteria used in the acceptance and amendment agreements is that the latter clearly provide that the principal amount of the loans shall never be extinguished and that there is a floor with respect to the payments, i.e. interest must always be paid. As a result of the acceptance and amendment agreements, the unpaid part of each instalment on account of the maximum payment is added to the principal amount.

The method of calculating the GDP for Iceland and ways to determine increase in economic growth, measured in EUR and GBP, does not entail a basic difference; the aim is to make it easier to determine whether the maximum payment shall be activated in each quarter. Therefore, there are provisions in the acceptance and amendment agreements providing that this shall be clear ten days before repayment date and that the cap shall be calculated according to the criteria available at that time. If this basis turns out to be incorrect, it shall be corrected for the following repayment date.

With respect to calculations of GDP for Iceland, Statistics Iceland calculates the GDP based on definitions from Eurostat. The Central Bank, IMF and other bodies projecting economic growth in Iceland base their projections on values calculated by Statistics Iceland. According to this, the difference between Article 3(4) of Act No 96/2009 and the method in the acceptance and amendment agreement is small, as the projections on the development of economic growth are based on the definitions of Eurostat. The decision was made to take account of the IMF's projection on the estimated GDP of the country.

As foreseen in Article 3(4) of Act No 96/2009, the estimated GDP of Iceland shall, according to the acceptance and amendment agreements, be based on the average ISK rate of exchange over a certain period. Unlike the Act, which provides that this be done on a yearly basis, the acceptance and amendment agreements presume that it be done quarterly, i.e. the average ISK exchange rate with respect to EUR or GBP shall be calculated as it was during the period between two different, but adjacent, cap calculation dates. This period covers, therefore, the date preceding the cap calculation date to the date preceding the following cap calculation date.

3.5 Legal criteria regarding the issue whether the state parties to the EEA Agreement shall be held liable vis-à-vis depositors as regards a minimum guarantee.

Pursuant to Article 4(1) of Act No 96/2009 the state guarantee is conditional on discussions taking place between Iceland and the negotiating parties in the event that a competent adjudicator rules that Iceland or other state parties to the EEA Agreement should not be held liable regarding a minimum compensation *vis-à-vis* depositors, including at the time of a systemic collapse of the financial market. Article 4(3) stipulates that if such discussions do not take place or they do not lead to an outcome, Althingi may limit the state guarantee pursuant to the Act as the case may merit.

To put it concisely, it may be said that the legal effects of the provision are contingent upon a competent adjudicator ruling that such a liability does not rest on the shoulders of the state parties to the EEA Agreement pursuant to Directive 94/19/EC on deposit-guarantee schemes, in circumstances similar to those that emerged in Iceland in October 2008.

The UK and the Dutch authorities believed this provision would create legal uncertainty as to the validity of the loan agreements of 5 June 2009 regarding obligations which rendered it unacceptable. On the other hand, the provision is a reaffirmation on the part of Althingi that a competent adjudicator has not ruled on whether Iceland was obliged to guarantee the payment of a minimum compensation to depositors in branches of privately owned Icelandic banks in another state party to the EEA Agreement. Since the parties agreed that the loan agreements, as amended by the acceptance and amendment agreements, would determine the legal status of the parties, the bill proposes that Article 4(1) of Act No 96/2009 be repealed.

Concomitant to the introduction of this bill, the aim is to issue a joint statement of the Finance Ministers of the three states to the effect that although Iceland reaffirms its binding guarantee of the obligations of the Icelandic Guarantee Fund to compensate UK and Dutch depositors, it does not admit any pre-existing legal obligation to provide that support. Furthermore, the statement will stipulate discussions between the parties at the request of any of the parties and on possible reactions to issues that may arise.

Apart from this statement, Article 2(1) of the bill proposes that Althingi reaffirm that the authorisation to issue a state guarantee does not constitute a recognition of the Icelandic state's obligation to guarantee the payment of a minimum compensation to depositors in the UK and Dutch branches of Landsbanki Íslands hf. Article 2(2) of the bill also proposes that the Minister of Finance is obliged to initiate discussions with the other parties to the loan agreements and, where applicable, also with the European Union and the institutions of the European Economic Area, on the impact on the loan agreements and the obligations of the state according to them, if there were a ruling that Iceland did not have this obligation or if another state party to the EEA Agreement did not have such an obligation in a comparable case. In order for the provision to be activated, a conclusion regarding this matter must be based on the decision of a competent adjudicator, in accordance with the advisory opinion of the EFTA Court or, as the case may be, a preliminary ruling obtained from the European Court of Justice.

It can be concluded from the above, that the legal obligation of the Icelandic state will remain unchanged according to the loan agreements, even if, at a later date, there was a ruling that such an obligation did not exist initially. However, these statements also mean that the Icelandic state will have an indisputable claim to have its position as guarantor reviewed and addressed in the political arena.

3.6 Legal criteria regarding the distribution of the assets of Landsbanki Íslands hf. or its bankruptcy estate upon settlement.

Article 4 paragraph 2 of Act No 96/2009 involves that the Guarantee Fund shall seek the ruling of a competent adjudicator whether the claims of the Fund with regard to the distribution of assets from the estate of Landsbanki Íslands hf. have special priority over the other claims originating from the same deposits The presumption is that the legal standards determining this issue are those in force on 5 June 2009, including Act No 2/1993 on the European Economic Area. If the outcome is such that the claim by the Guarantee Fund has priority in the distribution, discussions shall be initiated with the parties to the loan agreement on how to manage assets from the estate of Landsbanki Íslands hf. and how this affects the agreements and the obligation of the Depositors' and Investors' Guarantee Fund. Article 4(3) stipulates that if such discussions do not take place or they do not yield an outcome, Althingi may limit the state guarantee pursuant to the Act as the case may merit.

According to the provisions of the acceptance and amendment agreements the negotiating parties of the Guarantee Fund and of Iceland are aware of that the Guarantee Fund will likely seek a ruling on this issue before a competent adjudicator. If the Landsbanki resolution committee consents to the claim of the Guarantee Fund to this effect, and this decision is not appealed, the conclusion is that the provisions of the loan agreements are amended accordingly. The provisions of point c in Article 3.5.2 of the Dutch acceptance and amendment agreement entail that should an Iceland court conclude that the Icelandic Guarantee Fund has such legal status, or the negoatiating parties of the Guarantee Fund have such legal status for a part of the claim, as the case may be, the provisions on equal and proportionate payments from the estate of Landsbanki Islands, hf. shall be amended accordingly. An equivalent rule applies in the amendment agreement between the Financial Services Compensation Scheme and the Icelandic Depositors' and Investors' Guarantee Fund, *cf.* point e in Article 2(1) in the amendment agreement between the funds. In order for this provision to enter into force, the conclusion of an Icelandic court on this issue must not contradict an advisory opinion of the EFTA-court.

With reference to the aforementioned, Article 4(2) of Act No 96/2009 is derogated from in three different ways. Firstly, the possibility is not precluded that the negotiating parties of the Icelandic Guarantee Fund have a more extensive right to distribution than the Guarantee Fund. Secondly, the conclusion of an Icelandic court on this issue must not contradict the advisory opinion of the EFTA Court if the provision is to prevail over the provisions of the loan agreements of 5 June 2009. Thirdly, the provision of the agreement entails that a certain outcome before a court of law will automatically result in an amendment to the agreements, while the law presupposed that before this would be come to pass, discussions would take place, ensuing which Althingi would determine on a reduced state guarantee.

There is little chance that the first option is realistic, based on the Icelandic legislation applicable on 5 June 2009, i.e. it is unlikely that the negotiating parties of the Icelandic Guarantee Fund have a more extensive right to distribution than the Guarantee Fund, based on the rules in force on 5 June 2009. As regards the second condition, it was the opinion of the negotiating parties of the Icelandic Guarantee Fund and the Icelandic State that this issue should be addressed by an international court of law in order for the conclusion of the case by an Icelandic court of law to lead to a change of the provisions of the loan agreements of 5 June 2009. With regard to legal opinions obtained by the Icelandic government, *cf.* the opinion of professor Pierre Mathijsen of 28 July 2009 and the opinion of Andri Árnason, advocate to the Supreme Court and Helga Melkorka Óttarsdóttir, district court lawyer of 10 August 2009, it was seen as appropriate that an international court of law would conclude on the validity of European law in the matter. Thus, this was the outcome of the agreements on this issue.

When this latter outcome of the agreements is assessed, it is clear that it can not be guaranteed that Icelandic courts of law will consent to the requirement that issues of this kind be referred to the EFTA Court. This is a result of

the independence of Icelandic courts according to provisions of the Constitution, as well as provisions of Act No 21/1994 on seeking the opinion of the EFTA Court on the clarification of the Agreement on the European Economic Area. In light of the fact that domestic and foreign experts in European law have argued in their opinions that provisions of the Agreement on the European Economic Area can be relevant with regard to the settlement of that issue, it must be considered very likely that Icelandic courts would refer the matter to the EFTA Court, in accordance with Article 1 of Act No 21/1994. However, in the event that they will not do so, the provisions of the loan agreements of 5 June 2009 regarding this issue remain valid, even though Icelandic courts would come to the conclusion that the Icelandic Guarantee Fund enjoyed a special priority in the distribution of assets from the estate of Landsbanki.

Since the Icelandic state and the Guarantee Fund will reach an agreement to the effect that the Guarantee Fund will seek a ruling by a competent adjudicator regarding that special priority, it is not deemed necessary to include a special provision on the matter in this bill. The provision on this issue in Article 4(2) in Act No l96/2009 is therefore repealed if this bill enters into force.

4. Assessment of the content of the bill as a whole and individual sections of it.

Chapters VI-VIII of the aforementioned Committee Opinion of the majority of the Budget Committee, dated 15 August, addressed legal, economic and political questions related to the Icesave case. When assessing the content of this bill, these chapters of the Committee Opinion must be looked to for justification of granting a state guarantee in respect of the obligations of the Guarantee Fund with regard to the minimum compensation for deposits in the branches of Landsbanki in the UK and the Netherlands. These issues should, nonetheless, be discussed in more detail here.

4.1 Legal considerations.

With the Icesave loan agreements, as amended by the acceptance and amendment agreements, the sovereign immunity of the Icelandic state is in full keeping with the reservations to that effect contained in Act No 96/2009, and in addition the right of the Icelandic authorities to decide on the utilisation of its natural resources and their form of ownership is secured. In other respects, the provisions of the acceptance and amendment agreements entail that the legal reservations provided for in Act No 96/2009 are met. However, there are derogations from to this, as discussed above. These derogations should be analysed in some more detail and assessed.

As the Guarantee Fund and the Icelandic state have the option to extend the loan period unilaterally, as well as to keep to a maximum annual payment, the need to revise the loan agreements will most likely be reduced as the provisions of the agreements are now more in line with the Brussels Guidelines. The provision of Article 2(1) of Act No 96/2009 is, therefore, met satisfactorily in the acceptance and amendment agreements.

It is clear that the dispute over the obligation of the Icelandic state to guarantee the minimum compensation of depositors in the UK and Dutch branches of Landsbanki Íslands hf. has not been settled by a competent adjudicator. The reasons have already been addressed in these comments, but are covered in more detail in the aforementioned Committee Opinion from the majority of the Budget Committee, dated 15 August 2009. This bill proposes that it be reaffirmed that an authorisation to issue a state guarantee does not constitute an admission that the Icelandic state was under an obligation to guarantee the payment of a minimum compensation to depositors in the UK and Dutch branches of Landsbanki Íslands hf. If competent adjudicators conclude that the legal understanding of the Icelandic authorities was legitimate, or as the case may be, that of another state party to the EEA Agreement in a comparable case, an attempt shall be made to get the parties to the loan agreements to discuss what implications this has for the loan

agreements and the obligations of the state. In addition, the Ministers of Finance of Iceland, the UK and the Netherlands have issued a joint statement noting i.a. that Iceland will grant the guarantee without admitting any pre-existing legal obligation to do so. This conclusion is regarded as acceptable, as it is extremely difficult to negotiate this point in a binding manner while at the same time reserving the unilateral right to review the issue in its entirety if it is later revealed that the basic obligation was never present. Both positions simply can not be maintained in this instance.

The acceptance and amendment agreements provide that the Icelandic Guarantee Fund will put it to the test whether the claims of the Fund with regard to the distribution of assets from the estate of Landsbanki Íslands hf. have special priority over claims by other parties originating from the same deposits. According to the acceptance and amendment agreements, a ruling by an Icelandic court on this issue must not be in conflict with an advisory opinion obtained from the EFTA Court, if provisions of the agreements on the equal *pro rata* division of each claim are to be changed. If the conclusion is reached that the legal understanding on the special priority of the claims of the Guarantee Fund is legitimate then the provisions of the agreements on the *pro rata* division of individual claims will change automatically. This is to the advantage of the Icelandic Guarantee Fund and the Icelandic state, given the legal effects currently resulting from such a conclusion pursuant to Article 4(2) and (3) of Act No 96/2009.

4.2 *Economic considerations.*

The heavy and extensive debts of public entities and private parties is currently a serious problem in the Icelandic economy. The operation of many businesses is also difficult due to their inability to refinance their operations. In many respects, the current lack of loan capital and risk capital is a more serious issue for the Icelandic economy than heavy indebtedness. In order to, i.a., solve this issue, it is considered necessary to increase the foreign exchange reserves of the country and thereby create the scope to relax the foreign exchange restrictions and create a basis for lowering the policy rate of the Central Bank of Iceland. This would increase the likelihood of the swift and successful revival and stimulation of the Icelandic economy.

Despite the amended Icesave agreements, few people welcome the burden these will place on the finances of the Icelandic state. Various justifications could merit their rejection, however, this would evidently delay the economic measures necessary to put an end to the recession and stimulate the economy. While no loans in foreign currency are available to Iceland, it will become increasingly difficult to halt the vicious cycle invariably associated with a severe currency and financial crises.

The principal idea behind Article 3 of Act No 96/2009 is to endeavour to keep the debt service burden on account of the Icesave loan agreements manageable for the Icelandic state. In the amended loan agreements this has been taken into account in a major way. The Guarantee Fund and the Icelandic state are given the option to extend the loan period unilaterally and the maximum annual payment can be of great help while the Icelandic economy is still recovering. In view of this, the fixed annual interest rate of 5.55% on the loan agreements must be considered reasonable.

While a parliamentary bill on Act No 96/2009 was still under parliamentary deliberation, the Ministry of Finance, the Central Bank of Iceland and the Institute of Economic Studies at the University of Iceland assessed the economic impact of the Icesave loan agreements of 5 June 2009. The Institute of Economic Studies criticised somewhat how the Ministry of Finance and the Central Bank assessed the capability of the Icelandic state to repay the loan agreements; however, all these parties came to the conclusion that most likely the State Treasury would be able to fulfil the loan agreements.

In view of the above, it must be considered very likely that the provisions of the Icesave loan agreements, as amended by the acceptance and amendment agreements, will give the Icelandic economy adequate scope to restore its financial system and economy. Thus, if there are no further setbacks, the Icelandic state will be able to fulfil the agreements as they are presented, without them becoming too onerous for Icelandic society once the state guarantee comes into effect on 5 June 2016.

4.3 Political considerations.

The policy has been adopted to cooperate with other countries in regard to the restoration of the Icelandic economy. Other countries make the granting of loans to Iceland conditional on the assistance being compatible with the program of the International Monetary Fund. It has emerged that further loans will not be granted to the Icelandic state unless the Icesave dispute is solved. This has been the situation since November 2008 and largely explains the difficult negotiating position the Icelandic state finds itself in regarding the solution of the Icesave dispute.

In assessing the bill, the options facing Icelandic society must be considered with a view to its economic and political future. If the bill is rejected, evidently the Icesave dispute will remain unresolved. To this day, this has meant that inadequate credit facilities are available to Iceland resulting in ongoing economic difficulties. The uncertainty resulting if this issue remains unresolved will likewise reduce the options available to the economy in regard to obtaining loan capital or risk capital. This, in turn, will further increase the risk of a recession in the economy.

Internationally, Iceland's political position must be considered weak given the consensus not to grant the country loans unless the Icesave dispute is resolved. This situation is thus unchanged since the bill, which became Act No 96/2009, was deliberated in Althingi. As related in the Opinion of the majority of the Budget Committee, dated 15 August last, there are two opposing views in the matter, i.e. to accept the state guarantee or to reject it. One of the arguments presented in favour of rejecting the state guarantee is to request better agreements. This argument entails a twofold risk, on the one hand that Iceland will be isolated, and on the other hand that a more favourable conclusion will not be reached.

This applies, *mutatis mutandis*, to a position taken in regard to this bill as it is clear that hereinafter it will be difficult to conclude more favourable agreements on the solution of the dispute than have already been negotiated. It is certainly an option to outright refuse to resolve the issue and refer the negotiating parties of the Icelandic state to the judicial system. However, it is the opinion of this government that this would have much more severe political and economic consequences for Iceland than to conclude the matter in the manner proposed in this bill.

The government is of the opinion that the essential features of the reservations included in Act No 96/2009 are observed in the existing acceptance and amendment agreements to the loan agreements of 5 June 2009. It is necessary to conclude the matter and with the acceptance and amendment agreements the position of the Icelandic state has been strengthened considerably compared to the loan agreements from June last. The political and economic advantages that this conclusion to the matter will entail are much greater than the remaining issues which hinder full uniformity between the provisions of the acceptance and amendment agreements and Articles 1-4 of the current Act No 96/2009.

4.4 Overall assessment.

Most are aware that this issue has weighed very heavily upon Icelandic society, both domestically and vis-à-vis other countries. The principal reason is that the overall financial obligation of the Icelandic state can first and foremost be attributed to the operations of an Icelandic privately-owned bank abroad and the gross amount of the obligations reaches approximately half of the estimated GDP of Iceland in 2009. It is furthermore important to note here that reasonable legal grounds have been presented to the effect that the Icelandic state is not under any such

obligation and in addition a competent adjudicator has not ruled on the issue. Albeit, it is clear that if the legal justifications of Iceland were consented to this would present an unacceptable legal situation in the opinion of all member states of the European Economic Area, save for Iceland. This would create considerable difficulties when attempting to gain international support for Iceland's cause. Despite substantiated legal uncertainty it is urgent to conclude the Icesave dispute for economic and political reasons. Althingi must determine whether the acceptance and amendment agreements and this bill present a satisfactory solution to the matter.

It is clear that all the countries that have offered loans to the Icelandic state, save for the Faroe Islands, have in fact made their promises of loans on the condition that the Icesave dispute is brought to a conclusion. These loans from other countries will only be granted if the cooperation between Icelandic authorities and the IMF continues. Therefore, both the IMF and other countries' credit facilities for Iceland will not materialise unless a solution is achieved in the Icesave dispute.

It is the opinion of the current government that the restoration of the Icelandic economy hinges on the cooperation program between the Icelandic authorities and the IMF. It may prove necessary to review the program but that does not change the fact that any such cooperation programs will come to a halt unless the Icesave dispute is resolved. The government is of the opinion that the consequences of this would be serious for the Icelandic economy. The belief is that this bill will have the effect of resolving the most severe international dispute Iceland has been part of in latter times in a satisfactory manner. This solution entails that the most important features of the reservations included in Act No 96/2009 were used as a basis for the final outcome of the dispute.

Comments regarding individual Articles of the Bill.

Regarding Article 1.

This provision proposes that the current Article 1 of Act No 96/2009 be replaced with a new article authorising the Minister of Finance to issue a state guarantee to the Depositors' and Investors' Guarantee Fund in regard to the loans granted to the Guarantee Fund according to the aforementioned loan agreements dated 5 June 2009, as amended by the acceptance and amendment agreements dated 19 October 2009. If the bill is adopted in its entirety, this provision will mean that the Minister of Finance is authorised to issue a state guarantee covering the principal amount of the loans and interest without Icelandic law limiting that authorisation to certain reservations, i.e. Icelandic law will not unilaterally determine the legal status of the parties to the loan agreements, but rather that the legal status will be decided by the agreements. This is therefore meant to ensure that the Minister is granted unequivocal authorisation according to Icelandic law to issue the guarantee and that he will use it to activate the provisions of the agreements.

Regarding Article 2.

As already noted, in the general commentary, it is extremely difficult to do both at once – negotiate a solution to the Icesave dispute and at the same time preserve the legal uncertainty regarding the obligations of the Icelandic state to support the Icelandic Guarantee Fund. Despite this, the first paragraph of Article 2 proposes that the law does not in any way entail an admission of the Icelandic state's obligation to guarantee the payment of a minimum compensation to depositors in the UK and Dutch branches of Landsbanki Íslands hf. This statement serves the purpose of emphasising that the Icelandic government has neither acknowledged this legal obligation nor has it had the chance to have the dispute resolved by an independent adjudicator.

Therefore, paragraph 2 proposes that if, at a later date, a competent adjudicator confirms that Iceland did not have this obligation or that another state party to the EEA Agreement did not have such an obligation in a comparable

case, and this decision is in accordance with the advisory opinion of the EFTA court or a preliminary ruling of the European Court of Justice, the Minister of Finance shall initiate discussions with other parties to the loan agreements and also, if applicable, with the European Union and the institutions of the European Economic Area, on the potential implications of such a ruling on the loan agreements and the obligations of the state.

In light of the fact that it cannot be any adjudicator, whose decision will lead to an obligation for the Minister of Finance to initiate discussions with the other parties to the loan agreements, Article 2 stipulates that the decision by the competent party must be in accordance with the advisory opinion of the EFTA court or a preliminary ruling of the European Court of Justice, as the case may be. The reason why the European Union and the institutions of the European Economic Area are mentioned in Article 2 is that these parties all participated in the drafting of the Brussel Guidelines in the fall of 2008; in case it becomes apparent that the Icelandic state was never legally obligated to take on this liability, it is fair to assume that the aforementioned parties failed their duties. In light of the circumstances it would seem appropriate that they reconsider the case in order to find a reasonable and equitable solution.

As a whole, Article 2 should not have any legal effects except that under certain circumstances the Minister of Finance shall initiate discussions with other parties to the loan agreements and also, if applicable, with the European Union and the institutions of the European Economic Area. This arrangement is considered necessary as the loan agreements are to solely determine the legal status of the parties.

Regarding Article 3.

As is discussed in the general commentary above, it is deemed necessary to repeal Article 3-4 of Act No 96/2009 in order to ensure concordance between Icelandic law and the revised loan agreements. This has been argued for in detail. There is no need to fully repeal the first two paragraphs of Article 3 and it is proposed that they be largely incorporated into Article 5 of the Act on the revision of the loan agreements.

Regarding Article 4.

It is stated in Article 3(6) in the acceptance and amendment agreements that the provisions of Articles 5-8 are an internal matter for Iceland and do not affect the content of the loan agreements. Despite this provision it is clear that the substance of the first two paragraphs of Article 3 of Act No 96/2009 concerns primarily the revision of the agreements. Therefore, it is proposed that the first two paragraphs of Article 3 become the first two paragraphs of Article 5, except for the paraphrasing that mainly pertains to the existing first sentence of paragraph 1 in Article 3 of the Act. That sentence provides that the state guarantee pursuant to the Act is based on the assumption that the financial burden due to the guarantee will remain within reasonable limits, thus enabling Iceland to restore its financial system and economy. This sentence refers indirectly to the Brussels Guidelines and the reservations provided for in Articles 1-4 of Act No 96/2009. As previously stated, both the Brussels Guidelines and the reservations have been taken into consideration in the acceptance and amendment agreements. It is also proposed that paragraph 2 of Article 5 of Act No 96/2009 on the preconditions and criteria of the state guarantee be repealed.

With regard to the comments on Article 5 as amended, see the following comment from the Opinion of the majority of the Budget Committee of 15 August 2009 regarding the first two paragraphs of Article 3 of Act No 96/2009:

“The revision clauses of the agreements refer to the IMF Article IV review by the IMF, pursuant to an agreement on the statutes of the IMF from 1945, with subsequent amendments, as the criteria for a request for a

revision. The Committee majority is of the opinion that it is necessary to stipulate further how such a review is to be requested and the time-limits imposed. The majority emphasises a few points that must be considered when assessing the preconditions for revising the agreements. Therefore, it is laid down in paragraph 2 of the Article that account be taken of the status of the national economy and public finances at any given time, as well as an assessment of the outlook, giving special consideration to currency issues, foreign exchange trends and balance on current account, economic growth and changes in domestic production, as well as population trends and employment participation rate. The majority is of the opinion that these points bear direct reference to the Brussels Guidelines and are, therefore, of such a nature that the Contracting Parties may be expected to place them at the forefront in this context.
The state guarantee is based on keeping the resulting financial burden within reasonable limits and, therefore, the following criteria have been established to assess annually the liquidity of the national economy. It presupposes any of the following limits:

1. the percentage of foreign debt of the national economy must not exceed 240% of the GDP,
2. the percentage of foreign debt of public entities must not exceed 250% of tax revenues,
3. the percentage of foreign repayment instalments and interests must not exceed 150% of export revenues.

Thus, it is assumed that discussions will be initiated regarding the loan agreements should debt sustainability of the national economy and the State Treasury become untenable. If any of these three criteria are exceeded, the Parties shall initiate discussions pursuant to Article 5."

Regarding Article 5.

The Article requires no further explanation.

Attachment I. The UK AAA

Attachment II. The Dutch AAA

Attachment II. Budget Impact Analysis