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Deposit Subje
:ct

Confidential

Dear Joe

We have just had a brief call with Logos (Helga and Eirikur) on this issue and the discrimination point to catch up on what our respective thoughts were.

1994 Directive

1. Iceland's current obligation in respect of deposit guarantee schemes arises under Directive 94/19/EC (attached). I assume that there is legislation from the EEA Joint Committee which transposed these EC legislation into legislations binding in the EEA [*Logos to confirm*]. The Icelandic legislation is Act No 98/1999.

2. Under Directive 94/19/EC, the obligation (Article 3) is for "each Member State shall ensure that within its territory one or more deposit-guarantee schemes are introduced and officially recognised".

There is nothing in the Directive about a State back up if the fund is inadequate.

3. This strongly indicates that Iceland's obligation under the Directive is merely to ensure that an appropriate deposit guarantee scheme is introduced - not to require the Member State itself to provide the guarantee.

(Interestingly, Article 3 allows Member States to exempt credit institutions from the obligation to belong to a deposit guarantee scheme where a credit institution was already in a system which existed at the date the 1994 Directive was adopted and which met certain other criteria. One of those criteria was that the system must not consist of a guarantee to a credit institution by a Member State itself or by any of its local or regional authorities.)

4. Other points to note about the 1994 Directive:

- There is remarkably little in the Directive on what the deposit guarantee scheme has to involve.
- The Directive contains provisions requiring Member States to force credit institutions to participate in the appropriate deposit scheme.
- Article 4 requires deposit guarantee schemes recognised in an EU Member State to cover depositors at branches set up by the credit institution in other Member States.
- The Directive also contains provisions about foreign branches being able to opt to join host Member State schemes. [*Can anyone confirm whether any of the Iceland banks opted to join the UK scheme in respect of their UK branches?*]
- Under Article 6, a Member State has to check that branches established by banks from outside the EU either have equivalent cover to that prescribed in the Directive or they have to join a deposit guarantee scheme within the Member State where the branch is in the EU.
- The threshold under the 1994 Scheme is €20,000, but there is provision to allow Member States to exclude certain kinds of depositors or deposits or to give them a lower guarantee. The list of potential excluded deposits/deposit holders is set out in Annex 1 to the Directive - there is nothing in there to suggest that discrimination on grounds of nationality is permitted.

5. Under EC law, where a Member State has an obligation to introduce legislation to create a compensation scheme for individuals pursuant to an EC obligation and it fails to do so within the relevant time limit, then there is the potential for individuals who have been prejudiced by that failure by the Member State to take action directly against the Member State. However, since Iceland did set up a compensation scheme pursuant to the 1994 Directive (as implemented under the relevant EEA legislation) the Icelandic Government should have no further liability to individual deposit takers - arguably even if the deposit taking scheme fails to pay out - due to inadequate funds. We are looking further at this point.

Recent EC proposals on deposit guarantee schemes

6. On Wednesday October 15th, the European Commission published a proposal to revise the 1994 Directive to increase the minimum level of coverage for deposits from €20,000 to €50,000 and then €100,000 by 31 December 2009.

7. As far as we can see, this Directive has not yet been adopted by the European Parliament/Council although, oddly, the €50,000 limit is required to be applied by Member States as of 15 October 2008. We will continue to investigate the status of this proposal.

8. In any event, we understand from Logos (Helga) that the legislation to incorporate the requirements of this Directive into EEA law has not been adopted as yet by the EEA Joint Committee - consequently, at the moment Iceland's only obligation is to set up a scheme which provides protection up to €20,000 although it is possible that within a matter of days this will be increased to €50,000.

9. We understand from Logos that on 6 October the Icelandic Government issued a Declaration stating that it was proposing to guarantee directly all domestic deposits in banks and their branches in banks in Iceland. However, we understand from Logos that this is not a piece of legislation. The status of this Declaration is presumably appears to be purely a matter of Iceland law.

10. We understand that Logos provided similar advice on the deposit guarantee scheme overnight last night.

Non-discrimination

11. We agree with Logos that the best approach is to argue that there are grounds for treating Icelandic deposits more favourably because of the high percentage of Icelandic individuals'/businesses' assets held in these accounts and the consequent social and economic impact on Iceland if they are not protected (in contrast with the more limited impact on the UK and Dutch economies) - ie argue that there is no discrimination (or that discrimination is justified).

Do you need this advice in a more formal/extensive form?

Kind regards

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