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Urgent
Ministry of Finance
Directorate Financial Markets
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our ref. RT/-/10026743
your ref. -
re liability Republic of Iceland

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Dear Sir,

1 On 11 October 2008, the representatives of the Government of the Netherlands, the Government of Iceland and the Depositor's and Investors' Guarantee Fund of Iceland (DIGF) signed a Memorandum of Understanding, in which DIGF accepts the obligation to compensate each Netherlands depositor of Landsbanki Amsterdam branch up to a maximum of 20.887 euro. The Dutch Government is prepared to prefinance the amount required and to arrange that the Dutch Central Bank will settle with the Netherlands depositors their claims against DIGF as regards the minimum guaranteed amount of 20.887 euro. The amount thus required and prefinanced will be fully guaranteed by the Government of Iceland.

2 As I understand you were informed that the Icelandic Government raises objections against concluding a similar agreement with the British authorities as the abovementioned MoU, with a reference to the 24th recital in the preamble to Directive 94/19/EC on deposit-guarantee schemes. You asked my opinion on this matter, and on its potential relevance for the MoU concluded with the Government of the Netherlands.

3 This Directive applies to Iceland as an EFTA Member State, through a reference in Annex IX, section 19a, to the Agreement on the European Economic Area (EEA). It has been implemented into Icelandic law by Act no. 98/1999 and Regulation no. 120/2000. According to the Icelandic guarantee scheme the DIGF is obliged to repay the customer of the member company, which is unable to render payment of the amount of deposits. Act no. 98/1999 does not impose a general ceiling on the amounts to be paid. Only in the event that the assets of the DIGF are insufficient to pay the total amount of guaranteed deposits, deposits up to a maximum of 20.887 euro (EUR exchange rate of 5 January 1999) shall be paid in full, and amounts in excess of that figure shall be paid proportionally to the extent that the assets of the DIGF cover them (Article 10 of the Act no. 98/1999).

4 Although a deposit-guarantee scheme has been introduced and Act no. 98/1999 nor Regulation no. 120/2000 imposes a legal obligation for the Icelandic Government to finance DIGF, the Icelandic Government can not refer to the 24th recital in the preamble of Directive 94/19/EC as a kind of immunity to liability. A member State or its competent authority can not be made liable in respect of depositors, *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. The Directive sets the harmonized minimum guarantee level at 20.000 euro, in the interest both of consumer protection and of the stability of the financial system (16th recital of the preambule).

5 When DIGF is unable to pay deposits up to the national maximum of 20.887 euro, let alone up the the harmonized maximum of 20.000 euro, DIGF infringes the obligations stated in Act no. 98/1999 and the Icelandic Government infringes its obligations stated in Directive 94/19/EC. The purpose of those obligations 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 Directive 94/19/EC and therefore up to the harmonized minimum guaranteed level. Since the Icelandic Government is responsible for the introduction and *proper functioning* of the deposit-guarantee scheme as provided for by the Directive (see also Case C-222/02, Peter Paul, (2004) ECR I-9425), it is obliged even in the current circumstances to provide the DIGF with sufficient funds and thus to enable the depositors to assert their right to repayment up to the minimum guarantee level (see also Article 7, Par. 6, of Directive 94/19/EC).

6 Instead, the Icelandic Government may in fact have deprived the Directive and the Icelandic deposit-guarantee scheme of their practical effect by issuing Act no. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, together with the subsequent Decisions of the Financial Supervisory Authority (FME) in October 2008, which stipulate that the domestic assets

and liabilities of Landsbanki Íslands hf. are transferred to "New Landsbanki Islands hf", fully owned by the Icelandic Government. However, the assets and liabilities of foreign branches of Landsbanki (including all foreign deposits) are not transferred to New Landsbanki and stay behind in the 'old' Landsbanki that is likely to be wound up with no outlook of (full) payment of the non-Icelandic depositors. The judicial construction imposed by these Decisions, whereby the assets of Landsbanki are transferred to the new financial undertaking New Landsbanki, thus guaranteeing only domestic depositors, as opposed to international depositors, a full return of their investments, may deteriorate the possibilities of DIGF to compensate losses suffered by depositors and, thereby, constitutes a discriminatory measure.

Final judgement on this issue may hinge also on the compensation that will be paid by New Landsbanki to 'old' Landsbanki.

7 On the basis of Article 4, par. 1, of the Directive, the Icelandic deposit-guarantee schemes shall cover the depositors at branches set up by credit institutions in other Member States. Unlike Icelandic depositors, the depositors at the Amsterdam branch of Landsbanki therefore (principally) have to rely on the Icelandic deposit-guarantee scheme. They cannot be treated less favourably than domestic depositors. By adopting Act no. 125/2008 and the subsequent Decisions, the Government of Iceland and/or the FME infringe not only the obligations stated in Act no. 98/1999 and Directive 94/19/EC, but also the principle of fair and non-discriminatory treatment of non-residents, which principle forms part of Articles 4 and 40 EEA. The result could be that the Netherlands depositors are not compensated, not even for the minimum amount of 20,887 euro, which is discriminatory.

8 Article 4 EEA is home to the general principle of non-discrimination on grounds of nationality, while Article 40 EEA prohibits the restriction of free movement of capital within the EEA and provides that there shall be no discrimination based on the nationality or on the place of residence of the persons concerned, nor on the place where such capital is invested. The contested measures, in favour of New Landsbanki and its depositors, furthermore contravenes the Communication from the European Community on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis, adopted on 13 October 2008 (OJ 2008.10.25, C 270/8). According to Article 61 EEA any aid granted by EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings shall, in so far it affects trade between Contracting Parties, be incompatible with the functioning of the EEA.

9 In conclusion, the Icelandic Government is responsible for the proper functioning of the Icelandic deposit-guarantee scheme. It must comply with Act no. 98/1999 and Directive 94/19/EC and use all available means to provide DIGF with sufficient funds to

repay the Netherlands depositors their deposits, at least up to the minimum guarantee level of 20.887 euro. Article 10 of Act no. 98/1999 avails DIGF of the possibility, and under the current circumstances and in view of Directive 94/19/EC: the obligation, to take a loan in order to compensate losses suffered by claimants. The Icelandic Government on its part is obliged to at least cooperate in good faith with the Netherlands Government (see also Article 3 EEA) and finalize the agreements, laid down in the MoU of 11 October 2008, in the interest of the Netherlands depositors. The MoU offers the Icelandic Government and DIGF a certain and reasonable opportunity to repay the Netherlands depositors and therefore to meet their obligations according to Icelandic and EEA law.

10 Finally, Directive 94/19/EC does not in any way prohibit the Icelandic Government to come to the solution, offered by the Netherlands Government. On the contrary, even in view of the financial crisis Iceland is confronted with, a refusal to cooperate could be considered as inconsistent with the principle of proportionality. There are no reasonable grounds to justify such a refusal.

Yours sincerely,

R.J.M. van den Tweel