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PRIVATE & CONFIDENTIAL

29 December 2009

The Budget Committee
Althingi
Austurvollur
150 Reykjavik
Iceland

FAO: Mr. Gudbjartur Hannesson

REQUEST FOR DOCUMENTATION **SECOND LETTER**

Dear Sirs

Further to our earlier correspondence, please find enclosed 55 documents (sent attached to two separate emails) which we have in our Icesave folders but we note are not listed on the website www.island.is, referring both to those documents which are publicly available on www.island.is as well as those documents which are listed under item 82 on www.island.is but kept confidential by the Althingi.

Due to the short period of time we have been given to provide these documents, we cannot state conclusively that this exercise is totally comprehensive. Some of these documents may also already be in the possession of the Althingi through other means, but not listed on the website www.island.is, so we suggest that each document be reviewed individually.

Finally, in the time available we have not been able to review our email correspondence with the Icesave Committee and the Ministry of Finance. If it is thought that this email correspondence may be of assistance to you please let us know and we will provide them in the course of tomorrow.

1. Althingi - Memo - 8.10.08

2. Baldur Gudlaugsson - Letter from Baldur Gudlaugsson to unknown parties - (no date)

3. Baldur Gudlaugsson - Email from Baldur Gudlaugsson to Sael - 20.11.08

4. ECOFIN - Email from Stefan Johannesson to Ingibjorg Solrun Gisladottir - 4.11.08

Switchboard: +44 (0)20 7440 7000
Main Fax: +44 (0)20 7404 5982

5. ECOFIN - Memo - 4.11.08

6. ECOFIN - Memo - 6.11.08

7. EFTA - Letter from EFTA (Per Sanderud) to Icelandic Mission to the EU - 10.10.08

8. EFTA - Memo re Icelandic Banks - 15.10.08

9. EFTA - Letter from Ministry for Foreign Affairs to EFTA - 20.10.08

10. EFTA - Memo re Questions relating to the reorganisation of the Icelandic Banking System - 22.10.08

11. EFTA - Letter from Iceland Ministry of Finance - 3.11.08

12. EFTA - Letter from Icelandic Prime Ministers Office - 4.11.08

13. EFTA - Letter from EFTA to Icelandic Mission to EU - 28.11.08

14. EFTA - Letter from Icelandic Prime Ministers Office to EFTA - 18.12.08

15. EFTA - Letter from Icelandic Prime Ministers Office to EFTA - 27.02.2009

16. Icelandic Ambassador in London - Embassy of Iceland Timeline of Events concerning the State of Icelandic Banks in the UK – 03.04.09

17. Icelandic Ambassador in London - Letter from Embassy of Iceland to Ms Beckett - 30.04.09

18. Icelandic Government - Message from the Ambassador of Iceland to Mervyn King Governor of Bank of England - 16.10.08

19. Icelandic Government - Letter from Ministry for Foreign Affairs (Ingibjorg Solrun Gisladottir) to various - 23.10.08

20. Icesave - Comments on Specific Comments by UK on Agreements - 16.01.09

21. Icesave - Note from Matthew Collings QC - 25.03.2009

22. Icesave - Presentation to Icesave Committee - 26.03.2009

23. Icesave - The Third Way Draft Proposal to HM Treasury - 31.03.09

24. Icesave - Memo on a proposed structure concerning Icesave - (no date)

25. IMF - Letter from David Oddsson (Chairman of Central Bank) and Arni Mathiesen (Minister of Finance) to D Strauss-Kahn of IMF - 15.11.08

26. IMF - Email from Bjorn Olafsson to Jens Heriksson and others - 19.11.08

27. Landsbanki - FSA First Supervisory Notice to Heritable Bank Ltd - 03.10.08

28. Landsbanki - FSA First Supervisory Notice to Heritable Bank PLC - 06.10.08

29. Landsbanki - FSA First Supervisory Notice to Heritable Bank PLC to take effect from 07.10.08

30. Landsbanki - Deposits in foreign branches - 02.03.09

31. Landsbanki - Email from Lilja B.Einarsdottir to Skilanefnd - 04.03.09

32. Landsbanki - 4th ICC Meeting Presentation - MIP – FINAL - 31.03.2009

33. Landsbanki - Project_Resolution Final IV for distribution v4 - 14.04.09

34. Landsbanki - Icesave (UK/Holland) Wholesale Foreign (London/Amsterdam) EDGE (Germany) - (no date)

35. Landsbanki – Presentation – (no date)

36. Landsbanki - Table of entities in administration or insolvent - (no date)

37. Lex - Memo on Icelandic Government ability to guarantee the Icelandic Depositors and Investors Guarantee Fund - 12.10.08

38. Lex - Memo on obligations of Icelandic Government towards the Icelandic Depositors and Investors Guarantee Fund under the EEA Agreement - 13.10.08

39. Lovells - Actions taken by FSA and UK Government - 15.10.08

40. Lovells - Note on actions for damages against UK Government - 11.11.08

41. Lovells - Note on JR: Possible Outcomes - 11.11.08

42. Lovells - Advice on potential legal proceedings against HM Treasury - 11.11.08

43. Lovells - Note on JR Proceedings - 11.11.08

44. Lovells - Draft Pre-Action Letter - 19.11.08

45. Lovells - Chronology - 20.12.08

46. Lovells - Justifications provided by HM Treasury - (no date)

47. Lovells - Instructions to Counsel - 12.11.08

48. Nordic Finance Minister - Letter to Mr Sigurdsson from Per Callesen and others - 15.05.09

49. UK EU Report - Letter to EU Commissioner Charlie McCreevy from Andy Lebrecht - 08.10.08

50. UK Parliament - Question/Motion re Icelandic Banking Collapse - 6.11.08

51. UK Parliament - Letter from Austin Mitchell MP to Alistair Darling Chancellor - 18.10.08

52. UK Parliament - Discussions in Parliament Pertaining to Iceland - 27.10.08

53. UK Parliament - Letter from John Healey to Select Committee - 25.11.08

54. UK Parliament - Question to be tabled re Assistance to Iceland by Austin Mitchell – (no date)

55. UK Parliament - Statement to the Treasury Select Committee re International operations of Icelandic Banks - (no date)

If you have any queries please do not hesitate to contact me.

Yours faithfully,

Mike Stubbs
Partner
Mishcon de Reya

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30 December 2009

The Budget Committee
Althingi
Austurvollur
150 Reykjavik
Iceland

FAO: Mr. Gudbjartur Hannesson

STATEMENT

Dear Sirs

Further to recent press reports in the Icelandic media and requests for further information from the Budget Committee, we wish to state the following:

1. We understand that Ambassador Svavar Gestsson has today made a statement that allegedly rejects our letter yesterday to the Budget Committee, where we discuss the events that took place at the offices of Mishcon de Reya on 26 March 2009. We have reviewed the statement from Mr. Gestsson and we note that it appears to be rejecting issues, which are actually not raised in our letter. In particular the statement of Mr. Gestsson seems to turn on whether Mr. Gestsson trusted the Foreign Minister with certain information, rather than the circumstances of what actually took place at our offices on 26 March 2009. As a result we don't see the recent statement of Mr. Gestsson as being a substantial rejection of the events that took place 26 March 2009. Mishcon de Reya stands by the version of the events on 26 March 2009 as stated in our letter yesterday to the Budget Committee.

2. On 26 March 2009, our Presentation (from 26 March 2009), and the accompanying Note from Matthew Collings QC, (from 25 March 2009), was presented at Mishcon's offices. This meeting and presentation was attended by the following persons:
    a. Ambassador Svavar Gestsson - Chairman of the Icesave Committee
    b. Huginn Thorsteinsson – Finance Ministry
    c. Aslaug Arnadottir - Depositiors and Investors Guarantee Fund
    d. Mike Stubbs - Partner, Mishcon de Reya
    e. John Young - Senior Solicitor, Mishcon de Reya
    f. Gunnlaugur Erlendsson - Solicitor
    g. Rebecca Stubbs - Barrister, Maitland Chambers

    At this meeting, Mr. Gestsson, as our client, requested that certain information

be removed from an amended Presentation to be prepared for the Foreign Minister, Mr. Ossur Skarphedinsson, before his meeting with his counterpart, David Miliband, the British Foreign Minister. We note that the statement of Mr. Gestsson does not state that he did not ask Mishcon to remove certain information from the amended Presentation for the Foreign Minister (dated 29 March). We of course have no knowledge whether Mr. Gestsson shared this particular information at a later date with the Foreign Minister or anyone else.

3. On 31 March 2009 the amended Presentation for the Foreign Minister (dated 29 March) was presented to the Foreign Minister in person at a breakfast meeting at the Rib Room of the Jumeria Carlton Tower Hotel. This meeting and presentation was attended by the following persons:
   a. Ossur Skarphedinsson – Foreign Minister
   b. Kristjan Guy Burgees – Assitant to the Foreign Minister
   c. Ambassador Svavar Gestsson - Chairman of the Icesave Committee
   d. Huginn Thorsteinsson – Finance Ministry
   e. Mike Stubbs - Partner, Mishcon de Reya
   f. Gunnlaugur Erlendsson - Solicitor

   Shortly after this meeting the Foreign Minister went to meet with his counterpart, Mr. David Miliband, the British Foreign Secretary.

4. On 1 July 2009 (10:27 GMT) I sent Mr. Gestsson an email noting that documents regarding the Icesave matter were being posted on the website www.island.is, where I stated *"I am told this is a full documentary disclosure relating to Icesave. Which , if any , Mishcon documents are involved please (for my information) , or is all legal advice impounded ?"* Mr. Gestsson responded the same day (10:44 GMT) by stating *" Dear Mike! They - I am now in Copenhagen - published all formal documents but no Mischon documents but Mischon is mentioned as one of our advisers in the report to the Parliament. But I will also ask Indriði if I have missed anything sitting here in my embassy. And I will let you know. Svavar"* When asked further on how Mishcon de Reya should deal with the press if approached, Mr. Gestsson wrote us a second email the same day (11:22 GMT) stating *"Dear Mike! Of course you are free to say anything you like and you make the decision but I think that we are not going to comment on details in working papers - though we might do that if needed in confidential circles like parliament committees. But I doubt it very much that we will go that close into every detail. Svavar"*

5. On 7 July 2009 (09:21 GMT) I sent Mr. Gestsson a further email as the amended Presentation to the Foreign Minister (dated 29 March 2009) had then been leaked to the press. However the previous Presentation (dated 26 March 2009) was still undisclosed. Shortly thereafter I had a telephone conversation with Mr. Gestsson where we discussed this matter and where Mr. Gestsson informed me that the only copy of the Presentation (dated 26 March 2009) was securely in his safe. We are however aware that Mr. Hugin Thorsteinsson and Mrs. Aslaug Arnadottir also attended the meeting at Mishcon's offices on 26 March 2009 and we believe they took copies of the documents as well.

6. We do not have knowledge whether Mr. Gestsson at any point shared the contents of our Presentation (dated 26 March 2009) with anyone other than

those who attended the meeting that date. This is outside our scope of knowledge but we however note that the statement of Mr. Gestsson does not state whether Mr. Gestsson provided this information to the Foreign Minister or to the Althingi. We do however know that it was never posted on the website www.island.is.

7. We fully understand that the Icesave matter is very delicate. But we must stress as lawyers we are duty bound by our professional rules to our client to be entirely frank and transparent. If the Althingi would like to receive sworn statements, from the lawyers who attended the meeting on 26 March 2009, we would be happy to provide the same.

If you have any queries please do not hesitate to contact me.

Yours faithfully,

Mike Stubbs
Partner
Mishcon de Reya

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ICESAVE
Issues and Solutions

Presentation to Svavar Gestsson Chairman of the Icesave Committee

26 March 2009

Mishcon de Reya Solicitors

Introduction

Introduction

- Mishcon de Reya role and background on Icelandic situation
- Timeline of events and brief commentary

Index

1. Responsibility of the Icelandic Government under Directive 94/19/EC

(A) What demands has the UK Government made and what has the Icelandic response been to these demands?

We have received and considered a number of legal opinions, which we are continuing to review. However at this point we have not seen any evidence of a legal obligation on the Icelandic government to provide a sovereign guarantee of the liabilities of the Icelandic Depositors' and Investors' Guarantee Fund ("**DIGF**"). This is the current position of the Icelandic government

1. Responsibility of the Icelandic Government under Directive 94/19/EC

(A) What demands has the UK Government made and what has the Icelandic response been to these demands (cont.)?

Legal Opinions in favour of Icelandic Position:

(1) Icelandic law firm Logos dated 15 October 2008, referred to in their legal opinion of 11 February 2009

(2) Icelandic law firm Lex dated 12 October 2008 and 13 October 2008

Legal Opinions against the Icelandic Position:

(1) Dutch law firm Pels Rijcken & Droogleever dated 3 November 2008

(2) Submissions of the UK government prepared by KPE Lasok QC and R Williams and dated 4 November 2008

(3) EU/ESA legal opinion dated 7 November 2008

Mishcon de Reya and Rebecca Stubbs (Counsel – Maitland Chambers) are considering the position and in particular the documents recently provided to us and will prepare a further opinion. We understand no formal UK legal opinion has previously been requested by the Icelandic Government.

1. Responsibility of the Icelandic Government under Directive 94/19/EC

(B) What are the obligations of Iceland under Directive 94/19/EC (the "**Directive**")?

- It is common ground (as the agreed Guidelines reflect) that the Directive is effective in Iceland. The Icelandic Althing has implemented the Directive in Law 98/1999 on Deposit Guarantees and Investor Compensation Scheme.

- The recitals to the Directive recognise that the Directive may not result in states being made liable in respect of depositors if they have ensured that a scheme (ie the DIGF) guaranteeing deposits and ensuring the compensation or protection of depositors under the conditions set out in the Directive have been introduced and officially recognised.

- Whilst Iceland is required (by Article 3.2 of the Directive) to take appropriate measures to ensure that a credit institution which is not complying with the obligations incumbent upon it as a member of a scheme complies with those obligations, there is no express obligation imposed on Iceland to guarantee any payments from the DIGF.

1. Responsibility of the Icelandic Government under Directive 94/19/EC

(C) Has Iceland agreed to guarantee the Icesave deposits despite the wording of Directive 94/19/EC and its implementation into Law 98/1999?

- Despite the various conflicting statements and documents which we are still reviewing, Mishcon de Reya have yet to see any written evidence that Iceland has formally undertaken to guarantee DIGF's obligations in respect of the Icesave deposits, or undertake any further obligations other than those under the Directive as implemented by Law 98/1999. This would also require legislative approval in Iceland, according to the Icelandic legal opinions we have seen.

- The Guidelines agreed on 16 November 2008 do not in Mishcon's opinion appear to give Iceland any obligation beyond those set out in the Directive and merely parked the dispute at that time. The Guidelines merely state that the Directive applies to Iceland in the same way as to the EU Member States.

- There have been discussions in Iceland and legal opinion from Logos regarding the liability of the EU institutions and whether Iceland could bring a claim against them in respect of the Icesave situation. Such claim could only be applicable if Iceland has or will formally accept that it has an obligation to guarantee the DIGF.

2. Assignment of Icesave Claims from Depositors to FSCS

(A) When the FSCS compensated the UK Icesave depositors how did it obtain the benefit of the UK Icesave depositors' legal position against Landsbanki?

COMP 7.1 of the UK FSA's Handbook gives the FSCS authority to make an offer of compensation to claimants under its scheme.

COMP 15.1.18R provides that the FSCS may make payments of compensation conditional on the claimant assigning or transferring the whole or any part of all such rights as he may have, on such terms as the FSCS determines are appropriate.

While we are still obtaining a copy of the FSCS's offer of settlement to the UK Icesave depositors, the FSCS website makes it clear that the compensated depositors assigned their rights against Landsbanki, the DIGF and any other relevant party in relation to their Icesave deposits to the FSCS.

Most assignments appear to have taken place online. While we have yet to determine whether the assignments were valid, in our view they are likely to be valid.

2. Assignment of Icesave Claims from Depositors to FSCS

(B) Do the Icesave depositors in the UK and Holland have preferential status under Icelandic law?

- This is a matter of Icelandic law and Icelandic legal advice will be required to finally determine the order of priority of creditors.

- It will be vital in any negotiation to understand clearly (a) who is entitled to claim the Landsbanki assets, including the assets frozen in London, (b) the order in which those claimants are entitled to those assets and (c) the actual value of Landsbanki's assets as a whole, and those of its London branch.

- We understand from information provided by the Icesave Committee (Áslaug Árnadottir) that the Icesave depositors both retail and wholesale are preferred creditors in accordance Icelandic Law. We understand also from other sources that Glitnir's moratorium supervisor may soon apply to the Icelandic courts for a ruling on this issue.

2. Assignment of Icesave Claims from Depositors to FSCS

(C) Has the DIGF made any payments in relation to Icesave?

- We understand that no payments have been made by DIGF so far as a consequence of the Icesave situation.

(D) Does the FSCS have the same legal status as the DIGF, under Icelandic law when it compensates the UK Icesave depositors?

- This is a matter of Icelandic law but we understand that the issue is unclear. It is however certain that the UK government would take the view that FSCS should have the same preferred status as the UK Icesave depositors in much like Icelandic law allows for the DIGF to be a preferred creditor.

- We assume that same order of preference would apply in relation to the Dutch DNB deposit guarantee scheme, which would then be treated in the same manner as the FSCS in regards to claims in Iceland against Landsbanki.

3. The Landsbanki Freezing Order and the London Branch

(A) Can Landsbanki apply for Judicial Review of the Freezing Order?

- The time limit for Judicial Review of the Freezing Order expired on 7 January 2009. The Freezing Order provides that the assets of Landsbanki's London Branch will remain frozen, subject to the licences which the UK Government has granted or may grant in the future.
- The Freezing Order is valid for a fixed period of two years and can be renewed, but renewal would open up the possibility of Judicial Review.
- Furthermore, the UK Government's refusal to allow the London Branch assets to be released into an insolvency process may be susceptible to Judicial Review on a stand alone basis.

3. The Landsbanki Freezing Order and the London Branch

(B) How can the Freezing Order be reversed? What are the different routes to unfreeze Landsbanki's London Branch assets?

- The reversal of the Freezing Order will require the co-operation of the UK Government. Persuading the UK Government to give their co-operation will depend on what Landsbanki agrees should happen to the London Branch assets, possibly with approval of the Icelandic courts.
- The Freezing Order provides for the UK Government to grant "Article 6" licences, and these could be used to allow the release of the London Branch assets in a structured manner.
- An important factor in obtaining UK Government consent to any release of London Branch assets would be an exchange of information about those assets, how they might be managed to maximise their value and then allocated to the Icesave depositors, including FSCS and DNB.

3. The Landsbanki Freezing Order and the London Branch

(D) What is the status of Landsbanki London Branch and how can it be resolved?

- The assets of the Branch are in limbo: they are frozen (subject to various licences which have been granted) but cannot be administered in a UK liquidation or administration due to the provisions of the UK's Credit Institutions (Reorganisation and Winding Up) Regulations 2004 (SI 2004/1045).

- The Icelandic Government (via the Landsbanki Resolution Committee or the Icelandic Courts) potentially could ask the UK Government to grant licences varying the Freezing Order as referred to above to permit the transfer of Landsbanki London's assets to a new UK company ("**Icesave Newco**"), which can then be placed in administration under normal UK insolvency procedures and distribute its assets in accordance with an agreement between the UK and Icelandic Governments.

- At the point of the London Branch assets being transferred to Icesave Newco and that company being placed into UK administration to pay the Icesave depositors the controversial Freezing Order granted under the provisions of the UK Anti-Terrorism, Crime and Security Act 2001 ceases to have a purpose and can be withdrawn by the UK Government.

3. The Landsbanki Freezing Order and the London Branch

(E) What happens if the assets of Icesave Newco are insufficient to pay all the Icesave depositors?

We understand the Icesave depositors, both wholesale and retail, are preferred creditors according to Icelandic law, and therefore they still will have a claim against the Icelandic assets of Landsbanki for any remaining amount.

A further consideration is the position of other creditors, both senior and subordinated to the Icesave depositors. Further information from Landsbanki will therefore be required to evaluate the likely impact of on each class of creditor of the release, or not, of the London Branch assets to the Icesave depositors.

4. Legal Claims in relation to Heritable

(A) Can Landsbanki bring a claim v. FSA regarding Heritable on the basis of the Human Rights Act 1998 (the "**HRA**")?

Leading Counsel's (Matthew Collings) view is that there appear to be valid grounds for bringing a claim against the FSA pursuant to the HRA, and in particular Article 1 of the First Protocol to the European Convention on Human Rights entitled "Protection of Property" ("**Article 1**").

Article 1 provides that "Every... legal person is entitled to peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law."

The Article 1 rights are not absolute, and the protection may be eroded on grounds which justified and proportionate. For example

(1) shares may be expropriated by means of nationalisation provided adequate compensation is paid; and

(2) a regulator may put a company into administration, provided it is justified in doing so, not only are the basic facts sufficient to justify intervention, but intervention is proportionate.

4. Legal Claims in relation to Heritable

Can we bring a claim v. FSA regarding Heritable on the basis of the Human Rights Act 1998 (the "**HRA**")?

In this case there are serious questions as to whether: (1) there was actual justification for intervention at all, in particular having regard to the specific facts relating to Heritable and its solvency position, and not merely a general concern about "Iceland"; and (2) whether the intervention was proportionate.

Landsbanki's shares in, and therefore ownership of, Heritable are "possessions" within the meaning of Article 1, and we would say that they have been interfered with, detrimentally, by Heritable being put into UK administration and their value decimated.

The above may found a claim for damages, which would (unlike a claim for Judicial Review of the Freezing Order which is out of time) be brought by ordinary action with the requirement for disclosure and oral evidence and the possibility of great embarrassment for the UK Government.

Mishcon de Reya Solicitors

LANDSBANKI ISLANDS HF – ICESAVE

NOTE

1. This Note addresses, on a preliminary basis, the interests of what is now old Landsbanki in Heritable Bank plc ("Heritable"), its wholly owned UK subsidiary.

2. In doing so, it is necessary to consider the circumstances concerning the other Icelandic banks, and their interests in the UK, as the actions in respect of Heritable were taken in this factual matrix. The following contains reference to the basic facts as I understand them to be, but this is obviously subject to full investigation and verification.

Background in Iceland

3. Glitnir was the first bank in Iceland in respect of which the Icelandic authorities acted; but Landsbanki had greater problems, and had had for some time: for example, it had loan exposure in respect of the UK based XL Leisure Group, which went into administration in Summer 2008.

4. It appears that there were discussions (and a meeting) early last year between Iceland and London concerning Icesave, and the bringing of Icesave within the UK jurisdiction, with assets to match. This did not happen. There were then more meetings and discussions in early September 2008 about the position in Iceland more generally, and it may have been then that the UK authorities began to make preparations which culminated in the actions taken in early October: clearly they

would have taken some time to prepare. (It might, however, be fair to say that other market disturbances were also occupying HM Treasury; and that, at the time that the UK authorities moved in respect of the Icelandic banks, the Chancellor's major bank reconstruction statement on 8 October was receiving greater attention. Indeed there is a view that Icelandic affairs were dealt with at a relatively low, and uninformed, level within HM Treasury.)

5. The actions, and regulatory supervision, contemplated and undertaken were effected in circumstances of close cooperation and coordination between HM Treasury and the Financial Services Authority ("FSA") (and the Bank of England, although it does not seem to feature much) as members of the Tripartite Authorities. Clearly it is no coincidence that the relevant Statutory Instruments and the administrations in the UK occurred virtually simultaneously, or that the SIs were drafted on the basis that administrations would take place (or were at least contemplated).

6. The financial position of Kaupthing in Iceland was much stronger, with a much stronger asset base and no exposure of the kind of Landsbanki (or to a lesser extent Glitnir). It was the only one of the three banks which the Icelandic authorities hoped and expected to save.

7. There may have been some justification for the UK authorities to react in respect of Landsbanki, given its position in Iceland (its Resolution Committee process started on 7 October 2008), although the extent of the reaction in the UK may be questioned; but the UK authorities' actions in respect of Kaupthing's wholly owned UK subsidiary Kaupthing Singer & Friedlander Limited ("KSF") on 8 October are what brought about the collapse in Kaupthing in Iceland on 9 October, and not vice versa: there

seems to have been no attempt to analyse the position of the Icelandic banks (or their UK subsidiaries) individually.

Heritable

8. Although its parent company in Iceland was in difficulties, Heritable was a separate Scottish company which does not appear to have been in difficulty (or at least in insuperable difficulty). Its Administrators are planning a reasonably long procedure in order to maximise recoveries for creditors, and it is likely that there will be a substantial dividend. Indeed it appears that Heritable was perfectly viable, and that people are questioning why it went into administration at all.

9. Early on 7 October, the Heritable transfer order was made pursuant to the Banking (Special Provisions) Act 2008 (to a Bank of England company), and on 8 October a further transfer order was made to ING. The transfer orders only covered the retail deposits of individuals, and the commercial depositors were left behind. Heritable was then put into administration on 7 October on the application of the FSA.

10. The transfer orders have the following further features. First, there is no provision for compensation in respect of the transfer. Secondly, the ordinary provisions concerning administration in the Insolvency Act are required to yield to assisting the transfer and obligations related thereto. Thirdly, there are special provisions concerning the Financial Services Compensation Scheme ("FSCS"): clearly ING would not have been willing to take on liability to depositors without first having received deposits, and these were in effect provided by the FSCS. The FSCS then becomes a creditor in place of the depositors achieving, in effect, a statutory assignment.

Landsbanki

11. Landsbanki also traded in the UK in its own right (through the London branch), as well as through its UK subsidiary Heritable. It took deposits, and it engaged in commercial activity: including as a substantial lender to Baugur (or BG Holdings) which has (or had) substantial retail interests in the UK, and is now in administration.

12. Landsbanki became subject to the Resolution Committee procedure in Iceland on 7 October, and on 8 October the Landsbanki Freezing Order was made in the UK. There were subsequently certain General Licences granted in respect of it by HM Treasury, and an amendment order: the Freezing Order and its effect appears to have been somewhat ill considered. This Freezing Order route was employed because the 2008 Act 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.

13. The Freezing Order has had the effect of ring fencing assets in the UK (so that they cannot be repatriated to Iceland), but so that Landsbanki can continue to trade: the Bank of England even extended a £100m loan to the UK operation.

14. The Freezing Order has given rise to considerable controversy, not least because of the legislation under which it was promulgated. However, there was a debate in the House of Lords on 28 October 2008, which suggests both jurisdiction and justification. In this latter regard, an article in the FT on 24 November, which reported remarks of the Chairman of the Board of Governors of the Icelandic Central Bank, lends the UK government some support: the article is entitled "Banker signals Iceland may be to blame in UK clash", and this accurately summarises its substance; see also evidence to the Treasury Select Committee. It is hard to discern whether

some of the action taken by the UK authorities may have been on the basis of a fit of pique: certainly the Chancellor said on the radio on 7 October that action had to be taken because the Icelandic finance minister had told him that "they have no intention of honouring their obligations".

15. One further adverse effect on Landsbanki of the Landsbanki Freezing Order may have been the collapse of a sale of some of Landsbanki's assets, but the Freezing Order (on 8 October) did come after Landsbanki became subject to the Resolution Committee procedure in Iceland (on 7 October).

KSF

16. Not only was the parent in Iceland, Kaupthing, the strongest of the three Icelandic banks, KSF itself was a separate English company which appeared to be strong in its own right. It had the "Kaupthing Edge" retail deposit business, and it also had the long established Singer & Friedlander business, and many other interests.

17. In the Administrators' proposals concerning KSF, reference is made to the administration "following a period of increasingly intensive supervision". It is understood that this is an understatement.

18. I understand that for some time, on a daily basis, Kaupthing was being required by the FSA to bolster KSF in London, and all the demands were met. (It does appear that there were substantial customer withdrawals.) Finally, on 8 October the FSA made a further requirement for €250m within 30 minutes, and for a further €2.5bn within 7 days. Kaupthing immediately contacted Deutsche Bank to enable the demands to be met (by a line of credit secured on unencumbered assets), but it was reported that KSF had been placed in administration before the 30 minute deadline had expired.

19. The KSF transfer order was made at 12.05 pm on 8 October, and an administration order was made at 2.29 pm on the application of the FSA (although the authorities apparently began to take action physically at the premises about an hour and half before that). The transfer order transfers retail deposits to ING (via a Bank of England company), again leaving behind commercial depositors.

20. At an earlier stage, when KSF (in common with other UK authorised institutions) sought to take part in the Bank of England's liquidity support operation, this was apparently refused on the basis that it was "not for you".

21. We now also know that, on 3 October, the FSA issued a First Supervisory Notice to KSF requiring it to open a segregated trust account with the Bank of England and to pay into it monies equivalent to the deposits being received. We know this because the Administrators of KSF have had to apply to the Court for directions as to status of the approximately £147 million in this account.

22. The collapse of KSF in the UK on 8 October triggered the collapse of Kaupthing in Iceland the following day: this was because the administration triggered various break clauses (e.g. referring to the loss of more than 5% of Kaupthing's operations or assets), and lines of credit were called or closed. Confidence collapsed, and so did Kaupthing.

<u>The FSA</u>

23. HM Treasury is substantially insulated from any complaint concerning the administrations of Heritable and KSF. Although HM Treasury obviously worked closely with the FSA (both being within the Tripartite Authorities), and actions were clearly coordinated, it was not the transfer orders which were the immediate trigger

for the collapse of the two companies: it was the actions of their regulator (the FSA), and the transfer orders protecting the retail depositors were made in parallel (although in fact they were made just before the administration orders in each case).

24. It may well be, even if action was justifiably contemplated in respect of Heritable because of the position of its parent Landsbanki in Iceland, that the action taken in respect of Heritable was disproportionate: insolvency brings with it irreparable stigma and destruction in value. A Heritable freezing order (like the Landsbanki Freezing Order) could have been much more desirable, and less harmful; or the FSA could have issued regulatory directions (concerning the maintenance of capital, and the "fit and proper" test) to ensure that Heritable's assets were not sent to its parent in Iceland, and that Heritable's UK directors fulfilled their duties properly (not that it has been suggested that they would have done otherwise).

25. Of course the harm which was caused has not adversely affected the retail depositors because HM Treasury's transfer order took care of them.

26. It would appear that the position of Kaupthing in Iceland did not justify the action which was taken; but in any event KSF could likewise have been subject to a much less damaging regime.

27. However, it is the position that it was the FSA as regulator which made the applications for administration orders pursuant to its power in Section 359 of the Financial Services and Markets Act 2000 ("FSMA"). Even if the process can be criticised, such criticism can first be directed at the making of the orders. Then it can be directed at the FSA – which, as a regulator, enjoys immunity (albeit not from a damages claim under the Human Rights Act 1998: see paragraph 19 of Schedule 1 to

FSMA). After Railtrack and BCCI (the claim against the Bank of England), consideration of misfeasance in a public offence is not attractive.

28. There may be substantial grounds for querying the FSA's actions in respect of Heritable and KSF. Apart from the background referred to above, there are questions as to the procedure used on the applications for administration orders. At the KSF creditors' meeting on 1 December, it was said that the FSA acted on the basis of a belief of cash flow insolvency because of the outflow of funds from Kaupthing Edge accounts. However, many institutions were suffering such an outflow, and KSF had been denied access to the liquidity facilities. (This insolvency argument in respect of Heritable is possibly more difficult as I understand that Heritable's retail funds were relatively small.) Further, at the KSF creditors' meeting, the Administrators said that they thought that KSF had been given the requisite notice of an application for an administration order, albeit only the day before: but the Administrators were very uncertain about this, and it does not appear to be correct. The evidence upon which the application was based, and order made, is apparently "sealed" (probably a reference to the Rule 7.31(5) of the Insolvency Rules 1986, whereby the right to inspect the court file can be curtailed). However, Kaupthing has copies of the evidence because it is referred to in Kaupthing's application for judicial review concerning the KSF transfer order (which contains useful material). It should also be possible to obtain a transcript of the hearing itself from the court master tape (unless it was held in camera).

Discussion

29. The justification for Heritable's administration was based upon a conclusion by the FSA (on 7 October) that it was failing to meet its threshold conditions under FSMA,

as a result of which the FSA exercised its power under Section 45 of FSMA to prevent Heritable from accepting deposits. Reference is also made to the loss of confidence in the Icelandic banking system and Landsbanki, and to the fact that Heritable was apparently entirely dependent upon the ongoing support of Landsbanki. I am not at all sure about all of this so far as Heritable is concerned.

30. It appears that KSF had been subject to substantial withdrawals from its Kaupthing Edge accounts, but I do not know the extent to which Heritable was similarly so subject: this would be the best justification for action on the part of the FSA.

31. However, the whole decision making process in respect of the Icelandic banks in the UK may have been driven or tainted by irrational or collateral considerations; and/or Heritable may have been swept up without any, or any proper, consideration of its own position. One does wonder about the preamble to the Heritable transfer order:

> "It appears to the Treasury to be desirable to make this Order for the following purpose: maintaining the stability of the UK financial system in circumstances where the Treasury consider that there would be a serious threat to its stability if the Order were not made."

Such is necessary to fulfil Section 2(2)(a) of the 2008 Act, and it is this whole issue upon which Kaupthing's judicial review application is based.

32. As I have said, the Transfer order does not include any provision for the payment of compensation. Nor was Heritable nationalised, in contrast to Northern Rock and Bradford & Bingley, whose shareholders have to be compensated for the expropriation of their shares (albeit that there is considerable controversy in that regard concerning Northern Rock: see R (SRM Global Master Fund LP) v. The Commissioners of HM Treasury [2009] EWHC 227 (Admin), which is being appealed).

33. It is usually virtually impossible to sue regulators, but, as I have said above, there is a Human Rights Act window in respect of the FSA. We would be concerned with Article 1 of the First Protocol to the European Convention entitled "Protection of Property":

> "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."

34. These property rights are not absolute. There may be inroads, provided they are justified and proportionate. In Lithgow v. United Kingdom (1986) 8 EHRR 329 the ECHR considered a challenge concerning compensation arising from the nationalisation of the shipbuilding and aircraft industries, and said at para. 120 (p. 372):

> "In this connection, the Court recalls that not only must a measure depriving a person of his property pursue, on the facts as well as in principle, a legitimate aim 'in the public interest', but there must also be a reasonable relationship of proportionality. This latter requirement was expressed in other terms in the abovementioned Sporrong and Lönnroth judgment by the notion of the 'fair balance' that must be struck between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights. The requisite balance will not be found if the person concerned has had to bear 'an individual and excessive burden'. Although the Court was speaking in that judgment in the context of the general rule of peaceful enjoyment of property enunciated in the first sentence of the first paragraph, it pointed out that 'the search for this balance is ... reflected in the structure of Article 1' as a whole."

This approach has been reiterated in subsequent Strasbourg case law, as referred to at paragraph 74 of the SRM Global case. So shares may be expropriated by means of nationalisation in the public interest, provided adequate compensation is paid. A

regulator may put a company into administration, provided it is justified in doing so: and such justification will not only require the necessary basic facts to intervention, but also that such justify intervention is proportionate.

35. In the case of Heritable, there would appear to be prima facie issues in both of these respects: whether there was justification for intervention at all (having regard to the specific facts concerning Heritable, and not merely a general concern about "Iceland" or anything to do with it – although doubtless a factor); and, even if there was, whether, the intervention was proportionate.

36. Landsbanki's shares in, and therefore ownership of, Heritable are "possessions" within the meaning of A1P1, and we would say that they have been interfered with, detrimentally, by Heritable being put into administration and their value therefore being decimated. This may found a damages claim. Moreover, unlike judicial review, such a claim would be brought by ordinary action, with the attendant requirements of disclosure and oral evidence. It is to be recalled that when the Government's conduct concerning the administration of Railtrack was scrutinised in this way, considerable embarrassment ensued.

37. It follows that there are prima facie grounds upon which to consider a claim against the FSA in respect of Heritable, and certainly to justify investigation into the FSA's actions.

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Lincoln's Inn

25th March 2009

LANDSBANKI ISLANDS HF – ICESAVE

NOTE

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Ref: MAS

The Third Way - Draft Proposal to HM Treasury

- Landsbanki Islands ("Landsbanki") or Special Purpose Vehicle ("SPV") issues an asset-backed bond (the "Bond") backed by the assets of Landsbanki, including the assets of its London and Amsterdam Branches (the "Assets"), currently frozen in the UK and under Dutch administration.

- The Bond is issued for the benefit of Landsbanki's preferred creditors (the "Preferred Creditors"), being primarily the:
    - FSCS (UK Deposit Guarantee Scheme)
    - DNB (Dutch Deposit Guarantee Scheme)
    - UK and Dutch Wholesale depositors (Councils, Charities etc).

- Detailed negotiations will need to be conducted on the legal structure of the Bond, the value of the Bond, the repayment plan for the Bond and what (if any) interest rate the Bond should carry. The status and interests of other creditors needs to be considered as well.

- The Bond will be issued at a value discounted to the current claims, in line with the expected recovery rate from the Assets. The repayment of all creditors will be conducted in accordance with Icelandic law, international standards and in a way generally acceptable to the IMF.

- The future management of Landsbanki/SPV will be agreed between the Governments, based on the good relations of the London Branch with HM Treasury and qualified oversight agents (BDO) appointed by the Icelandic Government. The Assets are to be managed from the UK over a certain time horizon to preserve their value and maximize their realization to repay the Bond, while also leaving room to create residual equity value in the operations so they can be sold at a later date once conditions improve.

- Cooperation between Governments with investigations in the Icelandic banks, potentially leading to the recovery of further Assets in the future.

- Cooperation between Governments to counter any potential litigation from subordinated creditors looking to question the preferential treatment of the Preferred Creditors, under Icelandic law.

- Rebuilding confidence by sharing of information between Governments and common management and oversight over the Assets, may make a Sovereign Guarantee less critical as the negotiations on the "Third Way" develop, particularly in light of the sensitive nature of the situation in Iceland and not having to seek parliamentary approval for such Sovereign Guarantee. Not offering the Guarantee at the onset may at least allow for limitations on Sovereign Guarantee or have it agreed in a political rather than a directly legally binding way.