

9 December 2010

**Summary of the Negotiating Committee on the Outcome of Discussions
with the UK and Dutch Governments concerning Icesave**

1. Following an agreement between the political parties represented in the Icelandic parliament *Althingi* in January this year, a decision was taken to hold discussions with the UK and Dutch governments on a settlement concerning Landsbanki's Icesave accounts. Consultations were held on the composition of Iceland's negotiating committee and its general mandate.
2. The negotiating committee was comprised of Lee C. Buchheit, attorney and expert in international financial agreements, of the US law office Cleary Gottlieb Steen & Hamilton LLP in New York; Guðmundur Árnason, Permanent Secretary of the Ministry of Finance; Einar Gunnarsson, Permanent Secretary of the Ministry for Foreign Affairs; and Supreme Court Attorneys Jóhannes Karl Sveinsson and Lárus L. Blöndal; the latter was appointed jointly by the parties in opposition.
3. The negotiating committee was assisted by a number of internal and external experts and advisors, throughout by Andrew Speirs, financial consultant from the advisory firm Hawkpoint; attorney Nigel Ward from the legal office Ashurst; ambassador Kristján Andri Stefánsson; and economist Hrafn Steinarsson of the Ministry of Economic Affairs.
4. In addition to those states involved in the agreements, the Icelandic Depositors' and Investors' Guarantee Fund (TIF) is a party to them along with the Icelandic government. The Chairman of the Board of the TIF is attorney Guðrún Þorleifsdóttir of the Ministry of Industry and its general counsel is Eiríkur Elís Þorláksson, Supreme Court attorney.
5. Communications have been exchanged by the negotiating committee and representatives of UK and Dutch governments since February this year. Negotiating meetings were held in London in February this year and up until the referendum in Iceland on the validity of Act No. 1/2010, which was held on 6 March. Some time elapsed thereafter before active exchanges could recommence. The negotiating parties met in Reykjavík at the beginning of June and again in The Hague at the beginning of September. In addition, several informal meetings have been held. Apart from this communications have been conducted by telephone and e-mail.
6. Yesterday the negotiating committees reached agreement between themselves on an outcome to the negotiations, with draft agreements initialled in London yesterday 8 December. On Iceland's behalf the draft agreements were endorsed by all five of its negotiators, together with the Chairman of the Board of the Depositors' and Investors' Guarantee Fund (TIF), initialling them. It should be emphasised that this initialling is not equivalent to the signing of the agreements; rather, it merely confirms that an outcome has been attained in the negotiations. Final signing and acceptance of obligation on Iceland's part awaits the granting of the necessary authorisation by the *Althingi*.

7. The negotiating committee has today presented the initialled agreements to the leaders and representatives of all the parties who mandated the negotiations, together with a draft bill of legislation. "authorising the Minister of Finance to ratify agreements initialled in London on 8 December 2010, to guarantee (a) repayment by the Depositors' and Investors' Guarantee Fund to the UK and the Netherlands of cost incurred in payment of minimum guarantees to depositors in branches of Landsbanki Íslands hf. in the UK and the Netherlands, and (b) payment of outstanding amounts (the shortfall) and interest on these obligations."

The negotiating committee has thereby completed its task, at least as far as the actual drafting of agreements is concerned.

The Results

8. **Structure of the agreements.** Generally speaking, the results of the negotiations provide for the conclusion of Reimbursement and Indemnity Agreements, involving the states concerned and the respective TIFs, rather than traditional loan facilities. The Reimbursement Agreements differ in many respects from the previous loan agreements for settlement of minimum guarantees for Landsbanki's depositors in the UK and the Netherlands. They provide for the Icelandic TIF to repay to the UK and Dutch authorities the amounts which they advanced for this purpose, and to receive in return the corresponding portion of their claims against the bank's estate and handle their collection. Before this is effected, the Icelandic TIF is expected to utilise the funds it already possesses for reimbursement. Thereafter, payments will be made following distributions from Landsbanki's estate until the end of June 2016.
9. **Liability of the state** is limited as far as possible and in fact solely limited to (a) payment of interest as it accrues until June 2016, and (b) the portion which has not been recovered from the bank's estate after that time (the shortfall).
10. **Interest.** The interest provisions of the new agreements differ substantially from the contractual provisions of previous agreements.
 - Firstly, the interest rate is fixed until mid-2016. Interest on the Dutch portion of the loan is 3.0% and 3.3% on the UK portion. The average interest rate is approximately 3.2%.
 - Under the agreements no interest is calculated on the obligations until after 1 October 2009 (equivalent to a 9-month interest holiday as compared to the previous agreement).
 - Accrued interest for 2009 and 2010 is paid at the beginning of 2011.
 - Interest is paid quarterly from the beginning of 2011 until mid-2016.
 - In the second phase, under the agreement the interest on any outstanding principal on the loans after mid-2016 will be the appropriate Commercial Interest Reference Rates (CIRR), or documentary credit interest, as calculated and published by the

OECD, without any interest premium. These interest rates are generally the very lowest used in credit agreements between public parties.

11. **Macroeconomic provisos.** The agreement includes two macroeconomic provisos, which on the one hand place a ceiling on annual payments from the treasury and on the other hand extend the term of the loan automatically if the outstanding principal remaining of the TIF's obligations is higher than a specified amount, in proportion to the amount remaining.
- **Ceiling on annual payments** by the state after 2016 of 5% of Treasury revenue of the preceding year. Should the amount equivalent to this proportion of the state's revenue prove to be lower than 1.3% of GDP, the maximum repayment shall be based on this percentage of GDP (1.3% of GDP is currently equivalent to around ISK 20 billion).
 - **Extension of the loan term.** If the outstanding principal of the TIF's obligations amounts to less than the equivalent of ISK 45 billion, this is to be paid in full within 12 months, i.e. in the latter half of 2016 and the first half of 2017. In the event that the outstanding obligation is higher, the repayment period is lengthened by one year for each ISK 10 billion, although with the limit that the amount outstanding must be paid by the end of a 30-year repayment period beginning in 2016.

The above-mentioned provisions are to ensure categorically that repayments of Icesave obligations will always be within quite manageable limits. It is unlikely that the above-mentioned ceiling on payments will in fact be tested, as the annual debt service will be well below this amount.

12. **Legal questions.** Various legal issues have been amended to Iceland's advantage from previous agreements, including acceleration clauses, default provisions, reference amounts and payment deadlines. Most significant, however, is that dispute resolution is transferred from jurisdiction of UK courts to that of the Permanent Court of Arbitration in The Hague. Should any issue concerning the agreements be referred to this Court, the parties would each appoint their representative and the representatives then agree on a third arbitrator. This means that, in cases concerning Iceland, one party on the arbitration committee will always be appointed by Iceland.

The draft agreements retain similar provisions as before concerning consultations by the parties, should the economic situation in Iceland give cause for such; it is clearly stated that limits on inviolable rights shall not affect those rights of the state which enjoy protection under the Vienna Convention on Diplomatic Relations, those assets in Iceland which are vital to Iceland as a sovereign state, or the assets of the Central Bank of Iceland. Last but not least, a similar clause as before is included on natural resources.

13. **Cost.** The negotiating committee has estimated the cost which Iceland can be expected to incur in implementing the agreement. This estimate is based on an assessment by Landsbanki's Resolution Committee of recovery of the estate's assets,

the outlook for distributions to creditors, as estimated by the bank's Winding-up Board, and assumptions of the Central Bank of Iceland concerning exchange rate developments.

The conclusion of this estimate is that the cost which will be borne by the Treasury will be less than ISK 50 billion, or just over 3% of GDP. This is assuming that some ISK 20 billion of the current assets of the TIF have been utilised for the obligations.

The above outcome implies that only interest cost will be borne by the Treasury. At the beginning of next year, payment will be made of accumulated interest, totalling ISK 26 billion, of which ISK 6 billion will come from the Treasury. The following year payments should be around ISK 17 billion, decreasing rapidly in subsequent years. Payments should be complete in 2016.

Based on the current assumptions for recovery of the assets from the insolvent estate, the cost of the previous agreement would have amounted to over ISK 180 billion (approx. ISK 162 billion if the assets of the TIF are taken into consideration). Due to a number of factors, the cost has been decreasing. Here lower interest rates are of most significance (interest rates have remained low on international markets) together with ISK appreciation since April 2009, as the amount of claims is based on the exchange rate at that time. The cost therefore is equivalent to less than one-third of the previous cost assessment.

14. **Risk factors** in the agreements are primarily three and concern the recovery of the assets of Landsbanki's estate, the timing of payment of claims and exchange rate developments.

The outlook for recovery from Landsbanki's estate is more certain now, however, than when this matter was previously dealt with by the *Althingi* and the bank's Resolution Committee has now acquired full control of its assets in the UK and the Netherlands. In its report to a creditors' meeting on 9 November 2010, the Resolution Committee estimated that distributions would cover 86% of priority claims. Valuation of assets has proven to be realistic and cautious. The possibility cannot be excluded, however, that unforeseen changes could occur which would affect recovery of the bank's claims. Asset recovery could be lower than currently anticipated, but it could also improve. Delays in making distributions from Landsbanki's estate could increase the amount of accumulated interest on the principal. It is, in particular, delays in resolving court disputes which could result in such postponement. The estimates provided above are based on the current assessment of the Winding-up Board regarding distributions.

Finally, the ISK exchange rate, and relative exchange rates of the various currencies concerned, also affect what the total cost to the Treasury may be. As previously mentioned, ISK strengthening since April 2009 has resulted in a reduction. The conclusion, that the state's total cost of the Icesave agreements will amount to around ISK 47 billion, is based on assumptions by the Central Bank which provide for further ISK appreciation in coming years.

15. **Infringement proceedings.** As is known, the EFTA Surveillance Authority (ESA) has issued a letter of formal notice to the Icelandic authorities for infringement of provisions of the EEA Agreement. Should no agreement be reached to resolve the dispute, this action can be expected to continue in the traditional manner, i.e. with the delivery of a reasoned opinion from ESA and, as the case may be, referral of the case to the EFTA Court. Such a procedure could last for up to two years. If the outcome were to be unfavourable to Iceland, questions could arise concerning the state's liability together with specific problems in the implementation of the EEA Agreement thereafter. It is established that ESA will withdraw the afore-mentioned action if Iceland, the UK and the Netherlands arrive at an agreement to resolve the Icesave dispute.

Based on this new agreement, a draft bill of legislation has been prepared, which has been presented to the leaders of the parties represented in parliament. The main substance of this Bill involves authorisation to endorse the new agreements with the UK and Dutch governments, confirming that in accordance with them the Treasury may be obliged to bear the cost of outstanding amounts and interest on claims by the British and Dutch for having advanced funds in payment of minimum deposit guarantees for accounts in Landsbanki's branches in the UK and the Netherlands.

The agreements were initialled by the countries' negotiators in London yesterday, 8 December 2010. As previously stated, this initialling merely attests to the outcome which has been obtained in negotiations between the countries. It is established that the agreements will not be signed unless the *Althingi* has given its consent for the government to undertake these obligations.