

Chapter 17

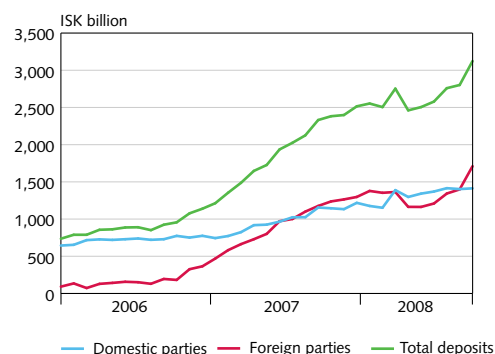
The Depositors' and Investors' Guarantee Fund and Deposit Guarantees in general

17.1. Deposits increased from 530 billion to 3,100 billion in four years

The Depositors' and Investors' Guarantee Fund (TIF) was established in its current form by Act No. 98/1999 on Deposit Guarantees and Investor-Compensation Scheme, and began operations on 1 January 2000.¹ At the beginning of 2000, deposits in the Icelandic banks amounted to over ISK 250 billion. Assets of the Guarantee Fund at that time came to about ISK 2.9 billion or around 1.2% of deposits. At the time of the collapse of the large banks in Iceland in October 2008, deposits of parties other than financial institutions in the Icelandic banking system amounted to over ISK 3,100 billion.² Of that amount a little over ISK 1,700 billion had been deposited with the branches of the Icelandic banks abroad. As may be seen in Figure 1, this increase in deposits mainly took place in 2007 and 2008, or a total of 303%, the majority of which was raised abroad, and in 2007 deposits in the banks owned by foreign parties exceeded 50% of total deposits. According to information submitted by the Guarantee Fund, its assets at the end of September 2008 amounted to ISK 13 billion (ISK 16.5 billion at the end of 2008), in addition to which letters of guarantee amounting to ISK 6 billion issued by banks and savings banks were regarded as assets at the end of September. When the banks collapsed these letters of guarantee became almost worthless. On the assumption that the Guarantee Fund's assets amounted to ISK 13 billion these came to less than 0.41% of existing deposits at the time of the collapse of the big banks.

This substantial increase in deposits not only had the effect of altering the financing of the Icelandic banks, especially Landsbanki and Kaupthing, over a short period of time. Foreign creditors in the form of banks and security holders had been replaced by a large number of foreign depositors who entrusted the Icelandic banks with their savings. Therefore, this did not only entail a manifold increase in aggregate deposits in the Icelandic banks, and consequently deposits covered by the Guarantee Fund, but also led to the fact that about half of the deposits were in foreign currencies and deposited with the banks' branches abroad.

Figure 1
Total Deposits within the Icelandic
Banking System
Domestic and Foreign Parties



Source: Central Bank of Iceland.

Deposits in the Icelandic banks increased by 571% in 2004-2008, of which 303% was in 2007-2008. Deposits by foreign parties increased by over 50% in 2007.

1. See generally about the operations of the Guarantee Fund in an article by Hallgrímur Ásgeirsson: "Tryggingarvernd innstæðueigenda og fjárfesta", in *Financial Stability* 2005, pp. 59–70.

2. Deposits of others than financial undertakings according to data from CBI. Based on end of December 2003 until end of September 2008.

Iceland's membership of the EEA Agreement, which entered into force on 1 January 1994, led to considerable changes in the operating environment of the Icelandic financial institutions and the rules governing their operations. When the Agreement entered into force, the rules on deposit guarantee schemes were under revision at the level of the European Community (EC). Subsequently, Directive 94/19/EC on deposit-guarantee schemes was adopted in mid-year 1994. Following this, the revision of the former rules on deposit guarantee schemes was launched in Iceland in accordance with the EC directive on the subject. The first legislative instrument on the subject was Act No. 39/1996. Current legislative provisions on this issue are to be found in Act No. 98/1999 on Deposit Guarantees and Investor-Compensation Scheme. The latter Act was adopted for the express purpose of implementing into Icelandic law a new directive of the European Union (EU) on investor-compensation schemes, which provided for coordinated rules on a minimum level of protection for investors with claims against securities firms and credit institutions in connection with securities trading, against the insolvency of the firm/institution in question.

In accordance with the EEA Agreement, Iceland was bound to implement into Icelandic law EC directives on deposit-guarantee schemes and investor protection. These rules were laid down as part of the EU directives on the free movement of capital and authorisation for financial institutions to operate across borders within the Community, and also within the EEA Member States following the adoption of the EEA Agreement. Based on these rules, it follows that if an Icelandic bank establishes a branch abroad and starts receiving deposits there, those deposits will automatically fall under the Icelandic deposit-guarantee scheme, including the Depositors' and Investors' Guarantee Fund. Additionally, in some cases there is supplementary compensation (the so-called "topping-up") which the bank negotiates with the deposit-guarantee scheme of the country (host state) where the branch is located. According to EU directives, foreign banks shall have the option to become members of the host state's deposit-guarantee scheme if that scheme's minimum amount guaranteed is higher than that offered by the home state's guarantee fund. If the Icelandic bank operates through a subsidiary registered in the host state, the deposits received by the subsidiary are covered by that state's deposit-guarantee scheme.

Despite the extensive increase in deposits received by the Icelandic banks over the past few years, particularly abroad, no amendments were made to the Guarantee Fund's operating rules, including on obligations regarding payment into or disbursements from the Fund. It should be noted, however, that data available to the Special investigation commission clearly show that the Guarantee Fund's position was repeatedly discussed at government level, primarily in 2008. On account of the increase in deposits, liabilities of the Guarantee Fund had multiplied over a short period of time. In a meeting between three ministries, the Central Bank and the Financial Supervisory Authority (FME) on 2 October 2008, the FME's Director General stated that the calculations made that summer revealed that the amount guaranteed by the Guarantee Fund was ISK 722 billion. As may be seen, e.g. from the discussion in Chapter 17.10.2, clear numerical data on the Guarantee Fund's financial liabilities were lacking until after the bank collapse.

In its examination, the SIC noticed that although the Icelandic banks had already started raising deposits in their foreign branches in 2006, with the increase peaking in 2007, especially as concerns the Landsbanki Icesave accounts, it was not until 2008, to name an example, that the transfer of the deposit-taking activities from the branches to subsidiaries (i.e. subsidiarisation) was discussed. Such plans were first made by Landsbanki in February 2008 and then in response to discussions that had taken place in the UK, including on the situation of the Guarantee Fund. Subsequently, the Icelandic authorities began discussing the transfer of the deposit-taking activities over to subsidiaries and also took this discussion up with the banks, but the transfer in the case of the Landsbanki Icesave accounts never materialised. As described in detail in Chapter 18, it was eventually the UK Financial Services Authority (FSA) that pressed in particular for the transfer of the Landsbanki Icesave accounts into a UK subsidiary in the summer of 2008.

From August 2008 to the beginning of October of the same year, the Ministry of Business Affairs and the Guarantee Fund received enquiries from authorities and deposit-guarantee funds, inter alia in the UK, Sweden and the Netherlands, seeking answers to specific questions concerning the Guarantee Fund's operating rules and its situation. The foreign parties specifically requested information on how the State would support the Guarantee Fund in case it was unable to meet its obligations under Icelandic laws and EU directives. These communications and the replies of the Guarantee Fund and the Icelandic authorities will be discussed later.

In the evening news of the Icelandic National Broadcasting Service on Friday 3 October, Prime Minister Geir H. Haarde and Minister of Business Affairs Björgvin G. Sigurðsson were interviewed and their statements on that occasion concerning depositor's deposits are referred to in the margin. In interviews with news reporters outside the government guest house in the evening of 5 October 2008, the Prime Minister iterated that deposits in the Icelandic banks and savings banks in Iceland were fully guaranteed. On the morning of 6 October at 08:51, a news bulletin was published on the website of the Prime Minister's Office wherein the Icelandic Government reaffirmed that deposits in the domestic commercial banks and savings banks and their local branches would be fully guaranteed.³ In a television address at 16:00 on 6 October 2008, the Prime Minister declared that deposits of Icelanders in all the banks were guaranteed and that the Treasury would ensure that such deposits would be fully paid to the depositors.

On the basis of Act No. 125/2008, the Emergency Act, the FME decided that liabilities arising from deposits of financial institutions, the Central Bank and individual customers in the branches of Landsbanki Íslands hf., Glitnir hf. and Kaupthing Bank hf. in Iceland would be transferred to the three new banks that were established on the foundations of the collapsed banks. The Emergency Act also introduced an amendment, cf. Article 6 of the Act, stipulating that when winding up the estate of a financial institution, deposit claims would be regarded as priority claims under the Act on Deposit Guarantees and Investor-Compensation Scheme, but not as general claims as

"We will protect the depositors and there is absolutely no reason for anyone to fear that their deposit is not safe in the banks here. [...] Depositors of the banks here in Iceland need not have any fear of their situation".

Prime Minister Geir H. Haarde, on the evening news of the Icelandic National Broadcasting Service, 3 October 2008.

"The depositors' deposits are safe".

Business Minister Björgvin G. Sigurðsson, in the evening news of the Icelandic National Broadcasting Service, 3 October 2008.

3. Cf. statement by the government from 6 October 2008, published in full in Chapter 17.17.6.

would otherwise have been the case pursuant to general rules. This priority applies equally to deposits in local branches and branches abroad.

During 2009, the FME made decisions on the basis of the Emergency Act on the transfer of deposits of other Icelandic banks and savings banks that have become insolvent, including SPRON and Straumur, to other banks. Due to the aforementioned FME decisions, the volume of claims that might be brought against the Guarantee Fund, originating from deposits in local branches of the Icelandic banks, has not been put to the test.⁴ The obligations that may remain with the Guarantee Fund relate to deposits in the branches of the Icelandic banks abroad. According to information from the Guarantee Fund (from 27 November 2009), the Fund had then received claims for disbursements because of the Icesave accounts in the Landsbanki branches in the UK and the Netherlands in addition to claims originating from wholesale deposits and money market accounts in these same branches, and the Glitnir UK branch. When this information was provided to the SIC, the Guarantee Fund had not determined the total amount of those claims in case the minimum amount of EUR 20,887 was paid to each account holder. The Depositors' and Investors' Guarantee Fund is a private foundation managed by a special board largely comprised of representatives of financial institutions. Despite the fact that this was the legal position of the Guarantee Fund as stipulated by law, the Fund's situation and any possible involvement and obligation of the State to enable the Fund to pay the minimum amount to account holders with deposits in branches of the Icelandic banks abroad gave rise to enquiries by representatives of foreign authorities to the Fund and the Icelandic authorities from the beginning of August 2008 and until after the collapse of the three banks in October 2008. Although these enquiries were partly directed to the Guarantee Fund, the fact that the Chairman of the Fund's Board of Directors held at the same time the position of Director at the Ministry of Business Affairs meant that this individual acted alternatively, e.g. vis-à-vis foreign parties, as an official and the Chairman of the private foundation. It is evident from the information acquired by the SIC that those in authority in Iceland were to a degree uncertain as to how to reply to these enquiries and in a number of cases there was a delay in providing those answers. There were also different views within the Icelandic administration as regards the Icelandic State's possible responsibility if the Guarantee Fund would be unable to meet its obligations. The answers and information presented by the Icelandic authorities and persons in authority to representatives of foreign authorities evoked reactions by the latter as regards depositors of branches of the Icelandic banks abroad and the banks themselves, and partially also the Icelandic State and other Icelandic companies. Following this, there was a debate on the Icelandic State's responsibility, and the opinion was broached at EU/EEA level that the Icelandic State had the obligation to see to it that depositors of branches of the Icelandic banks abroad would be paid the minimum compensation provided for in the EU Directive 94/19/EC on deposit-guarantee schemes, and the Act on the Depositors' and Investors' Guarantee Fund.

4. According to information from the Guarantee Fund (27 Nov. 2009) there is, however, disagreement about certain claims concerning Straumur hf. and claims have consequently been made against the Guarantee Fund. Furthermore, claims have been made because of so-called money market deposits in the banks' place of business in Iceland.

The settlement of these obligations of the Guarantee Fund became the object of negotiations between representatives of the Icelandic government and the governments of the UK and the Netherlands. The deposit-guarantee schemes in those countries had, with the support of their governments, paid the owners of deposits covered by the Guarantee Fund *inter alia* the minimum compensation, EUR 20,887 (in some cases the amount was higher), and the topic of the negotiations was the Fund's repayment of this amount, as well as the demand made by both states that the Icelandic State would guarantee the Fund's repayment. This was therefore a matter of the repayment of funds these foreign deposit-guarantee schemes had already paid to the depositors with the support of the governments of the UK and the Netherlands. For this reason, no private law relationship was in place that would otherwise have existed between the Guarantee Fund and individual depositors with the appropriate judicial remedies concerning court procedures.

In order to shed a light on whether arrangement and position of the Icelandic deposit-guarantee scheme may have contributed to the collapse of the banks in October 2008, the SIC considers it appropriate to examine the implementation of the EU directive on deposit-guarantee schemes into Icelandic law, the obligations imposed by the directive, general issues concerning the Guarantee Fund, and how deposits and deposit guarantees featured in the Icelandic authorities' contingency planning. The same applies to answers and communications between Icelandic and foreign administrators and representatives of guarantee funds before and during the collapse of the Icelandic banks. The SIC notes that its examination and discussions on the implementation of Directive 94/19/EC into Icelandic law and the resulting obligations of the Icelandic State are not aimed at taking a position on the basis or content of the agreements made by the Guarantee Fund, with the support of the Icelandic State, regarding deposits in the so-called Icesave accounts in the Landsbanki branches in the UK and the Netherlands. The same applies to the state guarantee for the agreements later adopted by the Icelandic Parliament. The SIC's task is to discuss the events leading to the collapse of the Icelandic banks in October 2008 and the adoption of Act No. 125/2008, the Emergency Act. However, the content of the deposit-guarantee scheme directive, its implementation into Icelandic law, and the obligations of the Icelandic State, including the possible obligations of the Icelandic Treasury, is significant when discussing the events leading to the collapse of the banks in the autumn of 2008. What were those obligations? How did the authorities react in regard to these and what actions were taken to prevent and/or minimise the possible damage to the Icelandic State – i.e. the Icelandic public – in case of a crisis in the operations of the Icelandic banks? The SIC was entrusted with the task of assessing whether mistakes or negligence occurred in the course of the implementation of laws and regulations on financial activities in Iceland and surveillance thereof, and who may be responsible in this regard. The implementation into Icelandic law of the EU directive on deposit-guarantee schemes was part of this implementation of laws, and the SIC's examination therefore focused on whether this entailed mistakes or negligence. Rules on the operation of the Guarantee Fund and deposit guarantees, as well as possible statements made by the authorities concerning State guarantee of such deposits, form part of a set of rules on financial activities and the authorities' contingency plans to retain and ensure financial

stability. The following SIC discussion on deposit guarantees and operations of the Guarantee Fund will for the most part address the events and situations leading up to the collapse of the banks.

The SIC points out that although the rules of Act No. 98/1999, the EU directives on which it is based, and thereby the operations of the Guarantee Fund, cover both guarantees of deposits with the commercial banks and savings banks and investors' guarantees in regard to trading in securities, the following discussion will first and foremost concern the former aspect. This is based on the importance of these factors in the events leading to the collapse of the banks and the effects of the collapse. Several legal issues may arise on account of any possible demands brought against the Guarantee Fund's securities department in relation to the collapse of the banks, but these will not be discussed specifically in this Chapter as their conclusions may rely heavily on individual circumstances.

17.2 Why deposit guarantees?

The receipt and safeguarding of deposits of depositors and customers has long been an important element in the operation of banks. Depositors may have various reasons for entrusting banks with their money to get interest on it. Banks lend out this money in return for interest and fees. The banks' lending rate is always higher than interest on bank deposits which makes it possible for the bank to cover its operating costs and possible risks if loans are not recovered. Deposits are generally short-term, and can in many cases be withdrawn without notice, whereas loans are generally for longer terms and the debtors can not be required to pay without notice. For this reason, deposit institutions are generally at risk because of the disparity between the maturity of deposits and loans. If the majority of depositors requests to withdraw their deposits simultaneously this can cause considerable liquidity difficulties for the bank. If this was the case the bank's ability to access liquid assets to disburse the deposits would be put to the test. A large number of depositors of a specific bank may wish to withdraw their deposits simultaneously for various reasons although historically this can in most cases be attributed to either fear or rumours to the effect that the bank in question is weak or that weaknesses have been revealed in the financial system of the state or area in question. The fact that customers arriving at the bank first are able to withdraw all their deposits, possibly at the expense of other depositors, considerably increases the risk of a run on the bank, as no-one wants to be last and return empty handed.

A deposit-guarantee scheme was established in the USA in 1933 during the Great Depression. Amongst other things, the turmoil and difficulties in the operation of banks and financial institutions at that time led depositors to react by suddenly withdrawing their money. This in turn increased the difficulties of individual banks and of the whole financial system, thereby creating a vicious circle. From the onset, the idea behind establishing deposit-guarantee schemes was to increase, in advance, trust in the banks and reduce the likelihood of bank runs in the form of deposit withdrawals. Therefore, a deposit-guarantee scheme mostly concerns the stability of the financial system. The arrangements of these deposit guarantees vary between nations. Thus, it varies whether they are administered by government agencies or

private law bodies. The way in which these guarantees are financed is by the same token varied, as well as the compensation criteria. At international level, various transnational organisations, such as the International Monetary Fund (IMF), the Bank for International Settlements (BIS), and the Organisation for Economic Cooperation and Development (OECD), have organised data collection on the deposit-guarantee schemes and issued guidelines on the preferred arrangement of these matters.

In discussions on deposit guarantees, it has been emphasised that their existence must not lead to what is termed a “moral hazard”. This refers to not allowing the arrangements of such deposit-guarantee schemes to reduce the stimulus for depositors to monitor and restrain the banks with which they deposit their money and in this way look after their own money. When depositors relax their monitoring of the deposit institutions, this creates scope for the latter to take increased risks, and thereby increase their potential profits. Therefore, there is every danger that because of deposit guarantees banks will become increasingly risk-taking in their lending and other activities. Consequently, it is considered that a direct and a priori state guarantee of deposits and the obligations of deposit-guarantee schemes is likely to undermine the responsible behaviour of depositors which in turn leads to risk-taking by the banks, e.g. in their lending activities. It is of great importance to maintain a responsible behaviour of those parties, that they can not depend, a priori, on the State in question to compensate lost bank deposits. However, a State’s decision to take such measures may be part of a response to difficulties in the financial markets which are likely to threaten financial stability. This measure may be similar to acting as a lender of last resort because of difficulties in the financial system. Furthermore, it is often pointed out that declarations of state guarantees on bank deposits are temporary and intended as part of measures to stabilise financial markets. In most states, the deposit-guarantee schemes are financed through contributions by banks and other deposit institutions into the fund in question, a predetermined percentage of their deposits. In addition, it varies whether these contributions are collected, i.e. paid in advance (ex ante) or paid after the fact, i.e. after the fund has compensated for lost deposits (ex post). In discussions on the arrangements of deposit-guarantee schemes, it is commonly pointed out that these guarantee schemes are collectively financed by the banks and deposit institutions of the country in question, and therefore, the failure of one bank financially affects, in this regard, the others. Likewise, it is pointed out that the contributions the banks pay into a guarantee fund must be reasonable so as not to tie down too much capital in the fund at any given time.⁵

As was pointed out above, the arrangements of deposit-guarantee schemes vary considerably between individual states. A comparison of these schemes reveals that their arrangements, e.g. a relatively high minimum amount guaranteed and direct state guarantee of the minimum amount,

5. See e.g. Demirgüç-Kunt, Asli; Edward J. Kane and Luc Laeven: cf *Deposit insurance around the world* cf. (World Bank) London 2008, in particular pp. 253-279; Misita, Nevenko: “Depositor Protection: An EC law perspective.” cf *Journal of International Banking Regulation* cf, 2003 Vol. 4, No. 3, pp. 254–274. Ognjenović: “Basic Principles of Financial Planning in Ex-ante Deposit Insurance Schemes.” cf *Financial Theory and Practice* cf, 2006 30 (4), pp. 369–380. See also documents and information in link: http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm.

tend to reflect whether or not the state in question has been recently hit by a banking crisis. In this context, it is worth mentioning that the highest minimum amount guaranteed within Europe is in Norway, NOK 2 million, and Sweden provided for a state guarantee of the deposit-guarantee scheme's obligations when rules on the guarantee fund were changed according to the Directive of the European Parliament and the Council of 30 May 1994. In both of these countries, the banks ran into considerable difficulties around 1990, and the State in each country partially took over the operation of the banks and supported them.

Deposit-guarantee schemes, and not least the way individual states react to limit extensive withdrawals from deposit accounts during a banking crisis or the period leading up to it, are in fact closely related to the measures authorities have been prone to take to protect or renew the financial and banking systems of the state in question. If individual states have not made any commitments on grounds of transnational or bilateral agreements, to establish an arrangement in this regard in a specific manner, each State has the sovereign right to have its competent authorities exercise its powers to determine which rules are applicable and which public funds shall be used.

An example of such transnational rules to coordinate and limit the powers of individual states to determine their own arrangement of deposit guarantees and state involvement in guaranteeing bank deposits, are the rules of the European Union, and consequently the rules of the EEA Agreement inasmuch as they concern these matters. These rules are twofold. In the period relevant in this case, these are rules set out in Directive 94/19/EC of 30 May 1994 on deposit-guarantee schemes and, where applicable, Directive 97/9/EC of 3 March 1997 on investor-compensation schemes, but, as will be discussed later, the former directive was amended at EU level through a process that began in October 2008 and ended on 11 March 2009.

These directives set out specific minimum rules which the Member States are obliged to follow. They are then authorised to determine further rules on these matters and can provide, *inter alia*, for increased rights for depositors beyond the minimum rights set out in the directive, notwithstanding a later set of rules which limit the Member States' authorisation to do so. This later set of rules includes *inter alia* rules of European law on the limitation of state aid, rules on competition and the prohibition of discrimination on the basis of nationality. Provisions in individual directives on financial institutions, e.g. Directive 2001/24/EC of 4 April 2001 on the reorganisation and winding up of credit institutions, can also limit which arrangements the Member States are authorised to apply regarding deposit guarantees and the settlement of related obligations.

In respect of the aforementioned EU directives on deposit-guarantee schemes and investor-compensation schemes, it must be noted that they are adopted as a step in facilitating the free movement of capital within the EU and the EEA. Although capital movement was once part of the so-called four freedoms within the EU (formerly the EC), capital movement was not, for a considerable time, as free as the movement of goods. It was not until Directive 88/361/EC for the implementation of the existing Article 67 of the Treaty of Rome, was adopted that complete freedom of capital movement between the EU Member States was established. Nonetheless, several states were granted a derogation from this until 1 January 1993. On the basis of

this directive, members of the public in the area were able to open bank accounts in other Member States.⁶ The European Commission had issued, on 22 December 1986, a recommendation concerning the introduction of deposit-guarantee schemes in the Community (87/63/EEC), but as the Member States' actions following the recommendation were not considered to have yielded the expected effects and that this might prevent the proper functioning of the internal market, as it was put in the preamble to Directive 94/19/EC, the rules on deposit guarantees within the EU were revised. The revision concluded with a directive of the European Parliament and the Council (94/19/EC) of 30 May 1994, which provided for the obligation of the Member States to establish deposit-guarantee schemes which would fulfil certain minimum rules set out in the directive. In the preamble to the directive, it is stated that its objective is primarily to deal with the situation where banks in a Member State no longer require authorization to open branches in other Member States "because the single authorization is valid throughout the Community, and its solvency will be monitored by the competent authorities of its home Member State" (see paragraph 7 of the preamble). With the EEA Agreement Iceland and Icelandic companies became part of that area and belonged to the parties holding the single authorization to operate in the financial market.

17.3 Introduction of Deposit Guarantees in Iceland and Compliance with European Law

When discussing the introduction of special protection or other means of guarantee for depositors in Icelandic banks, it must be kept in mind that during most of its existence, the Icelandic banking system was divided into two sectors. On the one hand, there were the state-owned commercial banks, and on the other hand, the savings banks.

As regards the state-owned commercial banks, it was directly stipulated by law that the State Treasury was responsible for all their obligations, see e.g. Article 4 of Act No. 115/1941 on the Agricultural Bank of Iceland (hereinafter *Búnaðarbanki*), Article 2 of Act No. 11/1961 on the National Bank of Iceland (hereinafter *Landsbanki*), and Article 8(3) of Act No. 43/1993 on Commercial Banks and Savings Banks, which provided that the Treasury was responsible for all obligations of the commercial banks. This guarantee by the State Treasury covered, inter alia, deposits in the state-owned commercial banks and was not abolished until they were turned into limited-liability companies, the last two being *Landsbanki* and *Búnaðarbanki*, in 1997, cf. Act No. 50/1997. In the period 1951-1970, the Icelandic parliament adopted a special law authorising the establishment of four banks owned by limited-liability companies⁷, and *Útvegsbanki Íslands hf.* (The Fisheries Bank of Iceland) became a state-owned commercial bank following the parliament's decision to expropriate the bank's equity securities, see Act No. 34/1957.

6. Stefán Már Stefánsson: *Evrópusambandið og Evrópska efnahagssvæðið* (The European Union and the EEA). Reykjavík 2000, p. 505.

7. These were Acts on the establishment of the banks *Lönaðarbanki*, *Verslunarbanki*, *Samvinnubanki* and *Alþýðubanki*.

When the Act on Savings Banks was revised in 1941, a special fund, the Deposit Protection Fund of Savings Banks, was established. The purpose of the Fund was to guarantee deposits in the savings banks and disbursements from them, cf. Article 17 of Act No. 69/1941 on Savings Banks. Until 1985, the Fund was owned by the savings banks in proportion to their contributions, but with Article 49 of Act No. 87/1985, a new fund was established under the same name, with the clear statement that it was a private foundation.

In 1985, a new law on commercial banks was under parliamentary discussion. Following a proposal for amendment it was agreed to establish the Deposit Protection Fund of Commercial Banks.⁸ Article 51 of Act No. 86/1985 stated that the Deposit Protection Fund was a separately funded independent state-owned body, the objectives of which were to ensure the full refunding of deposits when the estate of a commercial bank was wound up. It was stated that the total assets of the Deposit Protection Fund should be aimed at 1% of the overall deposits of the banks' customers in deposit accounts. To that end, each commercial bank was to make an annual contribution to the Fund, no later than 1 March each year, amounting up to 0.15% of the overall deposits, as further stipulated in a ministerial decision. The Minister of Commerce oversaw the administration of the Deposit Protection Fund and had the responsibility to issue a regulation *inter alia* laying down more detailed provisions on the Fund's Board of Directors.

When the Act on Commercial Banks and Savings Banks was revised in 1993 (cf. Act No. 43/1993) existing provisions on the Deposit Protection Fund of Commercial Banks and the Deposit Protection Fund of Savings Banks were mostly left intact, save for a special provision on the Board of Directors of the independent state-owned body, the Deposit Protection Fund of Commercial Banks, which was to be comprised of six members. Three members were to be appointed following nominations by the Icelandic Bankers Association, one nominated by the Central Bank, one by the Minister of Finance and one, the chairman, by the Minister of Commerce.

The EEA Agreement entered into force on 1 January 1994. At that time, work on the harmonisation of rules on deposit-guarantee schemes within the European Community had been ongoing for some time. This work resulted in Directive 94/19/EC of the European Parliament and the Council of 30 May 1994 on deposit-guarantee schemes. The EEA Joint Committee decided, in its meeting on 28 October 1994, that this directive should become part of the EEA Agreement and its provisions were to take effect no later than 1 July 1995.

On 11 December 1995, the Minister of Commerce submitted a bill to Parliament on various amendments to Act No. 43/1993 on Commercial Banks and Savings Banks, *inter alia* in reaction to the new EC directive on deposit-guarantee schemes, and to incorporate in Icelandic law the substance of the directive. Amongst other things, it was suggested that a new fund, the Deposit Protection Fund of the Deposit Institutions, be established to take over the role of the Deposit Protection Fund of the Commercial Banks and the Deposit Protection Fund of the Savings Banks.⁹ According to the bill, the Fund was to be a private foundation and its main role was

8. Parliamentary record 1984-1985, A-section, pp. 4040-4042.

9. Parliamentary record 1995-1996, A-section, p. 1850.

to ensure that depositors would be refunded their deposits upon request when a commercial bank or a savings bank was, in the opinion of the Bank Inspectorate, unable to make the payment immediately or in the near future due to payment difficulties.¹⁰ As in the case of the Deposit Protection Fund of the Commercial Banks, the bill provided that the total assets of the deposit department of the Deposit Protection Fund of the Deposit Institutions should be aimed at a minimum of 1% of the overall deposits guaranteed in the commercial banks and savings banks. To that end, each commercial bank and savings bank was to make an annual contribution to the Fund, no later than 1 March each year, amounting to 1% of the average increase in guaranteed deposits in the commercial bank or savings bank in question in the previous year.¹¹ In Article 16(4)(e) of the bill, which was to become Article 79 of the Act if the bill was passed, there was a provision on how the Fund's assets should be divided between depositors if the assets were insufficient to pay all demands. The minimum amount was set at ISK 1.7 million, but was to be tied to the value of the Euro. For more information, see the proposed provision in the margin.¹²

The commentary pertaining to the bill discusses, *inter alia*, the content of the EC directive on deposit-guarantee schemes from 1994 and notes that this directive replaced the European Commission's recommendation from 1986 for the establishment of deposit-guarantee schemes at Community level. Reference was made to the necessity of harmonising the arrangements of deposit guarantees within the European Union since a common market for banking services had been established. It was stated that the Member States should make provision for an officially recognised system of deposit guarantees and being a member of such a system was a prerequisite for the authorisation of a deposit institution. In addition, the guarantee should also cover deposits in overseas branches of local financial undertakings. The bill also discussed a disagreement between the EC Member States existing at that time on the effect of the new directive on the banks' transnational competitive conditions, as the amounts guaranteed varied between countries. It was furthermore stated that the minimum guarantee according to the directive should be EUR 20,000 (at the time just less than ISK 1.7 million)¹³ and this amount applied to individual depositors and not to deposit accounts.¹⁴ Following this, the commentary goes on: "It is worth mentioning that according to the directive a state guarantee or guarantee by other public bodies of the obligations of a commercial bank or savings bank can not replace deposit guarantees".¹⁵

The comments on individual Articles of the bill further discuss its provisions, but as previously stated it was proposed that a new fund be established, the Deposit Protection Fund of Deposit Institutions, which would be a private foundation. The comment with Article 16 of the bill on a new Article (Article 75) in the Act on Commercial Banks and Savings Banks,

"In the event that the assets of the Guarantee Fund of the Deposit Institutions are insufficient to pay the total amount of guaranteed deposits in the commercial bank or savings bank concerned, the payment from the Fund shall be divided between depositors so that the total deposit of each depositor, up to ISK 1.7 million, shall be compensated in full and any amount in excess shall be compensated for in equal proportions to the extent permitted by the Fund's assets." "This amount shall be linked to the value of the European Currency Unit (ECU) at the exchange rate on 3 January 1995." "No further claims can be made against the Fund at a later stage even if losses suffered by claimants have not been compensated in full." "The Board of Directors may, if it sees compelling reasons to do so, borrow funds in order to compensate losses suffered by claimants, should the total assets of the Fund prove insufficient."

The Parliamentary Records, 1995-1996, A-section, p. 1842.

10. Parliamentary record 1995-1996, A-section, p. 1855.

11. Parliamentary record 1995-1996, A-section, pp. 1842 and 1856-1857.

12. Parliamentary record 1995-1996, A-section, p. 1842.

13. In Article 10(1) of Act No. 98/1999 the minimum amount guaranteed by the Guarantee Fund is ISK 1.7 million and the amount is based on the exchange rate of the Euro on 5 January 1999 (1.700.000 : EUR 81.39 = EUR 20.887).

14. Parliamentary record 1995-1996, A-section, pp. 1845-1849.

15. Parliamentary record 1995-1996, A-section, p. 1849.

if the bill was passed, states: “The Deposit Protection Fund of Commercial Banks is state-owned but the Deposit Protection Fund of Savings Banks is a private foundation. It is assumed that the new Fund be a private foundation. Neither the State Treasury nor the commercial banks and savings banks, which are members of the Fund, will be responsible for its obligations.”¹⁶

In the comments in the bill regarding the Fund’s payments of the minimum compensation of EUR 20,000, it was pointed out that the situation could arise that the Fund would not have sufficient assets to pay the minimum compensation. Therefore it would be necessary to authorise the Fund to take out loans. Furthermore, it might be regarded as justifiable for the Fund to pay full compensation instead of reducing it if its assets proved insufficient, but no further explanation was offered as to how the Fund was to meet these payments.¹⁷ In the debate on the bill by Members of Parliament, no particular mention was made of the provisions implementing the EU directive on deposit guarantees. The debate concerned by and large other provisions of the bill on amendments to rules on the equity of financial institutions and in particular their connection to loan facilities received a short time earlier by Landsbanki due to difficulties in the bank’s operations.

The bill’s provisions on deposit guarantees were adopted, in essence unaltered, by Parliament on 3 May 1996, including provisions on minimum compensation set at EUR 20,000, and later published as Act No. 39/1996. However, the proposal to unite the two guarantee funds was not adopted; it should be noted that this had also been proposed by a committee established by the Minister of Commerce in May 1993 to formulate proposals on the future arrangement of deposit guarantees in Iceland and the roles and authorisations of the two guarantee funds. The committee had completed its work in April 1994 and proposed that the guarantee funds would continue to operate as before, apart from the changes necessary in order to implement the harmonised rules on deposit guarantees within the European Economic Area. Therefore, the Deposit Protection Fund of Commercial Banks continued to be an independent state-owned body and the Deposit Protection Fund of Savings Banks continued as a private foundation. Act No. 39/1996 had thus implemented into Icelandic law the content of the EU directive of 30 May 1994 on deposit-guarantee schemes.

On 3 March 1997, Directive 97/9/EC on investor-compensation schemes was adopted at EU level. The objective of the directive was to establish a specific minimum harmonisation of compensation schemes for investors trading with investment companies and financial institutions, e.g. in securities. In accordance with the EEA Agreement, Iceland was obliged to implement this directive into Icelandic law. The Minister of Commerce established a committee to prepare for this work on 6 August 1998. A bill presented by the Minister of Commerce to Parliament on 4 October 1999, based on the committee’s recommendations, proposed that the existing Deposit Protection Fund of Commercial Banks and the deposit department of the Deposit Protection Fund of Savings Banks would, along with a new guarantee scheme for investors, be merged into one fund, the Depositors’ and Investors’ Guarantee Fund. It was stated that the main argument for

16. Parliamentary record 1995-1996, A-section, p. 1854.

17. Parliamentary record 1995-1996, A-section, p. 1857.

such a merger was that banking activities and securities activities had become closely integrated. It would also be advantageous from an actuarial point of view to expand the Fund and spread the risks, as well as reduce operating costs. Furthermore, a complex interplay between two or more systems was not desirable from the point of view of consumer protection.¹⁸

The bill proposed a new legislation on deposit guarantees and investor-guarantee schemes replacing the Chapter on deposit institution guarantee schemes in the Act on Commercial Banks and Savings Banks. It was stated that the bill's provisions on deposit guarantees were based on existing provisions in the Act on Commercial Banks and Savings Banks. In the comments pertaining to the bill, it was also mentioned that it was partially based on Danish law, but Denmark had recently adopted an Act based on a similar idea to the one proposed in the bill (*Lov om en garantifond for indskydere og investor, No. 415 from 26.6.1998*).¹⁹

Although the bill's provisions on deposit guarantees were substantively identical to the provisions adopted by Parliament in 1996 with Act No. 39/1996, with the exception that a proposal was made to change the Deposit Protection Fund of Commercial Banks from an independent state-owned body to a private foundation, there was still extensive debate in Parliament on those provisions of the bill and proposals for amendment were submitted. However, the main topic of the debate in Parliament was whether it was right to merge into one fund the compensation schemes for traditional deposits in commercial banks and savings bank and an investor-compensation scheme.

In the bill, as in Act No. 39/1996, it was proposed that the total assets of the deposit department of the Guarantee Fund should as a minimum amount to 1% of the average of guaranteed deposits in commercial banks and savings banks in the previous year. Contributions made by banks and savings banks to the Fund were aimed at reaching that minimum before the annual settlement of accounts would take place. Again, it was recommended not to determine maximum contributions. Therefore, the total amount, e.g. of guaranteed deposits, was to be paid if the assets of the department in question proved sufficient to that end. If this was not the case, payments from the department were to be divided between the claimants whereby up to ISK 1.7 million (the equivalence at any time to EUR 20,000) would be fully compensated, while anything in excess of that amount would be compensated equally in proportion to the remaining assets of each department. It was emphasised that if the Fund did not have sufficient assets and its Board of Directors believed that there was urgent need for such a measure, the Fund was authorised to take out a loan to pay claimants.²⁰ In his presentation of the bill, the Minister of Commerce did not further mention these provisions or the Fund's situation, should its assets prove insufficient to pay the aforementioned minimum amount.

During the first reading of the bill in Parliament, MP Guðmundur Árni Stefánsson mentioned that governmental plans were underway to sell the state-owned commercial banks and that this might bring about changes in the State Treasury's backing of the biggest deposit institutions. He then asked

18. Parliamentary record 1999-2000, A-section, pp. 608-609.

19. Parliamentary record 1999-2000, A-section, p. 609.

20. Parliamentary record 1999-2000, A-section, p. 609.

"I do not want to speculate too closely on what will happen if a specific banking institution goes bankrupt. However, the fact is that if the Fund can not fully meet all its obligations, the presumption is that all depositors owning deposits up to ISK 1,7 million in the company in question, the bank in question, will be fully compensated. Any amount exceeding this limit would be paid in equal proportions to the Fund's remaining assets. This is the rule we established. Then an assessment is made of the extent of funding necessary for the Fund at any given time and how much funds it needs to have available at any given time depending on the size of the system. And hopefully we will not experience a full-scale major bankruptcy".

Minister of Commerce Finnur Ingólfsson, in a reply to an enquiry by Mr Guðmundur Á. Stefánsson at the Parliament on 7 October 1999.

Minister of Commerce Finnur Ingólfsson what he believed would happen if big deposit institutions, such as Búnaðarbanki or Landsbanki, were to run into payment difficulties, were on the brink of bankruptcy, and existing funds did not have the capacity to repay the depositors of these banks. He also pointed out that the deposit guarantees under discussion would not necessarily fully compensate depositors for their losses, and this was not the aim, when banks or savings banks ran into payment difficulties or became bankrupt even. He requested an answer from the Minister on whether he considered that, notwithstanding the privatisation of the major commercial banks, the State Treasury was still politically and morally responsible for the deposits beyond the guarantees offered by the proposed funds and other factors.²¹ The Minister's exact reply is stated in the margin.²²

Three Members of Parliament, Ms. Jóhanna Sigurðardóttir, Ms. Margrét Frímansdóttir and Mr. Ögmundur Jónasson, proposed an amendment to the provisions on minimum compensation stating that claims by individuals for deposit compensation should be fully met while claims by legal entities for deposit compensation and claims by individuals for guaranteed securities and cash would follow the rule recommended in the bill on minimum compensation, and that remaining claims would be compensated in proportion to the remaining assets of each department of the Fund.²³ They pointed out that in some of the neighbouring states provision was made for a higher compensation to depositors than the one corresponding to the minimum compensation set out in the EU directive. Moreover, it was pointed out that although most of the neighbouring states had long ago opted to lay down certain conditions for guaranteeing deposits in the banking system, the fact was that when the banking systems were on the brink of failure, as was the case in Norway and Sweden in the eighties, and in Canada, the USA and other countries, the State had, in every instance, lent its support.²⁴ Their proposal was rejected with 34 votes against 16. The bill was passed into law by Parliament on 21 December 1999 and published as Act No. 98/1999. As regards deposit guarantees, the most important amendment to the previous law was the merge of the guarantee funds that had previously been operating, i.e. the Deposit Protection Fund of Commercial Banks and the Deposit Protection Fund of Savings Banks, into one fund, the Depositors' and Investors' Guarantee Fund (TIF), as from 1 January 2000.

17.4 What Obligations derive from the EU Directive on Deposit-Guarantee Schemes and how were they fulfilled by the Icelandic Government?

17.4.1 Introduction

The SIC reiterates that this is not an exhaustive overview of the contents of Directive 94/19/EC from 30 May 1994 and the legislation adopted in Iceland to fulfil the obligations derived there from. This discussion will primarily deal with the issues of influence, or issues that the Commission

21. Parliamentary record 1999-2000, B-section, p. 195.

22. Parliamentary record 1999-2000, B-section, pp. 195-196.

23. Parliamentary record 1999-2000, A-section, p. 2280.

24. Parliamentary record 1999-2000, B-section, pp. 2659-2662.

believes should have been of influence, in deciding and carrying-out matters related to deposit guarantees by the Icelandic government, the Board of Directors of the Guarantee Fund and the Icelandic banks over the last few years and especially during the run-up to the collapse of the three major banks in October 2008. When comparing the rules on the operation of guarantee funds in Europe, this report will be based on the legal position as it was prior to October 2008 when the EU agreed, inter alia, to initiate the process of raising the minimum guarantee amount under the directive, and individual Member States took various measures to secure bank deposits.

17.4.2 Conflicting Objectives

Directive 94/19/EC on deposit-guarantee schemes was adopted in of an effort to enforce the policy of the European Community, later the European Union, to facilitate capital movement within the Member States and to eliminate restrictions on the right of establishment and the freedom to provide services. At the same time, the directive was intended to increase the stability of the banking system and protection for savers, as stated in its preamble.

Since this directive is only a part of the overall regulatory framework in force within the EU, its implementation by the Member States, for instance incorporation into national law and interpretation, may affect various other rules of the EU law. It is therefore clear from the preamble of the directive that it contains conflicting points of views. Like other EU *acquis*, it is the result of dialogue and preparations where different positions of the relevant field within the Member States and different points of view, inter alia on the extent to which the regulatory framework should coordinated, have been settled with a compromise.

An example of this is that in the preamble of the directive and its preparatory data,²⁵ it is assumed that the deposit-guarantee schemes include a certain guaranty of solidarity from financial institutions in the respective country and that these would generally bear the cost of financing such schemes. It is noted that the cost of credit institutions participating in a guarantee scheme is low compared to the cost of a bank-run, not just on the credit institution facing difficulties, but also on institutions in good standing, as depositors would lose faith in the stability of the banking system.²⁶ Later in the preamble it is described how the financing capacity of such guarantee schemes must be in proportion to their liabilities. It is added that this must not, however, jeopardize the stability of the banking system of the Member State concerned.²⁷ It is, on the one hand, presumed that it is the deposit institutions themselves that bear the cost of the deposit guarantees but on the other hand that this cost may not be to onerous for the banking system.

General rules of European law that impact the Member State's transposition of the provisions of this directive into national law include competition rules, restrictions on state aids and rules prohibiting discrimination on the grounds of nationality. Thus, it is derived from these rules and the directive, that

25. "Proposal for a council directive on deposit-guarantee schemes." COM(92) 188 final – SYN 415. Brussels, 4 July 1992. OJ 1992 C163/6, p. 2.

26. Cf. the 4th recital in the preamble to the directive.

27. Cf. the 23rd recital in the preamble to the directive.

individual Member States may not arrange their deposit-guarantee schemes in a manner that makes it difficult for companies from other Member States to compete for deposits and other banking services in the respective country. Therefore, companies from other Member States are expressly guaranteed, the right to join the guarantee scheme of the Member States where they establish branches and receive deposits, a so-called 'topping-up'. The general prohibition within the EU, and therefore the EEA, regarding state aids that can impact competitive operations, imposes restrictions on the extent to which the State treasuries and public organisations in the Member States can, through direct and indirect financial contributions, take part in the deposit-guarantee schemes and support to individual financial corporations that face difficulties.²⁸

It should be stressed that the rules of this directive on deposit-guarantee schemes belong to the so-called minimum rules within European law. Member States are therefore supposed to adapt the provisions of the directive so that the minimum requirements of the directive are fulfilled, but they are entitled to impose more far-reaching rules, provided they don't go against other rules of European law referred to above.

17.4.3 Public Organization or Private Body?

According to Directive 94/19/EC, each Member State shall ensure that within its territory one or more deposit-guarantee schemes are introduced and officially recognized. The directive does not state whether these deposit-guarantee schemes need to be part of the system of governance in each respective State, and thereby a public organization, or whether they can be a private law body. The path chosen here in Iceland was to assign this task, under Act No. 98/1999, to a special "institute" called the Depositors' and Investors' Guarantee Fund with the law stating that the Fund is a private foundation. It stipulates that commercial banks, savings banks and companies engaging in securities trading shall be members of the Fund, but it is noted that these companies, i.e. the Member Companies, shall not be liable for any commitments entered into by the Fund beyond their statutory contributions to the Fund.

A private foundation is by law an independent private law body and not subject to the property ownership of any particular party or parties. A private foundation is therefore liable for its obligations through its assets unless a second party has, by law or agreements, accepted such liability. It cannot be inferred from Directives 94/19/EC and 97/9/EC (on investor-compensation schemes) that their provisions prevent Member States from establishing private foundations to operate the guarantee schemes and investor compensations in order to fulfil the obligations derived from the directives. It is then an independent issue whether the substantive rules that apply to the operations of the private foundation and the system established in the respective country, including rules on financing and payments, comply with the rules derived from the directives. Chapter 17.5 will describe the

28. Cf. overview of applications and handling by the EU of rescue measures in the fall of 2008: "State aid: Overview of national rescue measures and guarantee schemes 12 January 2009", see <http://europa.eu/rapid/press>. Concerning EFTA Surveillance Authority, see <http://www.eftasurv.int>.

appointment of the Board of Directors of the Guarantee Fund and the operation of the Fund, as well as the connections that this arrangement has created with the government, both inwardly within the system of governance and outwardly, *inter alia* with foreign parties.

It should be noted that the method of conferring the task in question to a private foundation is used in various countries in the European Economic Area, including Denmark²⁹ and Norway.³⁰

17.4.4 Financing and Size of the Fund

In the preamble of Directive 94/19/EC, it is stated that it is not deemed indispensable, in the directive, to harmonize the methods of financing deposit-guarantee schemes, given, 'on the one hand, that the cost of financing such schemes must be borne, in principle, by credit institutions themselves and, on the other hand, that the financing capacity of such schemes must be in proportion to their liabilities'. Following this the preamble states: "This must not, however, jeopardize the stability of the banking system of the Member State concerned."³¹ The English wording of this provision is shown on the margin. It states that the cost of financing of such schemes must be borne, in principle, by credit institutions themselves. The articles of the directive do not include provisions stipulating how the financing of the deposit-guarantee schemes of individual Member States should be conducted.

Article 6 of Act no. 98/1999 provides that the total assets of the Deposit Department of the Fund shall amount to a minimum of 1% of the average amount of guaranteed deposits in commercial banks and savings banks during the previous year. In the event that total assets do not amount to this minimum, all commercial and savings banks shall, no later than 1 March each year, contribute to the Fund an amount equivalent to 0.15% of the average of guaranteed deposits in the commercial or savings bank concerned during the preceding year. It is also stated that if the total assets of the Department do not amount to the required minimum, all commercial and savings banks shall submit a declaration of liability. In the declaration, each commercial and savings bank shall undertake to render a special contribution to the Department when the Department is obliged to refund deposits in any commercial or savings bank that is a member of the Fund. The declaration of liability shall extend to a proportion of the amount required to make up the minimum corresponding to the proportion of the commercial or savings banks in question of the aggregate guaranteed deposits. It is noted that demands for contributions to the Department based on declarations of liability shall not exceed the equivalent of one-tenth of the minimum total assets of the Fund. Under the aforesaid conditions, commercial and savings banks shall render payment to the Fund on demand. The provision then contains a special rule

„Whereas it is not indispensable, in this Directive, to harmonize the methods of financing schemes guaranteeing deposits or credit institutions themselves, given, on the one hand, that the cost of financing such schemes must be borne, in principle, by credit institutions themselves and, on the other hand, that the financing capacity of such schemes must be in proportion to their liabilities; whereas this must not, however, jeopardize the stability of the banking system of the Member State concerned.“

Paragraph 23 of the preamble to Directive 94/19/EC.

“On the other hand, this indicates that the net assets of the Guarantee Fund would come nowhere near to guaranteeing a minimum amount of cover for all depositors and investors if it was needed at the same time. This conclusion should not come as a surprise.“
”It is in line with the understanding behind the current law that it is thought to be almost impossible for such a serious situation to arise within the financial system that 1% of the average of the guaranteed deposits would not be enough to disburse the minimum amount of cover.”

Mr Hallgrímur Ásgeirsson, lawyer and Managing Director of the Guarantee Fund, from an article in the Central Bank's publication, *Financial Stability*, 2005, p. 69.

29. Cf. Lov nr. 576 af 6. juni 2007, 1. gr.: "Garantifonden for indskydere og investorer (Fonden) er en privat selvejende institution." (Cf. Article 1 of Act No. 576 of 6 June 2007: "The Depositors' and Investors' Guarantee Fund (the Fund) is a private institution.")

30. Cf. Lov nr. 75 fra 12. juni 1996, 2-4. gr.: "Bankenes sikringsfond [...] er eget rettssubjekt. Ingen av medlemmene har eiendomsrett til noen del av fondet. Konkurs eller akkordforhandlinger kan ikke åpnes i fondet." (Cf. Articles 2-4 of Act No. 75 of 12 June 1996: "The Guarantee Fund of the banks is a legal personality of its own. None of its members has property ownership of any part of the Fund. The Fund can neither be declared bankrupt nor be a subject to composition.")

31. Cf. 23rd recital in the preamble to the directive.

on contributions from new commercial or savings banks to the Guarantee Fund. This arrangement of contributions to the Fund and the fact that it shall at any time amount to at least 1% of the average of guaranteed deposits is the same as under the previous law on deposit-guarantee funds before the Depositors' and Investors' Guarantee Fund was established.

When examining the rules of the EU and EEA Member States on the financing of deposit-guarantee funds, three different methods can be seen. In most states, the funds are financed *ex ante*. In some states, the funds are financed *ex post*, i.e. when a payment obligation towards depositors has been established. The third group consists of states where the financing is a mixture of both. In countries where deposit-guarantee schemes are financed *ex ante* as in Iceland, there is a difference in the requirements made as regards the limit of contributions and therefore the size of the funds. It is to be noted that in some states the calculation basis for the banks' contributions to the Fund takes into account the risk of their operations but that risk is calculated in different ways.³²

When looking at which limit values are used for minimum assets in individual states, i.e. the size of the funds relative to deposits, the numbers range from 0.5% to 1.5% of the total deposits or the guaranteed deposits. Therefore, it can only be assumed that the limit value adopted by law in Iceland, i.e. 1%, is in line with common practice in Europe. This is, according to the nature of the matter, based on the legal position in October 2008 when various states, and later the EU, amended their rules on deposit guarantees. Judging by this information, it appears that those countries assumed that the contributions to the deposit-guarantee scheme from financial corporations that accept deposits, were as such not aimed at enabling the fund, at any time, to satisfy its obligation to pay out the minimum amount stipulated by the directive, i.e. EUR 20,000, for all guaranteed deposits. It should be mentioned that in the preamble of the directive it is stated that the financing of the deposit-guarantee schemes must not jeopardise the stability of the banking systems.

Table 1 contains a comparison of assets of guarantee funds in the Nordic Region at year-end 2006 and year-end 2007, and their ratio of total deposits and guaranteed deposits. All amounts are expressed in millions of Euros. As far as Iceland is concerned, the so-called guaranteed deposits are not comparable with the other Nordic countries since those countries based the maximum guarantee on a specific amount (Denmark DKK 300,000, Finland EUR 25,000, Norway NOK 2,000,000 and Sweden SEK 250,000) and numerical data on the operations of the guarantee funds in these countries show that each year, *inter alia* at year-end, the amount of guaranteed deposits is calculated. In Iceland, the rule was that the total of deposits, other than the ones of the financial institutions which were parties to the Fund scheme were guaranteed, i.e. the Fund was to pay out those deposits that were not available in as far as the Fund's assets would allow, but if the claims were higher than that, the Fund's assets were to be divided proportionally. Each depositor was, however, to receive a minimum amount to the equivalent

32. "Review of the Deposit Guarantee Schemes Directive (94/19/EC)." Consultative Working Paper, 14 July 2005, p. 5.

of EUR 20,887 or the amount held in his account if it was lower than the aforementioned amount. The numerical data that the SIC has received from the Guarantee Fund and the government contains no information as to the total obligations of the Fund at each time, given that it would only compensate depositors to the maximum limit, equivalent to EUR 20,887. As described in chapters 17.9 and 17.10.2, information on the distribution of deposits by amounts and number of deposit accounts in the Icelandic banks at year-end 2007 were gathered especially for the work of a committee which at the time was working on a revision of the legislation on the Fund. This information was then used to estimate the obligations of the Fund based on the aforesaid minimum amount and lower deposits. In the case of Iceland, the comparison in table 1 is based on the method of counting as total deposits at year-ends 2006 and 2007 all deposits in the Icelandic banks, less the deposits of financial institutions, i.e. the same amount as the Fund calculated its 1% minimum assets from. As regards the year 2006, there is no information available on the Fund's obligations, given only a payment equivalent to EUR 20,887 and lower deposits, but the amount for guaranteed deposits in the case of Iceland at year end 2007 is in fact based on the amount of deposits at the end of September 2007 and is estimated on the basis of information from the examination commissioned by the Ministry of Business Affairs at the end of the year 2007. On the basis of this, it is estimated that the minimum obligations of the Fund at year-end 2007 (end of September) were at least ISK 325 billion or EUR 3,574 million. It should be noted that deviations in the Fund's balance at year-end, from the 1% of guaranteed deposits that the minimum assets of the Fund were to be based on, i.e. the total deposits according to the table in the case of Iceland, are partly explained by the fact that the settlement of the banks' contributions to the Fund for the preceding year did not take place until March and was then based on the average of

Table 1. Comparison of the assets of guarantee funds in the Nordic Region, and their ratio of total deposits and guaranteed deposits

<i>M. EUR</i>	<i>Total deposits</i>	<i>Guaranteed deposits¹</i>	<i>Assets of guarantee fund</i>	<i>% of total deposit</i>	<i>% of guaranteed deposits</i>
<i>End of year 2006</i>					
Denmark	171,399	62,140	480	0.30	0.80
Finland	83,433	38,271	422	0.50	1.10
Norway	137,431	79,468	2,009	1.50	2.50
Iceland	11,285	0	74	0.60	–
Sweden	157,706	57,800	1600	1.01	2.80
<i>End of year 2007</i>					
Denmark	206,280	61,765	490	0.20	0.80
Finland	96,577	41,014	474	0.50	1.20
Norway	173,051	89,940	2,091	1.20	2.30
Iceland	25,497	3,574	100	0.40	2.60
Sweden	169,833	63,800	1,720	1.01	2.70

1. Information about guaranteed deposits in Iceland was not available for the years 2006 and 2007. An approximation is used regarding guaranteed deposits in 2007, according to compilation by the Ministry of Business Affairs.

Sources: The Guarantee Fund, Ministry of Business Affairs, guarantee funds in the Nordic region, IMF.

deposits, i.e. payments, based on the average of deposits in 2007, were not made until March 2008.

Countries where the deposit guarantee scheme was financed ex-post at that time include the Netherlands. There, the deposit guarantee scheme is managed by the Dutch National Bank and the minimum compensation was EUR 40,000 per depositor. The British deposit guarantee scheme, the Financial Services Compensation Scheme (FSCS), was based on a mixed system of payments. The minimum payment to each depositor was, until October 2008, GBP 35,000.

As described above, the EU directive contains no direct provisions regarding the arrangement of the financing of guarantee funds, but in its preamble it is assumed that the financial institutions themselves bear, in principle, the cost of financing the guarantee schemes. Legal regimes on the financing of the funds differ between Member States of the EU and the EEA but when comparing the Icelandic legislation to the rules applicable to deposit-guarantee departments of comparable funds in the states to which the EU directive applies, it can only be assumed that the method followed in Iceland is similar to the one used in some of the countries where payments to the funds are made ex ante. Norway is an example.³³ It should be reiterated that the states have used different ways to finance their guarantee funds as the directive contains no instructions on the matter and therefore there is no measure on what is deemed a sufficient implementation of the directive into national law in this regard. It is then noted that according to the directive the deposit-guarantee schemes must “stipulate that the aggregate deposits of each depositor must be covered up to ECU 20 000 in the event of deposits’ being unavailable” according to Article 7(1), and that claims by depositors shall be paid within a certain time period which in principle should be three months from the date on which it is determined that the bank is unable to pay, cf. Article 10. This period was shortened with the amendments to the EU directive on deposit guarantees after October 2008.

It should be noted that, pursuant to Article 14 of Directive 94/19/EC, the Member States were to bring into force the laws, regulations and administrative provisions necessary for them to comply with the directive no later than 1 July 1995 and forthwith inform the Commission thereof. Member States of the European Economic Area were to do the same, also by 1 July 1995, and inform the EFTA Surveillance Authority (ESA) thereof. According to data available to the SIC, there is no mention of these bodies having made any objections to the implementation of the directive in Iceland or in other countries that used a similar method. Issues regarding the situation when assets of a guarantee fund are not sufficient to meet its commitments and the possible responsibility of the respective state under such circumstances and when the implementation of the directive is faulty, will be discussed later on.

33. Lov om sikringsordninger for banker og offentlig administrasjon m.a. av finansinstitusjoner av 6. desember 1996 nr. 75. (Act No. 75 of 6 December 1996 on Guarantee Schemes for Banks and Public Control, i.a. concerning Financial Institutions.)

17.4.5 Branches abroad

The EU directive on harmonisation of the deposit-guarantee schemes was passed explicitly to react to increased freedom of capital movement and authorisation for the operations of financial institutions within the Member States and across borders of individual states. A special reference was made to the fact that banks no longer needed an authorisation to establish branches in other Member States. The operating license of the home state authorised them to establish branches in other Member States, which would then be their host states. Deposits gathered in bank branches outside the home state are therefore, in accordance with the directive, supposed to be guaranteed in the same manner as deposits gathered within the home state. In addition to this, agreements such as those mentioned above can be made regarding further protection in the host state, so-called topping-up agreements, between banks and the guarantee fund in the host state in order to ensure that the insurance cover for depositors in their branches, e.g. as regards the minimum compensation amount, is comparable to domestic banks in the host state.

Act No. 98/1999, by nature of its subject, does not deal specifically with branches of the Icelandic banks abroad since they are by law considered a part of the operations domiciled in this country. The Act does, however, in chapter IV, contain provisions on branches of foreign banks, savings banks and credit institutions that may operate in this country and their membership to the Depositors' and Investors' Guarantee Fund with regard to deposits that are not guaranteed in a comparable manner in the European Economic Area.

It should be noted that according to article 4 of the EEA agreement, any discrimination on the basis of nationality is forbidden under the scope of the Agreement, unless otherwise determined from individual provisions.

In accordance with the content of the directive and Act No. 98/1999, deposits gathered in branches of the Icelandic banks abroad were guaranteed in the same manner as deposits gathered here in Iceland. However, the same did not apply when Icelandic banks established subsidiaries registered abroad or moved the gathering of deposits abroad into subsidiaries in foreign countries. In that case, the company concerned was registered in that country and was subject to the deposit-guarantee scheme of that country. It was therefore of significant importance for the obligations and position of the Icelandic Guarantee Fund whether the banks gathered deposits abroad in branches or subsidiaries. The Board of Directors of the Fund, however, had no direct authority by law to influence the way in which the banks operated in this regard. However, it should be noted that the Board of Directors of the Fund generally entered into negotiations with the foreign guarantee funds with which the Icelandic banks had made so-called topping-up agreements, with the aim of facilitating settlements of claims made by depositors. As is further discussed in chapter 17.10.1, it cannot be inferred otherwise from the available data than that the Board of Directors of the Guarantee Fund did, as a general rule, seek to speed up these negotiations on its part. Presumably, this was thought to be in the spirit of and in accordance with the aim of the EU directive to minimize barriers to financial institutions' ability to offer their services within the Member States, regardless of national borders. However, this did not take into account the increased commitments of the Icelandic Guarantee Fund consequent to this gathering of deposits abroad.

17.4.6 Deposits in the sense of Directive 94/19/EC. Authorisations for exemptions from compensation payments

1. Deposits by financial institutions as defined in Article 1 (6) of Directive 89/646/EEC.
2. Deposits by insurance undertakings.
3. Deposits by government and central administrative authorities.
4. Deposits by provincial, regional, local and municipal authorities.
5. Deposits by collective investments undertakings.
6. Deposits by pension and retirement funds.
7. Deposits by a credit institution's own directors, managers, members personally liable, holders of at least 5 % of the credit institution's capital, persons responsible for carrying out the statutory audits of the credit institution's accounting documents and depositors of similar status in other companies in the same group.
8. Deposits by close relatives and third parties acting on behalf of the depositors referred to in 7.
9. Deposits by other companies within the same group.
10. Non-nominative deposits.
11. Deposits for which the depositor has, on an individual basis, obtained from the same credit institution rates and financial concessions which have helped to aggravate its financial situation.
12. Debt securities issued by the same institution and liabilities arising out of own acceptances and promissory notes
13. Deposits in currencies other than: — those of the Member State— ECUs.
14. Deposits by which are of such a size that they are not permitted to draw up abridged balance sheets pursuant to Article 11 of the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies.

The provisions of Annex I to Directive 94/19/EC.

In Article 1 of Directive 94/19/EC, deposits in the sense of the Directive are defined as “any credit balance which results from funds left in an account or from temporary situations deriving from normal banking transactions and which a credit institution must repay under the legal and contractual conditions applicable, and any debt evidenced by a certificate issued by a credit institution”. It is stated that Bonds which meet the conditions prescribed in Article 22(4) of Directive 85/611/EEC shall not be considered deposits. According to Article 7(2) of Directive 94/19/EC, the Member States may provide that certain depositors or deposits shall be excluded from guarantee or granted a lower level of guarantee. Those exclusions are listed in Annex I of Directive 94/19/EC. They include inter alia deposits from financial institutions and insurance undertakings according to items 1 and 2 of the Annex, cf. the provisions of item 14 in Annex I of the directive. These exemptions are in principle based on the fact that the parties identified have, as holders of deposits, due to their expert knowledge or relationships with depository institutions, better knowledge than depositors in general of the position of depository institutions and the risks inherent in their operations. This group includes professional clients such as financial institutions, the State and local governments, investment companies and pension and retirement funds.

According to Act no. 98/1999, Article 9, obligation of payment by the deposits department of the Fund becomes effective when a member company, in the opinion of the Financial Supervisory Authority (FME), is unable to honour payments based on the “value of deposits”. Later in the provision, the definition of deposits put forth in Article 1 of the Directive from 1994 is repeated.³⁴

When comparing the provisions of the Icelandic Act with the authorisations in the directive to exclude deposits from guarantee, it becomes clear that in Iceland, the authorisations for such exemptions have only been used to a limited extent. When looking at the manner in which different Member States of the EU and the EEA have applied these authorisations for exemptions, it becomes apparent that there are many differences since the states have a certain freedom of choice in this matter.

As stated in the directive and Act no. 98/1999, it is assumed that credit balances that are derived from “normal banking transactions” shall be

34. In Act No. 98/1999, that was quoted, it is furthermore stated the guarantee does not extend to bonds, bills of exchange, or other claims issued by a commercial bank or savings bank in the form of securities. That is in accordance with permitted derogations according to the directive. The same applies to the provision of Article 9(6) where it is stated that deposits, securities and cash owned by Member Companies, their parent and subsidiary companies are not covered by the guarantee. The same applies to deposits, securities and cash connected with convictions of money-laundering. It should be mentioned that in Act No. 125/2008, the so-called Emergency Act which entered into force 7 October 2008, the following provision was added to Article 9 of Act No. 98/1999: “Nevertheless, deposits which Member Companies or their parent or subsidiary companies hold on behalf of depositors shall not be exempted from insurance pursuant to paragraph 1. Deposits in UCITS, investment funds, investment funds of professional clients, pension funds and other funds for collective investment shall not be exempted from insurance pursuant to Paragraph 1, even though the custodian or management company of such a fund may be a Member Company or parent or subsidiary company of a Member Company.”

considered guaranteed deposits. The meaning of “normal banking transactions” is not explained further. The operations of banks and financial institutions have undergone great changes in recent years, and this applies to various forms of deposits and collection of funds for raising interest on offer by these companies. In some instances, these have been contractual transactions for higher amounts than are common in conventional deposits, and agreements are made for a specific period for holding the funds and rates of return. When the Icelandic banks began gathering deposits through branches abroad, those operations often began in the way that branches started to receive so-called wholesale deposits, which were an important part of financing the Icelandic banks until their collapse, although there was a significant decrease in the renewal of agreements for such deposits and thereby their total amount also decreased in the last months and weeks before the collapse of the banks.

Wholesale deposits were either created by the respective bank or independent brokers. A bank would assess its need for capital, taking into account conditions in the financial market. Should a bank consider it proper to obtain capital in this manner, it approaches a broker on the money market with an offer for the rates and period that shall apply to the deposits. The brokers may make a counter offer or directly initiate an offer to a bank for such deposits. It is also possible that an agreement for wholesale deposits is made directly between the bank and its customer. Wholesale deposits therefore have no fixed pre-set terms that the depositor accepts, rather the parties negotiate the terms that shall apply to the wholesale deposit, including interest rates and time period. The owners of these funds tend to be large investors, public organisations and local governments, organisations and corporations. In some instances these parties require the bank they deal with to have a certain credit rating and therefore any changes to that credit rating may significantly affect the business relationship.

At the beginning of the year 2007, these developments in the operations of the Icelandic banks by gathering wholesale deposits abroad gave Landsbanki Íslands³⁵ and the Icelandic Financial Services Association³⁶ a reason to make observations on the Fund’s assumption that deposits from large investors, including wholesale deposits, were considered guaranteed deposits in this country and that payments were made on the basis of these deposits to the fund despite authorisations in the EU directive to exclude such deposits from the guarantee. The reactions to these communications were on the one hand that the Board of Directors of the Guarantee Fund requested an opinion from the Fund’s attorney at law on whether wholesale deposits were guaranteed deposits according to the Act on the Fund, and on the other hand that the Minister of Business Affairs appointed a committee to work on a revision of Act No. 98/1999, and the prelude to the appointment and work of that committee will be discussed further in Chapters 17.8 and 17.9.

35. Cf. account of the meeting of the CEO of Landsbanki and the Minister of Business Affairs in December 2006 in Chapter 17.8, the reservations to contributions and letters of guarantee with regard to the collection for the deposits department in 2006 and memorandum of Mr. Haukur Þór Haraldsson, employee of Landsbanki and member of the Board of Directors of the Guarantee Fund, both of which were submitted in the meeting of the Board of Directors of the Guarantee Fund 17 April 2007.

36. Cf. Chapter 17.8 concerning the letter of the association from 4 January 2007 to the Ministry of Economic Affairs.

The Fund requested a legal opinion from Mr. Karl Axelsson, Supreme Court Attorney, on deposits defined as guaranteed deposits according to Act no. 98/1999, Article 6. In his opinion dated 25 May 2007, Mr. Axelsson stated that it was his assessment, supported by further arguments that need not be further discussed here, that it was likely that the legislation on deposit guarantees also applied to this group of deposits. Disputes regarding the position of wholesale deposits, and whether it was right and permissible to exclude them from being guaranteed by the Fund, were then discussed in the context of the committee working on the revision of Act No. 98/1999.

There is no reason for further discussion here regarding the various forms of deposits and agreements for holding and raising interest on cash that were created within the Icelandic banks in recent years, and regarding which it may be in dispute whether it was permissible, considering the provisions of the EU directive, to exclude them from the guarantee of the Fund, and especially considering the origin of those deposits.³⁷

The observations of the Icelandic financial institutions mentioned above appear to have been based to no lesser extent on the fact that the banks' receipt of funds in the form of so-called wholesale deposits and money market deposits by its very nature did not constitute a receipt of deposits in the sense of traditional banking transactions. Here it should be noted that the receipt of deposits is a part of licensed operations of financial corporations, and such licensing is in place in order to ensure the general interest that the operations of financial institutions are sound and subject to official surveillance. In light of the aforesaid it must be considered doubtful that special contractual receipt of money for temporary holding and later repayment at a certain return falls outside the concept of deposits as used in the directive on deposits and Act No. 98/1999.

17.4.7 Payments to depositors

According to Article 7 of the EU directive, deposit-guarantee schemes shall stipulate that the aggregate deposits of each depositor must be covered up to EUR 20,000 in the event of deposits' being unavailable. According to the provisions of Article 10 of Act No. 98/1999 the minimum amount that the Fund is obliged to pay to each depositor is set at the equivalent of EUR 20,887 in ISK. However, it does draw attention that when a comparison is made of the rules in Act No. 98/1999 on payments to depositors and rules on the same subject in other European countries, the principle here in Iceland is that each depositor shall receive the total amount of their deposits, but the minimum amount only applies when the assets of the deposits department are not sufficient to pay the total amount of the guaranteed deposits. It seems evident that it is only in exceptional cases that this method is used in other

37. Another example of a business product of the banks that has raised questions concerning whether it can be considered deposits, and if so, whether it would be covered by the Guarantee Fund, are the so-called money market deposits. As was pointed out in the legal opinion by Karl Axelsson, Supreme Court Attorney, dated from 25 May 2007, the exemptions that are listed in the annex to the EU directive on deposit guarantees are based on deposits from certain parties but generally not on the substance of transactions behind a banks' possession of funds, but cf. the exception on securities and bills. The provision at the beginning of Article 2 is of the same ilk where it is stated that deposits made by other credit institutions on their own behalf and for their own account shall be excluded from any repayment by guarantee schemes.

European countries, as it is generally believed, when discussing deposit guarantees, that guaranteeing deposits in full may increase the so-called moral hazard of both depositors and banks.

In Article 11 of the directive, it is stipulated that without prejudice to any other rights which they may have under national law, schemes which make payments under guarantee shall have the right of subrogation to the rights of depositors in liquidation proceedings for an amount equal to their payments. Pursuant to Article 10 of Act No. 98/1999, in the event that payment is effected from the Fund, the claims made on the relevant Member Company or bankruptcy estate will be taken over by the Fund. It should be noted that deposits had, until the passing of the Emergency Act, Act No. 125/2008, in October 2008, the status of general claims when dividing up the bankruptcy estate of a depository institution, and the same applied to the claims taken over by the Guarantee Fund. With the Emergency Act, “claims for deposits, pursuant to the Act on Deposit Guarantees and Investor Compensation Scheme” and claims taken over by the Fund become so-called priority claims as provided for in the Act on Bankruptcy, Article 112(1).

17.4.8 The Position when Assets of the Guarantee Fund are not sufficient to pay Minimum Compensation

As described above the EU directive does not contain provisions regarding measures to be taken by member States to guarantee a minimum for financing deposit guarantees or regarding the size of guarantee funds in the States. However, the provisions in the directive to the effect that the deposit-guarantee schemes must guarantee the deposits of each depositor up to a specific minimum amount are clear. There is nothing in either the directive or its preparatory documents which indicates how to proceed if the assets of a guarantee fund are insufficient for minimum compensation.

In Act No. 98/1999, Article 10(2), there is the following provision on the Icelandic Guarantee Fund:

“Should the total assets of the Fund prove insufficient, the Board of Directors may, if it sees compelling reasons to do so, take out a loan in order to compensate losses suffered by claimants”.

According to Article 11 of the Act, the Board of Directors of the Fund may authorise loans of up to ISK 50 million between the Deposits Department and the Securities Department. The loan must be repaid within 36 months. It is also stated in Article 17 of the Act that the Fund shall not be subjected to bankruptcy proceedings, nor may its assets be attached for debt.

In accordance with the aforesaid, Parliament has decided that in this country the Deposit-Guarantee Fund shall be a private non-profit institution, and if the assets of the Fund are not sufficient to pay claims against it, it shall be the task of the Board of Directors of the Fund to determine whether the Fund's need for money will be solved by borrowing funds to meet the claims. It must be assumed that this is based on the assumption that the future contributions from banks and financial corporations to the Fund in accordance with law will be used i.a. to repay the loan.

When looking at laws on guarantee funds in Member States of the EU and the EEA, it becomes apparent that they generally do not contain provisions

on how to solve the position that might arise if the assets of the funds are insufficient to meet the obligations incurred. At most, they contain provisions on borrowing by the Boards of Directors of the funds, but in cases of such provisions, their contents differ. As stated previously, a distinction should be made in this comparison between the legal position, and consequently the law in the EU Member States, on the one hand before and on the other hand after the first days of October 2008, when the European Commission agreed that declarations by individual states on, among other things, state guarantees on deposits fell under the authorised exemptions from rules on restricting state aid in light of the situation that had arisen on the world's financial markets.

The provisions of laws governing guarantee funds in the other Nordic countries until October 2010 were in fact a cross-section of the rules found in other European countries. The Norwegian Act contained no provisions on borrowing by the guarantee fund. The Danish Act at first assumed that if the assets of a Fund's department, of which there were three, were insufficient to pay claims in accordance with the Act, the department should take a loan from the other departments. The amount of such loans was restricted. In the explanatory notes to the Act it is assumed that if lending options within the fund have been exhausted, and the department is still lacking funds to meet its obligations, it can borrow funds elsewhere. The Danish Act contained a provision to the effect that the Minister of Economic and Business Affairs could, upon approval by the Parliament's Finance Committee, provide a guarantee, i.e. a state guarantee, for loans that the fund would take in order to fulfil its obligations.³⁸ The Act on the Swedish guarantee fund contains provisions to the effect that the fund may borrow money from a special agency of the Swedish State that handles government debt (Riksgäldskontoret).³⁹ There are provisions on the deposit-guarantee scheme in Finland in the Finnish Act on financial institutions. Therein it is stated that the fund can, according to further stipulations in its statutes, take out loans to meet the obligations of the fund. It is stated in the Act that the statutes must contain a provision stating that the banks that are members of the fund must provide the fund with a loan so that it will be able to meet its obligations. The law furthermore contains provisions on how the obligation of the banks to provide the loans is divided between them, and on repayment.⁴⁰ These provisions are then followed up in the fund's statutes and there it is stated that the Financial Supervisory Authority can, if the fund has taken loans to meet its obligations, decide that the banks' contributions to the fund shall be higher until the fund has repaid the loan.⁴¹

38. Lovbekendtgørelse 2007-08-08 no. 1009, Art. 6, cf. KARNOV 2007, p. 6280.

39. The Swedish Act on Deposit Guarantees (1995:1571), Art. 15.

40. The Finnish Act on Credit Institutions (121/2007), Art. 109: "The deposit-guarantee fund may raise a loan for its operations in the way provided by its rules, if its own funds are not sufficient for the payment of the compensations referred to in this chapter. The rules of the deposit-guarantee fund shall include a provision on the obligation of the deposit banks belonging to a deposit-guarantee fund to grant loans to the deposit-guarantee fund for the fulfillment of the liabilities of the fund. [...] The obligation to grant a loan to the deposit-guarantee fund, which is stipulated in paragraph 1 for deposit banks belonging to the deposit-guarantee fund, shall be distributed among the deposit banks in the same proportion as their compensated deposit's share in the total amount of deposits compensated in all deposit banks belonging to the deposit-guarantee fund. The deposit amount referred to in this paragraph is calculated according to the situation at end of the calendar year preceding the year when the obligation to grant a loan arises."

41. Rules of the Deposit Guarantee Fund - 4 October 2006/15 February 2007, Art 15.

As evident by these provisions, the EU/EEA Member States have generally followed the principal view of Directive 94/19/EC that the credit institutions themselves must bear the cost of financing the deposit-guarantee schemes by stipulating an obligation of the credit institutions to pay what may be called premiums to the funds and then expect them to bridge financial gaps due to obligations falling on the funds temporarily through borrowing and by stipulating, where applicable, higher premiums from the credit institutions when the loans are being repaid. This assumes that in the respective country there will continue to exist credit institutions that are able and obliged to pay premiums to the guarantee fund. Provisions for authorisations and options of the guarantee funds to borrow from special agencies of the relevant country, cf. e.g. Sweden, or receive guarantees from such agencies or directly from the state, are exceptional. Where that method has been chosen, it can generally be understood from the available information that such arrangements by the respective states have been or are a part of measures to preserve financial stability and trust in the banking system of the states concerned, as they have in various such cases gone through banking crises not so long ago. It doesn't seem that such intervention by public bodies or the State were, according to preparatory documents for the Acts in those countries, generally considered to be directly derived from provisions in the EU directive.

When comparing the rules in the Icelandic Act on the Depositors' Guarantee Fund to rules on such funds in other EU/EEA Member States, and primarily those based on so-called *ex ante* financing of the funds, it seems evident that the Icelandic rules are generally analogous to the rules in those states. In this context, one must bear in mind that the EU directive provides that the Member States must introduce certain minimum rules and if these rules are met, the states may choose different methods and additional rules, as long as they do not go against other and general rules of European law.

17.4.9 Responsibility due to the Implementation of Directive 94/19/EC into Icelandic Law

The preamble to Directive 94/19/EC deals specifically with the responsibility of Member States and their authorities vis-à-vis depositors, cf. recital 24, which is printed verbatim in both English and Icelandic on the margin.

As described above, it seems evident that rules in the Act on the Icelandic Guarantee Fund are in many ways similar to the rules in place elsewhere in the Nordic Region, for example regarding the minimum requirements in the EU directive on deposit-guarantee schemes. This applies both to rules on the financing and size of the depositors' Guarantee Fund. It also seems evident that Iceland has, by law, substantially incorporated the minimum rules that derive directly from the directive and are relevant in this discussion. It should be noted that the EU and EEA Member States have, subsequent to their implementation of Directive 94/19/EC, informed the EU and EEA institutions concerned about the relevant law-making, and from available data it seems that those institutions accepted this information without comment.

This does not, however, answer the question of whether Directive 94/19/EC has been satisfactorily implemented in this country in view of recital 24 of the preamble to the directive.

According to the substantive rule in Article 7(1) of the directive, the deposit-guarantee schemes of the Member States shall stipulate that the

“Whereas this Directive may not result in the Member States' or their competent authorities being made liable in respect of depositors if they have ensured that one or more schemes guaranteeing deposits or credit institutions themselves and ensuring the compensation or protection of depositors under the conditions prescribed in this Directive have been introduced and officially recognized.”

“The directive may not result in the Member States' or their competent authorities' being made liable in respect of their depositors if they have ensured that one or more schemes guaranteeing deposits or credit institutions themselves and ensuring the compensation or protection of depositors under the conditions prescribed in this directive have been introduced and officially recognized.”

Paragraph 24 of the preamble to Directive 94/19/EC.

aggregate deposits of each depositor must be covered up to EUR 20,000 in the event of deposits' being unavailable. The Member States are responsible for ensuring that a guarantee scheme is established in each state which guarantees deposits and payment of compensation in accordance with this minimum guarantee. The issue here is the legal position of depositors when a deposit-guarantee scheme, that has been established in the relevant state and operates under rules that formally satisfy the minimum rules of the EU directive, does not have sufficient funds available to pay compensation in full for claims against it over lost deposits.

In this context, the question is whether the provisions of the directive have what is called direct effect for citizens of the EU/EEA so that they are able on the basis of the substantive rules of the Directive to make a claim against the Member State concerned, or whether this is a case of a liability claim by the depositors where they believe, and must prove, that the Member State did not implement and satisfy the rules provided for in the Directive and is therefore liable according to the rules that have been formed on the liability of states in European law in such cases.

The above-mentioned will be discussed further in Chapter 17.18 below: Findings of the Special Investigation Commission. First there will be a discussion on the Board of Directors and operations of the Guarantee Fund, the development of deposits in the Icelandic banks and the position of the Fund, work on revising the Act on the Fund, and the response by the Board of Directors of the Fund, the banks and the system of governance to the greatly increased deposits in the years 2006 to 2008 and the consequent obligations of the Fund. Following that, the discussion on the possible responsibility of the Icelandic State regarding the Fund's obligations and the views held within the system of governance and the banks on that matter will be resumed.

17.5 Board of Directors and Operation of the Depositors' and Investors' Guarantee Fund

According to Article 4 of Act No. 98/1999, the Board of Directors of the Guarantee Fund is composed of six members appointed for a period of two years at a time. The commercial banks appoint two members of the Board, the savings banks one member, companies trading in securities and other parties with legal authorisations to trade in securities one member jointly, and the Minister of Business Affairs two members. In addition, the Minister of Business Affairs shall appoint a representative of depositors and investors as an observer with freedom of expression and the right to make proposals within the Board; this representative shall fulfil the same requirements as members of the Board. The Minister of Business Affairs shall appoint the chairman of the Board.⁴²

42. Further, it may be pointed out, that according to the quoted provision, Alternate Members are be nominated in the same manner. It is stated that the Members of the Board of Directors shall be of legal age and shall never have been deprived of custody of their estates. They shall have an unblemished reputation, and shall not have been convicted in a court of law for any punishable action with regard to business dealings pursuant to penal law or statutory law on limited liability companies, private limited companies, accounting, annual statements, bankruptcy or taxes. Members of the Board of Directors and employees of the Fund are bound by confidentiality pursuant to the provisions of the Act on Commercial Banks and Savings Banks.

From this it is clear that the majority of the Board of the Guarantee Fund is appointed by the companies that are members of the Fund. Each member of the Fund has the right to attend its annual general meeting, cf. Article 5. Audited annual accounts shall be presented, at the general meeting together with the Board's annual report. At the annual general meeting, the Board adopts resolutions establishing the agenda of annual general meetings in detail; the resolutions are subject to the approval of the Minister, having received the opinion of the Financial Supervisory Authority (FME). A proposal for amendment to the Fund's resolutions needs the support of two thirds of the representatives voting at the annual general meeting and the Minister's approval.

The Minister of Business Affairs shall appoint, without prior nominations, two members of the Board of the Guarantee Fund and also the chairman; however, the Act does not prescribe whether the chairman shall be one of the two members appointed by the Minister. Although this is not provided for in the Act, the two representatives appointed by the Minister of Business Affairs to the Board of the Fund have been, in latter years, officers of the Ministry of Finance and the Ministry of Business Affairs. The Minister has appointed the officer of the Ministry of Business Affairs as chairman of the Board of the Guarantee Fund.⁴³ At the Guarantee Fund's annual general meeting in 2006, the Minister of Business Affairs appointed Ms. Þóra Margrét Hjaltested, lawyer at the Ministry of Business Affairs, and Mr. Þórhallur Arason, Director-General at the Ministry of Finance, as his representatives on the Board of the Guarantee Fund for the following two-year term, Ms. Hjaltested being appointed as chairman of the Board. Other members of the Board for that period were Mr. Haukur Þór Haraldsson, from Landsbanki Íslands, and Ms. Margrét Sveinsdóttir, from Glitnir Bank, appointed by the commercial banks, Mr. Guðmundur Hauksson, from Spron Savings Bank, appointed by the savings banks, and Mr. Andri Sigurðsson, from Kaupthing, appointed by companies trading in securities. The Minister of Commerce appointed Mr. Halldór Þ. Halldórsson as an observer on behalf of depositors. Ms. Hjaltested left her chairmanship in the middle of 2006 and a new chairman, Ms. Guðrún Þorleifsdóttir, lawyer at the Ministry of Business Affairs, was appointed in her place. In mid-year 2007, Mr. Kolbeinn Árnason, Kaupthing, replaced Mr. Andri Sigurðsson as representative of companies trading in securities. The Minister of Business Affairs appointed Ms. Áslaug Árnadóttir, Director-General in the Ministry of Business Affairs, then acting Permanent Secretary of State, as chairman of the Board of the Guarantee Fund as from the Fund's annual general meeting in 2008 (29 February) until the Fund's annual general

43. In this context, it is worth recalling, that when the Deposit Protection Fund operated from 1985 to 1999 as a government institution, regulation No. 54/1986 originally provided for a board with three members. Two were appointed by the Minister of Business Affairs after being nominated by the banks, but the third, the Chairman of the Board, was appointed by the minister without prior nomination. The number of Board Members of the Fund was increased to six, half of which were nominated by the commercial banks and the other three were nominated by the Central Bank of Iceland, the Minister of Finance and the Chairman was nominated by the Minister of Business Affairs, see Article 75 of Act No. 43/1993. It seems that the arrangement that one of the of the representatives that the Minister of Business Affairs appoints to the Board of the Guarantee Fund is an employee of the Ministry of Finance and that the Chairman of the Board is an employee of the Ministry of Business Affairs is based on previous arrangements even though it is not derived from the current legislation.

meeting in 2010. Ms. Jónína S. Lárusdóttir, Permanent Secretary of State of the Ministry of Business Affairs, was appointed alternate chairman. The Minister appointed Mr. Þórhallur Arason, Director-General in the Ministry of Finance, for the same term, with Mr. Pétur U. Fenger, officer at the Ministry of Finance, as his alternate member. The member companies' representatives on the Fund's Board of Directors, as from the annual general meeting 2008 (February), remained unaltered. The observer remained the same.⁴⁴

According to the minutes, the Board of the Guarantee Fund held seven recorded meetings in 2007, and in 2008 the Board held four meetings until the first of October, i.e. on 26 February, 21 April, 30 June and 1 October. The agenda of the Board meetings included topics such as return on and management of the Fund's assets, calculation of contribution to the Fund's departments and cooperative agreements of the banks with foreign guarantee funds concerning topping-up arrangements. Towards the end of September 2008, the Guarantee Fund had concluded such agreements with the guarantee funds in Norway, Finland, Denmark (on behalf of the Faeroe Islands), the United Kingdom (dated 31 October 2006) and the Netherlands (dated 22/30 April 2008). Further agreements were under preparation, inter alia with the Swedish guarantee fund. It can be deduced from the Board's minutes that the Icelandic banks had emphasised that such agreements existed. Thus the minutes from 22 November 2007 show that, in discussions on an agreement with the Finnish guarantee fund, the chairman had stated "that it was urgent that Kaupthing would accede to the Finnish fund", but the foreign guarantee funds emphasised that agreements between the guarantee funds existed to facilitate settlement in case the payment obligations of the funds were put to the test. However, it appears that the foreign funds showed signs of reluctance to conclude such cooperative agreements. The minutes of the Guarantee Fund's Board of Directors, dated 1 October 2008, reveal that "something was causing a delay by the Swedes" because an agreement submitted to them by the Guarantee Fund in the summer of 2008, in its final version, had not yet been returned. Furthermore, it was stated that the French guarantee fund was not willing to conclude a "topping-up" agreement with an Icelandic financial institution that had applied for accession. Moreover, it was made known that the Italians had delayed the matter.

The Act on the Guarantee Fund states that the Fund's Board of Directors is authorised to employ a managing director of the Fund or contract a legal entity to manage and hold the Fund. This legal entity may be the Central Bank of Iceland and a depository according to the Act on Undertakings for Collective Investment in Transferable Securities. Since the establishment of the Depositors' and Investors' Guarantee Fund and until the failure of the big Icelandic banks at the beginning of October 2008, an agreement was in force between the Fund and the Central Bank of Iceland specifying that an officer of the CBI should be employed as the Fund's managing director. From 2005 until October 2008, Mr. Jónas Þórðarson, officer at CBI's Financial Stability Department, acted as the Guarantee Fund's managing director. According

44. At the Guarantee Fund's annual general meeting in 2008, it was agreed that the remuneration for Board Members would be ISK 53.000 per month and that the Chairman would receive double that. The remuneration for observers was ISK 26.500 per month.

to information from the CBI the managing director's occupational activity was not based on a fixed work percentage, as the time dedicated by Mr. Þórðarson to this work was determined by incidental tasks concerning the Fund. Thus, these tasks became increasingly time-consuming, and in 2008, until the collapse of the banks, 50-75% of Mr. Þórðarson's working hours were dedicated to the Fund. In October 2008, the Fund contracted the law firm Lex to carry out certain tasks for the Fund, and one lawyer from Lex acted temporarily as the managing director of the Fund.

As from 2001, contracts on behalf of the Guarantee Fund's Board of Directors have been made with banks and financial institutions to manage the Fund's assets in terms of trust activities, return on assets and administration of assets in accordance with the Fund's investment policy.⁴⁵

In the SIC examination and comparison with the Guarantee Fund's sister organisations abroad, it was noted that, in many countries abroad, guarantee funds are engaged in much more extensive operations than in Iceland, and in many cases they participate actively, e.g. in the Nordic countries, in educational activities concerning risk-taking in banking and contingency measures in the event of crisis in the operations of banks and financial institutions. An example of this would be Bankenes sikringsfond [a guarantee fund] in Norway which prepared over the period 2004-2006 a summary of various scenarios that might emerge and require solutions in a bank crisis. On 2 Mars 2007, this summary, as well as guidelines on these scenarios, were published in a report and presented on the website of the fund.⁴⁶

In Article 4(5) of Act No. 98/1999 it is stipulated that every two years, or more frequently if so required, the Board of Directors of the Depositors' and Investors' Guarantee Fund shall report to the Minister on its views regarding the Fund's minimum assets as defined in provisions of the Act. Data examined by SIC, mostly from the period 2006-2008, do not show that this provision, which will be referred to in more detail in Chapter 17.10.1, was ever implemented.

As stated above, the Guarantee Fund of the Commercial Banks was an independent government institution. That Fund was dissolved on 1 January 2000. As from the year 2000, Section D of the annual accounts of the central government have recounted the annual accounts of the Depositors' and Investors' Guarantee Fund (TIF). Pursuant to Act No. 88/1997, the Government Financial Reporting Act, the annual accounts of the central government shall cover "Government financial institutions, including state-owned banks and insurance companies, as long as they are

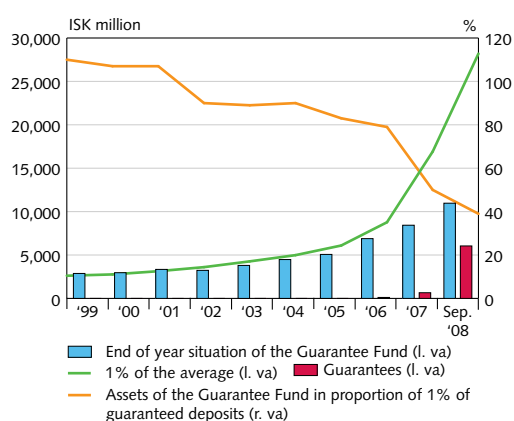
45. The Fund's investment policy states essentially that proportion of domestic government bonds should be between 30-75%, 15-55% in foreign government bonds and 0-15% in foreign equity. Furthermore it was stated that the proportion of government bonds could not be lower than 70% of the assets in management, applying to both domestic and foreign government bonds. In the minutes of the Board of Directors of the Guarantee Fund from 1 October 2008 it is revealed that the returns of the asset management parties that managed the assets of the Fund from the year-end 2007 until august 2008 had been 26,6% for MP Investment Bank and 20,1% for Kaupthing. It is noted that the benchmark had been raised by 21,5% in the period, but a substantial weakening of the krona and the rise of indexed domestic bonds accounted for the good return. In the minutes it was noted that at the end of August, 56% of the assets of the Guarantee Fund had been in domestic government bonds, 39% had been in foreign government bonds and 5% in foreign equity.

46. The report is accessible on the Fund's homepage: <http://www.banknessikringsfond.no/no/Hoved/Nyheter/Administrasjon-av-banker-i-krise--rapport>.

neither unincorporated enterprises nor joint-stock companies". The Icelandic National Audit Office has made, in its reports on the auditing of the central government's annual accounts, most recently for the year 2007, observations on this and has referred to the fact that the Guarantee Fund "can by no means be considered as state-owned and the State has no responsibility in regard to its obligations either".⁴⁷

17.6 Deposits and the Guarantee Fund's Situation 2000-2006, and Indications on Strengthening the Deposit-Guarantee Scheme

Figure 2
Assets of the Depositors' and Investors' Guarantee Fund
Income years of the Guarantee Fund



Source: The Central Bank of Iceland, The Depositors' and Investors' Guarantee Fund.

The Guarantee Fund began operations at the beginning of 2000 and received, at that time, the assets of the previous deposit guarantee funds. At the beginning of 2000, these assets were in total ISK 2.963 million, whereas guaranteed deposits in the Icelandic banking system were, on average, ISK 276 billion in 2000. The Fund's assets were thus approximately 1.07% of the deposits guaranteed. The Act establishing the Guarantee Fund had adopted the criterion already laid down in the previous law on the guarantee funds, i.e. that the total assets of the Deposit Department should, as a minimum, total 1% of the average of deposits guaranteed in the commercial and savings bank in the previous year, see Figure 2. In 2000 and 2001, the Guarantee Fund's assets were sufficient to meet the said 1% minimum, whereas from 2002 on deposits increased substantially. Thus, the average sum of deposits had risen to ISK 498 billion in 2004. What was short of the 1% limit was collected later from the financial institutions, either as a yearly charge, which however could not rise above 0.15% of the average of deposits guaranteed in the financial institution concerned in the preceding year, or by way of letters of guarantee submitted by the financial institutions as shown in Figures 2 and 3.

Towards the end of 2001, Ms. Jóhanna Sigurðardóttir, MP, submitted a formal question in Althingi to the Minister of Business Affairs concerning the Guarantee Fund. She asked, amongst other things, if the Minister was of the opinion that the Guarantee Fund had the capacity to sustain possible losses of the financial institutions, on the one hand on account deposits in commercial banks and saving banks, and on the other hand on account of investment securities. A written answer from Minister of Business Affairs, Ms. Valgerður Sverrisdóttir, referred to the very purpose of the Act on Deposit Guarantees, i.e. to provide customers of credit institutions with minimum protection in case of payment difficulties of the entity concerned. Furthermore, rules concerning disbursements from the Fund were described. Later the following is stated: "A major bankruptcy of a financial institution can result in the Fund being left with insufficient assets to meet the claimants' demands for disbursement and under these circumstances the Fund is authorised to take out loans to cover such disbursements." The MP also asked whether the Minister could give depositors any assurance to the effect that the protection of their deposits in the banks or of their securities assets was sufficient to compensate in full for their losses in case of bankruptcies or crisis in the financial market or of individual financial institutions. The Minister answered:

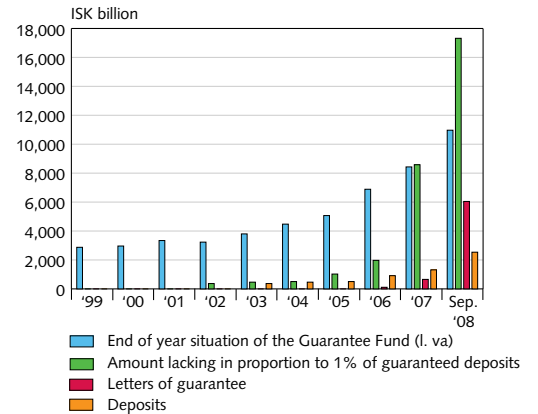
47. Revised Central Government Accounts 2007, page 9.

“No. Demands for disbursements are not satisfied in full unless the Fund’s assets cover such disbursements.” Then the Minister referred to points previously stated in her answer concerning the minimum protection for each claimant. The MP finally asked if the Minister was prepared to take measures to ensure that the Guarantee Fund would assume full coverage for individuals on account of deposits in banks or of securities assets. The Minister’s answer was negative and she was of the opinion that it was most important to satisfy in full the demands of individuals with low deposits. Evidence indicated that relatively few individuals had deposits over the minimum amount guaranteed and consumer protection in the form of a deposit guarantee scheme was not needed for prosperous individuals. Moreover, the Minister pointed out that protection of deposits was more efficient in Iceland than in most countries within EEA area, excepting Norway, and further still, Iceland had not implemented exemptions in accordance with the EU directive.⁴⁸

At the Financial Supervisory Authority’s (FME) annual general meeting on 3 November 2004, FME’s Director General, Mr. Páll Gunnar Pálsson, stated that in his opinion it would be reasonable, inter alia in view of changes that had been brought about as to the position and role of the owners of active shares in financial institutions and insurance companies, to examine, on a regular basis, if it would be necessary to strengthen the framework within which these institutions operated. Mr. Pálsson stated it would be right to raise the question if the then existing framework provided satisfactory restraint vis-à-vis and/or impetus for owners of active shares to emphasise important long-term interests in the operations of financial institutions and insurance companies as these entities are of both societal and economic importance. Mr. Pálsson emphasised that the extremely rapid growth of many financial institutions might point in the opposite direction. Mr. Pálsson mentioned issues which, in the opinion of the FME, might be considered in this context and went on to describe the views presented in the margin.⁴⁹

A month later, i.e. 7 December 2004, two formal questions were presented in Althingi concerning the Guarantee Fund, when Ms. Jóhanna Sigurðardóttir, MP, submitted questions to the Minister of Business Affairs, who presented written replies on 1 and 10 February 2005. The first formal question replied to concerned the Guarantee Fund’s assets and contributions made to the Fund by financial institutions; furthermore, the question was raised as to whether the FME had made any observations concerning the Fund’s situation with regard to coverage or risk management, or other factors relevant to the Fund’s financial situation and the security of depositors’ funds. The MP also asked whether proposals had been made by the FME to strengthen the financial position or surveillance of the Fund. Ms. Valgerður Sverrisdóttir, Minister of Business Affairs, referred in her answer to the fact that, in accordance with Article 15 of Act No. 98/1999, the FME had the role of supervising that the Guarantee Fund’s operations were in line with laws, regulations and statutes of the Fund. The answer also revealed that the FME had not made observations directed to the Guarantee Fund about the Fund’s situation as regards coverage or risk management or other

Figure 3
Assets of the Guarantee Fund and deposits
Income years of the Guarantee Fund



Source: The Central Bank of Iceland, The Depositors' and Investors' Guarantee Fund.

“First, it should be considered whether it is necessary to strengthen the insurance cover introduced with Act No. 98/1999 on Deposit Guarantees and Investor Compensation Schemes. [...] It is time to consider whether this guarantee scheme needs to be strengthened, with regard to the increased importance of financial institutions and the changes that have taken place in the ownership of these institutions since this scheme was last reviewed. We could give it some thought whether financial institutions which are members of the Guarantee Fund, and thereby, indirectly, its active owners, should contribute more to the fund. It may be mentioned the European Union is now considering a deposit guarantee scheme for insurers.”

Mr Páll Gunnar Pálsson, Director General of the FME, at the FME annual meeting on 3 November 2004.

48. Parliamentary record 2001-2002, Section A, pp. 1635-1638.

49. Mr. Pálsson’s speech was published on the homepage of the FME (Financial Supervisory Authority) and is accessible: <http://www.fme.is/lisalib/getfile.aspx?itemid=2777>.

factors concerning the Fund's financial situation and security of depositors' funds. Furthermore, the Authority had not submitted proposals vis-à-vis the Guarantee Fund to strengthen its financial position or regarding surveillance of the Fund. Towards the end of the reply it was stated that nevertheless it was only right to mention that at FME's last annual meeting on 3 November 2004 the Authority's Director General had discussed the need to strengthen depositors' and investors' coverage. Subsequent to that, the section of the speech recited above is quoted.⁵⁰

The second formal question the Minister of Business Affairs replied to concerned the MP's request for information on how depositors' coverage was arranged in Iceland in comparison to other Nordic countries, as well as information on average deposits in the banks. The last question was whether the Minister thought it would be appropriate, in view of the current situation in the financial market, to take measures to better secure the position of depositors, and if she thought that their position had been made sufficiently safe in case deposit institutions would suffer losses to the extent that they were unable to fulfil their obligations vis-à-vis depositors. A written reply made by the Minister of Business Affairs, Ms. Valgerður Sverrisdóttir, reveals her opinion that the current minimum guarantee of deposits, in accordance with the Act on depositors and an investor-guarantee scheme, offered depositors sufficient protection. Towards the end of the reply, the Minister expressed her opinion that there was good reason to investigate in the months ahead whether deposit institutions should increase their contributions to the Fund, e.g. by raising the percentage of guaranteed deposits at the Fund's disposal at any given time.⁵¹

It has not been demonstrated that the words of the Director General of FME above, spoken at the annual general meeting in November 2004, nor the final words of the above mentioned reply, made by the Minister of Business Affairs in Althingi in February 2005, lead to any specific propositions to adopt amendments to the Act on the operations of the Depositors' and Investors' Guarantee Fund in the months that followed.

However, it must be emphasised that at a meeting between the Prime Minister, the Minister of Finance, the Minister for Foreign Affairs and the Minister of Business Affairs and the Board of Governors of the Central Bank of Iceland, as well as the Director General of the FME, held on 15 January 2004, a decision was made to establish a consultative group, made up of representatives from the Prime Minister's Office, the Ministry of Finance and the Ministry of Business Affairs, along with representatives of the CBI and the FME, the objective of which was to prepare the Government's contingency plan in case of crisis in the financial system. The consultative group submitted an explanatory memorandum to the parties, which had established it, known as the Letter of Resolution of 17 February 2006. The memorandum suggested that a formal consultative group should be established to conduct the contingency effort (see more detailed discussion about the consultative group in Chapter 17.10.2 below and Chapter 19.2). Furthermore, the group discussed in its memorandum whether the then existing legislation

50. Parliamentary record 2004-2005, Section A, pp. 2984-2985.

51. Parliamentary record 2004-2005, Section A, pp. 3730-3732.

would suffice to secure the response necessary to address difficulties in the financial market. The memorandum pointed out that it was necessary to plan for concerted actions of the Guarantee Fund, the CBI, the FME and, where appropriate, the Ministry of Finance. Attention was drawn to the fact that it was of great public interest that the disbursements from the Fund due to lost deposits, securities and cash were prompt. In addition, attention was drawn to the fact that, pursuant to Act No. 98/1999, the commercial banks on the one hand and the savings banks on the other hand, were authorised to establish security funds to which all commercial banks or all savings banks should be members, with the aim of securing the interests of the customers as well as the financial security of the commercial banks or the savings banks. It was emphasised that the Deposit Protection Fund of the Savings Banks operated on the basis of this provision, whereas the commercial banks had not established any such security fund. The working group's proposals, presented in the memorandum, suggested that amendments to the provisions of the Act on the Depositors' and Investors' Guarantee Fund were necessary, but failed to describe in detail the nature of such amendments, with the exception that in paragraph 5 of the proposals it was suggested that the role and involvement of the Guarantee Fund needed to be considered and further still interaction with the Act on Bankruptcy Proceedings. Moreover, the Guarantee Fund's disbursement procedure needed to be looked into.⁵²

SIC's examination has not revealed any data showing that further work had been carried out to prepare proposals for amendment to the Act on the Depositors' and Investors' Guarantee Fund in the period 2000-2006, as a response to the consultative group's consideration; this is neither revealed in the replies of the Minister of Business Affairs to questions put to her in Althingi quoted to above, nor in the aforementioned speech of the FME's Director General in November 2004. Amendments made to the Act on the Guarantee Fund during these years exclusively concerned harmonisation of provisions of the said Act with adopted amendments to EU directives and other Icelandic legislation.

When the Guarantee Fund began operations in 2000, deposits in the Icelandic banking system subject to the Fund's coverage were exclusively in establishments of the commercial banks and savings banks in Iceland and that was still the case well into the year 2005. This changed dramatically when the Icelandic banks increased their activities abroad by establishing overseas branches which accepted deposits. In cases where the Icelandic banks purchased foreign companies, or established new ones and operated these as independent subsidiaries, the subsidiaries themselves did not become members of the Guarantee Fund, as their deposit-taking activities were covered by the deposit-guarantee scheme in the country concerned. Thus, deposits in a subsidiary of Landsbanki in the United Kingdom, i.e. Heritable Bank, and in a subsidiary of Kaupthing in the UK, Singer & Friedlander, were covered by the UK deposit-guarantee scheme.

52. "Letter of Resolution, Explanatory Report and Understanding" of the consultative group of the representatives of the Prime Minister's Office, the Ministry of Business Affairs and the Ministry of Finance and the representatives of CBI and the FME concerning the Government's contingency plan to deal with a possible crisis in the financial market, dated 17 February 2006. This document of 28 pages, attachments included, is accessible via the following link: http://www.forsaetisraduneyti.is/media/frettir/Skilabref_greinargerð_og_samkomulag_.pdf.

Chapter 18 outlines the raising of deposits in the Icelandic banks' branches abroad. As stated in Chapter 18, the deposits raised initially were mostly the so-called wholesale deposits. This raising of deposits had commenced already in 2005, as in the case of Landsbanki's London branch. Towards the end of 2005, deposits in the Icelandic banking system covered by the Guarantee Fund totalled ISK 689.5 billion,⁵³ 8% of which were in the banks' branches abroad, largely in the form of wholesale deposits. The Guarantee Fund's assets at the end of 2005 were in total a little over ISK 5 billion.

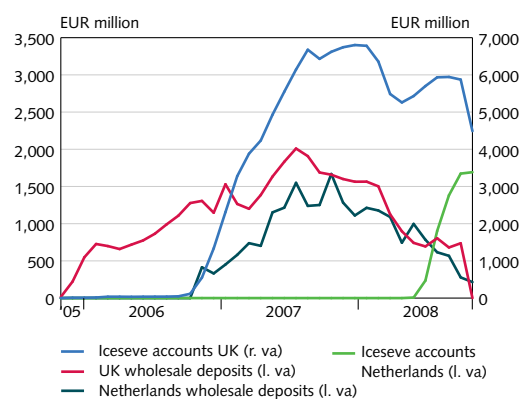
17.7 Increased raising of deposits abroad and its effects on the Depositors' and Investors' Guarantee Fund's obligations.

In 2006, a change occurred with regard to the acceptance of deposits in Icelandic banks in that the banks started to set up special deposit accounts in branches abroad, first and foremost intended for individuals. Landsbankinn was first with its Icesave accounts. The first of these accounts were created in October 2006 in the bank's London branch. It was not until a year later, in October 2007, that Kaupthing set up the Edge accounts, in the bank's branch in Finland in November 2007. At Kaupthing, the Edge accounts were either offered by independent subsidiaries of the bank or by its branches.⁵⁴ Glitnir introduced analogous accounts, Save & save, at the end of June 2008. These accounts were marketed as high interest deposit accounts competing with comparable accounts offered by banks in the countries concerned. As described in chapters 7 and 18, deposits in these accounts increased rapidly in the two aforesaid banks in a short period of time. At the end of the year 2006, deposits in the Icesave accounts in the UK amounted to a total of GBP 774 million or EUR 1.3 billion (ISK 124.8 billion), but as shown in Figure 4, the deposits reached their highest point in late 2007/early 2008 when they totalled GBP 4.9 billion (EUR 6.8 billion, or ISK 623.5 billion).

The accumulation of so-called wholesale deposits in the branches of the banks abroad was also an important aspect of the financing of all of these banks. In the case of Landsbankinn, these deposits reached their highest point in the London branch in July 2007, when they amounted to EUR 2 billion in total, and in the branch in the Netherlands they reached their highest point in October 2007, amounting to almost EUR 1.7 billion.

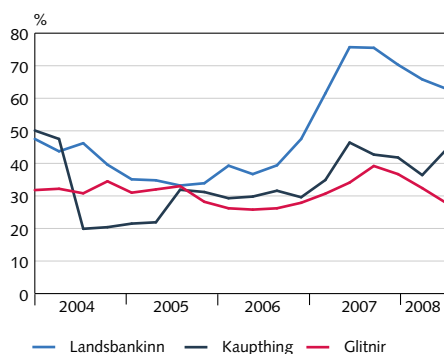
This increased deposit raising of the Icelandic banks abroad was done equally in reaction to limited availability of foreign credit both in the form of direct loans and issuance of bonds, and in reaction to criticism which credit-rating agencies had put forward at the beginning of 2006 regarding how low a share the deposits represented in their financing. Figure 5 shows the change in deposits as a percentage of the banks' lending activities in the latter half of 2006, and the subsequent increase in this regard in 2007, especially in the case of Landsbankinn. Figure 6 shows how the percentage of foreign parties involved in the deposit activities of the banks increased in the latter half of

Figure 4
Balance of the Icesave accounts



Source: Landsbanki Íslands hf.

Figure 5
Deposits as a percentage of the banks' lending activities



Source: Kaupthing, Glitnir and Landsbanki.

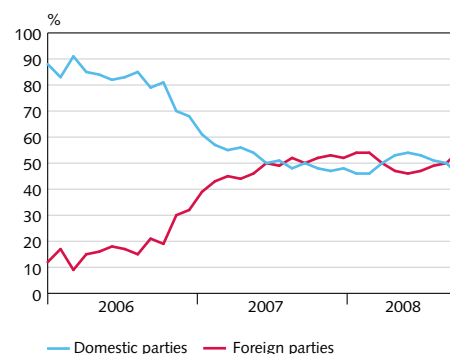
53. According to data from the Guarantee Fund.

54. The Kaupthing Edge accounts covered by the Guarantee Fund were offered in Finland, Sweden, Norway, Germany and Austria.

2007, and how in the summer of 2008, over 50% of the deposits came from foreign parties. These increased deposits that were accumulated through the overseas branches of the Icelandic banks naturally led to increased obligations on the part of the Depositors' and Investors' Guarantee Fund. The total amount of deposits covered by the Guarantee Fund increased substantially, and the owners of the deposits of the Icesave and Edge accounts began to limit the amounts in their accounts to the minimum compensation guaranteed by the guarantee funds. With respect to the Guarantee Fund this amounted to the equivalent of EUR 20,887 at the exchange rate of the ISK at each time, in addition to which there could be supplementary compensations, in accordance with agreements in the relevant countries, so-called "topping-up" agreements.

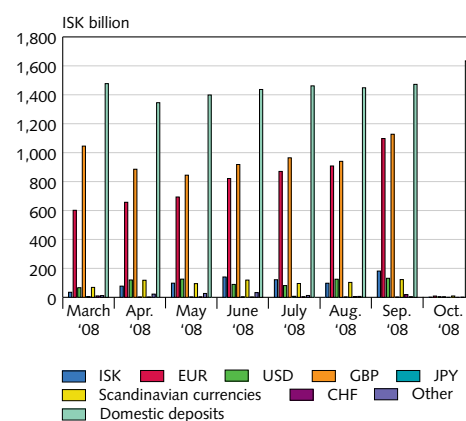
This development in the operations of the Icelandic banks had also the effect of creating substantial obligations for the Icelandic Guarantee Fund due to deposit accounts in currencies other than the ISK and accounts in branches of the banks abroad. A general principle in obligations law states that the place of fulfilment, i.e. the place of payment, is at the creditor's residence. That means that the debtor must make the payment at the creditor's residence or workplace, unless the provisions of previous agreements or applicable law indicate otherwise. Furthermore, according to the law of obligations, the payment must be made in the currency of the place of payment, unless it is indicated in a previous agreement or by circumstances at each time that payments shall or may be made in another currency.⁵⁵ There were no provisions in the Act on the Guarantee Fund regarding the authorisation of the Guarantee Fund to pay demands directed towards the Fund in another currency than that of the respective deposit, i.e. in accordance with the general rules of the law of obligations regarding place of payment and fulfilment of claims, before the Emergency Act No.125/2008 entered into effect on 6 October 2008.⁵⁶ It must be concluded that there was at least some doubt with regard to whether the Guarantee Fund had the authorisation to decide unilaterally what currency it would use to pay the claims directed towards the Fund in relation to deposits in foreign currencies, located in an overseas branch, and owned by individuals or legal persons domiciled outside of Iceland. The amendments that were made by the adoption of Act No. 125/2008 with regard to the legal position of those who already had deposits in the branches of the Icelandic banks abroad, and the provisions of the EU directive on deposit-guarantee schemes and the principle in European law of prohibition of discrimination, will not be discussed specifically here. Figure 7 shows the division between deposits of foreign parties in the branches of the banks abroad by currencies. It should be noted that neither the minutes of the Board of Directors of the Guarantee Fund nor any other data made available to the SIC indicate that there were any specific discussions on the aforementioned effects of the increased obligations with regard to foreign currencies, either within the Guarantee Fund or in communications between the Fund and the authorities. Even though the Chairman of the Board of Directors of the Guarantee Fund and the employee of the Ministry of Finance that was a member of the Board had in some regard taken part in

Figure 6
Total deposits within the Icelandic banking system
Proportional share



Source: Central Bank of Iceland.

Figure 7
Deposits of foreign parties in the foreign branches of the Icelandic banks
Domestic deposits for comparison



Source: Central Bank of Iceland.

55. Þorgeir Örlygsson et. al.: Kröfuréttur I, efndir kröfu. Reykjavík 2009, p. 117.

56. See now Article 9 of Act No. 98/1999, cf. Article 8 of Act No. 125/2008.

the preparation of the bill that later became the so-called Emergency Act, i.e. Act No. 125/2008, as described in more detail in Chapter 20, there is no indication that the Board had taken part in the preparation of that legislation, or that it had discussed whether, and in what form, legislative changes were needed in the opinion of the Board, apart from discussions within the Board, the last of which took place on 30 June 2008, concerning how legislative changes were proceeding in continuation of the revision initiated following the communication from the Icelandic Financial Services about increasing exemptions from the obligation to pay to and from the Guarantee Fund. This rapid and substantial increase of deposits, especially in branches of the Icelandic banks abroad, led only to a limited increase in payments from the banks to the Guarantee Fund. There were first and foremost three reasons for this.

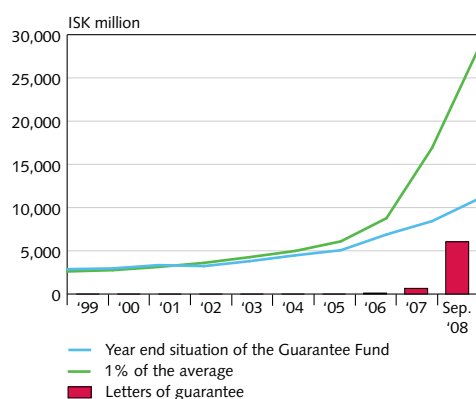
First, according to statutory provisions, the banks' and savings banks' payments to the Guarantee Fund were to be settled once a year, i.e. 1 March every year, for the preceding year. Second, annual payments were to be based on the average of guaranteed deposits with the relative establishment in the preceding year. Third, annual payments of a financial institution could not amount to more than 0.15% of the average of guaranteed deposits in the financial institution concerned in the previous year, and the balance required to reach the 1% minimum of total assets of the Fund was settled by letters of guarantee from the relevant bank or savings bank. Figures 3 and 8 show this development. In addition, according to statutory provisions, claims for payments to the Guarantee Fund on the basis of letters of guarantee could not be higher each year than one-tenth of the minimum size of the Fund.

Annual payments of the banks and saving banks to the deposits department of the Guarantee Fund were, as aforesaid, in compliance with the law calculated from the average of guaranteed deposits in the previous year, not from deposits as they were by the end of the year in question. This does not have a considerable effect when the growth of deposits is relatively stable, but it is a different matter when there is a substantial increase of deposits within a single year. When the difference between guaranteed deposits at year-end and the average which is the basis of calculation of payments to the Guarantee Fund from banks and savings banks is examined, it is revealed that the difference in payments for the year 2004, which were made in the beginning of 2005, was 6%. In the following years, the difference is 13% for 2005 and 21.5% for 2006. It then reaches 37% for calculations of payments for the year 2007, which were made at the beginning of 2008.

In Table 2, there is a comparison, on the one hand, of the amount of annual payments of the banks and savings banks, i.e. payments and letters of guarantee calculated on the basis of 1% of the average deposits, and, on the other hand, the payments if they had been calculated on the basis of 1% of guaranteed deposits at year-end. As shown, this difference became incrementally greater as the deposits increased more rapidly. For the year 2005 (payments made at the beginning of 2006), the difference was ISK 1.9 billion, but for 2007, the difference was just over ISK 6.2 billion. It must be noted that calculations for September 2008 did not become payable as regards the three major banks that collapsed in October of the same year.

The proportion of letters of guarantee was far greater than that of direct cash payments to the Fund in annual settlements to the Guarantee Fund as a

Figure 8
 Situation of the Guarantee Fund
 Income years of the Guarantee Fund



Source: The Central Bank of Iceland, The Depositors' and Investors' Guarantee Fund.

Table 2. Comparison of the amount of annual payments into the Guarantee Fund on the basis of 1% of the average deposits or on the basis of 1% of guaranteed deposits

	<i>Deposit at year-end</i>	<i>Guaranteed deposits (1%)</i>	<i>Maximum- payment (0,15%)</i>	<i>Average deposits</i>	<i>Guaranteed deposits (1%)</i>	<i>Maximum- payment (0,15%)</i>	<i>Difference of deposits</i>	<i>Difference of guaranteed deposits</i>	<i>Difference of maximum payment</i>	<i>Proportional lack of maximum payment</i>
	- A -	- B - 1% * A	- C - 0,15% * A	- D -	- E - 1% * D	- F - 0,15% * D	- G - A - D	- H - 1% * G	- I - C - F	- J - I/F*-1
2004	529,141	5,291	794	498,331	4,983	747	30,810	-308	-46	6%
2005	689,597	6,896	1,034	609,369	6,094	914	80,228	-802	-120	13%
2006	1,064,759	10,648	1,597	877,178	8,772	1,316	187,581	-1,876	-281	21%
2007	2,318,432	23,184	3,478	1,691,596	16,916	2,537	626,837	-6,268	-940	37%
Sep. 2008	3,123,281	31,233	4,685	2,819,204	28,192	4,229	304,077	-3,041	-456	11%

All amounts are in ISK million.

Source: The Depositors' and Investors' Guarantee Fund.

consequence of the statutory limitation stipulating that the annual payment of each bank or savings bank could only amount to 0.15% of the average of guaranteed deposits of the respective bank or savings bank on the preceding year, and consequently the funds available to the TIF for investment was also limited. The rapid growth of deposits in the Icelandic banks was not fully reflected in the tangible funds available to the Guarantee Fund because of this limitation, and because calculations were to be based on average deposits rather than on the position of deposits at year-end. Thus, letters of guarantee from banks and savings banks, which naturally depended on the ability of the relevant bank or savings bank to pay if they were to be put to the test, became a substantial portion of the Guarantee Fund's assets. Table 1 shows that in the year 2006 and up to and including 2008, payments for preceding years amounted to a total of ISK 4,766 million, whereas letters of guarantee submitted amounted to ISK 6,045 million. After receiving payments in 2007, the Guarantee Fund's assets totalled ISK 14,379 million, whereof letters of guarantee represented ISK 6,045 million. It must be noted that the Guarantee Fund had not redeemed the letters of guarantee of previous years when the banks collapsed. This is hardly surprising, since the letters could only be redeemed in cases of non-payment, see previous discussion.

Table 3. Contributions and letters of guarantee

	<i>Contributions on account of deposits in the previous year</i>	<i>Letters of guarantee on account of the previous year</i>
2006	914	112
2007	1,315	545
2008	2,537	5,388
Samtals	4,766	6,045

Source: The Depositors' and Investors' Guarantee Fund.

From what has been related earlier concerning the increased deposit raising of the Icelandic banks in their branches abroad, it is clear that there was a fundamental change in the proportion of deposits in the financing of the Icelandic banking system in the year 2006 and up to and including 2008. As a consequence, the commitments of the Guarantee Fund due to deposits increased substantially in this period, but no calculations of the possible

obligations of the Guarantee Fund were made by the Guarantee Fund or the Icelandic authorities apart from the gathering of information about the total deposits, as has been noted earlier. As an example, the extent of the obligations of the Guarantee Fund was not calculated with regard to the minimum compensation that the Fund would have to disburse. By the end of 2005, deposits in Icelandic banks amounted to ISK 689 billion, but had grown to ISK 3,123 billion by 1. October 2008. The assets of the Guarantee Fund grew in this period by 115%, from ISK 5,068 million at year-end of 2005 to ISK 10,871 million the end of September 2008.⁵⁷ Direct payments from banks and savings banks accounted for 82% of the growth, whereas 18% came from returns from the investment of its assets. It should be pointed out that in spite of the fact that the Guarantee Fund's gathering of information on the development of deposits was only carried out once during the year, in order to prepare the banks and savings banks for their payments on 1. March, it seems that this development ought to have been obvious to the Board of Directors of the Guarantee Fund. This increased emphasis, especially on the part of Landsbankinn and Kaupthing, on deposit raising abroad, was both well known from coverage in the news media, and due to the fact the banks had representatives on the Board of Governors of the Guarantee Fund as well. Additionally, the Board of Directors of the Guarantee Fund participated in the negotiation of agreements with guarantee funds in the countries where the Icelandic banks' branches were operating, with the aim of ensuring topping-up for deposits.

17.8 The Icelandic Financial Services Association requests a Revision of the Rules regarding which Deposits the Depositors' and Investors' Guarantee Fund (TIF) guarantees

As mentioned earlier (in Chapter 17.4.4), Iceland had not taken the approach, when implementing the EU directive on deposit-guarantee schemes, to exercise its authorisations to exclude specific types of deposits from the deposit-guarantee scheme, except to a limited degree. Such exceptions both reduce the obligations of the Guarantee Fund and the calculation basis for the financial institutions' contributions to the Fund, thus lowering their contributions.

During the hearing before the SIC, Mr. Jón Sigurðsson, former Minister of Commerce, stated that around mid-December 2006, Mr. Halldór J. Kristjánsson, one of two CEO's of Landsbanki, had come to see him at the Ministry of Business Affairs.⁵⁸ Mr. Kristjánsson business had been to request that the rules regarding the Guarantee Fund be extended "because a part of the deposits they [were] accumulating in this electronic form [came] from professional clients, [came] from local authorities, charities, other organisations and professional clients in the UK".⁵⁹ Judging by Mr.

57. Here it is assumed that calculated contributions in 2007 were paid in March 2008, but there is no information available on the returns of the Fund's assets in that period. Nevertheless, one can speculate that foreign exchange rate gain might have been a considerable portion, provided that the Fund's assets were as stated earlier in the text and in annual reports.

58. Mr Jón Sigurðsson was the Minister of Business Affairs from 15 June 2006 until 24 May 2007.

59. Statement by Mr Jón Sigurðsson before the SIC on 3 February 2010, p. 1.

Sigurðsson's description, with his request, Mr. Kristjánsson wanted to urge Icelandic authorities, or encourage them to exercise their aforementioned authorisations contained in Article 7(2) of Directive No. 94/19/EC to exclude certain deposits from their guarantee scheme. According to Mr. Sigurðsson the Ministry's officials took Mr. Kristjánsson's request for consideration. Their conclusion regarding the formal leeway for authorities to make such changes was that such amendments to the existing Icelandic regulation on the Guarantee Fund could not be made without amending the law. Mr. Sigurðsson states that Mr. Kristjánsson had been informed of this conclusion in the beginning of 2007, as well as of Mr. Sigurðsson's opinion that in light of the approaching general Parliamentary elections (the elections took place in the spring of 2007), he did not deem it appropriate that he, as Minister of Commerce, pursued further active preparations of the matter other than those described in a more detailed quotation to Mr. Sigurðsson's statement in the margin. In Mr. Sigurðsson description of the conversation he had with Mr. Kristjánsson in mid-December 2006, considerations were also presented which partly are referred to in the margin. Mr. Sigurðsson explained that he had unequivocally understood Mr. Kristjánsson so, on this occasion, and sought his confirmation thereof, that in relation to the deposits Landsbanki received through its branches in the UK, there would be no transfers of funds from there, "not in any direction", as Mr. Sigurðsson put it, cf. detail in the margin.

Subsequently, the Icelandic Financial Services Association sent a letter to the Ministry of Commerce dated 4 January 2007, or around the same time as Mr. Kristjánsson was, as described above, informed of the Ministry's conclusion concerning his request; in the letter the Association claimed they wished to point out to the Ministry there was a certain legal uncertainty regarding which deposits were considered "guaranteed deposits" within the meaning of Act No. 98/1999 on Deposit Guarantees and Investor-Compensation Schemes and Regulation No. 120/2000 on the same subject. In its letter, the Association pointed out that the EU directives covered per se all depositors and investors, but that the Member States were authorised to exclude certain parties from the guarantee. The list was extensive and included inter alia larger undertakings, the State and local authorities and their institutions, pension funds, undertakings for collective investment in transferable securities (UCITS), investment funds, etc. Also, the letter referred to how these matters were dealt with in the UK and the Netherlands. It stated that Britain had exercised its authorisation to exempt certain bodies from the guarantee and that in the Netherlands these authorisations for exemptions had been exercised to the fullest. The Association then brought up the competitive conditions of the Icelandic banks which sought to raise deposits abroad. The Association proposed to the Minister that the rules on the Icelandic Guarantee Fund (TIF) be amended in such a way that the exemptions, authorised in the directives, could be exercised. The Association inquired whether this might be done with the immediate adoption of a regulation, with reference to Article 9(7) and Article 18 of Act No. 98/1999, and sent, to that effect, a proposal for such an amendment of the regulation to the Ministry. The Association concluded its letter by pointing out that it would be preferable to strengthen the ground for establishing such provisions in a regulation by amending the law.

"[O]f course the writing on the wall was that it was very unlikely that I would still be in the Ministry after the election. Of course everyone who followed the public discussion could see this, so my conclusion was to prepare the ground but not to appoint the committee myself. The issue would simply be prepared and put before a new Minister as soon as he was in place, and this is how I really understood the matter. Other news regarding the Icesave deposits were not being discussed within the Ministry during the weeks, the months, that remained."

Statement by Mr Jón Sigurðsson before the SIC on
 3 February 2010, p. 2.

"Halldór Kristjánsson [CEO of Landsbanki] told me, because I specifically asked him, that it was part of their rules on Icesave that not one single pound of this money would ever be taken out of Great Britain, because I was asking him about this point: Is it clear that the risk involved for that branch – that there is always a balance against the risk in the country?
 [...] And he asserted that this was the case and it is important that this be revealed because of the news of their financial transfers, which admittedly did not take place until 2008.
 [...] But he asserted this to me and it went a long way to make me feel secure, I should stress that. [...] Always retained and invested and kept in the same place so that the risk would always be – so that there would always be enough to balance against the risk."

Statement by Mr Jón Sigurðsson before the SIC on
 3 February 2010, pp. 5-6.

Following this letter, representatives from the Ministry of Commerce held a few meetings with the Icelandic Financial Services Association. In the beginning of March 2007 the Ministry came to the conclusion, in accordance with its previous position on the request of Mr. Kristjánsson as described above, that it would not be possible to make the said amendment with the adoption of a regulation, as proposed by the Icelandic Financial Services Association. An exemption regarding the deposits in question would require an amendment of the Act on the Guarantee Fund. Mr. Jón Sigurðsson, then Minister of Commerce, decided to call for nominations to a committee to revise the Act.

17.9 The Minister of Business Affairs sets up a Committee to review the Act on Deposit Guarantees

Following the Ministry's of Business Affairs discussion on the request of the Icelandic Financial Services Association, the new Minister, Björgvin G. Sigurðsson, set up a committee to review the provisions of the Act on deposit guarantees and guarantee schemes. The committee was to investigate whether the depositors' insurance cover was too extensive with regard to current law, and whether the extent and amounts paid to the Guarantee Fund and by the Guarantee Fund, were equivalent to amounts paid in other countries where Icelandic financial institutions operated and which, in general, were taken into account in rule-making in Iceland. The investigation of the committee was to cover both of the Fund's departments. Furthermore, the committee was charged with examining whether there were grounds to propose amendments to the Act in relation to the EU directives on insurance schemes for investors and a guarantee scheme for depositors.

The committee was appointed on 30 May 2007, when the parties the Minister had called upon had sent their suggestions regarding the committee's representatives to the Ministry. The chairman of the committee was Ms. Áslaug Árnadóttir, Director of the Ministry of Business Affairs. Other members of the committee were Ms. Sigríður Logadóttir, Chief Legal Counsellor in the Central Bank of Iceland, appointed by the bank, Mr. Gunnar Viðar, lawyer, appointed by the Icelandic Financial Services Association, Ms. Árný Guðmundsdóttir, lawyer, appointed by the Financial Supervisory Authority, Mr. Vilhjálmur Bjarnason, Economist, appointed by the Investors Association, and Mr. Jónas Þórðarson, Managing Director of the Depositors' and Investors' Guarantee Fund (TIF). The committee was to submit its proposals to the Minister in September 2007.

The committee held its first meeting on 11 June 2007 and then met a few times during that summer. At the committee's meetings, memorandums were submitted, inter alia, concerning the committee's subject matter, as well as information on the arrangements of deposit guarantees in the neighbouring countries, and to what extent authorisations for exemptions in the EU directive had been exercised in these countries. Rules and amounts of payments into and out of these guarantee funds were also described the committee examined, inter alia the opinion of a few parties as regards discontinuing the insurance cover of those who were considered professional clients in accordance with the provisions of the EU directives. The committee

received some responses from the Icelandic Pension Funds Association and the Association of Local Authorities, arguing against such an amendment.

Table 5. Overview of amount distribution of deposits in commercial and savings banks

<i>Amount distribution</i>	<i>Total amounts in commercial and savings bank (ISK million)</i>		
<i>Domestic individuals</i>	<i>Number of deposits</i>	<i>Total</i>	<i>Time deposits</i>
< 0,5	585,462	33,773	15,517
0,5–1,7	45,419	45,339	14,237
1,7–5,0	25,326	75,877	20,776
5,0–100>	16,212	245,921	73,148
<i>Domestic legal entities</i>			
< 0,5	37,866	3,570	1,188
0,5–1,7	8,195	8,148	1,013
1,7–5,0	4,761	14,472	3,954
5,0–100>	5,472	638,269	221,227
<i>Foreign individuals</i>			
< 0,5	80,689	7,474	809
0,5–1,7	24,140	16,912	2,554
1,7–5,0	40,818	129,150	1,457
5,0–100>	21,978	409,081	3,936
<i>Foreign legal entities</i>			
< 0,5	322	19	1
0,5–1,7	30	29	4
1,7–5,0	26	88	2
5,0–100>	380	457,904	254,786
Total	897,096	2,086,026	614,609

Source: Compilation by The Ministry of Economic Affairs as of end of September 2007.

In the Ministry's reply to the SIC, received on 4 March 2009, the continuance of the committee's work is described as follows: "In the autumn of 2007 the so-called Northern Rock case came up and, subsequently, the committee decided to examine the deposits in Icelandic banks and how their deposits were distributed among the overseas and domestic branches of the banks."⁶⁰ Inquiries regarding deposits were sent to all financial institutions. Their replies were available in December 2007, but they were to be based on the deposits' status by the end of September 2007. According to the overview in Table 5, prepared in the Ministry of Business Affairs to summarise the replies from the financial institutions, and which indicates how the deposits were distributed relating to size in commercial banks and savings banks, the total deposits of domestic and foreign parties, both individuals and legal parties, at that time, amounted to ISK 2,086 billion. There were 897,096 deposit accounts but in the overview it is pointed out that a depositor can have accounts in more than one bank.

The sum of deposits that were less than ISK 1.7 million amounted to ISK 115.2 billion, while deposits ranging from ISK 1.7 to 5 million totalled ISK 219.6 billion. In the latter instance, an average deposit on an account was ISK 3 million. The minimum amount insured by the Guarantee Fund, specified as

60. It was on 22 February 2008 that UK authorities took over the operations of the bank Northern Rock.

ISK 1.7 million in the Act, was based on the EUR exchange rate at the time when the Act was passed, and, therefore, by the end of September 2007, this amount was ISK 1,828,866.

There were 782,123 accounts where deposits amounted up to ISK 1.7 million, and the sum of deposits on those accounts amounted to ISK 115.2 million, as stated above. Hence, accounts with larger deposits totalled 114,973. If that number is multiplied with the minimum amount of cover as it stood at the end of September 2007, ISK 1,828,866, it may be estimated that the Guarantee Fund's commitment regarding these accounts, would at the time have amounted to ISK 210 billion. In total, it may be estimated, that the Guarantee Fund's commitments, at the time, amounted to (115.2 + 210) ISK 325 billion. Still, the accounts excluded have not been deducted, e.g. deposit accounts of the members of the Guarantee Fund. Information is not available on the number of such accounts in the Ministry of Business Affairs' overview.

In the overview of the distribution of deposits in relation to size, the fixed-term amount is specifically indicated. In total, this amounted to ISK 614.6 billion out of ISK 2.086 billion, or a little less than 30 %. Of these ISK 614.6 billion, ISK 459 billion were in accounts of individuals and legal entities with deposits over ISK 100 million. Deposits below ISK 1.7 million amounted to ISK 115.2 billion in total. Thereof, ISK 35.3 billions were fixed-term deposits and ISK 29.7 billions were deposits on Icelandic individuals' accounts. In relation to accounts with deposits below ISK 1.7 million with Icelandic individuals, the fixed-term deposits were closer to 38 %, but in cases of foreign individuals, the ratio of fixed-term accounts in relation to amounts under ISK 1.7 million, were closer to 14 %.

In January 2008, the chairman of the committee, Ms. Áslaug Árnadóttir, compiled a draft bill regarding an amendment to Act No. 98/1999 on Deposit Guarantees and Investor Compensation Schemes. The copy the SIC has received is dated 13 January 2008, but it is evident that no policy has been adopted as regards several issues, e.g. the amounts to consider in the final bill, for instance regarding minimum compensations from the Guarantee Fund.

Amendments that appeared in this draft related to three issues in particular. Firstly, increase in the number of the categories of deposits, securities and cash excluded from the Guarantee Fund's coverage, was addressed, and therefore, also excluded from the calculation basis for payments to the fund.⁶¹ Secondly, changes to the amounts of total assets and payments in the Guarantee Fund's securities department, were taken

61. Act No. 98/1999 provided for exemptions from insurance for deposits, securities and cash owned by Member Companies, their parent and subsidiary companies and deposits, securities and cash connected with convictions of money-laundering. The draft bill of 13 January 2008 contained ideas concerning that in addition deposits, securities and cash from the following parties would be exempted from the responsibilities of the Guarantee Fund: Companies connected to the financial sector, cf. Article 28(1) of the Act on financial institutions; insurance companies; the state, local authorities, their institutions and other public bodies; mutual investment companies; pension and retirement funds (marked "???"); the CEO, managing director and other managers of financial institutions, by members with personal liability, by owners of at least 5% of a credit institution's equity, from persons responsible for legally auditing a credit institution's accounts, from depositors holding a similar position within other institutions in the same conglomerate; other institutions in the same conglomerate; depositors who have personally received financial gain which has played a part in reducing the credit institution's financial situation, and institutions of such a size that they are not authorised to draw up abridged balance sheet.

into account. However, what the new amounts should add up to was not indicated. Thirdly, it was assumed that payments from the fund should continue to extend to the total amount of guaranteed deposits, securities and cash in the sponsoring undertaking concerned, however, an individual should never receive payment higher than ISK [the amount is not mentioned in the draft] from each department. In this draft, there is no mention of a plan to change neither the ratio of the deposits' department of the Guarantee Fund's assets based on the deposits guaranteed nor payments of financial institutions to that department of the Fund. In a memorandum regarding the revision of the Act on the Guarantee Fund, compiled by the chairman of the committee on 6 December 2007, it was stated that there had not been need to amend the Act's provisions as regards payments to the deposits' department of the Guarantee Fund.

According to information from the Ministry of Business Affairs to the SIC, the committee last met to discuss issues concerning the Guarantee Fund in January 2008, and the above mentioned draft bill was also discussed. The Ministry also acquainted the SIC with the fact that at the time, the situation in international financial markets had already become unstable. It is also indicated that the draft bill had been presented to the Minister of Business Affairs and in the Ministry's reply to the SIC, which the SIC received on 4 March 2009, the following was stated: "He decided that it would not be advisable to submit a bill on this issue at the time, since that might lead to even more instability on the financial markets and even create a risk of a run on the banks and savings banks. The idea of presenting the bill to the Parliament was discussed several times during the spring of 2008 and inter alia discussed repeatedly by the members of the consultative group on financial stability. The same conclusion was reached repeatedly, that it would not be advisable to submit the bill because of instability on the financial markets."

Business Minister Björgvin G. Sigurðsson said in the hearing before the SIC that he had presented the bill, which was compiled from the proposals of a committee on the revision of the Act on the Guarantee Fund, "to the Government and [discussed] it there at least three times and that it [had] always [been], inter alia, at the suggestion of the Prime Minister, decided not to submit it. [...] The submission was postponed due to turbulence and difficulties that had surfaced in the financial markets."⁶² In the same hearing, Business Minister Sigurðsson commented further on this issue, as quoted in the margin. In a letter Business Minister Sigurðsson sent to the SIC, dated 24 February 2010, he stated that he had suggested that amendments would be made to the Act on deposit guarantees in order to strengthen the Fund's financial situation. He had discussed the matter with the Governments leaders, the Prime Minister Geir H. Haarde and the Minister for Foreign Affairs, Ingibjörg Sólrún Gísladóttir, and they had considered the situation was too sensitive to risk any changes. Furthermore, Business Minister Sigurðsson pointed out in the same letter, that the submission of the bill had been discussed in the authorities' consultative group "but other representatives than those of the Ministry of Business Affairs had considered it ill-advised to submit such a bill, considering the situation in financial markets".⁶³

"One didn't even mention that we had written the parliamentary bill, anywhere – if it were to get out that we were working on something like this which could be interpreted as preventive measures, that is, not against a collapse, but financial difficulties within the banking system, as we called it then. It could cause even more problems."

Statement by Mr Björgvin G. Sigurðsson before the SIC on 19 May 2009, p. 25.

62. Statement by Mr Björgvin G. Sigurðsson before the SIC on 19 May 2009, p. 24.

63. Cf. letter in annex 11 to the online version of the report of the SIC.

The Prime Minister, Geir H. Haarde, stated in the hearing before the SIC that he had not known that a bill of law had been prepared and that it had practically been completed at the beginning of 2008, where the objective had been to exercise to a greater extent authorisations provided for in the EU directive for exemptions from guarantees of the Guarantee Fund. Nor did he remember whether it had been discussed within the Government, whether such a bill should be submitted or not.⁶⁴ The Minister of Finance, Árni M. Mathiesen, when he was questioned in this context during the hearing for the SIC, whether he remembered any discussion within the Government, presumably in the former half of 2008, on a bill on amendments to the Act on the Guarantee Fund to be submitted or not, he said he thought it had been later in the year. He believed it had been in the spring or the summer, and that there were those who held the view that if it would be submitted under the circumstances at the time, it would have been interpreted as a signal that things were not as they should be. However, he said that he did not remember which issues had arisen concerning the ideas that were discussed, but that he remembered that the Minister of Business Affairs had been reflecting on this.⁶⁵

From the SIC's examination of the Government's minutes, there is no indication that this subject was ever discussed. In the SIC's letter dated January 23, 2009, addressed to the Minister of Business Affairs, Björgvin G. Sigurðsson, the Ministry was requested to provide the SIC with, inter alia, copies of all letters, memorandums, reports and other data which the Minister himself or his Ministry had sent or handed out, also during meetings, to specified parties during the period from 24 May 2007 to 7 October 2008 regarding the issues the SIC's investigation addressed, pursuant to Act No. 142/2008. Among the parties specified as recipients were the Government, individual Ministers and the Prime Minister's Office. Among the data which the SIC received from the Ministry of Business Affairs on 4 March 2009, there are no letters or other documents that have been sent to these parties in connection with the Government's discussions on amendments to the Act on the Guarantee Fund since the turn of the year 2007/2008 and until the bill on the Emergency Act was submitted to the Government by the Minister of the Business Affairs. In a letter addressed to the SIC, dated 24 February 2010, Minister Björgvin G. Sigurðsson referred to the fact that the bill on amendment to the Act on deposit guarantees had been on the list from the Ministry of Business Affairs, of issues to be taken up for discussions in Parliament, and had been sent to the Prime Minister's Office, first on 17 September 2007 and again on 19 September 2008. In his letter, Minister Sigurðsson also refers to the fact that others had addressed this matter on his behalf, e.g. his assistant, Mr. Jón Þór Sturluson, who had at his request taken the matter up for discussion at a meeting with the Permanent Secretary of the Prime Minister's Office and the Government's leaders in February 2008.⁶⁶ In a summary of the minutes of the Parliamentary party, Samfylkingin, on 11 February 2008, submitted by Minister Björgvin Sigurðsson with his letter, it is stated that at the meeting, there had been discussion regarding the ideas

64. Statement by Geir H. Haarde before the SIC on 2 July 2009, p. 62.

65. Statement by Mr Árni M. Mathiesen before the SIC on 20 May 2009, p. 14.

66. Cf. letter in annex 11 to the online version of the report of the SIC.

submitted by the Minister of Business Affairs and the Permanent Secretary of the Prime Minister's Office, inter alia regarding support for the Guarantee Fund.

At the Guarantee Fund's Board meeting, held on 30 June 2008, the revision of the Funds Act was addressed, inter alia, and the situation discussed, as stated in the minutes of the meeting. A comment from the Chairman of the Board, Ms. Áslaug Árnadóttir, was recorded on the committee's work regarding the revision of the Guarantee Fund, cf. the referral to the minutes in the margin. Subsequently, it was recorded that the committee would meet in the autumn, and an assessment made concerning a sensible course of action regarding the issue.

As described above, the Minister of Business Affairs instigated the above mentioned work of the committee following the Icelandic Financial Services Association's request, referring to differences in terms of competitive conditions for Icelandic banks, which at the time, increasingly sought foreign deposits in view of different rules regarding the guarantee funds in the countries concerned, on which deposits were guaranteed and, thus, the banks' payments to such funds. The SIC noted, while examining the data it had received regarding the work of the committee set up to revise the Act on the Guarantee Fund, that there is no specific reference to an increase in deposits to Icelandic banks in their branches abroad and the impact this might have on the Guarantee Fund's obligations. At the time the committee was working, i.e. from May 2007 until January 2008, the deposits in the branches abroad grew by ISK 576 billion, mostly in deposits from individuals. These individuals' deposits, were typically based on the deposit-guarantee scheme's minimum amount guaranteed in the country concerned, on the one hand an amount equivalent to EUR 20,887 covered by the Guarantee Fund and, on the other, additional payments, on the basis of agreements on "topping-up" from the guarantee scheme of the state where the account was created. This led to the fact that the Guarantee Fund's obligations regarding the minimum amount grew relatively more than the total growth of the deposits, and furthermore, as the Icelandic Act provided for calculations and settlement period of payments from the Icelandic banks to the Guarantee Fund, this increase did not become fully apparent at once in the payments to the Guarantee Fund.

"A committee on the review of the law on the Fund is still active. However, in the assessment of the Ministry of Economic Affairs it is not considered prudent to amend the law at this time, due to the instability of the financial markets. An amendment of the law at this time might be construed as a sign of weakness."

A formal note by Ms Áslaug Árnadóttir, Chairman of the Board of the Depositors' and Investors' Guarantee Fund, in the minutes for the Fund's board meeting on 30 June 2008.

17.10 How did the Guarantee Fund's Board of Directors and the Authorities react to the Fund's increasing Commitments?

17.10.1 The Guarantee Fund's Board of Directors

The administrative organisation of Guarantee Fund was described in Chapter 17.5 above. There it is stated, inter alia, that the Guarantee Fund is a private foundation and the management of the Fund is subject to an independent Board. Although the Minister of Business Affairs appoints two members of the Board, one of them being the chairman, the majority of the Board is composed of representatives from the financial corporations. According to the Act on the Depositors' and Investors' Guarantee Fund the Fund is financed with payments from financial corporations. Deposit-guarantee schemes, both here and abroad, have been established in order to contribute

to, among other things, operational stability in financial corporations that receive deposits. The SIC therefore has found reason to investigate whether the documents regarding the operation of the Guarantee Fund show, that the representatives of the financial corporations thought it in any way necessary for the Fund to make arrangements, or to take the initiative regarding suggestions to the government and Althingi, due to the growing commitments of the Fund, after the banks began accumulating deposits in their foreign branches.

The SIC has investigated the minutes of the meetings of the Board of Directors and the annual general meetings of the Fund for 2007 and 2008. An investigation of their content up until 1 October 2008 does not reveal that there were any specific discussions on the effects of increased deposits into Icelandic banks, and their overseas branches in particular, on the Fund's commitments and, consequently, whether there was any cause for action by the Board.

A meeting of the Fund's Board on 20 December 2007 discussed estimated deposits into the Deposits Department in 2008 for the year 2007. The following was noted: "Deposits in credit institutions have increased by 100% between years and significant contributions to the fund are thus expected at the beginning of next year." It should be noted in this context that Act No. 98/1999, Art. 4(5), stipulates the following: "Every two years, or more frequently if so required, the Fund's Board of Directors shall report to the minister on their views regarding the Fund's minimum assets," and this applies to both the Deposits Department and the Securities Department according to the rules established by the Act. The minutes of Fund's Board of Directors in 2007 and up until 1 October 2008 do not show that the Board discussed whether there was any need to formally inform the Minister of Business Affairs of the Board's position according to this provision.

The minutes contain no booking by the Board on the revision of the Act on deposit guarantees, which had begun in spring 2007, or the work of the revision committee, except for a mention by the managing director of the Fund in a Board meeting on 17 April 2007 that the Central Bank had suggested to the Minister of Business Affairs that he be appointed as a member of the revision committee. There is, furthermore, mention of the status of the committee's work in the minutes from 30 June 2008. This entry is quoted verbatim in the previous chapter. It should also be mentioned that Landsbanki Íslands, when making its payment to the Guarantee Fund for 2006, sent a letter to the Fund, in which it reserves the right to claim a refund of payments calculated from deposits from Icelandic and foreign institutional investors. This matter was discussed in a Board meeting on 17 April 2007, where it was decided to seek an expert opinion on the issue from the Fund's lawyer. The report was presented during a Board meeting on 30 August 2007 and it was noted in the minutes that according to the report there was no authorisation to exclude deposits other than specified in the Act. The Board found that the report would be "of good use for the group that is currently revising the Act on the Guarantee Fund."

Even though the majority of the Guarantee Fund's Board was appointed by the financial institutions, the Minister of Business Affairs followed the tradition of selecting the two representatives appointed by him without nomination from the staff of the Ministry of Finance, on the one hand,

and the Ministry of Business Affairs, on the other. The latter was appointed Chairman of the Board of Directors. Regardless of the Guarantee Fund's legal status as a private foundation, this arrangement entailed a close operational connection between the Fund and the two ministries. This connection should have facilitated the flow of information between the Fund and the ministries, and consequently the ministers, insofar as the information was available and obtained by the Fund. It should be mentioned that the provisions of Act No. 98/1999, Art. 4(4) did not prevent the Fund's staff from informing the relevant ministers and their co-workers in the ministries. This provision states that Board members and employees of the Fund are bound by confidentiality in accordance with the Act on Commercial Banks and Savings Banks, but this provision pertains first and foremost to information relating to the affairs of individual clients and companies with credit institutions, insofar as this information was disclosed to the Fund, but not to the general development of deposits at individual banks, in relation to the Fund's position and obligations.

In the middle of 2006, Ms. Guðrún Þorleifsdóttir, legal counsellor for the Ministry of Business Affairs, was appointed Chairman of the Fund's Board of Directors and held that office until the general meeting on 29 February 2008. At that point, Ms. Áslaug Árnadóttir, Director at the Ministry of Business Affairs, was appointed Chairman of the Fund's Board of Directors. Ms. Árnadóttir was also at that time, i.e. from the middle of December 2007 to 1 August 2008, acting Permanent Secretary of the Ministry of Business Affairs. As acting Permanent Secretary, she was a member of the consultative group of the Ministry of Finance, the Ministry of Business Affairs, the Central Bank of Iceland (CBI), and the Financial Supervisory Authority (FME), cf. further discussion on the work of the consultative group in Chapters 19.2 and 17.10.2. According to a statement given by Ms. Árnadóttir before the SIC, she began working on the Fund's issues within the ministry at the beginning of 2007, as the ministry had, amongst other things, received a request from the Icelandic Financial Services Association for a revision of the rules governing which deposits were guaranteed by the Fund.⁶⁷ Furthermore, she was the Chairman of a committee appointed by the minister on 30 May 2007 for the revision of the Act on the Guarantee Fund, cf. further in Chapter 17.9. As detailed in Chapter 17.10.2, the issues regarding the Fund and its growing commitments from the increased accumulation of deposits into the Icelandic banks abroad, Landsbanki in particular, were repeatedly discussed within the above-mentioned consultative group of ministries, FME and CBI. Documents that SIC received from the Ministry of Business Affairs and the Fund show that in 2008, Ms. Árnadóttir was in contact with representatives of foreign authorities and deposit-guarantee funds, and she corresponded with them either as Chairman of the Board of Directors of the Fund or as an employee of the Ministry of Business Affairs. This is discussed in more detail in Chapter 17.17.

The Minister of Business Affairs appoints one representative without nomination to the Fund's Board, as has been described previously. In the past years this representative has been Mr. Þórhallur Arason, Director of the Financial Management Department of the Ministry of Finance.

67. Statement by Ms Áslaug Árnadóttir before the SIC on 17 March 2009, p. 2.

“We had nothing to do with [the Depositors’ and Investors’ Guarantee Fund], and when you think about it afterwards, that there is such a fund and the Ministry of Finance had nothing to do with it and the Icelandic National Audit Office removed it from the central government accounts, didn’t think it belonged there, as I understand it.”

Statement by Mr Árni M. Mathiesen before the SIC on 20 May 2009, p. 13.

In light of the fact that a senior staff member of the Ministry of Finance was a member of the Guarantee Fund’s Board, the SIC found it noteworthy that when asked during a hearing before the SIC whether the situation of the Fund had been addressed in his ministry, Mr. Árni M. Mathiesen, Minister of Finance, said that this had not been the case, cf. the quote from his statement in the margin.⁶⁸

On the basis of an agreement between the Guarantee Fund and CBI, the bank managed the daily operations of the Fund until early October 2008. This included management of the Fund’s accounting records as well as providing meeting facilities and appointing a manager. Regarding the manager’s assignment for the Guarantee Fund, the agreement between the Fund and CBI, which was in effect from 12 February 2004, states the following: “[The Manager] shall convene and prepare meetings of the Board in cooperation with the Chairman, and carry out tasks that relate to the daily operations of the Fund and which have been entrusted to him in accordance with the Act on deposit guarantees and investor guarantee schemes and the Fund’s statutes.”⁶⁹

The CBI employee that was given the task of managing the Fund was Mr. Jónas Þórðarson, who was also working for the Financial Stability Department of the CBI. The manager handled, amongst other things, communications with foreign deposit-guarantee funds regarding preparations for cooperative agreements and preparing meetings on behalf of the Fund. No data has however emerged that shows that the manager provided information to or collected data for the Board regarding the increase of deposits in the Icelandic banks and the consequent effects on the commitments of the Fund in the years 2006 to 2008, with the exception of data compiled in connection with the annual collection of payments and letters of guarantee from banks and savings banks.

Considering that the majority of the Board was composed of representatives from financial institutions, including the banks, there should have been knowledge within the Board of the policy of the Icelandic banks, in particular Landsbanki and Kaupthing, to increase the proportion of deposits in the banks’ financing, in particular by accumulating deposits in their overseas branches, and how these plans developed. There is, however, nothing in the minutes of Board meetings or any other data regarding the Fund’s operation that suggests that the representatives of the financial institutions initiated any reaction on behalf of the Fund, for example by proposing changes to legislation to the minister, communicating directly between the Fund’s Board and the banks regarding actions on their part to strengthen the Fund’s position, or reducing the Fund’s commitments by changing the arrangements for deposit-collecting activities. It has been mentioned previously that the Act on the Depositors’ and Investors’ Guarantee Fund includes provisions regarding the Board’s obligation to inform the minister of its position on minimum assets for the Fund, and in Art. 5(3) there is a provision that

68. Statement by Mr Árni M. Mathiesen before the SIC on 20 May 2009, p. 13.

69. In Article 6 of the agreement the position and terms of employment of the managing director were set out more precisely and the remuneration to the CBI for the management and holding of the Fund was to be based on the extent of the services it rendered and be paid after the end of each year. It was further set out that the managing director would additionally receive a monthly remuneration from the fund which was to be equal to double the remuneration of a board member as it was decided on in the Fund’s annual general meeting.

authorises the Board to summon all member firms for a meeting, when this is considered necessary. This provision states furthermore that the Board is obliged to convene a meeting if this is requested by member firms holding a quarter of the votes.

As regards the Board members appointed by the Minister, it cannot be concluded from the documents available, that the employee of the Ministry of Business Affairs who held the post of Chairman of the Fund's Board of Directors from mid-year 2006 to February 2008, or the employee of the Ministry of Finance who was a Board member during the same period, had at the time any information regarding the increased accumulation of deposits in the Icelandic banks beyond what was available through news media and the annual statements, on which the banks' payments to the Fund were based.

Towards the end of February 2008, Ms. Áslaug Árnadóttir, Director at the Ministry of Business Affairs and acting Permanent Secretary at the time, assumed the office of Chairman of the Board of Directors of the Fund. Ms. Árnadóttir had, as an employee of the ministry, been involved in the Fund's issues and potential revision of the Act on the Fund from the beginning of 2007. In connection with that work, information had been gathered regarding legislation and status of deposit-guarantee funds in the neighbouring countries of Iceland. Information was also gathered particularly with regard to deposits in the Icelandic banks and break-down of amounts as they were by the end of September 2007, and this information was available in the Ministry in December 2008. As acting Permanent Secretary, Ms. Árnadóttir was also a member of the consultative group of three ministries, the CBI, and the FME on financial stability and contingency planning. The group repeatedly discussed the accumulation of deposits in the Icelandic banks and the effect this had on the obligations of the Fund. When Ms. Árnadóttir assumed the office of Chairman of the Board of Directors of the Fund she should have been aware of the effect that the increased accumulation of deposits in the Icelandic banks, and in particular in their overseas branches, had already had on the obligations of the Fund. There is, however, nothing that indicates that a discussion took place in Board meetings, similar to the one that took place in the consultative group regarding the risk inherent in the growing deposits, the situation of the Icelandic banks, and the subsequent effect on the Fund, but it should be noted that the Board only held two recorded meetings from the general meeting in February 2008 to 1 October 2008, i.e. on 21 April and 30 June. In connection with the work done by the consultative group, the Ministry of Finance in late July/early August of 2008 worked on the preparation for legislative drafts in case there would be need for legislation in connection with the banks' problems and this work was led by Mr. Þórhallur Arason.

It should be mentioned that a draft memo dated 15 August 2008, which was presented by Mr. Tryggvi Pálsson, Director of the Financial Stability Department of the CBI, to the consultative group, and in which he addressed government policy and contingency preparations, there was, amongst other things, a discussion of preparations by the Fund. The following is stated in a footnote to the document: "If the Fund undertakes this with the help of its hired experts, then the market participants are paying for the necessary preparations, which is positive. On the other hand, it is undesirable that the authorities disclose their contingency preparations to the banks' representatives on the Board of the Guarantee Fund."

"It is not desirable for the authorities that they disclose their contingency preparations to the banks' representatives on the Board of Directors of the Depositors' and Investors' Guarantee Fund."

From a memorandum by Mr Tryggvi Pálsson to the government consultative group, dated 15 August 2008.

17.10.2 The Consultative Group

As described in Chapter 19, an agreement was made between the Prime Minister's Office, the Ministry of Finance, the Ministry of Economic Affairs, the Financial Supervisory Authority (FME), and the Central Bank of Iceland, to form a consultative group on financial stability and contingency planning. The group held its first meeting on 1 June 2006. In 2006 and 2007, the group met twice a year, but in 2008, the group held a total of 27 meetings until 3 October.

A summary of the issues discussed in individual meetings of the consultative group is listed in Chapter 19. This summary provides an insight into the general progress of issues discussed by the consultative group and the main topics at any given time. A general discussion of the group's activities is found in Chapter 19. As from the fourth meeting of the consultative group on 15 November 2007 and onwards, the financial situation of the Guarantee Fund and its increased obligations due to the banks' deposit activities abroad was on the agenda in most of the group's meetings. The two main issues discussed in meetings of the group were, on the one hand, the necessity of applying pressure on the banks, in particular Landsbanki, to transfer deposit accounts in their branches to subsidiaries, and, on the other hand, whether or not the State Treasury should make a declaration regarding a guarantee on deposits exceeding the minimum amount guaranteed by the Guarantee Fund. Below is a summary of the main issues regarding the Guarantee Fund and possible guarantee on deposits from the draft meeting minutes that were delivered to the SIC. See Chapter 19 for a closer discussion of these draft minutes, their origin, and the persons who attended the meetings.

It is of considerable interest that the draft minutes for the second meeting of the consultative group on 30 November 2006 state that it was discussed how the Icesave deposits were presented in the Landsbanki's balance sheet. In this regard, attention should be drawn to the fact that at this time the bank had recently begun receiving deposits into Icesave accounts, i.e. in October 2006. Thus it is apparent that the consultative group had, from the beginning knowledge of the increasing deposit activities abroad, by means of opening and marketing special deposit accounts as a way of financing the banks. At the same meeting, information was disclosed regarding the increasing proportion of wholesale deposits in the banks' financing, and a document, which was presented at the meeting and which had been compiled by CBI towards the end of June 2006, brought to attention the necessity for Icelandic supervisory authorities to assess the reliability of these wholesale deposits as a financing option. As regards Landsbanki, this means was referred to as a permanent source of financing.

The consultative group held its fourth meeting on 15 November 2007 addressing the situation and future prospects on the financial markets. The Director General of the FME, Jónas Fr. Jónasson, pointed out that foreign deposits were more than half of the deposits in the Icelandic banks and it was necessary to consider the Guarantee Fund in this context. At the meeting, Mr. Jónsson submitted a document with seven numbered points titled "Reflections". The first point suggested putting a maximum on possible capital contributions, liquidity support, or deposit guarantees. The second point put forth the question whether there was reason to consider a geographical

division with regard to the same issues, and the third point was: “The size and capacity of the Guarantee Fund”. Towards the end of the minutes, it is noted that the Permanent Secretary of the Ministry of Business Affairs, Ms. Jónína S. Lárusdóttir, mentioned a committee from of the Ministry Business reviewing the Guarantee Fund’s situation.

At the sixth meeting of the consultative group on 15 January 2008, a memo was submitted, which the Managing Director of the Guarantee Fund (who also was a staff member of the Financial Stability Department of the CBI, as previously noted) had compiled on the regulations that applied to the operation of the Fund, its assets, etc. It was revealed that the assets of the Fund amounted to ISK 8.3 billion by year-end 2007, in addition to outstanding letters of guarantees for ISK 657 million. It was pointed out that more than 50% of deposits in Icelandic banks were from foreign parties. The rules regarding the minimum payment by the Fund to each depositor were described, and it was pointed out that the Act on the Guarantee Fund states that, should the assets of the Fund prove insufficient, the Board of Directors may take out a loan in order to compensate losses suffered by claimants. In the draft minutes it is noted that Ms. Áslaug Árnadóttir reported on the work being carried out at the Ministry of Business Affairs to revise the Act on the Guarantee Fund.

An item discussed towards the end of March and beginning of April 2008 by the consultative group was a document that had been produced on behalf of CBI and FME called “Measures available to the authorities against turbulence in financial markets” (cf. a more detailed discussion of the document contents in Chapter 19.3.7). This document discusses possible measures for the authorities and includes a section with the heading “Foreign deposits through subsidiaries”, cf. quote in the margin.

At the eighth meeting of the consultative group on 18 March 2008 a note was made that there had been discussions regarding the possibility of subsidisation of the banks’ overseas branches, and at the ninth meeting, the Director General of FME submitted a document with an analysis of deposits in commercial and savings banks. This document was based on the same figures that had been compiled by the committee that had been revising the Act on the Guarantee Fund, and which applied for end of September 2007.

At the group’s tenth meeting on 1 April 2008, questions were raised regarding deposit balances in Landsbanki and Kaupthing in the UK. Mr. Tryggvi Pálsson, Director of the Financial Stability Department of the CBI, informed that apparently Kaupthing Edge was still growing, but the deposits in Landsbanki, both wholesale and retail, were shrinking. The draft minutes note that Ms. Árnadóttir, then acting as Permanent Secretary to the Ministry of Business Affairs, pointed out that the critical factor was that Kaupthing registered the deposits with its subsidiary, whereas the Icesave deposits were registered in a branch of Landsbanki. The minutes also note that the week before, she had met with a delegation from the Financial Services Compensation Scheme (FSCS), in her capacity as Chairman of the Guarantee Fund, during their visit to Iceland. Preparations were being made to amend the regulations for the FCSC and this could make the comparison with the Guarantee Fund even more disadvantageous, as well as the situation for depositors with the Icelandic banks’ overseas branches. In the draft minutes from this meeting Mr. Bolli Þór Bollason, Permanent Secretary to the Prime

“The authorities should encourage financial institutions to record foreign deposits to foreign subsidiaries rather than branches. This would reduce the obligations of the Depositors’ and Investors’ Guarantee Fund. This might likewise reduce the likelihood of negative coverage abroad.”

From a document prepared by the CBI and FME titled “Measures available to the authorities against turbulence in financial markets”. Submitted before a meeting in the government consultative group.

Minister's Office, is quoted as saying that the directors of the banks should be aware that the administrative authorities had every intention to protect depositors, and not shareholders or creditors. Mr. Baldur Guðlaugsson, Permanent Secretary to the Ministry of Finance, pointed out that it was an important issue whether Landsbanki would be able to transfer the branch's deposits to a subsidiary in the UK. Mr. Tryggvi Pálsson, Director of the Financial Stability Department of the Central Bank of Iceland, is noted as saying that the FSA UK imposed the condition that assets would be transferred simultaneously to the subsidiary, including the adequate liquidity. Mr. Bollason added that the transfer of deposits where each depositor would be contacted must be a delicate operation.

At the eleventh meeting of the consultative group on the next day, 2 April 2008, the minutes state that Mr. Bollason, Permanent Secretary to the Prime Minister's Office, said that the time had come to draw up an action plan and "draw the line". He said that he was of the understanding that "from the Minister's point of view" the issue of the three major banks and their deposit guarantees should be tackled. It was noted that there had been discussions regarding the focus on this issue and the need to initiate special action in this regard. A decision was made to appoint two working groups; one of them should have the task to analyse issues regarding deposit guarantees and draft a declaration for the government, which could be used in case of need. Ms. Árnadóttir was appointed to lead this work, starting that same day.

The next meeting of the consultative group was on 4 April 2008 (meeting #12) and at the meeting Ms. Árnadóttir handed out and explained a summary on deposit guarantees. It contained a description of the rules on the Guarantee Fund, payments from the fund, and its assets. The summary states that by the end of September 2007 guaranteed deposits in commercial and savings bank equalled ISK 2,000 billion and the number of depositors behind this total amount were a total of 897,096 Icelandic and foreign individuals as well as legal entities. It was further noted that there was a total of 782,123 ID's behind the deposits with a minimum guarantee amounting up to ISK 1.7 million and 114,973 ID's behind deposits exceeding the minimum guarantee.⁷⁰ The summary also contained a table depicting the payments that the Guarantee Fund would have to make in case of the insolvency of an "average commercial bank", using three scenarios for guarantee limits amounting to ISK 5 million, 8 million, or 10 million. The summary concludes with a recap of the issues referred to in the previous meeting of the consultative group. The draft minutes from this meeting of the consultative group state that the working group had received a number of suggestions. Mr. Baldur Guðlaugsson is quoted as saying that a worst-case scenario should be used in the calculations. Ms. Árnadóttir informed that FSCS had submitted a proposal to the effect that it could, if it would prove necessary, compensate depositors in the UK and would subsequently be repaid by the Guarantee

70. The figures presented in these calculations are based on information that had been obtained by the committee that was revising the Act on the Guarantee Fund in November 2007, these calculations were based on the balance of deposits at the end of September 2007. It should be mentioned that in March 2008 the total deposits in the Icelandic banks (both here in Iceland and abroad) amounted to IKR 2,753,405 million, but had been IKR 2,086,028 million at the end of September 2007, according to the aforementioned summary by the Ministry of Business Affairs.

Fund. At this point, a referral is made to the ongoing negotiations for a cooperative agreement between the Guarantee Fund and FSCS regarding settlement due to Landsbanki's participation in FSCS, which stipulated "topping-up" for deposits in the Landsbanki London branch. The agreement on Landsbanki's participation in FSCS was made on 31 October 2006. It was further noted that the proposals for improvements on FSCS were expected on 22 April 2008.

At the beginning of the thirteenth meeting of the consultative group on 10 April 2008, Ms. Árnadóttir informed that an unfavourable news article on the Icelandic deposit guarantees had been published that morning in the Norwegian newspaper Aftenposten, and at 10 am that same day, an amount of NOK 23 million had been withdrawn from Kaupthing's Norwegian branch. The deposit guarantees were discussed as a special item on the agenda and Ms. Árnadóttir distributed a document with the letterhead of the Ministry of Business Affairs, dated 10 April 2008, with the title "Payments from the deposits department of the Depositors and Investors Guarantee Fund." Attached to the document were drafts for notifications on deadlines for claims and two different versions of statements from the Government. This document from the Ministry of Business Affairs described the rules on the Guarantee Fund and the conditions and arrangements for payments from the Fund. It further revealed that based on the exchange rate on 7 April 2008, the minimum amount that the Guarantee Fund would have to pay, i.e. EUR 20,887, amounted to ISK 2,372,000. There was a special discussion on deposit accounts in branches abroad and possible methods for the settlement of payments from the Guarantee Fund in such an event, also with regard to the cooperative agreements that had been made with foreign deposit-guarantee funds in connection with the banks' top-up agreements. The document from the Ministry of Business Affairs concluded with a comment regarding the payment currency according to an agreement between the Guarantee Fund and the Finnish Deposit Guarantee Fund, cf. quote in the marginal.

The different versions of drafts for a statement by the Government, which were attached to the Ministry's document, were pertaining to the State Treasury's intervention as regards support to the Guarantee Fund and deposit guarantees. The document begins with noting that a statement of this kind could be formulated in several ways but two possible presentations are suggested. Following a description of the regulations that apply to the Guarantee Fund, the two possibilities are set forth, cf. quote in the margin.

In the conclusion of this draft for the Government's statement regarding the Guarantee Fund, the issues that needed to be determined further were described as quoted in the margin.

The draft minutes for the thirteenth meeting of the consultative group do not indicate how those present at the meeting reacted to the documents presented by Ms. Árnadóttir on behalf of the Ministry of Business Affairs. It is only noted that Mr. Jónas Fr. Jónsson, Director General of the FME, requested that the possibilities of netting were examined. Similar provisions applied in the UK but the plan was to repeal them in the revision that was under way. No such provisions were in place in Icelandic law.

At the fourteenth meeting of the consultative group on 21 April 2008, a summary compiled by FME and CBI was presented dated 21 April 2008, with the title "Scenario of a Financial Collapse - Matters of Opinion, Workable

In the cooperative agreement between the Guarantee Fund and the Finnish deposit guarantee fund there is a provision that the Guarantee Fund should disburse Finnish depositors in Euros. There are no such provisions in other agreements, but it is probable that generally speaking deposits in foreign currencies would be disbursed in the deposit currency."

From a document prepared by the Ministry of Business Affairs document submitted before the consultative group's meeting on 10 April 2008.

"The government declares that the State Treasury will grant the Depositors' and Investors' Guarantee Fund a loan which the Fund's Board of Directors is authorised to take out according to Article 10 of the Act, to enable the Fund to disburse the claimants (minimum payment/payment of the amount of xxx).
OR

The government declares that should it become necessary, the State Treasury will guarantee all deposits/parts of deposits in xxxx/all commercial banks and savings banks while there is turmoil in the financial markets."

Proposals for statements by the Government regarding the Guarantee Fund's obligations set out in document form the Ministry of Business Affairs, submitted before the consultative group on 10 April 2008.

- "1. To promise the Guarantee Fund a loan or guarantee deposits.
2. To guarantee all deposits or some proportion thereof and if so to what extent.
3. To guarantee deposits in all the commercial banks and savings banks or the deposits of a certain party.
4. Should the guarantee be temporary."

Regarding a draft of the statements by the Government on the Guarantee Fund, cf. a document from the Ministry of Business Affairs that was submitted before the consultative group on 10 April 2008.

“If the State Treasury were to issue a guarantee statement regarding all deposits in the banking system it would amount to ISK 2,200 billion, i.e. a little less than double the domestic production. The possible legal authorisations need to be checked both in Iceland and with regard to the EEA (e.g. competitiveness issues regarding state aid). Such a guarantee could possibly prevent a run on the banks, but with a view to the size of the Icelandic banking system compared with the total of deposits it is possible that such a guarantee would be insufficient. It is unlikely that the whole of the guarantee would be used, since there are assets to balance the deposits.”

From the document prepared by the CBI and FME:
“Scenario of a Financial Collapse - Matters of Opinion,
Workable Measures and Conditions”, dated 21 April 2008.

Measures and Conditions”.⁷¹ This document mentioned the situation regarding the bank deposits, and thereby the situation of the Guarantee Fund, four times. It discusses the situation that could arise if the banks on which the scenario is based would become insolvent and finds it likely that this would be followed by a run on all deposit institutions. It then states: “The State Treasury would presumably have to guarantee deposits and the banking system would have to be reconstructed from the ground up.” In the discussion on whether one of the two banks used in the scenario should be rescued it is noted that one of them played an important role in deposit activities both in Iceland and abroad. The assessment would need to take into account the effect of deposit guarantees on the State Treasury’s obligations with regard to minimum guarantees on deposits. There was further discussion on whether the State Treasury should issue a guarantee statement regarding the deposits. See quotation in the margin.

In a summary of possible measures and the conditions for their application listed in the document from FME and CBI it is stated that in case a guarantee statement needed to be issued, this statement could become a double edged sword, cf. the British bank Northern Rock, where a similar statement triggered a run on the bank. This meeting (#14) did not deal specifically with the topics in the scenario pertaining to deposits and their guarantees, but the Permanent Secretary to the Prime Minister’s Office described the necessary next steps in the contingency effort.

At the next meeting of the consultative group (meeting #15) on 28 April 2008, the Director General of the FME presented a list of 7 items, where he summarised the main policy decisions that the government needed make in the period preceding a financial crisis. This document was later on referred to within the group as “the unappetizing menu.” The second item was with the heading “Amount (exceeding the minimum guarantee) that the State is willing to guarantee.” In the draft minutes it is noted that the Permanent Secretary to the Prime Minister’s Office observed that it was necessary to prepare answers and that it would perhaps be possible to write a memo based on the draft by Ms. Árnadóttir regarding the deposit guarantees.

Among the topics discussed in the sixteenth meeting of the consultative group on 9 May 2008 was “Action Plan – Deposit Guarantees.” At this meeting, Ms. Árnadóttir presented a document, dated 9 May 2008, with the letterhead of the Ministry of Business Affairs, titled “Deposit Guarantees.” The draft minutes note that the document revealed that if the State Treasury were to guarantee all deposits the amount would equal ISK 2,318 billion while the balance of the Guarantee Fund equalled ISK 10 billion. The document discussed the possibility of the State Treasury providing a guarantee for a loan to the Guarantee Fund, or a guarantee of a pay-out of the minimum guarantee. It also discussed the possibility of the Government guaranteeing a portion of the deposits and presented calculations of estimated total amounts in case of deposit guarantees for individual depositors of ISK 5 million, 8 million or 10 million, respectively, cf. Table 5. It is worth noting that the

71. See further in Chapter 19, but the document shows that it was compiled by Mr Tómas Örn Kristinsson and Ms Sýlvía Kristín Ólafsdóttir from the CBI and Mr Rúnar Guðmundsson and Mr Ragnar Hafliðason from the FME.

figures presented in these calculations are based on information that had been obtained by the committee that was revising the Act on the Guarantee Fund, these calculations were based on the balance of deposits at the end of September 2007.

Table 4. Proposals regarding State guarantee on deposits

	<i>ISK 5 million</i>	<i>ISK 8 million</i>	<i>ISK 10 million</i>
<i>Individuals</i>	<i>guaranteed</i>	<i>guaranteed</i>	<i>guaranteed</i>
Maximum guaranteed amount	ISK 499.5 billion	ISK 563 billion	ISK 647.2 billion
Guaranteed deposits as a percentage of total deposits (%)	52	58	67
Fully guaranteed parties (%)	95	97	98
<i>Legal entities</i>			
Maximum guaranteed amount	ISK 55.5 billion	ISK 73.1 billion	ISK 84.8 billion
Guaranteed deposits as a percentage of total deposits (%)	5	7	8
Fully guaranteed parties (%)	90	92	93
Individuals and legal entities in total	ISK 555 billion	ISK 636.1 billion	ISK 732 billion

Source: The Ministry of Business Affairs.

The nineteenth meeting of the consultative group on 29 May 2008 discussed an announcement by Landsbanki regarding the marketing of Icesave deposits the Netherlands, through their branch in Amsterdam, and it was pointed out that this increased the Guarantee Fund's obligations even more. The Director General of the FME revealed that ten applications for branches of the Icelandic banks had been filed with the agency. Later in that meeting there was discussion on possible decisions at a preparatory stage (cf. "the unappetizing menu" from the previous meetings of the group). It was noted that the Director General of the FME considered it necessary to make clear what the position was on certain issues, including the second item regarding the deposit amount that the State was prepared to guarantee. The draft minutes note that he dwelled on the ISK 5 million deposit limit, which covered 95% of the deposits, cf. the report from the Ministry of Business Affairs on deposit guarantees dated 9 May 2008. Later in the discussion on this item, the draft minutes note that the Permanent Secretary to the Prime Minister's Office was of the opinion that more detailed figures were needed, such as the extent of the foreign deposits and what would be the extent of monetary support from foreign depositors guarantee funds. The acting Permanent Secretary for the Ministry of Business Affairs and the Director General of the FME were to compile this material.

The discussion on the so-called possible decisions continued at the twentieth meeting of the consultative group on 7 July 2008, which took place six weeks after the previous meeting. It is noted that the Permanent Secretary to the Prime Minister's Office distributed photocopies of a news article in TimesOnline from 5 July 2008, which described the situation of the Guarantee Fund and its capability to guarantee deposits. The Director General of the FME informed that Norway was planning to amend regulations on deposit guarantees in order to prevent foreign parties to operate deposit activities under its coverage.

"It is doubtful that the Guarantee Fund has the capacity to bridge the gap by taking out a loan. The fund's creditworthiness is presumably very limited. It is uncertain whether loans taken out by the fund can be repaid with future receipts. If the outcome of a financial shock were a considerable retrenching of the activities of Icelandic financial institutions."

From the CBI document: "Urgent Government Decision Making concerning the Danger of a Financial Shock," dated 7 July 2008.

"No distinction is made between deposits here in Iceland and in the banks' branches abroad, but the assumption has been that the Guarantee Fund would try to disburse the depositors in the same currency as the deposits were made in. This immediately requires taking out foreign loans if there are claims against the Fund. There is a possibility that the Guarantee Fund would choose to disburse compensation in ISK only, cf. the statutory arrangement in Sweden. In that case the Fund will have to acquire a loan in ISK but the disbursement of the compensation would unavoidably have the effect of lowering the exchange rate of the ISK."

From the CBI document: "Urgent Government Decision Making concerning the Danger of a Financial Shock," dated 7 July 2008.

"The most pressing questions are the ones regarding the banks that are important for the banking system and deposit guarantees. [...] Should the government grant the Guarantee Fund assistance so that it can cover the minimum statutory compensation or even something exceeding that? To what extent can the authorities accept increased obligations without endangering the liquidity of the State Treasury?"

From the CBI document: "Urgent Government Decision Making concerning the Danger of a Financial Shock," dated 7 July 2008.

At the meeting, Mr. Tryggvi Pálsson, Director of the Financial Stability Department of the CBI, submitted a document, which was presented as a "First draft of a working document", dated 7 July 2008. The recipient was indicated as the consultative group and its title was "Urgent decision-making by the Government due to the risk of financial crisis" (see further on the content of the document in Chapter 19.3.10). The document discussed inter alia the effect of increasing deposit activities abroad by the Icelandic banks and pointed out that it was a contributing factor to the negative attitude towards the Icelandic banks and authorities. There was a special coverage of the Guarantee Fund in the document, clarifying that the fund was a private foundation, which was obligated pursuant to the law to provide a minimum deposit-guarantee equalling EUR 20,887. It further stated that the balance of the Fund equalled approximately ISK 11 billion, plus letters of guarantee from financial institutions amounting to approximately ISK 6 billion. It then stated that the minimum amount of coverage was "estimated to exceed ISK 115 billion, however (at the exchange rate on 8 May 2008)."⁷² The point is made that there is nothing to indicate that the Guarantee Fund has the capacity to bridge the gap by taking a loan on its own behalf. See quotation in the margin. The document goes on to set out views on the payment currency in which the Guarantee Fund should pay accrued claims and possible borrowing by the Fund should this be the case, cf. quote in the margin.

The document concludes with reflections on the next steps. It was concluded that the authorities would have to set the basic policy in the following weeks, i.e. what should be the main course of action in case of a financial shock. The question was asked whether the State should support the Guarantee Fund, and to what extent the Government could take on increased obligations. See quotation in the margin. The discussion in the meeting on the document and possible options focused in detail on the deposits, the situation of the Guarantee Fund, and possible decisions, including statements by the Government regarding deposit guarantees.

At the 21st meeting of the consultative group on 14 July 2008, the discussion topic was, inter alia, the position of smaller financial institutions and savings banks. The Director General of the FME was quoted as saying that among the options available was to let the Savings Bank of Mýrarsýsla "go" and thereby empty the Guarantee Fund. Possible Government decisions were discussed further, including how to meet deposit-guarantee obligations without putting the State Treasury at risk. At this meeting Mr. Jónas Fr. Jónsson, Director General of the FME, presented information, on the balance of deposits in Icelandic banks as at end of May 2008 compiled by FME. At the meeting, reference was made to a comment attributed to the Governor of the Swedish Central Bank, that all amounts turn out to be larger in the event of a crisis. Following this, Mr. Tryggvi Pálsson mentioned, as an example, that the estimated amount needed to meet the minimum deposit guarantee "would need to be more than ISK 420 billion, according to a table presented

72. At the next meeting of the coordinating group (meeting No. 21) it was made known that the figure of IKR 115 billion was incorrect. There a parallel figure of ISK 420 billions was reported.

by [the Director General of the FME] at the beginning of the meeting, while this amount had been estimated at ISK 115 billion in a summary on deposit guarantees by the Ministry of Business Affairs.” It should be noted that this estimate was based on a deposit balance of ISK 1.7 million at the exchange rate on 8 May. Directly following this, the draft minutes quote Mr. Pálsson saying that it is not clear “whether the State Treasury can handle this obligation.”

The deposit guarantee was yet again discussed in the 23rd meeting of the consultative group on 22 July 2008, along with the situation and prospects in the financial markets. Mr. Jónsson, Director General of the FME, referred to a summary he had submitted at the 21st meeting of the consultative group and pointed out that there the estimate of the minimum deposit-guarantee obligations equalled ISK 421 billion. This estimate did, however, only assumed a minimum amount of ISK 2 million, but this amount had now increased due to the falling exchange rate of the ISK.⁷³ Mr. Jónsson also informed of a debate taking place in a committee of the UK Parliament regarding deposit guarantees and the size of the Icelandic Guarantee Fund, and proposed that Icelandic financial institutions would pay additional fees in advance, in order to strengthen the Fund. Mr. Ingimundur Friðriksson, Governor of the Central Bank of Iceland, referred to the receipt of deposits in branches of the Icelandic banks. The FSA had encouraged Landsbanki to transfer its UK deposit book to a subsidiary in that country. That process had not been initiated and Landsbanki appeared to be against the idea. According to the draft minutes there was some discussion on whether this change could be accomplished through regulatory powers, but there is no note made as to specific discussions in the meeting on viable measures to that end. The opposite view was noted, however, that the establishment of branches and receipt of deposits abroad could not be prohibited, but merely delayed. In this context, Mr. Jónsson posed the question whether it was possible to apply requirements of increased equity or that the Fund would set a rule of incremental payments to the Fund. It was considered necessary to press for the transfer of the deposits to subsidiaries. Mr. Pálsson, CBI’s representative, expressed his opinion as quoted in the margin. Mr. Jónsson depicted the proportionate size of the Guarantee Fund by stating that if the Savings Bank of Mýrarsýsla, which had been discussed by the consultative group due to its financial situation, would become insolvent, the Fund could fulfil its obligations but would be drained of funds. Mr. Friðriksson revealed that Norwegian authorities would not authorise deposit taking by Icelandic banks in Norway under the coverage of the Norwegian deposit-guarantee fund. This was their intention even though it was not in compliance with EEA obligations.

At the next meeting of the consultative group on 31 July 2008 (the 24th meeting), the draft minutes reveal that an extensive discussion took place concerning the Landsbanki Icesave accounts and the bank’s interaction with FME and FSA on that subject, as well as the obligations of the Guarantee Fund and its situation in this regard. According to the draft minutes, there

“TP (Tryggvi Pálsson) said that the banks, especially Landsbanki, had more than doubled the Guarantee Fund’s obligations with their deposit taking in their foreign branches. If worst comes to worst these increased obligations might have to be circumvented, e.g. by the authorities assisting the Fund in taking out loans on the condition that Icelandic depositors would have priority or that the disbursements would be made in ISK. Although this would not conform to the EEA Agreement, provision would have to be made to ensure that the Icelandic State would not take on obligations that could bankrupt the State Treasury. Under the current circumstances it is not possible to fulfil the minimum obligations for deposit guarantees.”

73. On 31 May 2008 the worth of EUR 20,887 at the exchange rate (115,42) was ISK 2,410,777, and at the exchange rate of 22 July 2008 the amount was ISK 2,619,438.

Mr Tryggvi Pálsson to the consultative group, quoted in the draft minutes for the meeting of 22 July 2008.

was a discussion of the possible transfer of the Landsbanki deposits from its UK branch to a UK subsidiary; it was further revealed that the FSA had a few days earlier taken the unilateral decision of setting a GBP 5 billion limit on the Icesave deposits until the transfer had taken place. The meeting also discussed the time frame for a possible transfer of the Landsbanki deposits from its UK branch to a UK subsidiary, and that the FSA had stated that such a transfer could be completed in three months. Mr. Friðriksson stated that in substance it was the responsibility of Landsbanki to complete the transfer, while the CBI put pressure on the bank to do so. Mr. Jónsson stated that FSA's concerns regarding the Icelandic Guarantee Fund were centred on four main issues: (1) What was the balance of the Fund? (2) How would the Fund meet its obligations? (3) What was the Fund's back-up plan? (4) How did it operate and what were its procedures, inter alia regarding disclosure of information, external operations, and how claims against the Fund should be presented and processed. And furthermore, the FSA could not comprehend how it was possible to operate the Fund with only one part-time employee. Mr. Baldur Guðlaugsson's view as to the concerns of the FSA was that FSA should be reminded that the transfer of deposits to subsidiaries was in progress, which meant that any possible weaknesses of the Guarantee Fund would become immaterial. Mr. Jónsson pointed out that the FSA also had reason to be concerned about the period until the transfer would take place. The draft minutes also note that during a recent debate in the UK Parliament's Treasury Committee there had been discussions regarding the security of British savers' deposits and in this debate some specific questions had been raised regarding deposits in Icelandic banks. FSA's representatives had answered questions by the Treasury Select Committee. Subsequently, these issues had been addressed by the trilateral group formed by HM Treasury, the FSA, and the Bank of England. On this occasion, the meeting noted that it was fortunate that there had been no media coverage following the debate in the UK Parliament. At this meeting, other views were expressed regarding FSA's actions in the UK and their implications for the Icelandic banks, cf. quotes in the margin.

"TP (Tryggvi Pálsson) mentioned that the FSA was doing a fine job by limiting possible obligations of the Icelandic State on account of the Depositors' and Investors' Guarantee Fund. [...] TP (Tryggvi Pálsson) said that the Icelandic authorities should work with the FSA and at the same time wind down the deposit taking in the branches of the Icelandic banks elsewhere. [...] BG (Baldur Guðlaugsson) thought it could signify the downfall of the banks if public discussion was to centre on the weaknesses of the Guarantee Fund."

From the draft minutes of the consultative group,
31 July 2008.

The consultative group held their 25th meeting on 12 August 2008, 11 days after the previous meeting and the issue of the Guarantee Fund was one of the items on the agenda. Since the previous meeting, the composition of the group had changed as Ms. Jónína S. Lárusdóttir, Permanent Secretary to the Ministry of Business Affairs, had returned to her duties and thus replaced the acting Secretary, Ms. Árnadóttir. At the beginning of the meeting, FSA's visit to Iceland, and their meeting with the Icelandic authorities was discussed with a specific mention of the fact that FSA's representatives were satisfied with their meeting with Ms. Árnadóttir, Chairman of the Guarantee Fund. At the meeting, there was the ongoing discussion as to what measures could be taken by the Icelandic authorities to put pressure on the transfer of deposits into subsidiaries abroad. Mr. Jónsson claimed that two options came to mind. One was to decide that the Guarantee Fund premium would in effect be progressively higher for deposits in branches abroad. The other option was to raise the equity capital requirements for financial institutions that received such deposits. FME had the authorisation to impose the second option. Mr. Tryggvi Pálsson put forth the question whether the Board and members of the Guarantee Fund could decide to contribute more to the

Fund than the statutory minimum. It was noted that such a change would be difficult to implement without amending the current legislation on the Fund. Mr. Pálsson also reminded the group that the draft statement on deposit guarantees needed to be finalised and others present at the meeting concurred. Mr. Jónsson suggested a draft based on three options: all deposits guaranteed, minimum guarantee, or none at all. Further discussions ensued about the statement. Ms. Lárusdóttir posed the question whether it was advisable to submit the bill on the Guarantee Fund in the autumn. Mr. Jónsson maintained that whether it was advisable or not depended on a subtle judgement and stated that similar changes were being prepared in the UK and Europe, but there was some uncertainty regarding the submission of bills. It would be useful to examine the banks' opinions regarding the timing of the bill.

The 26th meeting of the consultative group on 20 August 2008 discussed the Guarantee Fund yet again. In addition to this, information was presented regarding the on-going dialogue between Landsbanki and FSA regarding FSA's demand for transfer of deposits in the bank's UK branch to a subsidiary. Mr. Jónsson gave an account of his and the FME chairman of the Board's meeting with the FSA in London and FSA's criticism of Landsbanki's conduct with respect to the requirements made by the FSA, cf. quote in the margin. The consultative group reacted to this information by posing the question whether Landsbanki had not previously declared that it accepted the transfer of deposits. According to the draft minutes, the Director General of the FME responded by saying that a transfer of this kind was not simple and timing was of great importance. The FSA had put forth escalating demands and now requested that Landsbanki agreed to an unconditional transfer and Landsbanki had to respond to this demand by the end of August. Within the group, it was criticised that Landsbanki did not appear to acknowledge the situation, taking into consideration the requests that were said to have been put forth by Landsbanki, regarding "statements from Icelandic authorities". The Director General of the FME stated that the bank was aware of the situation but was not faced with any advantageous options. The chairman of the consultative group subsequently stated the opinion that it was easy to appreciate position of the UK authorities and it was impossible to see that Landsbanki was in any position to object. The Director General of the FME was then quoted as saying that the measures would in any case have to be within the bank's tolerance limits. He is furthermore quoted as saying that he had mentioned the year 2010 as an adaptation period for large exposures between Landsbanki and Heritable Bank due to the transfer of the Icesave deposits.

The Director General of the FME mentioned that there seemed to be some unrest with regard to deposit guarantees in the Netherlands and that it were likely that the Dutch were communicating with the UK authorities. With regard to the Guarantee Fund in particular, Jónína S. Lárusdóttir, Permanent Secretary of the Ministry of Business Affairs, informed the meeting that the Fund had received a letter from the Dutch guarantee fund requesting answers to a number of questions. The reason for the letter was Landsbanki's deposit activities through the Icesave accounts in the Netherlands. The tone of the letter was described as coming as close as possible to asking directly whether official support was to be expected. Ms. Lárusdóttir stated that a response

"JFJ (Jónas Fr. Jónsson) outlined the meeting he and Jón Sigurðsson, Chairman of the Board of Directors of the FME, had had with the directors of the FSA in London on 18 August. Their interlocutors said that they thought there was a great risk of a run on Landsbanki's deposits. They also mentioned that Landsbanki had not been cooperative and had i.a. been running an advertisement campaign when the FSA was urging them to slow down their expansion."

From the draft minutes of the consultative group, 20 August 2008.

“TP (Tryggvi Pálsson) said that the Guarantee Fund and the authorities would have to convey the message to the Icelandic banks that they should accept new deposits abroad through their subsidiaries instead of branches.”

The representative of the CBI to the consultative group, quoted in the draft minutes for the meeting of 20 August 2008.

was being drafted to this letter as well as a letter received from HM Treasury on 7 August 2008. She also stated that a draft was available for a statement regarding the Government’s position on potential support for the Guarantee Fund if it proved necessary. Mr. Pálsson suggested that the Guarantee Fund and the Government should put pressure on the banks with regard to their deposit-taking activities abroad, cf. quotation in the margin. At the meeting, a document from the Ministry of Business Affairs, dated 19 August 2008, regarding contributions to the Guarantee Fund was submitted. The Ministry’s conclusion was that, if the contributions to the Fund were to be increased or were to be higher for banks possessing larger deposit books, this would have to stipulated by law. The Ministry referred to the provisions of Act No. 98/1999 on Deposit Guarantees and Investor-Compensation Scheme, which did not provide any margin for increase from the maximum stipulated by the Act, and also, to some extent, to the principles of European law. It would, in other words, be necessary to amend the Act on the Guarantee Fund and introduce authorisation for increased fees, if this were to be done. This was not possible under current legislation.

At the meeting, Tryggvi Pálsson presented what he called a draft memo, dated 15 August 2008. The recipient is the consultative group and the title: “Government policy and contingency preparation”. It addresses specific items that would need to be decided, such as to what extent the Guarantee Fund should be enabled to meet its obligations, and preparatory work in case of payments from the Fund.

On 4 September 2008, the consultative group held its 27th meeting. On the meeting agenda was, as before, the Guarantee Fund’s issues, and what was called “FSA’s mission”. It was noted that there had been some discussions with foreign authorities regarding the transfer of Icesave deposits to a subsidiary in the UK, and the Icelandic Guarantee Fund’s issues. The Permanent Secretary of the Ministry of Business Affairs gave an account of the minister’s meeting with the Chancellor of the Exchequer. In referral to a specific letter from Landsbanki to FSA regarding the bank’s position in the disagreement on how to transfer the deposits in the bank’s UK branch to a subsidiary, Jónína S. Lárusdóttir stated that she found it disagreeable that Landsbanki specified that it had knowledge of the Government’s declaration of support for the Guarantee Fund. Ms. Lárusdóttir then described further the meeting between the Minister of Business Affairs and the Chancellor of the Exchequer, which had taken place two days earlier, on 2 September 2008. The Chancellor expected that the UK authorities would guarantee deposits in full and asked “where to send the bill”. In other words, he was not referring to the maximum £35,000 deposit guarantee in the UK but rather the total amount. It was also noted that the ministers had also discussed the time frame for the transfer of Landsbanki’s deposits to a subsidiary and that it would need to be carried out as soon as possible.

The meeting had a further discussion on technical details regarding the transfer of deposits to subsidiaries, and deposits in commercial banks and savings banks and the estimated coverage of the Guarantee Fund based on different preconditions. The Director General of the FME presented a summary of deposits in commercial banks and savings banks on 30 June 2008 and the estimated guarantee coverage. It states that the total amount of deposits lower than the ISK 2 million limit was ISK 542 billion. The

Permanent Secretary of the Ministry of Business Affairs requested that FME compile a summary based on the stipulated minimum guarantee by the Guarantee Fund, which was ISK 2.5 million. The draft minutes also state that the Permanent Secretary of the Prime Minister's Office and chairman of the consultative group, Bolli Þór Bollason, suggested that the Permanent Secretary of the Ministry of Business Affairs and the Director General of the FME summarise the possibilities for limiting deposits in Icelandic banks' branches abroad. On this occasion, the Permanent Secretary of the Ministry of Finance stated that this issue had to be approached on the assumption that it was acceptable to operate a branch in another country but not for the branch to receive deposits. The Permanent Secretary of the Prime Minister's Office stated that Landsbanki obstinately refused to acknowledge the seriousness of the UK and Dutch authorities.

At the meeting, the representative of the CBI, Tryggvi Pálsson, submitted proposals for the title and introduction of a statement on deposit guarantees, as a previous meeting had requested comments on another available draft for a statement of this kind. Tryggvi Pálsson's proposal is attached to the consultative group's draft minutes. Cf. the text in the margin.

The Guarantee Fund's issues were yet again discussed at the consultative group meeting on 9 September 2008 (the 28th meeting). According to the draft minutes, some particular concerns by the Swedish Financial Supervisory Authority regarding the Guarantee Fund had been received by the Ministry of Business Affairs via Kaupthing, and these concerns suggested that European authorities were exchanging information on these issues. It was brought to attention that Swedish law stipulates a certain state guarantee of deposit guarantees. It was noted that Kaupthing had received ISK 2.6 billion in deposits in its Swedish branch. Mr. Tryggvi Pálsson speculated how the situation would be if the UK authorities would fully compensate for all deposits in the branches of Icelandic banks and then reclaim the amount from the State Treasury, cf. the comment made by the Chancellor of the Exchequer in a recent meeting with the Minister of Business Affairs (see 27th meeting). Mr. Tryggvi Pálsson explained his speculation further by noting that if foreign deposits would be thus fully covered, Icelandic authorities could find themselves in a more difficult position towards Icelandic depositors.

The 29th meeting of the consultative group on 16 September 2008, yet again discussed the Guarantee Fund's issues. A question was put forth regarding the communications between Landsbanki and the FSA and it was reported that FSA's managers were meeting on the issue that same day. It was noted that a report had been published by the British Treasury Select Committee, which was not considered to have caused any additional unrest, and television interviews with the committee's chairman that one of the members of the consultative group had seen did not include mention of the special position of foreign banks, with regard to deposit guarantees. The issues of Kaupthing in the Netherlands were also discussed, while at previous meetings it had been revealed that the Dutch authorities prevented Kaupthing from initiating deposit activities in a branch there. The Director General of the FME stated that Kaupthing did not want a confrontation with the Dutch central bank, but was nevertheless planning to apply for a licence for a branch for the bank's subsidiary in Luxembourg. Baldur Guðlaugsson stated that if the Dutch authorities would approve the branch of a subsidiary

"Examples of the authorities' statements regarding deposits in Icelandic banks.

Statement I (the most assertive one)

Deposits in Icelandic banks are safe

The Icelandic government has decided to guarantee all deposits. The State guarantee of deposits covers all Icelandic commercial banks, savings banks and branches of these parties in Iceland and abroad. Therefore deposits in Icelandic banks are as safe as possible. The State guarantee of deposits is valid for an indefinite period.

Statement II (less assertive)

Deposits in Icelandic banks are safe

The Icelandic government has decided to guarantee all deposits up to the amount of ISK 5 million (EUR 40,051). The State guarantee of deposits covers all commercial banks, savings banks and branches of these parties in Iceland and abroad. Therefore deposits in the Icelandic banks are safe. The abovementioned State guarantee of deposits is valid for an indefinite period.

Statement III (least assertive)

Deposits in the Icelandic banks are safe

The government of Iceland has decided to grant the Depositors' and Investors' Guarantee Fund a loan should it need one. The Guarantee Fund guarantees deposits in commercial banks, savings banks and branches of these parties in Iceland and abroad. The minimum guaranteed amount for deposits is ISK 2.5 million (EUR 20,887). Therefore deposits in Icelandic banks are as safe as European rules provide for."

Drafts of statements on deposit guarantees by the CBI's representative in the consultative group, dated 4 September 2008.

in Luxembourg, this could be interpreted as demonstrating a more favourable position towards deposit guarantees in Luxembourg, and thus as an expression of distrust in the Icelandic deposit-guarantee scheme. The plans of the Icelandic banks for deposit activities in other countries was discussed and Ingimundur Friðriksson, Governor of the CBI, stated that the authorities in all of these countries were communicating with each other.

Later in the meeting, the draft minutes note that the “nature of deposit guarantees” was discussed, as well as the time frame for a decision on guaranteed deposits. It was noted that the appropriate wording for a draft statement on deposit guarantees would have to be deliberated and decided upon. Jónas Fr. Jónsson reminded that if the Icesave deposits were transferred to a subsidiary, the deposit guarantee would be more manageable for the authorities. The necessity of calculating again the amounts of the deposit guarantees was discussed and it was reported that the FME would check the situation again the next month, i.e. in October. A summary on the financing of the commercial banks, which was presented at the meeting, stated that the deposits were currently a significant part of their financing.

At the 30th meeting of the consultative group on 2 October 2008, the draft minutes note that a number of inquiries regarding the Guarantee Fund were being received by the CBI and the ministries. The Fund’s Board of Directors had held a meeting the previous day and discussed complaints arising from vague and even misleading information. Inquiries had been made with regard to the amount available in the Fund. At the meeting, concerns were raised regarding bank runs, because of phone calls received by the Guarantee Fund from Icelanders who had observed that the Fund had limited reserves. It was, however, thought that the Icelandic situation, where the deposits were distributed among several banks, would not be cause for the same risk of complications that could result from a run on a single bank. The meeting of the Board of Directors of the Guarantee Fund the previous day received further discussion. Jónína S. Lárusdóttir, Permanent Secretary of the Ministry of Business Affairs, stated that the meeting had agreed to send the Government a letter, which she read to the group, and request its standpoint regarding the scope of the State Treasury’s guarantee for the Guarantee Fund. The Board of Directors of the Guarantee Fund considered it crucial that the Government would express some position, not necessarily in a statement but provide something on which the Fund could base its own answers. The draft minutes then note that Mr. Baldur Guðlaugsson, Permanent Secretary of the Ministry of Finance, considered the Board’s letter to be a request for a guarantee statement from the State. According to the draft minutes, Ms. Lárusdóttir emphasised that the Guarantee Fund wanted a reply from the State, preferably that same day, so that the Fund had a basis for its replies to inquiries. A statement from the Government, on the other hand, could be construed as an indication of despair. Jónína S. Lárusdóttir stated that she would draft this reply. The Director General of the FME informed that calculations that were done earlier that summer showed that the guaranteed amount was ISK 722 billion, but the amount had increased as the calculation was based on a lower deposit guarantee than was being discussed at this point in time.

Attached to the draft minutes for this meeting is a document, also dated 2 October 2008, entitled “Next steps”, and which had been produced by

the CBI that week. This document discusses possible next steps for the authorities. This includes the following items, on the so-called second level activities, under the item: "Negotiations with the International Monetary Fund for Assistance":

- "B: Statement of guarantee for all deposits (a variation of the Irish approach).
a. Take-over of the Guarantee Fund by the State Treasury."

The document later states that the Irish State Treasury had declared that it would guarantee all deposits, liabilities, and subordinated loans ("Tier 1"), but each institute would have to pay a fee to the treasury. It then states:

"The options for Iceland could include:

1. Similar to the Irish approach. Deposits, liabilities, and subordinated loans ISK 11,700 billion.
2. Only deposits and liabilities ISK 11,000 billion.
3. Only deposits ISK 3,800 billion.
4. Only domestic deposits ISK 1,500 billion."

It is noted that it is impracticable to guarantee all deposits, liabilities and subordinated loans, but a deposit guarantee would be manageable over a long period, especially if these guarantee amounts could be covered with Icelandic krona. That would mean that it would be possible to issue listed bonds against the liabilities.

The last meeting of the consultative group, the 31st meeting, was held on Friday 3 October 2008, at 17:30. At the beginning of the draft minutes, Bolli Þór Bollason, Permanent Secretary of the Prime Minister's Office and chairman of the group, stated that at the beginning of the meeting last Monday there had been some "hope that we could keep three banks, now it is a question of whether we can keep one". As to the issues of the Guarantee Fund, it is noted in the draft that Jónína S. Lárusdóttir, Permanent Secretary of the Ministry of Business Affairs, had pressed for a reply on the deposits from the Prime Minister's Office, cf. discussions at the group's 30th meeting, and Bolli Þór Bollason, Permanent Secretary of the PMO had informed that the Ministry had gone over the issue. He then stated that there had been news from the credit-rating agency Moody's that, if the Government would issue a statement of guarantee for a deposit guarantee for foreign depositors, it would cause a significant drop in Iceland's credit rating. Jónína S. Lárusdóttir then asked if this was based on the minimum guarantee or the total, and said that the pressure from the media was increasing. Mr. Ingimundur Friðriksson, Governor of the CBI, stated that it probably did not matter to Moody's whether the Government's statement of guarantee involved total deposits or minimum guarantees. Mr. Baldur Guðlaugsson, Permanent Secretary of the Ministry of Finance, presented some viewpoints on whether and to what extent the State was responsible toward the Guarantee Fund, cf. quote in the margin. Ms. Jónína S. Lárusdóttir emphasised that it was crucial to get a letter from the Government on some sort of guarantee. In the present situation, the Guarantee Fund could not state anything regarding the financing of guarantees. At a meeting with Alistair Darling, it had emerged that the

"Last Monday morning there was hope that we could keep three banks, now it is a question of whether we can keep one."

The chairman of the consultative group, in the draft minutes for the meeting of 3 October 2008.

"Trust is dwindling here in Iceland. A fast trip north with the cash now."

From the minutes of the consultative group, 3 October 2008.

"The law involves a guarantee of foreign deposits but it must be made clear whether the State is in any way responsible for the Guarantee Fund. [...] It is also a question whether the State is willing to accept responsibility for deposits abroad in advance. The difference will be counted in billions of ISK in the event of bankruptcy. [...] JL (Jónína Lárusdóttir) says that the British will claim that according to the Directive the Guarantee Fund must guarantee this amount. BG (Baldur Guðlaugsson) says that the state would probably not wish to guarantee such a large amount that is not do so in advance. Not do it in advance."

The representatives of the Ministry of Finance and the Ministry of Business Affairs on the consultative group, quoted in draft minutes from 4 October 2008.

British intended to provide a full deposit guarantee and had asked where to send the bill. According to Tryggvi Pálsson, the question was whether the deposits would be guaranteed by the State without the Fund's involvement. Jónína S. Lárusdóttir stated that the position of the British would be based on that the Guarantee Fund would have to guarantee this amount, according to the stipulations in the EU directive on deposit guarantee schemes. Baldur Guðlaugsson mentioned that the government would presumably want to guarantee such a large amount but not do it in advance.

17.10.3 The Central Bank of Iceland (CBI), The Financial Supervisory Authority (FME) and the ministries

As described above, members of the so-called consultative group were representatives from the Prime Minister's Office, The Ministry of Finance, The Ministry of Business Affairs, the FME and the CBI. The representatives of these bodies were a part of their managerial structure and, as a result, individuals who carried managerial responsibility for their functioning. The group was comprised of three permanent secretaries, the Director General of the FME, one of the governors of the CBI, who also sat on the Board of the FME, and one of the directors of the CBI. The directors of the bodies that took part in the group's work therefore had knowledge of the information which came to light during the meetings of the consultative group regarding deposits increases in the Icelandic banks, especially abroad, and the situation regarding the Guarantee Fund. Further details of certain aspects regarding the deposits status of the banks were then discussed more closely within the CBI and the FME, as the case might be. The growing ratio of deposits in the banks' financing structure was brought up when financial stability, liquidity management and monitoring thereof was discussed. For instance, the reversal in the international loan markets and its consequences for the financial system was discussed, among other things, during a meeting on financial stability on 15 November 2007 within the CBI (said to be the fifth meeting of that group in 2007), which was attended by all the bank governors, the bank's chief economist, some of the directors of individual departments within the bank and employees from the financial and economics department. Minutes from the meetings show that the developments in the raising of deposits in the banks had been discussed to some extent and that the reversal regarding deposit accounts had been considered rather sudden. It is also noted that deposit guarantees in the UK were discussed.

At that time, a dialogue regarding deposit accounts in branches of the Icelandic banks abroad, in particular the Landsbanki Icesave accounts, was ongoing between those bodies and their foreign counterparts, especially once 2008 had dawned. The same applies to communications with the directors of the Icelandic banks. These communications are described further elsewhere in the report, for example in Chapter 19.

The affairs of the Depositors' and Investors' Guarantee Fund fell under the Ministry of Business Affairs according to the division of duties in the Government Offices. As established earlier, ever since the Guarantee Fund was established, business ministers have appointed staff members of the Ministry of Business Affairs to the post of Chairman of the Board of Directors of the Guarantee fund. As described previously, the Ministry received a

request from the Icelandic Financial Services Association in the beginning of 2007 to the effect that the Guarantee Fund's regulations be amended in order to exercise, to a greater extent, authorisations for exemptions from obligations regarding deposit-guarantees contained in the EU directive, which would effect the types of deposits included when calculating contributions to the Fund. The reason behind the request was increased raising of so-called wholesale deposits abroad by the Icelandic banks. Mr. Jón Sigurðsson held the position of Minister of Commerce in the coalition government of the Independence Party and the Progressive Party. Scrutiny of those matters and the committee work in relation to the revision of the Act on Deposit Guarantees and Investor-Compensation Scheme which followed was under the supervision of a staff member of the Ministry of Business Affairs, Áslaug Árnadóttir, who had also been appointed chairman of the Guarantee Fund's Board of Directors in February 2008.

Upon the change of government in May 2007, when the coalition government of the Independence Party and the Social Democratic Alliance came into power, it was decided to separate again the activities of the Ministry of Industry and the Ministry of Commerce, which had been under the administration of one Permanent Secretary since 1992. Mr. Björgvin G. Sigurðsson was appointed Minister of Business Affairs on 24 March 2007. During a hearing before the Special Investigation Commission, Sigurðsson claimed that he had not been privy to any other numerical data regarding deposits increases in the Icelandic banks than the information made available in reports and data from the Financial Supervisory Authority and the Central Bank. He had, however, been aware of their raising deposits abroad, although he had only been informed in detail about these issues as 2008 progressed. Sigurðsson had, for example, not received information of an outflow of GBP 200 million from the Icesave accounts in the UK, which took place during three or four days in the beginning of April 2008, until much later. As he recalled, he had not begun making further enquiries regarding the Icesave accounts until September that year, during which time the Director General of the FME had informed him of the outflow. Moreover, these deposit accounts in the Icelandic banks' overseas branches, such as Icesave, had, in fact, only been placed on his agenda for the first time in late August and the beginning of September 2008.⁷⁴

In a letter from the Special Investigation Commission (SIC) to the Business Minister, dated 23 January 2009, information was requested inter alia whether the minister or the ministry of Business Affairs had, during the period of 24 May 2007 to 7 October 2008, initiated any appraisal or evaluation of possible financial risk for the Icelandic State and the State Treasury due to the domestic or foreign operations of the Icelandic financial institutions, particularly in light of recent changes, i.e. the raising of deposits abroad. The ministry's reply, received by the Commission on 4 March 2009, revealed that no such appraisal had been made. Otherwise, the Ministry of Business Affairs referred to the participation of its representatives in the work of the government consultative group and the gathering of information on deposits in the Icelandic banks during the autumn of 2007, which was

74. Statement by Mr Björgvin G. Sigurðsson before the SIC on 19 May 2009, p. 27.

conducted in connection with committee work on the revision of the Act on Deposit Guarantees and Investor- Compensation Scheme.

As demonstrated earlier, apart from the Permanent Secretary of the Ministry of Finance being a member of the consultative group, Mr. Þórhallur Arason, director at the Ministry of Finance and deputy Permanent Secretary, was appointed by the Business Minister to the Board of Directors of the Guarantee Fund. The SIC specifically requested that the Ministry of Finance hand over copies of data collected by staff members of the ministry or specialists outside the ministry, regarding possible amounts that might need to be covered by the State Treasury due to deposit accounts in overseas branches of the Icelandic banks. The only data made available by the ministry was e-mails from the economists Mr. Friðrik Már Baldursson and Mr. Jón Steinsson dated 10 October 2008 where deposits in the Icesave accounts were discussed. Judging by other available data and the replies made by Finance Minister Árni M. Mathiesen during a hearing before the SIC, there is nothing to indicate that issues regarding the Guarantee Fund were discussed on behalf of the Ministry of Finance or the minister during 2007 and until August 2008, except in connection with the participation of aforementioned staff members in the government consultative group and the Board of Directors of the Guarantee Fund.

Replies by the Prime Minister's Office to enquiries parallel to those made to the Ministry of Finance and the Ministry of Business Affairs, regarding an evaluation of the possible risk for the Icelandic State due to aggregate deposits in the Icelandic banks and the subsequent increase in obligations for the Guarantee Fund, only referred to the Prime Minister's Office having representatives on the consultative group and the data about the establishing of the group.

17.11. Views within the Administration and the Banks regarding Responsibility for the Obligations of the Depositors' and Investors' Guarantee Fund if the Guarantee Fund's Assets were insufficient to pay the minimum Compensation

17.11.1 Introduction

It has been previously described (cf. Chapter 17.3) that in the commentary on the bill of law proposed to the Parliament in 1996, when the provisions of the EU directive on deposit guarantees were first implemented into Icelandic law, it was specially stated that, according to the directive, a State guarantee or a guarantee by other public bodies of the obligations of a commercial bank or savings bank could not replace deposit guarantees. At the same time, it was stated that the new fund then proposed, which was to be named the Deposit Protection Fund of the Commercial Banks, would be a private foundation. It was especially stated that "neither the State Treasury nor the commercial banks and savings banks which [were] members of the fund [would] be responsible for its obligations." The parliament's conclusion in 1996 was to not establish a new independent fund that would cover deposit guarantees in both commercial banks and savings banks. Until 1999, the system was divided into two sectors, the Deposit Protection Fund of the Commercial

Banks, which was a separately funded decentralised body owned by the State, and the Deposit Protection Fund of the Savings Banks, which was a private foundation. Under Act No. 98/1999 these funds were united, becoming the Guarantee Fund, and the united fund was made into a private foundation. The law does not specially cover the responsibility for the Guarantee Fund's obligations should the Fund's assets not be sufficient to cover the minimum compensation, but it does state that if the Fund is short of assets and its Board of Directors is of the opinion that such action is necessary, the Board may take out a loan in order to pay the claimants, cf. Article 10(2).

As described in Chapter 17.10.2, the Guarantee Fund and its deposit guarantee obligations were frequently discussed within the consultative group of the three ministries, the FME and the Central Bank, in 2008. It is not clear from the draft minutes of the consultative group what the position of the group members was vis-à-vis a possible State guarantee for the Guarantee Fund's obligations if the Fund's assets proved insufficient to cover the minimum compensation it might have to disburse. However, discussions within the consultative group on the effects of increased deposits in the Icelandic banks, especially abroad, on the Guarantee Fund's position, had already begun at the end of 2007. There were concerns that the Fund did not possess enough assets to meet its obligations, but without specific discussion on how to solve this problem. Additionally, there was a discussion on the importance for the banks to practice these deposit-taking activities abroad in special subsidiaries rather than branches. The consultative group's meetings also yielded drafts of different statements regarding the responsibility of the State Treasury, on the one hand for a loan taken out by the Guarantee Fund and on the other hand on the responsibility of the Treasury for deposits up to a certain amount. Such a draft was first submitted at the consultative group's 13th meeting, on 10 April 2008.

At the group's meeting on 9 May 2008 (16th meeting) Áslaug Árnadóttir submitted, on behalf of the (then) Ministry of Business Affairs, a paper titled: Guarantee of deposits. It begins by stating that a position must be taken on several issues when discussing State guarantees of deposits. After describing the provisions of Article 10 of Act No. 98/1999 on the fund's authorisation to take out a loan to enable the fund to disburse the minimum payment to the claimants, i.e. the equivalent of EUR 20,887, the possibility of the government issuing a declaration of support to the Guarantee Fund is dealt with. Cf. the quotation in the margin. Interestingly, the representative of the Ministry of Business Affairs who submitted the paper does not seem to have presumed, when drafting the paper, a direct and existing responsibility of the State Treasury for the Guarantee Fund's obligations should the fund's assets not be sufficient to disburse all the minimum protection claims. Instead there is a call for decisions on the possible arrangement of the State's responsibility for deposits which would serve as part of the contingency work that was discussed within the consultative group.

"It is possible that the government will now issue a statement saying that the State will grant such a loan to the Guarantee Fund. The government could also guarantee the disbursement of the said minimum amount."

From a Ministry of Business Affairs document submitted before the consultative group's meeting on 9 May 2008.

At the consultative group's meeting on 7 July 2008 (meeting No. 20) a paper, called a basic draft of a working document for the consultative group, was submitted and discussed. Its contents were described thus: Urgent Government Decision Making concerning the Danger of a Financial Shock. The paper was submitted by Tryggvi Pálsson, a Director at the Central Bank. It refers to the fact that the Guarantee Fund is a private foundation but is legally obliged to guarantee deposits up to a minimum amount of EUR

20,887. It further states that the fund has assets of ISK 11 billion, plus letters of guarantee from financial institutions worth over ISK 6 billion and that the minimum protection is, on the other hand, estimated at over ISK 115 billion (at the exchange rate of 8 May 2008) according to a summary by the Ministry of Business Affairs dated 9 May 2008. It adds that it is doubtful that the Guarantee Fund has the capacity to bridge the gap by taking out a loan; that the Fund's creditworthiness is presumably very limited; that it is uncertain whether loans taken out by the Fund can be repaid with future premiums if the outcome of a financial shock were a considerable retrenching of the activities of domestic financial institutions. Possible responsibility of the State Treasury for the Guarantee Fund's obligations is not mentioned in this paper.

On the same day, 7 July 2008, a consultative meeting was also held with the participation of the Central Bank and the FME. In notes from the meetings Mr. Davíð Oddsson, Chairman of the Board of Governors of the Central Bank, is quoted as saying that the Guarantee Fund can not even handle the savings bank Sparisjóður Mýrasýslu and that the Icelandic banks' deposit taking through overseas branches should have been stopped. Mr. Jónas Fr. Jónsson, Director General of the FME, mentioned that the contributions to the Guarantee Fund were much too low. Mr. Tryggvi Pálsson of the Central Bank is then quoted as saying that he asserted that "the State Treasury was unable to assume responsibility for the deposit guarantees without risking the Treasury going bankrupt".

In the data from the authorities and the Guarantee Fund which was examined by the SIC the first indications that a special discussion had taken place on the possible existence of an explicit responsibility of the State Treasury for the Guarantee Fund's minimum protection obligations appear in notes written within the Central Bank on the meeting between the Governors of the Central Bank and the CEO's of Landsbanki on 31 July 2008. In the notes Mr. Davíð Oddsson, Chairman of the Board of Governors of the Central Bank, is reported to have said that nowhere was it stated that the Icelandic State was under an obligation, to which Mr. Sigurjón Þ. Arnason, CEO of Landsbanki, is said to have replied: "Oh God! Don't bring up that story." The notes show that the transfer of the Icesave accounts into a Landsbanki subsidiary, Heritable Bank, was discussed, and Mr. Halldór J. Kristjánsson, CEO of Landsbanki, is quoted as saying that he is not the only one of the opinion that EUR 20,000 is an obligation in accordance with international law. Mr. Oddsson is then quoted as saying: "No State guarantee unless stipulated by law." According to the notes, Mr. Kristjánsson replied that such an authorisation should be requested, to which Mr. Oddsson replied: "[You] are raising deposits without speaking to the nation about the commitment. The two of you can not bankrupt the nation." Cf. further discussion in Chapters 17.11.3 and 18.0.

In his statement before the SIC, Mr. Oddsson stated that this attitude of Mr. Kristjánsson's had caught his attention and that following this meeting he had phoned the Prime Minister Haarde, and Mr. Baldur Guðlaugsson, Permanent Secretary of State of the Ministry of Finance, and told them about this opinion held by a CEO of Landsbanki.⁷⁵ Mr. Oddsson said that he did

75. Statement by Mr. Davíð Oddsson before the SIC on 7 August 2009, pp. 84 and 86-87.

not know what their reactions had been, but the Board of Governors of the Central Bank had not reacted further. The stress had been on transferring these foreign deposits over to subsidiaries of the banks. As is further related at the end of the chapter, neither Mr. Haarde nor Mr. Guðlaugsson recalled having received such a call from Mr. Oddsson. Both of them did state, however, that they had later become aware of Mr. Oddsson's general attitude towards the issues under discussion here, regarding the Icelandic State's responsibility for the Guarantee Fund's obligations. When asked specifically, Mr. Oddsson said in his report to the SIC that at that point the Board of Governors of the Central Bank had not considered that there was a special need to request a specific legal appraisal of this matter, since it was his opinion and, to his best knowledge, that of others within the bank, that there was no explicit State guarantee of the Guarantee Fund's obligations.

It was confirmed during the hearings before the committee that, apart from the previously mentioned exchange of opinions between the Chairman of the Board of Governors of the Central Bank and the CEO of Landsbanki, there is no indication that either the Icelandic authorities or the Board of Directors of the Guarantee Fund began specifically discussing the possible responsibility of the Icelandic State for the Fund's obligations, until after the Guarantee Fund and Ministry of Business Affairs began to receive enquiries from abroad around the end of July 2008. The contents of these enquiries and replies of the Guarantee Fund and the Icelandic authorities are related in Chapter 17.17 below. As may be seen there, these replies were not altogether clear as to what the Icelandic authorities' plans were regarding a possible guarantee of deposits in Icelandic banks and the State Treasury's involvement in a settlement of the Guarantee Fund's affairs. It also describes the differences of opinion among the authorities on when to reply to these enquiries and what the substance of their replies should be.

The prelude to this correspondence with foreign authorities and guarantee funds were meetings and conversations that had taken place between on the one hand the Icelandic authorities and the Chairman of the Board of the Guarantee Fund and on the other hand representatives of the foreign parties. During these meetings and discussions the foreign parties requested information on what kind of backing the Icelandic State would give the Guarantee Fund if difficulties were to arise in the operations of the Icelandic banks which had branches abroad and were taking deposits there.

It cannot be deduced from the draft minutes of the consultative group's meetings in August and September (a total of 5 meetings) that the possible responsibility of the State Treasury for the Fund's obligations had been discussed directly enough to give a clear indication of the position of the group's members on this matter. The same applies to the question of how the State Treasury would possibly involve itself in the funding of the Guarantee Fund's obligations should its assets be insufficient to disburse the amount of minimum guaranteed protection. Discussions continued on possible declarations by the State Treasury regarding a guarantee of the loans taken out by the Guarantee Fund or the responsibility of the State Treasury for the banks' deposits. Chapter 17.16 outlines the correspondence between the Chairman of the Guarantee Fund and members of the authorities' consultative group on 29 and 30 September 2008, following the State's offer for a 75% share in Glitnir hf. In this correspondence, the Chairman

of the Guarantee Fund requested that the government issue a declaration on its support to the Guarantee Fund and/or a guarantee of the deposits in the Icelandic banks, including their overseas branches. The same chapter discusses letters sent by the Board of Directors of the Guarantee Fund to the Prime Minister on 1 and 9 October 2008, requesting clarification of how the Guarantee Fund would be enabled to meet its obligations under Act No. 98/1999, should the Fund's assets be insufficient to disburse the payments for which the law provides.

As described in Chapters 18 and 19, in August 2008 the Landsbanki requested a loan of GBP 2.5 billion from the Central Bank so that the Landsbanki could transfer the deposits in its branch to its subsidiary, Heritable Bank, in London. When the Central Bank examined the matter its employees wrote a memorandum to the Board of Governors, dated 26 August 2008, saying that this facilitation could enable the Landsbanki to transfer its British deposits from a branch to a subsidiary. It then goes on to say: "[...] which would considerably reduce the risk of the Icelandic Guarantee Fund and possibly the Icelandic State." This is a reference to the potential risk of the Icelandic State because of the Guarantee Fund's obligations.

Late in the afternoon of Friday 3 October 2008 the consultative group held its last meeting (No. 31) and discussed, among other things, deposit guarantees. The draft minutes state that Mr. Baldur Guðlaugsson, Permanent Secretary of State of the Ministry of Finance, said that the Act on deposit guarantees included a guarantee of foreign deposits but it must be made clear whether or not the State had any kind of responsibility for the Guarantee Fund. On that matter please see the above discussion on that meeting and previous consultative group meetings.

From what has been related earlier in this chapter, it cannot be seen from the data accessible to the SIC, which covers the period up to 6 October 2008 when the Emergency Act, i.e. Act No. 125/2008, was adopted, that there is a clear position by individual parties within the administration or the Board of Directors of the Guarantee Fund on the legal status regarding the Icelandic State's possible responsibility if the Fund's assets were insufficient to disburse the Fund's minimum guarantee. The only exception is the comment and reaction of Mr. Oddsson, which is revealed in the bank's notes from a meeting with the CEO's of the Landsbanki on 31 July 2008, and in conversations he claims to have had afterwards with the Prime Minister and the Permanent Secretary of the Ministry of Finance. When specifically asked in the hearing before the SIC, Prime Minister Haarde replied that he did not recall the Chairman of the Board of Governors of the Central Bank having told him about his communication with the Landsbanki CEO, but that the Chairman had later mentioned, in October, that he did not consider the Icelandic State to be responsible for the Guarantee Fund's obligations and that he had earlier told the representatives of the Landsbanki that the State bore no responsibility.⁷⁶ Nor did Mr. Guðlaugsson, during the hearing before the SIC, recollect having had a call from Mr. Oddsson "after and with any reference to conversations he had had with [...] the Landsbanki CEOs." He had "never heard before that there had been any conversation on the issue."

76. Statement by Geir H. Haarde before the SIC on 2 July 2009, p. 61.

He did, however, state, as did Mr. Haarde, that these issues had later been mentioned in conversation with Mr. Oddsson, where it had been revealed that Mr. Oddsson was emphatically of the opinion that the State had no responsibility for the Guarantee Fund's obligations. Mr. Guðlaugsson thought that this communication between him self and Mr. Oddsson had taken place around the time the Icelandic authorities started receiving enquiries from the U.K. on these issues, but according to other data to which the SIC has access it could have taken place in August of the same year, cf. further discussion on the inquiries below.⁷⁷

During the hearings before the SIC, an investigation was made into the views of those within the administration, who supervised the financial system and participated in the authorities' work on the contingency plan, on the State's possible responsibility for the Guarantee Fund's obligations. There was also a special attempt to discover when this issue was first discussed at that level. It is considered appropriate to relate a summary of the hearings on this issue.

17.11.2. The views of individual persons within the administration and governmental institutions

Geir H. Haarde, Prime Minister, said that it had probably only been in August 2008 that he realized that grave problems might arise concerning The Depositors' and Investors' Guarantee Fund and claims upon the State arising from the Fund's obligations. He stated that the British Financial Services Authority, (FSA) had sent representatives to Iceland to inquire about the significance of some provisions of the legislation on the Guarantee Fund, inter alia how the obligations pursuant to the legislation would be honoured. Even though the answers to these questions were supplied by the Ministry of Business Affairs, he had nevertheless kept tabs on the issue. The Permanent Secretary of State of the Ministry of Business Affairs and a surrogate - and perhaps other lawyers from the same ministry - had been adamant in claiming that the Guarantee Fund would "just pay it all and do so right away, but the conservative Permanent Secretary of State working in the Ministry of Finance did not quite agree, did not want to go that far". When asked whether he himself had considered that the State should be held responsible in this case, Mr. Haarde replied: "Yes, as it was presented to me to begin with, I considered that to be the case." He then referred to one of the consultative group's documents, which he had seen, where this had been discussed as a matter of course. He said that he had not yet formed a definite opinion when the subject was first brought up. "One just listens to what one is told," Mr. Haarde added.⁷⁸

Björgvin G. Sigurðsson, Minister of Business Affairs, said that the State's possible intervention as concerns the Guarantee Fund's obligations had been discussed late in the summer of 2008, following communications with the FSA. The wording of the EU directive had been taken for granted inside the Ministry of Business Affairs, and thus the State's guarantee was understood

"Yes, the way it was presented to me initially, I rather thought so [...] One just listens to what one is told."

The Prime Minister, Geir H. Haarde, when asked about the views held on the State taking responsibility for the Guarantee Fund's obligations during the prelude to the bank collapse, during the hearing before the SIC, 2 July 2009, p. 61.

77. Statement by Mr Baldur Guðlaugsson before the SIC on 3 February 2010, p. 1.

78. Statement by Geir H. Haarde before the SIC on 2 July 2009, pp. 59-61. See also statement by Mr Haarde before the SIC on 3 July, p. 1.

"People were living in the hope that we wouldn't have to pay and I had told Geir [H. Haarde] and Davíð [Oddsson] that the British would never let us get away with not paying" [...] I think it was really only Björgvin [G. Sigurðsson] and I who were certain almost from the start that we would have to pay."

Statement by Mr Árni M. Mathiesen before the SIC on 20 May 2009, p. 49.

"I personally was never prepared and would not have staked my head on the 100% validity of the conclusion that this was not the State's responsibility."

Statement by Mr Baldur Guðlaugsson before the SIC on 25 March 2009, p. 24.

to be indirect. He said that even though the Fund was autonomous, the State had to support its efforts to secure funds in order to be able to meet its obligations. He said these were the "obligations binding under international law".⁷⁹

Árni M. Mathiesen, Minister of Finance, stated that it was not until well into the year 2008 that the issue of the State's possible responsibility regarding the Guarantee Fund's obligations had been submitted to his office, as the this Fund had not been the ministry's concern. Once the issue arose, no one was quite clear on its legal status, viz. the reference to Mr. Mathiesen's report to the SIC in the margin. He further stated that in spite of these different approaches, no legal report had been made on the subject at that point. That came later, he said, referring to opinions that were sought in the context of negotiations with the British and the Dutch.⁸⁰

Bolli Þór Bollason, Permanent Secretary of State in the Prime Minister's Office, said that within the consultative group, it had been obvious that the Ministry of Business Affairs and the Financial Supervisory Authority, (FME), considered the State responsible for the Guarantee Fund's commitments. Mr. Bollason stated that he had been inclined to accept this explanation, without examining its legal aspect. "Simply that this was what guaranteeing the minimum compensation entailed," said Mr. Bollason, and when he was asked for the arguments for this conclusion, Mr. Bollason said that the Ministry of Business Affairs had pointed out that it was not unheard of that the Guarantee Fund was empty of funds or nearly empty. That was the general situation, but nevertheless there was some kind of standby letter of credit in effect, he said. When asked whether the substance of the EU directive had been looked into, Mr. Bollason replied that the Ministry of Business Affairs had stated that it had done so, and that this issue was not disputed.⁸¹

Baldur Guðlaugsson, Permanent Secretary of State in the Ministry of Finance, said that it was not until spring and summer 2008 that there were some debates in which he took part inside the administration, especially within the authorities' consultative group, on the Guarantee Fund's increased obligations and the importance of conducting the banks' deposit account activities abroad within their subsidiaries. When questioned as to the consultative group's stance in the spring of 2008 regarding the possibility of the Treasury guaranteeing the Guarantee Fund's obligations, Mr. Guðlaugsson said that discussions on these matters had hardly begun in the spring. Then, he said, inquiries began to come in regarding the Icelandic Guarantee Fund's situation and the regulations ruling it. He said that when this debate started, he had endeavoured to understand the regulations involved and had personally believed that questions might be raised as to whether the State had this undeniable obligation pursuant to the directive, and also regarding the provision of a minimum guarantee, or whether the State had in fact fulfilled its obligations by setting up the Guarantee scheme. See further on Mr. Guðlaugsson's view in the margin.

Mr. Guðlaugsson stated that all of a sudden, in August, perhaps, inquiries from the FSA had been received, pertaining to quite specific subjects.

79. Statement by Mr Björgvin G. Sigurðsson before the SIC on 19 May 2009, p. 26.

80. Statement by Mr Árni M. Mathiesen before the SIC on 20 May 2009, p. 49.

81. Statement by Mr Bolli Þór Bollason before the SIC on 5 March 2009, pp. 33-34.

These had not concerned Landsbanki in particular, as they were of a general nature. What if the Fund does not have the minimum required? What is the significance of the Fund's credit facility? What if it doesn't get credit? Would the State then consider itself under an obligation to assume responsibility, etc. Mr. Guðlaugsson continued: "Of course, in certain circumstances, one must put the theory aside for a while and just face the real tasks at hand. We were in the position of not wanting to rock the boat, naturally, [...] as it would surely not have been considered suitable, as things stood, to convey the message and say: Look here, the State firmly believes that it is not responsible for this minimum guarantee. Similarly, I was very much against us just stating unconditionally: The State did guarantee this minimum payment." Mr. Guðlaugsson went on to say that at the time, it had however been the firm position of the Ministry of Business Affairs - and subsequently, that of the Ministry for Foreign Affairs - that this was the State's obligation. Mr. Guðlaugsson confirmed that when these issues were broached for the first time within the consultative group, and during the preparation of responses to the aforementioned inquiries from the UK, no legal counselling or opinion was sought outside the consultative group.⁸²

Jónína S. Lárusdóttir, Permanent Secretary of State of the Ministry of Business Affairs, said that, as she recalled, she had taken part in the debate about the State's possible responsibility after she started working with the ministry in October 2000. She subsequently became Chairman of the Board of Directors of The Depositors' and Investors' Guarantee Fund (2003-2004). There had been conversations with the ministry's officer who had been in charge of the implementation of the directive concerning deposit guarantee funds at the time, and it had been said that it would be difficult to comply with the provision of EUR 20,000 as there would not always be enough capital in the fund, and then the State would have "to intervene". Ms. Lárusdóttir was on leave from her office as Permanent Secretary of State during the period from Dec. 2007 to August 1st, 2008. When she resumed her functions, there were ongoing debates within the ministry and the consultative group, pertaining to the Guarantee Fund's situation and the Fund's obligations. Her position and that of the Ministry of Business Affairs had been that the directive's provisions and the legislation on deposit guarantees were clear, and that a minimum sum of EUR 20,887 would have to be paid, and there was the risk that the Icelandic State would have to carry the responsibility if the Fund's assets proved inadequate. When questioned on the reasons for this, Ms. Lárusdóttir, replied that there had been parties inside the ministry who had studied the Directive as well as European legislation, and she also referred to the verdict made by the EFTA Court in the so-called Erla María-affair. It appeared that she had not examined any academic studies on the topic at the time, and that the ministry had not obtained any outside legal counsel.⁸³

Áslaug Árnadóttir, acting as Permanent Secretary of State, Ministry of Business Affairs, from mid-December 2007 until August 1st, 2008, and Chairman of the Board of Directors of The Depositors' and Investors' Guarantee Fund from February 2008, said that she had always thought

82. Statement by Mr Baldur Guðlaugsson before the SIC on 25 March 2009, pp. 24-25.

83. Statement by Ms Jónína S. Lárusdóttir before the SIC on 31 March 2009, pp. 7-8.

that it was the implied common understanding that the State would at least have to supply a loan, but that it would not necessarily be made to pay directly. Yet, the subject had never been thoroughly discussed. The Board of the Guarantee Fund considered that the State should be involved in some way, yet no attempt had been made to study the question from a legal point of view before October, i.e. whether the State was responsible for the Guarantee Fund's obligations. At a meeting held on October 13th, 2008, the Board had agreed to seek a legal opinion from the Fund's legal counsellors.⁸⁴ When specifically asked if she had, while in office as a member of the consultative group, ascertained whether the State was responsible for the Guarantee Fund's ability to meet its obligations, she said she had, yet that subject had not been thoroughly debated, and when it was, the Ministry of Finance's representative i.e. Baldur Guðlaugsson, had not agreed with her. Ms. Árnadóttir was also asked on what grounds a memorandum which was written in the Ministry of Business Affairs on October 15th, 2008, stated that under international law the State should carry the responsibility of insuring that the depositors would be paid the minimum guarantee. Ms. Árnadóttir replied that this had been the opinion of the legal counsellors and that no third party had been asked to comment on the issue. Ms. Árnadóttir stated that she had had the understanding that the State's obligation to pay out was pursuant to the EEA Agreement, providing that the State should set up a deposit guarantee scheme, and were the State to set up a scheme that proved inefficient, payments would nevertheless have to be made. She said it was the State's responsibility to support the Guarantee Fund. Ms. Árnadóttir said that this understanding had been explained to the Minister of Business Affairs in the course of conversations, but the subject had not really been debated until it had been necessary to respond to inquiries from abroad in August and September, and especially in October 2008.⁸⁵

Jón Þór Sturluson, assistant to the Minister of Business Affairs, said he did not remember exactly when the debate on the State's possible responsibility with regard to the Guarantee Fund's obligations had started, but concern about the Guarantee Fund's situation had grown as the authorities became aware of the sums deposited in the Landsbanki Icesave accounts. This debate on responsibility was not prominent at the minister's level of the Ministry of Business Affairs until the late summer of 2008. The subject had been discussed within the consultative group and there had been diametrically opposed opinions. The Ministry of Business Affairs supported the view that responsibility for these obligations should be declared pursuant to the EEA Agreement, while the Ministry of Finance was opposed to that. When he was asked whether the Icelandic authorities had defined a common stance concerning the legal status regarding a theoretical State responsibility for the Guarantee Fund's obligations prior to the difficulties of the banking system with which they had to deal in early October 2008, Mr. Sturluson said that this issue had obviously not been resolved. He said that the issue had been discussed extensively within the authorities' consultative group, yet a final conclusion had never been reached.⁸⁶

84. The opinion was delivered in a memorandum dated 13 October 2008 from LEX law offices to the Guarantee Fund.

85. Statement by Ms Áslaug Árnadóttir before the SIC on 17 March 2009, pp. 4-7.

86. Statement by Mr Jón Þór Sturluson before the SIC on 6 May 2009, pp. 8-13.

Jónas Fr. Jónsson, Director General of the FME, said that he had been convinced that the Icelandic State would have to pay out a minimum guarantee of EUR 20,887 to each depositor. That was his understanding of the directive, and it was also pursuant to Article 3 of the EEA Agreement. The Icelandic State had made a commitment by which it is bound. When asked whether, in view of the increased aggregation of deposits in other countries, made by the Icelandic banks, the aforementioned opinion on the State's responsibility had been the basis of the FME's stance, Mr. Jónsson said that this had not been the case. He claimed that no formal, legal position had been taken regarding this issue. See further on Mr. Jónsson's view in the margin. When asked whether it had never occurred to the consultative group or the FME to seek further legal arguments to support a conclusion regarding this issue, Mr. Jónsson said that it had not, and that he "believed it would have been within the scope of the Guarantee Fund, or that of the Central Bank, to seek such information."⁸⁷

In the hearings before the SIC, Davíð Oddsson, Chairman of the Board of Governors of the Central Bank of Iceland, referred to a meeting with the CEOs of Landsbanki on July 31st, 2008, where he had stated that the Guarantee Fund's obligations were not subject to a state guarantee. It was revealed that this position had not been founded on any legal research on the part of the Central Bank, but he said that, to his knowledge, there were no differences of opinion regarding this position within the bank. Later, he had realized that the Director General of the FME had had a different opinion, and then there had been differences among the ministries within the consultative group. Mr. Oddsson was asked whether this difference of opinions regarding the possible responsibility of the Icelandic State had not given cause to examine the issue from a legal point of view, and he replied that this had not been the Central Bank's mission. He said that following the meeting with the CEOs of Landsbanki, he had, during telephone conversations with the Prime Minister and the Permanent Secretary of State of the Ministry of Finance, conveyed their understanding and his position.⁸⁸

Mr. Eiríkur Guðnason, director of the Central Bank, also referred to the aforementioned meeting with the Landsbanki CEOs. It had been the opinion of the Chairman of the Board of Governors that the commercial banks could not put the Treasury up as a warranty without an authorisation from Parliament. Mr. Guðnason further described the meeting and Mr. Oddsson's point of view as quoted in the margin. Mr. Guðnason made it clear that he later became aware of the fact that there were differences of opinion within the administration on the State's responsibility in this matter, but as far as he recalled, there had been no mention of seeking legal counselling concerning this issue. He referred to the fact that this subject fell within the scope of the FME, and the Guarantee Fund within the scope of the Ministry of Business Affairs.⁸⁹

Ingimundur Friðriksson, governor of the Central Bank of Iceland, said that within the Central Bank, it was generally thought that the Guarantee Fund's obligations were not part of the responsibility of the Icelandic authorities. He said that according to the legislation, the Icelandic authorities

"[I] could never expect that the State would say that it would not stand by the obligations."

Statement by Mr Jónas Fr. Jónsson before the SIC on 23 March 2009, p. 30.

"It was the jurist who had formed this opinion and told it straight to Landsbanki: This can not be guaranteed by the State. They gasped. This was not supposed to be said. We don't know how much they had said when they were introducing their deposit accounts."

Statement by Mr Eiríkur Guðnason before the SIC on 26 May 2009, p. 40.

87. Statement by Mr Jónas Fr. Jónsson before the SIC on 23 March 2009, pp. 29-30.

88. Statement by Mr Davíð Oddsson before the SIC on 07 August 2009, pp. 84-85.

89. Statement by Mr Eiríkur Guðnason before the SIC on 26 May 2009, p. 40.

had no other duty than that of establishing a guarantee scheme pursuant to the EU directive, but that the State was not responsible for that scheme. This point of view had, inter alia, been discussed at meetings with Landsbanki CEOs. "They reacted quite strongly to this viewpoint of the Central Bank being heard in public, it would ruin their operations," Mr. Friðriksson said. The Landsbanki CEOs had taken for granted that the State was responsible for the Guarantee Fund. Mr. Friðriksson made it clear that he had realised that there were different opinions within the consultative group as to the possible duties of the Treasury in this context, yet this had not led to a special consultation with legal counsellors.⁹⁰

Sigríður Logadóttir, chief legal counsellor of the Central Bank of Iceland, was a member of the committee appointed by the Minister of Business Affairs in May 2007 to revise the legislation concerning the Guarantee Fund. When asked, she said that the revision committee had not, during its meetings, discussed the responsibility for the Guarantee Fund's minimum guarantee if the fund were to become depleted. She said that she, as a legal counsellor of the Central Bank, had not taken part in any assessment on the Bank's behalf of how the State's possible commitments concerning the Guarantee Fund would develop. The legal provisions stated clearly that the Guarantee Fund was responsible for the sum of EUR 20,887 in question, and there was "no direct channel to the State in that regard."⁹¹

17.11.3 Views within the banks

The SIC (special Investigation Commission) has examined the 2007 and 2008 minutes of the Landsbanki Board of Directors in order to assess the information contained therein regarding the Board of Directors' deliberations on the aggregation of deposits in the bank's branches abroad.

The Landsbanki Board of Directors' meeting, held on March 10th, 2008, dealt inter alia with the situation of Icesave and other deposit projects. In the minutes, it appears that the total Icesave deposits amounted to 4, 675 million pounds, of which 1,167 million were bound deposits, i.e. 25%. The average deposits had decreased sharply, having peaked at 45,000 pounds, but at the time, they were closer to 35,000. The so-called Iceflower project was also discussed; it was presented as the preparation for Icesave accounts in the Netherlands. It appears that the modalities of deposit guarantees were being discussed, and this had caused some delay. The following is recorded in the minutes:

"Halldór J Kristjánsson outlined the deposit guarantees for foreign deposits to the bank in general. The high CDS spreads have drawn attention to the question of safety of foreign deposits to Icelandic banks and kindled discussions on that aspect of deposit-taking activity. The rules of the European Community which apply uniformly to the governments, provide for their obligation to guarantee up to EUR 20,000. It is complicated to have to seek guarantees from more than one party."

90. Statement by Mr Ingimundur Friðriksson before the SIC on 19 March 2009, p. 19.

91. Statement by Mr Davíð Oddsson before the SIC on 8 May 2009, p. 48.

At the following meeting of the Board of Directors, on April 7th, 2008, there is an item on the agenda, entitled: Merger of local units in London. This is the first record in the Board of Directors' minutes during the period subjected to the scrutiny of the SIC, mentioning that the Board of Directors actually discussed the transfer of Icesave deposits in the Landsbanki branch in London to a subsidiary. It appears that Mr. Kristjánsson presented that subject. First there is a description of the deposit guarantees regarding Icesave, of which there are two aspects, i.e. from Iceland on the one hand and from the UK on the other hand. This would change if the operation was within a subsidiary in the UK. Later in the minutes it says:

"Therefore, it is appropriate to reconsider the arrangement, i.e. due to negative publicity in the British media concerning the current arrangement. The wholesale deposits should remain in the branch as the focus on that issue was different. This method was not chosen initially because of British regulations liquidity requirements, which take into account the balance of assets and liabilities for a period of 0 to 8 days, and then of 8 to 30 days."

Mr. Kristjánsson, CEO of Landsbanki, was questioned, during the hearings before the SIC, about comments attributed to him in the notes compiled within the Central Bank on the meeting of the CEOs of Landsbanki with the Board of Governors of the Central Bank on July 31st, 2008, described above. Mr. Kristjánsson's reply was as follows:

"I was always of the opinion that under any "normal" circumstances the "European directive" would be tantamount to an obligation under international law, "hobby lawyer" that I am; I regarded it as self-evident, that behind these twenty thousand. However, I am in absolute agreement on this point with those who claim that this could be disputed in case of systemic melt-down, and I recall that this was something the governor of the Central Bank in the Netherlands said to us when we spoke to him, that a fund of this type was to compensate in case of incidental setbacks but not systemic melt-downs. However, I am of the opinion that pursuant to the Act on the Guarantee Fund, the Fund is authorised to take a loan to pay and I, therefore, assumed that taking account of the status of the directive in terms of international law, the Fund was obligated to take such a loan and attempt to fulfil its obligations. And when people are trying to consider, when this kind of Fund is put to the test, then they obviously never expect total loss, rather a certain percentage of recovery, hopefully as high as possible. We simply had a debate regarding the nature of these guarantees and the Central Bank and in particular the Chairman of the Board of Governors of the Central Bank understood it this way which I believe is too limited, although I acknowledge it in principle."⁹²

"I was always of the opinion that under any "normal" circumstances the "European directive" would be tantamount to an obligation under international law, "hobby lawyer" that I am [...] But I completely agree with those who say that it can be seriously doubted that it applies when there is a systemic collapse [...]"

Statement by Mr Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 20.

92. Statement by Mr Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 20.

When further questioned, Mr. Kristjánsson replied that he had considered that the State would have to be a central counterparty concerning a loan to The Depositors' and Investors' Guarantee Fund, if the Fund's assets did not cover the minimum guarantee. Mr. Kristjánsson said that Landsbanki had taken for granted that the State would have to back up the guarantee fund in this regard, yet this did not count as a direct state guarantee. That would not be possible without the adoption of a law to that effect, and Mr. Kristjánsson continued:

"It is this presumed State support that is taken into consideration in the credit ratings of all systemic banks all over the world. Thus, there is a certain presumed State support for deposits but also for bank securities."

Statement by Mr Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 21.

"Yet I think everybody had in mind the same considerations for credit rating as elsewhere in the world, and that the states would support their central banks. This seemed to be the accepted view until Lehman's collapse, and it was reinstated later [...]. In fact, the Icelandic banks' credit rating, as assessed by Moody's, for instance, and Fitch, was based on a specific, basic assessment, giving a result, say, A, but they increased the rating and granted us a double A because of an "implied" state guarantee. And I do believe that when the economic crisis we are currently going through will be assessed on an international level, it will be agreed that this period must end. There must be either a clear state guarantee, which will be paid for, but it will not be possible to run complicated systems under the cover of an "implied" state support which has not been paid for. I do believe this is the lesson to be learned on an international level."⁹³

Sigurjón Þ. Árnason, CEO of Landsbanki, noted that he and his colleagues at Landsbanki had not considered the Guarantee Fund and a state guarantee thereof to be a part of the picture when the bank started collecting deposits into the Icesave accounts in the UK. It had not been until February 2008 that the Guarantee Fund had been taken into consideration, following discussion in the British media. Subsequently, Mr. Kristjánsson had started looking into the rules on the Icelandic Guarantee Fund and the EU directive on deposit-guarantee schemes. Mr. Kristjánsson had said that "perhaps this could be interpreted as some sort of an obligation in accordance with international law", but that the matter had not been examined in more detail. The matter then came up at a meeting with the governors of the Central Bank on July 31 2008. „And then Mr. Oddsson says [...] that there is no guarantee on this [...] that a state guarantee on things can not be assumed unless it is formally approved by Althingi. And Mr. Kristjánsson says something to the effect that possibly an obligation in accordance with international law may exist because of this and that - and I am the engineer [...] they are the lawyers“, said Mr. Árnason and added that uncertainties regarding the possible responsibility for the Guarantee Fund's obligations had become prominent when the British started asking questions about the Fund's position in August and September of 2008.⁹⁴

Hreiðar Már Sigurðsson, CEO of Kaupthing, said that leading officers of Kaupthing had believed that they had "discovered the model":

93. Statement by Mr Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 21.

94. Statement by Mr Sigurjón Þ. Árnason before the SIC on 19 August 2009, pp. 80 and 120.

“We had entered into ten European countries in order to refinance the bank. And then we intended to change, we didn’t mean to do this by getting a guarantee from the Guarantee Fund, which had – how much did it have? Two billion or eight billion? I don’t remember how much there was in it [...] we didn’t intend to do it that way, we were going to do it through the subsidiaries and by changing the bank’s structure.”⁹⁵

The SIC has not been in a position to thoroughly examine the promotional material, used by the banks both here in Iceland and abroad, to advertise and present the deposit accounts they were offering, such as Icesave and Edge, and what was stated therein about a potential responsibility for the Guarantee Fund’s obligations regarding the banks’ deposits. A part of this promotional material was available on homepages which underwent changes while the banks were operating and which were shut down after their collapse. Therefore, this material was only accessible to a limited extent. In the material it has looked into, the SIC has, in particular, tried to focus on whether some views were expressed therein regarding responsibility for the Guarantee Fund’s obligations should the Fund’s assets prove insufficient to meet its obligations. In the letters and promotional documents with which the SIC has been able to acquaint itself, it is generally stated that the deposits in the account in question are covered by the Icelandic Guarantee Fund, but that in addition the bank is also a member of the respective country’s deposit guarantee scheme due to what is known as “topping-up”. In some cases it is added that those deposit guarantees are in accordance with the EU directives relevant to these matters. It should be noted, however, that some examples were found of wording which suggested that the countries concerned were responsible for the deposit-guarantee schemes in question. One such example was found on the homepage of Kaupthing Edge Sparekonto, Norway, where the advantages of the account were described: “Full innskuddsforsikring i henhold til den islandske og norske stats innskuddsgaranti.” (Full deposit guarantee with reference to deposit guarantees of the Icelandic and Norwegian State).⁹⁶ The SIC reiterates that its examination of this particular issue is not exhaustive.

95. Statement by Mr Hreiðar Már Sigurðsson before the SIC on 21 July 2009, p. 15.

96. Presentation from the homepage of Kaupthing Edge accounts in Norway. Accessible at: <http://www.kaupthingedge.no/produkter/sparekonto>. Downloaded: 24 October 2009.

17.12 What kind of information was available in academic literature and in EU documentation regarding responsibility pertaining to obligations of deposit-guarantee funds within the European Economic Area?

17.12.1 General comments

The Special Investigation Commission's (SIC's) examination of matters relating to the Icelandic Depositors' and Investors' Guarantee Fund, government intervention as regards the Fund's work and tasks, and the implementation of the EU Directive on deposit-guarantee schemes aims at disclosing whether Althingi, the Government and the Board of Directors of the Guarantee Fund reacted adequately during the period leading up to the collapse of the Icelandic banks in October 2008. In that regard, one must, on the one hand, consider Iceland's obligations with regard to implementing the EU directive, and, on the other hand, on what ground the Icelandic authorities might have had reason to react, in light of the Guarantee Fund's financial status, at a time when there was great increase of deposits in the Icelandic banks, particularly of deposits at their overseas branches. Previously it has been recounted that, as the summer of 2008 progressed, different opinions came to light, as to a possible responsibility of the State Treasury and the State's obligation to support the Guarantee Fund, both during a meeting attended by the governors of the Central Bank and the bank directors of Landsbanki, and among representatives in the government consultative group on financial stability and contingency planning. Furthermore, as emerged in Chapter 17.11.1 when the views of those involved in work on contingency planning on behalf of the government, and the work of the Guarantee Fund were presented, for some time the Permanent Secretary of the Ministry of Business Affairs, the Chairman of the Board of the Guarantee Fund and the Director General of the Financial Supervisory Authority (FME) had been of the opinion that it had to be assumed that the Icelandic State had the obligation to ensure that the Guarantee Fund would be able to meet the minimum guarantee level arising from the EU directive on deposit-guarantee schemes.

In spite of differing opinions and positions, the discussion above also revealed that the authorities did not request a specific legal assessment with regard to the State Treasury's potential responsibility in that respect, until after the collapse of the three major banks. The SIC therefore felt the necessity to conduct an independent survey of available academic literature and EU documentation regarding responsibility of the obligations of deposit-guarantee schemes within the EEA, especially up until October 2008. This was done i.a. in order to establish what information officials, bank personnel, ministers and Board members of the Guarantee Fund were able to make themselves acquainted with at the time, for example by searching the Internet. It should be mentioned, that the purpose here is not to provide a critical account or a legal opinion in hindsight, with regard to such information and reference material, but to give an idea of the information which the authorities could have obtained and processed further, in order to provide those who should have been involved with decision making on these

issues, i.a. within the administration and government, with information about the perspectives that were being expressed with regard to the legal status in this respect. It may also be kept particularly in mind, how firm the position of senior staff in the Ministry of Business Affairs was on the obligations of the Icelandic State, especially on the subject of Iceland's obligations under international law.

17.12.2 Information in EU documents and academic literature

On 4 June 1992 the European Commission submitted a proposal for a directive on deposit-guarantee schemes to the Council of Ministers. In spite of a Commission Recommendation, presented on 22 December 1986,⁹⁷ not all of the Member States had established such a scheme by then.⁹⁸ The directive was said to have a dual objective: to protect depositors, on the one hand, and to ensure the stability of the banking system as a whole, on the other hand.⁹⁹ The proposal was based on the principle that branch depositors in a "host Member State" would be guaranteed by the scheme existing in the Member State where the institution has its head office, i.e. the "home Member State".¹⁰⁰

The explanatory memorandum accompanying the Commission's proposal included a special chapter detailing which issues were not dealt with in the proposal. The first issue was the legal status and organisation of a deposit-guarantee scheme provided for in each given country. Secondly, the proposal did not deal with the question of how the scheme should be financed. In this context it was specifically stated that once the Commission had "received assurance that the financing arrangements were sufficiently sound to pay off all depositors covered, including those at branches in another Member State, it was not considered necessary to harmonise rules which are closely linked with the management of the schemes in question." Then the issue was raised, whether the public sector would be able to provide assistance in emergency situations, and when the schemes' resources had been exhausted. The memorandum specifies, that it did not seem appropriate to prohibit such assistance, which could prove necessary in practice, in the directive although such assistance would not be desirable as a general rule and could contravene the rules of the EC Treaty regarding state aid.¹⁰¹

97. The recommendation is No. 87/63/ECE and was published in the Official Journal of the EU. It is accessible in an official Icelandic translation at EEA internet site of the Ministry for Foreign Affairs: <http://www.utanrikisraduneyti.is/samningar/ees>.

98. "Proposal for a council directive on deposit-guarantee schemes." COM(92) 188 final – SYN 415. Brussels, 4 July 1992. OJ 1992 C163/6, pp. 2-3.

99. "Proposal for a council directive on deposit-guarantee schemes", p. 2.

100. "Proposal for a council directive on deposit-guarantee schemes", p. 4.

101. "Proposal for a council directive on deposit-guarantee schemes", pp. 7-8. Is as follows, where directly quoted in the body of the text of the English version in the quoted source: "After receiving the assurance that the financing arrangements were sufficiently sound to pay off all depositors covered, including those at branches in another Member State, it was not considered necessary to harmonize rules which are closely linked with the management of the schemes in question." There are also substantial references, in the body of the text, to the two following comments in the referenced source. On the one hand: "The question of whether the public sector would be able to provide assistance for guarantee schemes in emergency situations of exceptional gravity and when the schemes' resources have been exhausted, has been raised in order to enable them to respect their commitments to depositors." On the other hand: "It did not seem appropriate, in the proposal for a directive, to prohibit such assistance, which could prove necessary in practice, although it is not desirable as a general rule and could be allowed to contravene the rules of the Treaty concerning state aid."

The legislative procedure within the European Economic Community (later the European Union) which was launched by the aforementioned proposal of the Commission, was finalised with Directive 94/19/EC on deposit-guarantee schemes. When discussions in academic literature regarding that directive are scrutinised, one can not identify much evidence of legal assessment of whether a direct obligation or responsibility of a Member State, where a deposit-guarantee scheme has been established and is compatible with this directive, is in place, to enable the relevant guarantee fund to pay out the minimum amount guaranteed as stipulated by laws that apply to the Fund. As described earlier, there are no direct provisions with regard to these issues in the directive, as it stood until it was amended on 11 March 2009, see further in Chapter 17.13.2. The 24th recital in the preamble to Directive 94/19/EC stated then, as it states now:

“This directive may not result in the Member States’ or their competent authorities’ being made liable in respect of depositors if they have ensured that one or more schemes guaranteeing deposits or credit institutions themselves and ensuring the compensation or protection of depositors under the conditions prescribed in this directive have been introduced and officially recognized.”¹⁰²

The last quoted recital from the preamble to Directive 94/19/EC is probably the part from the directive itself and its preparatory documents that most closely concerns the subject of this Chapter. It has been subject to discussion in academic literature and that discussion will be reiterated here to some extent.

Mr. Mads Andenæs, presently a professor at the University of Oslo,¹⁰³ discussed the 24th recital in the preamble to Directive 94/19/EC in an anthology published in 1995 on banking legislation and the internal market of the EU. He wrote i.a., that this recital cut off any general responsibility of a Member State; they held no liability vis-à-vis depositors as long as the Member States had complied with the directive. Having said that, Mr. Andenæs added, however, that many questions could quite possibly surface with regard to liability on account of defective implementation of the directive. It was unclear what limits to states’ liabilities might be inferred from the 24th recital in the preamble.¹⁰⁴

Mr. Andenæs’ comments reflect the substance of the differing opinions that have been presented on the interpretation of the provisions of Directive 94/19/EC, with regard to the 24th recital in the preamble to that directive, i.e. broadly speaking that those who want to preclude state guarantee on deposit-guarantee schemes in Member States refer to the general limitations on liability in the 24th recital in the preamble, but others, who assume

102. See the official Icelandic translation of the directive that is accessible through the search engine of the EEA website of the Ministry for Foreign Affairs, <http://www.utanrikisraduneyti.is/samningar/eas>.

103. Mads Andenæs is a former managing director of the British Institute of International and Comparative Law, London, (1999–2005) and Centre of European Law at King’s College, London (1993–1999).

104. Andenæs, Mads: “Deposit Guarantee Schemes and Home Country Control.” In Cranston, R. (Ed.): *The Single Market and the Law of Banking* cf. 2. edition. Lloyd’s of London Press, London 1995, p. 113.

that such a guarantee may be in place, point out that a prerequisite for the limitation itself is the correct implementation of the directive's provisions. It can thus be maintained, that the difference of opinion regarding state guarantee is not limited to the 24th recital in the preamble, but, due to the wording of the recital, centers on what should be considered "correct implementation" of the directive as a whole. Such questions then lead directly to disputed issues about possible liability of Member States on account of defective implementation; on the grounds of the appropriate rules of European law and the precedents of the European Court of Justice on such liability. The coverage of scholars retraced here, therefore relates to such disputes to a considerable extent.

In this context, a reference can be made to another article by Mr. Mads Andenæs, published in an Italian publication, *Diritto Bancario Comunitario*, in 2003. There he discussed the possible responsibility of Member States for rule-making and the surveillance of financial institutions, and whether and when EU acts in this field placed obligations on Member States which might entail their liability. It should be mentioned that such a discussion must, *mutatis mutandis*, be considered to apply to the EEA member states to the extent that the relevant acts apply to the EEA Agreement.¹⁰⁵

In an article by Mr. Nevenko Misita, then i.a. visiting professor at Stockholm University's Department of Law, published in the *Journal of International Banking Regulation* in 2003, where he discussed EU regulations with regard depositor protection, there is a special chapter on state guarantee.¹⁰⁶ Mr. Misita refers to the issues recounted earlier from preparatory documents for Directive 94/19/EC, and points out how the documents mention, that in principle deposit-guarantee schemes are financed by deposit institutions, and not by public funding. He also refers to the aforesaid 24th recital in the preamble and points out that opinions differ with regard to the interpretation of preambles to EU directives. This case, however, involves a directive which stipulates minimum harmonisation, and as a result the Member States can to a greater extent take their own circumstances into account. He then points out that two principal opinions have been dominant with regard to whether the directive implies a legally enforceable right to repayment for depositors, not only in the case of a failed bank, but also when guarantee funds established under deposit-guarantee schemes are unable to compensate the loss incurred due to such collapse. The latter would include that the effective enforcement of this right was ensured by the relevant Member State.¹⁰⁷

Mr. Misita describes the two aforementioned principal opinions on the possible responsibility of Member States with regard to their deposit-guarantee schemes in more detail, and explains that, on the one hand, some are of the opinion that the 24th recital in the preamble by its very existence entails that no responsibility rests upon a state or competent authority, provided that the relevant authorities have taken care of introducing or recognising protection in terms of the directive. The last quoted paragraph

105. See Andenæs, Mads: "Depositor Protection, European Law and Compensation from Regulators." In Alpa, Guido and Francesco Capriglione (Eds.): cf *Diritto Bancario Comunitario*. cf UTET, Torino 2002, pp. 505–532, see in particular pp. 510–513.

106. Misita, Nevenko: "Depositor Protection: An EC law perspective." cf *Journal of International Banking Regulation* cf, 2003 Vol. 4, No. 3, pp. 254–274.

107. Misita, Nevenko: "Depositor Protection: An EC law perspective", p. 267.

is explained by Mr. Misita as entailing that the deposit-guarantee scheme shall be sufficiently financed so as to be able to handle a bank failure that is “reasonably foreseeable”. He does not provide further explanation for that opinion, apart from mentioning that such arguments presume that a Member State is in no way liable for its deposit-guarantee scheme in case of system breakdowns. Consumers, i.e. depositors, could in such cases not rely on the directive to ensure that a Member State guaranteed vis-à-vis the depositors the obligations of a depositor-guarantee scheme, which had been established by said Member State, and found their claims on the precedents from the European Court of Justice in the so-called *Francovich* and *Faccini Dori* cases.¹⁰⁸ Mr. Misita in this instance is referring to well known rulings of the European Court of Justice on state-liability, subject to certain conditions, due to the insufficient implementation of EU directives into national law, but such precedents are frequently cited and subsequently taken into account in case law at later stages by the Court.

In direct continuation of the last-mentioned discussion, Mr. Misita explains the opposite view, i.e. that state guarantees of Member States with regard to the commitments of deposit-guarantee schemes are in fact entailed by Directive 94/19/EC. Proponents of that view point out that it is difficult to justify arguments where such state guarantees are rejected, cf. above, to the extent that they lead to a reduction of the minimum guarantee as stipulated by the directive itself. Judging by Mr. Misita’s argumentation, the proponents of that opinion look especially to the fact that the 24th recital in the preamble has as a precondition that deposit guarantee schemes ensure “the compensation and protection of depositors under the conditions” prescribed in the directive. Individual provisions of the directive could be interpreted as being sufficiently clear to oblige each and every deposit-guarantee scheme to involve a legally enforceable right to compensation for deposits, albeit only up to a certain amount and within strict time-limits. According to this point of view, the views that the 24th recital in the preamble constitutes a limitation on the responsibility of the Member States – which the proponents of the opposite view deem as “rather general and diffuse” according to a more specific referral from Mr. Misita – cannot set aside the “clear wording” of the directive itself. Further arguments for rejecting the former opinion, i.e. regarding limitations to the responsibility of the Member States, are according to Mr. Misita’s deliberations that it would be “hard to ensure” that Member States refrained from interfering with the deposit-guarantee schemes in cases of threatening systemic crises.¹⁰⁹

Mr. Misita, on the other hand, points out that if the latter opinion was correct, then it seemed that examples could be found of Member States not having implemented the directive correctly. As an example Mr. Misita mentions the withdrawal of a state guarantee for the obligations of public credit institutions, by providing a reference to Belgium, from the work of another scholar, where this was the case.¹¹⁰

108. Misita, Nevenko: “Depositor Protection: An EC law perspective”, p. 267.

109. Misita, Nevenko: “Depositor Protection: An EC law perspective”, pp. 267–268, and references to sources there.

110. Misita, Nevenko: “Depositor Protection: An EC law perspective.”, See endnote 87.

On 12 October 2004, the European Court of Justice issued a preliminary ruling in case No. C-222/02, *Peter Paul et.al. v. the Federal Republic of Germany*.¹¹¹ In the preliminary ruling the European Court of Justice ruled on questions from a German court, where the case of the above-mentioned parties ran, i.a. with regard to the interpretation of certain provisions of Directive 94/19/EC. The relevant facts of this case are referred to in a footnote.¹¹² The case was clear on the fact that Germany had not implemented Directive 94/19/EC within the time-limits prescribed in the directive, i.e. 1 July 1995, cf. Article 14(1) thereof, and had not adopted it until 1 August 1998. It should be noted that the preliminary ruling of the European Court of Justice i.a. states that German courts had agreed that due to its negligence in implementing the directive, the German state was on those grounds liable vis-à-vis Peter Paul et.al. up to the amount of the minimum guarantee stated in the directive or EUR 20,000, cf. Article 7(1) of the said directive. However, the dispute concerned the question of whether the State was liable for the part of the deposits which exceeded this minimum and the individuals claimed to have lost due to the insolvency of the bank. As mentioned earlier, they supported that claim independently by citing the alleged liability of the German authorities due to negligence in conducting official supervision of the bank.¹¹³

The European Court of Justice saw the first query formulated by the German court, and the one concerning the subject matter here, as a substantial question about whether the provisions of Article 3(2) to (5) of Directive 94/19/EC, where referral is made to the supervision of financial institutions by the authorities and the obligation to withdraw authorisation of activities under specific circumstances, precluded the above-mentioned rule of the German court on the limitation of state responsibility on account of such supervision. The conclusion of the European Court of Justice was that this was not the case. The grounds for the Court's conclusion were, in substance, that the purpose of Article 3(2) to (5) of the directive was to guarantee depositors that the credit institution where they deposited their money was a member of a deposit-guarantee scheme, which was intended to secure the right to payment in accordance with the provisions of the directive and especially Article 7 therein. Therefore, these particular provisions

111. The preliminary ruling of the Court of Justice of the European Communities from 12 October 2004 in Case C-222/02, *Peter Paul et al. vs. the Bundesrepublik Deutschland*. ECR I-9425.

112. The facts of the case before the Court of Justice were that it was claimed that the German State was liable on account of negligence of the German financial market regulatory agencies in regulating the activities of banks that demands were being made for insolvency proceedings for, in late 1997. Under German law the state's liability risk vis-à-vis individuals for this reason was precluded for the reason that supervision was based on public interests only but not on individual interests and therefore individuals could not base demands against the German state on possible neglect during such supervision. Mr Peter Paul and others had deposits in the insolvent bank. The bank had not been given access to a deposit-guarantee scheme but had been in operation from 1987 under a banking licence from the German authorities which required its participation in such a scheme, and it was known that the German authorities had repeatedly intervened in its operations until these interventions finally led to the cancellation of its banking licence and the demand for insolvency proceedings, according to the above. Therefore, when the bank became insolvent, the above mentioned individuals did not have any specific guarantee measures for their deposits but had to try to recover their funds by making claims against the bank's estate, there being an uncertainty as to whether if and to what extent anything would be recovered.

113. See paragraphs 16-18 in the preliminary ruling of the European Court of Justice in case no. C-222/02.

only outline that a deposit-guarantee scheme is established, and that it is operated in accordance with the provisions of the directive. If compensation to depositors was guaranteed in case their deposits became unavailable, as provided for in directive 94/19/EC, then the provisions of Article 3(2) to (5) of the directive would not confer any particular right on depositors to have the competent authorities take supervisory measures in their interest. This interpretation of Directive 94/49/EC was supported by the European Court of Justice by referring to the 24th recital in the preamble to the directive, where it says that the directive may not result in Member States' or their competent authorities' being made liable in respect of depositors if they have ensured compensation or protection of depositors under conditions prescribed in the directive.¹¹⁴

The finding of the European Court of Justice, with regard to the provisions of Article 3 of the directive on supervision by the Member States of credit institutions, seems to give rise to the conclusion, that the provisions of the directive on the establishment and operation of deposit-guarantee schemes, and the functions of the responsible authority with regard to them, does not provide depositors with independent legally protected rights which can be used in court. In other words, it was rejected that the provisions of Article 3(2) to (5) had direct effect in the sense of European law. As it was already clear, that German courts had on grounds of negligence by German authorities with regard to the implementation of the directive, ruled that Peter Paul et.al. should receive compensation in accordance with the minimum guarantee provided for in Article 7(1) of the directive, it must however be emphasized that a potential direct effect of Article 7 of the directive were not put to the test.¹¹⁵

In an article by the scholar Mr. Michel Tison¹¹⁶ from 2005, the preliminary ruling of the European Court of Justice in the aforementioned case is summed up by stating that the responsibility of a Member State only reaches as far as introducing or recognising a deposit-guarantee scheme that fulfils the minimum requirements of Directive 94/14/EC. He claims that the 24th recital in the preamble to the directive supports this conclusion. In a footnote of the article the author states that it is clear that the reservation contained in the preamble was clearly included for fear that cost arising from

114. See paragraphs 29-31 and 52 (the finding) in the preliminary ruling referred to. The finding in paragraph 52 is in line with the grounds described in the main part of the judgment. Word for word it reads, in English translation: "If the compensation of depositors prescribed by directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes is ensured, Article 3(2) to (5) of that directive cannot be interpreted as precluding a national rule to the effect that the functions of the national authority responsible for supervising credit institutions are to be fulfilled only in the public interest, which under national law precludes individuals from claiming compensation for damage resulting from defective supervision on the part of that authority."

115. It is worth mentioning that in the opinion of the Advocate General of the European Court of Justice in case no. C-222/02 it said that the direct legal effects of Article 7 of Directive 94/19/EC were indisputable and that there was no question regarding that provision in the German court's question since the German courts had agreed on the rights of the parties to the case and provided for the disbursement by the German state of compensation up to the minimum guarantee. He then pointed out that the provisions of Article 7 only covered certain rights for compensation but did not mention supervisory measures. See paragraphs 63-63 of the opinion, which can be found via the website of the European Court of Justice, http://curia.europa.eu/jcms/jcms/_6/. The opinion will come up with the preliminary finding in a search for case no. C-222/02.

116. Mr Michel Tison is a Professor of the Financial Law Institute of the law department of the University of Ghent in Belgium.

the failure of a bank would fall on a Member State to an excessive extent. As a result, a Member State would not have to bear “Francovich liability”, cf. previous referral to the ruling of the European Court of Justice in that case, for not complying with the directive if it had ensured that a scheme, which could reasonably be expected to compensate depositors, in accordance with the minimum requirements of the directive, had been introduced and officially recognized. Subsequently, the author said that clearly deposit-guarantee schemes of most Member States would not be able to cope with a major banking crisis. In this context, the 24th recital rightfully protected the Member States from a Francovich liability. Similarly, the Member States should not have to face Francovich liability, having recognised a deposit-guarantee scheme which, when put to the test, could not provide for adequate compensation because of mismanagement of its assets, while the funding arrangements imposed by the Member State were adequate.¹¹⁷

In the year 2000, the book *Banksikring og konkurranse* was published in Norway, which is based on a doctoral thesis by Ms. Inge Kaasen at Oslo University's Department of Law. It covers in detail the operations of the Norwegian Deposit Guarantee Fund and other support by public bodies for the banks, such as Norges Bank, the central bank of Norway, with regard to competition rules and state aid rules of the EEA Agreement. The book does not address whether there is a state guarantee in place on the obliged minimum level of protection by the Guarantee Fund, or whether the state has an obligation to enable the Fund to meet such payments. Taking into account the subject and scope of the dissertation it must be assumed that there would have been discussion of these issues, had the author assumed that such a rule of law might exist.

In this context, there are also grounds to mention that in a report delivered by a Norwegian committee on the review of domestic laws on credit institutions and financial activities (n. Banklovkommissjonen) in 1995, which dealt with deposit-guarantee schemes on the occasion of a review of Norwegian rules regarding deposit guarantees, due to Directive 94/19/EC, it is stated i.a.:

“Et særlig spørsmål er i hvilken grad EØS-regelverket setter grenser for statlig finansiering og drift av en sikringsordning. (A special question would be to what extent EEA rules set limits for state financing and operating of a guarantee fund). I fortalen til direktivet er det forutsatt at kostnadene ved finansiering av innskuddsgarantiordningen som hovedregel må påhvile kredittinstitusjonene selv. (In the preamble to the Directive it is a precondition regarding the cost of financing the depositor-guarantee scheme that as a principle the credit institutions must cover these themselves). Ordningen kan ikke bestå av en garanti som ytes av medlemsstaten selv eller av dens lokale eller regionale myndigheter, jf. art. 3 nr. 1. (The scheme can not contain a guarantee which is provided by the Member State itself or by its local or regional authorities, cf. Art. 3(1)). De kollektivt organiserte norske sikringsfondsordningene er i samsvar med dette. (The collectively

117. Tison, Michel: “Do not attack the watchdog! Banking supervisor's liability after Peter Paul.” Working Paper Series. Financial Law Institute, Universiteit Gent 2005, p. 25, incl. footnote no. 81.

organised Norwegian guarantee schemes are in accordance with this.). I fortalen pekes det på at dette ikke må sette stabiliteten i den berørte medlemsstats banksystem i fare. (The preamble points out that this must not jeopardise the stability of the relevant Member State's banking system.). Statlig bidrag synes således ikke utelukket, men må i tilfelle være i samsvar med de alminnelige regler om statsstøtte i EØS-avtalen. (A financial contribution from the state is, as such, not prohibited, but must in such a case be in accordance with the general rules on state aid referred to in the EEA Agreement.). Det antas således at en sikringsordning ikke bør være statlig finansiert og drevet. (The assumption is therefore that a guarantee scheme should not be financed and operated by the state.). [...] ¹¹⁸

The abovementioned quote is in accordance with that which has been set out in preparatory documents for Directive 94/19/EC earlier in the report. It may be considered likely, that Ms. Kaasen's silence as regards a possible direct state guarantee on the obligations of the Norwegian Guarantee Fund, takes note of the aforementioned position adopted during the preparation of domestic legislation on the Fund, recounted earlier.

In relation to the subject matter of this chapter, amendments to Danish legislation on deposit-guarantee schemes in the years 2003 and 2006-2007, on account of European rules on state aid in connection with appointments to the fund's board and regarding its assistance when credit institutions face liquidity problems, may also be mentioned. A discussion in the Danish legal database KARNOV shows i.a. that the amendments were made once the European Commission had pointed out to the Danish authorities, that the previous arrangement of the Danish fund might present complications and contravene EU rules on state aid. ¹¹⁹

17.12.3 Deposit-guarantee schemes and systemic collapse

Related to the open question as to whether there exists a direct obligation for EU/EEA Member States to enable their respective guarantee funds to compensate depositors up to the set minimum coverage level, is the question of whether a major shock to a country's financial system, let alone a collapse of its banking system, affects the former question. ¹²⁰ It has been pointed out in several articles on deposit-guarantee schemes in EU Member States, that

118. „Sikringsordninger og offentlig administrasjon m.v. av finansinstitusjoner – Utredning nr. 2 fra Banklovkomisjonen.“ (“Guarantee Schemes and Public Control, i.a. of Financial Institutions – Explanatory Report No. 2 of the Bank Legislation Commission.”) See chapter 2.2.1. The report is accessible at: <http://folk.uio.no/olav/Forarbeider/NOU/1995-25/ind-bu.html>. Downloaded 25 August 2009.

119. See KARNOV 2003, p. 5493, KARNOV 2006, p. 6097 and KARNOV 2007, p. 6279.

120. The discussion in this Chapter, like generally in Chapter 17.12, covers sources and data that was available before the collapse of the Icelandic banks in October 2008. However, one remark that was made after that time limit should be noted here in the footnotes, namely words spoken by Mr Wouter Bos, the Dutch Minister of Finance, in a speech during a convention held by the representative body of investors, Eumedion, in the Netherlands, on 3 March 2009, where he said, among other things, in the context of discussions about guarantee schemes within the European Union, that they were not meant to deal with a systemic crisis. Word for word he said: “First and foremost, European countries need to take a close look at how the deposit guarantee scheme is organised. It was not designed to deal with a systemic crisis but with the collapse of a single bank.” The Minister's speech may be read at: http://www.minfin.nl/english/News/Speeches/Wouter_Bos/2009/02/Six_Questions_for_the_Banking_Sector. Last downloaded 22 December 2009.

they are not designed to withstand systemic collapse but intended, first and foremost, for protecting depositors in the event of individual failure of small and medium-sized banks.

As an example of this, one can refer to the views of Mr. Michel Tison, as expounded above, on the limitations of liability of the Member States under such circumstances.

Similar viewpoints are also brought up in EU documentation. One example is a report commissioned under the auspices of the European Commission, published in May 2008, containing an overview of Member States' and their deposit-guarantee schemes' views on the necessity of revising EU rules on deposit guarantees. The following conclusion is reached in the executive summary at the beginning of the report:

“Even though DGS thus seem to be robust for smaller failures, there are clear limits: on average, without resorting to unlimited borrowing DGS declare themselves capable of coping with a single crisis of any of the smallest 64% of their members.”¹²¹

This substantiates that even though deposit-guarantee funds within the EU seem robust enough for smaller failures there are clear limits, as the funds claimed that they could cope with a single crisis of any of the 64% smallest financial institutions, eligible under their scheme, without having to resort to unlimited borrowing. It should be pointed out that, as the wording indicates, the data was collected from deposit-guarantee schemes in EU Member States, and judging by the report the survey extended to all the guarantee schemes.

In this respect, reference can be made to views expressed in a report published in 2001 by the international association the Financial Stability Forum (now the Financial Stability Board).¹²² The report contained guidance for developing effective deposit-guarantee schemes. The report was developed by a working group established to carry out the task following a meeting in Singapore the year before. According to the report, a deposit-guarantee scheme is not able to deal with systemic collapse, or as quoted verbatim from the text:

“[A] deposit guarantee system can deal with a limited number of simultaneous bank failures, but cannot be expected to deal with a systematic banking crisis by itself.”¹²³

121. “Investigating the efficiency of EU Deposit Guarantee Schemes.” European Commission, Joint Research Centre, Unit G09, Ispra (Italy), May 2008, p. 3. The speech may be downloaded at: http://ec.europa.eu/internal_market/bank/docs/guarantee/deposit/report_en.pdf.

122. The group Financial Stability Forum was founded in 1999 by the financial ministers and managers of the central banks of the so-called G7 states with a view to addressing and recommending new measures and structural arrangements within the international financial sector to improve cooperation between supervisory bodies, in the domain of nations and international bodies and international financial institutions, to promote the stability of the international financial system.

123. “Guidance for developing effective deposit insurance systems” Financial Stability Forum, 7 September 2001, p. 8. The report is accessible at: <http://www.fdic.gov/deposit/deposits/international/guidance/guidance/finalreport.pdf>. Downloaded 22 December 2009.

The report referred to earlier, which was drawn up in Norway on behalf of a special committee, partly on account of preparations for the implementation of the EU Deposit-Guarantee Schemes directive in that country, stated, i.a., regarding the purpose of deposit guarantees that the funds of the Norwegian deposit-guarantee scheme had not been and would not be robust enough to deal with failures beyond financial difficulties of small or medium-sized credit institutions. A stability of the financial system would have to be obtained by other means. The State would be the last line of defence in the event of failure of the deposit-guarantee scheme, however, the majority of the committee emphasised that such support should not exist by default.¹²⁴

It must be noted, that the Norwegian report took into account proposals which had been made to the effect, that schemes established in Norway should, on the one hand, issue payments according to a set minimum and, on the other hand, have authorisation for individual rescue aid of banks in case of their financial difficulties.

This open question is debated in Ms. Inge Kaasen's doctoral thesis from the year 2000, where she points out that fee payments to guarantee schemes are designed to fund a limited number of banks in distress and not intended to finance total losses, which may be incurred on account of systemic crisis in the financial industry. Ms. Kaasen goes on to say:

“Sikringsfondene skal ikke på egen hånd kunne ta seg av problemer i en eller flere storbanker eller mer omfattende systemkriser af den karakter som forelå undir siste bankkrise”. (The deposit-guarantee funds are not required to handle problems on their own which involve one or more large banks or more extensive system failures like the most recent banking crisis).¹²⁵

124. “Sikringsordninger og offentlig administrasjon m.v. av finansinstitusjoner – Utredning nr. 2 fra Banklovkommisjonen.” The report said, word by word, in Chapter 2.4 on this issue: “Fondens res-surser var rigtignok ikke tilstrekkelige, men fondene var heller ikke kapitalisert for å kunne møte en så omfattende krise. Heller ikke i fremtiden vil de privat sikringsfondene kunne ha kapasitet til å håndtere mere enn begrensede problemer innenfor næringen, særlig knyttet til kriser i mindre eller mellomstore banker. Trusler mot selve stabiliteten i den finansielle system må møtes på andre måter [...] ‘Førstelinjeforsvaret’ utgjøres primært av den enkelte banks ansvarlige kapital. Et ‘andrelinjeforsvar’ utgjøres av bankenes sikringsfond [...] ‘Sistelinjeforsvaret’ ved en eventuell systemkrise hvor bankenes sikringsfond ikke lenger er i stand til fylle sin funksjon, må ivarets av staten. [...] Flertallet mener at sikringsfondene som hittil bør ha mulighet til å yte støtte til medlemsbanker i krise, men at det ikke bør være noen automatikk i å få slik støtte.” (“Guarantee Schemes and Public Control, i.a. of Financial Institutions - Explanatory Report No. 2 of the Bank Legislation Commission.” The report said, word by word, in Chapter 2.4 on this issue: “The Fund’s assets were in fact not sufficient, nor were the funds’ capital intended to meet such a deep crisis. Nor in future will the private guarantee funds be able to cope with more than limited problems within the banking sector, in particular problems linked to crises of small and medium sized banks. Threats against the very stability of the financial system must be met in different ways. [...] ‘Measures of the first kind’ primarily concern the bank’s reserve capital. ‘Measures of the second kind’ concern the banks’ guarantee funds [...] ‘Measures of the third and last kind’, in case of potential system failure, where the banks’ guarantee fund is no longer capable of meeting its obligations, must be taken by the state [...] The majority is of the opinion that the guarantee funds should, as up to the present, be liable to support their member banks in times of crisis but without providing such support automatically.”)

125. Kaasen, Inge: Banksikring og konkurranse – En EOS-rettslig studie. Universitetsforlaget, Oslo 2000, p. 203. (Kaasen Inge: Securing the Banks and Competition – A Study into EEA Legislation. Universitetsforlaget, Oslo 2000, p. 203.)

Last, it is worth mentioning that a French committee, presided by the erstwhile Director of the Central Bank of France, Jean-Claude Trichet, which supervises financial activity in France (in French: “Commission Bancaire”), published a report in 2001, as part of the committee’s annual report, which included a discussion titled The functions and organisation of deposit-guarantee schemes: the French experience. The report propounds the same views retraced above about the limitations of deposit-guarantee schemes in the event of systemic collapse. More precisely, the report maintained, that it is generally accepted that deposit-guarantee schemes are neither capable of dealing with systemic crises now intended to deal with them, or as quoted verbatim:

“It is accepted that deposit guarantee schemes are neither meant nor able to deal with systemic banking crises, which fall within the remit of other parts of the “safety net”, e.g. supervisors, central bank, government.”¹²⁶

It has come to the attention of the SIC, i.a., with regard to the dialogue and views expressed when the Icelandic banks collapsed, and later concerning the alleged obligation of the State to enable the Icelandic Guarantee Fund to pay the minimum amount pursuant to Act No. 98/1999 and Directive 94/19/EC, that a more clear and systematic discussion of the possible obligations of Member States in this respect is not to be found in preparatory documents to the Directive, summaries thereof within the EU platform until October 2008 or in the writings of scholars, cf. examples retraced above. On the other hand, the discussion in this Chapter and the enumeration of sources included, gives rise to the conclusion that sources to conduct a more accurate assessment of the legal position of the Icelandic government, during the time leading up to the collapse of Icelandic banks in October 2008, were publicly available, and could for example be found by way of research on the Internet.

17.13 Changes to deposit-guarantee schemes of the EU and the neighbouring countries

17.13.1 Work relating to the revision of the EU directive during the years from 2005 until certain European countries declared state guarantees on deposits in the autumn of 2008

During 2005 and 2006 existing rules regarding deposit-guarantee schemes were examined under the auspices of the European Commission, in order to evaluate whether the protection the schemes offered was sufficient.¹²⁷ In November 2006 the European Commission issued a Communication announcing that a revision of the directive on deposit-guarantee schemes from 1994 had begun. Information on the issue was still being collected, during

126. “The functions and organisation of deposit guarantee schemes: the French experience.” Report by Commission Bancaire of France, June 2001. The speech may be downloaded at: http://www.banquefrance.fr/gb/supervi/telechar/2000_deposit.pdf.

127. See more at http://ec.europa.eu/internal_market/bank/guarantee/index_en.htm At this website you can also find data on the revision process that followed within the EU in the following years.

which Member States and guarantee funds in the countries were consulted for their views. During this process, information on the status of guarantee schemes in individual countries emerged, which revealed, as described above, that guarantee schemes in some countries were only sufficiently robust to face failures of single banks of the smaller kind. However, this work and ideas regarding the revision of the directive had not lead to any legislative amendments when the Icelandic banks collapsed in October 2008.

In the spring of 2008, Mette Winther Løfquist's doctoral thesis on European legislation on financial institutions was published in Denmark under the title "EU's pengeinstitutlovgivning". The thesis describes how the revision work within the EU did not lead to amendments of any kind to the directive but points out that various reports commissioned during the process raised questions regarding deposit-guarantee schemes on account of queries arising from lenders of last resort. The thesis continues:

"Med andre ord bør der for tilfældet af en eventuel grænseoverskridende bankkrise i EU tages stilling til: (In other words, in the event of a possible cross-border banking crisis in the EU a position needs to be taken on:) >>Hvem<< skal betale? (>>Who<< should pay?) Og >>hvem<< træffer afgørelse om: (And >>who<< involves a decision about:) Hvornår der skal betales? (When payment should be made?)" ¹²⁸

At this point, it is necessary to retrace that when European banks started to run into difficulties at the end of September and the beginning of October 2008 some governments resorted to offering state guarantees to cover bank deposits. The Irish government declared on 30 September 2008 that the State intended to provide guarantees over deposits and debt of six financial entities active on the Irish market for the next two years.¹²⁹ The government of Greece was next in Europe to declare a state guarantee of deposits in domestic banks. On Saturday 4 October 2008, several European leaders held a summit in Paris where, according to media reports, they sought to find a united response to the imminent finance crisis in their countries. On 5 October 2008, before they could reach a common conclusion, the German government declared an unlimited guarantee on all retail deposits in German banks. Most European countries subsequently adopted the same measure. The Danish government was next to introduce a state guarantee and so did the UK authorities on account of a growing trend among UK depositors to transfer funds to Ireland, since the Irish government had announced its decision on a state guarantee scheme.

In connection with these declarations on state guarantees it is worth recalling that the UK government decided to guarantee customer deposits at Northern Rock when the bank was nationalised in February 2008. Consequently, Danish banks lodged a complaint to the European Commission claiming that with government guarantees for Northern Rock's deposits the

128. Lofquist, Mette Winther: EU's pengeinstitutlovgivning. Copenhagen 2008, p. 389.

129. The Irish government's decision was later investigated by the EU, cf. e.g. the BBC, link <http://news.bbc.co.uk/2/hi/business/7646217.stm>

bank benefited from an unfair competitive advantage in the Danish market, as the bank had operations in Denmark. On 2 April 2008 the Commission decided to investigate whether this constituted an infringement of EU state aid rules.¹³⁰ The outcome of the investigation was not available when Europe began to face a financial crisis in October 2008.

17.13.2 Changes to deposit-guarantee schemes in the EU from October 2008 and the new Directive 2009/14/EC

Following said decisions of individual governments in Europe on responses to the imminent financial crisis in these states, EU Finance Ministers held a meeting on 7 October 2008, where they agreed on resolutions on the financial crisis and planned measures.¹³¹ As a part of these measures, it was assumed that the EU would not object, with regard to state aid rules, that individual states would temporarily declare guarantees on deposits, and preparations were also made for the revision of the deposit-guarantee scheme directive of 1994. On 15 October of the same year, the European Commission put forward a proposal for a directive amending the existing Directive 1994/19/EC on deposit-guarantee schemes.¹³² Thus, these revisions were taking place in the EU at the time when the Icelandic banks collapsed in the beginning of October 2008. The changes contained in the Commission's proposal for amendment from 15 October 2008 were mainly threefold. First, the minimum coverage level was to be increased from EUR 20,000 to EUR 50,000 to begin with, and in a further year to EUR 100,000. Second, the time limit for the deposit-guarantee scheme to pay depositors would be reduced to no more than three days, without the possibility of an extension, as opposed to the existing time limit, which as a general rule amounted to 15 weeks. Third, the so-called "co-insurance" would be abandoned; under the existing directive Member States may determine that the depositor himself carry a 10% share of the loss in certain cases.

The amendments made to Directive 94/19/EC on deposit-guarantee schemes following the proposal, were adopted on 11 March 2009 and the new directive was published in the Official Journal of the European Union on 13 March in the same year. The amended directive became Directive 2009/14/EC.¹³³ When the new directive is studied, it is worth noting that in addition to the changes introduced in a proposal for amendment from the Commission on 15 October 2008 the wording of Article 7(1) of Directive 1994/19/EC was amended; according to the directive from 1994 the provision was as follows: "Deposit-guarantee schemes shall stipulate that the

130. See more on the complaint by the Danish banks and the decision of the commission to investigate it at the following links: <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/489> and <http://www.reuters.com/article/idUSL187729920080318>.

131. Press Release – 2894th Council Meeting – Economic and Financial Affairs. Document No. 13784/08 (Presse 279). Luxembourg, 7 October 2008, p. 6. Accessible at www.consilium.europa.eu/App/NewsRoom/loadBook.aspx?target=2008&bid=93&lang=EN&id=350. Downloaded 2 December 2009. On the meeting's plans and resolutions cf. pp. 7 and 8.

132. "Proposal for a Directive of the European Parliament and of the Council amending Directive 94/19/EC on Deposit Guarantee Schemes as regards the coverage level and the payout delay." Document no. 2008/0199 (COD). Brussels, 15 October 2008, p. 2. Accessible at http://ec.europa.eu/internal_market/bank/docs/guarantee/dgs_proposal_en.pdf.

133. Directive 2004/19/EC is accessible in English at http://ec.europa.eu/internal_market/bank/docs/guarantee/200914_en.pdf.

aggregate deposits of each depositor must be covered up to ECU 20,000 in the event of deposits' being unavailable.”¹³⁴

Article 7(1) of Directive 2009/14/EC provides as follows:

“Member States shall ensure that the coverage for the aggregate deposits of each depositor shall be at least EUR 50,000 in the event of deposits being unavailable.”

Comparison of the provisions shows that “Deposit-guarantee schemes shall stipulate [...]” has been replaced by “Member States shall ensure [...]”. Thus, the change is twofold. On the one hand, the obligation stipulated in the provision is not addressed to the “deposit-guarantee schemes” as before but to the “Member States”. On the other hand, the verb accompanying the subject is changed from “stipulate” to “ensure”.

The proposal set out by the European Commission on 15 October 2008 did not include changes to the wording of Article 7(1) as said earlier, except for the amount specified therein. A closer scrutiny reveals that a proposal for this change was not debated during the meeting of finance ministers of the EU Member States on 2 December 2008.¹³⁵ The European Parliament subsequently received the proposal submitted by the Commission. According to its rules of procedure the Committee on Economic and Monetary Affairs compiled a report on the proposal, dated 10 December 2008, outlining the amendments it considered appropriate.¹³⁶ As for the first sentence of Article 7(1) of the directive no modifications were suggested by the Committee. It is at the session of the European Parliament on 18 December 2008 that the aforementioned amendment to Article 7(1) is made and adopted. The SIC notes, that during its examination of data available from EU information providers on the procedure regarding the new directive, no clarifications have been found regarding this change or what caused it.¹³⁷

A draft bill on Deposit Guarantees and Investor-Compensation Scheme, intended to replace the current Act No. 98/1999 on the same issue, is now before the Icelandic parliament; that bill takes, according to the bill's commentary, into account the amendments laid down in Directive No. 2009/14/EC.¹³⁸

134. In English: “Deposit-guarantee schemes shall stipulate that the aggregate deposits of each depositor must be covered up to ECU 20,000 in the event of deposits' being unavailable.”

135. On the website of the European Parliament there is a special overview of the enactment process of case no. COD/2008/0199 which led to the drawing up of Directive 2009/14/EB. The European Parliament's overview included links to other specific documents that were drawn up during the proceedings, including on the ECOFIN meeting of 2 December 2008. The European Parliament's overview is accessible at <http://www.europarl.europa.eu/oecil/FindByProcnum.do?lang=en&procnum=COD/2008/0199>.

136. “Report on the proposal for a directive of the European Parliament and of the Council amending Directive 94/19/EC [...]” European Parliament. Document No. A6-0494/2008. Accessible at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+REPORT+A6-2008-0494+0+DOC+PDF+V0//EN>.

137. See the European Parliament's special parliamentary document on the Parliament's opinions after its first discussion (“Position of the European Parliament”) of 18 December 2008. Document no. EP-PE_TC1-COD(2008)0199. The document, with its full title, is accessible in English at the link <http://www.europarl.europa.eu/sides/getDoc.do?type=TC&reference=P6-TC1-COD-2008-0199&language=EN>.

138. The bill with related parliamentary documents is accessible at the Althingi website, the bill itself at: <http://www.althingi.is/altext/138/s/0291.html>.

17.13.3 Debates on changes to deposit-guarantee schemes in the UK and Norway

Earlier in this part of the report, the viewpoints of Icelandic leaders and officials, who participated in the course of events before the collapse of the Icelandic banks, have been elaborated, that due to the delicate position of the Icelandic banks, and adverse conditions in the international financial markets, initiating any kind of revision of the Icelandic deposit-guarantee scheme, or debating individual ideas or emphases to that end, had not been an option. These points of view are manifested both in documents from that time, which have been expounded, and during hearings before the SIC. On account of this, the SIC considers appropriate to note that during its scrutiny of these issues it has noticed that proposals and ideas regarding modifications to deposit-guarantee schemes were in some cases being debated by public entities in European countries. Two examples shall be given, in this respect.

In October 2007 the UK Chancellor of the Exchequer Alistair Darling announced reforms to British regulations on financial supervision, including the legal framework for government intervention in banks in distress and changes to the deposits-guarantee scheme. An open consultation process with interested parties on account of the intended legislative changes took place in the first half of 2008 with the publication of specific public “consultation documents” where issues regarding possible changes to the financing of the Financial Services Compensation Scheme were discussed.¹³⁹ Eventually, the UK government submitted a bill in the British Parliament on 7 October 2008, or at the same time the Icelandic banks were failing, i.a. with regard to emphases and ideas for modifications described during the consultation process.¹⁴⁰

Mr. Svein Gjedren Governor of Norges Bank, Norway’s central bank, said in a lecture given at the Centre for Monetary Economics in Oslo on 12 September 2008, which was reported in the Norwegian media, that Norges Bank had proposed in a letter to the finance ministry on that same day that revisions be made to the Norwegian deposit-guarantee scheme.¹⁴¹ The central bank recommended, i.a., that the maximum coverage level be lowered from NKR 2 million to NKR 1 million and that rules on banks’ contributions to the guarantee scheme be changed in order to accommodate different levels of risk exposure. The central bank’s governor supported the proposed recommendations with the arguments that Norwegian banks had already

139. The first consensus document was issued on 31 January 2008. Cf.: “Financial stability and depositor protection: strengthening the framework.” January 2008. Consultation document. Bank of England, HM Treasury, FSA. Cm 7308. Cf. p. 3. The document is accessible at: http://www.hm-treasury.gov.uk/d/banking_stability_pu477.pdf. The second consensus document was issued in July of last year. Cf.: “Financial stability and depositor protection: further consultation.” July 2008. Consultation document. Bank of England, HM Treasury, FSA. Cm 7536.

140. “Financial stability and depositor protection.” News release from the website of HM Treasury, dated 7 October 2008. Accessible at http://www.hm-treasury.gov.uk/financial_stability_depositor.htm. Downloaded 22 December 2009. It is worth mentioning that the amended bill entered into force in the UK on 12 February 2009, as the Banking Act. The Act with notes can be found at the website of the British parliament, <http://www.parliament.uk>. For information on the substantive changes that were discussed and in some cases implemented, cf. e.g. the documents and data referred to so far.

141. The speech by the Governor of the Central Bank is published on the website of the Norwegian Central Bank, cf. http://www.norges-bank.no/templates/article____70853.aspx and e.g. <http://pub.tv2.no/dynnettavisen>.

funded the Norwegian guarantee scheme well and that foreign banks had now seen the opportunity to start raising deposits in Norway, in return for high interest, and gained membership to the Norwegian scheme without having contributed but a small amount. Eventually, this competition for deposits in return for high interest, and future costs which might be drawn from the scheme and, as a result, the remaining banks, should any of the financial institutions, who had been competing for deposits, fail, would have an effect on lending rates as well.¹⁴²

17.14 The Financial Supervisory Authority's (FME's) surveillance of the Depositors' and Investors' Guarantee Fund

Pursuant to Article 15 of Act No. 98/1999, the Financial Supervisory Authority (FME) surveils that the Depositors' and Investors' Guarantee Fund operates in conformity with the law and the regulation governing the Fund, and its statutes; the surveillance otherwise falls under the legislation on public supervision of financial activities. The Guarantee Fund has, in legal compliance, paid an annual surveillance fee to the FME; this fee amounted to ISK 150,000 upon the adoption of Act no. 99/1999 on the Payment of Costs for Public Supervision of Financial activities, whereas in 2008 it amounted to ISK 250,000.

In the Minister of Business Affairs' response to an inquiry at Althingi from MP Jóhanna Sigurðardóttir on 1 February 2005, it was revealed that the FME had not made any comments regarding the Guarantee Fund about the Fund's situation with regard to coverage or risk management or other factors regarding the Fund's financial situation and depositors' security. The FME also had not made any suggestions regarding the Guarantee Fund in regard to strengthening its financial situation or the surveillance of the Fund. The Minister of Business Affairs stated that in this respect, it was proper to refer to the text of a speech given by the Director of the Financial Supervisory Authority on 3 November 2004, cf. further details on the text of the speech in Chapter 17.6.¹⁴³

When questioned before the SIC about the FME's surveillance of the Guarantee Fund Mr. Jónas Fr. Jónsson, Director General of the FME, stated that this surveillance had been executed by monitoring the annual accounts of the Fund and the minutes of board meetings, especially those of the annual general meetings. He said that there had been no on-site investigations regarding the Fund. The SIC drew attention to the fact that no data had been found that indicated that an analysis or evaluation had been made of the State's possible risk due to the commitments accumulated by the Guarantee Fund from the time that the Icelandic banks started accumulating deposits abroad until the collapse of the banks in October 2008, as outlined above. Mr. Jónsson replied that this task should have been part of the systematic surveillance of the financial stability and of the system in general. It would have been necessary to "analyse [...] the possible risks and reactions [...] of

142. Cf. http://www.norges-bank.no/templates/article_70854.aspx.

143. Parliamentary record 2004-2005, A-section, pp. 2984-2985.

the support system to the business sector's development in line with the legal frame established for the business sector," Jónas said on that occasion. He also pointed out that, according to the Act on the Guarantee Fund, its Board of Directors should, on a biennial basis or more frequently if considered necessary, report to the Minister its view concerning the Fund's minimal assets.¹⁴⁴

As outlined elsewhere in the present report, FME representatives were involved in the Guarantee Fund's affairs in several instances where the position of the Icelandic banks was discussed. Both in the collaborative activity of the Icelandic authorities and also in the relations with the FME's counterparts abroad. For instance, a representative of FME's staff was a member of the committee appointed by the Minister of Business Affairs in the spring of 2007 in order to revise the Act on the Guarantee Fund. On the Guarantee Fund's side, there are instances of direct references, i.e. vis-à-vis foreign parties, to the Fund being subject to the surveillance of FME.¹⁴⁵

The FME was also informed about the banks' intended branches abroad, and about their intentions to start accumulating deposits there. Because of this, the FME sent, to quote Article 36(3) of the Act No. 161/2002 on Financial Undertakings, "a confirmation to the competent authorities of the host state, to the effect that the intended activity [was] in conformity with the enterprise's authorisation. The Financial Supervisory Authority [should] also send information on the enterprise's own funds, solvency, deposit guarantees and indemnity schemes protecting the branch's customers, to the competent authorities of the host state." When examining notifications sent by the FME on such occasions, it seems that the text used in its correspondence with foreign financial surveillance agencies was generally consistent as regards the membership of the bank in question to the Guarantee Fund and the Fund's situation, cf. a quotation from FME's letter to the FSA UK dated 6 June 2007, quoted in the margin.

"Landsbanki Islands hf. is a member of the Icelandic Deposit Guarantees and Investor Compensation Scheme that is intended to guarantee a minimum level of protection to depositors in commercial banks and savings banks, and to customers of companies engaging in securities trading pursuant to law, in the event of difficulties of a given company in meeting its obligations to its customers. The scheme is based on the EC Directives on the matter."

From a letter from the FME to the FSA dated 6 June 2007.

17.15 Safety Funds of Banks and Savings Banks

Article 19 of Act No. 98/1999 on Deposit Guarantees and Investor-Compensation Schemes, allows Icelandic banks and savings banks to establish private foundations, safety funds, to which all commercial banks and saving banks shall be members in order to preserve the interests of customers and the financial security of commercial or savings banks. The banks had not availed themselves of this authorisation by the time of the collapse of the major banks in October 2008. When the Guarantee Fund of Savings Banks was merged with the Guarantee Fund pursuant to Act No. 98/1999, it was decided that the so-called "credit department" of the guarantee fund would continue in operation in accordance with Article 19 of Act No. 96/1999. At the end of the year 2008, the capital of the Guarantee Fund of Savings Banks was entered as ISK 404.3 million, against ISK 398 million at the end of 2007.

144. Statement by Mr Jónas Fr. Jónsson before the SIC on 6 August 2009, pp. 24 and 25.

145. See, e.g. the e-mail from the Managing Director of the Guarantee Fund to a staff member of the Dutch guarantee fund dated 19 August 2008. It revealed that the FME was supervising the Fund and the institution had never made any comments on the management of the Fund or the size of its assets available to meet depositor's losses.

According to Article 19 of Act no. 98/1999, these safety funds are intended to secure the interests of customers and, therefore, the financial security of commercial banks or savings banks. Thus, the safety funds can grant loans or take over certain assets, put up guarantees, compensate for certain losses and costs incurred by a commercial bank or savings bank, and otherwise support commercial banks or savings banks in any other way determined by the funds' Boards of Directors in accordance with the provisions of this Act and the statutes of the fund in question. Therefore, a safety fund may request an investigation of the operations and financial position of a commercial bank or savings bank. Statutes should contain more detailed rules on operations, as well as on income and the granting of loans. Further, the safety fund may grant a commercial bank or savings bank subordinated loan capital in order to strengthen its capital position. The Fund's Board may set conditions when granting the subordinated loan capital. It may request an investigation of the operations and financial position of a commercial bank or savings bank receiving subordinated loan capital. In this context, the Board may request relevant information from the commercial bank or savings bank concerned. The supreme authority with regard to the affairs of the safety fund is vested in the fund's annual general meeting.

17.16 The Depositors' and Investors' Guarantee Fund seeks a Support Statement from the Icelandic Government

After the statement made by the Icelandic Government on the morning of 29 September 2008 to the effect that the Icelandic State would acquire 75% of the share capital of Glitnir banki hf., increasing unrest with regard to deposits was detected at the other Icelandic banks. The Chairman of the Guarantee Fund's Board of Directors then requested that the Icelandic Government would make an announcement on the status of bank deposits and that the Government would support the Guarantee Fund. At 09:18 a.m. on 29 September 2008, Ms. Áslaug Árnadóttir, Chairman of the Guarantee Fund's Board of Directors, sent an e-mail to Mr. Ingimundur Friðriksson, Governor of the Central Bank, Mr. Baldur Guðlaugsson, Permanent Secretary of State of the Ministry of Finance, and Mr. Bolli Þór Bollason, Permanent Secretary of State of the Prime Minister's Office, cf. note in the margin.

The three different drafts of the possible statement that were attached to the said letter from Ms. Árnadóttir all had the same heading: "Deposits in Icelandic banks are safe." The drafts read as follows:

- "A: The Icelandic Government has decided to guarantee all deposits in Icelandic commercial banks, public savings banks and branches of these parties in Iceland and abroad.
- B: The Icelandic government has decided to guarantee all deposits in Icelandic commercial banks, public savings banks and branches of these parties in Iceland and abroad. This guarantee will apply as long as there is unrest in the financial markets. Pursuant to Act No. 98/1999, the Depositors' and Investors' Guarantee Fund shall pay to the customer of a Member Firm an amount equivalent to his deposit in the event of the insolvency or bankruptcy of

"Enclosed are three versions of a statement regarding the Depositors' and Investors' Guarantee Fund. It is necessary for the Guarantee Fund to be able to answer questions and give clear, prompt answers which will prevent a run on the banks. Therefore, a reaction is requested as soon as possible. My cell phone number is [...]"

E-mail by Ms Áslaug Árnadóttir (see main text for recipients) dated 29 September 2008 at 09:18.

the Member Firm of the Guarantee Fund. The Member Firms of the Guarantee Fund are all Icelandic commercial banks and public savings banks. This statement entails that the Icelandic Government guarantees that the Guarantee Fund will be able to meet its obligations.

C: Pursuant to Act No. 98/1999, the Depositors' and Investors' Guarantee Fund shall pay to the customer of a Member Firm an amount equivalent to his her deposit in the event of the insolvency or bankruptcy of the Member Firm of the Guarantee Fund. The Member Firms of the Guarantee Fund are all Icelandic commercial banks and public savings banks. This statement entails that the Icelandic Government guarantees that the Guarantee Fund will be able to meet its obligations.“

Further communications between Ms. Árnadóttir and the said recipients of her e-mail correspondence will be detailed below as the SIC is of the opinion that these items are of importance, and this also applies to the accompanying drafts to the statement already cited.¹⁴⁶ Mr. Guðlaugsson replied to Ms. Árnadóttir's email at 09:34 with a cc to Mr. Friðriksson and Mr. Bollason. See his reply in the margin. At 09:44, Mr. Bollason replied by e-mail to Mr. Guðlaugsson with a cc to Ms. Árnadóttir and Mr. Friðriksson, cf. reference in the margin.

Ms. Árnadóttir replied by email at 09:45 with a cc to Mr. Bollason and Mr. Friðriksson.

“It will not work to limit the statement to deposits in Iceland, as this is contrary to the EEA Agreement and also creates the danger of a run on the deposits in Landsbankinn in London and the Netherlands, and probably also on deposits in Kaupthing abroad. Such a run on Icesave would cause Landsbankinn to collapse. If there is not sufficient willingness to go this far, it is possible to limit the guarantee to a certain amount of all deposits, based on the minimum EUR 20,887, which at the current rate is ISK 2,945,067, or ISK 5 or 8 million as we have discussed. Still, as has been discussed in the Committee on Financial Stability, such a statement could bring on a run on the banks with much worse financial consequences for the State Treasury than issuing such a statement of guarantee.

It is essential that we make a decision on this ASAP.”

At 10:26 Ms. Árnadóttir sent the following message to Mr. Bollason with a cc to Mr. Guðlaugsson, Mr. Friðriksson, Ms. Jónína S. Lárusdóttir, Permanent Secretary of State of the Ministry of Business Affairs, and Mr. Jón Þór Sturluson, Assistant to the Minister of Business Affairs:

“This statement is based on the current legislation. The Guarantee Fund has certain obligations to disclose information to depositors.

“In my opinion it is out of the question to issue any kind of statement saying that the State Treasury guarantees all deposits in overseas branches of the Icelandic banks. The content of possible statements must be looked at more closely.”

Reply by Mr Baldur Guðlaugsson to an e-mail from Ms Áslaug Árnadóttir, dated 29 September 2008.

“I agree with Baldur.”

Reply by Mr Bolli Þór Bollason to an e-mail from Ms Áslaug Árnadóttir, dated 29 September 2008.

146. For simplification every instance is referred to as a reply from the recipients to Ms Árnadóttir's letter, since the communication took place for that reason and on the basis of Ms Árnadóttir's original message to the recipients.

"Deposits in Icelandic banks are safe. The Depositors' and Investors' Guarantee Fund operates according to Act No. 98/1999 on Deposit Guarantees and Investor-Compensation Schemes. The objective of that Act is, i.a. to give the clients of commercial banks and savings banks a minimum level of protection in case of payment difficulties by disbursing the clients the value of their deposits, as is more closely provided for in the Act.

According to the law the Depositors' and Investors' Guarantee Fund is obliged to pay to the customer of a member company the amount of his deposit. In the event that assets are insufficient to pay the claims, payments shall be divided among the claimants in such a way that each claim up to EUR 20,887, which is equivalent to approximately ISK 2.9 million, shall be paid in full, and any amount in excess of that shall be paid in equal proportions depending on the extent of the deposit department's assets."

Draft statement regarding the Guarantee Fund, cf. e-mail by Áslaug Árnadóttir (see main text for recipients), dated 29 September 2008 at 10:26.

*"I have been wondering lately if and then how the State could distinguish between deposits in Iceland and deposits in branches abroad belonging to the Icelandic banks if it came to the authorities having to declare formally to what extent the State would guarantee deposits, believing they needed to calm the domestic depositors. I am not referring to verbal statements by individual ministers who may consider it appropriate to say that they think that the deposits in some bank or all the Icelandic banks are safe or secure (not secured), but to formal declarations on a State guarantee of deposits.
[...]"*

The beginning of an e-mail from Mr Baldur Guðlaugsson dated 29 September 2008 at 16:54.

Therefore, the Guarantee Fund intends to publish this statement if no statement will be forthcoming from the Government.

We have received many enquiries in the past two weeks and the news today will increase the pressure greatly. It is uncertain what consequences a statement to this effect would have, it might just as well cause more unrest and a run on the banks, at least in the way that people will begin to disperse their deposits, which in turn will increase the obligations of the State.

It should be emphasised that according to the Act there is in fact no cap on deposit guarantees, and depositors will receive the full amount of their deposits while there are sufficient resources within the Guarantee Fund, EUR 20,887 is merely the minimum amount."

Attached to the email from Ms. Árnadóttir was a draft statement, see reference in the margin. At 16:16, Ms. Árnadóttir sent another e-mail to Mr. Bollason with a cc to Mr. Guðlaugsson and Mr. Friðriksson. Therein was stated:

"Further to our conversations today I send you the following text for your consideration. The first two paragraphs are the same as I sent earlier; and a third paragraph has been added where it is stated that the Government will guarantee that the Guarantee Fund will be able to fulfil its obligations pursuant to the Act. Thus we keep to the minimum amount according to the Act, while at the same time we proclaim that the State will guarantee that the Guarantee Fund will be able to pay accordingly. There may not be reason at this time to issue a press release to this effect in Iceland, but I think it is critical for the Guarantee Fund to draft a press release to this effect and be able to issue it immediately if/when there is any sign of increased withdrawals in Icelandic banks, especially abroad."

The paragraph added by Ms. Árnadóttir to the first draft statement attached to her e-mail from 10:26 the same day quoted in the margin reads as follows:

"The Icelandic Government guarantees that the Guarantee Fund will be able to meet its obligations. The state guarantee covers all deposits in Icelandic commercial banks, public savings banks and branches of these parties in Iceland and abroad."

Mr. Guðlaugsson replied by email at 16:54 with a cc to Mr. Bollason, Mr. Friðriksson and Ms. Lárusdóttir. At the beginning of the e-mail, Mr. Guðlaugsson speculates whether it is possible to distinguish between deposits in Iceland and deposits in branches abroad belonging to the Icelandic banks, see a quote from his e-mail in the margin. Then he continues:

"We all know the EU Directive on Deposit Guarantee Schemes and the obligations it entails for the Member States, as well as the Act on Deposit Guarantees.

If it were the authorities' policy not to assume any further obligations than to guarantee that the Depositors' Guarantee Fund

could fulfil the minimum level of protection pursuant to the Directive and the Act, the presentation would not be complicated, technically. On the other hand, if it will be so assessed that the need will arise for the State to go further and declare that it will assume a wider-reaching guarantee than the minimum protection entails, things will get complicated. Deposits in the foreign branches of the Icelandic banks are huge and, consequently, so are the obligations of the Guarantee Fund, even when considering only the minimum protection. As far as I know, there has been no indication that the Guarantee Fund or the Icelandic State will cover deposits exceeding the minimum protection.

The issue is as follows: If Iceland decides to guarantee deposits in Icelandic banks in excess of the minimum protection, will the Icelandic State then be obliged to have the same apply regarding deposits in foreign branches of the Icelandic banks? Presumably, this would increase the obligations of the Icelandic State by hundreds of billions of ISK. This is probably not what people want.

What I have focused on is that it should be possible to differentiate between the obligations which the State has assumed pursuant to the Directive and the Act on deposit guarantees which, pursuant to the Directive's provisions, also apply to deposits in the branches, and what Iceland might be willing to do additionally."

Mr. Guðlaugsson discusses the subject of the Directive in more detail, cf. quote in the margin, and continues:

"Iceland has established a guarantee scheme (the Depositors' Guarantee Fund) which covers depositors with the branches. If there is any doubt that the Guarantee Fund will be able to fulfil its obligations regarding the payments of the minimum protection and the Icelandic State issues a statement that it will provide or guarantee the Guarantee Fund a loan which will enable it to make the payments of the minimum protection, thus, the Icelandic State is securing that the depositors will be compensated as provided for in the Directive. Even if the Icelandic State would also provide depositors in Iceland with wider protection (perhaps temporarily), it does not seem, at first glance, that this would constitute an infringement of someone else's rights. However, the presentation of this statement regarding additional guarantee on the part of the Icelandic State could be of great importance in the event of any repercussions. For instance, it would certainly be wise not to incorporate the additional guarantee into the deposit-guarantee scheme which Iceland has established, and therefore it would not be in the form of a guarantee for additional payments of the Depositors' Guarantee Fund to Icelandic depositors, but instead this guarantee would be separate from the other one (even though the Guarantee Fund would then, de facto, be authorised to manage payments and settlements, if necessary)."

"According to the directive depositors at branches must be protected by the same guarantee scheme, and deposit-guarantee schemes introduced and officially recognized shall cover the depositors at branches. It then says that the directive may not result in the Member States' or their competent authorities' being made liable in respect of depositors if they have ensured that one or more schemes guaranteeing deposits or credit institutions themselves and ensuring the compensation or protection of depositors under the conditions prescribed in this directive have been introduced and officially recognized."

From an e-mail from Mr Baldur Guðlaugsson dated 29 September 2008 at 16:54.

In the evening of 29 September 2008 at 22.02, Ms. Árnadóttir sent an e-mail to Mr. Guðlaugsson with a cc to Mr. Bollason, Mr. Friðriksson, and Ms. Lárusdóttir. In the e-mail, Ms. Árnadóttir agreed with Mr. Guðlaugsson's

“With regard to distinguishing between domestic and foreign deposits, I do not think that this is possible for three reasons. Firstly, it would be nearly impossible to implement. How does one distinguish between domestic and foreign deposits - by nationality, domicile or the geographical location of the branch? What happens to Icelandic nationals with deposits in the overseas branches of the Icelandic banks and foreign nationals with deposits in Icelandic banks. Then there is a large number of Icelandic nationals who are domiciled abroad and have accounts both in branches here at home and in Icelandic banks abroad. I also think that such a declaration could have very bad consequences for the Icelandic banks that are engaged in extensive deposit-taking abroad. Their reputation is badly enough at risk as it is without adding this to the mix.”

Ms Áslaug Árnadóttir, in an e-mail to Mr Baldur Guðlaugsson et al., 29 September 2008, at 22:02.

“It is very well to have different viewpoints expressed on this. In this situation no option can be considered good. I see no reason to continue debating in this way, but in my opinion it is both legally possible and possible in terms of execution to distinguish between domestic deposits and deposits in the overseas branches of Icelandic banks, if it comes to the point that the State wants to declare that it will guarantee deposits beyond the minimum coverage. The decision on which way to go will have to be based on a level-headed evaluation of the nation's best interests in the short and long term.”

Mr Baldur Guðlaugsson, in an e-mail to Ms Áslaug Árnadóttir et al., dated 30 September 2008, at 10:28.

view that at no point had any promise been made of further payments from the Guarantee Fund than provided for in the Act. On the other hand, she gave a reminder that Act No. 98/1999 provided for the Guarantee Fund's guarantee of all deposits. It was only if assets proved insufficient that the minimum of EUR 20,887 would apply. She believed that it would significantly strengthen the position of the Guarantee Fund if the Government declared that “Iceland would ensure that the Fund would be able to assume its obligations,” as Ms. Árnadóttir put it, as the authorities in the UK, Sweden, and the Netherlands had expressed some doubts in this regard. With regard to distinguishing between domestic and foreign deposits, Ms. Árnadóttir did not think that this was possible for three reasons: Firstly, that it would be almost unenforceable. Secondly, that quite a few Icelandic citizens are domiciled abroad and have accounts with Icelandic banks both in Iceland and abroad. Thirdly, that it would have very serious consequences for the Icelandic banks, which had already jeopardized their reputation. In direct continuation of the aforesaid, Ms. Árnadóttir presented her views which are quoted in the margin.

Mr. Guðlaugsson replied to Ms. Árnadóttir at 10:28 the following day, 30 September 2008, with a cc to those who had received a copy of Ms. Árnadóttir's e-mail. His reply is noted in the margin. Mr. Bolli Þór Bollason, Permanent Secretary of State in the Prime Minister's Office, wrote to Mr. Guðlaugsson at 10:37 with a cc to Ms. Árnadóttir, Mr. Friðriksson and Ms. Lárusdóttir:

“Of course, we have some leeway in this regard, irrespective of the EEA directives. I believe we should refrain from making any statements of this kind until we have absolutely no other alternative than to issue them. Actually, that might happen quite soon if the misfortunes continue unabated, cf. downgrade at S&P and the same imminent at Fitch. So we must be vigilant.”

This correspondence between the Chairman of the Guarantee Fund and the members of the authorities' consultative group ended with an e-mail from Chairman Árnadóttir to Mr. Bollason with cc to Mr. Guðlaugsson, Mr. Friðriksson and Ms. Lárusdóttir as well as the Director General of the FME, Mr. Jónas Fr. Jónsson, at 10:57 on 30 September 2008:

“I agree with Mr. Bollason that we have to be vigilant. These discussions reveal that there is every reason to discuss this matter until we reach a conclusion. Such a statement must be prepared beforehand, since it may be necessary to respond in a matter of minutes if the situation arises that a run on the banks is imminent.

Apart from breaches of the EEA Agreement and possible liability which might arise from such breaches, I want to emphasize that a statement to the effect that the Icelandic State will discriminate between Icelandic and foreign parties would create the risk of a run on Landsbankinn and Kaupthing abroad. The liquidity of Landsbankinn is fine today but solely because the bank has enormous deposits abroad. If there would be a run on the foreign deposits of Landsbankinn, it could have a serious impact on the bank's liquidity, which in turn could have consequences for the Treasury. This must be taken into consideration.

I agree that it is not desirable that the Icelandic banks commit the Icelandic State by maintaining large deposits in their foreign branches, which is the current situation and one that we must work with. The branches with the highest deposits are in the process of being turned into subsidiaries, which will immediately reduce this responsibility, but until then I believe we must be very careful not to do anything that will increase the risk of foreign customers withdrawing their deposits from the Icelandic banks.”

There is no indication in the minutes of the Guarantee Fund’s Board meetings of any discussion of a possible State guarantee of the Fund’s obligations, or loans which the Fund would take, i.e. not until the meeting of the Board of Directors on 1 October 2008. The following is noted in the minutes from that meeting:

“Discussions on the problem it generates for the Guarantee Fund that the law or the regulation on the Guarantee Fund do not provide for State guarantee of the Fund’s loans. ÁÁ (Ms. Áslaug Árnadóttir) said that the Guarantee Fund had requested clear answers from the Ministry of Finance in this regard, but had not yet received an answer. It was agreed to request that the Prime Minister’s Office would explain how the Guarantee Fund should honour its obligations, according to law, if its assets proved insufficient to cover them. In this respect, it was decided that the Guarantee Fund should not initiate any media coverage until the issue of the State guarantee was clear.”

In accordance with the decision of the Guarantee Fund’s Board of Directors, its Chairman sent the Prime Minister the following letter dated 1 October 2008, with a cc to the Minister of Business Affairs and the Minister of Finance:

“The Board of Directors of the Depositors’ and Investors’ Guarantee Fund agreed in its meeting today, to request that the Prime Minister explained by what means the Depositors’ and Investors’ Guarantee Fund would be enabled to honour its obligations pursuant to Act No. 98/1999 on Deposit Guarantees and Investor Compensation Schemes, should the Fund’s assets prove insufficient to cover the payments for which the law provides.”

The Guarantee Fund did not receive a reply from the Prime Minister. On 9 October 2008, the Board of Directors of the Guarantee Fund agreed to ask the Prime Minister again what his position was. For this reason, the Chairman of the Board sent a letter to the Prime Minister dated on the same day. The main subject of the letter was as follows:

“The Guarantee Fund is a private foundation with a statutory function pursuant to Act No. 98/1999. However, in view of your statements and those of the Government over the last few days, it is not quite clear to the Board of Directors of the Guarantee Fund what exactly it is that the authorities expect from the Guarantee Fund and whether

“Such a statement must be prepared beforehand, since it may be necessary to respond in a matter of minutes if the situation arises that a run on the banks is imminent. [...] The branches with the highest deposits are in the process of being turned into subsidiaries, which will immediately reduce this responsibility, but until then I believe we must be very careful not to do anything that will increase the risk of foreign customers withdrawing their deposits from the Icelandic banks.

Ms Áslaug Árnadóttir, in an e-mail to Mr Bolli Þór Bollason et al., 30 September 2008, at 10:57.

the Guarantee Fund will be able, with regard to the provisions of the Act, to honour the obligations imposed on the Guarantee Fund in the said statements.

With the interests of the depositors in mind, the Board of Directors of the Guarantee Fund is of the opinion that further explanation on your part is required. Among other things, the Board of Directors of the Guarantee Fund is wondering in what way the State Treasury will support the Guarantee Fund in raising sufficient funds [here was a reference to the Prime Minister's statement of 8 October 2008 in a footnote, cf. further details in Chapter 17.17.5], in what way you envisage the implementation of guaranteeing in full the deposits in domestic commercial banks, public savings banks and their branches in Iceland [here was a reference to the Government's statement of 6 October 2008 in a footnote, cf. further details in Chapter 17.17.5], and how the statement to the effect that depositors with the foreign branches of the Icelandic banks do not enjoy the above-mentioned protection conforms to Act No. 98/1999 and Iceland's obligations under international law.

In light of the aforesaid, we request that you explain in more detail the statements that have been given so that it will be possible to resolve the problems that have arisen and provide depositors with clear answers. Furthermore, the Board of Directors of the Guarantee Fund wishes and expects that a reliable cooperation and consultation will be established without delay between the Guarantee Fund and the Prime Minister's Office as regards foreseeable payouts from the Guarantee Fund.”¹⁴⁷

In the data which the SIC has received, there is nothing that indicates that this letter was specifically replied to by the Prime Minister. In the hearing before the SIC, Prime Minister Geir. H. Haarde expressed the following opinion on the abovementioned letters sent to him:

“[The Chairman of the Board of the Guarantee Fund] is writing a somewhat reprimanding letter to the Prime Minister, demanding answers and asking whether they should honour their obligations and such. It is odd.”

Statement by Geir H. Haarde before the SIC on 2 July 2009, p. 59.

“Actually, it is a bit peculiar that at the beginning of October one was receiving, addressed to me with a cc to other ministers, letters from the Managing Director or Chairman of the Board of the Guarantee Fund - who is an employee of the Ministry of Business Affairs, albeit Director at the Ministry of Business Affairs and Deputy Permanent Secretary of State - who was writing a somewhat reprimanding letter to the Prime Minister, demanding answers and asking whether obligations should be honoured and such. It is odd.”¹⁴⁸

147. Letter from Ms Áslaug Árnadóttir, Chairman of the Board of the Guarantee Fund, to Prime Minister Geir H. Haarde, dated 9 October 2008.

148. Statement by Mr Geir H. Haarde before the SIC on 2 July 2009, p. 59.

17.17 Replies to Inquiries by Foreign Authorities Regarding the Depositors' and Investors' Guarantee Fund (TIF) and the State's Position vis-à-vis the Fund

17.17.1 Introduction

In late summer 2008, the Icelandic authorities began receiving inquiries from the UK and Dutch authorities concerning the Guarantee Fund due to the deposits accumulated by Landsbanki in the UK and the Netherlands through the Icesave accounts. The inquiries were aimed, i.a., at obtaining general information on Icelandic legislation and the regulatory setting in this regard, in particular the organisation, financial standing, and composition of the Fund. The brunt of the inquiries, however, focused on how or whether the Icelandic government would react if the Fund's payment obligation became operative, and, in that case, on the one hand, what legislation on the Fund stipulated, and on the other hand, whether or what independent action was to be expected from the Icelandic authorities irrespective of any legal stipulations. The Special Investigation Commission (SIC) considers it appropriate to relate chronologically the communications between the Icelandic authorities and the UK and the Dutch authorities with regard to the issues mentioned above.

17.17.2 Communications with the UK Authorities

On 30 July 2008, the Icelandic authorities received a communication stating that Mr. Clive Maxwell, Director of Financial Stability at the HM Treasury, wished to speak with the Permanent Secretaries of the Ministry of Finance and the Ministry of Business Affairs. The following day, Mr. Maxwell spoke with both Mr. Baldur Guðlaugsson, Permanent Secretary of the Ministry of Finance, and Ms. Áslaug Árnadóttir, then acting Permanent Secretary of the Ministry of Business Affairs. As reported by the Ministry of Business Affairs, Mr. Maxwell voiced concerns over the Icelandic economy and what would happen to British Icesave depositors if Landsbanki would run into problems fulfilling its obligations. On that same day, 31 July 2008, representatives of the British Financial Supervisory Authority (FSA) arrived in Iceland, primarily, according to information from the Ministry of Business Affairs, to work on getting Landsbanki to transfer its Icesave accounts from branches to subsidiaries (i.e. subsidiarisation). Ms. Árnadóttir, Chairman of the Board of Directors of the Depositors' and Investors' Guarantee Fund, met that day with the representatives of the FSA and in that meeting it was revealed that the UK authorities emphasized the importance of an assurance from the Icelandic authorities that the Icelandic State would grant a loan to the Guarantee Fund if required. Documentation which the Ministry of Business Affairs has handed over to the SIC regarding this meeting shows that the FSA was informed that no such decision had been made, but also that the representatives of the FSA had pointed out that Iceland could be seen as being bound by international law,

149. For information on the events of those days and the discussions with the UK authorities, cf.: "Um Tryggingarsjóð innstæðueigenda og fjárfesta." A memorandum submitted in a meeting between the Prime Minister's Office, the Ministry of Finance and the Ministry of Business Affairs in the Prime Minister's Office on 18 August 2008. Cf. further discussion in Chapter 17.17.4.

on the basis of the EEA Agreement, to provide the depositors of Icelandic banks and their branches with the minimum guarantee stipulated in the EU directive on deposit-guarantee schemes.¹⁴⁹

It should be mentioned in this context that the consultative group of three ministries, the FME and the Central Bank of Iceland, cf. further in Chapter 17.10.2 above, convened at noon on 31 July, that is on the same day the representatives of the FSA were in Iceland. That meeting was attended by both Mr. Jónas Fr. Jónsson, Director General of the FME, and Ms. Árnadóttir, then acting Permanent Secretary of the Ministry of Business Affairs and Chairman of the Board of Directors of the Depositors' and Investors' Guarantee Fund. This was also the last meeting in the consultative group attended by Ms. Árnadóttir, because on 1 August 2008, Ms. Jónína S. Lárusdóttir, Permanent Secretary of the Ministry of Business Affairs, returned to her post after a leave and took a seat in the consultative group. According to the draft minutes from this meeting of the consultative group, the aforementioned visit from the representatives of the FSA to Iceland was discussed. Discussions took place on what was called the message from the FSA and the preparedness of the Guarantee Fund. It can be concluded from the draft minutes that this message primarily concerned a potential transfer of the deposits of Landsbanki in the UK from a branch to a subsidiary and limitations to the bank's raising of deposits. The draft minutes reveal that the UK authorities considered that they did not have adequate information on the Icelandic Guarantee Fund, its potential financing, payment procedure, etc. Nowhere is it stated that the meeting of the consultative group discussed the possibility of the State Treasury becoming involved with the obligations of the Fund, even though one subject of discussion was what was referred to as the Fund's weaknesses. The emphasis, like before, was on the deposits of Landsbanki in the UK being transferred to a subsidiary. This meeting is discussed further in Chapter 17.10.2.

Following the conversation between Ms. Árnadóttir and Mr. Maxwell mentioned above, she sent Mr. Maxwell information on the Guarantee Fund in an e-mail dated 3 August. It stated, *inter alia*, with regard to the provisions of Act No. 98/1999:

"In paragraph 2 in Article 10 it is stated that should the total assets of the Fund prove insufficient, the Board of Directors can take out a loan in order to compensate losses suffered by claimants."¹⁵⁰

Among the documentation received by the SIC is an undated document which the Ministry of Business Affairs is to have submitted to the British Department for Business around the same time. It states, *inter alia*, with regard to the same point mentioned in Ms. Árnadóttir's e-mail:

"If the total assets of the Fund prove insufficient, the Board of Directors may, if it sees compelling reasons to do so, take out a loan in order to compensate losses suffered by claimants."¹⁵¹

150. E-mail by Ms. Áslaug Árnadóttir, acting Permanent Secretary of the Ministry of Business Affairs, to Mr. Clive Maxwell, Director of Financial Stability at HM Treasury, dated 3 August 2008.

151. The document is undated and not identifiable in any way other than from its heading "The Icelandic Depositors' and Investors' Guarantee Fund – Handling of claims. August 2008."

Both quotations refer to the provision of Article 10(2) of Act No. 98/1999. The latter quotation is a direct translation of the provision as a whole and is more detailed than the former in so far as it not only mentions that the Board can take out a loan, but also includes the discretionary component of the authorisation, i.e. that the Board may take out a loan if it “sees compelling reasons to do so.”

The Ministry of Business Affairs received a letter in reply from Mr. Maxwell, dated 7 August 2008. It starts by referring to the e-mail of 3 August and thanking for the additional information it contained on the Guarantee Fund, following Mr. Maxwell’s conversation with Ms. Árnadóttir on 31 July 2008. It goes on to say that HM Treasury has reviewed the information and has a few further queries which it would like to obtain the Icelandic ministry’s view on. The letter subsequently states in a few sentences the Treasury’s understanding of the information provided by the Icelandic ministry. There it notes, inter alia, in relation to the discussion of payments from the Guarantee Fund:

“[...] If there is not enough to pay out the 1.7m krona per deposit there is then a discretion (but not a duty) for the directors to seek a loan. [...]”¹⁵²

There, HM Treasury is referring to the discretionary authorisation of the Board of Directors of the Depositors’ and Investors’ Guarantee Fund to take out a loan, cf. Article 10(2) of Act No. 98/1999, which the Icelandic ministry had referred to and is described above. The first two of the seven questions from the Treasury then dealt with the discretionary authorisation to take out a loan. The fifth question also relates to this subject, cf. further below. The first question is referred to in the margin, but the other two read as follows:

“(2) Linked to question (1), what steps would be taken if the Board of Directors was unable to take out a loan from the commercial markets to raise the necessary funding? In particular, I would be grateful if you could confirm that the Icelandic authorities would provide the necessary loan in such circumstances to ensure all claimants received their full entitlement up to the compensation limit of 20,887 euro.

(5) If we are right in our readings of the legislation would the Icelandic authorities ensure that the scheme is topped up so as to be able to make payouts of up to the minimum compensation limit of 20,887 Euros per depositor?”¹⁵³

“(1) The provision in paragraph 2 of Article 10 of Act 98 /1999 that if the total funds of the Guarantee Fund prove insufficient, the Board of Directors can, at their discretion, take out a loan to meet claims up to the minimum coverage. Would there be any circumstances in which the directors would not seek a loan to ensure the scheme pays out to the minimum ISK 1.7m / EUR 20,887 level?”

Question 1 in the letter from Mr Clive Maxwell to the Ministry of Business Affairs dated 7 August 2008.

152. Mr Clive Maxwell, in a reply e-mail to Ms Áslaug Árnadóttir dated 7 August 2008.

153. Mr Clive Maxwell, in a reply e-mail to Ms Áslaug Árnadóttir dated 7 August 2008. In the first of the cited enquiries by the British official the substantive question is whether the Board of the Guarantee Fund would, under any circumstances, not take out a loan according to the authorisation of Article 10(2) of Act No. 98/1999 to ensure that the Fund could disburse the minimum guarantee. In the second enquiry the question is what the reaction would be if the Fund’s Board were unable to secure a loan in the general market to acquire the necessary funds for this task. Then the question is posed whether the Ministry could confirm that the Icelandic authorities would grant the Fund the necessary loan under such circumstances in order to ensure that all claimants would receive the full minimum guarantee. Finally, the fifth enquiry is directly about whether the Icelandic authorities would “ensure” that the guarantee scheme would be topped up in order to be able to pay the minimum guarantee, which seems to mean whether the guarantee scheme would be guaranteed additional funds for this purpose, if necessary.

Mr. Maxwell followed up his letter with an e-mail to Ms. Árnadóttir, dated 14 August 2008, where he asked whether his letter had been reviewed. Ms. Árnadóttir replied with an e-mail the same day where, regarding questions 1 and 2 from Mr. Maxwell's letter of 7 August 2008, she said:

"[...] It is absolutely clear according to the law that the fund has to pay out claims up to 20.887 Euros and therefore the Board would always seek a loan to ensure that the scheme pays out to that minimum.

Regarding questions 2 and 5, the Board has not made any decision on this and before we can give you a definite answer on what the authorities would to this [...] would have to be discussed by the Government."¹⁵⁴

As stated above, regarding questions two and five which had to do with whether the Icelandic government would lend the Fund the necessary funds or otherwise ensure that the minimum could be paid out, Ms. Árnadóttir's answer states that the Board had not made any decisions and a definite answer could not be given until the matter had been discussed by the government.

It should be mentioned that Ms. Árnadóttir's reply contained an answer to all of Mr. Maxwell's questions save the last two mentioned.

17.17.3 Communications with the Dutch Authorities

According to information provided by the Depositors' and Investors' Guarantee Fund to the SIC, Ms. Áslaug Árnadóttir, Chairman of the Board of Directors of the Guarantee Fund, met with representatives from the Dutch Central Bank (DNB), which is charged with financial supervision in the Netherlands, on 14 August 2008. A representative of the Icelandic Financial Supervisory Authority was also present at the meeting. In the meeting laws and regulations applicable to deposit guarantees in Iceland were outlined.

Following this meeting, Ms. Árnadóttir and Mr. Jónas Þórðarson, Managing Director of the Guarantee Fund, received an e-mail dated 18 August 2008 from Ms. Louisa van den Broek, who according to the e-mail's signature was an employee in the DNB's supervisory and policy development department. The e-mail requested further information on the financial position of the Depositors' and Investors' Guarantee Fund, with regard to its potential obligations, its financing, and related issues. Detailed questions were posed on the same issue that the queries from the UK had focused on, as discussed above, namely the Board's authorisation to take out a loan if it saw "compelling reasons to do so". These questions read as follows:

"[...] In what case of insufficiency of the Fund might the Board of Directors consider that there [are] no compelling reasons to take out a loan? How does this relate to the obligation under the European directive (Article 10(1)) that schemes should be in a position to

154. Mr Clive Maxwell, in a reply e-mail to Ms Áslaug Árnadóttir dated 7 August 2008. The cited part of the reply substantially says that the law clearly states – from the context it could be surmised that this refers to Act No. 98/1999 – that the Fund is obliged to disburse claims up to the amount of the minimum guarantee and therefore the Government would always seek to take out a loan if it would become necessary to guarantee that the Icelandic guarantee scheme would be able to disburse up to that minimum.

pay duly verified claims? How will the Icelandic Depositors' and Investors' Guarantee Fund fulfil this obligation if no loan is taken out or if it turns out to be impossible to take out a loan even if the Board of Directors would want to do so? If the Icelandic Depositors' and Investors' Guarantee Scheme would need to be activated for one of the Icelandic banks, would the Board of Directors of the Fund actually be able to take out a loan of the size needed (our estimates are that this loan would be one of considerable size)? Is the Board free in choosing where the loan will be taken out?"¹⁵⁵

Mr. Þórðarson, Managing Director of the Guarantee Fund, replied to the e-mail from Ms. van den Broek with an e-mail sent the following day, 19 August 2008. The general remarks at the beginning of the letter state that Iceland is legally obliged in the same way as EU Member States to provide a minimum guarantee of deposits up to the minimum stipulated in the EU directive on deposit guarantee schemes. After discussing the Fund's assets, its financing and referring to the Board's authorisation to take out a loan, the letter goes on to say:

"[...] If the Fund's assets and guarantees are not sufficient to cover the minimum [...] the board of directors would see that as a "compelling reason" to borrow money. There are no restrictions on the Board of Directors of where to borrow money. So, the Fund would borrow money if needed to fulfil its responsibilities according to the EU Directive 94/19/EC."¹⁵⁶

An employee of the DNB sent further queries to Mr. Þórðarson, Managing Director of the Guarantee Fund, in an e-mail dated 20 August 2008. In addition to those that only touched upon financial issues relating to the Depositors' and Investors' Guarantee Fund, the following questions were posed:

"Regarding the loan that can be taken out by the Board of Directors. Are there any (in)formal arrangements with Central Bank of Iceland? Does the Central Bank step up if the funds of the Icelandic scheme are insufficient?

155. E-mail by Ms Louisa van den Broek, staff member of the Dutch Central Bank, to Ms Áslaug Árnadóttir, Chairman of the Board of the Guarantee Fund, and Mr Jónas Þórðarson, Managing Director of the Guarantee Fund, dated 18 August 2008. Inquiries by a staff member of the Dutch Central Bank in the cited section of her letter were substantially about the same issues as the British authorities had previously asked about, cf. above, i.e. under what circumstances the Fund's Board would not consider there to be "compelling reasons" to take out a loan to disburse the claimants if the Guarantee Fund's assets were short of covering its obligations. However, the enquiries from the Netherlands were more specific in that they substantially asked directly about the context of the Fund's Board authorisation to take out a loan according to Article 10(2) of Act No. 98/1999 and the obligation under Article 10(1) of Directive 94/19/EC that "Deposit-guarantee schemes shall be in a position to pay duly verified claims by depositors in respect of unavailable deposits." Subsequently the question was posed how the Guarantee Fund would fulfil this obligation without a loan being taken out or if no loan was available, whether the fund had the option of taking a loan of the magnitude which, according to the Dutch authorities' calculations, was necessary, and whether the Board had a free hand in choosing where to take out the loan.

156. Mr Jónas Þórðarson's E-mail to Ms Louisa van den Broek, dated 19 August 2008. In the reply from the Managing Director of the Guarantee Fund it is firmly stated that should the Fund's assets be insufficient to disburse the minimum guarantee, the Board would consider it a "compelling reason" for taking out a loan within the meaning of Article 10(2) of Act no. 98/1999, and that there were no limitations as to where the Board could seek such a loan.

Is it indeed safe to assume that the assets in the Deposit Department will prove insufficient to pay the guaranteed € 20.887 if one of the three largest Icelandic banks will fail? Are there any estimates on the size of the loan the Board would have to take out in that case?”¹⁵⁷

Written documentation available to the SIC does not provide information on whether, and if so how, these particular questions were answered.

It should be noted that Mr. Þórðarson received more e-mails from the DNB employee in question, dated 20 and 28 August 2008, but the content and questions contained therein do not relate to the subject of this Chapter.

17.17.4 Answers to the Two Remaining Questions of the UK Authorities

At the end of Chapter 17.17.1 above, it was noted that the e-mail from Ms. Árnadóttir, Director at the Ministry of Business Affairs and Chairman of the Board of the Depositors' and Investors' Guarantee Fund, to Mr. Maxwell, Director of Financial Stability at HM Treasury, on 14 August 2008 answered every question with the exception of two conveyed in Mr. Maxwell's letter to the Ministry of Business Affairs on 7 August of the same year. Those questions were answered by the Icelandic authorities in a letter to Mr. Maxwell dated 20 August 2008, which Ms. Árnadóttir signed on behalf of the Ministry of Business Affairs. According to information obtained by the SIC, there was a certain prelude to the answer by the Icelandic government.¹⁵⁸ A meeting was held between the Prime Minister's Office, the Ministry of Finance and the Ministry of Business Affairs on Monday, 18 August 2008 at the Prime Minister's Office. Present at the meeting were the ministers and Permanent Secretaries of said ministries in addition to Ms. Árnadóttir. According to the information available to the SIC, a memorandum was presented at the meeting entitled “On the Depositors' and Investors' Guarantee Fund.” The memorandum contained general information on the Guarantee Fund, including its legal basis, organisation, assets, obligations, current standing, etc. In the last part of the memorandum the communications with the UK authorities, both the Treasury and the FSA, regarding the matters of the Guarantee Fund were discussed. The memorandum has been quoted above in discussion of some of these issues, cf. the beginning of Chapter 17.17.2. In addition, the memorandum directly quoted another question from Mr. Maxwell and the reply by the Icelandic government, cf. the quotations at the end of Chapter 17.17.2. After quoting Mr. Maxwell's question directly, the reply by the Icelandic government was recapitulated as quoted in the margin. The aforementioned data and information demonstrates an effort on behalf of the Ministry of Business Affairs, which was the recipient of the letters from Mr. Maxwell to the Icelandic government, to present information on the letters' content and subject matter to other Icelandic governmental authorities, including as regards the concerns and questions voiced by the UK on possible lending by the Icelandic authorities to the Guarantee Fund if it proved necessary.

“The Ministry of Business Affairs answered the letter [i.e. Clive Maxwell's aforementioned inquiry] by way of saying that the Board of Directors of the Guarantee Fund had not specifically discussed the matter and that it was not possible to say what the authorities would do in such a situation until the issue had been discussed by the government's ministers. There has still been no response to the Ministry's reply.”

From a memorandum submitted before a meeting between the Prime Minister's Office, the Ministry of Finance and the Ministry of Business Affairs on 18 August 2008.

157. Ms Louisa van den Brock, in an e-mail to Mr Jónas Þórðarson, dated 20 August 2008.

158. More detailed information on the lead-up to the reply letter, i.e. especially the Ministries' meeting of 18 August 2008, was contained in a letter to the SIC from Ms Jónína S. Lárusdóttir, Permanent Secretary of the Ministry of Business Affairs, dated 24 February 2010.

In the aforementioned meeting the Ministry of Business Affairs was charged with drafting an answer to the remaining questions to the UK authorities which was to be presented to the Permanent Secretaries of the Prime Minister's Office and the Ministry of Finance. According to SIC's records, the Prime Minister specified in the meeting which issues the letter should address, "i.e. that the State would support the Central Bank of Iceland as a lender of last resort, that the government would do everything a responsible government would do, that the Icelandic government would assist in getting the Guarantee Fund a loan, that a revision of the Act on Deposit Guarantees and Investor-Compensation schemes was under way, and that obligations under the directive would be met".¹⁵⁹ In the margin there is a verbatim quote from a letter from Ms. Jónína S. Lárusdóttir on the process of writing the letter. Attached to the letter from Ms. Lárusdóttir were copies of e-mails between the Permanent Secretaries of the Prime Minister's Office, the Ministry of Finance and the Ministry of Business Affairs exchanged on 18 and 19 August 2008 which largely support the description of the letter-writing process found in the passage from Ms. Lárusdóttir's letter quoted in the margin. Attached to the letter from Ms. Lárusdóttir were also copies of e-mails exchanged shortly before noon on 20 August 2008, between the Permanent Secretary of the Ministry of Finance, on the one hand, and the Prime Minister and the Minister of Finance, on the other hand in which the Permanent Secretary sent to the ministers a draft of a reply letter formulated in the exchanges between the officials, cf. the description above. The letter from the Permanent Secretary and the Prime Minister's reply on behalf of both ministers, which was also sent, i.a., to the Minister of Business Affairs, is quoted in the margin. The Permanent Secretary's letter, inter alia, refers to consultations between the aforementioned ministries on the content of the replies and that the aim was to express "only as much as absolutely necessary on the involvement of the State". The Prime Minister and the Minister of Finance did not have comments on the content of the draft they received and approved the sending of the letter. As far as it is relevant to this discussion, cf. the quotes below, this last draft of the letter, contained in the SIC's documentation, is identical to the letter sent on the day that the last mentioned e-mail exchange took place, i.e. 20 August 2008.

The letter sent by Ms. Árnadóttir on behalf of the Ministry of Business Affairs to Mr. Maxwell on 20 August 2008, referred to their conversation on 31 July 2008, Mr. Maxwell's letter of 7 August of the same year containing the queries regarding the Guarantee Fund, and Ms. Árnadóttir's e-mail of 14 August of the same year where said queries were answered with the exception of questions number two and five. The letter noted that the following contained the ministry's position on the remaining questions. That position is quoted directly in the margin.¹⁶⁰

The ministry's position was, cf. the quote in the margin, that in the unlikely event that the Depositors' and Investors' Guarantee Fund could not obtain a loan on the financial markets, the Icelandic government would do everything a "responsible government" would do under such circumstances, including "assisting the Fund" in raising the necessary funds so that it would be able to meet its minimum guarantee obligations.

"The staff of the Ministry of Business Affairs then drafted a reply and sent it to the Prime Minister's Office and the Ministry of Finance. The representatives of the Ministry of Finance and the Prime Minister's Office both suggested changes in the wording and the Permanent Secretary of the Ministry of Finance made a suggestion to add a paragraph on the State Treasury's support of the CBI as the lender of last resort. A draft of the letter was also submitted to the consultative group [see Chapter 17.10.2] on 20 August 2008. In the Ministry of Business Affairs, the letter was written in close cooperation with the Minister, who both read the draft that was sent to the Permanent Secretaries of the Prime Minister's Office and the Ministry of Finance and the drafts sent back by them. Finally the letter was sent from the Ministry of Business Affairs after it had been approved by three ministers."

Ms Jónína S. Lárusdóttir, in a letter to the SIC dated 24 February 2010.

"I am hereby sending you the draft to a reply to a letter received by the Ministry of Business Affairs from HM Treasury (which handles stability issues), asking some pointed questions regarding the position of the Guarantee Fund and requesting that the authorities confirm that the state will see to it that the Guarantee Fund can cover the disbursements of the statutory minimum guarantee for depositors, should it come to that. The Ministries of Finance and Business Affairs and the Prime Minister's Office cooperated on writing the draft reply. The reference was to not say more than absolutely necessary on the State's involvement. The Chairman of the Board of the Icelandic Guarantee Fund is meeting with the FSCS in London tomorrow morning. It is considered preferable that the letter be sent today. It would be sent from the Ministry of Business Affairs. Can you authorise that the letter be sent today?"

Main text of an e-mail from the Permanent Secretary of the Ministry of Finance to the Prime Minister and Minister of Finance dated 20 August 2008 at 10:36.

"I think this reply letter is now quite good. The Finance Minister and I have no further comments. Greetings from Reykholt."

E-mail from the Prime Minister to the Permanent Secretaries of the Ministries of Finance and Business Affairs and the Prime Minister's Office, dated 20 August 2008, at 11:29.

159. See the last cited letter from Ms Jónína S. Lárusdóttir, to the SIC, p. 12.

160. Letter from Ms Áslaug Árnadóttir to Mr Clive Maxwell, dated 20 August 2008.

“In the eventm which we find very unlikely, that the Board of Directors of the Depositors’ and Investors’ Guarantee Fund could not raise necessary funds on the financial markets, we assure you that the Icelandic Government would do everything that any responsible government would do in such a situation, including assisting the Fund in raising the necessary funds, so that the Fund would be able to meet the minimum compensation limits.”

Ms Áslaug Árnadóttir, in a letter to Mr Clive Maxwell, 20 August 2008.

The next two paragraphs of the letter noted, on the one hand, that Act No. 98/1999 had been adopted to implement EU Directive 94/19/EC on the same subject matter. It was noted that the act was being revised and that the plan was to submit a new bill in the autumn. On the other hand, it was noted that in the event of liquidity problems of a financial institution with an otherwise strong capital position, on account of sudden and massive withdrawals of funds by depositors, the Central Bank of Iceland would act as a lender of last resort and would as such be supported by the government. Under such circumstances the obligations of the Guarantee Fund would not be put to the test. The last paragraph of the letter stated:

“We would like to underline that the Government is fully aware of its obligations under the EEA Agreement in relation to the Depositors’ and Investors’ Guarantee Fund and will fulfil those obligations”.¹⁶¹

The letter’s conclusion thus reiterated that the Icelandic government was fully aware of its obligations under the EEA Agreement with regard to the Guarantee Fund and would fulfil those obligations.

It is appropriate to mention here that a meeting was held in the consultative group of ministries and governmental institutions, cf. Chapter 17.10.2 above, on 20 August 2008, the same day that the aforementioned letter is dated. According to the draft minutes, Mr. Ingimundur Friðriksson, Governor of the Central Bank, inquired whether Mr. Maxwell’s letter of 7 August 2008 had been replied to. He was told by Ms. Lárusdóttir, Permanent Secretary of the Ministry of Business Affairs, that the letter would be replied to. Ms. Lárusdóttir further stated that a statement regarding the government’s position on potential support for the Guarantee Fund had already been drafted, in case it would be required. This draft was presented at the meeting, cf. further discussion of the meeting in Chapter 17.10.2. Ms. Lárusdóttir revealed in that same meeting that a letter had been received from the Dutch Guarantee Fund, requesting answers to numerous questions. The letter all but asked directly about governmental support. The letter referred to by Ms. Lárusdóttir was the letter from the representative of the DNB described above.

Finally, it should be noted that the Chairman of the Board of Directors and the Managing Director of the Guarantee Fund met with the Chief Executive and representatives of the Financial Services Compensation Scheme (FSCS) on 21 August 2008. According to available documentation obtained by the SIC, the meeting discussed cooperation between the two Funds in case of payments and related practical aspects. The documentation does not indicate that any matters were discussed that are directly relevant in the context of this discussion, i.e. regarding the actual liquidity of the Guarantee Fund and the State’s possible involvement, since the communications by the Icelandic authorities had not been with the FSCS but rather HM Treasury.

161. Letter from Ms Áslaug Árnadóttir to Mr Clive Maxwell, dated 20 August 2008.

17.17.5 Communications and Disclosure of Information to the UK Authorities at the Beginning of October 2008

According to documentation received by the SIC, the Icelandic authorities, primarily the Guarantee Fund and legal representatives of the Fund, continued communicating with the UK authorities in September 2008, mainly with the FSCS but with some involvement of the Treasury, on practical aspects of potential payments from the Guarantee Fund and cooperation between the Icelandic and the British guarantee funds in case of a collapse of an Icelandic bank which would require the involvement of both funds, i.e. Landsbanki, which had made a top-up agreement with the FSCS on account of deposits accumulated in its branch in the UK. These communications need not be retraced in any detail here for the same reasons as mentioned at the end of the last Chapter.

Chapter 17.16 above quoted in its entirety a letter sent by Ms. Árnadóttir, Chairman of the Board of Directors of the Guarantee Fund, to the Prime Minister, with a cc to the Minister of Business Affairs and Minister of Finance, on 1 October 2008. The letter requested that the Minister “explain how the Guarantee Fund would be enabled to meet its obligations according to Act. No. 98/1999 [...] if the Fund’s assets proved insufficient to make the payments required by law”. In the context of this chapter, the discussion in Chapter 17.10.2 on the meetings of the consultative group of ministries and governmental institutions during the same period being discussed here, merits mention. The matters of the Guarantee Fund and other issues substantively identical to those covered here were frequently discussed in those meetings. The reader is referred to that discussion.

Of the documentation obtained by the SIC on the written communications between Icelandic and foreign authorities from that time regarding questions on the actual liquidity of the Guarantee Fund and the State’s position vis-à-vis the Fund, the most relevant at this point in the discussion is Mr. Maxwell’s e-mail to Ms. Árnadóttir on 5 October 2008. It should be mentioned that Ms. Árnadóttir was no longer acting Permanent Secretary at this time, but had resumed her regular duties as director at the Ministry. Mr. Maxwell referred to their earlier conversation without detailed specification. The e-mail contained, among other things, the comment quoted in the margin.¹⁶²

It is not clear from Mr. Maxwell’s e-mail or other documentation what was meant exactly by the word “commitment” in the context of what followed, i.e. whether it referred to a specific statement by the Icelandic government or an interpretation by the UK authorities that the Icelandic State was obligated in this matter on the basis of Directive 94/19/EC.

Early the following day, at 1:39 GMT on 6 October, Ms. Árnadóttir sent an e-mail to Mr. Maxwell. The body of the e-mail had no content, but reference was made to an attached PDF file containing a letter from the Ministry of Business Affairs regarding the deposits in Landsbanki’s branch in the UK. That letter was signed on behalf of the Minister of Business Affairs by Ms. Jónína S. Lárusdóttir, Permanent Secretary, and is quoted in its entirety in the margin.¹⁶³

“Finally, as mentioned previously, we would be grateful for confirmation of how Iceland proposes to meet its commitment to finance its obligations under the Deposit Guarantee Scheme directive in the event of a failure of Landsbanki and its UK branch, and would then be happy to discuss further practical arrangements.”

Mr Clive Maxwell, in an e-mail to Ms Áslaug Árnadóttir dated 5 October 2008.

162. Mr Clive Maxwell, in an e-mail to Ms Áslaug Árnadóttir, dated 5 October 2008.

163. Letter from Ms Jónína S. Lárusdóttir, Permanent Secretary of the Ministry of Business Affairs, to Mr Clive Maxwell, dated 5 October 2008.

"Reference is made to the discussions you have had with the Ministry this weekend. If needed the Icelandic Government will support the Depositors' and Investors' Guarantee Fund in raising the necessary funds, so that the Fund would be able to meet the minimum compensation limits in the event of a failure of Landsbanki and its UK branch."

Letter from the Ministry of Business Affairs to Mr Clive Maxwell dated 5 October 2008.

"The letter in question – and it is good to have the chance to come forward with this – was the formal position of the government of Iceland, composed by four of its ministers and several officials, the Permanent Secretaries of two or three ministries and sent by a staff member of the Ministry of Business Affairs on behalf of the whole government. It was composed by four ministers, where the wording was changed *i.a.* – since you said that the letter stated that we would pay, which it does not do at all – for "guarantee" we put in "support", to "support the Fund", changing the letter to say that the government stated that it would support the Fund in its efforts to raise money but it would not guarantee the payments. There is a fundamental difference here and I am happy to have the chance to come forward with it."

From a speech by Mr Björgvin G. Sigurðsson before the parliament on 11 August 2009.

At the hearing before the SIC on 19 May 2009, Minister of Business Affairs, Björgvin G. Sigurðsson, stated that the quoted letter had been "composed at the government guest house". That location had, *i.a.*, on the weekend of 5-6 October 2008, been the meeting centre for persons in authority and the main actors in the course of events leading up to the collapse of the banks. Mr. Sigurðsson stated that the wording of the letter had been "chosen very carefully" and that Prime Minister Haarde, Finance Minister Mathiesen, Minister of Industry and acting Foreign Minister Skarphéðinsson and Mr. Sigurðsson himself had been involved in its composition along with the Permanent Secretaries and Mr. Jón Sigurðsson, Chairman of the Board of the FME. Mr. Sigurðsson noted that Mr. Baldur Guðlaugsson, Permanent Secretary of the Ministry of Finance, had been opposed to sending such a letter. Mr. Sigurðsson especially noted that Mr. Guðlaugsson had not wanted anything sent from the Icelandic government that "acknowledged international obligations relating to these activities".¹⁶⁴ Also among the documentation available to the SIC are e-mails from the evening of 5 October, timestamped from 22:28 to 23:45 GMT, where the Permanent Secretaries of the Prime Minister's Office, the Ministry of Finance and the Ministry of Business Affairs exchange drafts of the aforementioned letter. Judging from the drafts, two options were debated with regard to the wording of the letter as quoted in the margin. Apart from the version chosen, *cf.* the quotation, the other option used the wording that the Icelandic authorities would "guarantee that the Depositors' and Investors' Guarantee Fund will be able to raise the necessary funds" to meet the minimum guarantee but otherwise the wording was substantively the same.

During a debate in Althingi on 11 August 2009, Mr. Sigurðsson explained the origin and content of the aforementioned letter, *cf.* the quote in the margin. Considering the aforementioned, it can only be concluded from the wording of the statement in the latter paragraph of the quoted letter to the UK authorities from 5 October 2008 that the Icelandic authorities believed that it was not appropriate to declare decisively the position of the Icelandic State vis-à-vis the Guarantee Fund and its obligations at that point, just like it had not been deemed appropriate at earlier stages. This refers mainly to a substantively identical earlier statement in a letter to the UK authorities from 20 August of the same year, quoted above. The only difference is that the former statement used the word "assist" about the government's intentions with regard to the Guarantee Fund, but the latter used "support".

17.17.6 Communications with the UK Authorities around the Adoption of the Emergency Act with Relation to the Position of the Guarantee Fund and Deposits in the Banks' Branches in the UK

As previously noted, Ms. Árnadóttir sent an e-mail to Mr. Maxwell containing the quoted letter from the Ministry of Business Affairs dated 5 October, shortly after midnight on 6 October. The bill that later became Act No. 125/2008, the Emergency Act, was distributed during a parliamentary session at Althingi the following day and adopted that same evening. The Act

164. Statement by Mr Björgvin G. Sigurðsson before the SIC on 19 May 2009, p. 25.

entered into force upon electronic publication on the Government Gazette website on the night before 7 October 2008.

On 6 October 2008, shortly after noon, an e-mail was sent on behalf of Mr. Maxwell to Ms. Árnadóttir. The e-mail contained Mr. Maxwell's reply to the aforementioned letter from the Ministry for Business Affairs sent the previous day. The opening paragraph of Mr. Maxwell's reply is quoted in the margin.¹⁶⁵

If Mr. Maxwell's indirect reference to the Icelandic government's statement from the day before, cf. the quotation from his letter in the margin, is compared to the wording of the statement itself, it can be seen that Mr. Maxwell's reference fundamentally deviates from it. The difference is primarily that Mr. Maxwell quotes the statement as if it contained a formal obligation on behalf of the Icelandic government to ensure that the Guarantee Fund would be able to meet the minimum guarantee. The intention of the ministers in the Icelandic statement, like in the earlier statements, cf. above, had been to steer clear of any such wording and only state that the Icelandic authorities would "support" the Guarantee Fund in this regard. It should be pointed out that in the latter half of the quotation from Mr. Maxwell's reply, he describes the understanding of the UK authorities of the statement by the Icelandic government from 5 October 2008 that the Icelandic government would ensure that the necessary funds will be available to meet the obligations of the Guarantee Fund.

It may be said that with this letter from Mr. Maxwell, the UK authorities took the initiative in pressuring the Icelandic government to speak clearly about the Icelandic State's position vis-à-vis the Guarantee Fund.

Immediately following the e-mail to Ms. Árnadóttir containing the aforementioned reply from Mr. Maxwell, he sent a separate e-mail to Ms. Árnadóttir where he referred to his reply and asked for confirmation of receipt and that she bring it to the attention of her colleagues. Ms. Árnadóttir promptly confirmed the reception of the letter.¹⁶⁶ She forwarded the e-mail containing Mr. Maxwell's reply to Mr. Bolli Þór Bollason, Permanent Secretary of the Prime Minister's Office, and Mr. Baldur Guðlaugsson, Permanent Secretary of the Ministry of Finance, and added a remark stating that "someone will have to call Mr. Maxwell later today and answer this".¹⁶⁷

That same day, on 6 October 2008, the Icelandic Government issued the statement quoted in the margin.

Early the following day, on 7 October 2008 at 8:12 GMT, Ms. Árnadóttir received an e-mail from Mr. Maxwell stating that the UK Treasury wanted to discuss with her or her colleagues the content of Mr. Maxwell's aforementioned reply from the day before and asked what time would be convenient.¹⁶⁸ Ms. Árnadóttir also forwarded this e-mail to Mr. Bollason and Mr. Guðlaugsson, and sent a cc to Ms. Jónína S. Lárusdóttir. Ms. Árnadóttir's e-mail stated that she didn't think "[they] could avoid giving the UK Treasury some answers today, or at least tell them that [they would] reply to them

"Thank you for your letter dated 5 October, received very early this morning confirming your Government's formal commitment to ensure that the Icelandic Depositors' and Investors' Fund is able to meet the minimum compensation limits in the event of a failure of Landsbanki and its UK branch. We are taking this to mean the Icelandic Government would ensure funds were available to meet the minimum compensation limit of 20,887 Euros within the period currently prescribed by the regulations governing the Fund."

Mr Clive Maxwell, in a reply e-mail to Ms Áslaug Árnadóttir dated 6 October 2008.

"The government of Iceland reiterates that deposits in local commercial banks and savings banks and their local branches will be fully guaranteed.

Deposits refer to all deposits by general depositors and companies that the guarantee of the deposit department of the Guarantee Fund covers."

Declaration by the government of Iceland dated 6 October 2008.

165. Mr Clive Maxwell, in a letter to Ms Jónína S. Lárusdóttir, dated 6 October 2008.

166. Mr Clive Maxwell, in an e-mail to Ms Áslaug Árnadóttir, dated 6 October 2008, and the reply by Ms Árnadóttir of the same date.

167. Ms Áslaug Árnadóttir, in an e-mail to Mr Bolli Þ. Bollason and Mr Baldur Guðlaugsson, dated 6 August 2008.

168. Mr Clive Maxwell, in an e-mail to Ms Áslaug Árnadóttir, dated 7 August 2008.

shortly". She then asked the recipients of the letter directly: "How do you want to reply to this?"¹⁶⁹ Mr. Guðlaugsson replied to Ms. Árnadóttir right away and informed her that the Minister of Finance would "presumably speak to his British counterpart over the phone later today, at the request of the British". He then went on: "Perhaps that will suffice for now".¹⁷⁰ As described in greater detail in Chapter 18, Finance Minister Mathiesen and Mr. Alistair Darling, Chancellor of the Exchequer, conversed by phone on the morning of 7 October 2008. The aforementioned Chapter 18 and Chapter 20 describe the communications between the representatives of the Icelandic government and foreign authorities, including UK authorities, regarding deposits in foreign branches of the Icelandic banks and the obligations of the Depositors' and Investors' Guarantee Fund.

On 8 October 2008, the Prime Minister of Iceland issued another statement in addition to the one previously quoted from 6 October 2008. The Prime Minister's statement read (English version taken from a news release dated 10/8/08 on the Prime Minister's Office's website):

"The Icelandic Government appreciates that the British authorities are willing to step in and respond to the immediate concerns of depositors of Landsbankinn Icesave accounts.

The governments of the two countries will immediately review the matter in detail through official channels with a view to finding a mutually satisfactory solution.

It should also be highlighted that on Monday evening changes were made to the Act on the Depositors' and Investors' Guarantee Fund strengthening the position of depositors by giving them priority when allocating assets. There is a good probability that the total assets of Landsbankinn will be sufficient to cover the deposits in IceSave.

The Icelandic government reiterates that if necessary the Treasury will support The Depositors' and Investors' Guarantee Fund in raising the necessary funds.

The government of Iceland is determined not to let the current financial crisis overshadow the long standing friendship between Iceland and the United Kingdom."

17.17.7 Statements on Negotiations with the Dutch and UK Authorities

On 9 October 2008, Ms. Árnadóttir, Chairman of the Board of Directors of the Guarantee Fund, wrote a letter to the Prime Minister with a cc to the Minister of Business Affairs and Minister of Finance. The letter was written to follow up on a letter from 1 October of the same year to the same recipients which had not been replied to, cf. the reference at the beginning of this Chapter. Both letters are quoted in their entirety in Chapter 17.16 above and the reader is directed to that chapter the content of the letters. These letters were not formally answered by the Prime Minister.

169. Ms Áslaug Árnadóttir, in an e-mail to Mr Bolli Þ. Bollason and Mr Baldur Guðlaugsson, dated 7 August 2008.

170. Mr Baldur Guðlaugsson, in an e-mail to Ms Áslaug Árnadóttir and Mr Bolli Þ. Bollason, dated 7 August 2008.

This is not the place to retrace when and how the three major Icelandic banks collapsed in the first half of October 2008, and the Depositors' and Investors' Guarantee Fund was faced with claims against the Fund which mostly consisted of claims resulting from the Landsbanki Icesave accounts in the UK and the Netherlands.

As described above, it had not been concluded how the Guarantee Fund was going to, or would be able to, meet the obligations that the Fund would be faced with if it were required to pay the legally stipulated minimum amount in the case of those depositors of the Icelandic banks whose deposits would become unavailable. The Board of Directors of the Depositors' and Investors' Guarantee Fund agreed in its meeting on 11 October 2008 that the Guarantee Fund would take out a loan on the basis of Article 10(2) of Act No. 98/1999 to meet the Fund's obligations owing to payment of the minimum guarantee. The Chairman of the Board of Directors was given full authorisation to commit the Guarantee Fund to take out such a loan.

On 11 October 2008, it was reported on the Prime Minister's Office's website that the Netherlands and Iceland had come to an understanding on Icesave following deliberations between the governments of the two countries, and the content of the understanding was described as quoted in the margin. The same day another news release was posted on the Prime Minister's Office's website which was said to be a joint declaration by Iceland and the United Kingdom stating that delegations of the two countries had met in a friendly atmosphere in Reykjavík where significant progress had been made on the main points of an arrangement aimed at an accelerated payout to Icesave depositors. The delegations of the two countries had agreed to work closely on the other remaining issues over the coming days.

"The agreement provides that the Icelandic State will compensate each and every Dutch depositor their deposits up to a maximum amount of EUR 20,887. The Dutch government will grant Iceland a loan to cover these disbursements and the Dutch central bank will be in charge of disbursing the depositors' claims."

From a Ministry of Finance news bulletin, 11 October 2008.

Business Minister Sigurðsson was interviewed by Fréttablaðið on 16 October 2008 (p. 2) about the aforementioned discussions with the Dutch and the British and quoted as saying: "In negotiations like these we have to come to a pretty quick realisation as to what obligations there are under international law, and put this in context of the political reality we are faced with." On the continuation of these discussions, and documentation exchanged by the respective governments, reference is made to the data published on the information website of the Icelandic government: island.is; in addition, certain communications between the ministries of Finance in Iceland and the UK regarding explanations for British actions against Icelandic interests in the UK are discussed in Chapter 20.

17.18 Findings of the Special Investigation Commission

Iceland was obliged, in accordance with the EEA Agreement, to establish a deposit-guarantee scheme which would fulfil the minimum rules of Directive 94/19/EC. The directive was originally transposed into national legislation through Act No. 39/1996, and the rules subsequently incorporated into Act No. 98/1999 on Deposit Guarantees and Investor-Compensation Scheme. This Act was still in effect when the banks collapsed in October of 2008. When the provisions of this Act are compared with the minimum rules of the EU directive on deposit-guarantee schemes, as is done in Chapter 17.4 above, the SIC cannot but see that the aforementioned minimum

requirements, in so far as they can be interpreted according to the directive, are present in the Icelandic Act. It is also clear that the Icelandic Act was, as far as these issues are concerned, in general, parallel to other acts on deposit-guarantee schemes as they were until October of 2008, e.g. acts adopted by the other Nordic countries in order to implement the same EU directive. Another consequence was that the weaknesses that were present in the rules of the directive and, therefore, also in the structure of the deposit-guarantee schemes within the EEA Area, e.g. with regard to financing in order to guarantee minimum payments to depositors, also applied to the Icelandic rules. These weaknesses were largely known within the EU and had already been discussed there. These issues became more apparent when the repayment obligations of the Icelandic Guarantee Fund were put to the test due to the collapse of the Icelandic banks in the autumn of 2008.

In the preamble to Directive 94/19/EC it is stated that it is not considered necessary for the directive to harmonise ways of financing schemes intended to guarantee deposits, i.a., since credit institutions were, as a rule, supposed to bear the cost of financing such schemes themselves, and also due to the fact that the financial capacity of the schemes should be in accordance with its guarantee obligations. It was furthermore stated that this did not mean that the stability of the Member State's banking network could be put at risk. In Iceland it was opted to decree by law that the Guarantee Fund should be financed with annual payments from banks and savings banks, and that the total holdings of the Fund's Deposits Department should amount to at least 1% of the average amount of guaranteed deposits in banks and savings banks for the previous year, cf. Act No. 98/1999, Article 6(1). The minimum size of the Fund with regard to the ratio of deposits was similar to that which was usual in those states in the EEA, e.g. the other Nordic countries, where financial undertakings made ex ante payments to the deposit guarantee funds. This arrangement for calculating annual payments according to Icelandic law, as discussed further below, had the effect that the part that was paid into the Fund in cash did not keep up with the great increase of deposits that took place from the final months of 2006 onwards. However, there were instances of analogous accounting rules in laws governing deposit guarantee funds in the neighbouring countries. It is furthermore clear that in the rules that were established as a rule in states within the EEA, including states with a legal tradition largely analogous to that in Iceland, the EU deposit-guarantee directive was not introduced in such manner as to accommodate an arrangement whereby the assets available at each time to the deposit guarantee funds would be sufficient to meet all commitments they might be obliged to honour due to lost deposits, except in cases involving one or a few financial undertakings, and small undertakings at that. Such an arrangement would in fact be directly contrary to the benefit intended by the operation of banks with regard to mediation of funds between depositors and investors. The Special Investigation Commission also would like to state that with regard to the views that deposit-guarantee schemes have generally been based on, it cannot be seen that it was assumed that they would be fully financed in advance in order to meet all their obligations.

According to the provisions of Article 7 of Directive 94/19/EC, the deposit-guarantee schemes shall ensure that the total deposits of each depositor are guaranteed to the extent of up to EUR 20,000 if deposits

become unavailable. In line with the aforesaid, the Act on the Icelandic Guarantee Fund provides that the Fund shall in such cases pay a minimum of the equivalent of the amount of EUR 20,887 in ISK if the assets of the Fund are insufficient to pay more. The Depositors' and Investors' Guarantee Fund, therefore, had a clear obligation to pay. Neither the directive nor its preparatory documents contain any information regarding the manner in which to proceed if the assets of a guarantee fund are insufficient for minimum compensation. On the other hand, it is stated in Act No. 98/1999 that if the assets of the Guarantee Fund are insufficient, and if the Fund's Board of Directors is of the opinion that such action is necessary, the Board may take out a loan. There are no further provisions regarding this authorisation to borrow funds in the Act.

In Chapter 17.7 it is described, that when Landsbanki began to raise deposits by creating special on-line deposit accounts for natural persons in its London branch in the autumn of 2006, i.e. the Icesave accounts, a radical transformation of the obligations of the Icelandic Deposit Guarantee Fund did in fact take place. This applied to both the total amount of guaranteed deposits and where the deposits were raised. Even though the Icelandic banks had previously begun to raise wholesale deposits in their foreign branches, i.e. in the year 2005, and were able to collect substantial funds into these accounts in a short amount of time, there was a fundamental difference regarding the effects of these accounts on the obligations of the Depositors' and Investors' Guarantee Fund. The case of the wholesale deposits involved relatively few parties that deposited larger amounts. The increase of the wholesale deposits had the effect of formally increasing the Fund's obligations, under the existing rules governing the Fund, but at the same time it is clear that the effects of this increase could not be substantial unless the capacity of the Fund allowed payments in excess of the minimum amount. The Fund's obligation to pay the minimum amount was on the other hand established with reference to each depositor. Behind the on-line accounts of individuals were many more depositors than in the case of wholesale deposits. In addition to this, the sums on the on-line accounts were substantial, and these accounts were created in the banks' units abroad and in foreign currency, which could then be of significance with regard to the currency in which the Fund would have to make payments if the Fund's obligation to pay would be put to the test.

An indication of the total transformation that took place with regard to the deposit ratio in the Icelandic banks in a short amount of time is the fact that in the beginning of the year 2005 total deposits covered by the Depositors' and Investors' Guarantee Fund amounted to ISK 530 billion. This amount had reached ISK 689.5 billion by the end of that year. Of this amount, 8% were located in foreign branches of the banks. By the end of 2006, the amount of guaranteed deposits had reached just over ISK 1,000 billion. The big leap then occurred in 2007. At the end of that year, deposits guaranteed by the Fund totalled ISK 2,300 billion. Deposits in the Icesave accounts in the UK also reached their highest point in late 2007/early 2008 when they amounted to GBP 4.9 billion in total, or ISK 623.5 billion at the exchange rate at that time. In October of 2007, Kaupthing also began to offer Edge-accounts, either in their foreign branches or foreign subsidiaries. In the course of the year 2007 the change also occurred that more than 50% of deposits in the Icelandic banks were of foreign origin.

As aforesaid, the provisions of the Act on the Depositors' and Investors' Guarantee Fund were clear with regard to the Fund's minimum payment obligation towards each depositor. It was, therefore, the task of those responsible for managing the Fund and monitoring its operations to keep track of the Fund's ability to meet these obligations should the need arise. It was also the task of those responsible for monitoring financial stability in Iceland to keep track of the capacity and the significance of the Guarantee Fund in this regard. That task was also closely interlinked with the contingency planning by the government on account of possible shocks to in the Icelandic financial system. The Special Investigation Commission would like to reiterate that due to the laws in effect at the time, the altered financing of the banks by amassing deposits outside of Iceland could lead to a situation where the Icelandic Guarantee Fund would have to meet a considerable part of its obligations in foreign currency.

Deposit-guarantee schemes have been established in individual states or areas mostly for the purpose of strengthening the stability of financial systems and thereby decreasing the risk of sudden and extensive withdrawal of deposits by depositors. The Icelandic State had, by entering into the EEA Agreement, undertaken to establish a deposit-guarantee scheme that would comply with certain minimum requirements. The Icelandic Parliament had done this by passing legislation on a special private foundation, and stipulating payments from financial undertakings into the Guarantee Fund. Although a private foundation, with an independent Board of Directors mostly composed of representatives of financial undertakings, the Depositors' and Investors' Guarantee Fund was, therefore, assigned duties which the Icelandic State had undertaken to incorporate into Icelandic legislation. This state of affairs was bound to have significance with regard to the Icelandic Government's supervision of the status of the Fund at each time and of the Fund's ability to meet its obligations and take appropriate measures with regard to these obligations. This basis for the Fund's operations was also relevant when it came to the government's assessment of the Fund's capacity to fulfil the purpose of such funds in general, i.e. to increase the confidence of depositors in credit institutions.

According to the provisions of Act No. 98/1999 on Deposit Guarantees and Investor-Compensation Scheme, commercial banks, savings banks, companies trading in securities and other specified financial undertakings are members of the Fund and entitled to representation at the Fund's general meeting. The Board may also summon the member firms to other meetings should it deem this necessary, cf. Act No. 98/1999, Article 5(3). The Board is also obligated to convene a meeting if this is requested by member firms holding a total of a quarter of the votes. As regards the Fund's Deposits Department, the banks and savings banks that receive deposits are the institutions that shall make payments to the Fund, and the assets of the department shall, as aforesaid, amount to a minimum of 1% of the average amount of guaranteed deposits. It should therefore have been clear, under the laws then in effect, that in the event that payments would have to be made from the Fund due to individual credit institutions in difficulties, not to mention if the total assets of the Department would be required for such payments, it would be the task of the credit institutions still in operation to refinance the Deposits Department of the Depositors' and Investors' Guarantee Fund up to the aforesaid 1% minimum with increased payments.

In light of this and with reference to the aforesaid regarding the general purpose of deposit-guarantee schemes to uphold confidence in credit institutions, it has drawn the attention of the Special Investigation Commission to how little the representatives of credit institutions were in fact involved with the operations of the Fund. Representatives of the companies served as members of the Fund's Board of Directors. However, the SIC's examination of the minutes of the Board for the year 2007 and up until 1 October 2008 does not indicate that the Board as a whole, including the representatives of credit institutions, actively discussed ways in which the Fund would be able to meet the obligations that resulted from the banks' increased raising of deposits abroad, and consequently whether the Fund's position was credible vis-à-vis depositors in the event that difficulties would arise in the operations of credit institutions. There was also no discussion of what measures should be taken with regard to the affairs of the Fund when liquidity problems became apparent in the operations of the member firms and concerns were aired abroad regarding the Fund's capacity. The same situation was at hand in late 2008, and discussions took place about the necessity for anticipatory measures due to a possible financial crisis, in the forum provided by the special consultative group of the Icelandic authorities. One example mentioned during these discussions was that if one of the smaller Icelandic financial undertakings, savings bank Sparisjóður Mýrasýslu, went bankrupt, the Guarantee Fund would be drained of all its assets.

Landsbanki and the Icelandic Financial Services Association asked the Ministry of Business Affairs in late 2006/early 2007 whether it would be possible to change the rules governing the Depositors' and Investors' Guarantee Fund. The intended changes pertained to the increased application of exemptions authorised by the EU directive, regarding categories of guaranteed deposits, and consequently which deposits would be included in calculations of payments to the Fund. The reason for this was the raising of wholesale deposits by the three major banks in their foreign branches. Therefore, this arrangement would primarily have reduced payments from the banks to the Fund. This matter subsequently became the incentive for the new Minister of Business Affairs at the time, Mr. Björgvin G. Sigurðsson, to appoint a committee whose task was to review the provisions of the Act on Deposit Guarantees and Investor-Compensation Scheme. His predecessor in the office of Minister of Business Affairs, Mr. Jón Sigurðsson, had requested that members would be appointed to such a committee.

The Minister of Business Affairs, in accordance with Article 4 of Act No. 98/1999, appointed the Chairman of the Board of Directors of the Depositors' and Investors' Guarantee Fund. Even though it did not derive directly from the aforesaid Act, the minister adhered to the custom of appointing an employee of the Ministry of Business Affairs as chairman, as had been done since the Fund was established. One can only conclude that this led in practice to significant and close collegial relations being established between the Ministry and the Depositors' and Investors' Guarantee Fund, and in fact decreased the independence and efficiency of the Board of Directors of the Guarantee Fund. Leadership in matters concerning the Fund had, therefore, rested with the Ministry of Business Affairs to a greater extent than with the Board of the Fund as such, including representatives of the credit

institutions. This applies particularly to the time after the acting Permanent Secretary of the Ministry of Business Affairs, Ms. Áslaug Árnadóttir, took over as Chairman of the Board of Directors in late February of 2008, and also represented the Ministry in the consultative group of the Prime Minister's Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning until August of 2008. The affairs of the Guarantee Fund were discussed on several occasions during meetings of the consultative group at this time in the context of the perceived and imminent danger to the banks, and during these meetings the acting Permanent Secretary submitted various documents that had been prepared by the Ministry of Business Affairs on the development of deposits and the effect they had on the position of the Depositors' and Investors' Guarantee Fund. Despite the aforesaid, only two meetings were held by the Board of the Fund between 29 February 2008, when the general meeting took place, and 1 October of the same year. The minutes of these board meetings contain no reference to any discussions about the analogous predicament that the Guarantee Fund was facing and that was discussed during meetings of the consultative group. However, in the latter meeting, held on 30 June, it was stated that the revising of the Act on the Fund was still in process, but that the Ministry of Business Affairs did not believe that it was sensible to amend the Act at this point due to the uncertainty that existed in the financial markets.

After the acting Permanent Secretary of the Ministry of Business Affairs, Ms. Jónína S. Lárusdóttir, returned to work on 1 August 2008, the affairs of the Depositors' and Investors' Guarantee Fund continued to be extensively discussed within the ministry. These discussions took place, i.a., in the consultative group of the authorities, as well as during communications with foreign governments, in the form of responses from the ministry to inquiries from foreign governments on the subject of the Fund's standing and later in connection with possible government intervention with regard to the Fund's obligations. Ms. Áslaug Árnadóttir had at that time resumed her office as deputy under-secretary in the ministry. The documentation obtained by the Special Investigation Commission indicates that from that time and until after the collapse of the banks, Ms. Árnadóttir at various times provided answers, attended meetings, and was involved with the affairs of the Depositors' and Investors' Guarantee Fund, either in the capacity of Chairman of the Board of Directors of the Guarantee Fund or as an employee of the ministry. The situation was, therefore, that the Chairman of the Board of Directors of the Guarantee Fund was simultaneously involved in demanding that the Icelandic government clarify its position regarding its intentions on account of the Fund's obligations, and responding to inquiries from foreign parties about the Fund's affairs and obligations, either in the name of the Ministry or on behalf of the Guarantee Fund.

The Special Investigation Commission is of the opinion that this arrangement, involving a connection between the Ministry of Business Affairs and the Depositors' and Investors' Guarantee Fund, was unfortunate. This is especially true when considering the independence that the Fund was intended to have according to the provisions of law, and the involvement of financial undertakings, i.e. those that made contributions to the Fund, on the Fund's Board of Directors, as both factors should have made it more

likely that the Board would take action if it seemed likely that the Fund would not be able to honour its obligations. The aforesaid arrangement also had the effect, with respect to those parties that submitted inquiries, e.g. foreign governments, that the connection between the private foundation and the ministry could have appeared to be closer than actually provided for by Icelandic law. It should also be kept in mind that there are instances, for instance in states that submitted most of the inquiries, where guarantee funds operate within the central bank of the state in question or are in some other manner closely linked to the government.

The Special Investigation Commission thinks it necessary to reaffirm the aforesaid issue and emphasise the importance of maintaining at all times clear boundaries between authorities, so there is no doubt regarding the supervisory function of a ministry or the position and responsibility of a minister, e.g. with regard to measures taken under altered circumstances and in the event of impending danger in the area for which the minister is responsible and should therefore report to the Parliament.

In Act No. 98/1999, Article 4(5) it is stipulated that every two years, or more frequently if so required, the Board of Directors of the Depositors' and Investors' Guarantee Fund shall report to the Minister on its views regarding the Fund's minimum assets in accordance with the provisions of the Act, both as regards the Deposits Department (Article 6) and the Securities Department (Article 7). In the course of its examination, the SIC has discovered no documentation that indicates that the Fund's Board of Directors formally provided the Minister of Business Affairs with information about the Board's position on these issues during 2007 and until 1 October 2008. The legal provision directly stipulates that the Board is independently responsible in this regard, and that the Board shall be vigilant as its responsibilities include the assessment of whether the minister should be informed more often of the Board's position with regard to the Fund's minimum assets than at the minimum intervals as stipulated by law.

From the examination of the Special Investigation Commission it is clear that no later than late 2006/early 2007 the Ministry of Business Affairs had become aware of information regarding the change that had taken place regarding the raising of deposits by the Icelandic banks through their foreign branches. Moreover, news was published in the media about the success of Landsbanki in accumulating deposits into the Icesave accounts in the UK. During the first months of 2007, Ms. Áslaug Árnadóttir, who was deputy under-secretary at the time, was in charge of examining within the Ministry of Business Affairs whether there was cause for increasing exemptions from what constituted guaranteed deposits in the Icelandic Guarantee Fund, based on the report submitted by the Icelandic Financial Services Association on this issue. At the end of May 2007 the Minister of Business Affairs, Mr. Björgvin G. Sigurðsson, appointed a committee, chaired by Ms. Árnadóttir, that was given the task of reviewing the Act on the Guarantee Fund. In autumn 2007 it was decided, following difficulties experienced by the UK bank Northern Rock, that the Ministry of Business Affairs should gather information about deposits in the Icelandic banks and the manner in which they were divided between the banks' foreign and domestic branches. This information was available in December of 2007, for a period up until the end of September

2007. Discussions repeatedly took place in 2008 regarding deposits and the state of affairs of the Depositors' and Investors' Guarantee Fund during meetings of the consultative group and information was submitted that pertained to this matter, and Ms. Árnadóttir was involved in the work of the group in the capacity of representative of the Ministry of Business Affairs until 1 August 2008.

Ms. Áslaug Árnadóttir was appointed Chairman of the Board of Directors of the Depositors' and Investors' Guarantee Fund from the end of February of 2008. Due to her work in the Ministry of Business Affairs, Ms. Árnadóttir was in possession of various information regarding the banks' increased accumulation of deposits, the location of deposit accounts and simultaneously the effect that these changes would have on the obligations of the Depositors' and Investors' Guarantee Fund with regard to the Fund's legal assets and income. The treatment of information received by the chairman in the course of her work in the ministry, in the forum of the consultative group and elsewhere, was subject to general rules governing confidentiality of civil servants. However, the Special Investigation Commission is of the opinion that these rules cannot be interpreted in such a way as to have precluded any initiative on the part of Ms. Árnadóttir as Chairman of the Board of Directors of the Depositors' and Investors' Guarantee Fund to prompt the Board to comply in an independent manner with its obligation to provide information to the Minister as required by Act No. 98/1999, Article 4(5). The Special Investigation Commission is of the opinion that it must be assumed that such a course of action would have been possible for Ms. Árnadóttir without her having to directly reveal any knowledge in her possession that was to remain confidential. Such knowledge as already existed regarding these matters within the Ministry of Business Affairs also did not constitute grounds for relieving the Board of the Guarantee Fund of its formal duty of providing the Minister with information as required by law. By law, this disclosure of information was to be based on an independent assessment conducted by the Board with regard to the Fund's assets and obligations, and the authorisations that the Fund had to obtain information from credit institutions.

The Special Investigation Commission also points out that among the representatives of the banks on the Board of Directors of the Depositors' and Investors' Guarantee Fund was one of the CEOs of Landsbanki. The representatives of the banks on the Board of the Fund should, therefore, have been in possession of knowledge about changes in the deposit-taking activity of the banks, and consequently the effects of those changes to the position of the Depositors' and Investors' Guarantee Fund. These representatives had the obligation, as did other members of the Board, to execute the tasks that by law were assigned to the Guarantee Fund and its Board of Directors. It must be deemed an act of carelessness on the part of the representatives of the member firms that served on the Board of Directors of the Guarantee Fund that they did not themselves initiate discussion, whether within the Board or the member firms, about the Fund's ability to fulfil its task and in what ways it might be possible to respond to altered circumstances. Even though deposit-guarantee schemes are established by the government in order to guarantee the interests of depositors and to preserve stability in the operations of credit institutions, it should be clear that the credibility of the system and the confidence of the public in its ability may have an important effect on

whether a crisis occurs in the operations of credit institutions. The Icelandic Parliament has not only established the Fund by the Act on the Depositors' and Investors' Guarantee Fund, but also paved the way for banks and savings banks to establish private foundations, security funds, on their own accord in order to guarantee the interests of their customers and the financial security of the bank or savings bank, cf. Act No. 98/1999, Article 19. The Special Investigation Commission has not seen anything that indicates that the banks discussed such measures in connection with the total transformation that took place with regard to the deposit ratio in the banks after deposit-taking activities had begun abroad.

According to the Regulation on the Icelandic Government Offices, irrespective of whether reference is made to Regulation No. 3/2004, formerly in effect, or Regulation No. 177/2007, currently in effect, the Ministry of Business Affairs was at the time discussed here involved with cases that pertained to the financial market. Among the acts that came within the area of responsibility of the Ministry of Business Affairs was Act No. 98/1999 on Deposit Guarantees and Investor-Compensation Scheme. The Icelandic banks' accumulation of wholesale deposits in their foreign branches began in the year 2005, as stated above. Although the deposits soon became quite significant, the effect that they were likely to have on the obligations of the Depositors' and Investors' Guarantee Fund was not such as to warrant special measures in and of itself in order to safeguard the interests of the Guarantee Fund, at least not to begin with. However, the situation was quite different when on-line deposit accounts for natural persons were created in these branches, a process that started with the creation of Icesave accounts in the UK in October of 2006. At this time, Mr. Jón Sigurðsson was Minister of Business Affairs, an office he held until 24 May 2007. Chapter 17.8 above contains a description of the information which he received in December 2006 from one of the Directors of Landsbanki regarding the accumulation of deposits in the bank's London branch. After this conversation between Mr. Sigurðsson and the Director of Landsbanki, and after the report from the Icelandic Financial Services Association had been issued in early January 2007, efforts were made within the Ministry of Business Affairs to examine the grounds for increasing exemptions regarding deposit categories that needed protection. Mr. Sigurðsson described to the Special Investigation Commission that in light of the fact that Parliamentary elections were to take place in the spring of 2007 (cf. Chapter 17.8), he did not deem it appropriate to pursue the matter further, apart from requesting that members be appointed to a committee that would work on revising rules that applied to this matter. On the other hand, "other news regarding Icesave [i.e. apart from what had been said in his conversation with the Director of Landsbanki] [was] not the subject of discussions within the Ministry" between December of 2006 and until Mr. Sigurðsson left the office of Minister of Business Affairs. The deposits in the Icesave accounts were seeing a rapid increase by December 2006 and during the first months of 2007, and this great increase in deposits was added to the wholesale deposits accumulated by the banks in their foreign branches. Considering the operational and surveillance duties of the Minister of Business Affairs, and taking into account how rapidly this matter developed, it is the opinion of the Special Investigation Commission that it would have been a sign of better administration on the part of the Ministry of Business

Affairs, which was responsible for various aspects of the financial market, if it had conducted better surveillance at the time of the total transformation that was taking place with regard to the deposits of the Icelandic banks, and consequently with regard to the obligations of the Icelandic Guarantee Fund. It is, in fact, clear that within the ministry at the time in question, the rules governing deposit guarantees were being examined, but this examination only pertained to a limited part of those rules.

When a new government was formed on 24 May 2007, Mr. Björgvin G. Sigurðsson became Minister of Business Affairs. He followed up on the work that had been done in the Ministry of Business Affairs, and appointed a committee chaired by Ms. Áslaug Árnadóttir, deputy under-secretary, on 30 May 2007. The committee was, i.a., assigned the task of exploring whether the protection for savers was too widely defined under the present legislation, and whether the scope and amounts of payments to and from the Guarantee Fund were comparable to payments in countries where Icelandic financial undertakings conducted operations. According to this description given by the Ministry, the committee's task was more extensive than the examination that had been initiated at the beginning of the year. The committee worked at its task during the summer, gathering, among other things, as described in Chapter 17.9, information regarding the arrangement of deposit guarantees in the neighbouring countries. The goal was that the committee would submit recommendations in September of 2007. Above it was described that difficulties in the operations of the UK bank Northern Rock prompted the Ministry of Business Affairs to gather information for the committee regarding deposits in the Icelandic banks and their division between the banks' foreign and domestic branches. This information had been processed in December of 2007, but during this time the committee postponed the submission of recommendations.

A part of the operations of the Central Bank of Iceland is the acquisition of information regarding deposits in Icelandic banks. From September 2003 onwards, the Central Bank gathered information regarding the position of deposits owned by foreign parties. Already in the year 2006, the total deposits of the Icelandic banks saw an increase in the percentage of deposits in the foreign branches. This percentage increased even further in the year 2007. It has caught the attention of the Special Investigation Commission that in spite of this development, it was not until March of 2008 that the Central Bank began to distinguish between deposits owned by foreign parties in the foreign branches of the Icelandic banks, on the one hand, and in their domestic places of business, on the other. This distinction was incorporated into the information acquisition of the Central Bank after the Bank had amended the rules on reverse requirements in March of 2008. This explains why the Ministry of Business Affairs turned directly to banks and savings banks when it began to gather information about the division of deposits for the revision committee at the end of the year 2007. This information was used in order to establish the number of accounts and the division of amounts in the work of the Ministry of Business Affairs and the consultative group until the summer of 2008, cf. further in Chapter 17.10.2.

The Special Investigation Commission is of the opinion that it is clear that the authorities that were categorically intended to monitor the development of these matters, and that were responsible for the gathering of numerical

information regarding the financial system, which include the Depositors' and Investors' Guarantee Fund, a private foundation, did not respond in a sufficiently timely manner and adapt their information acquisition process to the alterations that took place in the accumulation of deposits in the Icelandic banks from the year 2006 onwards. If these matters had been addressed in a more appropriate way, the Ministry of Business Affairs would not have had to obtain all this information on its own from the banks and savings banks, and other authorities would also have been able to make use of such information in their consideration of, among other things, vital contingency measures. The Depositors' and Investors' Guarantee Fund had only gathered information about the total deposits of each deposit institution at the end of the year. The Fund, therefore, had not performed any analysis of the division of deposits with regard to what was at each time the estimated payment obligation of the Fund when it was taken into account that it would have to pay the minimum amount as required under the Act governing the Fund. This could only be estimated after the findings from the aforesaid information acquisition of the Ministry of Business Affairs had been made available.

The Ministry of Business Affairs gathered the aforesaid information about the situation with regard to deposits and their division by domestic or foreign branches at the end of 2007, as aforesaid. Mr. Björgvin G. Sigurðsson gave the answer, when asked during a hearing before the Special Investigation Commission, that he did not recall having been in possession of any other numerical data regarding deposits increases in the Icelandic banks, apart from the information made available in reports and data from the Financial Supervisory Authority and the Central Bank. However, he did state that he was aware of this accumulation of deposits by the Icelandic banks abroad. Furthermore, he stated that it was not until some time into the year 2008 that he was given precise information about these matters. Considering the manner in which the Minister of Business Affairs and his Ministry attended to their operational duties and the task of conducting surveillance of the operations and situation of the Depositors' and Investors' Guarantee Fund after Mr. Sigurðsson took office as Minister of Business Affairs, it is the opinion of the committee that due account must be taken of what has been submitted to the effect that between the spring of 2007 and early 2008, the Ministry worked towards examining whether it would be appropriate to amend the laws governing deposit guarantees. In view of the nature of the situation, this work was bound to constitute a part of the preparations for the minister's decision regarding whether he thought there was cause for exercising his authority to take initiative and introduce a bill in Parliament for the amendment of laws that came under his ministry's area of responsibility. This kind of action was part of the execution of the surveillance duties of the Minister and his Ministry. Although the substantial alteration that took place with regard to patterns in the deposit-raising activities of the Icelandic banks in the year 2007, with the resulting effect on the obligations of the Depositors' and Investors' Guarantee Fund, did, in the opinion of the Special Investigation Commission, warrant a more timely response on behalf of the authorities than was the case, it should be pointed out that there was not sufficient information available regarding the analysis of deposits conducted by regulatory authorities. The Ministry led the effort in acquiring such information. While such information was not available, it was naturally not

possible to satisfactorily conclude what measures would be appropriate on the Minister's part.

The chairman of the revision committee, Ms. Áslaug Árnadóttir, authored a memorandum on 6 December 2007, wherein it was revealed that following discussions within the committee it had been concluded that it was not necessary to amend the rules governing payments from credit institutions to the Deposits Department. In January of 2008, the chairman drafted a bill for the amendment of the Act on Deposit Guarantees No. 98/1999. This draft was presented to the Minister of Business Affairs, Mr. Björgvin G. Sigurðsson, and in the reply from the Ministry of Business Affairs, received by the Special Investigation Commission on 4 March 2009, it was stated that it was not advisable to submit a bill concerning this matter given the present state of affairs. In both the reply from the Ministry and the report given by Mr. Sigurðsson to the Special Investigation Commission it was stated that the submission had been postponed "due to the unrest or difficulties that had arisen in financial markets." As described in Chapter 17.9, the statements of parties concerned are not in agreement regarding whether the matter was addressed at the time by the government, including the involvement of the Prime Minister in the matter, and by the consultative group of the Icelandic authorities. A letter dated 24 February 2010, sent by Mr. Björgvin G. Sigurðsson to the Special Investigation Commission, wherein he describes that he had discussed the introduction of a bill for the amendment of the Act governing deposit guarantees with government leaders at the time, and that their assessment was that the situation was too delicate to risk amending the Act, is among the documents cited in this regard. As stated in Chapter 17.9, there is no indication in the minutes of the government that discussions about such a bill took place. In Chapter 17.10.2 there is a description of a meeting held by the consultative group on 15 January 2008. In the draft minutes of that meeting it is noted that Ms. Áslaug Árnadóttir described the efforts on the part of the Ministry of Business Affairs with the aim of revising the Act on the Depositors' and Investors' Guarantee Fund.

From the documentation available and the statements given before the Special Investigation Commission, the Commission does not find that it is possible to determine the actual course of events, including the involvement of other ministers, which led to the decision in January of 2008 that the Minister of Business Affairs would not introduce a bill for the amendment of the Act on deposit guarantees.

The Special Investigation Commission is of the opinion that there is reason to point out that, irrespective of the liquidity problems that the Icelandic banks were beginning to experience in their operations at this time, that not only had the major banks, Landsbanki in particular, begun raising deposits in their foreign branches, but the lending activities of those banks had also been drastically altered. Investment banking services had been increased at the expense of traditional commercial banking services, and consequently the risks involved with the operations of the banks had increased. As described in Chapter 17.7, the rules then governing payments from credit institutions into the Guarantee Fund had the effect that the rapid increase in deposits that occurred already at the end of the year 2006, and became even more rapid in 2007, meant that a corresponding increase in funds paid to the Fund did not occur immediately. In addition, the proportion

of letters of guarantee delivered to the Fund by credit institutions increased, which meant that the institutions could settle accounts up to a certain extent instead of making direct payments of assets into the Fund. The committee working on the review of the Act on deposit guarantees had in December of 2007 reached the conclusion that there was no cause for revising the rules governing the payments from banks and savings banks into the Fund's Deposits Department.

In light of the changes that had occurred in the operations of the Icelandic banks after Act No. 98/1999 was adopted, the Special Investigation Commission has seen cause to ponder especially this position taken by the revision committee and the subsequent decision of the minister not to introduce the bill. These changes gave, in the opinion of the Commission, ample cause for considering ways in which to strengthen the Depositors' and Investors' Guarantee Fund, for instance by making changes to the arrangement of payments from credit institutions to the Fund. It should also be pointed out that in recent years, the method of deciding the amount of payments from individual credit institutions on the basis of the assessed risk involved with their operations has been employed in the US and several European states. In the summary given by the Ministry of Business Affairs in the beginning of 2008, wherein the suggestions of the committee working on the revision of the Act on the Depositors' and Investors' Guarantee Fund, such a risk-based payment arrangement is among the matters discussed. In the opinion of the SIC, there was cause for such a change to the rules governing payments to the Depositors' and Investors' Guarantee Fund.

The Special Investigation Commission would like to state that when assessing the Minister of Business Affairs' performance of his operational and surveillance duties with regard to the aforesaid matters, after the fact, the situation as it was at the beginning of 2008 must be kept in mind. At that time, the banks were beginning to experience liquidity problems. In spite of that fact, it was nonetheless the task of the Minister of Business Affairs, by virtue of his office and function according to law, to make an independent decision regarding whether the changes that had occurred in the arrangement and volume of deposits in the Icelandic banks warranted amendment of the rules governing the operations of the Depositors' and Investors' Guarantee Fund, in order to ensure further the position of the Fund and consequently that of depositors. At the same time, the government and Parliament had an opportunity to exercise their influence in this regard on the interaction between the guarantee factor and the banks' accumulation of deposits. It should be remembered that at the time in question, it was being discussed in the UK, for example, whether the rules governing deposit guarantees in that country should be amended. The Special Investigation Commission would like to reiterate that when discussing the cause for and necessity of revising the Act on the Depositors' and Investors' Guarantee Fund, the Commission cannot see that there were grounds for assuming that this review process would focus on ensuring that payments from financial undertakings into the Fund, and consequently the Fund's assets, would be sufficient to meet the calculated obligations of the Fund in full, especially under the circumstances that arose from the major financial crisis that hit the country's financial system in the autumn of 2008. It was natural that the revision of the Act on the Depositors' and Investors' Guarantee Fund would take into account legal

procedures that apply to deposit guarantees in other countries, especially in the EEA, although equal attention should be given to the question whether the arrangement of deposit-taking activities of the Icelandic banks called for special rules. It is the opinion of the Special Investigation Commission that clearly the reasons behind the fact that a bill for the amendment of the Act on deposit guarantees was not introduced in the beginning of 2008, i.e. the views regarding difficulties and unrest in the financial market, were in the same way believed to stand in the way of such an initiative on the part of the government, and consequently also in the way of the involvement of the Minister of Business Affairs at later stages of that year.

The Ministry of Business Affairs also participated in the consultative group of the Icelandic authorities on financial stability and contingency planning. As described in Chapter 17.10.2, the matters of the Depositors' and Investors' Guarantee Fund, and the possibility of government intervention in order to guarantee deposits up to a certain amount, was repeatedly discussed during meetings of the consultative group in the year 2008. In continuation of further discussion of the course of events in the years 2007 and 2008, and of the work of the consultative group later in this report, the significance of the group's work and discussions held within the group in light of the operational and surveillance duties of individual ministers, government institutions and their employees, will be discussed further.

Deposits, in particular from private individuals and parties that are not professional investors, have a certain special status above and beyond other commitments of banks. Behind such deposits, there is usually a broad group of individuals who have entrusted their savings to the banks. Normal accessibility to bank deposits is a general prerequisite for daily trade and commerce to proceed in a satisfactory manner. Experience shows that deposits enjoy something of a special status in the choices made by government authorities when they are seeking ways in which to respond to difficulties in the operations of financial undertakings and resolve them. Examples show that in such circumstances a state may declare that the government guarantees deposits in banks, either in full or up to a certain amount and temporarily. From an economic perspective it is believed that states must nonetheless tread carefully in such matters, especially with regard to declaring in advance that such guarantee will be undertaken to a great extent. This may create a so-called moral hazard with banks in such a manner that they will take increased risks under cover of state guarantees. Rules and international agreements on limitations of government support of economic activities in individual states may also impose restrictions on how far states can go in this regard.

It is clear that in the time leading up to the collapse of the banks, the Icelandic authorities discussed whether the Icelandic State should or could declare that it would guarantee deposits up to a certain amount, as part of increasing confidence in the Icelandic financial system. Suggestions were presented and discussed within the consultative group of the Icelandic authorities, but the situation never arose that government ministers had to decide on them. The Icelandic government later declared that deposits in banks and savings banks in Iceland and their domestic branches were guaranteed in full. Such a declaration was first made by the Prime Minister on the evening of 3 October 2008. It was not stated whether these declarations

were based on specific legal grounds, and this was in fact a case of a political declaration made by the government. In the course of its examination, the Special Investigation Commission has not found any documents that pertain particularly to its preparations, including whether an assessment was made from a legal point of view of what significance it might have with regard to the obligations of Iceland according to the EEA Agreement to distinguish in this manner between deposits in the Icelandic banks located in Iceland and their foreign branches.

Despite the fact that ever since early 2008, the Icelandic authorities were increasingly concerned about the position of the Icelandic financial undertakings, and that discussions were held regarding the limited ability of the Depositors' and Investors' Guarantee Fund to meet the obligations that the Fund would be facing in the event of a crisis in the operations of credit institutions, it cannot be seen that any clear position was taken regarding if and how the Icelandic State would intervene in the affairs of the Fund if its payment obligations were put to the test.

The examination of the Special Investigation Commission with regard to the affairs of the Depositors' and Investors' Guarantee Fund, revealed that different views were aired within the government about the possible legal obligations and responsibilities of the Icelandic State due to the obligations of the Depositors' and Investors' Guarantee Fund, and consequently what duties derived from Directive 94/19/EC in this regard. What particularly drew the attention of the Commission was that in spite of this it was not until after inquiries had been submitted by foreign governments in late July/early August of 2008 that the issue of the possible obligations of the Icelandic State in this respect was discussed by the Icelandic authorities.

As described in Chapter 17.7, it was on 31 July 2008 that representatives of the UK authorities emphasised the importance of an assurance from the Icelandic authorities that the Icelandic State would grant a loan to the Depositors' and Investors' Guarantee Fund if required. In a meeting with the Chairman of the Board of Directors of the Depositors' and Investors' Guarantee Fund and the then acting Permanent Secretary of the Ministry of Business Affairs, the UK representatives also pointed out that it could be considered that Iceland had an obligation under international law, on the basis of the EEA Agreement, to ensure that depositors of Icelandic banks would have the protection of the minimum guarantee stipulated in the EU directive on deposit guarantees. Still further demands were made by letter from HM Treasury to the Ministry of Business Affairs, dated 7 August 2008, for answers regarding intervention on the part of the Icelandic authorities in the form of a government loan to the Depositors' and Investors' Guarantee Fund. Correspondence regarding inquiries from foreign parties is described in Chapter 17.17. There it is shown that the first replies from Iceland mostly have to do with legal procedures concerning the Guarantee Fund. In a reply to an employee of HM Treasury, prepared and approved by the Prime Minister, the Ministry of Finance and the Minister of Business Affairs and their staff, it was stated that if the Depositors' and Investors' Guarantee Fund would be unable to raise necessary funds on the general financial market, the Icelandic government would do everything that any "responsible government" would do in such a situation, including "assisting the Fund" in raising the necessary funds so that the Fund would be able to meet its obligations under

the minimum guarantee. This letter was dated 20 August 2008 and sent from the Ministry of Business Affairs, signed by Ms. Áslaug Árnadóttir, i.e. the employee of the Ministry who was also the Chairman of the Board of Directors of the Depositors' and Investors' Guarantee Fund. With reference to the preparation of this reply, it is the opinion of the Special Investigation Commission that the subject of the letter was mostly determined by the political positions of the ministers involved.

The consultative group of the Icelandic authorities on financial stability and contingency planning held a total of five meetings in August and September of 2008. It has come to the attention of the Special Investigation Commission that although inquiries were received from abroad and there were different views within government circles about the obligations of the Icelandic State with regard to the Depositors' and Investors' Guarantee Fund, it cannot be seen from the minutes of these meetings that any discussion took place explicitly about the possible responsibility of the Icelandic State for the obligations of the Depositors' and Investors' Guarantee Fund, with reference to the EU directive. As aforesaid, discussions did however take place during these meetings about the possibility of the Icelandic State declaring that it would guarantee deposits up to a certain amount, as part of its efforts to diminish the risk of a financial crisis. However, there is no indication that this was in any way connected to the existing and intended legal obligation of a State guarantee on the deposit guarantees of the Depositors' and Investors' Guarantee Fund, or the obligation to assist the Fund in borrowing funds.

On 29 September 2008, the same day that the intention of the Icelandic State to purchase a 75% share in Glitnir was made public, e-mail correspondence took place between the Chairman of the Board of Directors of the Guarantee Fund, who was also an employee of the Ministry of Business Affairs, and the Permanent Secretary of the Ministry of Business Affairs, Ministry of Finance and the Prime Minister's Office, of which copies were sent to other staff members within government circles, cf. Chapter 17.6, and where the subject was different views regarding what the obligations of the Icelandic State were according to the EU directive.

On 5 October 2008, a new inquiry arrived from an employee of HM Treasury in the UK, wherein further demands were made for information about the manner in which Iceland intended to meet the obligations under the directive on deposit guarantee schemes in the event Landsbanki and its UK branches became insolvent. It is clear, from what is stated in Chapter 17.17.5 about the involvement of four government ministers, a permanent secretary, and the Director General of the Financial Supervisory Authority in preparing the reply of the Icelandic State to this inquiry on the same day, that different views continued to be aired about what obligations the Icelandic State could be facing according to the EU directive if the Guarantee Fund would be unable to honour its obligations.

In Chapter 17.11.2 there is a description of what was revealed during hearings before the Special Investigation Commission about this matter. The Minister of Finance, Mr. Árni M. Mathiesen, stated that when this matter arose there was uncertainty about its legal position. However, it may be inferred from the replies that the Director General of the Financial Supervisory Authority was of the opinion that according to the EU directive the Icelandic State was obliged to assist the Depositors' and Investors'

Guarantee Fund to the extent that the Fund would be able to honour the minimum guarantee. The same view appears to have been held within the Ministry of Business Affairs. The governors of the Central Bank were of the opinion that the obligation was not of such an unequivocal nature, and that the Icelandic State was not obliged to provide a guarantee in this regard, and the Permanent Secretary of the Ministry of Finance expressed the view that it should not be declared with undue haste that the State would assume responsibility for the minimum guarantee. It was revealed in the course of the examination of the Special Investigation Commission that in spite of these differing views, no specific efforts were made to obtain a legal assessment or expert advice from outside the ministries about this matter until after the banks had collapsed. Furthermore, no documentation has come to light that indicates that the aforesaid matter was explored specifically at the time by the employees of the ministries involved, apart from an examination of the text of the directive on deposit guarantees, the contents of which had previously been discussed within the Ministry of Business Affairs at the time of its implementation and when the Act on deposit guarantees was revised, as well as on other occasions.

The Special Investigation Commission would like to emphasise that the position taken by the Icelandic authorities with regard to the EU directive on deposit guarantees was bound to be of considerable importance when it came to any and all contingency planning on the part of the authorities and their assessment of the options available to the Icelandic State in the event that it would have to respond to a crisis in the operations of the Icelandic banks. In this respect, it was of great significance whether it was considered that, under the EU directive, a Member State was directly and legally obliged to enable the deposit guarantee scheme that it had established to honour the minimum guarantee as stated, if the scheme did not possess sufficient assets or credit options to do so. This did not only apply when the banks had reached their breaking point. If it was the opinion of those who were responsible for the matters of the Depositors' and Investors' Guarantee Fund according to the division of duties in the Government Offices, and were required to monitor the activities of the Fund, that the responsibility of a Member State with regard to a guarantee fund in the aforesaid sense did in fact exist, it was important to express this view at earlier stages when the nature of the changes in the deposit-taking activities of the Icelandic banks, and the consequent effects on the obligations of the Depositors' and Investors' Guarantee Fund had become clear. In this regard, a distinction must also be made between this particular legal issue and the aforesaid course of action that may be taken by governments in connection with difficulties in the operations of the banks and the financial system of the country in question, i.e. to declare specifically that the state will guarantee deposits.

At the time when the bill for implementing the EU directive on deposit guarantees was introduced in Parliament by the Minister of Business Affairs, it was stated in the comments accompanying the bill that state guarantees could not replace deposit guarantees.¹⁷¹ Later, in the parliamentary discussions of the plans for establishing a private foundation that was to execute the duties

171. Parliamentary record 1995-1996, Section A, p. 1849.

of Iceland under the directive, it was stated that the State Treasury was not responsible for the private foundation.¹⁷² Therefore it seems quite clear that the Minister of Business Affairs and the Parliament had established during the discussions of the obligations derived from the directive that the State Treasury was not directly responsible for the obligations of the Depositors' and Investors' Guarantee Fund. Directive 94/19/EC, prior to amendments made in March of 2009, contained no provisions to the effect that treasuries of Member States were directly responsible for the obligations of the deposit guarantee schemes that had been established in accordance with the directive. In the 24th recital in the preamble to the directive, which has remained unaltered since the directive was adopted in 1994, it is stated that the directive can neither obligate a Member State nor competent authorities to guarantee deposits vis-à-vis depositors if they have ensured the establishment of one or more schemes acknowledged by the authorities that guarantee either the deposits or the credit institutions themselves, and guarantee that depositors will receive compensation and guarantees as provided for in the directive. It was pointed out earlier in this Report that it seems clear that the minimum rules directly mentioned in the directive were transposed into Icelandic law, by a process similar to that employed in the neighbouring countries, including the Nordic countries. The provisions of the directive and the Icelandic Act on the Depositors' and Investors' Guarantee Fund clearly indicate that each depositor shall be paid a certain minimum amount in the event that deposits become unavailable.

With reference to the aforesaid, the Special Investigation Commission was of the opinion that it should be examined if anything could be found in academic writings and other documents from the EU about the possible liability of Member States in the event that a guarantee fund operating under the directive on deposit guarantees found itself in circumstances where it was unable to honour its obligations. The goal of this examination was to explore what information the representatives of the Icelandic authorities would have been able to obtain in a relatively simple and speedy manner, had they been instructed to examine the legal position during the time leading up to the collapse of the Icelandic banks in October of 2008. The findings of this examination are described in Chapter 17.12. From the sources cited there, it seems that it had not been clearly established in general at the time in question that any direct responsibility of Member States existed for the obligations of the guarantee funds. Similarly, the aforesaid sources contain no clear position on the requirements that must be met by the deposit-guarantee schemes with regard to financing so that the directive can be considered to have been effectively implemented in the Member States, with reference to what is stated in the 24th recital in the preamble to the directive. It may be assumed that disputes regarding these matters would, therefore, have to be resolved on the basis of the possible liability of a Member State where the subject matter was whether the directive had been implemented effectively. This would include the question of the way in which these matters had been addressed in general in the Member States and what had been the position taken by the surveillance authorities of the EU and the EEA Agreement upon

172. Parliamentary record 1995-1996, Section A, p. 1854.

receipt of announcements of the establishment of deposit-guarantee schemes in order to implement the directive. Although the sources described in chapter 17.12 do not provide decisive or complete answers to issues concerning the aforesaid matter, the Special Investigation Commission is of the opinion that it would have been important for the Icelandic authorities, in the time leading up to the collapse of the banks, and especially following the inquiries made by foreign authorities at the end of July and beginning of August 2008, to prepare a review of what data were available on the interpretations of the obligations of the Member States of the EEA Agreement, in the event that a guarantee scheme created under the EU directive on deposit guarantees could not meet its payment obligations. Such a review could have made clearer the different views that were both expressed on behalf of the aforesaid sources and were held within the Icelandic administration, on the obligations of the State in this regard. It was also important that the ministers and others within the administration who were involved in decision making and communicating with foreign governments on the matter could have been given a clear picture of the legal issues put to the test by this and could have considered them in their decisions and their replies to questions and demands by foreign governments.

Chapter 17.13 contains a description of amendments that were made to the EU directive on deposit guarantees following the collapse of the Icelandic banks, whereby provisions were adopted that stipulate the direct responsibility of Member States for the ability of the relevant deposit guarantee scheme to pay the minimum amount guaranteed.

In accordance with the aforesaid, it is the assessment of the Special Investigation Commission that it cannot be maintained that the Icelandic authorities or Parliament was negligent or made mistakes with regard to the implementation of Directive 94/19/EC as such. The Special Investigation Commission, on the other hand, is of the opinion that the major change in the financing of the Icelandic banks via the raising of deposits into on-line accounts from the year 2006 onwards should have alerted bodies responsible for the arrangement and implementation of matters concerning deposit-guarantee schemes in Iceland, to the necessity of starting the process of amending the rules on the Depositors' and Investors' Guarantee Fund in order to strengthen its financial standing. In the opinion of the Special Investigation Commission, these developments also called for more thorough consideration on the part of the Depositors' and Investors' Guarantee Fund regarding the Fund's ability to meet its obligations in the event that they would have to be honoured. This became even more important when the effects of the liquidity crisis began to be felt in earnest in the operations of the Icelandic credit institutions in the winter of 2007-2008, and the Icelandic authorities began to discuss possible responses in the event of a financial shock. The rule regarding the obligation of the Depositors' and Investors' Guarantee Fund to pay a minimum amount to each depositor was legally clear. It was clear as well, that the Fund's assets were insufficient, at least temporarily, to meet the obligations of the Fund if larger financial undertakings became insolvent. This applied whether or not changes in legislation had been made, for example in the beginning of 2008. Thus, one of the challenges that needed to be addressed in the government's contingency plan was how to meet the obligations of the Depositors' and Investors' Guarantee Fund in the event of a financial crisis. It is described

in Chapters 19 and 20 of the Report that this work had not been completed within the consultative group when the banks collapsed in October of 2008. One of the consequences, was the uncertainty that came about during the collapse, and later in the affairs of the Depositors' and Investors' Guarantee Fund with regard to guarantees of deposits in the foreign branches of the Icelandic banks, which did not fall under the State guarantee declared by the government on deposits in Iceland.