4-21-2009

Summary of Government Interventions Iceland

Mayer Brown

Summary of Government Interventions
Iceland

Overview

The Icelandic economy collapsed in the wake of the global financial meltdown. All four of its largest banks have now been nationalised and a USD 10bn relief package has been put together by the International Monetary Fund ("**IMF**") in conjunction with several European countries in an effort to rescue the State's economy.

In March 2009, there have been a number of reports indicating that Iceland may be put on a fast track to join the European Union in order to rescue the State from its financial collapse. This comes amid rising expectations that Iceland, which is already a member of the European Free Trade Association, will apply for full EU membership within months. EU membership, among other things, could allow Iceland to swap its hard-hit currency for the Euro.

State guarantees

On 7 October 2008, Iceland's three main commercial banks, Kaupthing, Glitnir and Landsbanki, were nationalised. This was followed by the nationalisation of the investment bank Straumur-Burdaras on 9 March 2009. The Icelandic Financial Supervisory Authority (FME) took control of all four banks, guaranteeing all domestic deposits, pursuant to the Act on Depositors' and Investors' Guarantee Fund. Since then, a receivership committee has been appointed by the FME to all four banks, which has assumed the role of the board of directors to ensure continued operations.

On 21 October 2008, the Central Bank of Iceland, Sedlabanki, announced that it would guarantee all payments which were routed through the Central Bank of Iceland would reach the account of the ultimate beneficiary.

On 16 November 2008, Iceland reached an accord with the UK and the Netherlands on repaying Icesave retail depositors, which were Landsbanki online savings accounts under its "Icesave" brand available only to personal savers from the UK and the Netherlands. The Icelandic Prime Minister undertook to guarantee the deposits in accordance with the EU directive. However, the period over which the payments will be made and the annual payment obligation are yet to be negotiated.

Government loans

On 20 November 2008, the Executive Board of the IMF approved a 2-year SDR 1.4bn (about USD 2.1bn) loan ("**Stand-By Arrangement**") for Iceland to support the country's programme to restore confidence and stabilise the economy.

The approval makes SDR 560m immediately available and the remainder available in eight equal instalments of SDR 105m, subject to quarterly reviews. The Stand-By Arrangement entails exceptional access to IMF resources, amounting to 1,190 per cent. of Iceland's quota, and was approved under the IMF's fast-track Emergency Financing Mechanism procedures. An interim review of this arrangement was published on 12 February 2009. Following discussions about their review of the USD 2.1bn Stand-By Arrangement, the IMF published a further statement at the end of its mission to Iceland on 13 March 2009.

In 7 November 2008, the USD 2.1bn IMF deal was complemented by the more than USD 3bn in loans from Nordic countries, Russia and Poland as well as close to USD 5bn or more by Britain, the Netherlands and Germany, making the whole package worth about USD 10bn.

Swap facilities

On 20 November 2008, the central banks of Sweden, Norway and Denmark announced an extension of their swap agreements until year-end 2009. Each agreement provides the Central Bank of Iceland with access to a maximum of EUR 500m, or a combined total of EUR 1500m in exchange for Icelandic krónur.

Notable developments with commercial banks (and other key financial players)

After Iceland passed its Emergency Act 125/2008 on 6 October 2008, resolution committees (**"Resolution Committees"**), Icelandic forms of receivership, were appointed over Glitnir, Landsbanki and Kaupthing banks on 7 October 2008 and over Straumur-Burdaras on 9 March 2009.

Landsbanki

On 7 October 2008, following continued deterioration in financial markets, Iceland's Financial Services Authority ("**FME**") took control over Landsbanki Íslands hf. under Article 100 of Act No. 161/2002, as amended, to ensure continued commercial bank operations in Iceland. Domestic deposits were fully guaranteed by the Government of Iceland.

The FME announced on 9 October 2008 that assets of Landsbanki were being moved to new Landsbanki, subsequently named Landsbankinn ("**NBI hf.**"), and all liabilities together with rights and obligations under derivative contracts were to remain with Landsbanki Íslands hf. ("**Old Landsbanki**"). Old Landsbanki's domestic deposits, as well as a significant part of the old bank's assets from its Icelandic operations, were transferred to NBI hf. New Landsbanki is now fully owned by the FME.

On 4 November 2008, it was reported that investors who sold credit default swaps on bonds issued by Old Landsbanki may lose as much as USD 1.8bn as the credit derivatives settlement auction set the price for contracts written on the senior bonds at 1.25 per cent. and for contracts written on the subordinated bonds at 0.125 per cent. The auctions were conducted in accordance with the International Swaps and Derivatives Association (**"ISDA"**) 2008 Landsbanki CDS Protocol. Markit and Creditex are the official administrators of the Credit Event Auctions.

The first informal creditors' committee meeting was held on Friday 14th November, in Reykjavík, Iceland. The committee was made up of creditors and representatives of creditors of Old Landsbanki.

To help distinguish the bank's equity holdings from its main commercial banking operations in Iceland, NBI hf. established on 13 February 2009 an investment company to manage its equity holdings, Horn Fjárfestingarfélag ehf. Horn Fjárfestingarfélag ehf. will thereby take over the listed and unlisted equity holdings of NBI hf. which it acquired from Old Landsbanki.

Glitnir

On 29 September 2008, the Icelandic government announced that it intended to nationalise and to take a 75 per cent. share in Glitnir bank hf. However, the FME used powers granted to it by the Icelandic Parliament (with reference to Article 100 of Act. No. 161/2002, as amended) to take control of Glitnir banki hf (**"Old Glitnir"**) instead on 7 October 2008.

On 15 October 2008, New Glitnir Bank hf (**"New Glitnir"**) was created and Old Glitnir's deposits in Iceland, as well as the assets relating to Old Glitnir's Icelandic operations, were transferred to it. New Glitnir is now wholly-owned by the Icelandic government.

Deloitte & Touche LLP was hired on the 24 October 2009 to assist with the communication and consultation with all remaining creditors of Old Glitnir including its international branches.

The Resolution Committee of Old Glitnir announced the appointment of UBS Securities LLC on 30 January 2009 to act as financial and capital markets advisor to the Resolution Committee in connection with the restructuring of Old Glitnir.

The Resolution Committee of Old Glitnir held its first informal creditors' meeting on 13 November 2009 with the Informal Creditors' Committee (the **"ICC"**), made up of representatives of key creditors of Old Glitnir.

On 6 January 2009, Glitnir Bank hf. won US Chapter 15 bankruptcy protection, shielding it from lawsuits during its reorganisation. While, on 19 February 2009, the District Court of Reykjavik ruled in favour of Old Glitnir's request for an extension to the moratorium order originally granted on 24 November 2008. The extension period is to end on 13 November 2009. New Glitnir is unaffected by this moratorium.

On 20 February 2009, New Glitnir was renamed Íslandsbanki.

Glitnir's Resolution Committee and the Central Bank of Luxembourg signed an agreement on 6 March 2009 providing for settlement of debts for Glitnir's subsidiary, Glitnir Bank Luxembourg S.A. This agreement should facilitate Glitnir's Luxembourg subsidiary to be placed into voluntary and solvent liquidation.

Glitnir's Resolution Committee on 16 March 2009 enforced its charge on the share capital of Moderna Fince AB, a subsidiary of the Swedish parent company Milestone ehf.

Kaupthing

New Kaupthing Bank (**"New Kaupthing Bank"**) took over domestic operations of Kaupthing banki hf. (**Old Kaupthing**) on 22 October 2008. Old Kaupthing's operations were transferred to 'New Kaupthing' while the bank itself is now fully owned by the FME. The FME appointed a Resolution Committee of Old Kaupthing on 9 October 2008. This was then followed by a moratorium on the bank's payments to creditors on 24 November 2008.

Following a creditors' meeting on 5 February 2009, the District Court of Reykjavik agreed to extend the moratorium until 13 November 2009.

On 2 April 2009 the Tribunal d'arrondissement de et à Luxembourg (Luxembourg District Court) granted a two-month extension of the suspension of payments' period for Kaupthing Bank Luxembourg which was due to expire at midnight on 8 April 2009. As a result, until 8 June 2009, all payments by the Bank are still deferred temporarily and Kaupthing Bank Luxembourg may not act or make a decision unless the court appointed administrators agree, as this was already the case as from 9 October 2008. Had the suspension of payments' period not been extended, it would have had no choice but to wind up Kaupthing Bank Luxembourg, since the interbank creditors rejected the restructuring plan submitted to their vote by the administrators from a group of Middle Easter investors in mid-March.

In the UK on 23 March 2009, Kaupthing scored a victory in the courts towards forcing the UK Government to revisit its decision to put its UK arm into administration when the UK High Court agreed to a request for a judicial review on claims that the decision contributed to the bank's downfall. Kaupthing Bank also contends that the actions of the UK authorities were unjust and illegal. The UK arm, Kaupthing Singer & Friedlander (KSF), was seized by the UK government in October 2008 following a recommendation by the UK Financial Services Authority that argued that KSF was unable to honour its obligations to customers. The UK Treasury invoked new banking powers to transfer KSF's GBP 2.5bn of retail deposits for 160,000 customers to Dutch bank ING Direct.

In terms of asset valuations, Deloitte & Touche LLP have provisionally concluded reports for the FME on the net valuations of the assets transferred from the old banks to NBI hf., New Glitnir Bank and New Kaupthing Bank. The management consultancy firm Oliver Wyman has also reviewed the process for each individual bank.

Straumur-Burdaras Investment Bank hf

On 9 March 2009, Straumur - Burdarás Investment Bank hf (Straumur) was taken over by the FME after it had less than half the funds required to meet a EUR 33m (USD 42m) obligation that fell due. Straumur was subsequently granted a moratorium on 19 March 2009 until 11 June 2009.

On 17 March 2009, the FME decided to dispose of nationalised Straumur's deposits to Íslandsbanki hf., which will be allocated according to the balance and interest earned at the date of nationalisation (with some exceptions). All the terms for these deposits, such as duration, interest terms and currency, are the same as for Íslandsbanki hf. Furthermore, Straumur - Burdarás Investment Bank hf. was made to issue a bond as repayment for the deposit obligations that are taken over and all assets of Straumur will be put up as collateral for this bond. The Resolution Committee of Straumur has been authorised to execute these FME decisions. The events prompted a change to the bank's management committee on 24 March 2009 and redundancies in its Iceland, UK and Denmark offices on the 19 March 2009.

On 30 March 2009, the Depositors' and Investors' Guarantee Fund (the **"Depositors' Fund"**) became obligated by the FME to render payments in accordance with Article 9 of Act No. 98/1999 on the Deposit Guarantees and Investor Compensation Scheme to Straumur's customers who did not receive the amounts of their deposits when the bank was nationalized. The Depositors' Fund is a private foundation operating pursuant to Act No. 98/1999 and guaranteeing a minimum level of protection to depositors in commercial banks and savings banks, and to customers of companies engaging in securities trading.

On 6 April 2009, Straumur disposed of its Icelandic deposit obligations to Íslandsbanki hf. Deposits created in relation to settlement of prior debts before maturity are however excluded. Straumur has successfully secured access to funds to meet obligations towards depositors in its Danish branch, to be paid as and when due.

SPRON

On 21 March 2009 the FME assumed the powers of a meeting of the shareholders of Sparisjódur Reykjavíkur og nágrennis hf. (SPRON), another of Iceland's banks, and made a decision on the disposal of certain assets and liabilities of this bank.

Since the outbreak of the banking crisis in Iceland in October 2008, the bank has been operating on an exemption from FME's capital adequacy requirements (four week grace periods that have been extended several times since the end of October 2008), and liquidity support has been provided by the Central Bank of Iceland. This liquidity support was provided on the basis of two conditions, namely (1) an agreement be reached with its creditors, which would address the capital deficiency situation when combined with capital injections from the government; and (2) that the bank provide eligible collateral. However, the FME deemed the discussions with the bank's creditors were unsuccessful and that the bank's liquidity positions had continued to deteriorate.

Hence, the FME decided that SPRON was unable to render payment of certain deposits in accordance with applicable terms. Therefore, the FME appointed a Resolution Committee to take over all authority of the Board of Directors of SPRON and oversight of the institution's assets. New Kaupthing Bank will take over the bank's obligations according to the decision.

Sparisjóðabanki Íslands hf

Just like SPRON and for the same reasons, the FME assumed the powers of a meeting of the shareholders of Sparisjóðabanki Íslands hf. (formerly known as 'Icebank hf') on 21 March 2009 and made a decision on the disposal of certain assets and liabilities of the bank. Just like SPRON, it too had been operating on an exemption from the FME since October 2008.

However, the FME decided that Sparisjóðabanki Íslands hf. was unable to render payment of certain deposits in accordance with applicable terms. Therefore, the FME appointed a Resolution Committee to take over all authority of the Board of Directors of Sparisjóðabanki Íslands hf. and oversight of the institution's assets.

Therefore, on 27 March 2009 the FME required the Depositors' and Investors' Guarantee Fund to render payments to the customers of Sparisjóðabanki Íslands hf, in accordance with Article 9 of Act No. 98/1999 and pursuant to the Deposit Guarantees and Investor Compensation Scheme, who did not receive the amount of their deposits.

Baugur

On 11 March 2009, Baugur Group, the retail company which owns many famous UK high-street chains, including House of Fraser, and a number of its wholly-owned subsidiaries filed for bankruptcy after a judge denied the company more time in the moratorium process in Iceland. The moratorium petition was filed on 4 February 2009 following Landsbanki's decision to discontinue discussions regarding a potential restructuring of the company.

Other developments

Interest rates

Due to the financial instability, base interest rates jumped from 12 per cent. in early October 2008 to a high of 22 per cent. in December 2008 before dropping slightly to 18 per cent. in January 2009.

However, the Monetary Policy Committee of the Central Bank of Iceland reduced this rate again to 15.5 per cent. on 8 April 2009 after already lowering to 17 per cent. on 19 March 2009. The Monetary Policy Committee also announced that economic indicators suggest conditions for Iceland's economic easing were now in place. Inflationary pressures have subsided as demand, employment levels and the króna have all stabilised. A large trade deficit has turned into a significant surplus.

Foreign exchange

On 16 December 2008, the Central Bank of Iceland issued new rules on foreign exchange. The new rules provide certain exemptions to specified groups who have been deemed to have "critical interests at stake". In its statement, the Central Bank of Iceland said that it considers it unlikely that these groups' transactions will cause serious and significant volatility in exchange rate and monetary affairs. Exemptions are granted to the State and municipalities; certain companies affiliated with the State; companies with over 80 per cent. of their revenues and expenses abroad; and commercial banks, savings banks and credit institutions.

The government have imposed restrictions on foreign exchange transactions for movement of capital and foreign currency to financial institutions. The legislation on which these rules are based is temporary and will expire at the end of November 2010. The rules were reviewed by 1 March 2009 and the Central Bank decided the preconditions for lifting the restrictions had not been met. The rules are to be reviewed again no later than 1 September 2009.

Short selling

On 7 October 2008, the FME banned short selling of shares of certain banks (Glitnir banki hf., Kaupþing banki hf., Landsbanki Íslands hf., Straumur-Burðarás fjárfestingarbanki hf., Spron hf. and Exista hf., which have been admitted to trading on a regulated market in Iceland), and reclassified the action as market abuse in accordance with Article 117 of the Act on Securities Transactions No. 108/2007, unless the seller already holds the shares in custody and has notified the FSA. This prohibition also includes any instrument with the same purpose and the same economic exposure as the short selling of these bank shares. The ban was extended for a further period of time in January 2009.

Ratings

On 24 November 2008, Standard & Poors Ratings Services ("S&P") lowered its long term foreign currency rating on the Republic of Iceland to BBB- from BBB due to the sovereign's mounting public sector debt. S&P's Transfer & Convertibility assessment was also lowered to BBB- from A- in response to controls on the capital account and some current account transactions.

On 4 December 2008, Moody's Investors Service downgraded the foreign and local currency ratings of the Republic of Iceland to Baa1 with a negative outlook, from A1. The short term rating of the government was changed to P-2 from P-1. It also lowered the issuer rating and local currency bond ratings of Iceland's Housing Financing Fund ("HFF") to Baa1 from A1.

On 23 January 2009, Moody's maintained that Iceland remained an investment-grade country, despite maintaining its negative outlook on its earlier Baa1 rating. This negative outlook is due to the continued economic uncertainty Iceland still faces.

Bad debt bank

On 10 February 2009, new Prime Minister Johanna Sigurdardottir, who won power in January after public protests of the last regime, announced government plans to create a separate company to take over debts owed by 15-20 of the biggest companies which have run into financial difficulties due to the crisis and announced plans for a parliamentary bill to allow Icelanders access to funds in private pension plans which they normally would not be able to use until retirement.

Contact us

For further information, please contact

Bruce Bloomingdale
Partner
T: +44 20 3130 3211
E: bbloomingdale@mayerbrown.com

Ed Parker
Partner
T: +44 20 3130 3922
E: parker@mayerbrown.com

Husam El-Khatib
Associate
T: +44 203 130 3230
E: khatib@mayerbrown.com

About Mayer Brown

Mayer Brown is a leading global law firm with offices in major cities across the Americas, Asia and Europe. We have approximately 1,000 lawyers in the Americas, 300 in Asia and 500 in Europe. Our presence in the world's leading markets enables us to offer clients access to local market knowledge combined with global reach.

We are noted for our commitment to client service and our ability to assist clients with their most complex and demanding legal and business challenges worldwide. We serve many of the world's largest companies, including a significant proportion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world's largest investment banks. We provide legal services in areas such as Supreme Court and appellate; litigation; corporate and securities; finance; real estate; tax; intellectual property; government and global trade; restructuring, bankruptcy and insolvency; and environmental.

OFFICE LOCATIONS

AMERICAS
- Charlotte
- Chicago
- Houston
- Los Angeles
- New York
- Palo Alto
- São Paulo
- Washington

ASIA
- Bangkok
- Beijing
- Guangzhou
- Hanoi
- Ho Chi Minh City
- Hong Kong
- Shanghai

EUROPE
- Berlin
- Brussels
- Cologne
- Frankfurt
- London
- Paris

ALLIANCE LAW FIRMS
- Mexico, Jáuregui, Navarrete y Nader
- Spain, Ramón & Cajal
- Italy and Eastern Europe, Tonucci & Partners

Please visit www.mayerbrown.com for comprehensive contact information for all Mayer Brown offices.

0728ten
March 2009