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TIF (Guarantee Fund)

Review of UK & Dutch Loan Agreements

TIF (GUARANTEE FUND) – REVIEW OF UK AND DUTCH LOAN AGREEMENTS

1. INTRODUCTION

1.1 Schjødt represents the Ministry of Foreign Affairs of Iceland. Schjødt has asked us to review two loan agreements dated 5 June 2009 entered into by Iceland (as guarantor) and the Depositors' and Investors' Guarantee fund of Iceland as borrower ("**TIF**" or the "**Guarantee Fund**"). One loan agreement is with the UK and one with the Netherlands.

1.2 The Financial Services Compensation Scheme Limited ("**FSCS**") in the UK and the Dutch Central Bank ("**DNB**") have compensated depositors with Landsbanki in London and Amsterdam respectively in respect of deposit monies owing to them by Landsbanki which Landsbanki has been unable to repay. Those deposits were guaranteed by TIF up to €20,887 per depositor. The loans to be made available by The Commissioners of Her Majesty's Treasury ("**HMT**") under the UK loan and by the State of the Netherlands (the "**Netherlands**") under the Dutch loan will be used by TIF to reimburse those compensation payments made by FSCS and DNB respectively.

1.3 Both the UK loan and the Dutch loan are governed by English law.

1.4 We have reviewed the loan agreements. We focussed in particular on the following areas:

- English governing law and submission to jurisdiction;
- Waiver of sovereign immunity;
- General observations (highlighting any unusual features);
- Reimbursement provisions relating to the loans;
- Termination Events relating to the loans.

1.5 We summarise our conclusions in section 2 (Summary). We include diagrams in section 3 giving an overview of each loan arrangement. Sections 4 to 10 then cover each of the areas mentioned in paragraph 1.4 above in greater detail. The summary should be read in conjunction with the more detailed analysis.

1.6 The background to the loan agreements relates to the obligation of EEA Member States to fulfil the requirements of Directive 94/19/EC as incorporated into the agreement on the European Economic Area, in the context of the failure of the Icelandic Banks. Directive 94/19/EC sets out the obligation to ensure that depositors are repaid up to at least 20,000 EUR (in the case of Iceland, 20,887 EUR) for each depositor when deposits become unavailable, regardless of whether their deposits are held in a bank in an EEA state or at a branch of such a bank in another EEA state.

2. SUMMARY

2.1 Amounts: The UK loan and the Dutch loan are made on substantially similar terms. The Dutch loan is for a fixed amount of €1,329,242,850. No further drawdowns may be made under the Dutch loan. The UK loan is for a maximum of £2,350,000,000. It contemplates an initial drawdown followed by further drawdowns after signing as further compensation payments are made to depositors by FSCS.

2.2 Interest and repayment: Both loans bear interest at 5.55% per annum. The interest compounding annually until 5 June 2016 and from then on is payable in cash quarterly.

The loans must be repaid by 32 quarterly instalments which start on 5 June 2016 and end on 5 March 2024. However, to the extent that recoveries are made from Landsbanki's liquidation they must be applied against the UK and Dutch loans pro rata and so recoveries will reduce the amount of the quarterly repayment instalments which apply after 5 June 2016. If there are no such recoveries then all the scheduled repayments must be met in full.

2.3 Iceland guarantee: Iceland guarantees outstandings under the loan agreement but the guarantee only comes into force as from 5 June 2016.

2.4 Governing law and jurisdiction: Both loans are governed by English law and the English courts are given jurisdiction to hear any disputes. This is common for international loan agreements and it is common for lenders to be able to insist on their chosen law and courts of jurisdiction. We would expect the choice of law and jurisdiction to be upheld by the English courts.

2.5 Sovereign immunity: Iceland waives its rights to sovereign immunity. As a result the UK and Dutch lenders will be entitled to obtain court judgments against Iceland if it fails to pay on its guarantee and also obtain court orders against its assets. The UK and Dutch lenders will not be entitled to obtain judgment against the assets of the Icelandic Central Bank (Sedlabanki) unless Sedlabanki independently waives its rights to immunity in respect of those assets. In addition, we have reviewed an email sent by Gary Roberts (Head of Financial Services Statutory at the UK Treasury) confirming (on behalf of both Dutch and UK governments) that the waiver of sovereign immunity recorded in the loan agreements is not intended to "*extend to a waiver of the various forms of diplomatic immunity provided by the Vienna Convention of 1961. Also that [HM Treasury] will not seek to issue process or levy execution in circumstances where that would infringe upon the immunities granted to Iceland by the Vienna Convention.*"[1]

2.6 Loan agreement terms: The terms of the loan agreements are fairly typical of those we would expect to see in an international loan agreement – although tailored for the rather unusual circumstances in which the loans are being made available to TIF. We summarise some points of particular interest in section 7. The main items relate to:

- the springing nature of the guarantee and the delay in operation of the guarantee;
- the requirement to treat creditors of Landsbanki in a way which accords with accepted international or European principles of treatment of creditors in an international winding up;[2]
- the requirement for Iceland or TIF to give the UK and Dutch lenders at least equivalent treatment to any other lender which finances claims of depositors of an Icelandic bank;[3]

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1 The email further records that this is also the Dutch position. The UK is a signatory to the Vienna Convention and certain of the provisions of the Vienna Convention have the force of law in the UK by virtue of the Diplomatic Privileges Act 1964. These provisions include article 22 of the Vienna Convention which records that the "*Premises of the mission [i.e. embassy], their furnishings and other property thereon and the means of transport of the mission shall be immune from search, requisition, attachment or execution.*" The UK government has, however, pursuant to section 3 of the Diplomatic Privileges Act 1964 reserved the right to withdraw such privileges if the home state of the relevant embassy (here Iceland) does not afford the same privileges and immunities to the UK embassy.

2 There is some vagueness in this requirement because it is not easy to say with certainty what constitutes "*accepted international or European principles of treatment of creditors in an international winding up.*" However, as we understand Iceland intends to act in conformity with international standards to ensure fair treatment of creditors we do not anticipate that this provision (though unusual) is likely to cause particular difficulties.

3 These types of "*equal treatment*" provisions, whilst relatively unusual in standard loan agreements, are more common in loan agreements entered into by borrowers who find themselves in difficult financial circumstances. In fact these provisions can favour a borrower by helping it resist demands from future lenders for better terms than

- the requirement to make further payments to depositors if payments above €20,887 are made to any Landsbanki depositor by way of compensation;[4]

- whilst the Netherlands waive any further claims against Iceland and TIF in respect of the making of compensation payments relating to Landsbanki, DNB (which actually made the compensation payments) does not. However, we understand that the DNB will provide such a waiver in a separate assignment agreement the signature of which is a condition precedent to the Dutch loan agreement coming into force.

2.7 Reimbursement provisions: The loans are repayable in instalments as summarised in section 2.2.

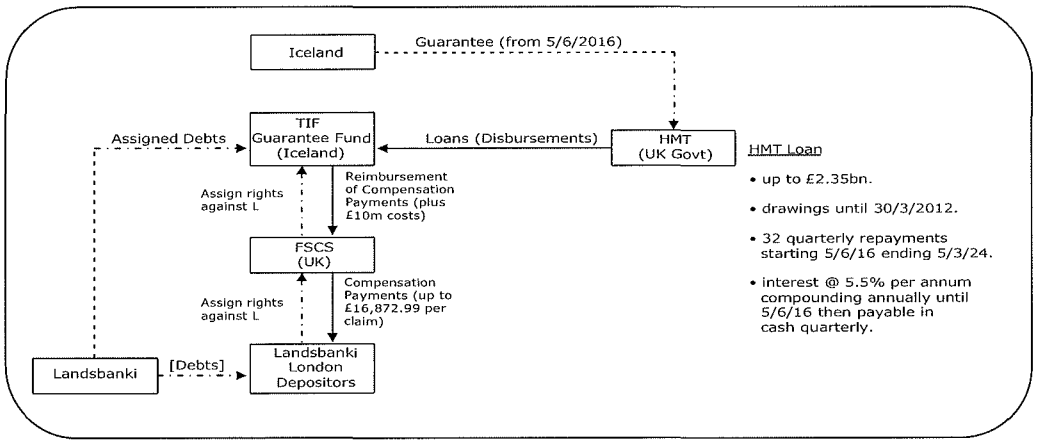
2.8 Termination Events: Whilst most of the Termination Events are fairly typical for an international loan there are a few which warrant closer attention (see section 10). The loan is potentially immediately repayable if any of these events occur and they include:

- any payment by TIF or Iceland under the loan agreements[5] being set aside invalidated or reduced;
- TIF or Iceland failing to comply with the requirements of Directive 94/19/EC in respect of any Landsbanki depositor in any way;
- TIF being unable to pay its debts as they fall due;
- if TIF is dissolved or ceases to be the sole deposit guarantee scheme in respect of Landsbanki depositors officially recognised in Iceland.

3. OVERVIEW

3.1 Set out in box 1 below is a diagrammatic overview of the UK loan arrangements.

Box 1



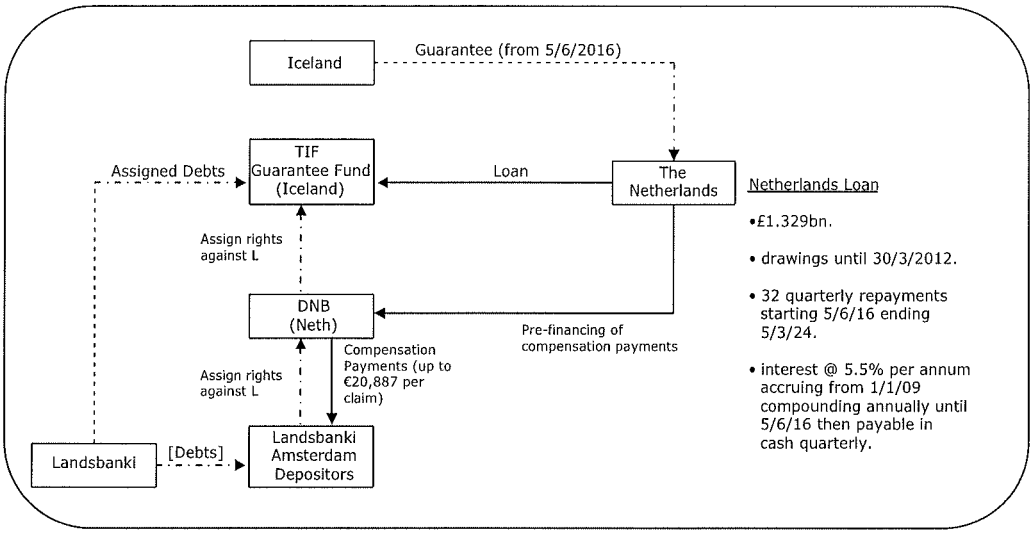
those negotiated by the original lenders.

4 We understand this is a further provision intended to ensure equal treatment across all creditor groups, a principle that we understand is fully endorsed by the Icelandic government.

5 Or, in the case of the UK loan, under the Settlement Agreement.

3.2 Set out in box 2 below is a diagrammatic overview of the Dutch loan arrangements.

Box 2



4. APPROACH

4.1 We present our observations and conclusions in summary form.

4.2 As a result we do not go into the full technical detail which supports the conclusions and observations. This is particularly the case in relation to sections 5 (English Governing Law and Submission to Jurisdiction) and 6 (Waiver of Sovereign Immunity).

4.3 We express views only as to English law.

5. ENGLISH GOVERNING LAW AND SUBMISSION TO JURISDICTION

5.1 The UK and the Dutch loan agreements both record (a) that they are governed by English law and (b) that the parties submit to the jurisdiction of the English courts for the purpose of resolving any claim or dispute arising out of the loan agreements.[6] Each lender nonetheless reserves the right to take legal proceedings relating to any dispute in any other courts which have jurisdiction.

5.2 The text of the governing law jurisdiction clause in the UK loan[7] is as follows:

"*This Agreement and any matter, claim or dispute arising out of or in connection with it, whether contractual or non-contractual, shall be governed by, and construed in accordance with, the laws of England.*

*Any matter, claim or dispute arising out of or in connection with this Agreement, whether contractual or non-contractual, including a matter, claim or dispute regarding the existence, validity or termination of this Agreement (a "**Dispute**"), shall be subject to the exclusive jurisdiction of the English courts.*

The Parties agree that the courts of England are the most appropriate and convenient courts to settle Disputes and accordingly no Party will argue to the contrary.

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6 See clause 17 of the UK loan and clause 16 of the Dutch loan.

7 The text of the corresponding clause in the Dutch loan is different but has essentially the same effect.

This paragraph ..... is for the benefit of the Lender only. As a result, the Lender shall not be prevented from taking proceedings relating to a Dispute in any other courts with jurisdiction. To the extent allowed by law, the Lender may take concurrent proceedings in any number of jurisdictions."

5.3 It is common for international loan agreements to adopt English law (and include submission to the jurisdiction of English courts) even if the parties to the loan agreement are not themselves English. In our experience it is standard practice for the lender to select the law which will govern the loan agreement and the jurisdiction of the courts who will determine any disputes relating to the loan agreement.

5.4 We would expect the English courts to give effect to the choice of English law and to the submission to the jurisdiction of the English courts.[8] This means that the legal rights and remedies of the parties will be determined in accordance with English law[9] and that any disputes relating to the loans or the loan agreements will be litigated before the English courts.[10]

5.5 Each lender reserves the right to litigate any dispute in a jurisdiction other than England if it so chooses. We consider that the lenders will be entitled to do this (as a matter of English law) but will have to demonstrate that the alternative court in the alternative jurisdiction is an appropriate forum to litigate the relevant dispute and that the court in that country has jurisdiction.[11]

5.6 Each lender also reserves the right to bring concurrent proceedings in more than one court – to the extent permitted by law. It is rare for courts to entertain concurrent proceedings so we consider this provision is unlikely to apply in most circumstances.

6. WAIVER OF SOVEREIGN IMMUNITY

6.1 The general rule under English law is that a State (such as Iceland) is not subject to the jurisdiction of the English courts[12] and no proceedings to enforce any judgment may be brought against the assets of the relevant State.[13]

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8 In theory, the English courts could refuse to recognise the choice of English law as the governing law of the Netherlands loan if they conclude it is contrary to public policy for the Netherlands loan to be governed by English law (see article 16 of the Rome Convention). However, we consider it unlikely that an English court would find anything in the arrangements relating to the Netherlands loan to suggest that such a public policy reason for rejecting the choice of law would be upheld. Also under article 3.3 of the Rome Convention "*the fact that the parties have chosen a foreign law...shall not, where all the other elements relevant to the situation at the time of the choice are connected with one country only, prejudice the application of the rules of the law of that country which cannot be derogated from by contract.*" This means that if the choice of law was being selected to avoid certain mandatory rules of (say) Netherlands law limiting the rate of interest which could be charged on this type of loan then again the choice of English law may not be upheld.

9 This is because the parties have expressly agreed this in the loan agreements and because the UK has implemented the Rome Convention (through the Contracts (Applicable Law) Act 1990) which in turn confirms that if parties contractually agree their choice of law the courts will give effect to this choice.

10 Iceland, the UK and the Netherlands are all parties to the Lugano Convention on jurisdiction and the enforcement of judgments in civil and commercial matters. Article 17 of the Lugano Convention says that if the parties to a contract (one or more of whom being domiciled in a contracting state – as here) have agreed that a court in a contracting state (here England) is to have jurisdiction to settle any disputes then the chosen court has exclusive jurisdiction. Article 17 also says that if the agreement conferring jurisdiction is concluded for the benefit of one of the parties (here the lender) then that party (the lender) retains the right to bring proceedings in any other court which has jurisdiction by virtue of the Lugano Convention.

11 To bring proceedings in an alternative jurisdiction the lenders would need to otherwise establish that the relevant courts in the relevant country have jurisdiction in accordance with the rules laid down by the Jurisdiction Regulation or the Lugano Convention (as the case may be). In contractual matters this is the place of performance of the contractual obligation in question (so it is likely to be Iceland or the Netherlands in the case of the Dutch loan agreement or Iceland or the UK in the case of the UK loan agreement).

12 See section 1 State Immunity Act 1978.

13 See section 13(2) State Immunity Act 1978.

6.2 This immunity extends to include:

- the sovereign or other head of State in his or her public capacity;
- the government of the State;
- any department of that government; and
- any separate legal entity connected with the State but only if the proceedings relate to an act done by the legal entity in the exercise of sovereign authority and the State itself would be immune.

6.3 A State (or legal entity enjoying State immunity) can, however, contractually agree to waive the above immunity it would otherwise have.[14]

6.4 Each loan agreement includes a contractual waiver of immunity in the following terms (emphasis added by us):

"Each of the Guarantee Fund and Iceland consents generally to the issue of any process in connection with any Dispute and to the giving of any type of relief or remedy against it, including the making, enforcement or execution against any of its property or assets (regardless of its or their use or intended use) of any order or judgment. If either the Guarantee Fund or Iceland or any of their respective property or assets is or are entitled in any jurisdiction to any immunity from service of process or of other documents relating to any Dispute, or to any immunity from jurisdiction, suit, judgment, execution, attachment (whether before judgment, in aid of execution or otherwise) or other legal process, this is irrevocably waived to the fullest extent permitted by the law of that jurisdiction. Each of the Guarantee Fund and Iceland also irrevocably agree not to claim any such immunity for themselves or their respective property or assets."

6.5 Both Iceland and TIF therefore contractually waive any immunity they may have. This means that if HMT or DNB obtain a judgment against Iceland or TIF under either loan agreement they will be entitled to enforce that judgment against Iceland and/or TIF (as the case may be) and (subject to obtaining an appropriate court order) seek to enforce that judgment against the property or assets of Iceland and/or TIF (as the case may be). An important point to note is that just because HMT or DNB obtain a monetary judgment against Iceland or TIF they cannot simply take any assets of Iceland or TIF to satisfy that monetary judgment.[15] Instead they would have to take the additional step of obtaining a court judgment requiring that assets be sold or that the assets be attached in their favour and the proceeds applied in paying the judgment debt.

6.6 We understand that Sedlabanki is constituted as a separate legal entity. The UK's State Immunity Act has a special regime for a State's central bank and specifically provides that the assets of such a central bank " *shall not be subject to any process for the enforcement of a judgment ..... or an action in rem for its arrest, detention or sale*".[16] As such property and assets of Sedlabanki will benefit from state immunity from enforcement proceedings, detention or sale unless Sedlabanki itself agrees to waive its rights to State immunity.[17]

6.7 The guarantee given by Iceland of payments due under the UK and Dutch loan agreements does not come into force until 5 June 2016. See clause 6.1 in each of the UK loan agreement and the Dutch loan agreement. Iceland cannot, therefore, be liable for monies owing under the loan agreements until that date. The lenders could not,

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[14] See section 2(1) and 13(3) State Immunity Act 1978.

[15] Other than by exercising rights to set off debts they owe Iceland or TIF against the money Iceland or TIF (as the case may be) owes to them under the loans.

[16] See section 14(4) State Immunity Act 1978.

[17] This position was confirmed in AIC Limited v The Federal Government of Nigeria (2003) EWHC 1357.

therefore, obtain any judgment against Iceland for failure to pay and it is therefore difficult to see how either lender could take any action against any assets of Iceland prior to that date.

7. GENERAL OBSERVATIONS ON THE UK LOAN AGREEMENT

7.1 The general form of the loan agreement is fairly typical of a loan agreement governed by English law and contains protections for lenders typically seen in international loan agreements. The exceptions to this are those matters which flow from the unusual circumstances which give rise to the loan and include:

- Drawdowns: The provisions relating to how the loans are drawn down (with FSCS being the sole person authorised to request and receive drawdowns under the loan agreement) (TIF itself cannot control making the drawdowns – it has delegated this right to FSCS)). We understand this provision has been included for practical reasons given that FSCS has significantly greater administration resources than TIF and can therefore handle the compensation and drawdown procedures on behalf of TIF.[18]

- Pro rata prepayments: The requirement that (a) recoveries received by TIF in respect of depositor claims from the insolvency of Landsbanki and (b) voluntary prepayments be applied pro rata to amounts outstanding under the UK loan and to amounts outstanding under the Dutch loan agreement;[19]

- Springing guarantee: The fact that the Iceland guarantee of outstandings under the loan agreement does not come into force until 5 June 2016;[20]

- Landsbanki creditors: The requirement that Iceland will not take action which will result in creditors of Landsbanki being treated in a manner "*contrary to generally accepted international or European principles of treatment of the creditors in an international winding up*;"[21]

- Favoured financier treatment: The requirement in clause 7.1 that if Iceland or TIF enters into a similar agreement with another financier (relating to financing claims of depositors of an Icelandic bank) and that financier enjoys a more favourable treatment (or benefits from security) then a similar favourable treatment (or security) will be given to HMT;

- Excess compensation payments: The requirement that if any compensation fund (whether TIF or any other deposit guarantee scheme recognised by Iceland) makes payments in excess of €20,887 to any Landsbanki depositor then an amount equal to that excess must also be paid to Landsbanki London depositors (or if excess payments have been made by FSCS TIF must pay the equivalent excess to FSCS);[22]

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18 See clause 2.3.2 of the UK loan agreement.

19 See clauses 4.2 and 4.4 of the UK loan agreement. This is consistent with the philosophy that there will be equal treatment in respect of recoveries and repayments as between HMT (as UK lender) and the Netherlands (as Dutch lender). It is also consistent with the repayment instalments (and the guarantees) commencing after seven years thereby allowing any reimbursements received out of the Landsbanki liquidation proceedings prior to June 2016 to be applied in reducing the loans (pro rata) and thereby reducing the repayment instalments.

20 See clause 6.1 of the UK loan agreement.

21 See clause 6.9 of the UK loan agreement. There is some vagueness in this requirement because it is not easy to say with certainty what constitute "*accepted international or European principles of treatment of creditors in an international winding up*." However, as we understand Iceland intends to act in conformity with international standards to ensure fair treatment of creditors we do not anticipate this provision (though unusual) is likely to cause particular difficulties.

22 See clause 7.2 (Equal Treatment) of the UK loan agreement. These types of "*equal treatment*" provisions, whilst

- Partial payments: Partial payments are applied first against principal and then against unpaid interest. The convention is that partial payments are paid first to interest and then to principal (though this formulation in the UK loan agreement is beneficial to TIF/Iceland);

- Change in circumstances: If the IMF concludes that there has been a significant deterioration in the sustainability of Iceland's debt relative to its assessment as at 19 November 2008 then the lender acknowledges it will on request meet with Iceland to consider how the loan agreement should be amended to reflect the change in circumstances.[23]

8. GENERAL OBSERVATIONS ON THE DUTCH LOAN AGREEMENT

8.1 The Dutch loan agreement is in substantially the same terms as the UK loan agreement. Accordingly, the comments made in 7.1 above apply equally to the Dutch loan agreement.

8.2 The main differences in respect of the Dutch loan appear to be as follows:

- Fixed amount: The loan is fixed at €1,329,242,850. As such it is a final settlement amount of the sums owing by TIF to the Netherlands and DNB in respect of the compensation payments made to Amsterdam depositors with Landsbanki;[24]

- Excess payments: Excess payments made under clause 4.1 reduce the repayment instalments on a pro rata basis (in the UK they reduce instalments in order of maturity);

- Interest accrual: Interest on the loan accrues from 1 January 2009 (as opposed from the date of disbursement in the UK loan);

- No agency drawdowns: Because there are no further drawdowns there is no mechanism for DNB to make drawdowns on behalf of TIF (as applies in relation to FSCS under the UK loan).

9. REIMBURSEMENT PROVISIONS

9.1 The UK loan is available for drawing until 30 March 2012.[25] The maximum amount which can be drawn is £2.35 billion. The Dutch loan is deemed outstanding in the sum of €1,329,242,850 and no further drawings can be made.

9.2 Interest is payable at 5.55% per annum (fixed) and compounds annually until 5 June 2016. The total principal amount of the loan then outstanding then pays interest (again at 5.55% per annum) on a cash pay basis with interest to be paid in cash quarterly.

9.3 Each loan outstanding as at 5 June 2016 is repayable in 32 equal quarterly instalments – starting on 5 June 2016 and ending on 5 March 2024.

9.4 Iceland's guarantee of each loan does not commence until 5 June 2016. Icelandic cannot, therefore, be called upon to repay the loan (or any amount in respect of the loan) by virtue of its guarantee before 5 June 2016. Such 'springing guarantees' are unusual but are occasionally encountered on international transactions. Usually the guarantee comes into force after a much shorter period than the seven years which apply in relation to the

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relatively unusual in standard loan agreements, are more common in loan agreements entered into by borrowers who find themselves in difficult financial circumstances. In fact these provisions can favour a borrower by helping it resist demands from future lenders for better terms than those negotiated by the original lenders.

[23] See clause 16 (Change in Circumstances) of the UK loan agreement.

[24] See clause 2.1 of the Dutch loan agreement.

[25] Unless terminated earlier because of a termination event.

guarantees given by Iceland here. However, we cannot think of any reason under English law why such long dated "springing guarantees" should not be valid.

10. TERMINATION EVENTS

10.1 Termination Events: If a Termination Event occurs then HMT or the Netherlands (as the case may be) can;

(a) cancel the facility (so that no further drawings can be made); and/or

(b) declare all or part of the loan and all other amounts due owing under the loan agreement are immediately due and payable.

10.2 The Termination Events are fairly typical of the types of events which would trigger cancellation and/or repayment of an international loan. However, there are a few Termination Events on which we would comment in particular.

10.3 Avoidance of payments: Clause 12.1.3 stipulates a Termination Event if "*any payment previously made by the Guarantee Fund or Iceland in respect of amounts due under the Finance Documents is avoided, set aside, invalidated or reduced.*" So if for any reason an amount paid to the relevant lender when due is for some reason set aside or reduced or similar then the entirety of the loan could become repayable.

10.4 Compliance with laws: A Termination Event occurs if TIF or Iceland "*fails to comply with the requirements of the Directive 94/19/EC in respect of any Landsbanki Depositor in any material way.*" In respect of the UK loan, as it is FSCS alone which has the right to drawdown monies under the loan agreement, TIF is dependent upon FSCS making those drawdowns to ensure TIF complies with the requirements of the Directive.

10.5 Inability to pay debts: It is a Termination Event if "*the Guarantee Fund is unable (taking into account any support available to it) or admits its inability to pay any of its debts as they fall due....*"

10.6 Compensation fund: It is also a Termination Event if TIF "*is dissolved or ceases to be...the sole deposit-guarantee scheme in respect of the Landsbanki Depositors officially recognised in Iceland for the purposes of Directive 94/19/EC*".[26]

11. DOCUMENTS EXAMINED

11.1 In preparing this paper we examined PDF copies of the following documents:

- The UK loan dated 5 June 2009;
- The Dutch loan dated 5 June 2009;
- A settlement agreement dated 5 June 2009 relating to the UK loan.

11.2 We have not examined any other documents for the purpose of preparing this paper.

Ashurst LLP
25 June 2009

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[26] We note that clause 7.2 (Equal Treatment) of each loan agreement contemplates the possibility of another deposit guarantee fund being introduced in Iceland for the purpose of Directive 94/19/EC and that if such guarantee fund makes additional payments to Landsbanki depositors in excess of €20,887 per claim then additional corresponding payments are made under the UK loan and the Netherlands loan. We would also note that clause 7.2 on the one hand says additional payments must be made whilst the Termination Event gives the UK and Dutch lenders the opportunity to terminate the loans and demand repayment in the circumstances which give rise to an additional payment under clause 7.2.