THE ICESAVE BANK OF ICELAND; FROM ROCK-SOLID TO VOLCANO HOT: IS THE EU DEPOSIT GUARANTEE SCHEME RESISTING FINANCIAL MELTDOWN?

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Summary: The Icelandic internet bank Icesave went bankrupt in late 2008. The insufficient Icelandic deposit guarantee scheme (Tryggingasjóður) did not resist the Icelandic financial meltdown and failed to compensate British and Dutch depositors the guaranteed sum of EUR 20,887 as settled in Directive 94/19/EC, which according to the European Economic Area Agreement (EEA) regulates the Icelandic financial sector. The British and Dutch deposit schemes paid out guarantees to their national Icesave depositors on behalf of the Icelandic scheme. Subsequently, an agreement was reached between Iceland, the United Kingdom and the Netherlands. As part of the arrangement, the Icelandic government guaranteed the reimbursement of the British and Dutch bridging loan. The Icelandic referendum of 6 February 2010 rejected the agreement and the Icesave Act, which torpedoed the Icesave reimbursement plan. The EFTA Surveillance Authority (ESA) issued a formal reprimand to Iceland. However, this has not been followed by any infringement proceedings as provided for by the EEA agreement. My position is that the ESA position results from a confusion of regulatory commitments with pecuniary liabilities. The key point is whether the Icelandic guarantee is in accordance with EU Directive 94/19/EC. The Directive requires the legislator to act. It is not a directive to force the government to pay (see Directive 94/19/EC Article 3.1.) This provision contributes to the implementation of the ban on Member States against guarantee schemes that distort competition. The schemes are self-financing and fully paid by the financial institutions. In the case of insufficient coverage, all depositors are subject to an equal pro rata reduction in compensation, as the scheme guarantee of full payment of the deposit guarantee sum of EUR 20,887 is an objective to be reached within a reasonable time and not a legal right from day one. Government aid to top up the fund

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is prohibited, whether it is the intention or consequence. The Icelandic government cannot cover the scheme's insufficiency by granting money to the fund. As the EU enjoys exclusive autonomy over its external relations, Member States cannot bilaterally arrange for such a solution. Thus, depositors not fully reimbursed are stuck with Icelandic bankruptcy proceedings. Claims are considered by the administrators in accordance with the Icelandic Bankruptcy Act on outstanding debts not paid out by the deposit guarantee scheme.

Market disturbances could be caused by branches of credit institutions which offer levels of cover higher than those offered by credit institutions authorized in their host Member States; whereas it is not appropriate that the level of scope of cover offered by guarantee schemes should become an instrument of competition.

Directive 94/19/EC on deposit guarantee schemes, preamble, 14th recital

1. The topic for discussion

Are deposit guarantee schemes (the main-road solution; see Section 3) a safe haven for depositors that entrusted their funds to failing financial institutions? Are national states' bailouts the answer, or are perhaps ordinary bankruptcy proceedings the only way (the alternative route in Section 4)?

This article debates the appropriateness of state intervention in the financial sector with respect to subsidisation, in particular focusing on the Icesave bankruptcy, the trilateral agreement between Iceland, the United Kingdom and the Netherlands[1] and the EFTA Surveillance Agency's criticisms of Iceland.[2] Different opinions exist on the validity of the Icesave agreement.[3] My position, as elaborated in this article, is that the trilateral agreement between Iceland, the UK and the Netherlands, amounts to illicit state aid and is therefore not in accordance with EU/EEA law.

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1 Agreement of 19 October 2009 between the UK, the Netherlands and Iceland. See the Letter of Intent between Iceland and the United Kingdom of 5 June 2009.

2 In its Letter of Formal Notice to Iceland, the EFTA Surveillance Authority on 26 May 2010 accused Iceland of breaching EU Directive 94/19, Case Ni 65560 – Dec, No 224/10/COL.

3 A spokesperson for HM Treasury said in *The Guardian* (London 6 June 2009): 'The government welcomes Iceland's commitment to recognise its obligations under the EC deposit guarantee scheme to repay depositors in Icesave'. For an opposite opinion, see Professor of economics John Kay, *The Financial Times* (London 24 February 2010), who characterised the Icesave agreement as 'shameful bullying'.

While it is clear that '[t]here may be state financing at this level … [it] only requires that *if* that option is chosen, *EU state aid rules are complied with*'(emphasis added)[4] The purpose of this article is to search for competition law regulations in cases where solutions result from Directive 94/19/EF,[5] the Treaty on the Function of the EU (TFEU) Article 107 and the EEA Agreement Article 61 (state aid limitations).

It is an undisputed fact that the Icelandic deposit guarantee scheme (Tryggingarsjóður innistæðueigenda og fjárfesta, hereinafter Tryggingarsjóður, the fund or scheme) was liable to cover all depositors' losses *up to* the sum of EUR 20,887 (which is about 1.7 million Icelandic krónur at a fixed, agreed exchange rate). However, since the total sum available was no more than 10.8 billion Icelandic krónur (EUR 68 million), funding was insufficient to cover all losses, which were approximately EUR 3.75 billion. Thus, the trilateral arrangement put a loan at the disposal of the fund for the purpose of reimbursing British and Dutch depositors in full (EUR 20,887). As the growth expectancy of the Icelandic fund was modest, the British and Dutch parties demanded that the Icelandic *government* guarantee the full performance of the contract, which in practice meant that Icelandic *citizens* were liable for the payment. The key point, however, is whether Directive 94/19/EC allows such public participation.

Obviously, there was an EU-law perspective present during negotiations. As told by the Icelandic Special Investigation Commission, the British and Dutch parties to the failing[6] agreement had 'no problem in finding support in European regulations for stopping irresponsible Icelandic banking activities … this "was the common understanding all over Europe"'.[7] However, law abidance is an untidy game, especially when

4 Statement by Chantal Hughes, Spokesperson of the European Commission, in answer to questions from various journalists on the Icesave and Deposit Guarantee Schemes (Press Conference, Brussels 3 August 2010). On-the-record statement on deposit guarantee schemes.

5 The 1994 Directive was amended by Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay [2009] OJ L 68/3. This was followed up in late 2009. See Financial services: Commission launches call for evidence on review of Investor Compensation Schemes Directive (IP/09/230) of 09/02/2009. Internal Market and Services Commissioner Charlie McCreevy said: 'We want to gather information on the practical application of the Investor Compensation Schemes Directive since it entered into force ten years ago, especially in light of the current financial crisis. This will help us to assess whether and how the Directive should be modified in order to better protect investors. I encourage all interested parties to give us their views', Commission letter from Charlie McCreevy to the Norwegian former Minister of Finance Kristin Halvorsen, jno 001582 (1 October 2009).

6 See EFTA Surveillance Authority (n 2) 2: 'To date, these negotiations have not resulted in an agreement being reached'.

7 P Hreinsson, T Gunnarsson and S Benediktsdóttir, *Rannsóknarnefnd Alþingis*, The Special Investigation Commission (SIC) Report of 12 April 2010, Althing Act No 142/2008, Chapter 18 Deposits in financial institutions 59.

public authorities like De Nederlansche Bank (The central bank of the Netherlands) stated the following: 'The deposit-guarantee schemes in the European Economic Area are a mess'.[8]

While law and economics is an important sector of jurisprudence, my effort here is neither to examine legislative issues on good governance within the financial sector nor predict the ultimate outcome of the EU's ongoing political discussions on banking policy revision. This article is mainly legal dogmatic and relates to the question of illicit state aid to the banking sector. Is the government of Iceland breaching EEA-law when agreeing to reimburse Dutch and British deposit guarantee schemes?

This article progresses as follows: section 2 presents certain basic facts; section 3 considers the legality of the proposed trilateral agreement with a special emphasis on the governmental reimbursement guarantee; section 4 outlines the legal status of the alternative route under Icelandic bankruptcy provisions; section 5 concludes the article.

2. The case: a short review

> The race to the bottom had begun in late 2007, as central banks globally began to lower collateral standards for open market operations … Ireland surprisingly in September 2008 removed any limits on bank deposit insurance coverage, which prompted Germany to follow suit and left Britain confronted with the threat of large deposit outflows. Soon much of the rest of Europe was raising coverage limits. Rather than containing the rush to nationalization of the bank funding base, the EU Economic and Financial Affairs Council fueled the race by proposing to massively expand minimum coverage to 50,000 [euros] and shorten payout periods while allowing member states to keep increasing their coverage without limit and cover non-retail depositors.
>
> Hans-Joachim Dubel[9]

2.1. The background[10]

Icesave, a subsidiary of the Icelandic bank of Landsbanki, was established in 2006 as a purely internet bank, gaining customers at first in

[8] Hreinsson et al (n 7) s 58.

[9] HJ Dubel, 'Europe's Second Pillar: a European Deposit Insurance System, Complementing Monetary Union, Can Help to Contain the European Race' (2008) (fall) Entrepreneur Magazine. <http://www.entrepreneur.com/tradejournals/article/191646692_3.html> accessed 21 October 2010.

[10] For a detailed presentation of the background, see Wikipedia <http://en.wikipedia.org/wiki/Icesave_dispute> accessed 26 October 2010.

the United Kingdom and later (spring 2008) in the Netherlands. Its potential resulted from aggressive marketing offering sky high interest rates. Icesave, operating in the United Kingdom and the Netherlands, was the recipient of a tremendous sum of deposits due to its deposits policy. While the average Central Bank of England discount rate was 4.75% at the time of its British start-up, Icesave offered interest at 6.2%. The Dutch, following the European Central Bank (ECB) discount rate of 3.75%, became the victim of Icesave 'predator' interest rates of 5.25%, which resulted in billions of euros of fresh injections into the Icelandic banking industry. This aggressive policy led to a strong 'dissatisfaction within the Central Banks in those European countries where the Icelandic banks had started raising deposits with high interest rates'.[11]

Icelanders, however, were not offered such advantageous terms. This resulted in an inflow of Dutch and British funds to the benefit of the Icelandic Landsbanki, the owner of Icesave.

Due to the still not fully harmonised EU rules on bank compensation schemes,[12] national funds may offer different coverage provided that all financial institutions operating within one state are part of a national treatment scheme; ie that all banks enjoy the right of topping up. While Tryggingarsjóður's guarantee covers *up to* EUR 20,887, the coverage of the British fund (Financial Services Compensation Scheme, FSCS) is GBP 36,000 (about EUR 43,000). The Dutch fund offers compensation up to EUR 100,000. As will be shown, this maximum delimitation not only addresses the depositor, but also the Member State.

Clearly the British and Dutch Icesave bank deposits were the sole result of the Icelandic predator interest rate: 'the deposit volume [started to] fall off when the banks stopped offering best-in-market interest rates'.[13]

Due to the failed Icesave refund of Dutch (of total deposits of EUR 1.7 billion, EUR 1.3 billion to be repaid) and British deposits (of total deposits of EUR 4.1 billion, EUR 2.35 billion to be repaid), the two states decided to honour obligations to all domestic depositors. In the Netherlands, 'Ice-

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[11] Hreinsson et al (n 7) 63.

[12] This, however, is about to happen. The Former Norwegian Minister of Finance, Kristin Halvorsen argued in a letter to the EU Commission on 4 September 2009 that Norway was eligible, within the framework of the EEA, to keep the special Norwegian deposit scheme roof of 2 million Norwegian kroner (EUR 250,000) and thus refused to abide by the draft EU limitation (EUR 100,000 maximum). A Commission letter from Charlie McCreevy, jno 001582 (1 October 2009), is, however, in the negative: 'If a neighbouring EEA country could apply a 135% higher coverage level, this would lead to a significant competitive distortion' (p 1).

[13] MJ Flannery, 'Iceland's Failed Banks: A Post Mortem', in *Vidauki 3 til Rannsóknarnefnd Alþingis*, Report prepared for the Icelandic Special Investigation Commission (November 2009) 106. <http://sic.althingi.is/pdf/RNAvefVidauki3Enska.pdf> accessed 22 October 2010.

save savers qualify for compensation up to EUR 100,000 each'.[14] In the United Kingdom, the depositors 'will receive their money in full'[15] (ie GBP 36,000). The explanation was simply that solutions to the contrary would result in furious reactions among people in the United Kingdom and the Netherlands. Despite insufficient Icelandic coverage, the necessity of politics overruled strict dogmatic law.

Subsequently, these domestic British and Dutch policies led to the trilateral agreement, which Icelanders overwhelmingly rejected in a referendum (98.4% against).

2.2. The EFTA Surveillance Authority's position – a presentation

The EFTA Surveillance Authority (ESA), in a letter of formal notice as the first step in infringement proceedings as provided for by the EEA agreement,[16] expressed a criticism of Iceland's breach of the trilateral agreement. Among its central premises are the following:

1. Directive 94/19/EC '"imposes obligations of result on the EFTA States".[17] … Accordingly, the Authority considers that the Article imposes an obligation of result on the Icelandic Government'.[18] The result was to honour the guarantee, which never happened. 'To the Authority's knowledge no payments at all have been made by the Fund'.[19]
2. The 'Authority considers that the fund forms part of the Icelandic State within the meaning of the EEA Agreement although it is, in Icelandic law, constituted as a private foundation'.[20]
3. Such a result is to ensure that a 'deposit guarantee scheme is set up that is capable of guaranteeing the deposits of depositors up to the amount laid down in Article 7(1)'.[21]
4. The wording of Article 7 (1) is unconditional. It provides for a right to compensation in the event of deposits being unavailable.[22]

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14 See De Nederlandsche Bank decision of 11 December 2008 <http://www.dnb.nl/en/news-and-publications/news-and-archive/news-2008/dnb208600.jsp> accessed 3 October 2010.

15 Se HM Treasury decision of 9 October 2008 <http://www.hm-treasury.gov.uk/press_103_08.htm> accessed 1 October 2010.

16 By 18 October 2010, the ESA had not yet decided to deliver a reasoned opinion on the alleged Icelandic breaches of Directive 94/19/EC. See EFTA Surveillance Authority (n 2) 15.

17 EFTA Surveillance Authority (n 2) 7. The same view is made even more explicit in the ESA press release of 26 May 2010: 'Iceland is obliged to ensure payment of the minimum compensation to Icesave depositors in the United Kingdom and the Netherlands, according to the Deposit Guarantee Directive'.

18 EFTA Surveillance Authority (n 2) 8.

19 EFTA Surveillance Authority (n 2) 9.

20 EFTA Surveillance Authority (n 2) 9.

21 EFTA Surveillance Authority (n 2) 6-7; statement by ESA President Per Sanderud (press conference 26 May 2010).

22 EFTA Surveillance Authority (n 2) 7.

5. There is no 'specific legislative provision' in Directive 94/19/EC to justify exceptional circumstances to derogate from the above mentioned effects.[23]
6. No provision of Directive 94/19/EC indicates that the obligation 'to refund deposits can be reduced in any way under any circumstance'.[24]
7. While domestic depositors 'were covered in full … the foreign depositors did not enjoy that minimum guarantee … The principle of equal treatment … would be rendered meaningless if states were permitted to move some depositors out of a failing bank while leaving others there'.[25]

From these premises, ESA draws the following conclusion: 'Therefore, as neither the Fund nor the government have ensured payment to those depositors in the Netherlands and the United Kingdom whose deposits became unavailable … Iceland has failed to comply with its obligations under Article 7'.[26]

I am not convinced by these arguments, as discussed in section 3.3. Here, I follow the position of distinguished Icelandic legal scientists: 'All in all these arguments show that the Icelandic government has no responsibility for deposits made in domestic banks' foreign subsidiaries at the time of the bankruptcy. No liability for the national state can result from the view that directives have been breached'.[27] In the same vein, the Director of the Norwegian Deposit Guarantee Scheme stated: 'If Landsbankinn had been under Norwegian jurisdiction, the bank's subsidiaries abroad would not have been included in our national scheme'.[28]

Before I come to these issues, please let me first introduce the reader to a short description of EEA competition law, as implemented by Iceland.

3. The 'main road' solution of deposit guarantee schemes

> In your letter you propose 'topping up' and an export ban as remedies for competitive distortions. However … [f]rom a European perspective topping-up agreements pose difficulties as they introduce a discrepancy in the European financial safety net framework … These arguments plead for removing topping-up and for full application of

[23] EFTA Surveillance Authority (n 2) 10-11.

[24] EFTA Surveillance Authority (n 2) 12.

[25] EFTA Surveillance Authority (n 2) 13.

[26] EFTA Surveillance Authority (n 2) 8. See also the conclusion on p 15.

[27] L Blöndal, S Líndal and SM Stefánsson, 'Stjórnarskráin og Icesave-samningarnir' ('The Constitution and the Icesave Agreements') *Morgunblaðið* (Reykjavik, 2 December 2009).

[28] Statement by Arne Hyttnes in the Icelandic newspaper *Morgenbladid* (Reykjavik 18 February 2010).

> the home country principle – which will effectively be in place with the full harmonisation of the coverage level as of end 2010.
>
> Charlie McCreevy[29]

Iceland is a member of the EEA and bound by its provisions. The internal market seeks to satisfy equality and non-discrimination of traders in all areas, including the financial sector: 'Where domestic rules governing the capital market and the credit system are applied to the movements of capital liberalized in accordance with the provisions of this Agreement, this shall be done in a non-discriminatory manner' (EEA Article 42.1). EU Directive 94/19/EC was incorporated into the EEA by EEA-committee decisions No 18/1994 and 12/1998. One of the main obstacles to domestic financial sector subsidisation is the Directive's preamble, 13th recital:

> the retention in the Community of schemes providing cover for deposits which is higher than the harmonized minimum may, within the same territory, lead to disparities in compensation and unequal conditions of competition between national institutions and branches of institutions from other Member States … whereas it is not appropriate that the level of scope of cover offered by guarantee schemes should become an instrument of competition.

A legal study has indicated that deposit security schemes have reached the attention of the Competition Directorate in connection with unlawful subsidisation:

> In late 2008, the Irish decided that during the following two years, national state guarantees under Irish deposit guarantee schemes would increase to the benefit of deposits. The Irish scheme is similar to the Icelandic one. This decision included six Irish banks only. The British and several other Member States took the position that Irish policy contradicted EU competition law, since it implied state aid, which resulted in a distortion of competition. As a consequence, the common ground for financial sector competition in Europe was shaken … Accordingly, the position among the dominant EU Member States, at the end of September 2008, was the rebuttal of borrowing arrangements guaranteed by a national state.[30]

Iceland transposed and implemented EC Directive No 94/19 with Act No 98/1999 on deposit guarantee schemes and the investment compen-

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[29] Statement by Charlie McCreevy (EU Commission letter 1 October 2009, j no 001582) to the former Norwegian Minister of Finance Kristin Halvorsen.

[30] Blöndal et al (n 27). The Irish action prompted heavy criticism from Hans-Joachim Dubel, founder of Finpolconsult, Berlin (n 9).

sation system (see the Trade Department Statute of 21 February 2000). The key point is whether Iceland could live up to the rules of the game, which will be discussed later.

3.1. Iceland: domestic provisions on deposit guarantee schemes

The basic question relates to the territorial reach of the Icelandic rules. Do we face extraterritorial effects: a long-arm reach in deposit guarantee schemes? Do Icelandic rules embrace depositors living in the UK and the Netherlands? Since the Icelandic scheme transposes EC Directive 94/19, its reach closely follows the EU *acquis*: 'Deposit-guarantee schemes introduced and officially recognized in a Member State in accordance with Article 3 (1) shall cover the depositors at branches set up by credit institutions in other Member States'.

Thus, there is no doubt that foreign branches' activities, like Icesave's in the Netherlands and the UK, are included. To sum up: Icelandic deposit guarantees cover the first EUR 20,887. The topping up of the British or Dutch scheme is covered by these countries' respective schemes.

The deposit guarantee scheme of Iceland was established by *Lög um innstæðutryggingar og tryggingakerfi fyrir fjárfesta* (the Deposit Guarantee Fund and Investment Compensation Fund Act) of 27 December 1999 No 98 (hereinafter Icelandic Act No 98/1999) and the Ministry of Trade Statute of 21 February 2000. The implementation of this was achieved with the creation of Tryggingasjóður. Subsequently, Iceland established the Financial Supervisory Authority (*FME*) to supervise the depositor guarantee scheme: 'Each Member State shall ensure that within its territory one or more deposit-guarantee schemes are introduced and officially recognized' (Article 3.1). In addition, it is clear that the Member State will check that branches, such as the Icesave branch of Landsbanki, operating abroad 'have cover equivalent to that prescribed in this Directive' (Article 6.1).

This fund covers all deposits up to EUR 20,887. Its status as a private fund is stated in Article 2. All banks offering services in Iceland are obliged to become members. In accordance with Article 13, this also applies to foreign branches if their domestic coverage does not cover the Icelandic guarantee level. In such cases, membership is compulsory (Article 15). The contingent connection to a specific deposit guarantee fund should be communicated to the bank's depositors (Article 12 i f).

The fund's objective is to raise sufficient capital to resist financial meltdown in the banking sector. The emphasis is on the private financing of the fund (0.15% of bank deposits in the preceding year in accordance with Article 6), the minimum of which is 100 million Icelandic króner (Article 7). The provisions limit the national state's engagements, as the objective is a self-regulating financial sector independent of state aid or funding from guarantee schemes.

Some seem to think that all depositors enjoy a legal claim to the deposit guarantee sum, which in the Tryggingasjóður case is estimated at EUR 20,887.[31]

Setting aside the estimated compensation, the starting point is that Tryggingasjóður should pay depositors an amount equivalent to 'the value of his stocks, shares and cash deposits' (Article 9 Paragraph 1). This provision should be read in the context of Article 10, which regulates the case of insufficient funds. In this case, the scheme should refund all depositors up to 1.7 million Icelandic króner (based on the exchange rate *vis-à-vis* the Euro on 5 January 1999; ie EUR 20,887). Any surplus should be divided equally among all depositors. The explicit amount per investor is determined by the fund's total size. Claims on the fund are final. Thus, a person that fails to regain his deposit through the claims settlement procedure is also unable to gain from future recovery from the fund. The settlement date therefore marks the end of the reimbursement claim, which also indicates that the guarantee sum of EUR 20,887 is nothing but a limited apportioned solution. No depositors may receive payment in full if the fund is insufficient.

There is no obligation for the Icelandic state to top up the private fund of Tryggingasjóður (Act No 98/199 Article 2). But does the government of Iceland have the right to contribute monetary support to the fund? Is an agreement with the British and Dutch governments an option? Is it in accordance with EU competition law to contribute money to the Icelandic fund?

The answer lies in Directive 94/19/EC, read in conjunction with other provisions of competition law. This is an area of EU common policy. Competition law grants the EU autonomy and pre-emptive powers. There are no remaining competencies with the Member States. This includes both domestic and foreign relations.[32] State aid is valid under the TFEU Article 107(3) 'by decision of the Council on a proposal from the Commission'. Such a decision is necessary as Directive 94/19/EC presupposes that a deficiency removes the ability to borrow money and leaves no other option. Deviating from such a prohibition requires the relevant Member State to adopt a bill in accordance with Article 107(3). This, however, is not the case. No such proposals exist. Thus, the trilateral agreement between Iceland, the UK and the Netherlands is invalid.

[31] Per Christiansen, professor of law, now a judge at the EFTA Court (*Aftenposten* Oslo 12 January 2010).

[32] For a general discussion on the EU's exclusive autonomy, see P Orebech, 'The EU Competency Confusion: Limits, Extension Mechanisms, Split Power, Subsidiarity and Institutional Clashes' (2003) 13 Journal of Transnational Law and Policy 99-151.

Even more compelling in the Icelandic situation is the fact that the country is party to the EEA only. To legally adapt to the challenging situation in the aftermath of the Icesave bankruptcy, it was necessary to implement a new EU solution in the EEA in line with procedures in EEA Part VII Chapter 2 (see especially Articles 102-104).

Clearly, the direct trilateral contract and negotiations are not in line with the required procedure. Thus, Iceland enjoys no right of intervention in the decisions of Tryggingasjóður.

3.2. The Icesave agreement: an overview

First of all, it is necessary to make some comments on the legal context. Trade in services is the exclusive competence of the EU, the consequence of which is the pre-emptive force of the EU *acquis*, not only internally but also externally. Internal EU competence is mirrored by competence in external relations, which results from the principles of parallelism and implied power developed in the case law. Despite a lack of express power, the EU enjoys external competence that matches its internal common policies.[33] Clearly, trade in banking services is fully within the EU's competence.

The agreement between Iceland, the United Kingdom and the Netherlands was signed on 19 October 2009. The EU was not involved, at least not formally. The text builds on a Letter of Intent with the United Kingdom of 5 June 2009. Formally, the agreement is a civil law loan from the United Kingdom (GBP 2.35 billion) and the Netherlands (EUR 1.33 billion) granted to the non-governmental Icelandic fund (Tryggingarsjóður).

This builds on the fact that Member States retained their own deposit guarantee schemes, which required that foreign banks operating abroad be invited to top up their guarantee by becoming parties to the host country scheme so as to equalise guarantees for all banks competing on the same market, as prescribed in Directive 94/19/EC:

> Whereas the retention in the Community of schemes providing cover for deposits which is higher than the harmonized minimum may, within the same territory, lead to disparities in compensation and unequal conditions of competition between national institutions and branches of institutions from other Member States; whereas, in order to counteract those disadvantages, branches should be authorized to join their host countries' schemes so that they can offer their

[33] See Case 22/70 *Commission v Council* [1971] ERTA ECR 263. For exclusive EU competency, see Opinion 1/75, *Local Cost Standards* [1975] ECR 1355, 1363; Opinion 2/91, *ILO Convention 170 on Chemicals at Work*, [1993] ECR I-1061; Case C-268/94 *Portuguese Republic v Council* [1996] ECR I-6177.

> depositors the same guarantees as are offered by the schemes of the countries in which they are located.[34]

This provides for a guarantee system abroad in the host state of the foreign branch, and not the system at home (in this case Iceland), ie a provision related to banks operating abroad, in this case the Icesave branches of Landsbanki in its UK and Dutch operations. Secondly, the topping-up is carried out by branches abroad by contributing membership fees of 0.15% of their share capital.

Icesave Bank became a member of the UK and Dutch deposit guarantee schemes, which subsequently qualified Icesave depositors for the UK and Dutch reimbursements. For the British fund, the following was said on the Landsbanki subscription to the British deposit guarantee scheme: 'The firms that have topped up into the UK Scheme are listed below with their FSA reference numbers and the month and year FSCS or the predecessor scheme accepted their application to top up. In Iceland, Landsbanki Islands …'[35]

Since Tryggingarsjóður was hopelessly out of funding, the UK and Dutch funds reimbursed all UK and Dutch depositors in full, with a view to claiming against Iceland for a refund. In practical terms, this means that the Icelandic compensation scheme should pay out to all depositors at the maximum level of EUR 20,887.[36] The Agreement ensured that 'UK taxpayers are refunded for the compensation the UK Government paid out via the Financial Services Compensation Scheme (FSCS) on behalf of the Icelandic Depositors' … Fund … to Icesave retail depositors with the UK branch of Landsbanki'. The government of Iceland guaranteed reimbursement within a period of 15 years, but enjoyed respite for the first 7 years. In the final 8 years, the refund of the loan and interest should take place. As it became clear to everyone that Tryggingarsjóður, due to the slow growth in funding because of the modest deposits in Icelandic banks today, would not be capable of servicing the debt, the guarantee of the Icelandic state became the salient point. It was further agreed that there would be a system to pay back to the FSCS any compensation from the administrators in the Landsbanki bankruptcy case that devolved on Tryggingarsjóður.

As pointed out by Iceland, the validity of the Agreement depends upon the national ratification process. This ratification never took place

[34] Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes, preamble, 13th recital [1994] OJ L135/5.

[35] Financial Service Authority accepts Landsbanki Islands hf (FSA No 207250/July 2006) <http://www.fscs.org.uk/consumer/making_a_claim/deposits/EEA_firms_that_have_topped_up/> accessed 8 October 2010.

[36] Press release by the Government of the Netherlands (13 October 13 2009).

because the compulsory sanctioning of the Icelandic President in accordance with the Icelandic Constitution, Article 26, was denied.

The Agreement states the understanding that both the United Kingdom and the Netherlands recognise, as part of the Icesave Agreement, the Icelandic Icesave Act of 28 August 2009 (No 96/2009). This Act was amended on 30 December 2010 (Act No 1/2010 on the State Guarantee for Loans by Security Schemes for the Benefit of Depositors).[37] The UK position on these amendments was as follows: 'Iceland reaffirms its binding guarantee of the obligations of the Icelandic Deposit Guarantee Fund to compensate UK and Dutch depositors with Icesave without admitting any pre-existing legal obligation to provide that support'.[38] Thus, the British position is that Iceland stands by its guarantee without regard to what might have been prior conditions. However, these issues, due to the referendum of 6 March 2010[39] are beyond the scope of this article.[40]

Does the Icelandic action prior to the agreement with the United Kingdom and the Netherlands result in legal obligations for Iceland? Could one say that talks and diplomatic action, *aide memoirs*, etc produce more or less contingent obligations for the Icelandic state to comply with? 'The UK government has made it clear repeatedly that this decision to protect UK depositors in Icelandic banks was made after extensive conversations with the Icelandic government.'[41] The political contact between Iceland's Minister of Finance Arni Mathiesen and the UK Treasury Secretary Alistair Darling resulted in the following: 'At no point does the Icelandic finance minister state unequivocally that Iceland would not honour its obligations. Instead, Mr Mathiesen says that Iceland plans to use its compensation scheme to try to meet obligations to British depositors'. In response to direct questions from Mr Darling, Mr Mathiesen said the following: 'We have the [deposit] insurance fund according to the Directive and how that works is explained in this letter [to the UK] and the pledge of support from the government to the fund.' Mr. Darling followed up: 'So the entitlements the people have which I think is about £16,000, they will be paid?' Ari Mathiesen answered: 'Well, I hope that will be the case. I cannot state that or guarantee that now but we are certainly working to solve this issue. This is something we really don't want to have hanging over us.' Clearly, any legally binding international obligation cannot follow from this conversation.

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37 *Althingi* Decision (30 December 2009) (33 for and 30 against).

38 See HM Treasury press release no 94/09 (19 October 2009) paragraph 10.

39 98.4% voted no and 1.6% yes. Voter turnout was 62.4%.

40 See statement by the Government of Iceland (press release 6 March 2010) 'Work continues on a mutually acceptable solution to Icesave … Early figures indicate a decisive result and assuming final results in line with these figures, Act 1/2010 will be automatically repealed pursuant to Article 26 of the Constitution of the Republic of Iceland'.

41 Transcript of telephone conversation, *Financial Times* (London 23 October 2008).

A Dutch presentation on Icesave stated the following:

> the deposit-guarantee scheme is predicated on an EU directive that obligates governments to ensure that the minimum deposit insurance protection of EUR 20,000 is provided for ... We are aware that in a response to a request for clarification regarding the governmental backing of the Icelandic deposit guaranty scheme, the government of Iceland has at least in one instance issued a letter clarifying its role in the funding of that scheme and reiterating its obligation pursuant to the relevant EU directive.[42]

The latter citation illustrates the Landsbanki understanding of the public liabilities of Iceland. Any additional obligation to EC Directive 94/19 is out of the question.

The ongoing joint considerations and negotiations on reimbursement illustrate that no agreement has been reached and that the Icelandic referendum is recognised by the UK and the Dutch:

> Over the past several weeks there has been steady progress toward a settlement. In the context of these new talks, the British and Dutch Governments have indicated a willingness to accept a solution that will entail a significantly lower cost for Iceland than that envisaged in the prior agreement ... The three governments have declared their intention to continue the talks and find a solution to the matter.[43]

In conclusion, I would like to add that the former Minister of Finance, Ari Mathiesen,[44] maintained that Iceland's responsibility was limited to the EEA Agreement provisions. This consistent position is mirrored by an Icelandic press release:[45] 'During the talks, the Icelandic negotiating team has also put forward a proposal which entails that Iceland guarantees full payment of deposits up to the minimum laid down by EEA rules.' Thus, Iceland admits its obligations within the limits of the EU Directives, especially EC Directive 94/19. For new obligations to occur, a new agreement is needed. As any solution is still pending, the correct position is that the legal state is mirrored by the above-mentioned directive.

The following discussion relates the analysis of EEA/EU competition law to Icelandic legislation on bankruptcy and deposit guarantee funds.

3.3. The ESA position: a discussion

This section elaborates on the ESA criticism of Iceland. Is the ESA position based on safe legal grounds? I am considering here the issues

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[42] Hreinsson et al (n 7) 57.

[43] Statement of the Government of Iceland (Press Release 6 March 2010).

[44] A Mathiesen (personal communication in the Althing, 11 January 2009).

[45] Icelandic Government press release (Reykjavik March 2010).

raised in the ESA Letter of Formal Notice of 26 May 2010. A basic difficulty is what the problem under discussion is all about. One issue is whether domestic Icelandic provisions may preclude individuals from claiming compensation for damages resulting from defective supervision on the part of that authority. Another is whether Iceland's actions have met the required objectives.

Clearly Member States bound by the Directive have an obligation to achieve the results envisaged by it. There is no disagreement that Member States should take all necessary measures to accordingly ensure fulfilment of their obligations, as stated by the European Court of Justice on several occasions: 'to take all appropriate measures, whether general or particular, to ensure the fulfillment of that obligation'.[46] I have no difficulty in adhering to that position. The discussion, however, concerns the reach of national obligations according to Directive 94/19/EC. This is discussed below.

3.3.1. The 'obligations of result'

1. ESA's understanding is that the EEA requirements of Member States to produce 'obligations of result'[47] are not satisfied in the case of Iceland, as:

> the objective of the Directive to enhance depositor protection would be compromised if the Directive were interpreted as only obliging Member States to set up a deposit guarantee scheme without any obligations to actually ensure that the aggrieved depositors are provided with compensation.[48]

The ESA position is that since 'neither the Fund nor the Government have ensured payment to those depositors … [to] whom deposits became unavailable within the meaning of the Directive, Iceland has failed to comply with its obligation under Article 7'.[49] Therefore, the competent authorities (in Iceland the FME) should not only verify the credit institutions' compliance with the conditions of Directive 94/19/EC but also make certain that depositors *de facto* enjoy compensation in full: 'From this reasoning, it can be inferred that if compensation of depositors prescribed by the Directive is not ensured in the event that deposits become unavailable … the State should be held liable'.[50]

The EU seems to support ESA here:

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[46] See Case 14/83 *von Colson and Kamann v Land Nordrhein-Westfalen* [1984] ECR 1891 para 26.

[47] EFTA Surveillance Authority (n 2) 6.

[48] EFTA Surveillance Authority (n 2) 13.

[49] EFTA Surveillance Authority (n 2) 8.

[50] EFTA Surveillance Authority (n 2) 9.

> The Commission considers that in the specific case of Iceland, the liability of the Icelandic State for the reimbursement due by the Icelandic Deposit Guarantee Scheme to the EU depositors stems from the *defective implementation of the Directive in Iceland*. The capacity of the scheme was not proportionate in relation to the size and risks posed by the Icelandic banking sector.[51]

I disagree.[52] My position derives from the Directive's preamble, 24th recital, which reads as follows:

> 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.

'Proportionate capacity', meaning that Tryggingarsjóður should fully refund all deposits *from day one*, is not among the liabilities of Directive 94/19/EC (see paragraph 3.3.4).

2. While ESA mainly argues its case on the basis of the Directive's preamble, 24th recital, the answer to national state obligations follows from Article 3.1, read in conjunction with the 13th and the 23rd recitals. As clearly indicated, and which has escaped the considerations of ESA, the actual financing of the system is nothing but a private enterprise: 'the cost of financing such schemes must be borne, in principle, by credit institutions themselves' (Directive 94/19/EC, preamble, 23rd recital). This is further elaborated on in Article 3.1 (which is also not emphasised by ESA): 'the system must not consist of a guarantee granted to a credit institution by a Member State itself or by any of its local or regional authorities'. This provision should be read in the context of the preamble, 13th recital:

> Whereas the retention in the Community of schemes providing cover for deposits which is higher than the harmonized minimum may, within the same territory, lead to disparities in compensation and unequal conditions of competition between national institutions and branches of institutions from other Member States**.**

This text clearly indicates that the deposit guarantee scheme is prohibited from any steps that may lead to distortion of competition, which

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51 Hughes (n 4) emphasis added.

52 See also Blöndal et al (n 27) 11 'The national State's responsibility according to Directive No 94/19 occurs only if the State fails to establish provisions or fails to comply with commitments deriving from the Directive. In this case, State liability is a possibility and compensation may result if the prerequisites are fulfilled. No indication exists, however, that confirm their existence'.

may very well result if Member States of the EU/EEA are allowed to throw money into their own schemes:

> Nearly all countries regulate their banking industries quite heavily. In part, such regulation reflects formal and informal government policies that choose to subsidize troubled banks instead of letting them fail. Some regulation is motivated by the belief that governments will not permit their banks to fail and impose losses on depositors.[53]

Such policies are not in accordance with EU competition goals. The financial sector should be unshackled from state subsidisation and other discriminatory practices, otherwise a 'race to the bottom' is a distinct possibility.[54]

3. Competition law prohibits 'unequal conditions of competition between national institutions and branches of institutions from other Member States' (Directive 94/19/EC, preamble, 13th recital). Clearly, it 'is not appropriate that the level of scope of cover offered by guarantee schemes should become an instrument of competition' (preamble, 14th recital). If the Directive is interpreted so as to place the government of Iceland with pecuniary responsibility, the Member State has breached the ban on state subsidisation.

The EU Directive on depositor guarantee schemes does not imply any duty on the part of Iceland to top up or in any way provide monetary support to the fund. There is no provision that makes the government of Iceland liable to pay EUR 20,887 to British and Dutch depositors as a result of the failing depositor guarantee fund. On the contrary, national states are prohibited from contributing to the fund. In the case of insufficient funds due to collapse or bankruptcy, the answer is private insurance against insufficiency (Article 7). Thus, Directive 94/19/EC does not entitle the establishment of any reimbursement system.

Directive 94/19/EC does not provide any other route for the rescue of Icesave Bank depositors. Thus, whether or not private depositors are excluded from any action, Iceland and other national states may not by their own efforts pump money into the failing fund. However, no Directive provision prohibits states from granting money to depositors. This conclusion results from the basic presumption in TFEU Article 107(3): 'by decision of the Council on a proposal from the Commission'. This action, however, has never taken place.

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[53] MJ Flannery, 'The Importance of Government Supervision in Producing Financial Services' in *Vidauki 8 til Rannsóknarnefnd Alþingis*, report prepared for the Icelandic Special Investigation Commission (Reykjavik 2009) s 3 <http://sic.althingi.is/pdf/RNAvefViduaki3Enska.pdf > accessed 22 October 2010.

[54] See Dubel (n 9).

4. The position of the Icelandic government is that it has 'fully complied with its obligations under Directive 94/19/EC. The government has no further obligation based on the Directive than to set up a Guarantee Scheme in line with the Directive'.[55] The role of the national state is to initiate the establishment of, supervise, control and sanction the depositor guarantee scheme: 'Each Member State shall ensure that within its territory one or more deposit-guarantee schemes are introduced and officially recognized' (Article 3.1). In addition, it is clear that the Member State shall check that branches, such as the Icesave branch of Landsbanki and other Icelandic banks, operating abroad 'have cover equivalent to that prescribed in this Directive' (Article 6.1). However, it is not the responsibility of the national state to inform depositors of the 'amount and scope of cover offered by the guarantee scheme' (Article 9.1). This responsibility does not even rest with the Fund, but with the credit institutions of the financial industry.

Here the question is whether Iceland's depository protection schemes are construed as provided for by the Directive. With Act No 98/1999 on Deposit Guarantee Schemes and Investment Compensation Systems and the Trade Department Statute of 21 February 2000, Iceland has transposed the EEA rules of Directive 94/19/EC. Both Tryggingasjóður and the existence of a guarantee sum have been established, as has the supervision of Tryggingasjóður by the Icelandic Financial Supervisory Authority, Fjármálaeftirlitsins (FME). The required fee system of funding the deposit guarantee scheme has been set up, ie a tax of 0.15% on bank deposits for the previous year, the minimum of which is 100 million Icelandic krónur. When it comes to monitoring Iceland's performance, it is a common understanding that

> [a]s Icesave was operated under a Landsbanki branch, EU/EEA rules stipulate that control of its activities shall be in principle the responsibility of the FME in Iceland, although, pursuant to the same rules, the FSA UK was to supervise the liquidity management of the branch and, furthermore, was authorised to intervene in the branch's market behaviour related to Icesave.[56]

5. How can it be assessed whether or not the national scheme is in line with the relevant provisions? Some arguments can be derived from the Case of *Peter Paul and Others*:

> Directive 94/19, Article 3(2) to (5) thereof does not confer on depositors a right to have the competent authorities take supervisory measures in their interest … That interpretation of Directive 94/19

[55] Letter of the Icelandic Government to the Authority 23 March 2010, 5.

[56] Rannsóknarnefnd Alþingis, Special Investigation Commission (SIC) Report 12 April 2010 ch 18, p 5.

is supported by the 24th recital in the preamble thereto, which states 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 the compensation *or* protection of depositors under the conditions prescribed in the directive.[57]

The salient point is whether governmental responsibilities, named by the ESA as obligations of result, relate to *pecuniary refunding* or *regulatory activity*, or both. As stated, the obligation is fulfilled *either* by ensuring the compensation *or* protection of depositors as prescribed in Directive 94/19/EC. If so, such Member State action pre-empts depositors' legal proceedings. The deposit guarantee scheme is, as stated in the 23rd recital, fully self-financing. Tryggingasjóður is a private fund. Accordingly, it suffices that the fund's domicile state has arranged for *the necessary protection* in accordance with the 94/19/EC prescriptions. Consequently, as stated in Article 3.1, *it is a directive to the legislator to act. It is not a directive to the government to pay*; 'the system must not consist of a guarantee granted to a credit institution by a Member State itself or by any of its local or regional authorities'.

Thus two conclusions seem appropriate: first of all, the EEA or EU Member State should not contribute monetarily to the establishment of the fund. Secondly, no public payment is entitled if insufficient funding is demonstrated at the time of a bank collapsing.

3.3.2. Is Tryggingasjóður a twin of the government of Iceland?

Or, otherwise formulated, should the deposit guarantee fund of Iceland include not only Tryggingasjóður but the entire Icelandic treasury? The ESA understanding is that a Member State's obligation goes further. Not only does the system initiate and implement requirements, the government of Iceland, as ESA understands it, is responsible for de facto remuneration of depositors. Despite the Guarantee Scheme's private foundations (Article 3.1), ESA identifies Tryggingasjóður with the government of Iceland: 'Finally, the Authority considers that the Fund forms part of the Icelandic State within the meaning of the EEA Agreement although it is, in Icelandic law, constituted as a private foundation'.[58] As a result; 'the Fund is to be regarded, for the purposes of EEA law and Directive 94/19/EC, as an emanation of the Icelandic State'.[59]

From this platform, ESA construes a national state liability additional to Tryggingasjóður to ensure that the necessary results are attained

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[57] Case C-222/02 *Peter Paul and Others v Bundesrepublik Deutschland* [2004] ECR I-09425 paras 30-31 emphasis added.

[58] See EFTA Surveillance Authority (n 2) 9.

[59] EFTA Surveillance Authority (n 2) 10.

'if the Deposit Guarantee Fund established under the Directive fails to achieve the result prescribed'.[60]

The implication of this is that the national state with its assets *in toto* is responsible for the remuneration of depositors in the case of financial crisis. Thus the ruin of the equal competition that resulted from unilateral topping up of deposit guarantee schemes, which was so heavily criticised,[61] is instantly put into effect by the ESA interpretation. My position is that ESA confuses the statutory subjects. No provision invites the mixing of a private fund's obligation to pay with that of a public agency. As stated above (section 3.3.1), there is no way that Directive 94/19/EC imposes *pecuniary* obligations on the domicile state.

3.3.3. Depositors' legal interests

The ESA view is that 'individual depositors have rights conferred on them by the directive'.[62] If that is the case, the question arises whether these rights are against the Icelandic government. Clearly, rights exist in relation to Tryggingarsjóður. However, the Directive does not promote analogies between the Fund's depositor liability and the liability of the national state. As justified in *Peter Paul and Others*, the liability *ratio jurisdictione personae* is limited.

> [I]f the compensation of depositors prescribed by Directive 94/19 is ensured, Article 3(2) to (5) thereof 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 (paragraphs 30-32).

Since the provisions are issued by means of a directive, the main addressee is the Member State and not its citizens, with the exception of cases of direct applicability which follow from a close interpretation of the Directive text.[63] Member State liability to prescribe a compensation system as construed by Directive 94/19/EC should be ensured, not the compensation as such. Thus, private depositors have no right to reimbursement *vis-à-vis* national authorities if the national state otherwise satisfies its obligations according to the Directive. As is clear from its domestic legislation and political statements, Iceland has no intention of

[60] EFTA Surveillance Authority (n 2) 12.

[61] As documented in Wikipedia (n 10).

[62] EFTA Surveillance Authority (n 2) 7.

[63] As stated by the European Court of Justice in Case 1974/41 *van Duyn v Home Office* [1974] ECR 1337, provisions, if the text is explicit enough, may enjoy direct application.

transposing or implementing requirements beyond the Directive.[64] Thus, depositors can raise no liability claims against the government of Iceland. Accordingly, the ESA position here is ill-considered and out of touch with legal realities.

3.3.4. Is it a minimum deposit, a maximum, or both?

Alternatively, if 'obligations of result on the EFTA States'[65] are not met in the case of the Icesave collapse, the question is whether the *de facto* refund of depositors' money as guaranteed in Directive 94/19/EC is measured by a minimum or maximum reimbursement sum?

The answer here relates to whether the national state owes any obligation to reimburse depositors the minimum sum of EUR 20,000. The textual interpretation is clear: it is the sum *up to* EUR 20,000 that is guaranteed. Does, for example, EUR 5,000 or 10,000 etc satisfy the provision? In other words, is the 'up-to' provision a prospective goal to be reached or is it a legal right to be enforced by the depositor?

The ESA position implies that the sum of EUR 20,887 is a minimum. Seemingly, this is supported by the text in the preamble: 'whereas it would appear reasonable to set the harmonized minimum guarantee level at ECU 20,000; whereas limited transitional arrangements might be necessary to enable schemes to comply with that figure' (Directive 94/19/EC, preamble, 16th recital). Clearly; the founding fathers of this text consider ECU 20,000 (now EUR) as a suitable guarantee sum. Interpreting this text, one should keep in mind that the addressees are twofold: both the national state and deposit fund on the one hand, and the depositor on the other, the latter by means of direct applicability. The depositor relation dictates that no one may extract more money from the fund than is actually deposited in the bank. This is obvious, and I have no further interest in this.

However, as I understand the text, as far as the national state and guarantee deposit fund are concerned, 20,000 is the *ultimate target* of the deposit guarantee schemes to be fulfilled in the years to come. Since the text is *a directive* and not a regulation, the provisions point out *directions and objectives* to be reached, but not an exact non-discretionary legal claim as of day one. Thus, it is for the Member State or even the guarantee deposit scheme to decide whether the maximum is also a minimum from day one or whether another sum is appropriate in the period of building

[64] See transcript (n 40) in connection with n 43 and n 44.

[65] EFTA Surveillance Authority (n 2) 7. The same view is made even more explicit in the ESA press release of 26 May 2010: 'Iceland is obliged to ensure payment of the minimum compensation to Icesave depositors in the United Kingdom and the Netherlands, according to the Deposit Guarantee Directive'.

up the fund. The idea behind the prescriptions is the need for time in working up basic capital (of which the Icelandic fund at the date of the bank's collapse possessed EUR 17.5 million). There is no timeframe within which sufficient funding should be achieved. Article 3.1 states 'Each Member State shall ensure that within its territory one or more deposit-guarantee schemes *are introduced and officially recognized*' (emphasis added). The national state liability is to establish legal systems of compulsory membership of such funds and also to license the funds. This is what the requirements are all about. Clearly, there is no provision forcing upon Member States a fully functional system lock, stock and barrel from day one. In Article 7.4, the question is one of a 'percentage guaranteed', which relates to the 'aggregate deposits until the amount to be paid under the guarantee reaches the amount referred to in paragraph 1'. Again, it is implicitly said that the guarantee sum is not fixed, but accumulative and increasing until it has reached its maximum level of EUR 20,000.

The EU recognises that the set up of fully workable schemes may take time:

> for certain classes of credit institutions which take only an extremely small proportion of deposits, the introduction of such a system may in some cases take longer than the time laid down for the transposition of this Directive; whereas in such cases a transitional derogation from the requirement to belong to a deposit-guarantee scheme may be justified; whereas, however, should such credit institutions operate abroad, a Member State would be entitled to require their participation in a deposit-guarantee scheme which it had set up.[66]

Thus, for financial institutions that operate abroad and who suffer from insufficient guarantees at home, foreign systems of deposit security schemes should come to the rescue. If we call to mind the Icesave case, we see that while national Icelandic coverage was failing, British and Dutch schemes took care of their own domestic depositors through the Icesave membership of these schemes – the topping up procedure.

The case of *Peter Paul and Others* does not support the minimum position.[67] 'The depositor's right to compensation … is governed by Article 7(1) and (6) of that directive. Article 7(1) determines the *maximum* amount of compensation …' (Paragraph 27, emphasis added). This maximum is stipulated as follows: 'aggregate deposits of each depositor must be covered up to ECU 20,000' (Article 7(1)).

This amount is not, as in the ESA position, a *minimum* reimbursement obligation. It is a conditional minimum and a maximum at the

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[66] EFTA Surveillance Authority (n 2) 7.

[67] *Peter Paul* (n 56).

same time. The minimum should be read under a *ratione jurisdictione terminae* limitation. This understanding is supported by the reading of the second paragraph of Article 7 (1): 'Until 31 December 1999 Member States in which, when this Directive is adopted, deposits are not covered up to ECU 20,000 may retain the maximum amount laid down in their guarantee schemes, provided that this amount is not less than ECU 15,000'. Here, former guarantee schemes older than the year 2000 may be retained, though not if below EUR 15,000. This means that 15,000 is the maximum for countries that would like to retain their previous maximum level. The provision does not, however, say anything on the minimum in such countries.

In case the Member State maximum deposit guarantee is less than 15,000, this country is obliged to increase the fund 'up to' EUR 20,000. As stated in Directive 94/19/EC Article 3.1, *it is a directive to the legislator to act. It is not a directive to the government to pay*; 'the system must not consist of a guarantee granted to a credit institution by a Member State itself or by any of its local or regional authorities'.

No minimum limit relates to new schemes founded during this last decennium. Thus, while EUR 20,000 is *a goal* towards which Member States should direct their regulations, it is not required that such a sum be instantly in place, and that the fund be *de facto* capable of reimbursing depositors in the event of financial breakdown. It takes time to work up capital. Deposit guarantee funds are allowed to take their time. See, as an illustration, the case described in the preamble, recital 16; 'limited transitional arrangements'. This covers the Icelandic Tryggingasjóður scheme, which was in a build-up phase. As the fund pay-out is final, this solution is supported by the fact that the deposit guarantee fund in the event of insufficient coverage is distributed to depositors on a *pro rata* scaling-down basis.

3.3.5. Does Iceland discriminate against foreign depositors?

1. The ESA claims that the 'domestic depositors of Landsbanki were transferred to a new bank "new Landsbanki" … The domestic depositors had thereby access to their funds in full at all time'.[68] The discrimination argument seems at first sight to carry. As said in Directive 94/19/EC, preamble 3rd recital: 'in the event of the closure of an insolvent credit institution the depositors at any branches situated in a Member State other than that in which the credit institution has its head office must be protected by the same guarantee scheme as the institution's other depositors'. Accordingly, foreign depositors are protected by Tryggingasjóður as well. No one seems to object to this perception.

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[68] EFTA Surveillance Authority (n 2) 2.

However, for ESA, this is not the case. On one hand, there are the Icelandic regulatory competences, which happen to bring about disadvantages to foreigners in contravention of the EEA Agreement Article 4,[69] and on the other there is the issue of civil law acquisitions, which is the case here. My position is that the EEA agreement does not ordain which investments to make. National states, like private enterprises, may possess companies (in this case financial institutions), which according to the EEA Agreement Article 125 are beyond the scope of the agreement.[70] The government of Iceland is fully sovereign as to which commercial engagements to undertake. Iceland and other national states enjoy full autonomy in their commercial considerations. The takeover of Landsbanki does not necessitate the takeover of Icesave. This is my primary position.

2. An alternative position is to say that an Icelandic takeover bid for Landsbanki that leaves out Icesave is in itself not discriminatory in a national sense, as all foreign depositors in the old Landsbanki were offered identical solutions to domestic depositors. This includes all depositors, whether they are domiciled in Iceland or not. Icelandic citizens abroad might deposit money in Icesave.

I concur with Blöndal, Líndal and Stefánsson's views.[71] As a starting point, no subsidiary EU statutes (directives or regulations) may contradict EU treaties (in this case TFEU Article 107 – illicit state aid),[72] and neither may national provisions. The situation is similar under EEA Article 61 with regard to Iceland, Liechtenstein and Norway. State aid is prohibited if not otherwise explicitly decided on by the Council (or the Commission). As it is commonly acknowledged that illegal subsidisation relates to the consequences not the intentions,[73] the effects of national state guarantees on the Deposit Guarantee Schemes are fully established.

The salient point is whether the Icelandic Guarantee Scheme, which requires that the Icelandic state top up the fund, contravenes EC Directive No 94/19. Since the Directive is decisive, one does not need to include TFEU/EEA treaty interpretations. The Directive was drafted under the influence of competition law measures and aims to avoid situations in which

> schemes providing cover for deposits which is higher than the harmonized minimum … within the same territory, lead to disparities

[69] For a closer look at the provision, see S Norberg, K Hökberg and others, *The European Economic Area. EEA Law. A Commentary on the EEA Agreement* (Fritzes, Stockholm 1993) 102-103.

[70] Peter Orebech, 'The Art of Subsidizing Fuel Free Electricity under the European Economic Area Agreement as Illustrated by the Norway Reversion Instrument' (2010) 74 Chicago-Kent Law Review 101-129.

[71] Blöndal et al (n 27) 11.

[72] ESA misses out the state aid perspective. Nowhere is subsidisation up for discussion. See EFTA Surveillance Authority (n 2).

[73] J Shaw, *The European Union Law* (Palgrave, Basingstoke 2000) 30.

in compensation and unequal conditions of competition between national institutions and branches of institutions from other Member States. (preamble, 13th recital)

or which consist of 'a guarantee granted to a credit institution by a Member State itself or by any of its local or regional authorities' (Article 3.1).

4. Taking the alternative route: Icelandic bankruptcy law

If not otherwise provided for in legislation, creditors are subject to bankruptcy law proceedings in cases of insolvency and insufficiency for sharing remaining possessions on an equal footing.

The owner of the Icesave internet bank, Landsbanki Islands is under investigation, which may end up in composition or bankruptcy. The Iceland Finance Surveillance Committee put the bank under administration on 7 October 2008 in accordance with the Lög um fjármálafyrirtæki (the Financial Industries Act) of 20 December 2002 No 161 Article 100 a. It is expected that proceedings will last several years.[74]

Bankruptcy is dealt with in accordance with the Icelandic Lög um gjaldþrotaskipti. (Bankruptcy Act) of 26 March 1991 No 21. The Financial Institutions Act, Article 98 Paragraph 2, explicitly states that the Bankruptcy Act relates to 'a financial institution's right to apply for a period of grace or composition'. We are told that 'general bankruptcy rules are valid for the liquidation of finance institutions with regard to mutual contractual rights and obligations'.

The position of depositors has improved resulting from amendments that took place in the aftermath of the Icesave failure. Secured creditors replaced unsecured ones. Accordingly, 'the amendments result in the account-holder gaining strength in the final distribution of assets'.[75] One issue, however, should be considered, and that is the possibility of setting aside fraudulent preferences if conditions are satisfied (see Chapter XX in Lög um gjaldþrotaskipti – the Bankruptcy Act).Thus, by implementing such instruments, depositors' losses will remain where they belong: with the chief executive officers (CEOs) that plunged the financial institutions of Iceland over the cliff.

Following this line of thought, depositors' only option is to chase up the assets of the failing Landsbanki through bankruptcy proceedings. In this way, depositors are forced to follow the general path taken by all failing companies. As always, the option of special treatment for bankruptcy debtors needs special arrangements. However, no special arrangements have been construed or singled out under Icelandic competition law with

[74] Statement by Professor Thoralfur Matthiasson (University of Island) *Aftenposten* (Oslo 6 January 2010).

[75] Blöndal et al (n 27).

regard to the implementation of EC Directive 94/19. Thus, bankruptcy proceedings are all that are available to depositors or their successors, the Dutch and British states respectively.

5. Conclusion

The EU/EEA financial sector is in principle self-financing, a position that however is not shared by ESA.[76] Funding the depositor guarantee schemes is subtracted from the 0.15% tax on Icelandic banks' total assets. In the case of insufficiency, the scheme may borrow money, whether private or public. Another option is to insure against unexpected and uncovered losses. There are no other ways. Going for a national state guarantee prompted by insufficiency, as is the case with Tryggingasjóður in the Icesave case, is a breach of Directive 94/19/EC.

However, an agreement on the Icesave reimbursement, financed by loans taken out by Tryggingasjóður, stripped of any guarantees from the Icelandic government, is clearly legal, as the growing scheme alone should service the loan.

Since a depositor guarantee scheme may not operate as a means of competition, it is equally prohibited to implement legal systems *the effect* of which is distortion of competition. State funding cannot be brought into national depositor guarantee schemes, as stated in Directive 94/19/EC. In the event of lacking coverage, all depositors suffer from a *pro rata* scaling-down. National state 'filling in' is clearly unwarranted. A possible new system requires amendments to this Directive. Such amendments should be transposed into EEA law to become binding in Iceland. I am afraid that no initiative has yet been undertaken to fill this gap.[77]

The following is the conclusion of this survey: neither the government nor the people of Iceland should pay for the failure of Icesave Bank. The Landsbanki-Icesave CEO's responsibility cannot be doubted. As stated in Directive 94/19/EC, preamble, recital 19, one vital objective is 'to encourage depositors to look carefully at the quality of credit institutions'. Clearly, it is a directive to the legislator to act. It is not a directive to the government to pay. Depositors should critically assess bank leadership before trusting private funding to the bank. The bank deposit rules are published. Those seeking high profits are also subject to high risks.

This solution places responsibility where it belongs, with the leadership of the banks and the CEO that failed to run the company and keep it afloat. Such a solution does not spoil the expectations of depositors.

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[76] On the contrary; EFTA Surveillance Authority (n 2) 9.

[77] See Financial Services Directive (n 5), which does not introduce state aid as an appropriate instrument. On the contrary, a new harmonised deposit guarantee scheme system will result. See Financial Services (n 5).