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Chapter 18: Deposits in Financial Institutions in Branches Abroad

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Chapter 18

Deposits in Financial Institutions in Branches Abroad

18.1 Introduction

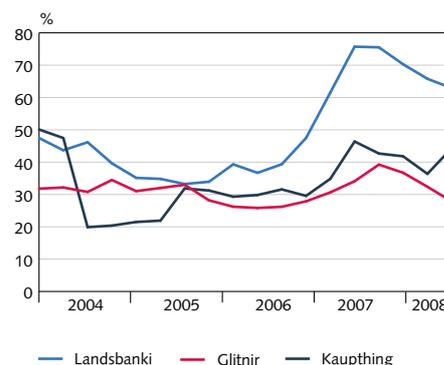
As related in Chapter 8.0, where the financing of the Icelandic banks is discussed, as well as changes to the financing structure, the ratio of deposits in their financing had decreased at the beginning of the decade, while the banks increasingly satisfied their financing needs through foreign loans and by issuing securities. Around the turn of the year 2005/2006, foreign ratings agencies, as well as analysts, criticised the Icelandic banks, e.g. for having their ratio of deposits to lending too low. The banks reacted to this criticism by stating their intention to increase deposits. In light of the substantial increase in total lending by the banks, there were limited possibilities to sufficiently increase deposits in the domestic market to improve this ratio. The banks had placed great emphasis on expanding their activities abroad, either by establishing subsidiaries or through the operation of branches. Although these activities were initially aimed at securities activities, participation in syndicated loans and corporate finance, as well as related financing, the banks soon focused increasingly on utilising their operations abroad to increase deposits as part of their financing for both their domestic and foreign operations. Some of the banks' subsidiaries abroad already offered deposit accounts; however, this factor in the banks' operations will not be discussed specifically here.

The Icelandic banks started raising deposits in their branches abroad through so-called wholesale deposits, i.e. deposits based on agreements arranged by intermediaries. This generally involves funds which companies, public bodies, organisations or well-to-do individuals choose to keep for a certain period of time with agreed rates of return. Later, the banks started offering special retail deposit accounts. Landsbanki Íslands hf. was the first to offer such accounts in October 2006, marketed under the name Icesave. Kaupthing Bank hf. opened their so-called Edge accounts in November 2007, and in June 2008 Glitnir Bank hf. marketed their accounts under the name Save & Save.

These accounts brought the banks into new markets where the customers were invited to do their transactions over the Internet, in addition to which high interests were offered compared to the interest rates generally offered by banks in these markets on deposit accounts.

Whether deposits were raised through subsidiaries or branches was relevant, both as regards how the funds could be used for financing within the banking group concerned, and whether the deposits would be covered by the deposit guarantee scheme in Iceland or the state in which the operation was carried out. The branches were a part of the banks' parent companies in

Figure 1
Ratio of deposits to lending



Source: Banks annual reports.

Iceland and the deposits raised by them were covered by the Depositors' and Investors' Guarantee Fund of Iceland; however, it varied whether the rules of the branch's host state limited the possibilities of the parent companies to transfer funds, accrued to deposit accounts, to other parts of the banking group, including to Iceland. As the branches were a part of a parent company located in Iceland, the Financial Supervisory Authority (FME) in Iceland became responsible for supervising their operations. Therefore, the Special Investigation Commission (SIC) decided to examine especially the establishment of the branches and their deposit-taking activities. The so-called Icesave accounts, offered by Landsbanki through its branches in London and the Netherlands, occupy a unique position in this regard which will be discussed later. First, the deposit-taking activities of the banks' branches abroad will be discussed in general terms.

The so-called wholesale deposits, raised by the Icelandic banks' branches abroad, were already substantial in volume when the banks decided to offer their special deposit accounts under the brand names Icesave, Edge and Save & Save. Thus, the wholesale deposits in the Landsbanki London branch amounted to €1,432 million in total when the bank started marketing the Icesave accounts in October 2006 and wholesale deposits in the Landsbanki branch in the Netherlands €997 million when the bank launched Icesave there. It should be noted that despite the SIC's requests, adequate information has not been submitted regarding the division between wholesale deposits and other deposits, and any changes made to these, in the banks' branches abroad.

Kaupthing initially offered the so-called Edge accounts in the bank's branch in Finland in November 2007. In the end, the bank had received deposits into such accounts in a total of 11 countries and was preparing to open these accounts in other countries. However, it varied whether these accounts were within branches or subsidiaries abroad; as mentioned earlier, deposits received by branches were covered by the Depositors' and Investors' Guarantee Fund in Iceland. The Kaupthing Edge accounts were located in branches in the following countries (months and years in parentheses

Balance of deposits in Kaupthing Edge

<i>All figures in millions of Euros</i>	<i>1 Nov. 2007</i>	<i>5 Dec. 2007</i>	<i>3 Jan. 2008</i>	<i>4 Feb. 2008</i>	<i>3 Mar. 2008</i>	<i>3 Apr. 2008</i>	<i>2 May 2008</i>	<i>3 June 2008</i>	<i>1 July 2008</i>	<i>1 Aug. 2008</i>	<i>1 Sep. 2008</i>	<i>30 Sep. 2008</i>
<i>Branch¹</i>												
Finland	15	43	49	53	63	73	84	102	111	123	132	134
Sweden	–	66	90	97	119	134	145	185	223	260	274	262
Norway	–	–	–	79	149	194	175	186	203	244	255	239
Germany and Austria	–	–	–	–	–	3	46	196	300	420	510	533
<i>Subsidiaries</i>												
UK an the Isle of Man	–	–	–	–	89	510	1,124	1,573	2,055	2,599	3,054	3,646
Belgium, Luxembourg and Switzerland	–	–	–	–	7	48	64	78	130	224	325	396
Denmark	–	–	–	–	–	–	41	92	118	146	165	178
<i>Total</i>												
Branches	15	110	139	230	331	403	450	669	837	1,047	1,171	1,168
Subsidiaries	–	–	–	–	97	558	1,230	1,744	2,303	2,969	3,544	4,220

1. Guarantee by the Depositors' and Investors' Guarantee Fund.
Source: Kaupthing banki hf.

denote when the activities commenced): Finland (November 2007), Sweden (December 2007), Norway (February 2008), Germany (April 2008) and Austria (September 2008). On the other hand, the Edge accounts were operated in Kaupthing subsidiaries in the following countries (months and numbers in parentheses denote when the activities commenced): UK (February 2008), Denmark and Luxembourg (May 2008), Isle of Man (June 2008) and Switzerland (July 2008).

On 30 September 2008, the deposits in the Kaupthing Edge accounts amounted to a total of €5,388 million, thereof a large majority was received by subsidiaries or €4,220 million, whereas €1,168 million were received by branches. The branch in Germany had received the largest amount, €532 million. In the investigation carried out by the SIC, it emerged that Kaupthing had started offering its Edge accounts in the UK through its branch there but soon abandoned the idea. At the time when the marketing of these accounts started, there were discussions, i.a. in the British media, about the situation of depositors holding accounts with the Icelandic banks with regard to the situation of the Depositors' and Investors' Guarantee Fund in Iceland. Because of this, Kaupthing transferred its Edge accounts in the UK to a subsidiary, Kaupthing Singer & Friedlander.

Out of the three large banks, Glitnir had the lowest ratio of deposits to lending in past years. Glitnir started raising wholesale deposits once it had opened its branches abroad, which were an addition to its subsidiaries operated i.a. in Norway and later in Finland. The largest part of these deposits was received by the bank's London branch, and by the end of 2007 these amounted to £1.3 billion. In the period between March and September 2008, deposits in Glitnir's London branch were reduced by £528 million. In Glitnir's profit announcement for the third quarter of 2007, it was revealed that the owners of deposits in the London branch were i.a. central banks, companies, banks, housing financing agencies and local governments. It was not until June 2008 that Glitnir started offering high rate electronic retail deposit accounts abroad. These accounts went under the brand name Save & Save. Such accounts were first introduced in Norway but were also available in Iceland. In his presentation on these new deposit accounts, Lárus Welding, CEO of Glitnir, stated that the bank's goal was to increase considerably the ratio of deposits in the bank's operation over coming years. Considering how late these accounts were established in the Glitnir operations, the SIC sees no further cause to discuss them in this report.

18.2 Icesave Accounts in the London Branch of Landsbanki Íslands hf.

18.2.1 General Remarks on the Icesave Accounts of Landsbanki Íslands hf. in London

In 2002, Landsbanki Íslands hf. bought Heritable Bank Ltd in the UK.¹ In early 2005, Landsbanki opened its London branch and according to a notification submitted to the FME, the purpose of operating the branch was twofold, on the one hand credit granting services, and corporate finance on

1. Halldór Jón Kristjánsson and Sigurjón Þorvaldur Árnason: Developments leading up to the Icelandic banking crisis in October 2008. Draft 16 March 2009, p. 7.

the other. In a letter dated 29 June 2004, the bank notified the FME that it had decided to expand the services of the branch so as to include deposit taking. It was stated that this would entail that the branch would accept wholesale deposits acquired through the intermediation of Heritable Bank Ltd. The branch then started marketing its electronic deposit accounts under the name Icesave Easy Access in October 2006, however these were only intended for retail customers. In addition, the branch continued to accept wholesale deposits.² Although the deposits into the Icesave accounts were accepted by the London branch of Landsbanki, the day-to-day administration of the accounts was carried out by the staff of the bank's subsidiary, Heritable Bank, on the one hand, and an agreement was made with Newcastle Building Society, on the other hand, concerning computing, settlement, etc.

Mark Sismey-Durrant, Chief Executive of Heritable Bank, was also the Managing Director of Icesave.

It was decided to keep the deposit accounts in a branch, rather than establish a special subsidiary for that purpose or operate these within the subsidiary Heritable Bank. This way it would be easier to transfer funds upstream from the accounts to other parts of the group.³ UK rules on large exposures place considerable limitations on such transfers of funds in the case of subsidiaries. This arrangement entailed, however, that the deposits were guaranteed in Iceland by the Depositors' and Investors' Guarantee Fund, as is covered in greater detail in Chapter 6.0. In his statement before the SIC, Sigurjón Þ. Árnason, CEO of Landsbanki, described that in 2008 circumstances had changed. "We have raised five billion [GBP] through the branch and now there is this unfavourable publicity and the Guarantee Fund has become the main point, not the strength of the banks, but suddenly the Guarantee Fund has turned into some main point, which was never the case before, and nobody had even contemplated. This suddenly becomes the main focus," said Árnason.⁴

He also mentioned that it had "not occurred to anyone that there was a remote chance of a collapse like that which [would] later come to pass".⁵

Árnason stated that in June 2007, a quarter of the Icesave deposits had been transferred to a fund used to buy foreign securities considered both very safe and marketable. At the end of June 2008, the deposits in the Icesave accounts amounted to around £3.6 billion. The fund's aim was to help the bank even out fluctuations caused by withdrawals from the Icesave accounts. Árnason stated that these securities had later been used in repurchase transactions with the Central Bank of Europe (ECB) in late 2007, which prevented them from being used to even out fluctuations.⁶ When asked whether the bank had otherwise changed its lending policy or had stated any intention to do so once its financing became increasingly reliant on deposits, Árnason claimed that the intention had been to increase asset based lending, for example in the UK. That market had been highly developed in the United States but underdeveloped in Europe.⁷

2. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 39.

3. Halldór Jón Kristjánsson and Sigurjón Þorvaldur Árnason: Developments leading up to the Icelandic banking crisis in October 2008. Draft 16 March 2009, p. 88.

4. Statement by Sigurjón Þ. Árnason before the SIC on 19 August 2009, p. 80.

5. Statement by Sigurjón Þ. Árnason before the SIC on 27 August 2009, p. 8.

6. Statement by Sigurjón Þ. Árnason before the SIC on 27 August 2009, p. 12-13.

7. Statement by Sigurjón Þ. Árnason before the SIC on 25 August 2009, p. 25.

When asked how Landsbanki had intended to obtain foreign currency to meet withdrawals from the Icesave accounts, i.a. in view that the facilitation of the Central Bank of Iceland was largely limited to Icelandic krónur, Árnason stated that the bank had assumed it had access to euros there and would be able to acquire other currencies through the ECB. In addition, there was the so-called “swap market” for the exchange of currencies.⁸

In the hearing, Sigurjón Þ. Árnason also described how the brand name Icesave was created. He claimed that Landsbanki representatives had initially thought it was negative for an Icelandic bank to market deposit accounts in the UK. An advertising agency employed by the bank pointed out that it would never be possible to conceal the origin of the bank and, therefore, it would be better to simply advertise it especially. As a result, the brand name “Icesave” was created.⁹

Viggó Ásgeirsson, Director of Marketing and Web Development, Landsbanki, had previously described in an interview with *Morgunblaðið* newspaper on 28 February 2008 that research had indicated that “a simple and clear message together with a strong link to Iceland would prove beneficial” in the marketing of the Icesave accounts.

As 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. The Icesave issue was also discussed within the Central Bank of Iceland, which i.a. held meetings with representatives of Landsbanki on a number of occasions. Both the FME and the Central Bank also interacted with their counterparts in the UK in respect of the Icesave accounts, and meetings were held with their representatives in the latter part of 2008. Finally, the Icesave issue was discussed in meetings held in the consultative group of the Prime Minister’s Office, the Ministry of Finance, the Ministry of Business Affairs, the FME and the Central Bank of Iceland on financial stability and contingency planning. This interaction will not be related here in detail as it is covered in other parts of this report, Chapter 19.0 in particular. However, certain aspects relevant to the overall picture of the history of the Landsbanki Icesave accounts will be addressed. The SIC also believes that there is reason to point out that despite the fact that the Icesave operation in the UK commenced in the autumn of 2006, and its growth and attendant deposit increases culminated in 2007, it was not until 2008 that Icesave became prominent within these institutions according to existing documentation on their activities and their mutual relations, and interactions with Landsbanki.

In the hearing before the SIC, Eiríkur Guðnason, Governor of the Central Bank, stated that one of the directors of Landsbanki had told him in late 2007, in the period leading up to the Central Bank amending its rules on reserve requirements regarding deposits into the accounts of the banks abroad, that Landsbanki was not transferring to Iceland the funds accrued to the deposit accounts in the branches abroad. It was not until after the middle of 2008 that it had emerged that these funds were being transferred to Iceland.¹⁰

“According to him [Viggó Ásgeirsson] the single largest project abroad was the marketing of the Icesave accounts in the UK. “Research indicated that a simple and clear message together with a strong link to Iceland would prove beneficial. The numbers speak for themselves and the Icesave deposits have increased at an incredible speed.””

Morgunblaðið newspaper, an interview with Viggó Ásgeirsson, Director of Marketing and Web Development, Landsbanki, 28 February 2008.

8. Statement by Sigurjón Þ. Árnason before the SIC on 19 August 2009, p. 92.

9. Statement by Sigurjón Þ. Árnason before the SIC on 19 August 2009, p. 8.

10. Statement by Eiríkur Guðnason before the SIC on 26 May 2009, p. 37-38

“As from today Landsbanki offers depositors in the UK a new tax-free savings account, Icesave Isa, with an interest rate of 6.1% on deposits of one thousand pounds or more [...] and The Sunday Times reports that this is best rate offered on savings accounts of this type [...]. In fact, various banks in the UK which offer similar or the same type of savings accounts have reduced their interest rates following the cut of policy rates by the Bank of England which results in Landsbanki offering significantly better rates. As with the Icesave accounts, which have been a great success, the rates are guaranteed to be 0.3% above the policy rate of the Bank of England until the beginning of 2011 and at least equal to it until 2013.”

Icelandic Financial News, 15 January 2008, p. 4.

“Results published by the key players in Iceland’s financial sector last week helped alleviate fears that the country is on the cusp of a Northern Rock-style bank funding crisis. But analysts reckon that, thanks to a series of cross-shareholdings across the Icelandic economy, it would not take much for the whole country’s financial system to go into meltdown.”

The Daily Telegraph, 5 February 2008.

“British savers have billions in Icelandic accounts, but its banking system is looking shaky.”

The Sunday Times, 10 February 2008.

“Like many Icelandic companies, FL owned big stakes in other local blue chips. Such cross ownership has been cited as a chief vulnerability in the Icelandic system because it means that when one company’s shares are hit, others are as well.”

Reuters, 14 February 2008.

Davíð Oddsson, Chairman of the Board of Governors of the Central Bank, stated in the hearing before the SIC that it had not been until well into 2008 that the Board had realised that the funds accrued to the Icesave accounts were being transferred home to some extent.¹¹ Eiríkur Guðnason noted that in hindsight it had been a bad mistake to discontinue the detailed information acquisition previously employed by the Central Bank on the division of deposits by branches, and only oblige the banks to submit this information in overall summary statements. It was not until after amendments had been made to the rules on reserve requirements in March 2008 that the Central Bank started collecting information where a distinction was made between deposits of foreign parties in branches abroad on the one hand and domestic branches and headquarters on the other hand.¹²

In the hearing before the SIC, Sigurjón Þ. Árnason said that he believed that the Governors of the Central Bank should have realised that the funds accrued to the Icesave accounts were being used in part in the bank’s activities in Iceland. They had been part of the funds used in the capital management of the bank as a whole. Árnason, however, stated that in 2008 there had in fact not been any scope to transfer funds to Iceland from the bank’s Icesave accounts. The reason, he said, was the extensive outflow of wholesale deposits that year. Therefore, the inflow of deposits had been, in fact, balanced by the aforementioned outflow of wholesale deposits.¹³

Capital management of the Icesave funds will be covered in greater detail in the discussion on the financing of the banks, see Chapter 8.0.

18.2.2 Liquidity Management of the London Branch of Landsbanki Íslands hf.

Landsbanki Íslands hf. was granted a special Global Liquidity Concession from FSA liquidity control which was to remain valid until 2011. The parent company was in charge of the branch’s liquidity management under the supervision of FME in Iceland.¹⁴

Following the liquidity problems Northern Rock encountered in the autumn of 2007, which later resulted in the UK overtaking the bank in February 2008, the British media turned its attention to other banks that might pose a risk in regard to savings. The Icelandic banks received unfavourable publicity, especially as regards their rising CDS spreads. To name an example, an article was published in *The Daily Telegraph* on 5 February 2008 under the title “Is Iceland headed for meltdown?”. A mention could also be made of an article in *The Sunday Times* on 10 February 2008, titled “Time to bale out of Iceland?”. On 3 March 2008, *The Financial Times* published an interview with Prime Minister Geir H. Haarde under the title “Iceland’s PM urges banks to curb plans for expansion”. That same day, i.e. 3 March 2008, the television station Channel 4 in the UK ran a programme on the safety of deposits in the country. In this programme, the host interviewed Davíð Oddsson, Chairman of the Central Bank’s Board of Governors. Davíð states

11. Statement by Davíð Oddsson before the SIC on 7 August 2009, p. 24-25 and 49.

12. Statement by Eiríkur Guðnason before the SIC on 26 May 2009, p. 37-38.

13. Statement by Sigurjón Þ. Árnason before the SIC on 19 August 2009, p. 57 and 61.

14. Undated memorandum from the FME on communications with the FSA in 2008, compiled by GJ.

that the CDS spread for the Icelandic banks is too high. He goes on to say: “The economy of this country is quite extraordinary good. [...] I think that the CDS that are so much higher on some of these banks than on the average elsewhere is not fair and should not be so high.” He claims that no bank can withstand in the long run a CDS spread of 5-600 points. Later in the interview, the reporter quotes Oddsson as claiming that the Icelandic State can afford to guarantee deposits in all the banks. In Oddsson’s own words: “These banks are so sound that nothing like that is likely to ever happen. And if something would happen we would never be talking about the whole amount, because it is never like that, but even so Icelandic economy, the state being debtless, this would not be too much for the state to swallow, if it would like to swallow it.”

On 15 March 2008, The Financial Times published an article where anonymous interlocutors liken Iceland to a giant hedge fund. An article published in MoneyWeek on 19 March 2008 could also be mentioned in this context as it discusses which banks in the UK could be risky to entrust with one’s savings. The Icelandic banks are considered most risky of these, cf. the following concerning their CDS spreads: “But if they’re Icelandic, then be afraid; these banks are starting to be priced for bankruptcy risk.” Finally, The Daily Telegraph published an article on 8 April 2008 stating that in all likelihood Iceland will need the assistance of the International Monetary Fund (IMF). The title of the article was “Fear of Iceland bail-out could signal new future for the IMF”. Around the same time, various analysts, such as J.P. Morgan, Merrill Lynch, Moody’s, and others, published unfavourable reports on the Icelandic banking system. This led to a run on the Landsbanki Icesave accounts.

In the period between 10 February and 22 April that same year, withdrawals amounted to close to £1 billion, or approximately 20% of the total deposits in the Icesave accounts at the London branch of Landsbanki.¹⁵

Nonetheless, Landsbanki managed to withstand the run and deposits started flowing in again.

As mentioned earlier, the Icesave operations, as well as significant deposit-taking services vis-à-vis legal entities, were carried out within the London branch of Landsbanki and not in a subsidiary. According to Halldór J. Kristjánsson, CEO of Landsbanki, this was considered a preferable arrangement, making it possible to “use and manage the funds of the group as a whole”.¹⁶

In February 2008, it seems that discussions had started on transferring the deposit-taking activities of the London branch to a subsidiary. Another idea that emerged in early 2008 was to transfer the Icesave brand name, as far as easy access deposit accounts were concerned, to the subsidiary Heritable Bank, so that all consequent deposits would fall under the subsidiary and not the branch.¹⁷ However, these ideas never materialised.

On 7 February 2008, the Central Bank’s Board of Governors met with Prime Minister Geir H. Haarde, Minister of Finance Árni M. Mathiesen,

“Kazakhstan: A Comparison with Iceland.”

Title of a report by Bear Stearns, 29 February 2008.

“Some say Iceland is a “giant hedge fund”, with its corporate and banking sectors leveraging up to make above-average returns. The banks are being hammered in credit markets as investors fret about their perceived dependence on wholesale funding, macro-economic imbalances, alleged lack of transparency, and cross-ownership issues.”

The Financial Times, 15 March 2008.

“Iceland shows cracks as the krona crashes.”

Headline of an article in *The Daily Telegraph*, 23 March 2008.

“The spreads on Icelandic bank debt have risen above 800 basis points, near levels seen in Bear Stearns’ debt before the Federal Reserve’s rescue. Which raises the thorny question: Is the Icelandic government - which presides over an economy the size of Bristol - big enough to underpin its encephalitic banks if push ever comes to shove?”

The Daily Telegraph, 27 March 2008.

“When clients ask us why the Icelandic banks are considered to have a higher risk profile than their other European peers, one does not have to search hard for answers: rapid expansion, inexperienced yet aggressive management, high dependence on external funding, high gearing to equity markets, connected party opacity. In other words: too fast, too young, too much, too short, too connected, too volatile.”

From a report by Merrill Lynch, 31 March 2008.

15. Halldór Jón Kristjánsson and Sigurjón Þorvaldur Árnason: Developments leading up to the Icelandic banking crisis in October 2008. Draft 16 March 2009, p. 90.

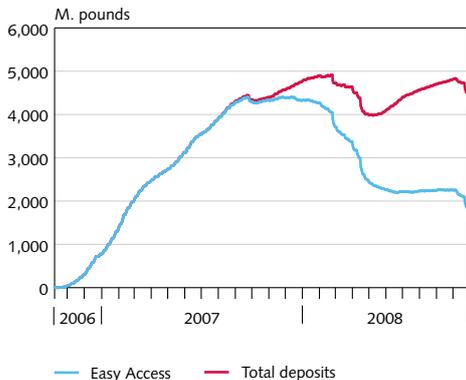
16. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 5.

17. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 7 and 24.

“Fear of Iceland bail-out could signal new future for the IMF.”

The Daily Telegraph, 8 April 2008.

Figure 2
 Balance of Icesave in the UK



Source: Landsbanki Íslands hf.

“Given the nature of the business to be transferred (and particularly having regard to the fact that the transfer will not be limited solely to the retail deposit-taking activities) we recommend that the procedure under Part VII of FSMA be used to give effect to the proposed transfer.”

From the opinion of Allen & Overy, 22 February 2008.

and Minister for Foreign Affairs Ingibjörg Sólrún Gísladóttir in the Prime Minister’s Office. In the draft minutes it is stated that Davíð Oddsson, Chairman of the Central Bank’s Board of Governors, described his journey to London where he met with various parties, amongst these the ratings agency Moody’s. In that meeting concerns were expressed regarding the Landsbanki Icesave accounts, i.a. as mistrust in the bank could lead to an outflow of funds. On this same journey, Davíð Oddsson and Sturla Pálsson, Director of the International and Market Department of the Central Bank, also met with Landsbanki representatives. In the hearing, Sigurjón Þ. Árnason, CEO of Landsbanki, stated that the issues of the Icelandic banks had been discussed in detail in that meeting.¹⁸

On 8 February 2008, the Central Bank’s Board of Governors held a meeting with the Landsbanki CEOs, Halldór J. Kristjánsson and Sigurjón Þ. Árnason. In the Central Bank’s minutes, Kristjánsson is quoted as stating that on behalf of Landsbanki the option to transfer the Icesave accounts over to a UK company was under examination. Then Árnason is quoted as stating that if Icesave was transferred to a subsidiary the option to transfer the funds upstream would no longer be available. In this context it should be mentioned that in draft minutes from a meeting between the same parties on 12 January that same year, Kristjánsson is quoted as saying Landsbanki would not be able to withstand a run on Icesave.

Landsbanki obtained a legal opinion from the law firm Allen & Overy LLP on the options available regarding a transfer of the deposit accounts from the bank’s branch to its subsidiary in London. In the opinion of the law firm, dated 22 February 2008, three possible options are laid out:

1. Transfer the deposit accounts with the consent of the depositors from the bank’s branch to Heritable Bank or another of its subsidiaries. In this context, the law firm points out two options. On the one hand, to send all the depositors a request to consent. This entails a few disadvantages as it is not certain that all would reply and in addition some might refuse to have their accounts transferred. On the other hand, the law firm states it is an option to assume the consent of depositors until proven otherwise, i.e. the so-called implied consent route. However, the law firm believes there is some uncertainty as to the legitimacy of this approach.
2. All deposit accounts could be transferred to Heritable Bank or another newly established subsidiary of the bank through court procedure pursuant to the provisions of Part VII of the Financial Services and Markets Act 2000 (FSMA).
3. Finally, the deposit accounts could be transferred between banks on grounds of a special legislation on transfer.

Option no. 2 is recommended in the opinion. It is noted that it would take, in all likelihood, six months to conclude the procedure pursuant to Part VII of FSMA.

On 4 March 2008, the Central Bank and the FME met with the Landsbanki CEOs at the request of the FME. In the Central Bank’s draft

18. Statement by Sigurjón Þ. Árnason before the SIC on 19 August 2009, p. 72-74.

minutes it is stated that deposit guarantees had been discussed. Halldór J. Kristjánsson claimed that it would be preferable to keep the deposits within a subsidiary even if this meant less efficient use of liquid assets.

The previous day, i.e. 3 March 2008, Davíð Oddsson and Ingimundur Friðriksson had met in the Bank of England with the Governor, Mervyn King, and Sir John Gieve, the Bank's Deputy Governor, Financial Stability Department. In a memorandum of the Central Bank of Iceland it is stated that Oddsson had in the meeting emphasised that: "the situation of the banks was pretty good". And directly thereafter the following is stated: "Their liquidity position was comfortable as they had learned their lesson from the 2006 ordeal." Later in the memorandum: "It could be concluded from what the Bank of England representative said that they had inadequate information to assess the situation of the Icelandic banks accurately. For example, they believed that the deposits raised in the UK had been used mostly to fund the rapidly expanding lending services in Iceland." The memorandum also states: "It was evident from what the Bank of England representatives offered that they were preoccupied with the possible consequences if extensive withdrawals were made from accounts in the banks, including Landsbanki Íslands in London. That could become contagious. They were rather preoccupied with the arrangements of deposit guarantees and how these would work in practice."

On 6 March 2008, Davíð Oddsson met with Geir H. Haarde. In the hearing, Haarde informed that Oddsson had on that occasion related to him his meeting in the UK where the representatives of the Bank of England had expressed their concerns regarding the Landsbanki Icesave accounts.¹⁹

Haarde also stated that following the meeting with Oddsson he had summoned Sigurjón Þ. Árnason. They had sat three such meetings in March 2008. The topic in these meetings had been i.a. the Icesave accounts and the financing of Landsbanki. Haarde had told Árnason in one of these meetings, on 19 March 2008, that any unfavourable publicity would adversely affect the Icesave accounts. The accounts had culminated in £4.9 billion but were currently £4.5 billion. That day, £15 million had been withdrawn.²⁰

On 14 March 2008, the CEOs of Landsbanki met with FSA representatives regarding the FSA's recent assessment (ARROW²¹ visit) of the bank.²²

At the same time, discussions took place on the FSA's view that there was now cause to suspend the aforementioned concession regarding FSA liquidity control previously granted to the bank. This entailed that the FSA would from then on exercise liquidity control vis-à-vis the branch. The FSA justified this i.a. on the grounds that the business of Landsbanki had undergone substantial changes and that the business environment had likewise changed since the concession was granted.²³

Furthermore, it was discussed whether it would be desirable to have Landsbanki transfer the Icesave deposit accounts from the London branch to its subsidiary, Heritable Bank. Such transfer would entail that the responsibility for the deposit guarantees would be transferred from the Depositors'

19. Statement by Geir H. Haarde before the SIC on 2 July 2009, p. 42.

20. Statement by Geir H. Haarde before the SIC on 2 July 2009, p. 43.

21. Abbreviation of Advanced, Risk-Responsive, Operating frameWork.

22. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 6.

23. Cf. letter from the FSA to the CEOs of Landsbanki Íslands hf. on 21 May 2008.

and Investors' Guarantee Fund to its UK counterpart (the Financial Services Compensation Scheme). The reason for the meeting was the weak position of the Depositors' and Investors' Guarantee Fund, rising CDS spreads of the Icelandic banks and unfavourable publicity in the British media related above.

In a memorandum by Mark Sismey-Durrant, Chief Executive of Heritable Bank, who was also the Managing Director for Icesave, dated 20 March 2008, a summary is presented on the aspects to be kept in mind in relation to the transfer of the deposit accounts to the bank, and the members of staff able to oversee this.

Sigurjón Þ. Árnason stated in the hearing that the FSA had declared that if the Icesave accounts were to be transferred from the branch to a subsidiary, Landsbanki must transfer in a single transaction 20% of the bank's assets to Heritable Bank against the deposits which amounted to close to £5 billion. Presumably, the deposits at the London branch could be transferred as part of this. Naturally, this would have affected the liquidity position of the bank and its obligations vis-à-vis other creditors significantly.²⁴

On 30 March 2008, a meeting was held between the Central Bank and the CEOs of Landsbanki. In the Central Bank's draft minutes, Halldór J. Kristjánsson is quoted as stating that there had been an outflow from the Icesave accounts that day. He had further claimed that general views reflected mistrust vis-à-vis the Depositors' and Investors' Guarantee Fund. Further on in the minutes it is stated that Sigurjón Þ. Árnason had mentioned "two time-bombs", i.e. Icesave and the wholesale deposits. Finally, Árnason is quoted as saying that "the likelihood that the Icelandic banks would get through this [was] very, very little".

On 1 April 2008, a meeting was held in the consultative group of the Prime Minister's Office, the Ministry of Finance, the Ministry of Business Affairs, the FME and the Central Bank of Iceland on financial stability and contingency planning. In the draft minutes it is stated that the deposit accounts of Kaupthing hf. and Landsbanki in the UK had been discussed. Áslaug Árnadóttir, appointed Permanent Secretary to the Ministry of Business Affairs, had pointed out that it was important that Kaupthing would register deposits with its subsidiary and likewise pointed out that the Icesave accounts were not in a subsidiary but a branch of Landsbanki. According to Árnadóttir the rules of the Depositors' and Investors' Guarantee Fund's UK counterpart will be changed and consequently any comparison between the guarantee schemes of the two countries will become even more unfavourable to Iceland, thereby weakening the position of depositors in the Icelandic banks abroad. In the draft minutes, Bolli Þór Bollason, Permanent Secretary to the Prime Minister's Office, is furthermore quoted as saying that the directors of the banks should be aware that the administrative authorities had every intention to protect depositors and not shareholders or creditors. Then Baldur Guðlaugsson, Permanent Secretary to the Ministry of Finance, is quoted as saying: "BG states that the problem is that people are seeking simple solutions. What matters at this point is whether Landsbanki will succeed in transferring the branch's deposits to a subsidiary in the UK." Following this: "TP [Tryggvi Pálsson] mentioned that the FSA UK imposed the condition that assets would

"The likelihood that the Icelandic banks will get through this is very, very little".

Sigurjón Þ. Árnason quoted in the Central Bank's draft minutes of 30 March 2008

24. Statement by Sigurjón Þ. Árnason before the SIC on 27 August 2008, p. 1.

be transferred simultaneously to the subsidiary, which included the relevant liquidity assets. BB [Bóli Þór Bollason] added that the transfer of deposits where each depositor would be contacted must be a delicate operation.”

That same day, i.e. 1 April 2008, Geir H. Haarde and Ingibjörg Sólrún Gísladóttir met with the Central Bank’s Board of Governors. Gísladóttir’s memorandum states i.a.: “Davið Oddsson spoke for the Board and commenced by saying that £193 million had been withdrawn from the Icesave accounts over the weekend and up until that day. He claimed that Landsbanki could withstand 6 more such days.” Later, Gísladóttir quotes Oddsson as stating that the FSA UK wanted Landsbanki to move the Icesave accounts to a UK subsidiary. This was “probably due to the rules on deposit guarantees”.²⁵

On 4 April 2008, the CEOs of Landsbanki wrote a letter to the FSA. There their opinion was presented that it would be the best course of action to aim at transferring the Icesave accounts together with all the assets of the branch into Heritable Bank. This would remove the current perceived problem regarding the Icelandic deposit protection arrangements. This measure would render a revision of the arrangement for the branch’s liquidity control unnecessary. In the letter, the CEOs propose following the route of implied consent, cf. the discussion on the legal opinion of Allen & Overy above. However, the CEOs recognised that this approach entailed a lack of legal precision. For this reason, applying Part VII of FSMA might have to be considered in order to clear up any anomalies which might result from this process.²⁶

Finally, the bank expects that this strategy be implemented satisfactorily as the transfer was a matter of urgency.

That same day, i.e. 4 April 2008, the CEOs of Landsbanki met with the Central Bank’s Board of Governors. The Central Bank’s draft minutes quote i.a. Halldór J. Kristjánsson: “Icesave receives negative publicity. A good day if no more than 25 million are withdrawn.” Later, Kristjánsson points out that if the transfer takes place this will entail a transfer of the tax base to the UK. However, this would reduce the obligations of the Depositors’ and Investors’ Guarantee Fund.

In a meeting of the Landsbanki Board of Directors on 7 April 2008, the combining of the bank’s establishments in London was discussed. The minutes state that Halldór J. Kristjánsson had acquainted himself with this issue and pointed out that the deposit guarantees on account of Icesave were twofold, i.e. through Iceland on the one hand and its latter part through the UK. This would change if the operation was within a subsidiary in the UK. Therefore, it was appropriate to reconsider the arrangement, i.e. due to negative publicity in the British media concerning the current arrangement. The wholesale deposits would remain in the branch as these were not given attention to the same extent. The Board of Directors agreed to this proposal of the CEOs.

On 10 April 2008, the Supervisory Board of the Central Bank convened. In the minutes, Ragnar Arnalds is quoted as stating that there is reason to be concerned about the deposits in Icelandic banks abroad when appeals are published to avoid everything Icelandic.

Following this, it is stated that Davið Oddsson had explained the different positions of subsidiaries and branches.

25. Undated memorandum from Ingibjörg Sólrún Gísladóttir regarding a meeting on 1 April 2008.

26. As noted earlier, transfer pursuant to Part VII of the Financial Services and Markets Act 2000 entails a transfer to a subsidiary through court procedure.

The Icelandic deposit guarantee scheme applied to branches. He then discussed the outflow from the accounts of the Landsbanki London branch. Oddsson is quoted as stating that the situation had “calmed down somewhat”.

In a letter from the FSA to Landsbanki dated 16 April 2008, FSA expressed its opinion that liquidity control and liquidity management of the branch would have to be altered as it was unlikely that the transfer of the Icesave accounts to the bank’s subsidiary would be a quick process. Regarding the possible transferring routes, FSA expressed its opinion that if Landsbanki intended to use the implied consent route the FSA considered it necessary to first establish if the route was legally effective and that it would yield the desired result.

Landsbanki replied to the FSA in a letter dated 24 April 2008. There it is stated that the transfer of the Icesave accounts to a subsidiary would fall within the bank’s medium or longer term strategy and that this must be carefully thought out before any steps are taken. Furthermore, the CEOs believe that the transfer of the accounts based on Part VII of FSMA might be a more sound route than the implied consent route if and when this would take place.

In a letter from the FSA to Landsbanki dated 25 April 2008, it is emphasised that the FSA has noted the transfer of Icesave to a subsidiary was no longer part of Landsbanki’s short term strategy. However, the FSA would continue to consider this a possible option and notes that its staff is prepared to discuss this further.

Landsbanki replied in a letter dated 28 April 2008 where the bank expressed its understanding of the FSA’s position regarding the transfer of the Icesave accounts. Discussions on the issue will continue if and when Landsbanki decides to go forward on this restructuring.

On 7 May 2008, the Board of Governors of the Central Bank of Iceland met with Geir H. Haarde, Árni M. Mathiesen and Ingibjörg Sólrún Gísladóttir. In Gísladóttir’s memorandum Oddsson is quoted as stating that it has aggravated the Bank of England that the Icelandic banks have increased their deposit-taking activities and are offering more favourable rates than their UK counterparts. This the British believe will ruin the market.²⁷

On 23 May 2008, the FSA wrote a letter to Landsbanki. There the authority expresses its surprise that despite the recent extensive discussions, a final arrangement on its liquidity standards for the bank’s London branch have not been completed. The continuing delay is of great concern to the FSA.

On 27 May 2008, Landsbanki replied to the FSA. Reference is made to previous communications with the FSA regarding the liquidity management at the London branch. Attached to the letter was the Landsbanki memorandum covering the conclusion of discussion points between the parties. There it emerges that Landsbanki agrees to waive the FSA Global Liquidity Concession. As regards the transfer of the Icesave accounts to a subsidiary it is stated that there is an agreement that this is a long-term discussion if Landsbanki deems it appropriate to start the process.

The FSA replied to Landsbanki in a letter dated 29 May 2008 where the Global Liquidity Concession is revoked. Included was a schedule for liquidity management where the FSA makes i.a. the requirement that Landsbanki will

27. Undated memorandum from Ingibjörg Sólrún Gísladóttir, “Notes from meetings with the Board of Governors of the Central Bank in 2008 and other notes and materials related thereto”.

at all times hold a reserve amounting to 5% of the total wholebank (Group) instant access balances. This reserve, which should have amounted to around £110 million, was to be held at the Bank of England. No restrictions were imposed regarding upstreaming funds to Landsbanki headquarters in Iceland.

In the minutes from the Landsbanki Board of Directors' meeting no. 1954 on 2 June 2008, the FSA decision from 29 May regarding liquidity management of the London branch is reported. It is noted that in fact the FSA is also attempting to influence Landsbanki's interest rate decisions regarding deposits in the UK. Both the reaction and demands of the FSA are extremely severe. It is evident that the FSA is looking after British interests and not merely following the rules.

A document of the Central Bank, dated 24 June 2008, called "The Ugly List", contains a summary of criticisms and negative publicity concerning the Icelandic financial system over the preceding weeks. There it is stated, i.a., that the ratings agency Moody's considers Icesave "not to be stable deposits" and contemplates reducing its credit rating for Landsbanki.

18.2.3 Plans to Transfer the Icesave Accounts of Landsbanki Íslands hf. from its London Branch to a Subsidiary Re-introduced

On 2 July 2008, the CEOs of Landsbanki Íslands hf. met with the FSA to discuss the Icesave issue. According to Halldór J. Kristjánsson, CEO of Landsbanki, the FSA requirement that the Landsbanki Icesave accounts be transferred to a subsidiary was introduced for the first time in this meeting.²⁸

On 7 July 2008, a consultative meeting was held with the participation of the FME and the Central Bank of Iceland. In the draft minutes of the Central Bank, it is reported that Jónas Fr. Jónsson, Director General of the FME, had stressed that the most important task at hand was for Landsbanki to transfer its deposits in the UK from the branch to a subsidiary. Then the minutes continue: "Tryggvi Pálsson [Director of the Financial Stability Department of the Central Bank] claimed that the State Treasury was unable to assume responsibility for the deposit guarantees without risking bankrupting the State Treasury."

The following day, i.e. 8 July 2008, the CEOs of Landsbanki received an e-mail from the FSA where it is reiterated that the transfer of the Icesave accounts to a subsidiary of the bank must be looked to. It was stated that it was evident that the FSA and Landsbanki assessments differed considerably regarding the risks in the Icelandic economy as well as how this risk could affect the interests of depositors in the UK. In this regard a special mention was made of concerns regarding the ability of the Central Bank to support the Icelandic banking system. Concerns were also expressed regarding the funding of the Depositors' and Investors' Guarantee Fund. Based on these arguments, the FSA assessed that the risks to UK depositors were increasing. With this in mind and with regard to the discussions the FSA had undertaken with Landsbanki representatives concerning Icelandic risk, i.a. the IMF paper,²⁹ the FSA and the bank had reached the following agreement:

"Tryggvi Pálsson claimed that the State Treasury was unable to assume responsibility for the deposit guarantees without risking bankrupting the State Treasury."

Central Bank's draft minutes on a consultative meeting between the FME and the Central Bank on 7 July 2008.

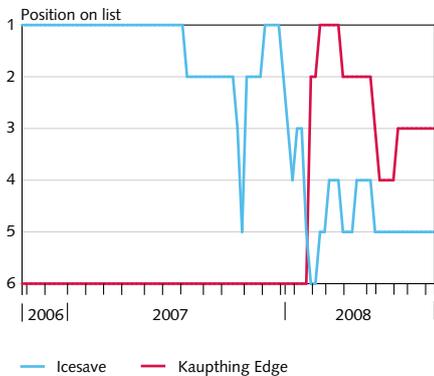
"In this light, and after a very useful discussion about Icelandic risk [...] we agreed that you would do the following: (i) subsidiarise the Icesave book in as short a timescale as possible with a target date of end-2008."

E-mail by the FSA to Landsbanki on 8 July 2008.

28. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 26.

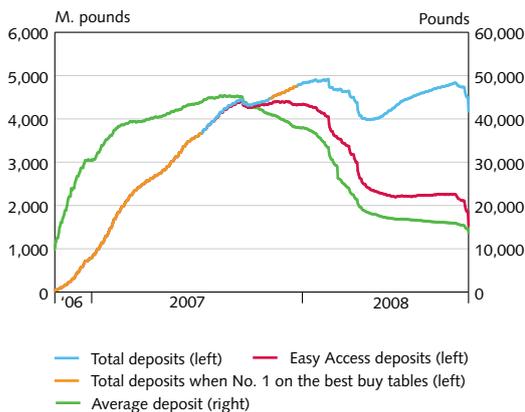
29. This most likely refers to the report of the IMF delegation dated 4 July 2008.

Figure 3
 Position of Icesave Easy Access and the Kaupthing Edge accounts on the best buy tables



Source: http://www.moneysorter.co.uk/best_buy_internet_bank.html.

Figure 4
 Icesave development and position on the best buy tables in the UK



Source: Landsbanki Íslands hf., http://www.moneysorter.co.uk/best_buy_internet_bank.html.

"[...] Icelandic authorities didn't really push us in this [...]. It wasn't about that anyway, it was not as if we didn't want to do it, it was just not possible to fulfil the conditions imposed. [...] However, British authorities really wanted this and put on this pressure and I am of the opinion the British authorities wanted to have their way and a state guarantee for the whole stuff."

Statement by Sigurjón Þ. Arnason before the SIC on 19 August 2009, p. 127.

1. Transfer the Icesave book to a subsidiary in the UK in as short a timescale as possible. The target was to have this completed at the end of 2008. The FSA promised to assist Landsbanki in the process insofar as it could.
2. Limit the growth of the Icesave book to £5 billion until the book has been transferred to a subsidiary.
3. Adopt policy of ensuring that Icesave Instant Access interest rates would not be in the best buy tables.

Figure 3 reveals that Icesave Easy Access accounts were for most of 2007 at top of list of accounts offering the best deposit rates in the UK, cf. the website of Moneysorter, which is dedicated to financial matters. However, at the beginning of 2008 these accounts moved down the list. At the same time, the Kaupthing Edge accounts of Kaupthing Singer & Friedlander were marketed in the UK.³⁰

In the minutes of the Landsbanki Board of Directors dated 10 March 2008, it is stated that the interest rates on Icesave accounts were in the 12th to 7th place in the UK. In order to hold the top place, 125 basic points were required on top of the rates of Bank of England. The total deposits into Icesave accounts now amounted to £4,675 million whereof £1,167 million, or 25%, were in fixed-term deposit accounts. It is reported that the average deposits have fallen fairly rapidly. They had peaked at £45,000 but were now closer to £35,000.

The CEOs of Landsbanki replied to the FSA in a letter dated 15 July 2008. In it they declare their readiness to reopen the discussion on the transfer of the deposit accounts from the bank's branch to a subsidiary. However, before any decision could be made in this regard a number of issues must be clarified. It is, furthermore, stated that Landsbanki is not prepared to agree on a specific limit on deposits into its branch. Finally, Landsbanki reserves the right to determine the interest rates on the Icesave accounts and refers to its policy to offer its customers competitive interest rates.

In the meantime, i.e. 14 July 2008, the Central Bank's Board of Governors met with the CEOs of Landsbanki. In the Central Bank's draft minutes it is reported that Davíð Oddsson, Chairman of the Central Bank's Board of Governors, had enquired after the transfer of deposits to a subsidiary. As far as the UK is concerned, the draft minutes note, Halldór J. Kristjánsson had stated that the issue was under examination, following which a positive report from the FSA would be required and a period of five to six months. Sigurjón Þ. Arnason was quoted as stating that he is "not certain that a transfer would pay off except for the Guarantee Fund". Later in the draft minutes it is reported that Ingimundur Friðriksson, Governor of the Central Bank, had asked whether preparations for the transfer of the deposit accounts from the branch in the UK to a subsidiary were underway and the reply was that this was not the case. In Davíð Oddsson's statement before the SIC it was revealed that this had come as a great surprise to the Central Bank's Board of Governors as the Board had been of the firm belief that the transfer of the Icesave accounts to a subsidiary had been underway since the issue had been discussed in its meeting with the CEOs of Landsbanki in early 2008, and that

30. See the website http://www.moneysorter.co.uk/best_buy_internet_bank.html.

the Governors had not received any notification concerning Landsbanki's change of policy in this regard.³¹

In this context, it may be mentioned that in his hearing before the SIC, Halldór J. Kristjánsson had claimed that he had been "very supportive" of subsidiarisation.³²

In the hearing before the SIC, Eiríkur Guðnason and Ingimundur Friðriksson, Governors of the Central Bank, stated that in a meeting with the Landsbanki Board of Directors in July 2008 they had come to realise that the CEOs were not in agreement as regards the transfer of the Icesave accounts to a subsidiary. They had got the impression that Árnason was against the transfer.³³ In the hearing, Sigurjón Þ. Árnason denied that he had not been of the same opinion as Kristjánsson. Árnason claimed, however, that he had at all times been very forthright concerning the problems that needed to be solved in order to transfer the Icesave deposit accounts from a branch to a subsidiary, and perhaps for that reason others may have got the impression that he had been in disagreement with Kristjánsson.³⁴

Around the same time, the Icelandic banks and the Depositors' and Investors' Guarantee Fund had been the object of discussion in parliament in the UK. On 1 July 2008, Lord Oakeshott had presented two questions replied to on 14 and 15 July that same year.³⁵ The former question concerned the total assets of the Icelandic Guarantee Fund. The latter question concerned what measures British authorities had taken to verify the solvency and stability of the Icelandic Guarantee Fund, as well as that of the Icelandic banks accepting deposits in the UK at that time. On 16 July 2008, discussions took place in the Treasury Select Committee on an article in *The Times* from 5 July on the situation of the Depositors' and Investors' Guarantee Fund. The article states i.a. regarding the Guarantee Fund: "It describes itself, not very accurately, as "prefunded" but actually has £88 million in the kitty. That's to cover deposits totalling £13.6 billion, 154 times as much." It further states: "The total deposits covered are twice the country's entire GDP." In a meeting of the Treasury Select Committee, Michael Fallon, MP, posed i.a. the question whether UK depositors were guaranteed in full in case an Icelandic bank went bankrupt. This issue was discussed again in the committee's meeting on 22 July the same year.

The FSA sent an e-mail to Landsbanki on 22 July 2008 where concerns are expressed over the bank's reply in its last letter dated 15 July 2008. Given recent events, it was evident that the risk of a run on the Icelandic banks had increased and that Landsbanki did not have adequate liquidity to repay UK depositors. This assessment was not only based on the analysis of the International Monetary Fund³⁶ but also other factors, such as rising CDS rates and negative media coverage. The general public was concerned over branches of banks from other member states of the European Economic Area

"To be honest, the only thing I blame myself for in this process is not to have pushed more for the subsidiarisation of the activities in the UK and when we started up in the Netherlands ..."

Statement by Halldór J. Kristjánsson before the SIC on 12 May 2008, p. 23.

31. Statement by Davíð Oddsson before the SIC on 7 August 2009, p. 49.

32. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 29-30.

33. Statement by Eiríkur Guðnason before the SIC on 26 May 2009, p. 39. See also statement by Ingimundur Friðriksson before the SIC on 19 March 2009, p. 27.

34. Statement by Sigurjón Þ. Árnason before the SIC on 2 September 2009, p. 30-31.

35. Information obtained from the website of the British Parliament. See http://www.publications.parliament.uk/pa/ld/lords_hansard_by_date.htm.

36. This most likely refers to the report of the IMF delegation dated 4 July 2008.

and a Treasury Select Committee had discussed the matter on 16 July 2008. There doubts had been expressed as to the ability of the Icelandic authorities to assist the banks given the overall size of Icelandic banks' borrowing in relation to GDP. For this reason, it was a great disappointment that Landsbanki was not prepared to agree to the £5 billion limit to the growth of their deposits. As deposits had since 29 May risen from £4 billion to £4.6 billion it was necessary to strengthen the liquidity position of the branch to meet withdrawals. Therefore, the reserve must be raised to 10%. If Landsbanki did not follow recommendations to improve its liquidity position and limit deposits to £5 billion, the FSA would consider exercising its powers of intervention to protect UK depositors. A reply was requested before 30 July followed by meetings in Iceland on 30 July and 1 August to discuss the matter.

On that same day, i.e. 22 July 2008, a meeting was held in the consultative group of the Prime Minister's Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning. In the draft minutes i.a. the following is stated: "IF [Ingimundur Friðriksson] referred to the receipt of deposits in branches of the Icelandic banks, the FSA having encouraged Landsbanki to transfer its deposit book to a subsidiary in that country. The process had not been initiated and Landsbanki appeared to be against the idea. IF asked whether this change could be accomplished through regulatory powers. ÁÁ [Áslaug Árnadóttir] stated that the establishment of branches and receipt of deposits could not be prohibited but only delayed. The procedure was simple." Towards the end of the minutes: "JFJ [Jónas Fr. Jónsson] emphasised that the transfer of the deposits to subsidiaries must be pressed for.

On 24 July 2008 a telephone conference took place between the CEOs of Landsbanki and FSA representatives which was recorded. The FSA placed great emphasis on the risk of a run on the Landsbanki branch in the UK. This risk had increased very significantly and the time Landsbanki had to transfer the accounts to a subsidiary was running out. If Landsbanki was unwilling to take action, the FSA would exercise its powers vis-à-vis the bank. The demand of the FSA was as follows: "[...]we need a solid cap, a solid liquidity buffer and a firm intention to move towards subsidiarisation in a reasonable time-scale and we do think that those three commitments can and should be made."

"To clarify our position we can commit in principle to the following: 1. Landsbanki has firm intentions to move towards subsidiarisation of the Icesave operations in the UK within a reasonable timeframe."

Letter from the FSA to Landsbanki on 28 July 2008.

The FME in Iceland and the FSA also met around this time, cf. a telephone conference which took place on 28 July 2008. The reason for the meeting was a letter by the FSA to Landsbanki dated 22 July 2008. According to a FME memorandum, the authority emphasised "how quickly these FSA actions had come about and that Lí had been given a short notice although it had recently reached an agreement³⁷ on the progress of liquidity issues with regard to UK deposits".³⁸

In a letter to the FSA dated 28 July 2008, Landsbanki expressed its willingness to work towards transferring the Icesave deposit accounts from its branch to a UK subsidiary within a reasonable timeframe. In addition, a £5 billion limit would be put on total Icesave deposits. Finally, the bank prom-

37. This most likely refers to a memorandum of the FSA, which was included with a letter from the authority to Landsbanki dated 29 May 2008.

38. Memorandum from Guðmundur Jónsson, Head of Unit at the FME, dated 28 July 2008.

ised to raise its cash reserve from 5% to 10% of instant access balances in the UK. That same day, Landsbanki sent a memorandum to both the Central Bank of Iceland and the FME explaining its reasons for accepting the conditions of the FSA. In it Landsbanki emphasised:

1. That all existing rights of the branch and rules concerning liquidity management should remain unaltered in the subsidiary, i.e. the rules already agreed on with the FSA in the spring of 2008 would apply. For Landsbanki this point was essential so as not to upset the liquidity position of the bank group as a whole.
2. That the increase of the reserve with the Bank of England from 5% to 10% as regards easy access deposits in the UK be made conditional upon establishing explicit rules on the disposal of those funds. In case of unexpected withdrawals these would have to be first liquid assets of the bank used to compensate such outflow. Furthermore, Landsbanki preferred that this reserve be with the Central Bank of Iceland, at least the 5% increase.
3. That negotiations regarding limits on the total amount in Icesave up until subsidiarisation were very delicate. The bank was prepared to accept certain limitations, however with a tolerance limit. Another possibility in case the amount exceeded a certain limit would be to increase the reserve with the Bank of England by the amount in excess of £5 billion.

As has already been mentioned, the FSA had assessed the risk factors of the London branch of Landsbanki in the so-called “ARROW visit”.³⁹

In a letter dated 30 July 2008, the FSA presented its formal results to Landsbanki. There it is stated that based on the FSA’s assessment the branch’s risk was above medium: The reason for this was first and foremost attributed to the part of the bank’s activities linked to the Icesave deposit accounts. It is, furthermore, stated in the letter that while no further measures had been taken to reduce the risk related to Icesave, the FSA had decided to add the branch to its watch list. To be removed from the list, Landsbanki would have to establish that it had taken remedial actions to reduce risk. The FSA placed great emphasis on the branch’s liquidity management, which related mostly to Icesave, i.e. that access to adequate liquid assets was available in case a run was made on the branch entailing withdrawals from the accounts.⁴⁰

On 31 July 2008, Davíð Oddsson, Ingimundur Friðriksson and Tryggvi Pálsson, on behalf of the Central Bank of Iceland, met with two FSA representatives, Michael Ainley and Melanie Beaman. From the draft minutes of the Central Bank it can be deduced that the FSA representatives had emphasised the transfer of the Landsbanki Icesave accounts to a subsidiary in the UK. It is stated that the FSA and the Central Bank of Iceland were in agreement that such transfer should be pursued.

That same day, i.e. 31 July 2008, the CEOs of Landsbanki met with the Central Bank’s Board of Governors. From the Central Bank’s draft minutes it can be deduced that the transfer of the Icesave accounts to Heritable Bank

39. ARROW is an abbreviation of Advanced, Risk-Responsive, Operating frameWork.

40. Letter from the CEOs of Landsbanki to its Board of Directors regarding a review by the FSA of the risk factors of the Landsbanki London branch, dated 5 September 2008.

had been discussed. Sigurjón Þ. Arnason is quoted as stating that Landsbanki will need to be granted an exemption from the rules on large exposures. The draft also reveals that deposit guarantees vis-à-vis the Icesave accounts had been discussed. In Arnason's words: "It does not help when you state that the Guarantee Fund has no money." Later, Davíð Oddsson says that nowhere is it stated that the Icelandic state is under obligation. In the draft minutes, Halldór J. Kristjánsson is also quoted as stating that he is not the only one of the opinion that the €20,000 is seen as an obligation in accordance with international law. It is reported that Oddsson had disagreed on this point and stated: "No state guarantee unless stipulated by law." Then Kristjánsson answered that such authorisation must be obtained. Then Oddsson is quoted: "[You] are raising deposits without speaking to the nation about the commitment. The two of you can not bankrupt the nation."

In the hearing before the SIC, Halldór J. Kristjánsson was asked further about the aforementioned meeting with the Central Bank's Board of Governors. Kristjánsson then admitted that he and Davíð Oddsson had been in disagreement concerning the obligation of the Depositors' and Investors' Guarantee Fund. Kristjánsson stated regarding this point: "I was always of the opinion that under any kind of "normal" circumstances the "European Directive" equalled a commitment in terms of international law, being a kind of "hobby lawyer" I regarded it as self-evident, behind these twenty thousand. However, I am in absolute agreement on this point with those who claim that this could be disputed in case of systemic melt-down, and I recall that this was something the Executive Director of the Central Bank in the Netherlands said to us when we spoke to him, that a fund of this type was to compensate in case of incidental setbacks but not systemic melt-downs. However, I am of the opinion that pursuant to the Act on the Guarantee Fund, the Fund is authorised to take a loan to pay and I, therefore, assumed that taking account of the status of the Directive in terms of international law, the Fund was obligated to take such a loan and attempt to fulfil its obligations. And when people are considering, when this kind of Fund is put to the test, then they obviously never expect total loss, rather a certain percentage of recovery, hopefully as high as possible. We simply had a debate regarding the nature of these guarantees and the Central Bank and in particular the Chairman of the Board of Governors understood it this way which I believe is too limited, although I acknowledge it in principle."⁴¹

Later that same day, i.e. 31 July 2008, a meeting was held in the consultative group of the Prime Minister's Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning. The draft minutes indicate that an extensive discussion took place concerning the Landsbanki Icesave accounts and the bank's interaction with the FSA. Jónas Fr. Jónsson, Director General of the FME, was quoted as stating that British authorities believed they did not have adequate information on the Depositors' and Investors' Guarantee Fund, its financing, pay-out procedure, etc. Jónsson is also quoted as stating: "A telephone conference between the FSA and the FME was held last Monday but then the FSA had in fact already made its decision without consulting the FME. The FME has remarked on

41. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 20-21.

the limited consultation and expressed its doubts that limits on volume such as this are in accordance with the “letter and spirit of European law” and requested at least “a tolerance limit”. Nonetheless, it is questionable for Landsbanki to enter into a legal quarrel with the FSA.” Following this, Tryggvi Pálsson stated that the FSA was doing a fine job by limiting possible obligations of the Icelandic state on account of the Depositors’ and Investors’ Guarantee Fund. Ingimundur Friðriksson claimed that in a meeting of the Central Bank and FSA representatives it had emerged that the transfer of the Icesave accounts to a subsidiary could be completed in three months. Furthermore, draft minutes quote Tryggvi Pálsson as stating that Icelandic authorities should work with the FSA and at the same time wind down the receipt of deposits in branches of the Icelandic banks elsewhere. Later, Baldur Guðlaugsson, Permanent Secretary to the Ministry of Finance, stated that it could signify the downfall of the banks if public discussion was to center on the weaknesses of the Depositors’ and Investors’ Guarantee Fund. Ingimundur Friðriksson was also quoted as saying that the Central Bank was putting pressure on Landbanki to complete the transfer to a subsidiary. Further on, Baldur Guðlaugsson suggested that the FSA be reminded that the transfer of the deposits into a subsidiary was underway, which meant that any possible weaknesses of the Depositors’ and Investors’ Guarantee Fund would become immaterial. Then Jónas Fr. Jónsson claimed that the FSA also had cause to be concerned about the period until the transfer would take place. It had been a stroke of luck that no media coverage had taken place following the debate in the Treasury Select Committee.

On 31 July and 1 August 2008, the Landsbanki CEOs met with the FSA in Iceland and introduced i.a. the conditions the bank believed were necessary in order for it to transfer its deposits into a subsidiary. The main topic was an exemption the bank requested, pursuant to Section 148 of Part VII of the Financial Services and Markets Act (FSMA), from the rules on large exposures between the parent company and a subsidiary, so that deposits could be transferred without limitations from the subsidiary to the parent company. Following the latter meeting with the FSA, the CEOs held a meeting with FME staff. In the FME minutes from that meeting, Sigurjón Þ. Árnason is quoted as stating that the total assets of Heritable Bank were £1,000 million. Out of these, Landsbanki would like to transfer £600 million to asset backed securities, however, the FSA was not satisfied with that arrangement as its representatives considered this too high a ratio of the Heritable Bank’s total assets. Later in the minutes: “Árnason thought this showed the mindset of the FSA UK in a nutshell, i.e. they did not view the matter comprehensively. They would have to view it on a group basis, otherwise Landsbanki was finished and thereby Iceland.”

On 1 August 2008, the CEOs of Landsbanki wrote a letter to the FSA. Reference is made to meetings held over the past two days. Attached to the letter were two memorandums of Landsbanki. In the former, the bank presents its formal proposals concerning the subsidiarisation of the Icesave operations. The bank proposed that the deposits of the London branch be transferred to Heritable Bank, Landsbanki’s subsidiary, under Part VII of FSMA. This approach would entail an open court procedure in the UK. In the opinion of Landsbanki, the bank would simultaneously have to be granted exemptions on the basis of Section 148(4) of FSMA in order to be able to

“BG [Baldur Guðlaugsson] suggested that the FSA be reminded that the transfer of the deposits into a subsidiary was underway, which meant that any possible weaknesses of the Depositors’ and Investors’ Guarantee Fund would become immaterial. JFJ [Jónas Fr. Jónsson] claimed that the FSA also had cause to be concerned about the period until the transfer would take place. It was a stroke of luck that no media coverage has taken place following the debate in the Treasury Select Committee.”

Draft minutes of the consultative group of the Prime Minister’s Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland, dated 31 July 2008.

“Árnason believes this shows the mindset of the FSA UK in a nutshell, i.e. they did not view the matter comprehensively. It must view it on a group basis, otherwise Landsbanki was finished and thereby Iceland.”

Minutes by the FME, dated 1 August 2008.

“We must receive your commitment to the principle of transfer to a subsidiary that operates on a normal basis and this revised proposal by close of business 12 August 2008. We are also setting a target completion date for subsidarisation on 31 October 2008 and a firm deadline 31 December 2008. If you do not meet the deadline, or we are unable to agree on a proposal for subsidarisation, then as previously discussed the FSA will consider using its legal powers to take further steps to mitigate the risks to depositors.”

Letter from the FSA to Landsbanki on 5 August 2008.

transfer the deposits from the subsidiary to other parts of the bank group. Landsbanki's second memorandum presented a detailed justification for granting such an exemption.

The FSA wrote a letter to Landsbanki, dated 5 August 2008. The letter indicated that the FSA had assumed that an agreement had been made concerning a £5 billion cap on the deposits of the bank's London branch, and a reserve in regard to the branch's Instant Access Deposits would be increased from 5% to 10%. The FSA did not accept that the bank could exceed the £5 billion cap on the condition that it would deposit pound for pound, i.e. all deposits exceeding the £5 billion cap, into an account with the Bank of England or the Central Bank of Iceland. However, the FSA agreed to it that 5% of the bank's reserve would be deposited into an account with the Central Bank of Iceland. Furthermore, the FSA also agreed to transferring the deposit accounts to Heritable Bank, Landsbanki's subsidiary. On the other hand, it did not consent to granting an exemption from the rules on large exposures in transactions between Heritable Bank and Landsbanki. Therefore, Landsbanki was requested to review its strategy concerning the transfer of deposits to a subsidiary in view of this. The new proposal must assume that assets from other parts of the Landsbanki group would be transferred to Heritable Bank. In addition, the FSA imposed the condition that a confirmation would be received no later than 12 August 2008 to the effect that Landsbanki agreed to transfer the accounts to a subsidiary using this approach. Furthermore, it was stated that the FSA had as its target to complete the transfer by 31 October 2008, and no later than 31 December the same year. If Landsbanki was unable to honour this time-limit or if an agreement could not be reached concerning the conditions regarding the transfer, the FSA would consider exercising its formal powers vis-à-vis the bank.

Immediately after receiving the aforementioned letter from the FSA dated 5 August 2008, the CEOs of Landsbanki met with Davíð Oddsson and Eiríkur Guðnason, Governors of the Central Bank of Iceland. The topic was difficulties concerning the subsidarisation of Icesave. According to the Central Bank's draft minutes, the Landsbanki CEOs found the FSA unyielding in regard to the subsidarisation. The minutes state: “In the first place, the FSA had rejected the ideas of Landsbanki to deposit any funds in Icesave exceeding £5 billion into the Bank of England or the Central Bank of Iceland. Secondly, the FSA had rejected Landsbanki's proposals concerning the implementation of the transfer of Icesave to the subsidiary Heritable Bank as assets would have to be transferred to meet the deposits transferred to Heritable Bank. Landsbanki was also disappointed as the agreements with the FSA concerning the liquidity management between Landsbanki and Heritable Bank had been suspended; Landsbanki had expected these would apply until 2011 and planned its operations accordingly.” Later in the minutes it is stated that Davíð Oddsson had stressed the importance of keeping Icesave activities in other countries in subsidiaries. Sigurjón Þ. Árnason stated that the current situation was the most difficult in the bank's history. Later in the draft minutes it is reported that Halldór J. Kristjánsson had mentioned the idea that the Central Bank would overtake the deposits from Heritable Bank amounting to £2.5 billion⁴² and relend the money immediately to Landsbanki against collateral.

42. In the draft minutes, the amount referred to is £2.5 million, but from the context it is evident that the amount in question is £2.5 billion.

Eiríkur Guðnason had answered stating that this idea came close to describing loans from lenders of last resort. Such facilitation would greatly affect the balance sheet of the Central Bank and if granted a public notification would be required. This would entail risking the reputation of the Icelandic banking system. In the draft minutes, Davíð Oddsson is quoted as asking whether it was an option to “stand firm against the FSA”. Then the minutes continue: “SPÁ [Sigurjón Þ. Arnason] stated that it would be very risky to stand firm against the FSA at this stage. [...] A decision to stand strong was of such magnitude that the Lí representatives were not able to make it alone as it could affect the Icelandic financial system extensively. For this reason they had met with the Central Bank of Iceland.” At the end of the minutes: “SPÁ concluded by saying that he believed it was likely that a possible facilitation by the Central Bank of Iceland would have to be maintained until Landsbanki had regained its access to the debt securities market.”

Halldór J. Kristjánsson revealed in the hearing that the proposal of the CEOs of Landsbanki, mentioned in the Central Bank’s minutes above, that the Central Bank receive the deposits from Heritable Bank but would then relend the same amount immediately to Landsbanki, had been a measure to bypass British rules on large exposures. On this same occasion, Halldór J. Kristjánsson revealed that later on in August 2008 the message had been received that the Central Bank could accept the Landsbanki CEOs’ request.⁴³

Sigurjón Þ. Arnason claimed that he had further elaborated the idea in discussions with the members of staff of the Central Bank entailing that loans from the Central Bank would only have to be in Icelandic krónur. The proposal entailed that Landsbanki, as a parent company, and Heritable Bank would make a currency swap agreement where Heritable Bank would exchange its pounds sterling from Icesave accounts to Icelandic krónur. Heritable Bank would deposit these krónur with the Central Bank of Iceland. The Central Bank would then relend these krónur to Landsbanki against collateral in part of the Landsbanki loan portfolio in repurchase transactions. Arnason implied that this proposal had not been well received. He believed that the Central Bank’s Governors had not understood his idea.⁴⁴

In the hearing before the SIC, Eiríkur Guðnason discussed the aforementioned request of Landsbanki. When asked further about why the Landsbanki request had been turned down, Guðnason replied: “Yes, well they requested this facilitation to have these Central Bank securities against collateral in Landsbanki assets without notifying anyone of this. This was obviously unthinkable as it would have become evident at the end of the month when the Central Bank published its balance sheet that the balance sheet had grown, inflated, what, around 60% or something enormous? It was in a similar meeting when I asked Arnason: Why do you have to do it this way?” Guðnason claimed that Arnason had then answered that the regulatory authority abroad did not understand these loans. Guðnason then claimed to have asked: “And is that because the regulatory authority abroad is so stupid or the loans so bad?” To which Arnason then replied: “Probably both.”⁴⁵

43. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 32-34.

44. Statement by Sigurjón Þ. Arnason before the SIC on 19 August 2009, p. 107-110, and on 27 August 2009, p. 153. See also memorandum by Sigurjón Þ. Arnason, “Memorandum regarding Icesave and a potential state guarantee”, dated 27 August 2009.

45. Statement by Eiríkur Guðnason before the SIC on 26 May 2009, p. 49-50.

In this context it must be mentioned that in the hearing, Sturla Pálsson, Director of the International and Market Department of the Central Bank, had declared that in June 2008 Sigurjón Þ. Árnason had told him flat out that the Landsbanki loan portfolio was such that British authorities would not accept it as an asset against the Icesave obligations. When asked about the reason for this, Pálsson said that he could only understand Árnason's word as meaning "that no-one except perhaps the Icelandic FME would accept this".⁴⁶

In this context it is worth mentioning a draft memorandum composed by experts from the Central Bank at the request of the Central Bank's Board of Governors. It includes an assessment of the aforementioned Landsbanki proposal. It is pointed out that the facilitation requested would amount to double the market value of Landsbanki as it was registered at the stock exchange. In addition, it states that it must be taken into account that the facilitation in question would on its own amount to almost a third of the GDP. The question is put forth whether the interests of the state and depositors in Landsbanki would perhaps be better served if the Central Bank or the state would overtake the stocks of Landsbanki, at least until reasonable market conditions were reestablished. The Central Bank's experts conclude by suggesting that the patience and flexibility of the FSA, Landsbanki and the largest shareholders of Landsbanki be tested to their limits. Landsbanki must prepare the plan the FSA insists upon and the owners of Landsbanki may have to support the bank even further in order to reach an acceptable agreement with the FSA. It further states: "By the same token a possibility that has not been fully explored is how flexible the FSA is willing to be in order to enable the accomplishment of the principal objective of transferring the deposits of the branch of L [Landsbanki] to H [Heritable Bank], i.e. to what extent the FSA is prepared to accept L's loan book as collateral, whether the limit of L's exposure with H could be relaxed, and an extended adjustment period acquired. If the CBI [Central Bank of Iceland] accepts immediately to solve the problems of these parties the risk is that their own contribution towards the solution would be less than expected." It then states that the Central Bank should advocate market solutions for as long as possible, and at the same time explore if "an intermediate solution" would be viable. The Central Bank's facilitation could be employed "when these options have been fully explored, given that the results are advantageous and in keeping with the will of the government".⁴⁷

On 11 August 2008 the FME wrote a letter to the FSA requesting discussions on possible provisional exemptions for Landsbanki from the British rules on large exposures during the transfer of the Icesave accounts to Heritable Bank. A meeting to discuss this issue was held on 18 August 2008.

On 12 August 2008, a meeting was held in the consultative group of the Prime Minister's Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning. Draft minutes reveal that following the FSA visit at the beginning of the month, representatives from

"If the CBI [Central Bank of Iceland] accepts immediately to solve the problems of these parties the risk is that their own contribution towards the solution would be less than expected."

Draft minutes of experts of the Central Bank to the Central Bank's Board of Governors, dated 26 August 2008.

46. Statement by Sturla Pálsson before the SIC on 20 July 2009, p. 59.

47. Draft memorandum of experts of the Central Bank to the Central Bank's Board of Governors, "Assessment of L's proposals. Prepared at the request of the Board of Governors", dated 26 August 2008.

the Bank of England had contacted the Central Bank of Iceland. Ingimundur Friðriksson is quoted as stating that the telephone conference had been very grave and the need to reduce the size of the Icelandic banks stressed time and again. Towards the end of the telephone conference, the British had mentioned the possibility, not spoken of before, that Landsbanki could sell Icesave.

In a letter Landsbanki wrote to the FSA dated 12 August 2008 the bank iterated that it would need an adjustment period until the end of 2010 to transfer the assets to Heritable Bank against the financial commitments concerning the Icesave deposit accounts. In addition the bank stood firm on its proposal to be authorised to exceed the £5 billion cap on the condition it would deposit on a pound for pound basis into the Bank of England or the Central Bank of Iceland. In the letter a step-by-step plan is presented concerning the transfer of the Icesave accounts. The first step was the transfer of the Icesave deposits to Heritable Bank, cf. the bank's memorandum included in its letter to the FSA on 1 August 2008. The target was to conclude the matter in as short a time as possible and preferably by the end of October 2008 but no later than by the end of the year. The second step was to transfer the branch's lending operations to Heritable Bank. The aim was to complete this as soon as possible in the former half of 2009 with a deadline at the end of June 2009. The third and last step entailed that Landsbanki would continue to balance the assets and liabilities of Heritable Bank as well as guarantee regular reporting to the FSA. The aim of Landsbanki was to reach the aforementioned balance in the subsidiary no later than by the end of 2010. In the interim period, Heritable Bank on the other hand would require a reasonable adjustment period or an explicit waiver of the rules on large exposures within the group. Landsbanki iterated its earlier request for a waiver or for the FSA to show understanding that it would take time to balance the assets and obligations within Heritable Bank.

On 13 August 2008, Jónína S. Lárusdóttir, Permanent Secretary to the Ministry of Business Affairs and Baldur Guðlaugsson, Permanent Secretary to the Ministry of Finance, met with the CEOs of Landsbanki and the Director of the Legal Division of the Bank. In the hearing, Lárusdóttir described that in the meeting, which had been held at the request of the bank, the CEOs had described their interactions with the FSA and presented the Permanent Secretaries with documentation, i.a. their correspondence with the FSA up until that time.⁴⁸

On 15 August 2008, the FSA replied to the letter of Landsbanki dated 12 August and stressed its view that the economic outlook in Iceland had deteriorated significantly. In its letter, the FSA lists the following actions which it believes are necessary for Landsbanki to take:

1. To provide a schedule for the reduction of the Icesave Instant Access Deposits in the period to end-2008, together with a plan for the replacement of the funding lost in the former action. The FSA's provisional assessment is that it would be prudent to implement a plan for a 50% reduction in the level of deposits until the end of the year.

"We are all in agreement that subsidiarisation is an alternative and preferable goal for the Icesave book [...] I must however reiterate our view that transfer of Icesave liabilities to Heritable Bank must be matched by assets in a way that Heritable is able to continue as a standalone bank with connected lending within the parameters of connected lending limits the FSA agrees for other firms."

Letter from the FSA to Landsbanki on 15 August 2008.

48. Statement by Jónína S. Lárusdóttir before the SIC on 31 March 2009, p. 12.

2. To cease all marketing of the Icesave Instant Access Deposits.
3. Not to make any changes to the interest rates on fixed rate deposit products without notifying the FSA with at least two business days notice.
4. To increase the cash reserve to 20% of Instant Access Deposits.
5. To provide the FSA within three weeks with a plan on how Landsbanki intends to repay the Icesave fixed-term deposits which mature between then and end of June 2009.

Finally, the FSA letter states that the authority wants to discuss the transfer of Icesave to a subsidiary with the target of reaching a firm agreement by 31 August 2008. The FSA reiterates its view that the transfer of commitments due to the Icesave accounts to Heritable Bank must entail the transfer of assets. Towards the end of the letter it is stated that if an acceptable agreement concerning the arrangement of the transfer is not reached, the FSA will consider exercising its powers in order to wind-down completely the retail deposit book of Landsbanki in the UK.

The SIC has in its possession a memorandum of the Central Bank of Iceland dated 16 August 2008 which addresses the aforementioned letter from the FSA dated 15 August. The Central Bank's memorandum is written in English. It states i.a.: "The FSA's action seems destined to bring about the chain of events that it sets out to avoid." It further states: "For the safety of Icesave deposits in the UK it appears essential not to do anything from an official side that might undermine confidence or trigger a liquidity crisis." It continues: "The emphasis given to macro economic developments in Iceland is largely irrelevant to the position and operations of Landsbanki in the UK."⁴⁹

In the hearing before the SIC, Prime Minister Geir H. Haarde stated that on 16 August 2008 he heard of the aforementioned FSA letter to Landsbanki: "[...] then the letter arrives from the FSA to Landsbanki, dated 15 August, a horrible letter. The way in which it was brought to me that weekend was that the Chairman of the Central Bank's Board of Governors phoned me, I was then at the Government Guest House at Thingvellir, this is Saturday morning, and finally I decide to have the letter collected and brought to Thingvellir. He states: We immediately set in motion the work to answer all the nonsense in this letter concerning the Icelandic economy, as the letter contained countless inaccuracies in that respect [...]. Haarde also stated: "[...] however, this was not the main point in the letter but the FSA's conclusion that the bank had in fact come to the end of the road, it can not be understood any other way, the conditions for transferring to a subsidiary or in fact continue this were such that it was difficult to see how it could fulfil these. [...] This was obviously very serious but I did, well, speak to the CEO shortly after the letter arrived, Kristjánsson, and he actually told me that the bank was reacting very decisively, and would be sending its people abroad, as soon as they could and that all of this was being taken very seriously and they believed they had a good chance to reach some sort of an agreement with the FSA to do this; it was always said that this was some kind of misunderstanding and they would iron this out, work it out." When asked whether he had detected any difference in the attitudes of Halldór J. Kristjánsson and Sigurjón Þ. Árnason

49. Memorandum of the Central Bank of Iceland, "FSA letter dated August 15, 2008", dated 16 August 2008.

concerning the transfer of deposit accounts to a subsidiary, Haarde replied: "I did not notice this as such but I think, yes, that I can say that Árnason was more reluctant but Kristjánsson perhaps understood the necessity of doing this as fast as possible."⁵⁰

On 17 August 2008, Landsbanki sent an e-mail to the FME explaining the bank's position that the aforementioned requirement made by the FSA were unrealistic. In the bank's view the FSA requirements meant that the decrease in easy access Icesave accounts equalled the withdrawal of around 60% of deposits over a period of four months without any increase in other deposits. This outflow would also compromise the bank's liquidity position and this could reduce its credit rating. Finally, the letter states: "One of the issues Landsbanki has noticed and which is the most prominent in discussions abroad are doubts as regards the Icelandic Guarantee Fund which (due to lack of assets) is seen as untrustworthy. It would be a great improvement for the system as a whole if the state's guarantee for the Fund's obligations was put beyond any shadow of a doubt as this would make it a lot easier for the banks to stave off the unfair criticism invited by the existing uncertainties. Perhaps a comment from the FME to the government to this effect was justified."

The CEOs of Landsbanki met with FSA representatives on 19 August 2008 as their presence had been requested by the FSA in a letter dated 15 August.

On 20 August 2008, the CEOs of Landsbanki met with the Minister of Business Affairs Björgvin G. Sigurðsson and the Permanent Secretary to the Ministry of Business Affairs. In the meeting, convened at the request of Landsbanki, the CEOs requested that Sigurðsson would take up their cause vis-à-vis British authorities and gave the Minister a copy of the letter from the FSA to the bank dated 15 August 2008.⁵⁰ In the hearing, Björgvin G. Sigurðsson stated that he and Jón Sigurðsson, Chairman of the Board of Directors of the FME, had subsequently convened a meeting with Alistair Darling on 2 September that year for the purpose of convincing British authorities "to reduce their demands regarding the transfer of funds and allow it [Landsbanki] to subsidarise".^{51, 52}

That same day, i.e. 20 August 2008, the FME wrote a letter to the FSA emphasising its views presented in the meeting with the FSA nine days earlier, that it was urgent that Landsbanki be granted a provisional exemption from the rules on large exposures in order for it to transfer the Icesave accounts to Heritable Bank.

On that same day, i.e. 20 August 2008, a meeting was held in the consultative group of the Prime Minister's Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning. In the draft minutes it is stated that Jónas Fr. Jónsson had given an account of the meeting he and Jón Sigurðsson, Chairman of the Board of Directors of the FME, had with the FSA on the 18th of that month. Jónsson is quoted as stating that the FSA considered there was a great risk of a run on Landsbanki. It had also emerged that the FSA had found Landsbanki to be uncooperative

"However, we sought his [Björgvin G. Sigurðsson] support in pleading our case vis-à-vis British authorities, as they were constantly presenting the justification that they were under political pressure. Then it occurred to us that if political pressure was being applied from the UK side maybe it was time to apply some political pressure from Iceland, so that the Icelandic politicians would acquaint themselves with the case and assist us in it."

Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 26.

"[...] he [Jón Sigurðsson] was working with them towards this, I am sure he had many conversations with the Landsbanki directors on the issue and was very involved in this and this is why Jón Sigurðsson and I went to London on 2 September to this meeting we managed to arrange almost without notice with Darling, to try and get them to reduce the requirements for the financial transfers and allow them to transfer to a subsidiary."

Statement by Björgvin G. Sigurðsson before the SIC on 19 May 2009, p. 10.

50. Statement by Geir H. Haarde before the SIC on 2 July 2009, p. 55-56.

51. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 26.

52. Statement by Björgvin G. Sigurðsson before the SIC on 19 May 2009, p. 10.

and that the bank had carried out an advertising campaign at the time the FSA was putting pressure on the bank to curb its marketing efforts. Later Jónsson is quoted as stating that the FSA believes that Landsbanki is “resisting”. Then Bolli Þór Bollason, Permanent Secretary to the Prime Minister’s Office, is quoted as stating that he believes that the “Landsbanki people” did not fully grasp the situation. However, Jónsson stated that they were aware of the situation but their options were not good.

The FSA reacted to a letter from the FME dated 20 August 2008 in a letter of 27 August. There it is stated that its refusal to grant the requested exemption was based on the FSA’s assessment of the liquidity position of Landsbanki.

On 29 August 2008 Landsbanki wrote a letter to Hector Sants, Chief Executive of the FSA, where the bank states that it has engaged the law firm Allen & Overy to explore what effect the transfer of the Icesave deposit accounts to a subsidiary would have on the bank’s covenants. It also states that the bank hopes that it will receive the final legal opinion at the beginning of the following week. In addition, the bank will have to consult the FME. For this reason, the bank requests that the time-limit for submitting proposals regarding the transfer be extended to 8 September. Furthermore, the bank suggests that on that day a meeting with Hector Sants be held.

Two days later, i.e. on 31 August 2008, Landsbanki wrote a letter to Michael Ainley, a member of the FSA staff. Attached to the letter were two legal opinions. On the one hand the aforementioned opinion of Allen & Overy and on the other hand the advice presented by solicitors T.A.G. Beazley and James Segan concerning the powers of the FSA, i.a. with a view to the rules of European law. In the bank’s letter it is stated that Allen & Overy had come to the conclusion that the restructuring of the Landsbanki operations in question may lead to covenants being breached and may therefore possibly not be implemented without the consent of the bank’s loan providers. In the opinion of T.A.G. Beazley and James Segan it is stated that it is their view that the FSA does not have authority to compel Landsbanki to transfer the branch’s Icesave accounts to a subsidiary. In addition, the solicitors believe that there is some doubt as to whether the FSA is authorised to require that Landsbanki cease the operations of its UK branch or reduce its deposit taking. More specifically, the decision that Landsbanki must close down the operations of its UK branch may fall outside the scope of the FSA’s powers. However, the authority may be authorised to stipulate that the receipt of deposits be reduced although that may be difficult to justify with regard to the rules of EU law.

As related above, a memorandum was written on 16 August 2008 in the Central Bank of Iceland concerning the FSA letter to Landsbanki dated 15 August. In this context it must be mentioned that the SIC is also in possession of a draft letter by the Central Bank to Mervyn King, Governor of the Bank of England, dated 27 August and 1 September 2008. According to the Central Bank’s information this draft was never completed and therefore never sent. In the draft, dated 1 September 2008, it is stated i.a.: “In closing, I wish to emphasise that the Central Bank of Iceland is prepared to do its utmost so that this matter may be brought to a satisfactory conclusion for all parties. However, it can hardly support a solution that could involve a potential threat to an Icelandic bank with unforeseen consequences for the financial system. The repercussions of that development could be serious and felt widely.

Therefore, we must seek to co-operate in this case and, by so doing, underpin financial stability in our respective countries. Current conditions in the global financial system add to the responsibilities of regulatory and monetary authorities in different countries to work together to strengthen the foundations of financial stability world wide and in individual countries.“ In an e-mail to the SIC dated 8 December 2009, Ingimundur Friðriksson revealed that it had been discussed within the Central Bank’s Board of Governors to send the aforementioned draft letter to the Bank of England. However, as interactions between the FSA, the FME and Landsbanki were extensive at that time the Central Bank’s Board of Governors decided against it.

On 2 September 2008, Björgvin G. Sigurðsson, Minister of Business Affairs, and Jón Sigurðsson, Chairman of the Board of Directors of the FME, met with Alistair Darling in London. Present at the meeting were also Baldur Guðlaugsson, Permanent Secretary to the Ministry of Finance, Jónína S. Lárusdóttir, Permanent Secretary to the Ministry of Business Affairs, Jón Þór Sturluson, Assistant to the Minister of Business Affairs, Áslaug Árnadóttir, Director at the Ministry of Business Affairs and Chairman of the Board of Directors of the Depositors’ and Investors’ Guarantee Fund, and Sverrir Haukur Gunnlaugsson, Ambassador to the UK. In the hearing before the SIC, Björgvin G. Sigurðsson stated that he and Jón Sigurðsson had initiated the meeting.⁵³

Amongst existing documentation, there is a document containing the arguments Björgvin G. Sigurðsson and Jón Sigurðsson presented as their point of reference at the meeting. Jón Sigurðsson emphasised the issues of Landsbanki at the meeting. He stated that the FSA and the FME were in agreement that the subsidiarisation of the Landsbanki Icesave account was the safest way to solve the issue. However, the hope was that British authorities would approach the matter realistically and show necessary flexibility in view of the situation in the financial markets. Landsbanki must be granted a reasonable time limit for the orderly transfer of assets against deposits so as to upset the bank’s covenants as little as possible.⁵⁴ Jón Sigurðsson also discussed the Icelandic economy in general. He referred to a report by the International Monetary Fund where it is stated that the longterm economic outlook in Iceland was enviable. Furthermore, the three banks had passed the FME’s rigorous stress tests around the middle of 2008. In the hearing, Jón Þór Sturluson described that in the meeting Darling had used words such as: “Do you not understand how serious this is?”⁵⁵

On 4 September 2008, a meeting was held in the consultative group of the Prime Minister’s Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning. In the draft minutes Jónína S. Lárusdóttir is quoted as stating: “JSL mentioned a meeting between the Minister of Business Affairs and the British Chancellor of the Exchequer. Before this he had visited Glitnir and Landsbanki in London. Landsbanki’s

53. Statement by Björgvin G. Sigurðsson before the SIC on 19 May 2009, p. 46.

54. Cf. the response of the Minister of Business Affairs to a query by Siv Friðleifsdóttir regarding a meeting with the British Chancellor of the Exchequer, parliamentary document No. 214 - parliamentary item No. 113 of the 136th legislative session 2008-2009.

55. Statement by Jón Þór Sturluson before the SIC on 6 May 2009, p. 29.

“It was evident that the Chancellor [Alistair Darling] was fully briefed on the matter. He expected that British authorities would guarantee deposits in full and asked where to send the bill.”

Jónína S. Lárusdóttir quoted in draft minutes, dated 4 September 2008, of the consultative group of the Prime Minister’s Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning.

position still seemed to be based on the legal opinion of an English solicitor sent by the bank to the FSA the previous Saturday. JSL and BG [Baldur Guðlaugsson] are of the opinion that the Landsbanki representatives who had been consulted in London did not fully grasp the situation. BG revealed that there had been two letters. One concerning covenants in the Landsbanki debt agreements and the other concerning the unjust demands of the FSA. JSL claimed it inappropriate that in one of the bank’s letters it is stated that Landsbanki is aware of the government’s declaration of support to the Guarantee Fund.” It then goes on: “JSL gave further details from the meeting between the Minister of Business Affairs and Alistair Darling, the British Chancellor of the Exchequer. Jón Sigurðsson, Chairman of the Board of Directors of the FME, had explained the matter in great detail. It was evident that the Chancellor was fully briefed on the matter. He expected that British authorities would guarantee deposits in full and asked where to send the bill. In other words, he did not refer to the maximum deposit guarantee in the UK which is £35,000 but to the total amount. The subsidiarisation timeframe had been discussed as this would have to take place as soon as possible. When it was mentioned that the issue must not be pursued with such force so as to lead to a crisis the Chancellor said he understood that.”

Sverrir Haukur Gunnlaugsson, Ambassador in London, disclosed in the hearing before the SIC that neither he nor the embassy had been involved in the possible transfer of the Landsbanki Icesave accounts to a subsidiary in London until that meeting of the ministers on 2 September 2008; although he had received a request from the assistant to the Minister of Business Affairs in Iceland on 22 or 23 August 2008 to organise a meeting between the Minister of Business Affairs and the British Chancellor of the Exchequer. It had caught his attention that when he phoned HM Treasury the minister’s personal secretary had replied explicitly that Alistair Darling would be unavailable all next week, however, the Icelandic minister could meet with the Chancellor on 2 September “at this time”. Gunnlaugsson had been surprised as not everyone could arrange a meeting with the Chancellor almost without notice but the secretary was quite clear: “Yes, yes, this has been decided, he will without a doubt want to meet the Minister of Business Affairs.” Gunnlaugsson claimed he had forwarded the message home to Iceland and had later been present at the meeting in his capacity as the Ambassador; however, he had not received any documentation. He had sent back to the Ministry for Foreign Affairs the routine report from the meeting.

When asked further about this, Gunnlaugsson said that he had not had any knowledge of the matter before the meeting and that his knowledge of the said accounts had first and foremost been based on reports he had seen on television and other media abroad. That coverage had mostly taken place in March 2008. Later, he had been present at a meeting between Geir H. Haarde and Gordon Brown, Britain’s Prime Minister, in April 2008 but there, as far as he could recollect, no mention had been made of Icesave.⁵⁶

Three days after the meeting, i.e. 5 September 2008, Clive Maxwell, staff member at HM Treasury, phoned Ambassador Sverrir Haukur Gunnlaugsson. In an e-mail sent by Gunnlaugsson to Björgvin G. Sigurðsson, Jónína S.

56. Statement by Sverrir Haukur Gunnlaugsson before the SIC on 4 May 2009, p. 1-2.

Lárusdóttir, Jón Þór Sturluson and Baldur Guðlaugsson on 5 September 2008 at 14:58, Gunnlaugsson repeated after Maxwell that the Chancellor had been disappointed over the meeting in London on 2 September as he got the impression that the representatives of the Icelandic state had not understood the seriousness of the matter. Gunnlaugsson claimed that he had replied that the Icelandic authorities had fully understood the seriousness of the matter, which had been clearly underlined by their strong presence at the meeting. Maxwell allegedly goes on to say that it was “very necessary that the party concerned (the private party) would present its clear response on the following Monday (8.9) on how [...] it intended to continue the matter [...] as then a meeting on the issue is scheduled”. It then states: “HM Treasury was hoping that Icelandic authorities were encouraging the party concerned to come to a conclusion in the matter as soon as possible.” Finally, his e-mail states: “Maxwell also mentioned that the Chancellor had emphasised how political the matter had become as parliament continually asked about a response. It was very desirable that the Icelandic authorities could consult the Treasury on how to respond to these questions.”

In the hearing before the SIC, Gunnlaugsson stated that once he had forwarded this message to Iceland, he and the embassy had not been further involved in the matters of Landsbanki and Icesave until 8 October 2008: “I was called down to the ground floor to watch the TV at 9:15. That is when it started and then Gordon Brown makes his statement which took us completely by surprise.”⁵⁷

On 3 September 2008, Michael Ainley, staff member of the FSA, replied to a letter by Landsbanki dated 31 August same year. In the letter, the legal opinions obtained by Landsbanki were discussed specifically. There Ainley declares that the FSA disagrees on Landsbanki’s interpretation of the Allen & Overy opinion that the transfer of the Icesave accounts to a subsidiary would automatically lead to a breach of the bank’s covenants. Furthermore, the FSA believes that the decision that Landsbanki must reduce deposit taking in its UK branch must be regarded as reasonable and proportionate given the risk that there will be a run on the branch’s deposits.

That same day, i.e. 3 September 2008, Hector Sants, Chief Executive of the FSA, replied to a letter by Landsbanki dated 29 August same year. In the letter the requested extension of the deadline is granted, i.e. until 8 September 2008. In addition, the FSA agrees to a meeting on the issue once the bank had submitted its proposals. It was proposed that the meeting be held on 10 September 2008. Close to the end of the letter it is stated that if the Landsbanki proposals were not received by 8 September or if they did not adequately or immediately address the need to manage the liquidity risks identified by the FSA, then the authority would contemplate exercising its powers pursuant to Part XIII of FSMA.

On 3 September 2008, Geir H. Haarde met with the CEOs of Landsbanki.

On 4 September 2008, Jón Sigurðsson, Chairman of the Board of Directors of the FME, sent an e-mail to Geir H. Haarde. In it Jón Sigurðsson states that it is clear that British authorities would put pressure on Landsbanki to transfer their “Internet based accounts” in the UK from the branch to a

57. Statement by Sverrir Haukur Gunnlaugsson before the SIC on 4 May 2009, p. 4.

UK subsidiary. Sigurðsson states that this change would lead to liquidity difficulties for Landsbanki as the Internet based accounts had become “an extremely important source of liquidity for Landsbanki in Iceland and other countries”. Sigurðsson continues: “What matters is to obtain a reasonable adaptation period for Landsbanki to implement this change without creating serious problems on the market. From the standpoint of the Icelandic state “subsidiarisation” of the Icesave accounts in the UK is not disadvantageous as this would entail transferring the responsibility for deposit guarantee entirely over to Britain.

As stated above, a meeting was held on 4 September 2008 in the consultative group of the Prime Minister’s Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning. In the draft minutes Baldur Guðlaugsson stated that the banks could not be prohibited from establishing branches abroad, however, a way must be found to make it disadvantageous for them to receive deposits and thereby increase obligations of the State Treasury. Later, Bolli Þór Bollason, Permanent Secretary to the Prime Minister’s Office, stated that Landsbanki was still focused on continuing their deposit taking as a source of funding for the bank. Then it is reported that Jónas Fr. Jónsson had concurred with Bollason.

“BÞB [Bolli Þór Bollason] claimed Landsbanki was still fixated on continuing their deposit taking as a source of financing for the bank and JFJ [Jónas Fr. Jónsson] concurred.”

Draft minutes, dated 4 September 2008, of the consultative group of the Prime Minister’s Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning.

That same day, i.e. 4 September 2008, Fréttablaðið newspaper published an article by Ingibjörg Sólrún Gísladóttir, Minister for Foreign Affairs, where she, i.a., discussed the liquidity problem of the banks and claimed that this could be attributed to the shortage of loanable funds in international markets. Further on in the article: “The banks themselves will have to seek liquidity abroad and sell assets where possible. They will have to continue to raise deposits in foreign markets.”

In a meeting of the Landsbanki Board of Directors on 5 September 2008, the FSA’s assessment of the risk factors of the Landsbanki London branch were discussed. In a record on the issue it is stated that Ársæll Hafsteinsson had outlined the case and stated that “most factors [were] in good order”. It is then stated: “The FSA is concerned over the liquidity management, i.a. as regards the Icesave deposit accounts, the bank having had discussions with the authorities concerning the arrangement of those accounts for some time that autumn, however, now operations were according to an agreement with the FSA dated 29 May last and regular reporting to the FSA had been established.”

On 8 September 2008, Landsbanki wrote a letter to the FSA. There the bank submits its proposals, as well as various legal comments. The bank proposed that the subsidiarisation be achieved in two steps. The first step could be achieved by the end of 2008, the second step planned at the beginning of 2009. Each step would lead to a transfer of approximately 10% of the total assets of Landsbanki to the bank’s subsidiary, which Landsbanki considered to be the maximum that can be achieved in one calendar year due to covenants in funding arrangements. Since high risks are involved, the bank also submitted a contingency plan in the event the bank’s lenders would conclude that the operation was in breach of covenants. Furthermore, the bank proposed that it would try to work under the agreement reached on 29 May 2008 and how it might then meet the concerns of the FSA. Finally, the bank made its proposals subject to the approval of the FME and that a satisfactory legal opinion be obtained demonstrating that the transfer of 10% of total assets per

one calendar year would not constitute a breach of covenants in its funding arrangements.

Representatives of Landsbanki met with the FSA in the UK on 10 September 2008. Following the meeting, the FSA sent a letter to Landsbanki, dated 17 September 2008, emphasising that the authority had agreed to the solution that on the one hand Instant Access Deposits would be lowered from £2.2 billion to £1 billion by the end of 2008 and, on the other hand, that the overall cap on branch deposits would be £5 billion. The three following measures were to be employed to reach these goals:

1. Change the interest rate strategy to seek to ensure that interest rates on any of the UK branch's Icesave Instant Access Deposits would not appear in any of the best buy tables.
2. Cease all marketing of Icesave Instant Access Deposits as soon as practicable.
3. Introduce, as soon as possible, a fixed-term product aimed exclusively at existing Instant Access customers.

The FSA was firm on its decision, announced on 15 August 2008, that Landsbanki would have to raise its cash reserve to 20% of Instant Access Deposits. In addition, the FSA required that the bank also build up a reserve so as to enable repayment of the Icesave Fixed Term Deposits which would mature over the next six months. Landsbanki was then given two days to decide whether it accepted these terms. The FSA also announced that the authority intended to exercise its powers according to Part XIII of FSMA and order the bank to remedy the current situation and that an official letter pertaining thereto would be sent to the bank at a later date.

The same letter also discusses transferring the bank's Icesave accounts to a subsidiary. It is stated that the FSA fully understands why Landsbanki wants to implement the transfer in two stages where 10% of the bank's assets are to be transferred to Heritable Bank at each stage. This, however, entails the disadvantage that for a period of time, assets covering obligations arising from deposits transferred to Heritable Bank will be insufficient. Such circumstances would be unprecedented, and this is unacceptable to the FSA.

On 16 September 2008, a meeting was held in the consultative group of the Prime Minister's Office, the Ministry of Finance, the Ministry of Business Affairs, the FME and the Central Bank of Iceland on financial stability and contingency planning. The draft minutes quote Jónas Fr. Jónsson: "JFJ reminded that if the Icesave deposits were transferred to a subsidiary, the deposit guarantee would be more manageable for the authorities."

Landsbanki answered the aforementioned letter from the FSA with a letter dated 19 September 2008. It states that the bank accepts the conditions imposed by the FSA with regard to liquidity management. The bank does, however, object to the conditions and finds them extremely harsh and unreasonable to the bank. As regards the transfer to a subsidiary, the bank reiterates its position that the transfer of 10% of Landsbanki's total assets is the maximum the bank is ready to transfer in one calendar year. In the letter, Landsbanki restates the risk of the bank's lenders viewing these actions as a carefully crafted measures designed to circumvent the covenants. This may lead to lenders assuming a breach of covenant.

"We had sensed that they [the FSA] placed such enormous emphasis on this that we would have to find some way to do it, they wouldn't make any concessions, even if they were fully authorised to do so. In the end, we sent this to them and went to their meeting, discussed this and listened to them. After the meeting we thought that if they sent a negative letter we wouldn't know how to solve this. If, however, a letter with a positive tone arrived, which must really be the case, then we would have to solve it this way. Then this solution would be the case. Then the letter arrives [...] where they reject everything. And we are just, oh my God, how do we solve this? Then a few days later when we are beginning to work out a solution, something new happens, Glitnir is overtaken and then this is simply forgotten. A new, even bigger problem, had come up."

Statement by Sigurjón Þ. Arnason before the SIC on 19 August 2009, p. 126.

"I have never understood how these people [the FSA] can want so much but are not prepared to see that we need to work together to solve the matter. I have often suspected that they did not want this responsibility in fact, not when push came to shove."

Statement by Sigurjón Þ. Arnason before the SIC on 19 August 2009, p. 127.

The same day, i.e. 19 September 2008, Landsbanki wrote a letter to the FME recounting the correspondence with the FSA. It lays out the opinion that from then on it would be reasonable for communications with the FSA on liquidity management to be conducted via the FME. It also notes that requests and clarifications by Landsbanki are seemingly ignored by the FSA and that the authority seems to be ready to take action which may place the bank in great jeopardy in very precarious times. It requests that the FME assist Landsbanki in communicating with the FSA so as to ensure a normal working environment for the bank in accordance with the European and English legal regimes.

The same day, i.e. 19 September 2008, the FME wrote a letter to Hector Sants, Chief Executive of the FSA, stating that the FME believed that the FSA had not cooperated sufficiently with the FME in the matters regarding Landsbanki. The FME is of the opinion that the situation calls for the FSA to consult from here on with the FME on any recommendations or decisions regarding Landsbanki before they are sent to the bank. The FME will also notify Landsbanki that the authority expects to be consulted before any proposal is sent to the FSA on behalf of the bank.

The FSA responded to the letter of 19 September 2008 from Landsbanki with a letter on 25 September 2008. In the letter it is stated that the authority believes the bank does not comply with the financial adequacy rule set out in section 1.2.26R of The General Prudential Sourcebook Instrument (GENPRU).

With regard to the obligation of the FSA to control the liquidity position of the branch it was both necessary and appropriate to require Landsbanki to remedy the situation. As already stated, Landsbanki was neither being required to subsidiarise nor close its branch. Rather the authority had been prepared to explore Landsbanki's suggestion concerning subsidiarisation of its branch as a possible means of addressing the authority's concerns about liquidity. The FSA then states that it sees the issues of liquidity and subsidiarisation as quite separate insofar as it has a legal responsibility for effective supervision of the former, regardless of any agreement that might be reached on the latter. Then it is pointed out that the FSA reserves the right to revisit the liquidity measures if subsidiarisation were to be delayed. Having taken Counsel's advice on the limits of its host state competence pursuant to Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions, the FSA remains confident that its requirements are legitimate. The argument presented by Landsbanki cannot be accepted that the measures the FSA proposes cannot properly be characterised as genuine liquidity measures. Later it is stated that pursuant to Article 30(1) of the Directive and Section 199(3) of FSMA, the FSA requires that Landsbanki remedy the ongoing non-compliance with the general liquidity requirement set out in the overall financial adequacy rule of GENPRU 1.2.26R. One of the main reasons mentioned by the FSA in this context is that in the view of the authority there is a significant risk that Landsbanki will suffer a liquidity stress that will exceed the liquidity resources available to its branch and that its liabilities will consequently not be met as they fall due. The FSA states that in assessing this risk it has taken account of the risks facing the Icelandic economy and its banks, retail deposit-takers in the UK, EEA branches that collect retail deposits in the UK, and press coverage. A run could be made

on Landsbanki at any time. To remedy the situation, the FSA considers the following measures necessary:

- a. A revised interest rate strategy providing for:
 1. A reduction to £1 billion in the overall level of Icesave Instant Access Deposits by end 2008.
 2. A reduction in the interest rates on Instant Access Deposits entailing the immediate withdrawal of all Instant Access Deposits from the best buy tables.
 3. No change to interest rates on Icesave fixed rate deposit products without notifying the FSA.
- b. Cessation of all marketing of Icesave Instant Access Deposits by 10 October 2008.
- c. An increase in the bank's cash reserves (or unencumbered Bank of England eligible securities) to 20% of Instant Access Deposits. By 17 October 2008 Landsbanki is requested to submit a plan setting out the circumstances in which Landsbanki would make use of the reserves and a timetable for rebuilding the reserves after such use.
- d. Submission by 17 October 2008 of a plan to ensure the sustained build up of reserves to enable repayment of the fixed-term deposits which mature between then and end of June 2009.
- e. Deposits of all types do not in aggregate exceed £5 billion.

On the morning of 29 September 2008 it was officially announced that the Icelandic government and the biggest shareholders of Glitnir Bank hf. had reached an agreement for the state to provide the bank with a capital contribution of €600 million due to the bank's difficult liquidity position and the extremely difficult circumstances in international financial markets. This would make the state owner of 75% of the bank's capital.⁵⁸ The antecedent to this decision and its consequences are covered in greater detail in Chapter 20.2.

On 30 September 2008, a working group of the Central Bank of Iceland met to discuss reactions to liquidity problems. The minutes state that a large part of the Icesave deposits had been withdrawn the previous night.

The following day, i.e. 1 October 2008, a solicitor at Allen & Overy sent an e-mail to Mark Sismey-Durrant, Chief Executive of Heritable Bank, expounding the options available for transferring the Landsbanki Icesave accounts over to Heritable Bank. The solicitor refers to an earlier opinion of the law firm dated 22 February but subsequently brings up a number of points which he believes merit being brought to the attention of the FSA.

1. A transfer through court process pursuant to the provisions of Part VII of FSMA would take time.
2. A transfer on the basis of implied consent from the depositors is a solution the solicitor thinks is both simple and transparent. However, he believes that the FSA will view this solution with suspicion since it is legally imperfect. In spite of this, he is of the opinion that this solution is possible.

The FSA emphasised that the authority, as a host state competent authority, is responsible in cooperation with the FME for supervising the liquidity of Landsbanki. Accordingly, the FSA has made the aforementioned decision pursuant to Article 30(1) of Directive 2006/48/EC and to Section 199(3) of FSMA. The letter continues to say that the FSA can assure Landsbanki that in assessing the bank's proposals concerning the subsidiarisation, the authority has been and is prepared to consider ways forward which would be unprecedented for the authority. Later in the letter it is stated that the FSA reiterates that it does recognise and respect the importance of Landsbanki's wholebank stability. Towards the end of the letter it is stated that the FSA must reiterate that at the request of Landsbanki a £2.4 billion connected lending waiver is unprecedented and that the authority wishes to explore all possible avenues to reduce it.

"This would be the simplest solution by far although I would reflect on whether this would send a negative message to the market, i.e. as soon as the market sees the involvement of the Treasury they will assume it is for all the wrong reasons whereas implied consent route would enable you to convey the right message in your letter to depositors."

E-mail by a solicitor with Allen & Overy to Mark Sismey-Durrant, 1 October 2008.

58. See news release from the Prime Minister's Office, dated 29 September 2008. The news release may be obtained on the website of the Prime Minister's Office, <http://www.forsaetisraduneyti.is/frettir/nr/3018>.

3. Since option no. 1 is simply not practical and the likelihood of no. 2 not finding favour with the FSA, the solicitor recommends exploring whether the FSA can be persuaded to put pressure on the Treasury to make use of its emergency statutory powers under the Banking (Special Provisions) Act 2008. He points out that the Treasury last used these powers to transfer the depositors of Bradford & Bingley. The letter then states that these powers may only be used in circumstances where it is necessary to safeguard the stability of the financial markets. The solicitor states that given the FSA's concerns regarding Icesave and given the significant numbers involved this should not be an issue. This would by far be the simplest solution. However, he wonders whether this would send a negative message to the market, i.e. as soon as the market sees the involvement of the Treasury they will assume it is for all the wrong reasons. On the other hand, he believes that a transfer on the basis of implied consent may enable the bank: "to convey the right message in your letter to depositors."

It merits mention in this context that relating to discussions of the transfer of Landsbanki's Icesave accounts to a subsidiary receiving fast-track treatment, the SIC directed a number of questions to the FSA in a letter dated 11 June 2009. Michael Ainley, a member of the FSA staff, answered with a letter on 3 July 2009. It states that the application of the Banking (Special Provisions) Act 2008 had not been an option. The reason is that the powers may only be used to transfer the assets and liabilities of an authorised UK deposit-taker. In order to fall under that definition, a firm must be a UK undertaking. The FSA thus seems to consider that the solution set out in point 3 of the solicitor's e-mail above is not possible since the Icesave deposit accounts were in a branch of an Icelandic legal entity and not a UK subsidiary. It is appropriate to point out the FSA's comment on the solution set out in point 2 of the solicitor's e-mail, i.e. the implied consent solution. The FSA letter of 3 July 2009 states that the implied consent solution would likely prove problematic. For a certain period, e.g., it may be unclear which depositors have been transferred from one institute to another. This would create legal uncertainty while the transfer was in progress. The length of the period would depend on the circumstances, but it could clearly be a significant amount of time. In addition, a transfer on the basis of an implied consent may raise concerns about the fair treatment of depositors.

18.2.4 British Authorities Assume Control of the London Branch of Landsbanki Íslands hf.

In a letter dated 3 October 2008, the FSA announced it was exercising its powers in respect of Landsbanki Íslands hf. pursuant to the rules of the Financial Services and Markets Act 2000 (FSMA). According to the FSA's decision, Landsbanki was i.a. required to increase its reserves to 20% of Icesave Instant Access Deposits to be held at the Bank of England. This was to have been completed by 6 October 2008. The bank was also required to decrease the Icesave Instant Access Deposits at the branch to £1 billion by the end of 2008 and a £5 billion limit was placed on overall deposits in the branch. The bank was required to revise the interest rate strategy employed so as to ensure that interest rates on the Icesave Instant Access Deposits

would not be listed in any best buy tables. Finally, all marketing of Icesave Instant Access Deposits was to cease by 10 October 2008.

After the markets closed that same day, i.e. Friday 3 October 2008, the ECB announced that instead of Landsbanki being able to increase its repurchase transactions by €400 million the following Monday, it would on the contrary have to decrease them by the same amount. Landsbanki had thought it could increase its repurchase transactions with the ECB because of the so-called Avens security deposited with the bank which was not fully utilised, i.e. the loans against the security were lower than the worth of the collateral.⁵⁹ Sigurjón Þ. Árnason, CEO of Landsbanki, said this about the situation: “[...] the assets that we had estimated to be worth [EUR] 2.8 billion and they [ECB] had up to that point valued at 2.4 [they now valued at] [...] [EUR] 1.6 [billion EUR].”⁶⁰ This new risk assessment from the ECB thus created a further €800 million disparity in Landsbanki’s plans. It is safe to say that this news put increased pressure on Landsbanki’s liquidity position. In the hearing, Sigurjón Þ. Árnason described this as a “knockout”.⁶¹

In Halldór J. Kristjánsson’s statement before the SIC it was revealed that on the weekend in question transfers from the Icesave accounts had been beset by technical difficulties. The malfunction had been repaired, however, and the outflow from the accounts had then continued.⁶²

A comparable account can be found in an e-mail from Mark Sismey-Durrant, Chief Executive of Heritable Bank, to Sylvía K. Ólafsdóttir at the Central Bank of Iceland, on 27 November 2008. It states that on Saturday 4 October 2008, he had been informed that traffic on the Icesave website had exceeded normal traffic by 400%. Technical difficulties had occurred and caused the computers of some customers to display error messages. According to Sismey-Durrant, the problem had been solved around noon. The problem had reoccurred, however, in the evening of the following day. Sismey-Durrant says that the problem had been solved around midnight. He goes on to say that the following morning, i.e. the morning of Monday 6 October 2008, web traffic had exceeded normal traffic by 450%. That number rose to 600% later the same morning.

At noon on Sunday 5 October 2008 a meeting was held between the CEOs of Landsbanki Íslands hf. and the Board of Governors of the Central Bank of Iceland where the CEOs of Landsbanki reported on the operational problems the bank was now facing.

Later that same day, i.e. 5 October 2008, Jónas Fr. Jónsson, Director General of the FME, wrote an e-mail at 16:11 to Halldór J. Kristjánsson, CEO of Landsbanki. Jónsson referred to a conversation between him and with Hector Sants, Chief Executive of the FSA, and said i.a.: “The FSA says that you have to bring £200 million (i.e. in addition to 10% of easy access) to the UK branch if you want to remain in business. If that doesn’t happen they will most likely close you down tomorrow.”

Halldór J. Kristjánsson replied to Jónsson’s e-mail five minutes later, i.e. at 16:16 that same day, and said: “Weren’t they offering a fast track to subsidiarisation.”

“[...] we got the knockout after closing on the Friday with the “margin call” [...]”

Sigurjón Þ. Árnason on the margin call by the Central Bank of Europe vis-à-vis Landsbanki Íslands hf., cf. Árnason’s statement before the SIC 27 August 2009, p. 123.

“And on Saturday the 4th [October 2008] we met at Siggí Einar’s [Sigurður Einarsson] and then we receive a phonecall, the Icesave website was down, and at that point the end was self-evident.”

Statement by Jón Ásgeir Jóhannesson before the SIC on 18 August 2009, p. 13.

59. See discussion on the Avens bond in Chapter 7.0.

60. Statement by Sigurjón Þ. Árnason before the SIC on 27 August 2009, p. 123.

61. Statement by Sigurjón Þ. Árnason before the SIC on 27 August 2009, p. 123.

62. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 63.

Jónsson replied to Kristjánsson's e-mail at 16:20 and said: "I asked Sants, assuming that you bring £200 million tomorrow, and wanted to subsidiarise quickly, whether that was possible and if so, how fast. He reacted positively and said 1-2 weeks subject to any reservations."

Shortly after 20:00 that same day, i.e. 5 October 2008, the CEOs of Landsbanki held a telephone conference with Hector Sants, Chief Executive of the FSA, and some of his associates. The conference was recorded and the SIC is in possession of a manuscript of the conversation. During the conference, it was revealed that the possibility had been discussed that Landsbanki would take over Glitnir, thereby giving Landsbanki access to assets which could be transferred to Heritable Bank at the same time the Icesave accounts were transferred there. It was discussed during the telephone conference how long it would take to transfer the Icesave accounts to a subsidiary. Hector Sants referred that question to his associate, Michael Ainley, who answered that it would take at least three to four months as discussed the previous week, since it would always have to go through a court process. Kristjánsson specifically asked whether there wasn't a speedier way to achieve this. Michael Ainley answered that it was his understanding that this would always take at least three to four months. However, he would consult with a solicitor and this point could be discussed further the following day. Hector Sants declared that the FSA was willing to explore whether there was any speedier way of proceeding in this matter. However, no specific time was mentioned in this context.

"So we must have the 200 million or we will have to say that the retail deposit base, we will have to make it clear to UK depositors that they cannot continue using the bank which I think would cause effectively us saying, it's a failed bank. So if you want to continue as a bank I think you have to give us 200 million tomorrow morning. We have no choice, there is no money left."

Hector Sants in a phone conference between the FSA and Landsbanki in the evening of 5 October 2008.

"The reality is that the London branch is now out of money and therefore you have to transfer 200 million to us tomorrow morning or otherwise we will have to shut the branch to retail activity because there is no money."

Hector Sants in a phone conference between the FSA and Landsbanki in the evening of 5 October 2008.

It is repeatedly stated on behalf of the FSA during the conference that no matter how things otherwise proceed, it is imperative that £200 million will come through the following morning, i.e. 6 October 2008, due to the outflow from the Icesave accounts at the London branch. It is also stated that if the bank does not fulfil that requirement the FSA will be forced to notify British depositors that they cannot continue using the bank; Hector Sants then states that this would effectively mean the FSA was declaring it a failed bank. Furthermore, an additional £53 million will have to be transferred to Heritable Bank.

In this context it should be noted that a letter from Michael Ainley, staff member of the FSA, to the SIC, dated 3 July 2009, relating to the SIC's enquiry to the FSA, states that Ainley can confirm on behalf of Hector Sants that Sants at no point said or sought to imply that a conventional transfer of a deposit book was possible in 1-2 weeks. In the hearing before the SIC, Sigurjón Þ. Arnason said that his understanding of the term "fast track" was that the transfer of the accounts would be carried out on the basis of implied consent of the depositors.⁶³ Halldór J. Kristjánsson seemed to agree with this in the hearing, but he furthermore stated that he had hoped that the British authorities could unilaterally transfer the accounts to a subsidiary of Landsbanki. The transfer of deposit accounts to a subsidiary would also have necessitated the transfer of assets to the subsidiary. Kristjánsson reiterated that £200 million would not have been enough in this context. Kristjánsson stated that at this point in time the CEOs of Landsbanki had been ready, in light of the situation that had arisen, to risk having the covenants regarded

63. Statement by Sigurjón Þ. Arnason before the SIC on 19 August 2009, p. 131.

as breached.⁶⁴ Sigurjón Þ. Árnason agreed that £200 million would not have been enough for Landsbanki. The hope had been that British depositors could be calmed and further runs on the bank's accounts prevented. In this context, Árnason noted that he had been under the impression that the FSA had been ready to issue a special statement to that effect. When asked, Árnason said that if the route of implied consent had been chosen, that would probably have taken a few weeks. The timing was entirely dictated by how long the FSA would take to examine Landsbanki's assets.⁶⁵

In the evening of 5 October 2008, Landsbanki received news that the limitations on repurchase transactions with the ECB that were announced on 3 October 2008 would not be enacted.

That same night, a letter was sent from the CEOs of Landsbanki to the Central Bank of Iceland. In it, the CEOs say that they want to inform the Central Bank of three events that have taken place that day: "First, the ECB has reported to Landsbanki that the limitations on repurchase transactions announced last Friday will not be enacted for the time being. This greatly eases the bank's liquidity needs this week." It then goes on: "Secondly, Landsbanki is engaged in discussions with the Chief Executive of the FSA about the rapid subsidiarisation of the Icesave accounts in the UK. In relation to this, Landsbanki has requested that the announced limitations on deposit activities be changed." It finally states: "Thirdly, discussions are already underway between Landsbanki and Kaupthing on the one hand and representatives of the state on the other to take over the deposits and assets of Glitnir if legally viable."

The following day, i.e. Monday 6 October 2008, the CEOs of Landsbanki wrote a letter to the Central Bank of Iceland disclosing that a significant outflow had taken place from the Icesave accounts in London over the previous weekend, to a total of £318 million. For this reason, the FSA had demanded that Landsbanki transfer £200 million in cash to the UK in addition to depositing £53 million into a reserve account at Heritable Bank. In the letter, Landsbanki refers to discussions which had taken place over the weekend on repurchase transactions or a currency swap agreement with the Central Bank of Iceland. Landsbanki states that there is an urgent need for funds in foreign currency and requests an immediate meeting with the Central Bank's Board of Governors. The letter does not mention the transfer of the Icesave accounts to a subsidiary or any fast-track treatment relating thereto. The same applies to two letters sent from Landsbanki to the Central Bank of Iceland later that day. The former reiterates the bank's earlier request but the latter asks that the meeting be delayed from 14:00 to 15:00.

Between 15:15 and 15:35 that same day, i.e. 6 October 2008, the CEOs of Landsbanki met with the Central Bank's Board of Governors. From the Central Bank's draft minutes it can be assumed that facilitation was rejected because the Central Bank did not think it had further funds available because of a loan to Kaupthing Bank hf. The draft minutes further state that in the estimation of the Governors of the Central Bank, the outflow from the Icesave accounts would become so great "that it would be like throwing money

"[...] in that phone conference then [...]. I understood that as a way which would somehow [...] that it would be enough [...] that someone sends you a letter, you are the customer, and says: Landsbanki, working with the Financial Supervision Authority in the UK, has reached an agreement to transfer all deposits, formerly in the Landsbanki branch to a subsidiary [...] and if you do not make any observations concerning this, like from tomorrow or something like that, then you deposit has become part of [subsidiary Heritable Bank] and this means that now everything falls under the deposit guarantee scheme in the UK."

Statement by Sigurjón Þ. Árnason before the SIC on 19 August 2009, p. 131.

"It's as if nobody wanted to understand or did understand that if one bank fails for one day it makes no difference if he is given all the money in the world the next day, he is gone."

Statement by Sigurjón Þ. Árnason before the SIC on 27 August 2009, p. 121.

"Hopefully, you will not let these people sacrifice the currency reserves."

Sigurjón Þ. Árnason quoted in the Central Bank's draft minutes of 6 October 2008.

64. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 34 and on. See also statement by Sigurjón Þ. Árnason before the SIC on 19 August 2009, p. 131.

65. Statement by Sigurjón Þ. Árnason before the SIC on 19 August 2009, p. 132-133.

“[...] however, I remember that we went to the Central Bank around three or four o'clock that Monday where I and Árnason, and I believe Jón Þorsteinn was with us, to meet all the Governors, and there Oddsson tells us that they have scraped the barrel by providing these funds.”

Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 56.

“[...] when the British asked them how they would acquire enough pounds, they simply said that they would go to the swap market [i.e. the currency swap market] [...]”

Statement by Guðmundur Jónsson before the SIC on 10 August 2009.

away”. Ingimundur Friðriksson, Governor of the Central Bank, has stated that it was revealed in the meeting that the amount would most likely be much higher than £200 million. There was no indication that this would prove to be anything other than “a bottomless pit”.⁶⁶ Halldór J. Kristjánsson told the SIC that Davíð Oddsson, Chairman of the Board of Governors of the Central Bank, had said that the bottom of the barrel had already been scraped in the process of obtaining funds for a loan to Kaupthing.⁶⁷

On 6 October 2008, the FSA notified Landsbanki of its decision to prohibit the bank from invoking any contractual term or condition in relation to deposit accounts that allow it to temporarily cease or limit withdrawals from accounts up to 60 days unless it has given the FSA at least 1 day's written notice of the proposed action. The FSA also imposed the condition that the authority would have to confirm that it did not have objection to the bank's proposal. Landsbanki objected to this decision in a letter to the FSA sent the following day, i.e. 7 October.

In the evening of 6 October 2008, the London branch of Landsbanki was closed down.⁶⁸

At 23:18 on 6 October 2008, Althingi adopted a law which was published the following day as Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances, etc., or the so-called Emergency Act. On the morning of 7 October, a special Resolution Committee assumed control of Landsbanki based on the provisions of the Act. These events are discussed in more detail in Chapter 20.4.

At around 10:00 on 8 October 2008, HM Treasury issued a freezing order for Landsbanki's assets and certain assets of the Icelandic authorities and the Icelandic government in UK territory on the basis of the Anti-Terrorism, Crime and Security Act 2001. The order came into force at 10:10 that same day.

18.2.5 Findings of the Special Investigation Commission on the Icesave Accounts in the London Branch of Landsbanki Íslands hf.

As previously related, it is clear that the directors of Landsbanki Íslands hf. decided to locate the Icesave deposit accounts at the London branch of the bank rather than a subsidiary so that it would be possible to move funds upstream from the accounts. The reason for this is that British rules on large exposures place considerable limitations on such transfer of funds in the case of subsidiaries. However, this arrangement had the fateful consequences that the deposits were guaranteed in Iceland by the Depositors' and Investors' Guarantee Fund. It was also clear that this involved incurring deposit obligations on behalf of Landsbanki vis-à-vis individuals in the UK and that withdrawals, including in case of a run on the bank, would have to be made in pounds whereas Landsbanki could not expect a last resort facilitation from the Central Bank in a currency other than the Icelandic króna. In case of sizable payments having to be made from Iceland to meet withdrawals from these accounts, it should have been clear that this might have a significant

66. Statement by Ingimundur Friðriksson before the SIC on 19 March 2009, p. 58.

67. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 56.

68. Statement by Halldór J. Kristjánsson before the SIC on 12 May 2009, p. 41.

effect on the exchange rate of the Icelandic króna. The Icesave accounts were electronic and the account holders generally had easy access to them for making deposits and withdrawals with the exception of fixed-term deposits. They offered high interest compared to other deposit options in the UK and for a good part of 2007 the Icesave accounts were at the top of the best buy tables published in the UK.

It is clear from the available clarifications and information that as far as Landsbanki was concerned, the raising of deposits abroad was mainly viewed as a component of financing the bank at the same time as options were becoming more scarce for financing through foreign loans and the issue of securities. In spite of this altered financing situation there was no change in the lending policy or operations of Landsbanki with the exception of purchases by the bank in London of securities believed to very safe and marketable and an increase in asset-based lending in the UK. According to the terms of these loans, their repayment could be required within 24 hours.

Whether the debtors could then if need be abide by the time limit is another story.

As to the trade in securities, it did not start until June 2007 and the securities were later that year used in repurchase transactions with the ECB. It is appropriate to note that these measures of Landsbanki, which only lasted a few months, were not enacted until the Icesave deposits had grown to £3.6 billion. The funds that were deposited into the Icesave accounts in London and were in excess of the liquid assets that had to be available at the branch were transferred and used in other establishments of the Landsbanki Group, including in Iceland. As may be deduced from the information presented in Chapter 7.0 these funds were primarily used for repayment of the bank's older loans and for the granting of new loans which were however in large part for the refinancing of older loans. The SIC emphasises that there is nothing to indicate that this radical change in the financing of Landsbanki over a short period of time, i.a. in proportion to lending, did lead the bank, in its operations or policy making, to take account of this fundamental difference in the nature of its financing except to a very small degree. Instead of financing the bank mostly with funds from foreign credit institutions and professional investors, a large number of foreign individuals had now also become creditors to the bank and entrusted it with safeguarding and earning a return on their savings.

The SIC notes that in the documentation it has received there is no indication that an evaluation or appraisal was conducted by the Icelandic regulatory authorities of how stable and secure the Icesave accounts were as a financing option for Landsbanki Íslands and what risks they might entail for the Icelandic economy and financial system, cf. the discussion in Chapter 7.0 of how mercurial in character these deposits were. This applies in fact in equal measure to the time when the marketing of the Icesave accounts began in the UK and after. The SIC points out that with the advent of the Icesave accounts and the success that Landsbanki achieved already in the first half of 2007 in collecting Icesave deposits, a significant change occurred in the financing of the bank and the Icelandic banking system. Subsequently, there was the addition of the wholesale deposits that Landsbanki and the other two big banks had already started collecting abroad. This was therefore a fundamental change in the financing of the Icelandic banking system which at the same time entailed new risks for the Icelandic financial system.

Collection of deposits into the Icesave accounts in the UK began in October 2006 and around the turn of the year 2006/2007 the number of accounts had reached 32,013 and deposits totalled £774.5 million. On average the deposits on the Icesave accounts grew by £337.8 million a month during the year 2007 and by over £4 billion for the whole year. Towards the end of 2007, the number of accounts had grown to more than 131,000. The deposits on the Icesave accounts in the UK reached their highest point in January 2008 when they totalled £4.9 billion. Even though most of the growth in the Icesave accounts occurred during 2007, the SIC finds it especially noteworthy that during its investigation no documentation or information has emerged to suggest that those circumstances gave the Icelandic authorities, including the Central Bank and the FME, reason to react to these growing deposits in the Icesave accounts with regard to risk factors relating to the Icelandic financial system.

The SIC believes that in this context it should be especially noted that Landsbanki Íslands was what is called a systemically important bank. It was clear that a crisis in its operations could significantly influence financial stability in Iceland which the Central Bank was entrusted with preserving pursuant to law. When financial institutions are faced with liquidity problems, without them being equity problems, the Central Bank of Iceland is authorised to grant a last resort loan in exchange for secure collateral. By the middle of 2007, the deposits in the Icesave accounts amounted to around £4 billion and when coupled with the wholesale deposits of foreign parties at the same branch, the overall deposits at the London branch of Landsbanki were £5.5 billion. In light of the fact that the foreign currency reserves of the Central Bank of Iceland were only £1.2 billion at that time, it may be viewed as certain that the Central Bank would not have been able to act as a lender of last resort to Landsbanki if that proved necessary. Since Landsbanki was a systemically important bank, it was obvious that a run on the deposits in the UK would jeopardise financial stability in Iceland. The SIC is of the opinion that this should have been obvious to the Central Bank of Iceland no later than the middle of 2007. This knowledge should have given the Central Bank occasion to act to reduce the potential risk to financial stability in Iceland.

It is not until 2008 that there is any indication that the transfer of the Icesave accounts from the bank's London branch to a subsidiary is being discussed. That discussion began at Landsbanki Íslands at the beginning of 2008 and from the documentation and clarifications given to the SIC it seems to have been a response by the bank's directors to discussions in the British media about the situation facing the Icelandic banks, including with regard to the development of their CDS spreads and the limited ability of the Depositors' and Investors' Guarantee Fund of Iceland to repay lost deposits if their operations ran into problems. These discussions had put focus on the role and position of deposit guarantees from the vantage point of depositors, but the SIC has deduced from the reports it has obtained from the directors of the Icelandic banks that up until that point that the existence of the guarantee funds and their importance in the minds of depositors, especially abroad, had not played a significant role in the decision making in the Icelandic banks regarding the organisation of their operations. It is appropriate to point out that when this matter was discussed in a meeting of the Landsbanki Board of Directors on 7 April 2008, it was noted that it was appropriate to look into

transferring the deposits to a subsidiary due to unfavourable publicity in the British media about the arrangement regarding deposit guarantees, but it was further stated that the wholesale deposits would remain at the branch since “the focus on that issue was different”. This was clearly a reference to the fact that in those cases the number of account holders was small and the deposits relatively large, so that the issue of a minimum deposit guarantee was less important. The idea of transferring the Icesave accounts to a subsidiary was thus primarily born out of Landsbanki’s effort to prevent unfavourable media coverage from causing a reduction in deposits to the accounts.

Landsbanki had already obtained a legal opinion in February 2008 on the options available for the transfer of the Icesave accounts to a subsidiary where it was stated that the recommended route would most likely take six months. The directors of Landsbanki thus knew by the end of February 2008 what options were available for transferring the accounts with regard to the account holders. It was also clear then that the FSA required, concurrent with the transfer of the accounts, the transfer of assets equalling 20% of Landsbanki’s assets to the subsidiary. The transfer of funds deposited into the Icesave accounts upstream to other parts of the Landsbanki Group would furthermore not be possible anymore.

The CEOs of Landsbanki had briefed the Governors of the Central Bank of Iceland in a meeting on 8 February 2008 that the transfer of the Icesave accounts to a subsidiary was being examined by Landsbanki. The Chairman of the Central Bank’s Board of Governors and a staff member of the authority had travelled to London shortly before the meeting and met with ratings agencies. In that meeting concerns were expressed regarding the situation of the Icelandic banks, i.a. regarding the Landsbanki Icesave accounts, and the point raised that mistrust in the banks could lead to an outflow of funds. In a special meeting on 7 February 2008, the Central Bank then presented three ministers with the subject and conclusions of the meetings in London. During this time and the weeks that followed, the discussions on the situation of the Icelandic banks and their depositors became prominent in the British media. Similar concerns were raised in a meeting the Governors of the Central Bank of Iceland, Davíð Oddsson and Ingimundur Friðriksson, had with Mervyn King, Governor of the Bank of England, on 3 March 2008, where the deposit taking activities of the Icelandic banks in the UK were discussed specifically. Three days later, Davíð Oddsson, Chairman of the Board of Governors of the Central Bank, met with Prime Minister Geir H. Haarde and informed him i.a. of these concerns expressed by the representatives of the Bank of England. Haarde subsequently met three times with Sigurjón Þ. Arnason, CEO of Landsbanki, and i.a. discussed the Icesave accounts and Landsbanki’s financing. The Central Bank and the FME had also met with the CEOs of Landsbanki on 4 March 2008 and discussed deposit guarantees and the transfer of the Icesave accounts to a subsidiary.

Despite the fact that the aforementioned concerns had been expressed and discussed between at least three ministers, the Central Bank and the FME, the SIC’s investigation has yielded no documents, data or unequivocal confirmation in its hearings to the effect that the Icelandic authorities at that time formally requested Landsbanki to transfer the Icesave accounts to a subsidiary or called for a schedule for such a transfer from the bank if the authorities thought the bank was preparing the transfer. Regardless of Landsbanki’s

legal authorisation to operate a branch in London, it was clear that progress in the transfer of the Icesave accounts to a subsidiary could be of significant importance when it came to the reaction and actions of the Icelandic authorities over the coming months, e.g. because of the Depositors' and Investors' Guarantee Fund and in relations with foreign regulatory bodies and central banks. At this point, it would at least have been reasonable in accordance with the principles of good governance for the authorities competent in regard to these matters to request confirmed plans regarding the timing of the transfer of the accounts to a subsidiary. This was also part of being able to monitor and follow up on whether the bank's plans were being carried out.

Concerns over the Icesave accounts continued to grow as March 2008 drew to an end and April began. It emerged in a meeting with the CEOs of Landsbanki at the Central Bank on 30 March 2008 that there had been an outflow from the Icesave accounts that day and that the general debate reflected a distrust with regard to the situation of the Icelandic deposit guarantee fund. The Central Bank's draft minutes quote Sigurjón Þ. Árnason, CEO of Landsbanki, as talking about "two time-bombs," i.e. Icesave and the wholesale deposits, and saying that "the likelihood of the Icelandic banks getting through this is very, very little". On 1 April 2008, the situation of the Icesave accounts was discussed in the consultative group formed by three ministries, the Central Bank and the FME and it was noted that it had now become important whether Landsbanki would be able to transfer the branch's deposits to a subsidiary in London. In a meeting the Central Bank's Board of Governors held that same day with Geir H. Haarde and Ingibjörg Sólrún Gísladóttir, Minister for Foreign Affairs, it was stated that £193 million had been withdrawn from the Icesave accounts over the previous weekend and up to that day. The Chairman of the Central Bank's Board of Governors was quoted as saying that Landsbanki would be able to withstand this situation for six days and that it was the will of the FSA that Landsbanki transfer the Icesave accounts to a UK subsidiary.

It has caught the attention of the SIC that in spite of the extremely serious situation that Landsbanki was facing and had been described there, and that the problems would not only manifest themselves in Iceland but also vis-à-vis the authorities and a large group of individuals in the UK, i.e. the deposit holders in the Icesave accounts, no documentation or information has emerged on a specific response on behalf of the Icelandic authorities with the exception of the meeting between the Central Bank's Board of Governors and the leaders of the government. It has not been demonstrated that the ministers themselves called for, or requested that the Central Bank or the FME call for, a plan with a schedule from Landsbanki on the transfer of the Icesave accounts to a subsidiary and information whether something was to prevent compliance with the FSA's wishes of transferring the accounts to a subsidiary. Official information on the subject must have constituted an important component of deciding whether there was an occasion for intervention or other measures on behalf of the Icelandic government or the Central Bank to facilitate the transfer.

As is stated above, the available information clearly indicated that a crisis in the affairs of Landsbanki could be imminent, with associated impacts on the situation of Icelandic financial institutions and, thus, Icelandic interests in the UK. The Minister for Foreign Affairs had been briefed on the situation in a

meeting with the Central Bank's Board of Governors. Regardless, there is no indication in the documentation and information that the SIC has received, i.a. from the Ministry for Foreign Affairs, that any specific measures were taken by the Foreign Service on account of this to prepare response measures or mobilise relations with foreign governments if e.g., the run on the Icesave accounts in the UK would continue, but it had been made clear that the bank could only withstand a similar outflow to what had already taken place for 6 days.

The SIC believes that in this context it should be especially noted that in the hearing before the Commission, the Icelandic ambassador in London disclosed that the information that he had concerning the Icesave accounts, right up until the time he attended a meeting between the Icelandic Minister of Business Affairs and the British Chancellor of the Exchequer on 2 September 2008, had come from the media. Excepting the ambassador's involvement in that meeting, in addition to having arranged it and following up on a subsequent message received from a staff member of HM Treasury, it was only after the British Prime Minister had announced in the media his actions towards Landsbanki and Icelandic companies on 8 October 2008 that the ambassador and the embassy were mobilised to look after Iceland's interests as they related to the situation and collapse of the Icelandic banks.

As stated above, the FSA had previously indicated that there was every reason to transfer the Icesave accounts over to a subsidiary of Landsbanki in the UK. This, amongst other things, had been discussed in a meeting between the FSA and the CEOs of Landsbanki on 14 March 2008. On 4 April 2008, the CEOs of Landsbanki wrote a letter to the FSA where it is stated that the bank believed that it would be appropriate to aim at transferring the Icesave accounts, along with the assets of the London branch, to Heritable Bank. The bank's ideas on how the transfer should be executed were delineated. In the FSA's reply dated 16 April 2008, it was pointed out that alterations in the branch's liquidity control and liquidity management must be looked to, as it was unlikely that the transfer of the Icesave accounts to a subsidiary would be a quick process. The FSA also considered it necessary to further verify whether the approach proposed would be legally effective and that it would yield the desired result.

Based on the available documentation and information obtained by the SIC, it is clear that in April 2008 the attitude of the Landsbanki directors in regard to the speed with which the transfer of the Icesave accounts to a London subsidiary should be executed changed, and the emphasis shifted towards discussions with the FSA regarding the arrangement of the liquidity management and liquidity requirements for the London branch. The outflow of funds from the Icesave accounts that had taken place at the end of March and beginning of April 2008 did not continue and as April progressed, discussions in the British media on the situation of the Icelandic banks grew less salient. The Icesave deposits started growing again. It had also been clearly stated in meetings, e.g. between the CEOs of Landsbanki and the Governors of the Central Bank, that the transfer would not be without complications for Landsbanki. Assets would have to be transferred to the subsidiary against the loans and the transfer would mean the loss, as per Sigurjón Þ. Arnason's statement in the draft minutes of the Central Bank from 8 February 2008, of the possibility to transfer funds to other parts of the bank group. This would

affect the liquidity position and capital management of the bank. The SIC iterates that the determining factor in Landsbanki's assessment at the beginning of 2008, that transferring the Icesave accounts to a UK subsidiary was the right course of action, had been concerns about negative publicity regarding the deposit guarantee arrangements and uncertainty about the situation of the Icelandic guarantee fund. In much the same way, everything indicates that as soon as those discussions subsided in the UK, the bank changed its tune. Landsbanki thus notified the FSA in a letter on 24 April 2008 that the transfer of the Icesave accounts to a subsidiary would fall within the bank's medium or longer term strategy and that this must be carefully thought out before any steps are taken. The FSA replied to the letter the following day stating that the authority noted that the transfer of Icesave to a subsidiary was no longer part of Landsbanki's short term strategy but that the authority would nevertheless continue to consider this a possible option and noted that staff members of the authority were prepared to discuss this further. Communications between Landsbanki and the FSA regarding the London branch over the coming weeks centred on the branch's liquidity management and concluded with the FSA notifying the bank on 29 May 2008 that the waiver the bank had been granted by the FSA and was meant to be in effect until 2011 had been revoked. The authority also made certain requirements with regard to the liquidity position of the branch.

It has caught the attention of the SIC that the documentation the Commission has been granted access to does not contain letters or other documents which demonstrate that Landsbanki did at this time inform the Central Bank of Iceland or the FME of this change in the bank's position with regard to how quickly the subsidiarisation of the Icesave accounts should proceed. In this context it should be noted that a document had been prepared jointly by the Central Bank of Iceland and the FME on possible measures available to the government against turbulence in financial markets as described in greater detail in Chapter 19.0. The document was first presented at a meeting of the consultative group formed by the two authorities and three of the ministries on 25 March 2008 and discussed further in the group's subsequent meetings. Among the possible measures mentioned in the document is that the authorities encourage financial institutions to credit foreign deposits to foreign subsidiaries rather than branches. Reference is made to the fact that this would reduce the obligations of the Icelandic deposit guarantee fund and the possibility that this may likewise reduce the likelihood of negative foreign coverage abroad. Despite these deliberations by the authorities, the SIC's inquiry has not discovered any document or information to the effect that the authorities formally conveyed this encouragement to the banks at the time. Furthermore, there is no indication that they sought information regarding the status of the potential transfer of the Icesave accounts to a subsidiary. This was, in fact, the case, at least as far as the senior management of the Central Bank is concerned, until mid-July 2008.

Furthermore, Icelandic authorities were not next to put pressure on Landsbanki to transfer the Icesave accounts to a UK subsidiary. On 2 July 2008, Landsbanki continued its discussions with the FSA concerning the liquidity management of the London branch and the situation of Icesave, further to the letter of 29 May 2008. In this meeting, the FSA demanded that the Icesave accounts be transferred to a subsidiary. It was noted in an e-mail from

the FSA received by Landsbanki on 8 July 2008 that the FSA and the bank had agreed that the Icesave book would be subsidiarised in as short a timescale as possible. It was noted that the target date was the end of 2008. But the FSA also wanted to limit the total amount of deposits to £5 billion until the book had been transferred and the bank continued the policy of ensuring that Icesave Instant Access interest rates were not in the best buy tables.

The SIC points out that it should have been clear to the directors of Landsbanki no later than the summer of 2008 that the FSA had doubts concerning the ability of the Central Bank of Iceland to support the Icelandic banking system in a crisis. Concerns had also been voiced about the situation of the Icelandic Guarantee Fund. The Governor of the Bank of England had in March 2008 expressed his concerns about the collection of deposits into the Icesave accounts in a meeting with the Governors of the Central Bank of Iceland. The response of the directors of Landsbanki at this time was however primarily shaped by the objective of Landsbanki being able to continue for some time collecting deposits in the UK as before. Landsbanki's focus was on fulfilling the liquidity requirements of the FSA seemingly for the purpose of delaying the transfer of the Icesave accounts. It is appropriate to iterate that it had been clear since the beginning of the year that the transfer of the Icesave accounts to a subsidiary would most likely take at least between five to six months. It should also have been clear with regard to earlier media coverage in the UK that the sudden transfer of the Icesave accounts to a UK subsidiary could renew that debate and the unease among depositors.

In this context, the SIC finds it surprising that Landsbanki did not on its own initiative take measures or submit plans to the British authorities about changing the arrangement of these deposit accounts in stages and e.g. transfer the brand name Icesave at least partially over to Heritable Bank. This could have been accomplished by locating new deposit accounts opened in 2008 in the subsidiary. This applies in particular to new savings options, such as Individual Savings Accounts (ISAs). In addition, the owners of fixed-term accounts, as well as those who held easy access accounts, could have been offered to transfer them, thereby seeking to increase the ratio of fixed-term accounts at the branch. It is appropriate to iterate that Landsbanki's London branch already held loans and assets which then could have been transferred against the deposits to the subsidiary. In this way, subsequent transfers would have been more manageable for the bank and the accounts in the subsidiary would have been the responsibility of the UK guarantee scheme and not the Icelandic one. Concerns about the standing of the Icelandic scheme were indeed what the British authorities seemed to place at the forefront.

The Governors of the Central Bank of Iceland have stated that it had come as a surprise to them that the CEOs of Landsbanki, when asked in a meeting on 14 July 2008, said that preparations for the transfer of the Icesave accounts to a subsidiary were not underway. They had not been previously notified about the policy change in this matter at Landsbanki. It has further been demonstrated during the hearings before the SIC that the CEOs of Landsbanki had differing views on the transfer of the Icesave accounts to a subsidiary. The Governors of the Central Bank attest to this and state that shortly after the middle of July 2008 it had seemed that Landsbanki was opposed to the transfer of the accounts to a subsidiary. The SIC emphasises that regardless of what opinion the CEOs of Landsbanki held with regard to whether and

“To start using the reserves requirements, of course one could imagine in hindsight [...] that if we had had a kind of military leader who would have said: “Well, now I am just going to use the means, whether monetary policy instruments or other instruments to stop these activities”, then the reserves requirement might have been the means, if one could say: “I will simply place a 10-15% reserves requirement here, I don’t care what they do elsewhere.” Of course, this would have slowed down the banks but they would definitely, with results, been able to convince politicians of the time that by these new operations were being put under restraints and the rule within the EEA was that all were in the same playground.”

Statement by Tryggvi Pálsson before the SIC on 10 March 2009, p. 37.

when the Icesave accounts should be transferred from the London branch to a subsidiary of the bank and their legal authority to determine the arrangement of the bank’s operations, it was the position of both the British and the Icelandic authorities that it was important, both for the public interest and the interests of depositors, that the aforementioned transfer to a subsidiary take place. This position of the authorities had emerged in the first half of 2008. In spite of both this and repeated discussions between the Icelandic authorities on the necessity of the transfer, it is noteworthy that the Icelandic authorities never established e.g. a special working group to push for and facilitate the transfer of the Icesave accounts. It was also never decided which party within the Icelandic administration should lead the effort to push for a solution to the matter and a specific party or parties were never entrusted with working specifically on the matter. In fact, in the hearings before the SIC, it was repeatedly stated in answers by ministers and administrators of the ministries, the FME and the Central Bank that they did not think that it was the responsibility of their respective authority to push for the transfer or lead the effort and pointed to other authorities instead. Based on the available documentation it can be deduced that the administrators of both the FME and the Central Bank of Iceland discussed these matters repeatedly with the CEOs of Landsbanki and communicated with their UK counterparts on the matter. It does however seem that the FSA generally communicated directly with Landsbanki but that the FME became more directly involved around the middle of 2008. It is appropriate to iterate that the Board of Governors of the Central Bank seems to have wrongly assumed that Landsbanki was working on the transfer of the Icesave accounts to a subsidiary in the first half of 2008, specifically until 14 July that year. In light of the interests that were at stake for the stability of the Icelandic banking system, and especially for the Depositors’ and Investors’ Guarantee Fund, it is noteworthy that in his statement, Sigurjón Þ. Arnason said that the British authorities were much more adamant about the deposit accounts being transferred from the branch to a subsidiary than the Icelandic authorities.⁶⁹ In this context, the SIC wants to draw attention to what was said above about the communications and views expressed by the FME to the FSA in the summer of 2008. The Commission also iterates that it was the role of the Central Bank of Iceland to take measures to preserve financial stability in the country.

Even though the Icelandic authorities had at the beginning of 2008 requested that the directors of Landsbanki transfer the Icesave accounts to a UK subsidiary, none of the controls or measures available to the authorities were employed to see the matter through. In this context, an option would have been to declare that after a certain time the reserve requirements for foreign deposit accounts of the Icelandic banks would be raised significantly. It could also have been important to stipulate the currency of the reserves, i.a. with regard to the fact that these were obligations incurred by an Icelandic party mostly in a foreign currency. Measures such as these could have had an impact on the feasibility of accepting deposits at foreign branches, e.g. for Landsbanki. Instead, the Central Bank of Iceland decided in March 2008 to lower the reserve requirement for deposit accounts in branches abroad

69. Statement by Sigurjón Þ. Arnason before the SIC on 19 August 2009, p. 127.

with a view to harmonising the Central Bank's rules with those of the ECB without being under any obligation to do so. It must be presumed that what prompted this decision was the fact that it gave the Icelandic banks greater access to liquid assets which were greatly lacking at that time. Other remedies available to the authorities were to require increased equity at the credit institutions accepting deposits at branches abroad in light of the increased risk entailed in these activities. It should also be kept in mind that the Icelandic banks put great pressure on the Icelandic authorities to increase the country's foreign currency reserves through borrowing abroad in the first half of 2008. However, there is no indication that representatives of the authorities had pointed it out to the banks that it might have an effect in this context if they transferred the deposits at their branches abroad to subsidiaries there. This would have mitigated a weakness that foreign parties supposed was present in the Icelandic financial system.

In the hearing before the SIC, Davíð Oddsson, Governor of the Central Bank, stated that it had not been until after mid-2008 that the Board had realised that the funds deposited into the Icesave accounts were being transferred to Iceland to some extent. The SIC believes that it is appropriate in this context to point out that in a meeting between two of the Governors of the Central Bank and the Governor of the Bank of England in March 2008 the representatives of the Bank of England declared that it was their belief that the deposits raised in the UK were mostly being used to fund the rapidly expanding lending services in Iceland. In a memorandum of the Central Bank of Iceland regarding the meeting, this is noted after it is stated that the Governors of Central Bank did not think the British had enough information to accurately assess the situation of the Icelandic banks. The SIC is of the opinion that the Board of Governors of the Central Bank had reason to obtain clear information on how Landsbanki utilised the funds deposited into the Icesave accounts at the branch in London in its capital management, and, in particular, whether they were transferred in any significant amounts to Iceland or used for the financing of the bank's headquarters in Iceland." That the Central Bank had responded to the points raised in the aforementioned meeting with the Bank of England in March 2008, and this despite the fact that they were presented in relation to the concerns by the representatives of the Bank of England concerning the situation of the Icelandic banks and the deposits in question. In this regard, it had to be important for the representatives of the Central Bank of Iceland to be able to respond on the basis of available information and inform the representatives of the Bank of England of the actual use of these funds. Furthermore, it is also appropriate to point out that in March 2008, outflow from the branch's wholesale deposits started and it is thus likely that the funds deposited into Icesave were largely used to counter that outflow. These were also significant amounts with regard to the bank's capacity to meet withdrawals in case of a run on the Icesave accounts.

By August 2008 it had become clear that it would be very difficult for Landsbanki to transfer the Icesave accounts from the London branch to the subsidiary, Heritable Bank. The economic outlook in Iceland had deteriorated significantly and the CEOs of Landsbanki feared that the FSA would not accept the assets intended to be transferred from the parent company to Heritable Bank. At this time, the deposits amounted to slightly less than £5 billion, and it would therefore have been necessary to transfer about 20% of

the parent company's assets to Heritable Bank in order to meet the deposit obligations of the Icesave accounts. In light of covenants in the bank's debt agreements, it was feared that such a large part of the bank's assets could not be transferred without the consent of its lenders. Landsbanki therefore maintained that the transfer of assets would have to be carried out in two stages. This was unacceptable to the FSA and an exemption from the rules on large exposures in transactions between Heritable Bank and Landsbanki was not granted.

It should have been clear to both the representatives of Landsbanki and the Icelandic authorities in the wake of a letter the FSA sent to Landsbanki on 5 August 2008, that the fateful moment was near that would determine whether the transfer of the Icesave accounts from the London branch to a subsidiary would be successful and that this could be of crucial importance for the future operations of Landsbanki and thereby the stability of the Icelandic financial system. Sigurjón Þ. Árnason stated in a meeting with the Governors of the Central Bank that the current situation was the most difficult in the bank's history. Landsbanki turned to the Central Bank of Iceland and suggested that the Central Bank would overtake the deposits from Heritable Bank amounting to £2.5 billion (just under ISK 390 billion) and relend the money immediately to Landsbanki against collateral.

Again, the SIC finds it noteworthy how the Icelandic authorities reacted to the serious situation Landsbanki found itself in. The SIC does not see a reason as such to remark on the Central Bank's position not to go with the idea of facilitation put forth by Landsbanki, since it would have been very risky for the Central Bank. It was also subject to complications that would probably have influenced the FSA's position if the authority's consent had been sought. It should also be iterated that Landsbanki's idea was centered on the Central Bank granting the requested facilitation without announcing it publicly. It must be considered extremely unlikely that this would have been in compliance with applicable laws on the operations of the Central Bank and reporting requirements concerning the operations of financial institutions and companies listed in the stock market.

This request from Landsbanki and the information which the Governors of the Central Bank and the Director of the International and Market Department of the Central Bank claim they received from a CEO of Landsbanki about the, at least, alleged attitude of the regulatory authorities in Britain concerning the quality of Landsbanki's loan portfolio was of such a nature that it was imperative for the Icelandic authorities to take appropriate measures immediately. It should be iterated that Landsbanki had requested facilitation from the Central Bank which amounted to double the market value of Landsbanki as it was then registered at the stock exchange and nearly a third of the GDP. In view of the Central Bank's role in safeguarding financial stability, and as the case might be, as lender of last resort vis-à-vis the Icelandic banks, it was important to ascertain whether the attitude of the FSA had been correctly stated, and, furthermore, the information itself should in fact have prompted the Central Bank to look into the matter or request the FME to determine the quality of Landsbanki's loan portfolio to find out whether equity problems existed at the bank. It must be kept in mind that according to law, a special last-resort facilitation from the Central Bank can only be granted against adequate collateral from the bank concerned. In addi-

tion, the Central Bank had at this time already granted Landsbanki significant liquidity facilities both directly and indirectly in the form of mortgage loan business and liquidity problems were evident in the Icelandic banking system.

The available documentation provides no indication that the Central Bank took special measures based on the aforementioned grounds to determine the quality of Landsbanki's loan portfolio, or have it determined, or whether the FSA's alleged attitude towards the loans was accurate. It is noteworthy that Landsbanki's idea for the facility in question was put forth on 5 August 2008 but the draft memorandum drawn up by staff members of the Central Bank regarding the request is dated 26 August 2008. The draft states that the opinion of the staff members is that the patience and flexibility of the FSA with regard to the transfer of the loan portfolio should be tested and the possibility explored whether the owners of Landsbanki would provide it with more funds. Yet again there is nothing to indicate that the Icelandic authorities coordinated their response or that any one party was directly entrusted on behalf of the authorities, e.g. with the support of a minister or the government, to ensure progress in this matter. The FME did nonetheless correspond with the FSA on 11 August 2008 requesting discussions on possible provisional exemptions for Landsbanki from the British rules on large exposures during the transfer of the Icesave accounts to a subsidiary. There is no further documentation to show that at this time, i.e. well into August 2008, the Icelandic authorities, ministers or representatives of the Central Bank or the FME contacted the British authorities directly about the situation that had arisen in the matters concerning Landsbanki. Representatives of the Bank of England, however, did contact the Central Bank of Iceland, and in that reportedly grave conversation the possibility of Landsbanki selling Icesave was even mentioned.

This gravity on behalf of the British authorities was also evident in a letter from the FSA to Landsbanki on 15 August 2008. It has been disclosed that the Chairman of the Board of Governors of the Central Bank briefed the Prime Minister on the letter immediately the following day. If it was at all the policy and will of the Icelandic authorities that the Icesave accounts be transferred as soon as possible from Landsbanki's branch in London to a subsidiary there, it should have been clear to the Prime Minister and the administrators of the Central Bank of Iceland and the FME upon receiving the letter that regardless of Landsbanki's expectations of reaching an agreement with the FSA, the direct involvement of the Icelandic authorities in the matter was needed. That involvement had to focus on determining whether and how the Icelandic authorities could through financial facility or by other means facilitate the transfer of the accounts. Significant interests relating to the preservation of financial stability in Iceland, and therefore public interest, were simply at stake. It should also be mentioned that in meetings of the consultative group of three ministries, the FME and the Central Bank, on 20 August and 4 September 2008, the view was advanced that the directors of Landsbanki did not fully grasp the situation. It should be iterated that there is no indication in the documentation and information which the SIC has obtained that the Icelandic authorities initiated communication with the British authorities in August 2008 or in early September with the exception of the letters sent by the FME on 11 and 20 August to the FSA. It should be noted that the impetus for the meeting between the Minister of Business

Affairs and the British Chancellor of the Exchequer on 2 September 2008 was Landsbanki's request that the Minister of Business Affairs represent the bank vis-à-vis the British authorities. The letter sent by the FME to the FSA on 19 September 2008 was also written following Landsbanki's request for assistance with interactions with the FSA.

In view of the nature of the situation, it was first and foremost the responsibility of the directors of Landsbanki to try to find a way to effect the transfer of the Icesave accounts to a subsidiary in cooperation with the FSA. It is clear from the available documentation on these interactions that the FSA emphasised that Landsbanki significantly reduce any deposits to the Icesave accounts and their marketing until the transfer to a subsidiary was completed. Requirements for increased cash reserves were also made. On behalf of Landsbanki there seems to have been optimism that the bank would succeed in reaching an agreement with the FSA on transferring assets to the subsidiary against deposits over a certain period following the transfer of the deposits. When it came to Landsbanki's response to the FSA's requirements, there was certain reluctance to reduce the deposits. Landsbanki also deemed it appropriate at the end of August 2008 to send the FSA two legal opinions obtained by the bank where it is stated i.a. that the FSA lacked powers for its actions. It has previously been noted that the view had emerged within the Icelandic administration that the directors of Landsbanki did not fully grasp the situation and Landsbanki's reaction to the FSA's requirements seems to support this in many ways. The directors of Landsbanki seem to have been focused on obtaining an exemption from the rules on large exposures in relation to the transfer of assets to a subsidiary against the deposits which would be transferred from the FSA but actions which could have reduced deposits were less salient.

Comments were made earlier about the lack of initiative on behalf of the Icelandic authorities when it came to intervening in the serious situation that had developed between Landsbanki and the FSA, especially as the summer of 2008 progressed. In this context, there is reason to call attention to how little the FME was involved in the matter for the most part and how in the letters it sent to the FSA towards the end of August and into September it essentially supported Landsbanki's position. The FME thus follows up a letter from Landsbanki to the FME on 17 August 2008 by iterating in a letter to the FSA on 20 August 2008 that Landsbanki needs an exemption from the rules on large exposures. The authority then received a letter from Landsbanki on 19 September 2008 where the bank requested that the FME assist Landsbanki in its interactions with the FSA so as to ensure a normal working environment for the bank in accordance with the European and English legal regimes. The FME wrote a letter to the FSA that same day stating the position that it would be appropriate from then on for the FME to be more involved in the communications between the FSA and Landsbanki. On the other hand, the SIC finds it noteworthy that its investigation has not yielded any documentation demonstrating that the FME put forth an official position or suggestions to Landsbanki, the FSA or other Icelandic authorities, e.g. the government or the Central Bank, for possible solutions on how the Icesave accounts might be rapidly transferred to a subsidiary. With regard to the FSA, everything indicates that the FME first and foremost presented and supported Landsbanki's viewpoint. The meeting between the Minister of

Business Affairs and the British Chancellor of the Exchequer on 2 September 2008, where the Chairman of the Board of the FME spoke on behalf of the Icelandic delegation, was held to follow up on the requests by Landsbanki to be granted an extension for the transfer of assets to the subsidiary even if the deposits would be transferred earlier.

From the accounts of the meeting between the Minister of Business Affairs and the delegation on the one hand and the British Chancellor of the Exchequer on the other it seems that it should have been clear to the Icelandic delegates that from the standpoint of the British Chancellor there was at that time a significant risk that Landsbanki would not be able to meet its obligations vis-à-vis the owners of the Icesave accounts. The British minister stated that the intention was for the British authorities to guarantee deposits in full and simply asked the Icelanders where the bill should be sent. Even though the meeting certainly discussed Landsbanki's request to be granted a reasonable grace period to transfer the Icesave accounts to a subsidiary and it has been stated that the British minister was sympathetic to the viewpoint that the reaction could not be too harsh, it should have been clear to the Icelanders that the reaction of the British authorities was primarily focused on protecting the interests of British depositors and to prevent that problems in the operation of the Icesave accounts would prompt runs on banks in the UK and unrest among deposit owners. This state of affairs and HM Treasury's grave estimation of the situation, should have been even clearer to the Icelandic authorities after a staff member of HM Treasury contacted the Icelandic ambassador in London on 5 September 2008 and told him that the British minister had been disappointed with the meeting on 2 September 2008 since he did not sense that the Icelandic authorities fully appreciated the serious nature of the matter. In this context, it is appropriate to draw attention to an account of the meeting of the Landsbanki Board of Directors which was held on 5 September 2008. The focus there is primarily on the branch's liquidity management, and it is noted that bank has been for a while engaged in discussions with the FSA concerning the arrangement of the Icesave accounts and that regular reporting to the FSA has been established. No great concern over the state of the matter was in evidence.

It must also be kept in mind here that the Icelandic delegation that met with the British Chancellor of the Exchequer on 2 September 2008 was in fact requesting that the British authorities would agree to insufficient assets in Heritable Bank for a certain period to meet the obligations arising from the deposits transferred from the branch. Judging from the discussions between Landsbanki and the FSA, this would presumably equal up to half of the assets that the FSA had required to be transferred to the subsidiary or £2.5 billion. The Icelanders were thus requesting that any loss resulting from this would be the responsibility of the British.

In spite of the meeting in London on 2 September 2008 and the comments subsequently received from Britain about the sentiment of the British Chancellor of the Exchequer, nothing suggests that the Minister of Business Affairs or other ministers from the Icelandic government did in the weeks that followed explore what options might be available for facilitating the transfer of the Icesave accounts to a subsidiary or follow them up vis-à-vis Landsbanki or the British authorities. However, it should be noted that the Prime Minister met with the CEOs of Landsbanki on 3 September 2008 but

it has not been demonstrated that specific actions regarding the matter were directly discussed. The following day, the Prime Minister received an e-mail from the Chairman of the Board of the FME discussing the position of the British authorities regarding the transfer of the accounts.

The matters relating to the Icesave accounts continued to be the subject of correspondence and discussions between Landsbanki and the FSA with the involvement of the FME. These discussions had not yielded results by the end of September/beginning of October 2008 when the problems in the Icelandic banking system were starting to emerge. After that the discussions swerved towards determining whether there was an even more rapid way of transferring the Icesave accounts to a UK subsidiary. It can be deduced from the discussions between Landsbanki and the FSA that in the minds of the CEOs covenants in the bank's debt agreements were the primary obstacle to transferring the Icesave deposit accounts from the branch to a subsidiary. However, the CEOs seem to have changed their minds after a telephone conference with Hector Sants, Chief Executive of the FSA, on the evening of 5 October 2008. They then wanted to attempt to transfer the deposit accounts to Heritable Bank as soon as possible and also transfer 20% of the group's assets simultaneously. This carried the risk of lenders assuming a breach of the covenants of the bank's debt agreements. However, this was too late. In order to keep Landsbanki's branch open on 6 October 2008, Landsbanki had come up with £200 million in addition to £53 million for Heritable Bank. This did not include the funds that presumably would have to be on hand to keep the branch open in the following days, but on 6 October, £1,531 million were still in easy access Icesave deposit accounts at the bank's branch in London.

The option discussed under "fast track" involved in the estimation of the CEOs of Landsbanki basing the transfer of the deposit accounts from the bank's branch to a subsidiary on the implied consent of the depositors. The FSA letter of 3 July 2009 to the SIC states that the implied consent solution will likely prove problematic. It may e.g. be unclear for a certain period which depositors have been transferred from one entity to the other. This creates legal uncertainty for the depositors while the transfer is being completed. The length of the period will depend on the circumstances, but it could clearly be a significant amount of time. It is appropriate to keep in mind that the FSA had not assessed whether the quality of the asset portfolio that Landsbanki wanted to transfer against the deposit accounts was adequate. Since it had become impossible to obtain liquid assets in pounds sterling to meet the outflow from the easy access Icesave accounts over the period needed to transfer the accounts following this approach, it must be considered highly unrealistic that the transfer could have been effected in October 2008. When Landsbanki could not even provide the £200 million the FSA had required, the bank's London branch was closed down in the evening of 6 October 2008.

As previously noted, the deposits in the Icesave accounts in the London branch of Landsbanki were in pounds sterling. Since Landsbanki was an Icelandic bank the great weakness in its operating environment was that in case of the Central Bank of Iceland having to act as lender of last resort, that loan would generally be granted in the Icelandic króna. The bank did therefore not have access to a last resort loan in pounds sterling and it had also emerged that the expectation that repurchase transactions with the ECB

could be used to obtain currency other than Icelandic króna would not be realised. Landsbanki had in June 2007 started to build a securities portfolio which had grown to about a billion pounds to even out fluctuations caused by withdrawals from deposit accounts. This was supposed to enable the bank to compensate for withdrawals from the accounts. When the situation became more dire in the credit crisis towards the end of 2007 this portfolio was however used in repurchase transactions with the ECB.

As discussed in more detail in Chapter 4.0 the Icelandic banks were too big with regard to GDP and the ability of the Central Bank of Iceland to assist them. Even if Landsbanki's liquidity position was good in Icelandic króna, the bank could not obtain pounds to meet the outflow from the Icesave accounts at the London branch expected to take place on 6 October 2008 and in the following days. The reasons for this were that the international foreign exchange market for the Icelandic króna was at that time closed, the ECB did not want to increase repurchase transactions with Landsbanki's subsidiary in Luxembourg, and that the Central Bank of Iceland did not have enough foreign currency to lend the bank to cover the withdrawals. For these reasons, there was no saving Landsbanki from collapsing.

18.3 Icesave Accounts in the Amsterdam Branch of Landsbanki Íslands hf.

18.3.1 The Rise and Fall of the Amsterdam Branch of Landsbanki Íslands hf.

Landsbanki Íslands hf. opened a branch in the Netherlands in 2006. That same year, the bank started accepting deposits there from legal entities. In the wake of the success of the bank's Icesave accounts in Britain, it was decided to offer the general public in the Netherlands deposit accounts under the same name. The CEOs of Landsbanki have said that they saw the Netherlands as an attractive market, i.a. because other banks there offered low interest rates on deposits.⁷⁰

The minutes of the Landsbanki Board of Directors dated 31 July 2007 state that the launch of Icesave accounts in the Netherlands is underway.

On 6 September 2007 Landsbanki sent the FME a notification in accordance with Article 36 of Act No. 161/2002 on financial undertakings stating that the acceptance of deposits and other repayable funds would shortly fall under the operation of the bank's branch in Amsterdam. The FME then sent the Dutch Central Bank (De Nederlandsche Bank, hereinafter DNB), which is also charged with financial supervision in that country, a letter on 17 September 2007 reporting on Landsbanki's notification.

A letter from Landsbanki notified the FME on 10 March 2008 that since the Depositors' and Investors' Guarantee Fund only grants depositors minimum protection, the bank's branch in Amsterdam has applied to join the Dutch deposit guarantee scheme at DNB in order to ensure that depositors in the Netherlands have comparable protection to that enjoyed by customers of other banks there.

"Liquidity requirements equally apply to separate banking institutions in the Netherlands and to branch offices of foreign banks. This means, in principle, that the liquidity requirements for Landsbanki should not fundamentally change if the branch office is converted into a subsidiary."

From the legal opinion of Allen & Overy for Landsbanki from 25 March 2008.

70. Halldór Jón Kristjánsson and Sigurjón Þorvaldur Árnason: Developments leading up to the Icelandic banking crisis in October 2008. Draft 16 March 2009, p. 97.

As already noted, Landsbanki's Icesave deposit accounts in Amsterdam were operated through a branch and not a subsidiary. According to Dutch law, there are no rules comparable to those in English law which significantly limit the possibility of transferring funds from a subsidiary to other parts of a banking group. According to the legal opinion obtained by Landsbanki from Allen & Overy on 25 March 2008, it was of very little significance for liquidity management within the banking group whether the deposits were accepted through a branch or subsidiary in the Netherlands. It, therefore, seems that Landsbanki's position on the liquidity management of the group did not require choosing the subsidiary form in the Netherlands like the case was in Britain.

In a meeting of the Landsbanki Board of Directors on 6 May 2008, it was agreed to establish a subsidiary in the Netherlands. In the hearing before the SIC, Sigurjón Þ. Arnason, CEO of Landsbanki, said that the bank's business plan was to transfer the deposit accounts to a subsidiary as soon as practicable and then commence accepting deposits in the countries neighbouring the Netherlands through the new subsidiary. The reason for accepting deposits through a branch to begin with was that the process of establishing a subsidiary had been started too late, a process which required some time.⁷¹

On 23 May 2008, the directors of Landsbanki's branch in Amsterdam signed an agreement with the DNB on the bank's membership in the Dutch deposit guarantee scheme. The agreement was a so-called topping up agreement which entailed that the difference between the Dutch minimum guarantee and the Icelandic minimum guarantee would be covered by the Dutch guarantee scheme. Deposits in Landsbanki's branch in Amsterdam would thus be guaranteed up to same amount provided for deposits in Dutch banks.

On 29 May 2008, Landsbanki started accepting deposits into the branch's Icesave accounts in Amsterdam. This became a subject of discussion in a meeting in the consultative group of the Prime Minister's Office, the Ministry of Finance, the Ministry of Business Affairs, the FME and the Central Bank of Iceland on financial stability and contingency planning held that same day. The draft minutes state i.a. that this further increases the obligations of the Depositors' and Investors' Guarantee Fund.

The minutes from the meeting of the Landsbanki Board of Directors on 2 June 2008 state that the marketing campaign in the Netherlands is centered around the concept of a transparent bank. To begin with easy access deposits under the name Icesave will be offered on the Internet through the Amsterdam branch and then the deposits will be transferred to a subsidiary as soon as possible. In August, fixed-term deposits will be offered for six months, one, two or three years, much like in Britain. Landsbanki currently offers the highest Euro interest rate or 5%. The next step is to offer Icesave accounts in Belgium, Luxembourg, Germany and Norway, and in 2009 the plan is to add Italy, Switzerland, Spain, Austria and Canada. The minutes further state that it is preferable to have a banking licence in the Netherlands and start the operations in Germany through a subsidiary in the Netherlands rather than Iceland since deposit guarantees are an important factor with regard to customers. The question is how long it takes to obtain a Dutch banking licence.

71. Statement by Sigurjón Þ. Arnason before the SIC on 27 August 2009, p. 19.

In June 2008, Landsbanki issued Vol. 2 of the magazine *Moment* where Jón Sigurðsson, Chairman of the Board of the FME, is interviewed. The interview is in English. The title reads: “Finances of the Icelandic banks are basically sound”. In the interview, Sigurðsson discusses the situation of the Icelandic banks. He is i.a. quoted as saying that their finances are basically sound. Sigurðsson believes that this is evidenced by their 2007 annual and Q1 2008 statements. Sigurðsson says that undervaluation of risk has kept interest low in global financial markets in recent years. That situation no longer exists, however, as risk aversion now prevails. Sigurðsson goes on to say that this increases the importance of strengthening the reputation of the Icelandic financial system through responsible actions, rationalisation and transparent disclosure of its financial position. Sigurðsson says that the Icelandic banks are clearly already overhauling their own affairs in this spirit. He goes on to say that the banks have shown resourcefulness in dealing with the international liquidity squeeze.

Icesave in the Netherlands was received much better than the CEOs of Landsbanki had anticipated.⁷² One CEO described the success with Icesave in a meeting with the Board of Governors of the Central Bank of Iceland on 14 July 2008. The Central Bank’s draft minutes quote Sigurjón Þ. Árnason as commenting that the most positive thing is how well raising deposits is going in the Netherlands. Customers now number 47,000 and the amount is over €500 million. In the same meeting the CEOs of Landsbanki were asked whether the intention was to transfer the deposits from the branch in the Netherlands to a subsidiary. According to the draft minutes, Halldór J. Kristjánsson confirmed that this was the goal. The plan was to undertake the transfer in the first quarter of the following year.

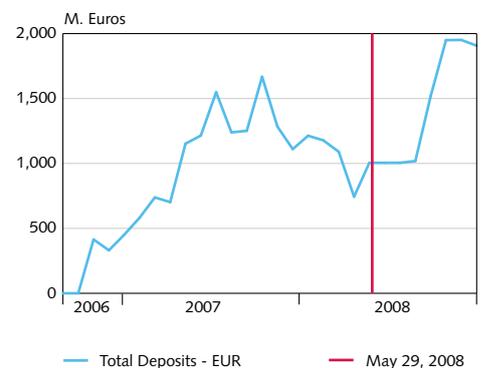
On 3 July 2008, the DNB requested miscellaneous information from the FME, including on liquidity control with regard to Kaupthing and Landsbanki and whether the banks had a contingency plan for liquidity management. The DNB also requested information on the Depositors’ and Investors’ Guarantee Fund. The DNB then requested a meeting at the FME where the information would be presented. The meeting was set for 14 August that year. The DNB met for the first time with Landsbanki that day and the meeting was also attended by representatives of the FME. The Dutch authorities expressed their concerns about the Icelandic economy and the Depositors’ and Investors’ Guarantee Fund. The representatives of the DNB stated in the meeting that further increases of deposits to the Icesave accounts would not be tolerated. The CEOs of Landsbanki did not think that the DNB had adequate justification for this position and subsequently obtained a legal opinion from the law firm Allen & Overy on the powers of the DNB. They then requested a meeting with the Executive Director of the DNB.⁷³

Later that day, i.e. 14 August 2008, the representatives of the FME met with the DNB. In a hearing before the SIC, Guðmundur Jónsson, Head of Unit at the FME, stated that the representatives of the DNB had in the meeting expressed concerns over how little money there was in the Depositors’

“The finances of the Icelandic banks are basically sound, as evidenced by their 2007 annual and Q1 2008 statements. Even though the Icelandic banks, not least Landsbanki, have recently managed to increase the share of deposits in their financing, their activities abroad still depend to a great extent on access to loans from international markets. Some problems still remain, but now we can hope for better times. It is clear that the undervaluation of risk which kept interest low in recent years no longer exists. Instead, risk aversion prevails. This increases the importance of strengthening the reputation of the Icelandic financial system through responsible actions, rationalisation and transparent disclosure of its financial position. The Icelandic banks are clearly already overhauling their own affairs in this spirit. They have shown resourcefulness in dealing with the international liquidity squeeze.”

Jón Sigurðsson, *Moment*, 2nd Issue, June 2008.

Figure 5
 Total deposits in the Netherlands
 Wholesale and retail deposits



Source: Landsbanki Íslands hf.

72. Halldór Jón Kristjánsson and Sigurjón Þorvaldur Árnason: Developments leading up to the Icelandic banking crisis in October 2008. Draft 16 March 2009, p. 98.

73. Halldór Jón Kristjánsson and Sigurjón Þorvaldur Árnason: Developments leading up to the Icelandic banking crisis in October 2008. Draft 16 March 2009, p. 98. Statement by Sigurjón Þ. Árnason before the SIC on 27 August 2009, p. 53.

"Landsbanki will probably go bankrupt and the Dutch who have placed their deposits in the bank's Icesave accounts will probably never see them again." These are the words of Bert Heemskerck, CEO of the Dutch bank Rabobank. [...] Heemskerck said this in a debate on state television in that country this week. He said that the Dutch who place their savings into the bank's Icesave accounts will probably never see that money again. Heemskerck likened Landsbanki to a Turkish bank which are not trusted in the Netherlands."

Market news, Channel 2, 8 July 2008.

"[...] at some point in the middle of a meeting they [staff members of the DNB] suddenly say: "Yes, we are thinking of telling Landsbanki that it can't raise any more deposits."

Statement by Guðmundur Jónsson before the SIC on 10 August 2009.

"At the meeting, it was indicated that the banking supervisory authorities in the Netherlands were considering to possibly restrict the deposit taking operations of Landsbanki branch in the Netherlands. These considerations came as a surprise to us, as the FME has at no time been consulted on the issue or informed about any possible concerns. Furthermore, no legal arguments were given. [...] Landsbanki's business is healthy, capital levels are strong and it performs well in various stress-tests that the FME applies."

E-mail by the FME to the DNB on 15 August 2008.

and Investors' Guarantee Fund and how the Central Bank of Iceland was lacking in ability to assist the banks in case of liquidity difficulties. For these reasons, the representatives of the DNB had stated that their position was that deposits to the Icesave accounts in the Netherlands should be halted. However, no legal authorisations existed to halt the operations of Landsbanki on account of the concerns of the DNB over the Depositors' and Investors' Guarantee Fund and the Central Bank of Iceland.⁷⁴

The meeting is discussed in an e-mail that Guðmundur Jónsson sent to the DNB the following day, 15 August 2008. It states that it was indicated that the DNB was contemplating restricting the deposit taking operations of the Landsbanki branch in the Netherlands. The e-mail states that these considerations had come as a surprise to the FME as the authority had neither been consulted by the Dutch authorities nor informed about any possible concerns. Furthermore, no legal arguments were given. Later the letter states that the FME is not aware of any arguments that could justify such a measure on behalf of the DNB. It is then stated: "Landsbanki's business is healthy, capital levels are strong and it performs well in various stress-tests that the FME applies." Finally, it states that for these reasons the Director General of the FME requests a meeting with the top officials at the DNB so that any concerns may be addressed and the future arrangement of cooperation between the two institutions discussed. In the statements of Guðmundur Jónsson and Jónas Fr. Jónsson before the SIC, it was revealed that the information discussed in the e-mail was based on Landsbanki's 6M results which had looked good. This was the information which the FME had at the time.⁷⁵

On 20 August 2008, a meeting was held in the consultative group of the Prime Minister's Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning. The draft minutes quote Jónas Fr. Jónsson, Director General of the FME, as saying that there seems to be a certain unrest with regard to deposit guarantees in the Netherlands and that it is likely that the authorities there are communicating with the British authorities. Jónína S. Lárusdóttir, Permanent Secretary to the Ministry of Business Affairs, informed that a letter had been received from the Dutch guarantee fund requesting answers to a large number of questions. A clarification regarding governmental backing is all but asked for. Tryggvi Pálsson, Director of the Financial Stability Department of the Central Bank of Iceland, is then noted as saying that the Depositors' and Investors' Guarantee Fund, along with other authorities, will have to convey the message to the Icelandic banks that they should only accept new deposits abroad through their subsidiaries instead of branches.

The CEOs of Landsbanki met with Nout Wellink, Executive Director of the DNB, on 27 August 2008. The meeting discussed DNB's position towards Landsbanki's increase in deposits. In his statement before the SIC, Sigurjón Þ. Árnason noted that Nout Wellink had been concerned that the guarantee fund in fact only worked when small banks or savings banks could not meet their obligations vis-à-vis depositors but not in case of bigger banks. It had

74. Statement by Guðmundur Jónsson before the SIC on 10 August 2009, p. 64.

75. Statement by Jónas Fr. Jónsson before the SIC on 6 August 2009, p. 15, and statement by Guðmundur Jónsson before the SIC on 10 August 2009, p. 64-65.

also been revealed that Wellink had calculated the amount that would have to be distributed to the Dutch banks for the topping up agreement with the Dutch guarantee fund in case things turned for the worse for Landsbanki. Árnason said that he had told Wellink that he would have to discuss the weaknesses of the deposit guarantee scheme with the Icelandic authorities since it was not under the purview of Landsbanki. He would also have to discuss with the FME the conditions and requirements that he wanted to impose on Landsbanki's Amsterdam branch and reach an agreement with the FME on solutions. Landsbanki would then fulfil any requirements that the authorities agreed on.⁷⁶

The SIC has in its possession a presentation that Landsbanki gave in the aforementioned meeting with Wellink. The document discusses i.a. the Icelandic deposit-guarantee scheme. It states i.a. that the deposit-guarantee scheme is predicated on an EU directive that obligates governments to ensure that "the minimum deposit insurance protection of €20.000 is provided for." Later the document states:

„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 obligations pursuant to the relevant EU directive

We assume that a similar letter could be sent to the DNB if requested“

The DNB discusses what took place in the meeting in an e-mail to the FME on 28 August 2008. It states that the DNB took the position that Landsbanki must put a halt to any increase in the Icesave accounts in the Netherlands. The DNB provides two arguments to support this. On the one hand the DNB has concerns about the Icelandic economy. On the other hand it refers to the uncertain position of the Icelandic state vis-à-vis the Depositors' and Investors' Guarantee Fund. The letter states that there is uncertainty concerning the role of the state in case the fund cannot meet its obligations.

That same day, i.e. 28 August 2008, a staff member of the Financial Stability Department of the Central Bank sent an e-mail to the Board of Governors relating to the query from the DNB to Landsbanki on liquidity management and contingency plans and the answers subsequently sent by Landsbanki to the DNB. It states that a staff member of the Central Bank has received the documents from Landsbanki together with the bank's answers to further questions. It states that the documents in question were the following:

1. Icesave Netherlands confidence crisis manual.
2. Landsbanki Amsterdam liquidity management policy.
3. Landsbanki group crisis communication plan.
4. Landsbanki liquidity contingency plan.
5. Landsbanki group liquidity management policy.
6. Results from Landsbanki's liquidity stress test.

76. Statement by Sigurjón Þ. Árnason before the SIC on 27 August 2009, p. 54-55 and 66.

It goes on to say: “The questions from the DNB mostly relate to liquidity management and stress tests, how Landsbanki can raise funds, how the bank has reduced its activities and how Landsbanki can meet any sudden outflow of deposits. The Department of Financial Stability has already received a copy and weekly reports on Landsbanki’s liquidity position/stress tests and that information is identical to that provided in these answers.”

On 2 September 2008, Nout Wellink met with Jónas Fr. Jónsson. On that occasion, Wellink expressed his concerns about the Icesave matter in much the same terms as had previously been used in the e-mail from the DNB on 28 August that year. In Jónas Fr. Jónsson’s statement before the SIC, it was revealed that they had discussed the bank’s 6M statement and that Wellink’s concerns had, like before, centered on the economic situation in Iceland and not specific factors in the bank’s operations. They had agreed to seek ways to “put the brakes on” the increase in deposits at Landsbanki Amsterdam and also to assign Landsbanki with suggesting solutions that the DNB might accept. Following the meeting, Jónsson had contacted the CEOs of Landsbanki and explained the task. Jónsson also said that he had pressed them to stop marketing the Icesave deposit accounts which they had agreed to.⁷⁷

On 4 September 2008, a meeting was held in the consultative group of the Prime Minister’s Office, the Ministry of Finance, the Ministry of Business Affairs, the Financial Supervisory Authority and the Central Bank of Iceland on financial stability and contingency planning. The draft minutes show that the FME’s visit to the DNB’s Banking Supervision Department was discussed. Jónas Fr. Jónsson is quoted as noting that the DNB’s concerns are primarily as follows:

1. The economic outlook in Iceland.
2. The size of the Icelandic banks compared to the size of the national economy. The banks have rushed to expanded to other markets.
3. The deposit-guarantee schemes in the European Economic Area are a “mess”. The “top up” agreement must be taken up with Iceland. The Depositors’ and Investors’ Guarantee Fund is weak and it is incomprehensible why a larger contribution is not required for deposits abroad.
4. The Icelandic banks are preying on the Dutch guarantee scheme which will not be tolerated.

Later in the same draft minutes, Jónsson is quoted as stating that the Dutch authorities think it is preferable for the deposit-taking activities to be conducted through a subsidiary rather than a branch. A statement from the Icelandic authorities on governmental backing of the Depositors’ and Investors’ Guarantee Fund is therefore not the main issue.

The minutes from the meeting of the Landsbanki Board of Directors on 5 September 2008 state that all marketing has been put on hold while the discussions with the Dutch authorities are ongoing and simultaneously efforts continue to transfer the Icesave accounts to a subsidiary. Product development has also been halted and new fixed-term accounts will not be launched. The success of Icesave has prompted harsh reactions abroad. The Board of Directors authorises the preparation for the launch of deposit accounts in

77. Statement by Jónas Fr. Jónsson before the SIC on 6 August 2009, p. 16-18.

those countries where the management thinks it is advisable. The goal is to spread financing risks.

According to information from the DNB the deposits in Landsbanki's Icesave accounts in the Netherlands amounted to €1.2 billion by the latter half of August 2008. The deposits continued to grow and had become €1.4 billion on 1 September 2008. On 9 September 2008, the DNB requested regular reporting on deposits in the bank's Icesave accounts. On 10 September 2008, the Icesave deposits amounted to over €1.5 billion.

According to information given by Wouter Bos, the Dutch Minister of Finance, to the Dutch Parliament, Nout Wellink talked with Davíð Oddsson on 8 September 2008. In Davíð Oddsson's statement before the SIC it was revealed that in the meeting in question, which was held in Basel, Wellink had been ill-tempered and spoken very harshly about the conduct of the Icelandic banks in raising deposits and said that they would be stopped. Oddsson said that he had then asked whether that would be done in accordance with European regulation. Wellink had answered that it was no problem to find support in European regulation for stopping the irresponsible Icelandic banking activities. The Icelandic banks could not meet their obligations if a run was made on them. It had been stated that Wellink was not simply talking on behalf of the Netherlands, but that this "was the common understanding over in Europe".⁷⁸ Oddsson said that this viewpoint held by the Governor of the Dutch Central Bank had been of the same ilk as comments made by Alex Weber, the German Central Bank Governor, in a speech at a meeting of Central Bank Governors in Basel in March 2008 where he had maintained that the greatest threat to the stability of the banking system, in addition to everything else, was the irresponsible incursion into deposit markets and the break up of the deposit-guarantee scheme. Oddsson said that he presented the CEOs of Landsbanki with the Dutch Central Bank Governor's position when he came back to Iceland.⁷⁹

On 23 September 2008, the CEOs of Landsbanki wrote a letter to the FME regarding the operations of the Amsterdam branch. There they set forth arguments against the requirement that the bank must stop accepting deposits into the Icesave accounts in the Netherlands. They further maintain that the DNB does not have authority to force the bank to do so. In support of this they refer to the opinion from Allen & Overy. The CEOs declare themselves willing to encourage increased deposits to fixed-term accounts. Since this entails raising the overall deposits, they say that they are further willing to undergo certain obligations to alleviate the concerns of the DNB. They suggest that all deposits in easy access accounts in excess of €1,150 million be handed to the DNB in the form of securities which fulfil the ECB's conditions for repurchase transactions. In this way, the CEOs believe that the DNB's request that deposits should not exceed €1,150 million may be fulfilled. At the same time, Landsbanki's liquidity position would be reinforced. The letter states that the CEOs believe that based on the deposits currently in easy access accounts, this means that the DNB will be receive a €500 million reserve. This amounts to about 30% of total deposits. In addition, the CEOs

78. Statement by Davíð Oddsson before the SIC on 12 August 2009, p. 39-40.

79. Statements by Davíð Oddsson before the SIC on 7 August 2009, p. 47, and 12 August 2009, p. 40.

offer to cease the marketing of easy access accounts. Furthermore, they say that they have offered to hand over 5% of all of the bank's easy access deposits in the Netherlands to the DNB. This does not include the funds already at the DNB in the form of reserves. These funds are intended to meet sudden withdrawals from the Icesave accounts. The letter states that the CEOs assume that the aforementioned measures would be in effect until market conditions change for the better. It seems that the representatives of the DNB thought that these proposals from Landsbanki were a step in the right direction but not a solution to the problem. Jónas Fr. Jónsson said in the hearing that the administrators of the DNB had seemed rather disinterested in the proposals.⁸⁰

In the aforementioned letter, Landsbanki also offers to have the entire group adhere to Dutch liquidity requirements in addition to delivering liquidity reports regularly to the DNB so the authority can monitor compliance with the rules.

The FME forwarded the abovementioned letter from Landsbanki to the DNB in an e-mail on 24 September 2008 and noted: "As requested, see attachment, a copy of the letter from Landsbanki Íslands to the FME regarding its banking operations in the Netherlands." It went on to note that if the DNB has any question regarding the matter they should not hesitate to be in contact. In his statement before the SIC, Guðmundur Jónsson noted that the DNB subsequently did not submit any questions.⁸¹

Jónas Fr. Jónsson was attending the International Conference of Banking Supervisors in Brussels that same day, i.e. 24 September 2008, and delivered a copy of the abovementioned letter from Landsbanki to a representative of the DNB. In his statement before the SIC, Jónsson noted that he had suggested further discussions with the DNB after they had finished reviewing the letter.⁸²

In a debate in the Dutch Parliament, Wouter Bos, the Dutch Finance Minister, answered a question concerning the Icesave issue by stating that the FME had delivered the letter to the DNB and on that occasion implied that the authority agreed with the position advanced by Landsbanki therein. The Ministry for Foreign Affairs subsequently requested further explanation of this statement by the Dutch authorities. The Dutch authorities answered in an e-mail that Jónas Fr. Jónsson had delivered Landsbanki's letter to Arnold Schilder, a representative of the DNB, at the International Conference of Banking Supervisors in Brussels on 24 September 2008. The Dutch authorities further maintain that Jónsson on that occasion had declared to Schilder and Houben, another representative of the DNB who was also present, that the FME fully agreed with the content of Landsbanki's letter. When asked about this in the hearing before the SIC, Jónas Fr. Jónsson denied having voiced any opinion regarding the content of Landsbanki's letter. He had merely iterated that they would have to talk when the representatives of the DNB had familiarised themselves with the content of Landsbanki's letter, where the bank presented proposals for possible ways to meet the requests of the DNB in accordance with the procedure that Jónsson thought the FME and the DNB had agreed to in their meeting on 2 September 2008. The logi-

80. Statement by Jónas Fr. Jónsson before the SIC on 6 August 2009, p. 18-20.

81. Statement by Guðmundur Jónsson before the SIC on 9 September 2009, p. 1.

82. Statement by Jónas Fr. Jónsson before the SIC on 6 August 2009, p. 26.

cal continuation would have been for the DNB to formulate opinions of the proposals and evaluate whether any of them were acceptable. However, a response from the DNB to Landsbanki's proposals had never been received.⁸³

According to what is stated in a response by the Dutch Finance Minister to a question in the Dutch Parliament, the Icesave website in the Netherlands became inoperative on 6 October 2008, at which point the DNB froze the branch's assets.

On 7 October 2008, the DNB wrote a letter to Landsbanki. It states that the DNB has decided to appoint an insolvency practitioner for the branch. It furthermore sets out a number of requirements for Landsbanki to fulfil, including the transfer of all deposits in the Icesave accounts in the Netherlands to an account held by the DNB in order to protect the interests of depositors. The letter notes that on 29 September 2008 the deposits in the Icesave accounts in the Netherlands amounted to €1.7 billion.

The same day, i.e. 7 October 2008, the DNB wrote another letter to Landsbanki. It states that there is a great risk that the DNB will have to reimburse depositors significant amounts for Landsbanki's accounts. It goes on to state that Landsbanki has on numerous occasions provided the DNB with both wrong and insufficient information. The bank has thereby violated its obligations pursuant to an agreement with the DNB from 23 May 2008.

Landsbanki replied to the letter the same day, i.e. 7 October 2008, confirming reception of DNB's recommendations but at the same time objecting to them. The bank also rejected DNB's requirement to transfer funds to the Netherlands on the basis that this was not permissible according to instructions from the FME.

The same day, i.e. 7 October 2008, the DNB requested in a Dutch court that an insolvency practitioner be appointed for Landsbanki's branch. A ruling issued on 13 October appointed an insolvency practitioner for the branch.

18.3.2 Findings of the Special Investigation Commission (SIC) on the Icesave Accounts in the Amsterdam Branch of Landsbanki Íslands hf.

When Landsbanki Íslands hf. started accepting deposits into the Icesave accounts in Amsterdam on 29 May 2008, the bank had already experienced negative media coverage in Britain about the Icelandic economy and the Icelandic banks. The coverage focused on the high CDS spreads for the banks, in addition to which doubts had been voiced about the ability of the Central Bank of Iceland and the State Treasury to aid the banks in case of liquidity difficulties. Doubts had also been expressed about the capacity of the Depositors' and Investors' Guarantee Fund to meet setbacks in the banks' operations. It must be presumed that the run which lasted from February until April 2008 on the Icesave accounts in Landsbanki's London branch can be attributed to this coverage. Compounding this was the risk of difficulties arising in the acquisition of foreign currency to meet sudden withdrawals from deposit accounts abroad.

When this is kept in mind, it is nearly incomprehensible that Landsbanki decided to start accepting Icesave deposits at its branch in Amsterdam rather than a Dutch subsidiary. Landsbanki thus took the obvious risk of having the

83. Statement by Jónas Fr. Jónsson before the SIC on 6 August 2009, p. 26-28.

same issues that the British media had covered in the preceding months pointed out in the Netherlands sooner or later. This is rendered even more incomprehensible when it is taken into consideration that according to Dutch law, there do not seem to have been any rules in effect comparable to those which in English law significantly limit the possibility of transferring funds from a subsidiary to other parts of a banking group.⁸⁴ The only explanation given for this is that it took longer to establish a subsidiary than open a branch and that it was not until the first half of 2008 that the establishment of a subsidiary was considered.⁸⁵

In a statement made by Jónas Fr. Jónsson, Director General of the FME, before the SIC it emerged that according to Article 36(4) of Act No 161/2002 on financial institution, the FME was not authorised to prohibit the establishment of a branch unless it has a legitimate reason to believe that the management and financial position of the financial institution in question was not sufficiently sound. At that time, Landsbanki had notified the proposed deposit-taking activities of the Amsterdam branch, the position of the bank had been strong, its credit rating was Aaa and its capital ratio 12.5%.⁸⁶

When asked whether the FME had considered the liquidity management of the bank in Euros, given that the Central Bank of Iceland was only a lender of last resort in the Icelandic króna, Jónsson claimed that this had not been the case since liquidity management was one of the functions of the Central Bank of Iceland, and in general regulatory authorities had not carried out any examinations on that basis when handling notifications on the establishment of a branch in another state.⁸⁷

In this context, it must be pointed out that it had been established that in the latter half of 2007 the FME had started developing liquidity control regarding the three banks on a wholebank basis.

In the hearing, Jónsson stated that the FME had itself initiated liquidity control of Landsbanki.

Initially, reporting by Landsbanki to the FME had been based on the Moody's model but later it became more detailed when the bank had reached an agreement with the FSA concerning liquidity management of the London branch in the spring of 2008.⁸⁸

In his statement before the SIC, Guðmundur Jónsson, Head of Unit at the FME, claimed that in a discussion with Landsbanki representatives it had been clear that the bank had intended to obtain Euros in currency swap markets to repay any withdrawals from the Landsbanki deposit accounts in Amsterdam.⁸⁹

However, the currency swap market with the Icelandic króna was inactive in part from 19 March 2008, cf. discussions in Chapter 13.0.

There is no sign that the FME had seen any reason to react despite the significant risk for Landsbanki which was a systemically important bank.

On 29 May 2008, i.e. the same day Landsbanki started accepting Icesave deposits in Amsterdam, a meeting was held in the consultative group of the

84. See a legal opinion of Allen & Overy dated 25 March 2008, prepared for Landsbanki Íslands hf.

85. Statement by Sigurjón Þ. Arnason before the SIC on 27 August 2009, p. 15.

86. Statement by Jónas Fr. Jónsson before the SIC on 6 August 2009, p. 1. It should be noted that the Moody's credit rating of Landsbanki at this time was Aa3.

87. Statement by Jónas Fr. Jónsson before the SIC on 6 August 2009, p. 2-7.

88. Statement by Jónas Fr. Jónsson before the SIC on 23 March 2009, p. 10.

89. Statement by Guðmundur Jónsson before the SIC on 10 August 2009, p. 61.

Prime Minister's Office, the Ministry of Finance, the Ministry of Business Affairs, the FME and the Central Bank of Iceland on financial stability and contingency planning. The draft minutes state i.a. that this further increases the obligations of the Depositors' and Investors' Guarantee Fund. Due to the extensive coverage of the Icelandic banks and the Icelandic economy abroad and in particular in light of the run on Landsbanki in the UK in early 2008, it must be criticised that the consultative group did not examine the issue with Landsbanki closely or propose a new ad hoc working group be established for that purpose. Furthermore, there is no evidence that Landsbanki's extended deposit taking by branches abroad had given ministers in the government of Iceland any cause to intervene. It must have come as a surprise that the CEOs of Landsbanki, who had previously discussed transferring the Icesave accounts from a branch to a London subsidiary because of the aforementioned problems which seemed insurmountable, established at the same time new deposit taking activities in Amsterdam with the same shortcomings, i.e. which were operated through a branch with the associated risk for the Depositors' and Investors' Guarantee Fund.

As regards the Central Bank of Iceland, this increased activity of Landsbanki in the Netherlands would further increase the risk in relation to the Central Bank's function to maintain financial stability in Iceland. Parties within the Central Bank were already aware of the dissatisfaction within central banks in those European countries where the Icelandic banks had started raising deposits with high interest rates. The Central Bank claims to have presented these views to the Landsbanki CEOs. The dissatisfaction of Nout Wellink, Executive Director of the DNB, was discussed especially at his meeting with the Chairman of the Board of Governors of the Central Bank on 8 September 2008, and the Chairman stated that he had recounted the stand of the Director of the DNB to the Landsbanki CEOs after the meeting.

Although Landsbanki's half-year financial statement for the former half of 2008 had not given reason, in the opinion of the FME, to limit the licence of Landsbanki to receive further deposits in the bank's Amsterdam branch, it had to be evident that the bank's increasingly restricted access to Euros once the currency markets started closing down, and especially once the effect of the fall of Lehman Brothers emerged, would affect its possibilities to honour its deposit obligations. This should have presented ample cause for the FME to separately investigate the issues facing the branch.

As recounted above, the Executive Director of the DNB met with Jónas Fr. Jónsson on 2 September 2008 where they agreed, according to Jónsson, to seek ways to "put the brakes on" the increase in deposits at Landsbanki Amsterdam and also to assign Landsbanki with suggesting potential solutions that could be acceptable to the DNB. Considering the interests at stake, the Landsbanki proposals emerged too late. Nonetheless, it was positive that the FME had put pressure on the CEOs of Landsbanki to cease marketing the Icesave accounts and they seemed to heed that recommendation.⁹⁰

As the target was to reduce the deposits of Landsbanki Amsterdam branch it must, however, be criticised that the FME did not make recommendations to the bank to reduce deposits into easy access accounts, however without

90. Statement by Jónas Fr. Jónsson before the SIC on 6 August 2009, p. 18.

risking a run on the deposit accounts. It is noteworthy that following the aforementioned meeting the deposits of Landsbanki in the Netherlands increased from €1.4 billion on 1 September 2008 to €1.5 billion on 10 September 2008 and finally €1.7 billion when Landsbanki collapsed. It is intriguing that the DNB clarified its supervisory powers as the host state of the Landsbanki branch in many ways as more limited than the FSA.

Thus, the FSA exercised its control concerning the liquidity managements of Landsbanki London branch by obtaining data on the liquidity management of Landsbanki wholebank. It has been revealed that Landsbanki had offered the DNB similar liquidity management concerning the Landsbanki wholebank but the DNB had declined the offer.⁹¹

In addition, it is worth noting that the DNB had not considered itself to be in a position to investigate whether there was any evidence that the parent company in Iceland had insufficient liquid assets for the Amsterdam branch to meet its obligations.⁹²

In a report from 11 June 2009 drawn up by an investigation committee working under the auspices of the Ministry of Finance in the Netherlands, it emerged that the DNB did not consider itself empowered to stop Landsbanki in its deposit taking when the authority believed a crisis was inevitable. When regarding the powers of the host state pursuant to recitals 18 and 22, as well as Articles 30, 31, 33 and 34 of Directive 2006/48/EC, the conclusion of the Dutch investigation committee must be agreed upon stating that the DNB had been in a position to decide on its own initiative to exercise its powers vis-à-vis the Landsbanki branch in Amsterdam by instructing the bank to cease its deposit market penetration and ensure satisfactory liquid position of the branch in the Netherlands, as long as the said provisions of the Directive had been properly transposed into Dutch legislation.⁹³

As regards the powers of the FME vis-à-vis the deposit taking of the Landsbanki branch in the Netherlands, it should be noted that the FME is obliged under Article 8 of Act No. 87/1998 on Official Supervision of Financial Activities, to monitor that the activities of regulated entities are in accordance with laws, regulations or statutes applicable to the said activities, as well as monitor that the activities are in other ways in keeping with sound and normal business practices.

Article 10 of the Act stipulates the remedies available to the FME in case the authority considers any aspect or activity of a regulated entity as otherwise unsound or inconsistent with proper business practices. It should be stressed that the deposits in the branch's Icesave accounts increased in three months from nothing to close to €1.5 billion at the end of August 2008. At the same time, wholesale deposits of the branch decreased. As far as the FME is concerned the issue had to be resolved how Landsbanki was prepared to meet, given the situation that had emerged in international financial markets concerning the raising of liquidity and currency markets, a sudden outflow of these deposits since the deposits had been raised with relatively high interest

91. Statement by Jónas Fr. Jónsson before the SIC on 6 August 2009, p. 9. See also letter from Landsbanki Íslands hf. to the FME dated 23 September 2008.

92. De bevoegdheden van De Nederlandsche Bank inzake Icesave. Onderzoek in opdracht van het Ministerie van Financiën. Pub. 11 June 2009, p. 58.

93. De bevoegdheden van De Nederlandsche Bank inzake Icesave. Onderzoek in opdracht van het Ministerie van Financiën. Pub. 11 June 2009, p. 67.

rates compared to general interest rates on deposit accounts in the market area. Furthermore, these activities had entailed a rapid increase in obligations on the Icelandic and Dutch deposit guarantee schemes; even though payments, in the case of the Icelandic Guarantee Fund, were not due until one year had passed. In view of this situation, it must be assumed, whatever authorisations Landsbanki may have been able to refer to in the law and the EEA Agreement to justify establishing deposit taking in its Dutch branch, that the situation in the operations of Landsbanki was such, i.a. as regards the position of the Icesave accounts in the UK and the relevant requirements made by British authorities, at least in the latter part of the summer, that it was inexcusable that the FME did not initiate an investigation immediately to see if the activities of the bank were in this respect in accordance with requirements stipulated by law concerning the sound and normal business practices of banks.

The SIC points out that it was, irrespective of the functions and obligations of regulatory and administrative authorities, a business decision and the responsibility of the directors of Landsbanki to establish deposit taking and carry on raising deposits from the general public in a new market area by offering high interest rates, despite the situation that had emerged in the operations of Landsbanki and in international financial markets; a situation that kept deteriorating as 2008 progressed.