Case Nos: 65843, 66740, 66793,
66794, 66795, 66797 and 66935
Event No: 571071
Dec. No: 501/10/COL

EFTA SURVEILLANCE AUTHORITY

EFTA SURVEILLANCE AUTHORITY DECISION

of

15 December 2010

to close seven cases against Iceland commenced following the receipt of complaints against that State in the field of capital movements and financial services

THE EFTA SURVEILLANCE AUTHORITY

Having regard to the Agreement on the European Economic Area (hereafter "the EEA Agreement"), in particular Articles 4, 36, 40 and 109 thereof,

Having regard to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, in particular Article 31 thereof,

Having regard to the Act referred to at point 19a of Annex IX to the EEA Agreement

> *Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes* (hereafter "the Deposit Guarantee Directive"),

as adapted to the EEA Agreement by Protocol 1 thereto,

Having regard to the Act referred to at point 16c of Annex IX to the EEA Agreement,

> *Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the reorganisation and winding up of credit institutions* (hereafter "the Winding-up Directive"),

as adapted to the EEA Agreement by Protocol 1 thereto.

Whereas:

EFTA SURVEILLANCE AUTHORITY

1 Procedure

1. On 5 January 2009, the EFTA Surveillance Authority (hereafter "the Authority") received a complaint (Case No: 65843) against Iceland which alleged that, by transferring some liabilities (mainly domestic deposits) and some assets from the Icelandic bank Glitnir bank hf. (hereafter "Glitnir") to a newly established entity and thereby leaving the rest of the creditors in an insolvent bank, the Icelandic authorities have breached the rule of non-discrimination contrary to Articles 4 and 40 of the EEA Agreement and established unjustified restrictions to the free movement of capital and the freedom to provide services contrary to, respectively, Articles 40 and 36 of the EEA Agreement.

2. The complainants filed an addendum to the complaint on 23 April 2009 elaborating on the discrimination issue and on other solutions the Icelandic Government could have chosen in response to the financial crisis.

3. On 2 June 2009, the Authority received another complaint (Case No: 66740) concerning the Icelandic authorities' action as regards Kaupthing bank hf. (hereafter "Kaupthing"), Landsbanki Islands hf. (hereafter "Landsbanki"), Sparisjódur Reykjavíkur og nágrennis hf. (hereafter "SPRON"). and Sparisjódabanki Íslands hf. (hereafter "Spar") in addition to Glitnir. The measures as regards Kaupthing and Landsbanki were adopted in October 2008. As regards SPRON and Spar, specific measures were adopted in March 2009.

4. On 25 June 2009, the Authority received five new complaints (Case Nos: 66793, 66794, 66795, 66796 and 66797) against Iceland in the same area as mentioned above. The complaints regarded one or more of the three Icelandic banks Glitnir, Landsbanki and Kaupthing. Broadly, the allegations were the same as in the previous complaints. The complaint registered as Case No: 66796 was withdrawn on 15 November 2010 and will not be dealt with here.

5. On 31 July 2009, the Authority received the eighth complaint (Case No: 66935) against Iceland regarding the treatment of general creditors, this time of Landsbanki and Kaupthing. Again, this complaint was mainly based on the claims referred to above.

6. Both on its own initiative and as a result of the complaints received, the Authority has been in extensive dialogue with the Icelandic Government since the banking crisis erupted in October 2008 as regards the measures the Icelandic authorities have adopted during the crisis.

7. As the complainants mentioned above all have in common being general creditors of one or more of the Icelandic banks, *i.e.* not being depositors, and to a large extent have presented the same arguments, the Authority has assessed the cases as a whole.

8. On 4 and 10 December 2009, the Authority sent pre-closure letters to all the complainants. The Authority found that the cases should be assessed on the basis of Article 40 of the EEA Agreement. The Authority concluded preliminarily that general creditors and depositors were not in comparable situations. Thereby the measures were not a discriminatory restriction of Article 40 of the EEA Agreement. Moreover, the preliminary conclusion was that the measures did not constitute a non-discriminatory restriction on the free movement of capital. In the event of the

measures being regarded as restrictive of the free movement of capital, the Authority considered that they would have been justified on the overriding requirement of safeguarding the functioning of the banking system. As the measures did not constitute a restriction, they were outside the scope of EEA law and, accordingly, the general principles of EEA law such as protection of fundamental right and the principle of legal certainty, were not applicable. On the assumption that they had been applicable, the Authority considered that a breach of the general principles could not be established. Finally, the Authority could not conclude that Iceland had violated the Winding-up Directive either.

9. On 25 and 28 January 2010, the Authority received comments from the complainants contesting the preliminary conclusion of the Authority. With some minor exceptions, the comments were identically worded in all cases. In addition to commenting on the findings of the Authority, the complainants also elaborated on claims relating to lack of transparency and creditor involvement in the winding-up procedures in Iceland.

10. Following requests made by the Authority in letters of 9 February 2010, the complainants provided further information by letters of 29 and 30 March 2010. On 16 June 2010, a meeting was held between representatives of the Authority, the complainants and their lawyers.

11. In light of the above, the Authority has sufficient information to conclude on the legality, under the EEA Agreement, of the principal measures taken by the Icelandic authorities in October 2008 and in March 2009. The present decision, thus, deals with the two main sets of measures taken by the Icelandic authorities relevant to the complainants' position. First, the legislative amendments of 6 October 2008 granting depositors priority ranking in insolvency proceedings over that of other unsecured creditors (see Article 6 and 9 of Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc.). Second, the various decisions of the Icelandic Financial Supervisory Authority ("the FME") to transfer assets and liabilities from the failed banks to newly established entities, taken on the basis of Article 5 of the said Act ("the FME measures"). Unless otherwise specified below, the present decision's assessment of the legality, under EEA law, of these Icelandic emergency measures refers to both (sets of) measures taken by the Icelandic authorities.

12. In contrast, the Authority considers that, at this stage, it does not have sufficient information before it to conclude on all of the allegations raised by the complainants; that Iceland has failed to comply with all its obligations under the Winding-up Directive in respect of the failed banks. The remaining parts of the complaints are, therefore, not dealt with in the present decision and will be assessed separately at a later stage in Case No: 69055.

13. Also, the present decision does not deal with questions of discrimination between domestic and foreign depositors. While that issue has been raised in separate complaints received by the Authority from other complainants, it does not concern the position of the present (corporate) complainants who are all unsecured creditors rather than depositors. Consequently, the present decision does not express any views on the legality, under EEA law, of differences in treatment between deposit accounts located within Iceland on the one hand and outside Iceland on the other hand.

2 Facts

2.1 Measures as regards Landsbanki, Kaupthing and Glitnir

14. The three Icelandic banks Landsbanki, Kaupthing and Glitnir have a long history. Landsbanki was founded in 1885, Glitnir traces its origins back to 1904 and Kaupthing to 1930. After its establishment, the European Economic Area (hereafter "the EEA") has been by far the three banks' largest and most important market. The Icelandic banking sector boosted its assets from 100 to almost 900 percent of the Icelandic gross domestic product (hereafter "GDP") between 2004 and the end of 2007.[1] This expansion made the Icelandic banking system one of the largest in the world in relation to GDP. In absolute terms, Kaupthing was the 7th largest bank in the Nordic region and had operations in nine other EEA States (Finland, Sweden, Denmark, Norway, the UK, Belgium, Germany, Luxembourg and Austria) as well as Iceland. In several of these countries, Kaupthing had introduced Kaupthing Edge, a savings product based on Internet banking. The main European operations of Glitnir were in Norway, Finland and Luxembourg. Landsbanki operated among others in the Netherlands, the UK and Luxembourg. Similar to Kaupthing Edge, Landsbanki had launched Icesave, which also was a savings product based on Internet banking. Both these products became popular in the Netherlands and the UK.

15. In the interim balance sheet of each bank, the following figures can be found as per 30 June 2008[2]:

ISK billion	**Total assets**	**Total deposits**	**Total liabilities**
Kaupthing	6,604	2,519	6,166
Landsbanki	3,970	2,080	3,769
Glitnir	3,863	1,021	3,662
Total	**14,437**	**5,620**	**13,597**

16. In comparison, Iceland's GDP in 2007 was Icelandic króna (ISK) 1,309 billion.[3] The total liabilities of the combined balance sheets were therefore equivalent to more than ten times Iceland's GDP in 2007.[4]

17. According to information from the Icelandic Government, the total deposits in the three banks were, at the end of September 2008, ISK 2,761 billion, with the foreign branches amounting to ISK 1,566 billion. These figures and those in the table above may not be directly comparable. While subsidiaries could be included in the figures in the table (*e.g.* if the accounts of subsidiaries are consolidated in the parent companies' accounts), they may not be included in the information from the

[1] International Monetary Fund Country Report No. 08/362 (November 2008), page 5.

[2] http://www.kaupthing.com/lisalib/getfile.aspx?itemid=17006, http://www.landsbanki.is/Uploads/Documents/ArsskyrslurOgUppgjor/landsbanki_consolidated_interim_financial_statements_30-jun-2008.pdf and http://www.sff.is/media/auglysingar/Glitnir_Q2_results_2008.pdf.

[3] According to information available at http://www.statice.is/?PageID=1267&src=/temp_en/Dialog/varval.asp?ma=THJ01102%26ti=Gross+domestic+product+and+Gross+national+income+1980%2D2009%26path=../Database/thjodhagsreikningar/landsframleidsla/%26lang=1%26units=Million ISK

[4] Compare to the total assets' value per end 2007 of almost nine times the GDP, see paragraph 14. During the first six months of 2008, there was apparently a substantial growth in the Icelandic banking sector.

Icelandic Government. The Icelandic Government's definition of deposits could be different from the one used in the interim balance sheet of the banks.

18. The Icelandic economy was hit particularly hard by the financial crisis in 2008. During autumn 2008, the three banks suffered from refinancing and liquidity problems. On 25 September 2008, after the news of the failure of the US investment bank Lehman Brothers on 15 September, Glitnir announced to the Icelandic Central Bank that it was not able to meet a loan payment of EUR 600 million due on 15 October. The bank requested an emergency loan from the Central Bank to meet this obligation.

19. The request was turned down and on 29 September, the Icelandic Government announced it would provide Glitnir with EUR 600 million in equity and become owner of 75% of the shares in the bank in order to restore confidence in the Icelandic banking system.

20. On 30 September, the credit ratings of Landsbanki were downgraded dramatically. A depositor run had started in the non-domestic branches of both Landsbanki and Kaupthing. Landsbanki's Icesave deposits in the UK shrank by 20% from 15 September to 7 October 2008. Kaupthing's Edge deposits shrank by more than 30% from 28 September to 8 October 2008.

21. On 3 October, Glitnir was unable to render payment of certain wholesale deposits, according to an opinion of the Icelandic Financial Supervisory Authority issued on 4 November 2008.

22. According to information from the International Monetary Fund (hereafter "the IMF"), the onshore foreign exchange market dried up, the ISK depreciated by more than 70% in the offshore market, and the equity market in Iceland tumbled by over 80% in October 2008[5]. The external payment systems were severely disrupted, hampering repatriation of export proceeds. The real economy was threatened with severe disruptions. The IMF characterised this as a crisis of huge proportions[6].

23. On 6 October, it became clear that Landsbanki was on the verge of bankruptcy. Its Icesave websites ceased to work and the access to the funds of depositors were blocked.

24. On the same day, trading in Iceland's six biggest financial undertakings was suspended on the OMX Nordic Exchange Iceland (all financial instruments issued by Glitnir, Kaupthing, Landsbanki, Exista, Straumur-Burdaras Investment Bank and Sparisjodur Reykjavikur og nagrennis).

25. Further on the same day, the Icelandic Government stated that it guaranteed all domestic deposits. In addition, on 6 October, the Icelandic Parliament adopted Act No 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc. (hereafter "the Emergency Act").

26. By Article 6 of the Emergency Act, Article 103 of the Icelandic Act No 161/2002 on Financial Undertakings was amended so that in dividing the estate of a bankrupt

[5] See IMF report at http://www.imf.org/external/pubs/ft/scr/2008/cr08362.pdf
[6] See http://www.imf.org/external/pubs/ft/survey/2008/123108.pdf.

financial undertaking, claims for deposits, pursuant to the Icelandic Act on Deposit Guarantees and an Investor Compensation Scheme, are accorded priority as provided for in Article 112, Paragraph 1 of the Icelandic Act No 21/1991 on Bankruptcy etc. It follows that claims for deposits, together with claims for wages and some other claims, will be covered before unsecured general claims when the estate of a bankrupt financial undertaking is divided.

27. Later in the same month, the FME took control of the three banks on basis of the Emergency Act which was adopted on 6 October 2008. The takeovers were executed as regards Glitnir and Landsbanki on 7 October and as regards Kaupthing on 9 October. In all cases, the banks' existing boards were dismissed and replaced by resolution committees. These committees have taken over the responsibilities of the shareholders' meeting and the Board of Directors.

28. Based on Article 100a of the Icelandic Act on Financial Undertakings, as amended by the Emergency Act, the FME decided to transfer some assets, some liabilities and some guarantees from Kaupthing, Landsbanki and Glitnir to newly established entities. The following liabilities and guarantees were, with some exceptions, transferred to New Glitnir (later Islandsbanki) according to the FME's decision of 14 October 2008, as amended on 19 October 2008:

- domestic deposits;
- export and import guarantees;
- guarantees due to discharge of contract by companies and individuals regarding regular activities; and
- debt backed by collateral which rested upon appropriated assets which were transferred to the new bank[7].

29. This approach was used also for Kaupthing and Landsbanki. The new banks would carry on domestic operations with domestic assets. The Icelandic authorities intended to transfer more assets than liabilities to the new banks. However, the old banks were to be compensated for the net value of the transferred assets. The compensation was to take the form of financial instruments issued by the new banks to the old banks. The finalisation of these processes was due several times but was repeatedly postponed by the FME.

30. In a report and a publication of November 2008[8], the IMF stated that Iceland's economy was in the midst of a banking crisis of such extraordinary proportions that it was expected to lead to a deep recession, a sharp rise in the fiscal deficit, and a dramatic surge in public sector debt, reflecting a very high fiscal cost of restructuring the banking system. The virtual collapse of the on-shore foreign exchange market posed, in view of the IMF, a serious and immediate risk to the economy considering its very high import dependence. The Central Bank of Iceland and the State had suffered a loss of creditworthiness in the eyes of the international financial community. This situation in which Iceland suddenly found itself was an unprecedented calamity for a developed country.

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[7] http://fme.is/lisalib/getfile.aspx?itemid=5732 and http://fme.is/lisalib/getfile.aspx?itemid=5733.
[8] http://www.imf.org/external/pubs/ft/scr/2008/cr08362.pdf and http://www.imf.org/external/pubs/ft/survey/2008/123108.pdf

31. On 19 November 2008, the IMF executive board approved a two-year stand-by arrangement for Iceland totalling USD 2.1 billion. USD 827 million was made immediately available to Iceland, the remainder in eight equal instalments, subject to quarterly reviews. There were three main objectives of the IMF-supported programme: Preventing a further sharp ISK depreciation, ensuring medium-term fiscal sustainability and developing a comprehensive bank restructuring strategy. On 28 October 2009, the IMF completed the first review of Iceland's economic performance under the arrangement which also was extended to 31 May 2011. About USD 167.5 million was disbursed to Iceland after the review. A second review of Iceland's economic performance was completed by the IMF on 16 April 2010, approving disbursement of about USD 160 million to Iceland. At the same time, the arrangement was prolonged to 31 August 2011. After a visit from 14 to 28 June 2010, the IMF Mission to Iceland stated on 28 June 2010 that while the Icelandic economy technically had emerged from the post-crisis recession, "headwinds and risks remain significant".

32. The old banks were granted moratoria until 24 November and 5 December 2010 respectively by the District Court of Reykjavik.[9] After these dates, the banks automatically entered into winding-up proceedings. The Court also appointed Winding-up Committees for the three banks. The Moratorium Supervisors are automatically members of such committees. The Winding-up Committees shall, *inter alia*, handle the claims against the banks. The Winding-up Committees invited creditors to lodge their claims within certain deadlines: for Landsbanki by 30 October 2009[10], for Glitnir within 26 November 2009[11] and for Kaupthing by 30 December 2009[12].

33. On 14 August 2009, the Icelandic Government announced that it would capitalise Islandsbanki (previously New Glitnir) with ISK 65 billion.[13] On 15 October 2009, a joint press release was issued by the Icelandic Ministry of Finance, Islandsbanki and the Resolution Committee of Old Glitnir.[14] According to this press release, the parties had reached an agreement that Old Glitnir would acquire 95% of Islandsbanki. The Icelandic Government would support Islandsbanki with ISK 25 billion as a subordinated loan and continue to own 5% of the bank. This would, according to the press release, conclude the settlement concerning assets transferred from Old Glitnir to Islandsbanki. The transfer of ownership was finalised on 31 December 2009 according to Islandsbanki's Consolidated Financial Statements 2009, page 3.[15]

34. On 4 September 2009, the Icelandic Government announced that it had reached an agreement with the Resolution Committee of Kaupthing regarding the capitalisation

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[9] See press releases regarding granting of the moratoria for the first time at http://www.glitnirbank.com/home/119-a-moratorium-order-on-glitnir-bank-.html, http://www.kaupthing.com/Pages/4006?NewsID=4103 and http://www.lbi.is/Home/News/News-Item/2008/12/06/Landsbanki-Islands-hf.-granted-a-moratorium/. All moratoria were later extended.

[10] http://www.lbi.is/Home/News/News-Item/2009/05/08/Handling-of-Claims-against-Landsbanki-Islands-hf/, point 4

[11] http://www.glitnirbank.com/home/189-invitation-to-lodge-a-claim.html

[12] http://www.kaupthing.com/lisalib/getfile.aspx?itemid=20358

[13] http://www.ministryoffinance.is/publications/news/nr/12400

[14] http://www.glitnirbank.com/home/337-creditors-acquire-95-of-share-capital-in-islandsbanki.html

[15] http://www.islandsbanki.is/servlet/file/Islandsbanki%20-%20Consolidated%20Financial%20Statment%202009.pdf?ITEM_ENT_ID=60927&COLLSPEC_ENT_ID=156

of New Kaupthing and the basis for the compensation following the creation of New Kaupthing in October 2008.[16] The Icelandic Government injected ISK 74 billion into the new bank which from 21 November 2009 took the name Arion banki hf. (hereafter "Arion"). Apparently, the assets transferred from Old Kaupthing to Arion had a lower value than the transferred liabilities. This follows from Arion's Consolidated Financial Statements for the year 2009, note 73, where it emerges that Old Kaupthing has issued a compensation instrument of ISK 38,300 million to Arion, due 30 June 2012.[17] However, there is an agreement to recalculate the amount depending on how the value of certain assets transferred to Arion changes. According to a joint press release of 1 December 2009 from the Icelandic Ministry of Finance and the Resolution Committee of Old Kaupthing, the parties had agreed that Old Kaupthing would acquire an 87% share in Arion.[18] The Icelandic Government would continue to own 13%. The acquisition was effected on 8 January 2010 according to Arion's Consolidated Financial Statements for 2009, note 120.

35. According to a joint press release of 16 December 2009 from the Icelandic Ministry of Finance and the Resolution Committee of Landsbanki, the parties had agreed with New Landsbanki (registered name NBI hf.) that the Icelandic Government would acquire 81% of the share capital in New Landsbanki.[19] The Icelandic state would contribute ISK 122 billion in equity. Landsbanki's Resolution Committee would control 19% of New Landsbanki which in addition would issue a debt instrument with a 10 years term to the Old Landsbanki for ISK 260 billion. According to the press release, the debt instrument and the share Old Landsbanki would take over, would be equivalent to the assets taken over by the new bank net of liabilities. The amount will be recalculated depending on how the value of assets will change. Final assessment of the assets will be made at year-end 2012. The press release stated that this was the final agreement on the settlement of assets and liabilities following the split of Landsbanki in October 2008. The FME approved the acquisition on 27 January 2010.[20]

2.2 Measures as regards other banks

36. In addition to Glitnir, Kaupthing and Landsbanki, the Icelandic authorities adopted crisis measures as regards other banks as well. In March 2009, the FME took action as regards three banks; Straumur-Burdaras Investment Bank (hereafter "Straumur-Burdaras"), Sparisjodabanki Islands (hereafter "Spar") and Sparisjodur Reykjavikur og nagrennis (hereafter "SPRON"). Straumur-Burdaras offered investment banking services to undertakings and investors in the Northern and Central European region. Outside Iceland, the bank took deposits in Denmark and the Czech Republic. Spar focused on wholesale and investment banking services to savings banks, Icelandic and foreign financial institutions and other large customers. The bank had no deposit-taking branches in other EEA States. SPRON offered commercial and investment banking services to retail and corporate customers as well as institutional investors in the Greater Reykjavik area. The bank had also no deposit-taking foreign EEA branches. All depositors of these three banks have been reimbursed or have been transferred to other banks.

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[16] http://eng.fjarmalaraduneyti.is/publications/news/nr/12477
[17] http://www.arionbanki.is/lisalib/getfile.aspx?itemid=19606
[18] http://www.kaupthing.com/Pages/4006?NewsID=4262
[19] http://www.lbi.is/Home/News/News-Item/2009/12/16/Joint-press-release-by-the-Ministry-of-Finance-and-the-Resolution-Committee-of-Landsbanki-Islands-hf/
[20] http://www.fme.is/?PageID=581&NewsID=509

37. On 9 March 2009, the FME dismissed the Board of Straumur-Burdaras and appointed a Resolution Committee taking over all authority of the Board of Directors.[21] On 17 March 2009, the FME decided to transfer the domestic deposits at Straumur-Burdaras to Islandsbanki (*i.e.* New Glitnir), except for money market deposits and some other deposits.[22] As payment, Islandsbanki would receive a bond with all the bank's assets as collateral. The other depositors were paid out. On 19 March, the District Court of Reykjavik granted a moratorium for Straumur-Burdaras.[23] After prolongations, the moratorium expired on 24 November 2010. According to a press release of 13 July 2010 from the Resolution Committee, the creditors had voted on and approved a composition agreement for the bank.[24] The ownership and control of the bank was transferred to creditors who would convert a part of their claims for shares and receive a bond issued by the bank. Unsecured creditors could expect a recovery of about 50% of their claims. According to a press release of 5 October 2010 from the bank, a new board for ALMC hf. (formerly Straumur-Burdaras) had been elected to replace the Resolution Committee.[25] The press release stated that this completed the restructuring of the company.

38. As regards Spar, a Resolution Committee was appointed on 27 March 2009 by the FME.[26] The FME had already on 21 March 2009 decided to transfer some deposits and some guarantees to the Icelandic Central Bank, New Kaupthing Bank and Byr Savings Bank.[27] As compensation for the transfer of liabilities, some assets were transferred along with the liabilities. Should there turn out to be a difference between the transferred liabilities and the assets (*i.e.* if the assets are of a higher value than the liabilities), the remainder is to be paid to Spar, according to the FME decisions of 21 March 2009 and 17 April 2009. A moratorium for the bank has been granted until 15 March 2011.[28]

39. As regards SPRON, the FME decided on 21 March 2009 that most of the deposits and some guarantees were to be transferred to New Kaupthing.[29] All the assets of the bank were transferred to a special purpose vehicle fully owned by SPRON. The subsidiary issued a bond to New Kaupthing to compensate for the transferred liabilities. SPRON's shares in the subsidiary and all the subsidiary's assets were collateralised for the bond. Also on 21 March 2009, a Resolution Committee was appointed for the bank.[30] A Winding-up Committee was appointed on 23 June 2009.[31]

2.3 Depositors and other creditors

40. As mentioned in paragraph 14 above, Landsbanki, Kaupthing and Glitnir had extensive activities in other EEA States, through branches or subsidiaries. Foreign

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[21] http://www.fme.is/lisalib/getfile.aspx?itemid=6055
[22] http://www.fme.is/lisalib/getfile.aspx?itemid=6077
[23] http://www.straumur.com/CreditorInformation/
[24] http://www.straumur.com/NewsandEvents/ReadMore/creditorsapproveacompositionagreementforstraumur/
[25] http://www.straumur.com/NewsandEvents/ReadMore/straumursrestructuringcompletedandnewboardelected/?bcsi_scan_A7E1E556D7B2F94D=caMSihbbtcwWMZB+R9+woCPwNAwXAAAAjtE5Ag==
[26] http://www.fme.is/lisalib/getfile.aspx?itemid=6112
[27] http://www.fme.is/lisalib/getfile.aspx?itemid=6099
[28] http://www.icebank.is/article.aspx?ArtId=3161&catID=1308
[29] http://www.fme.is/lisalib/getfile.aspx?itemid=6098
[30] http://www.spron.is/en/AboutSpron/
[31] http://www.spron.is/media/PDF/SPRON_Creditor_Report1.pdf, page 12

depositors were cut off from their deposits in October 2008 and were not covered by the guarantee the Icelandic Government issued on 6 October 2008 for domestic depositors, see paragraph 25. However, due to action taken by other EEA States, solutions for the foreign depositors were found, with some exceptions. One exception regards depositors of the Landsbanki branches in the UK and the Netherlands. The UK Government decided to pay out all retail depositors in full. The Dutch Government paid out the depositors up to a maximum of EUR 100,000. Negotiations between the UK and the Dutch Governments on the one hand and the Icelandic Government on the other have taken place regarding the repayments of the part that falls under the Icelandic Deposit Guarantee Scheme (EUR 20,877 per depositor). On 26 May 2010, the Authority sent Iceland a letter of formal notice concluding that by not ensuring payment of the minimum guarantee to Icesave depositors Iceland had failed to comply with its obligations under the Deposit Guarantee Directive and Article 4 of the EEA Agreement. On 9 December 2010, the Icelandic, UK and Dutch Government announced that they had reached an agreement on the repayment. That agreement will be subject to ratification in the Icelandic Parliament.

41. The biggest losses due to the Icelandic banking crisis have been and/or will be suffered by the general unsecured creditors like the complainants. An indication can be found in the table in paragraph 15. As per 30 June 2008, Glitnir, Kaupthing and Landsbanki had total liabilities of ISK 7,977 billion, deposits excluded.

42. This creditor group also includes Icelandic investors. According to statistics published by the Icelandic Central Bank, 19 pension funds holding 94% of all Icelandic pension funds' assets had per September 2008 around ISK 148 billion in bonds issued by Icelandic banks (exclusive of investment banks). It is clear from public information that three pension funds with around 50% of the total assets of Icelandic pension funds wrote down ISK 86 billion in the value of bonds issued by Icelandic financial institutions and other Icelandic companies[32]. Statistics from the Icelandic Central Bank show that UCITS and investments fund managed by eight different management companies per September 2008 held almost ISK 113 billion in bonds issued by Icelandic banks (exclusive of investment banks). Per 1 October 2008, the Icelandic Central Bank had loaned ISK 520 billion to Icelandic financial institutions against collateral[33]. Collateral in the form of unsecured bonds issued by Glitnir, Kaupthing and Landsbanki had a value of ISK 303 billion.

2.4 Iceland's ratings and economic outlook

43. According to information on the website of the Icelandic Central Bank[34], Iceland's sovereign credit ratings are as follows:

Credit rating agency	Debt nominated in foreign currency		Debt nominated in domestic currency		Outlook
	Long-term	Short-term	Long-term	Short-term	
Moody's (per April 2010)	Baa3	P-3	Baa3	P-3	Stable
Standard & Poor's (per March 2010)	BBB-	A-3	BBB	A-3	Negative
Fitch Ratings (per January 2010)	BB+	B	BBB+		Negative
R & I (per November 2010)	BB+				Negative

[32] See *e.g. Viðskiptablaðið* from 6 May 2010, pages 12-13.
[33] See page 10 of the Annual Report 2008 of the Icelandic Central Bank.
[34] http://www.sedlabanki.is/?PageID=789

44. On 29 July 2010, Moody's Investors Service changed the rating outlook for Iceland from stable to negative. The action was triggered by a ruling from the Icelandic Supreme Court on the illegality of foreign-exchange-linked loans, and the Icelandic Government's continuing difficulties in achieving a resolution with the UK and the Dutch Governments as regards Icesave, see above in paragraph 40.

45. The credit information specialist firm CMA calculated the probability of payment cessation for the Icelandic sovereign debt to be 21.7% in its Global Sovereign Credit Risk Report for the 3rd Quarter 2010. The corresponding figure for 2nd Quarter 2009 was 37.4%.

46. The unemployment rate in Iceland was according to information from Statistics Iceland 1% in September 2008, 7% in September 2009, 9% in February 2010 and 6.1% for 3rd Quarter 2010, all calculated in percentage of labour force.

3 Assessment - introduction

47. In light of the above, the Authority has sufficient information to conclude on the legality, under the EEA Agreement, of the principal measures taken by the Icelandic authorities in October 2008 and in March 2009. The present decision, thus, deals with the two main sets of measures taken by the Icelandic authorities relevant to the complainants' position. First, the legislative amendments of 6 October 2008 granting depositors priority ranking in insolvency proceedings over that of other unsecured creditors (see Article 6 and 9 of Act No. 125/2008 on the Authority for Treasury Disbursements due to Unusual Financial Market Circumstances etc.). Second, the various decisions of the Icelandic Financial Supervisory Authority ("the FME") to transfer assets and liabilities from the failed banks to newly established entities, taken on the basis of Article 5 of the said Act ("the FME measures"). Unless otherwise specified below, the present decision's assessment of the legality, under EEA law, of these Icelandic emergency measures refers to both (sets of) measures taken by the Icelandic authorities.

48. In contrast, the Authority considers that, at this stage, it does not have sufficient information before it to conclude on all of the allegations raised by the complainants; that Iceland has failed to comply with all its obligations under the Winding-up Directive in respect of the failed banks. The remaining parts of the complaints are, therefore, not dealt with in the present decision and will be assessed separately at a later stage in Case No: 69055.

49. Also, the present decision does not deal with questions of discrimination between domestic and foreign depositors. While that issue has been raised in separate complaints received by the Authority from other complainants, it does not concern the position of the present (corporate) complainants who are all unsecured creditors rather than depositors. Consequently, the present decision does not express any views on the legality, under EEA law, of differences in treatment between deposit accounts located within Iceland on the one hand and outside Iceland on the other hand.

50. The principal grounds of the complaints are that the Icelandic authorities allegedly discriminated against foreign creditors of the Icelandic banks (contrary to Articles 4 and 40 of the EEA Agreement), that the transfer of assets and liabilities to the new

banks amounted to unlawful state aid (contrary to Article 61 of the EEA Agreement)[35], that the Icelandic authorities have breached Article 16 of the Winding-up Directive by treating claims of foreign creditors differently to those of Icelandic creditors, that the actions of the Icelandic authorities have unlawfully interfered with the complainants' rights to peaceful enjoyment of their possessions (contrary to Article 1 of the First Protocol to the European Convention on Human Rights) and that the legitimate expectations of the complainants were breached contrary to general principles of law.

3.1 Discriminatory restriction - Article 40 EEA

51. Regarding the discriminatory treatment the complainants allege to have suffered, they refer to both Articles 4 and 40 EEA.

52. Article 4 EEA reads: "*Within the scope of application of this Agreement, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited*".

53. Article 40 EEA reads: "*Within the framework of the provisions of this Agreement, there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in EC Member States or EFTA States and no discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested. Annex XII contains the provisions necessary to implement this Article*".

54. Neither the Treaty on the Functioning of the European Union (hereafter "TFEU") nor the EEA Agreement define the terms "*movements of capital*" and "*payments*". However, it is settled case law of the Court of Justice of the European Union (hereafter "the Court of Justice") that Directive 88/361[36], together with the nomenclature annexed to it, may be used for the purposes of defining what constitutes capital movements[37]. The nomenclature of capital movements in Annex I to Directive 88/361 provides a non-exhaustive list of capital movements. It covers various forms of unsecured credits. In particular, the following are included: in section III of Annex I "*operations in securities normally dealt in on the capital market*", which refers, *inter alia*, to bonds; in section V of Annex I "*operations in securities and other instruments normally dealt in on the money market*"; and in section VIII of Annex I "*financial loans and credits (not included under I, VII, XI)*". Under that section are listed short term, medium terms and long term loans and credits granted by non-residents to residents and by residents to non-residents. Accordingly, the provision of unsecured credits constitutes capital movement within the meaning of Article 40 EEA.

55. The Authority recalls that pursuant to the case law of the EFTA Court, the general non-discrimination principle in Article 4 EEA applies independently only to situations governed by EEA law for which the EEA Agreement lays down no specific rules prohibiting discrimination. The principle of non-discrimination has been given effect in the field of free movement of capital by Article 40 EEA[38]. As

[35] This decision does not deal with State aid issues.
[36] Act referred to at point 1 of Annex XII to the EEA Agreement.
[37] Case C-222/97 *Trummer and Mayer* [1999] ECR I-1661, paragraphs 20 and 21; Case C-98/01 *Commission v United Kingdom* [2003] ECR I-4641, paragraph 39 and Case C-147/04 *Commission v Italy* [2005] ECR I-4933, paragraph 27.
[38] Case E-1/00 *Íslandsbanki-FBA* [2000-2001] EFTA Ct. Rep. 8, paragraphs 35-36.

outlined above, the present cases concern the free movement of capital and therefore the Authority has examined issues of alleged discrimination under Article 40 EEA. The Authority would like to observe that the conclusion of this case would be the same irrespective of which Article of the EEA Agreement it would be examined under, Article 4, 36 or 40 EEA.

56. With regard to the changes made to the ranking order in insolvency proceedings, the Authority recalls, as a preliminary point, that Article 125 EEA corresponds to Article 345 TFEU (ex 295 EC) and provides that the EEA "*[...] Agreement in no way prejudices the rules of the Contracting Parties governing the system of property ownership*". The Icelandic rules on ranking of claims in insolvency proceedings concerning financial institutions fall within the scope of Article 125 EEA. Nevertheless, national measures by the EFTA States remain subject to the fundamental rules of EEA law, including those of non-discrimination and free movement of capital[39].

57. The changes made to the ranking order in insolvency proceedings, by Articles 6 and 9 of the Emergency Act, do not make any distinction on grounds of nationality and apply equally to Icelandic nationals (or entities) and nationals (or entities) of other States, including EEA States. They are therefore not, *a priori*, discriminatory in nature[40]. In addition, the measures apply in principle irrespective of the residence of the creditor or of the place where the credit is provided. It follows that the changes to the ranking order do not constitute direct discrimination on the grounds of nationality, residence or of the place where capital is invested, as the measures were not expressly based on such grounds.

58. Turning to the issue of indirect discrimination, the complainants have maintained that depositors and other unsecured creditors are in comparable situations. They refer, *inter alia*, to the legal situation before the Emergency Act was enacted. Depositors are also creditors and normally with equal rank as other unsecured creditors.

59. The Authority finds that the existence of the Deposit Guarantee Directive at EEA level demonstrates a general acceptance in the EEA that depositors are in another situation than general creditors and in greater need of protection in the event of insolvency of financial institutions. This view is by no means confined to the EEA. The International Monetary Fund and the World Bank stated in their report of 17 April 2009 on an overview of the legal, institutional and regulatory framework for bank insolvency on page 54 paragraph 122.

> *Generally, depositors rank as unsecured creditors. However, some jurisdictions give depositors a degree of preferential treatment over other unsecured creditors, or even first priority for part of their claim. This may be considered appropriate especially in jurisdictions without a deposit insurance scheme.*

60. The complainants have argued that the Deposit Guarantee Directive exhaustively regulates to what extent depositors may be granted preferential treatment, by the EEA States, compared to other unsecured creditors. The Authority does not share

[39] See to that effect Case C-452/01 *Ospelt and Schlössle Weissenberg* [2003] ECR I-9743, paragraph 24 and the case law cited and Case E-2/06 *the Authority v Norway* [2007] EFTA Ct. Rep.167, paragraph 62.
[40] See to that effect Case C-452/01 *Ospelt and Schlössle Weissenberg*, cited above, paragraph 37.

the complainants' interpretation of the Directive. The Authority considers that it contains the minimum requirements imposed on EEA States with regard to depositor protection. However, subject to compliance with the general principles of EEA law, the States may grant them further protection than laid down under the Directive.

61. Moreover, the Authority considers that the underlying flow of capital is different for depositors than with regard to other unsecured creditors. Deposits can normally be withdrawn on a daily or short-term basis, different from loans to banks, which usually are agreed for medium or long terms. Moreover, there are considerable differences in the psychological role which depositors and, in particular, retail depositors play in terms of public perception as compared to that of professional financial institutions. The general confidence of retail depositors in the functioning and stability of banks with which they have entrusted their savings is an essential feature and prerequisite for the stability of both the banking and the financial system. Lack of confidence by depositors could well trigger a run on banks, potentially with severe consequences for the stability of the financial system. This danger was generally imminent in Europe, and in particular in Iceland, when the emergency measures were taken in October 2008. The Authority, therefore, takes the view that depositors and other unsecured creditors were not in comparable situations with regard to the emergency measures.

62. The issue also arises whether unsecured creditors are in a comparable situation to guarantee holders, which were transferred to the new banks. As explained in paragraphs 28 and 29, the Icelandic authorities transferred some assets, some liabilities and some guarantees from the old banks to the new banks. This left foreign depositors, bondholders, lenders and other creditors in the old banks. As regards the three last groups of creditors, their nationality, domicile or place of establishment was of no significance. Also Icelandic bondholders and most of the creditors, other than depositors, were left in the old banks. As stated above in paragraph 42, a not inconsiderable part of unsecured credits in the Icelandic banks were held by Icelandic entities such as the pension funds and the Central Bank.

63. The guarantee holders are only potential creditors of the banks. Only if the underlying obligation is not honoured the guarantee holders will enter into creditor positions towards the banks. To the Authority, this strongly indicates that the position of the guarantee holders was not comparable to the position of the unsecured general creditors. More importantly, the Authority has no information indicating that the nationality or the place of residence of the guarantee holders or the place of the underlying claim was, directly or indirectly, decisive for whether the guarantees were transferred.

64. According to information provided by the Icelandic Government, none of the new entities have taken over debt backed by collateral which rested upon appropriated assets which were transferred to the new banks.

65. Based on the above, the Authority concludes that unsecured creditors like the complainants were not in a situation comparable to that of depositors with regard to the Icelandic emergency measures. Consequently, these measures did not amount to indirect discrimination of the complainants within the meaning of Article 40 EEA.

3.2 Non-discriminatory restrictions – Article 40 EEA

66. In this section, the Authority will examine whether the changes made to the ranking order in insolvency proceedings under Articles 6 and 9 of the Emergency Act constitute a non-discriminatory restriction of the free movement of capital under Article 40 EEA.

67. The case law of the Court of Justice concerning non-discriminatory restrictions of capital movements has primarily been limited to measures concerning limitation of state privileges regarding shareholdings in previously state-owned companies[41]. The rationale behind concluding that these measures constituted restrictions was that the measures hindered shareholders from other EEA States from fully participating in the management of the company corresponding to their portion of the shareholding in the company. In many of these cases the State, by special arrangements, had influence on the management of the companies in question exceeding its part of the ownership. In addition, the Court of Justice has concluded that prior authorisation schemes such as for the acquisition of property and investments in companies or shares constitute restrictions for the purposes of Article 63 TFEU (ex 56 EC)[42].

68. The Court of Justice has stated (with regard to investments) that national measures must be regarded as restrictions within the meaning of Article 63 TFEU if they are likely to prevent or limit the acquisition of shares in the undertakings concerned or to deter investors of other Member States from investing in their capital[43]. The scope of what constitutes restrictions is literally very wide. However, not all measures that might deter investments or other movements of capital may automatically be regarded as restrictions for the purposes of Article 63 TFEU/Article 40 EEA. In examining whether the changes to the ranking order can be regarded as a restriction on the free movement of capital it is also important to bear in mind the purpose of the free movement provisions of the EEA Agreement. In that context the following observations of AG Tizzano in *Caixa Bank* are important:

> *In an effort to unravel the case-law, I observe first of all that I find it difficult to describe national measures that regulate the pursuit of an economic activity without directly affecting access to that activity and without discriminating either in law or in fact between national and foreign operators as restrictions contrary to the Treaty for the sole reason that they reduce the economic attractiveness of pursuing that activity.*[44]

69. Accordingly, the fact that the changes in the ranking order reduces the economic attractiveness, for unsecured creditors other than depositors, of doing business with Icelandic financial institutions does not render the Emergency Act restrictive for purposes of Article 40 EEA. Indeed, an interpretation of Article 40 EEA to the

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[41] See *e.g.* Case C-98/01 *Commission v United Kingdom*, cited above; Case C-463/00 *Commission v Spain*, cited above; Joined Cases C-282/04 and C-283/04 *Commission v the Netherlands* [2006] ECR I-9141; C-112/05 *Commission v Germany* [2007] ECR I-8995. This line of cases is generally referred to as the "golden share" case law.

[42] See *e.g.* Case C-300/01 *Salzmann* [2003] ECR I-4899; Case C-370/05 *Festersen* [2007] ECR I-1129; Case C-567/07 *Woningstichting Sint Servatius* [2009] ECR I-9021; Case C-54/99 *Association Eglise de scientologie de Paris* [2000] ECR I-1335.

[43] See most recently Case C-171/08 *Commission v Portugal*, judgment of 8 July 2010 not yet reported, paragraph 50 and Case C-543/08 *Commission v Portugal* judgment of 11 November 2010, not yet reported, paragraph 47, and the case law cited therein.

[44] Case C-442/02 *Caixa Bank France* [2004] ECR I-8961, opinion of AG Tizzano, paragraph 58.

effect that changes in the ranking of claims in bankruptcy proceedings would constitute a restriction would nullify the effect of these rules coming within the scope of Article 125 EEA.

70. With reference to the above the Authority considers that, provided that the measures are non-discriminatory, as is the case here, EEA States may enact national legislation that grants deposit claims a higher ranking, and thus preferential treatment, compared to claims of other creditors in winding-up proceedings. It is, therefore, the view of the Authority that EEA States can, as a matter of principle, enact such general legislation without it constituting a restriction for the purposes of Article 40 EEA.

71. However, the issue arises whether the Emergency Act could nevertheless be regarded as involving a restriction on the free movement of capital in light of the timing of the measure. The changes to the insolvency order came into effect without prior stakeholder consultation and at a time when the consequences of the new regime were not just of a theoretical nature, but entailed immediate effects on the unsecured claims affected, both positive (as regards deposits) and negative (as regards other unsecured credits). To the Authority's knowledge, there is no case law from the Court of Justice or the EFTA Court to the effect that the timing, lack of transitional provisions, or the procedure for adoption of a measure that does not constitute a restriction, alter as such the classification of the measure into a restriction. To the extent that the measures come within the ambit of EEA law, these considerations are addressed under the principle of legal certainty.

72. As regards secondary legislation there exists no harmonisation of the ranking of claims at EEA level. The Winding-up Directive 2001/24/EC generally recognises that EEA States may rank creditors' claims on the estate of a bank in winding-up proceedings. According to Article 10(2) letter h of the Directive, the law of the credit institution's home EEA State shall determine, *inter alia*, "the ranking of claims".

73. In December 2007, the European Commission issued a report on a public consultation on the reorganisation and winding-up of credit institutions[45]. The report recognises that some Member States have granted certain creditors priority rights in accordance with the Directive[46]. The same report also reveals that in the context of the Winding-up Directive, some Member States have introduced priority rights relating to deposit claims[47].

74. The Insolvency Proceedings Regulation (EC) No 1346/2000 determines the jurisdiction for insolvency proceedings, but covers only to a limited extent substantive law questions. In particular the Regulation does not preclude EU Member States from adopting national legislation granting certain creditors priority rights against the assets of the estate of the bankrupt company. Moreover, credit institutions are not covered by the Regulation as explained in Recital 9 "*Such undertakings should not be covered by this Regulation since they are subject to*

[45] European Commission, Summary of the public consultation on the reorganisation and winding-up of credit institutions, December 2007. See: http://ec.europa.eu/internal_market/bank/docs/windingup/spc_en.pdf.
[46] Page 4 (point 11) and page 6 (point 23).
[47] Page 10 (points 50-52).

special arrangements and, to some extent, the national supervisory authorities have extremely wide-ranging powers of intervention."

75. In light of the above, the Authority takes the view that the changes made to the ranking order in insolvency proceedings under Articles 6 and 9 of the Emergency Act do not constitute a restriction of the free movement of capital.

76. The Authority will now examine the question of whether the FME measures based on Article 5 of the Emergency Act can be regarded as non-discriminatory restrictions under Article 40 EEA. The FME measures concern the splits between the existing assets and liabilities of the failed Icelandic banks into new banks and old banks. Any detrimental effect on the claims of the creditors is first and foremost a consequence of the change in the order of ranking in insolvency proceedings, which does not constitute a restriction on the free movement of capital.

77. If the old banks had insufficient assets to cover the deposits and other claims with priority, nothing would have been left for the other unsecured creditors. In such circumstances, the latter's position would not have been influenced by the transfer of assets.

78. However, even in a situation where there are enough assets to cover all prioritised claims and parts of the claims of unsecured general creditors, the latter creditors' coverage is not affected by the transfer of assets when the transferred liabilities and the financial instruments issued by the new entities to the old entities are taken into account.

79. The complainants have not contested the correctness of this view in principle but claim, firstly, that the FME measures must be seen in connection with the re-ranking measure. Secondly, the complainants contend that the new banks have not issued any financial instruments to the old banks to compensate for the net transfer of assets received when the new banks were created.

80. The Authority considers that the first issue raised by the complaints is dealt with in the preceding paragraphs.

81. As regards the second argument made by the complainants, the Authority notes that the process of compensating the old banks for the net transfer of assets was more complex than seemingly anticipated by the Icelandic authorities in October 2008. However, as referred to above in paragraphs 33, 34 and 35, agreements have in the meantime been concluded between the competent bodies of the new and old entities regarding the compensation foreseen by the FME measures in form of shares, bonds and future bonds.

82. Against this background, the Authority considers that the compensation of the old banks foreseen as part of the FME measures has been put into practice. Moreover, the method of compensating the old banks by means of financial instruments issued by the new banks does, as such, not amount to a restriction on the free movement of capital as it is designed to provide the unsecured creditors of the failed banks with the same recovery as they would have been entitled to under the Icelandic insolvency rules, as amended by the Emergency Act. On that basis, the question whether the methodology set out in the respective FME measures has since been applied correctly with regard to each of the banks concerned, goes beyond an

assessment whether the FME measures are restrictive of the free movement of capital within the EEA in that they are likely to discourage residents of one EEA State from moving capital to Iceland in the form of granting Icelandic banks unsecured credits.

83. Apart from the complexity involved in determining whether in practice the compensation accurately reflected the value of the assets transferred to the new banks, the Authority takes the view that issues regarding the correct implementation of the compensatory measures foreseen by the FME measures, both procedural and substantive, concern the lawfulness of the application of the FME measures (under national law) rather than the compatibility of the FME measures with Iceland's obligations under the EEA Agreement.

84. The Authority, however, recalls that the allegations raised by the complainants that Iceland has failed to comply with its obligations under the Winding-up Directive in respect of the failed banks (that is other than the alleged breach of the obligation of equivalent ranking of claims under Article 16 of the Winding-up Directive examined below) will be assessed separately at a later stage.

85. Accordingly, the Authority takes the view that the FME measures did not constitute non-discriminatory restrictions of the free movement of capital.

86. Based on all of the above, the Authority concludes that neither the changes made to the ranking order in insolvency proceedings under Articles 6 and 9 of the Emergency Act nor the FME measures based on Article 5 of that Act constitute non-discriminatory restrictions of the free movement of capital within the meaning of Article 40 EEA.

3.3 Justification

87. Having reached the above conclusion that the emergency measures do not constitute restrictions on the free movement of capital there is, in principle, no reason to examine possible justifications. Nevertheless the Authority has, for the sake of completeness, examined, on the assumption that the measures were regarded as restrictions, whether they would be justified. Article 40 EEA is essentially identical in substance to provisions under EU law prohibiting restrictions on the movement of capital in relations between Member States[48]. The EFTA Court, in determining whether restrictions can be justified, has held that the rules of the EEA Agreement governing the free movement of capital are essentially identical in substance to those in the TFEU. Consequently, national rules restricting the free movement of capital in the EEA may, as in EU law, be justified on grounds such as those stipulated in Article 65 TFEU (ex 58 EC) or on considerations of overriding public interest. In order to be so justified, the national rules must be suitable for securing the objective that they pursue and must not exceed what is necessary in order to achieve it, so as to accord with the principle of proportionality[49]. Deviations from the fundamental principles and freedoms of the EEA Agreement must be construed

[48] Case E-1/04 *Fokus Bank* [2004] EFTA Ct. Rep. 11, paragraph 23 with reference to Case C-452/01 *Ospelt and Schlössle Weissenberg*, cited above, paragraph 28.
[49] Case E-10/04 *Piazza* [2005] EFTA Ct. Rep. 76, paragraph 39 with reference to Case C-174/04 *Commission v Italy* [2005] ECR I-4933, paragraph 35.

narrowly and justification can only be accepted in the case of a *genuine and sufficiently serious threat affecting one of the fundamental interests of society*[50].

88. It is settled case law of the Court of Justice and the EFTA Court that mere economic grounds cannot serve as justification for restrictions to the fundamental freedoms[51]. However, that does not mean that restrictions, which are partially economically motivated are always impermissible. The Court of Justice and the EFTA Court have concluded that it is possible that the risk of seriously undermining the financial balance of a social security system constitutes an overriding reason in the general interest capable of justifying an obstacle to the freedom to provide services[52]. The Court of Justice has also concluded that this could apply with regard to the financial balance of other social policies such as social housing.[53] In his opinion in *Kohll* AG Tesauro explained the underlying rationale behind this finding as follows:

> *"So far as preserving the system's financial stability is concerned, let me begin by stating that this is, in my view, a requirement worthy of protection by Community law. While it is true that the Court has on occasion categorically dismissed economic aims put forward to justify indistinctly applicable measures (as well), [...] it is also apparent, on a closer reading of the relevant judgments, that economic aims are indeed justifiable, where far from being an end in themselves, they are crucial to the operation of the system in question [...] or affect interests of vital importance to the State. [...]*
>
> *From that point of view, I believe it is beyond dispute that the preservation of the financial stability of the social security system, which is indeed the essential aim of the measure in question, is not an end in itself but a means which contributes (at least) to providing insured persons with services of a certain standard in terms of both quantity and quality."*[54] (emphasis added)

89. Similarly, with reference to the reasoning below, the Authority considers that the objective of the emergency measures was not merely economic but rather to safeguard the functioning of the domestic banking system and the real overall economy in Iceland. The functioning of a country's banking system is of systemic significance for the proper functioning of the state's real overall economy and that of society. The existence of a banking system is of vital importance not only for the economy of the state but also for society as a whole, since payment systems of the country depend thereon. Therefore, the objective of the emergency measures is an overriding requirement in the general interest capable of justifying restrictions to the free movement of capital, provided that the measures taken can be regarded as proportionate to the attainment of the objective pursued.

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[50] See Case E-10/04 *Piazza*, cited above, paragraph 42; Case E-3/98 *Rainford-Towning* [1998] EFTA Ct. Rep. 205, paragraph 42.

[51] See, *e.g.* Case C-367/98, *Commission v Portugal* [2002] ECR I-4731, paragraph 52 and the cases cited therein; Case E-1/04 *Fokus Bank*, cited above, paragraph 33 and Case E-1/09 *the Authority v Liechtenstein*, not yet reported, paragraph 36

[52] Case C-158/96 *Kohll* [1998] ECR I- 1831, paragraph 41; Case C-157/99 *Smits and Peerbooms* [2001] ECR-I 5473, paragraph 72; Case C-385/99 Müller-Fauré [2003] ECR I-4509, paragraph 73; Case C-372/04 *Watts* [2006] ECR I-4325, paragraph 103; Joined Cases E-11/07 and 1/08 *Rindal and Slinning* [2008] EFTA Ct. Rep. 320, paragraph 55.

[53] Case C-567/07 *Woningstichting Sint Servatius*, cited above, paragraphs 30-31.

[54] Opinion of AG Tesauro paragraph 53.

90. The Icelandic emergency measures changing the ranking of creditors were taken in extreme circumstances entailing a real risk of a collapse of the whole Icelandic banking system. Depositors in Europe (and elsewhere) feared for the solvency of commercial banks, for the stability of the financial systems and for the safety of their deposits. The ability of deposit guarantee schemes to pay out deposits was questioned.

91. It was against this background that Articles 6 and 9 of the Emergency Act were intended by Iceland to enhance protection of depositors with the aim of safeguarding the functioning of the Icelandic domestic banking system. The purpose of the amendments can be seen as conveying to depositors the message that even in the worst case (insolvency of the affected banks), deposits would be safe and would not have to be withdrawn in an uncontrollable manner. The psychological importance of such reassurances for the overall domestic confidence in the functioning of the Icelandic banking system should, in the view of the Authority, not be underestimated.

92. In *Campus Oil* the Court of Justice considered, as regards petroleum supply, that petroleum products are of fundamental importance for a country's existence since not only its economy but above all its institutions, its essential public services and even the survival of its inhabitants, depend upon them. An interruption of supplies of petroleum products, with the resulting dangers for the country's existence, could therefore seriously affect the public security that the [ex EC] Treaty allows states to protect. The aim of ensuring a minimum supply of petroleum products at all times transcends purely economic interests[55]. Similarly, the Court of Justice has stated "... *the criteria at issue apply to common interests concerning, in particular, the minimum supply of energy resources and goods essential to the public as a whole, the continuity of public service, national defence, the protection of public policy and public security and health emergencies. The pursuit of such interests may, subject to observance of the principle of proportionality warrant certain restriction of the exercise of the fundamental freedoms*".[56]

93. The same reasons apply, in the view of the Authority, to the functioning of a country's banking system and the systemic significance of the banking system for the proper functioning of the state's real overall economy as well as the security of the general public and the functioning of society. The existence of a banking system is of vital importance not only for the economy of the state but also from a public security point of view, since the payment systems of the country depend thereon. Conversely, bank runs would lead to the collapse of these systems, which could potentially lead to the collapse of the whole economic system and jeopardise the functioning of society at large.

94. The Authority considers that the emergency measures can be seen as suitable for the attainment of the aim of safeguarding the functioning of the Icelandic domestic banking system. Giving depositors higher ranking in insolvency proceedings and the transfer of domestic deposits to the new banks contributed to rebuilding confidence of the domestic depositors in the safety of their deposits.

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[55] Case 72/83 *Campus Oil and Others* [1984] ECR 2727, paragraphs 34 and 35.
[56] Case C-326/07 *Commission v Italy* [2009] ECR I-2291, paragraph 45.

95. Further, the changes in the ranking order did not go beyond what was necessary in order to attain the legitimate aim. The Authority notes that confidence, in particular that of depositors, is of systemic importance for the functioning of any banking system. This justifies measures to protect depositors beyond the protection offered to other unsecured creditors, cf. also the discussion above regarding the comparability of the two groups. Moreover, it is the view of the Authority that equally suitable, but less restrictive, measures which the Icelandic authorities could have taken are not apparent. In particular, including a transitional provision providing that the Emergency Act and the measures taken on its basis did not affect existing obligations to unsecured creditors would have defeated the objective of the measures to safeguard the Icelandic banking system.

96. The proportionality of the emergency measures, both the Emergency Act and the FME measures, has to be considered against the background that, at the time these measures were taken, almost the entire banking sector in Iceland was on the brink of collapse. As described under paragraphs 22 and 30, the IMF found that Iceland's economy was in the midst of a banking crisis of extraordinary proportions.

97. Consequently, the measures taken by the Icelandic authorities were aimed at remedying a real and imminent danger of total collapse of the domestic banking system. Similarly, the Icelandic measures were designed to safeguard the functioning of the economy as such rather than the interests of individual depositors.

98. The success of the emergency measures depended largely on the credibility of the action taken. Measures taken to back up the Icelandic banks as a whole would probably have lacked the necessary credibility. In its budget for 2008, Iceland's total State revenue was estimated at ISK 460 billion. The deposits in the Icelandic banks alone were at the time of their collapse around ISK 2,800 billion, thereof the equivalent of ISK 1,600 billion in foreign currencies in the foreign branches of the banks. The foreign currency reserves of Iceland consisted of ISK 410 billion in October 2008, *i.e.* approximately 1/4 of deposits in the non-domestic branches. In comparison, according to publicly available information, the total credit claims against Glitnir, Kaupthing and Landsbanki accounted for ISK 13,597 billion by June 2008, see the table in paragraph 15.

99. The three banking groups covered by the measures taken under the Icelandic emergency legislation in October 2008, together, played a predominant role in the Icelandic banking sector both numerically and in terms of significance. In particular, and according to the Icelandic authorities, by October 2008, the total operations of Glitnir, Kaupthing and Landsbanki accounted for over 85% of retail banking in Iceland. Consequently, practically the entire payments systems of the country depended upon them. Almost every family and business in Iceland is said to have been a customer, holding debit and savings accounts with these banks. The Icelandic authorities claim that deposits with banks are not just savings; the current accounts are used by the bank's customers for their regular financial transactions. Limits in accessing such accounts would have instantly risked causing a full run on the banks with consequent serious risks for public security. Businesses could not have used funds to pay for their resources and to pay wages to employees; retail suppliers could not have imported necessities for the public, drugs and food etc; lawyers' trust accounts and other similar forms of deposits would have been non-operable with dire consequences. The general public would not have been able to access money deposited at the banks, *e.g.* proceeds from sales of real-estate, to finance the

purchase of a new home. Money could not have been withdrawn to honour large payment obligations to banks and other institutions. This would have increased the already existing risk of systemic financial collapse.

100. The complainants argue that there were other solutions available for the Icelandic authorities by referring to what other states have done (Sweden, Denmark, Germany, Ireland, the UK, Latvia and Asian central banks during the financial crisis in the 1990s). However, as the complainants to a certain extent also admit, the situation in Iceland was unique. There was not only one bank in trouble but three banks accounting for 85% of the banking operations in Iceland. The ratio between the Icelandic State revenue as referred to above and the banks' liabilities, both as regards deposits and other claims, clearly shows that the Icelandic situation was very different from the examples given by the complainants.

101. The Authority cannot agree with the complainants' view that, the Icelandic authorities could and should have relied on the Icelandic deposit guarantee scheme and that the Deposit Guarantee Directive shows that on 7 October 2008 any guarantee of depositors in excess of EUR 20,000 must have been unnecessary.

102. As stated above, the Deposit Guarantee Directive provides for minimum protection of depositors. Thus, the EEA Agreement does not preclude the Icelandic Government from granting depositors more extensive protection than laid down in the Directive. Such action was also taken by governments of other EEA States. For instance the Irish Government decided on 20 September 2008 to increase the statutory limit for the Irish deposit guarantee scheme for banks and building societies from EUR 20,000 to EUR 100,000 per depositor per institution[57]. Also the German Government issued statements in the beginning of October 2008 with the intention of enhancing depositor confidence outside the Deposit Guarantee Directive[58].

103. In addition it may be noted that the existing Icelandic scheme was far from sufficient to cover even domestic deposits. According to information from the Icelandic Government,[59] the Icelandic deposit guarantee scheme had assets for around ISK 11 billion in October 2008. In another letter[60], the Icelandic Government stated that per 30 September 2008, Glitnir, Kaupthing and Landsbanki had deposits from resident depositors of more than ISK 110 billion covered by the minimum amount of the Deposit Guarantee Directive.

104. The complainants point out that the Icelandic authorities could have taken action before October 2008 to prevent the crisis. As outlined extensively in the report of the Parliament Special Investigative Commission, the Icelandic authorities made numerous mistakes in the years and months before the crisis hit in October 2008[61]. However, these mistakes are not determinative for the legality of the emergency measures adopted.

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[57] http://www.finance.gov.ie/viewdoc.asp?DocID=5466

[58] http://www.bundeskanzlerin.de/nn_700276/Content/DE/Archiv16/Artikel/2008/10/2008-10-02-finanzmarktkrise-bk.html and http://www.bundeskanzlerin.de/Content/DE/Archiv16/Interview/2008/10/2008-10-02-merkel-bild-finanzmarkt.html

[59] Letter of 27 February 2009 (Event No: 510889), page 24.

[60] Letter of 26 May 2009 (Event No: 519778), page 2

[61] See *e.g.* chapter 19 of the Report on the actions taken by the Icelandic authorities in 2007-2008.

105. It is therefore the view of the Authority that on the assumption that the measures were restrictive of the free movement of capital within the meaning of Article 40 EEA, they would have been justified on the grounds of safeguarding the functioning of the Icelandic banking system. Moreover, the Authority considers that the emergency measures were proportionate to the objective to remedy a genuine and sufficiently serious threat to the domestic banking system, the functioning of which constitutes one of the fundamental interests of society.

3.4 Equivalent ranking of claims under Article 16 of the Winding-up Directive

106. The complainants claim that the emergency measures were incompatible with Article 16 of the Winding-up Directive. Article 16(2) requires that claims of an equivalent nature shall be accorded the same ranking irrespective of the domicile of the creditor.

107. The Authority recalls that the Winding-up Directive is mainly concerned with setting out certain procedural rules applicable to the winding-up of institutions with branches in more than one EEA State. Article 10(2) of the Directive provides that the law of the home State (in this case Iceland) shall determine the issues listed in sub-paragraphs (a) – (l). According to sub-paragraph (h), the law of home State determines the rules governing the distribution of the proceeds of the realisation of assets, the ranking of claims etc. As outlined above the Emergency Act changed the ranking of claims under Icelandic bankruptcy law.

108. As regards the allegation that the FME measures were in breach of the equivalent ranking obligation set out in Article 16 of the Winding-up Directive, the Authority refers to its examination above where it concludes that the emergency measures respected the equal treatment requirement of Article 40 EEA. In particular, claims of unsecured creditors are not regarded as being of an equivalent nature to deposit claims under Icelandic law. Unsecured creditors with domicile in Iceland have been treated in the same manner as the complainants under the FME measures. Consequently, the Authority considers the measures taken by the FME to be compatible with Article 16 of the Winding-up Directive.

109. The Authority recalls that it will separately examine further the issue of whether Iceland has complied with the transparency obligations laid down in the Winding-up Directive in Case No: 69055.

4 General principles of EEA law

110. The Authority will now examine the legal objections raised by the complainants with regard to alleged breaches of their right to property and of the principle of legal certainty.

4.1 The human right to peaceful enjoyment of possessions

111. The new ranking order established by the Emergency Act affected both existing and prospective creditors of Icelandic banks. In that respect, the complainants allege that the actions of the Icelandic authorities have unlawfully interfered with their right to peaceful enjoyment of their possessions according to Article 1 of the First Protocol to the European Convention on Human Rights ("the ECHR").

112. Although there is no express provision in the EEA Agreement corresponding to Article 11 TFEU (ex 6(2) EC), the EFTA Court has held that provisions of the EEA Agreement are to be interpreted in light of fundamental rights[62]. It follows from the case law of the Court of Justice that measures derogating from European Union law, such as a restriction of one of the fundamental freedoms, can only be justified insofar as they are compatible with a right guaranteed under the ECHR, which constitutes general principles of European Union law. Moreover, to the extent that national measures are not within the scope of European Union law, they cannot be reviewed under the general principles of European Union law.

113. The Authority considers that the legal situation is the same under the EEA Agreement. However, the EFTA Court has never indicated that the ECHR or fundamental rights could be relied upon as a supplementary, or altogether alternative, ground outside of the EEA Agreement. As the Authority concluded above that the emergency measures do not constitute a restriction caught by Article 40 EEA, any issue of whether the emergency measures are compatible with Article 1 of Protocol 1 ECHR does not come within the scope of EEA law. Consequently, the compatibility of the measures with the ECHR is not within the Authority's competence to examine. However, in the following, the Authority will briefly analyse the issue based on the hypothetical assumption that the measures do constitute a restriction on the free movement of capital.

114. It appears that there is no case law of the European Court of Human Rights concerning the ranking of claims in insolvency proceedings and thus it is not certain whether a priority ranking comes within the term "possessions", for the purposes of Article 1 of Protocol 1 to the ECHR. The same would apply *a fortiori* to the issue of whether the Article protects a certain class of creditors from another class being given priority ranking. Consequently, it would appear to be unclear whether the rights at stake are protected by the Convention.

115. However, assuming that general unsecured creditors' claims in insolvency proceedings are protected by Article 1 of Protocol 1 to the ECHR, and that the ranking measure resulted in a dramatic reduction of the unsecured general creditors' possibilities for coverage for their claims, it falls to be assessed whether the measures are compatible with the provision. It must be assessed whether three conditions, developed in the case law of the European Court of Human Rights, have been fulfilled: first, the measures must be based on an act of law; second, they must aim at meeting a public interest aim; and third, the measures must be proportionate in relation to the aim pursued.

116. The measures either originate from or have the provisions of the Emergency Act as legal foundation for administrative decisions and are thus based on law. The aim of the measures was to ensure the functioning of the Icelandic banking system, which must be considered to be a legitimate public interest aim. As regards the third condition, the Authority emphasises that the European Court of Human Rights has generally left a wide margin of appreciation for states in cases concerning Article 1 of Protocol 1 ECHR, in particular as regards economic and social policies[63].

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[62] See Case E-2/03 *Ásgeirsson* [2003] EFTA Ct. Rep. 52 paragraph 23; Case E-2/02 *Technologien Bau- und Wirtschaftsberatung and Bellona v EFTA Surveillance Authority* [2003] EFTA Ct. Rep. 236 paragraph 37.

[63] See *e.g. Mellacher and others v Austria* judgment of 19 December 2009 paragraphs 45-55; *Immobiliare Saffi v Italy* judgment of 28 July 1999, paragraph 49.

117. Above in section 3.3, the Authority has examined in detail the proportionality of the measures in relation to Article 40 EEA. The principle of proportionality is similar under Article 40 EEA on the one hand and Article 1 of Protocol 1 ECHR on the other. The cases referred to in the previous paragraph suggest that, if anything, the test is less stringent with regard to Article 1 of Protocol 1 ECHR. Therefore, the Authority cannot see any reason to deviate from its conclusion reached above regarding the proportionality of the emergency measures.

118. In the light of the above, the complainants' right to peacefully enjoy their possessions in accordance with Article 1 of Protocol 1 to the ECHR appears not to have been violated.

4.2 The principle of legal certainty

119. The complainants have also claimed that their legitimate expectations were breached contrary to general principles of law. The protection of legitimate expectations and the principle of non-retroactivity both form part of the principle of legal certainty, which is recognised as a general principle of EEA law[64]. As stated above, the general principles of EEA law are not applicable with regard to those measures of national law that do not come within the scope of EEA law. The Authority concluded above that the measures were not restrictive for the purposes of Article 40 EEA. Therefore, the Authority considers that the EEA principle of legal certainty is not applicable in the case under examination. However, in light of the complainants' submissions it will nevertheless briefly comment on the matter.

120. As regards the principle of legitimate expectations, the Authority notes that prior to the enactment of the emergency measures, there was no State action which could have made unsecured creditors believe that the Icelandic authorities would not make changes to the insolvency order for financial institutions, even in times of crisis.

121. Regarding non-retroactivity, the emergency measures did not take effect prior to their enactment. Thus, these measures had no effect for the past. They were, however, immediately applicable and thus affected past transactions, which still had effects. When reviewing Community measures, the Court of Justice has generally considered that immediate application requires justification by an overriding public interest consideration. On the assumption that such a test would be applicable to the emergency measures, the Authority considers that the result of its application would not lead to a different outcome from that reached in Section 3.3 above on justification.

5 Conclusion

122. There are, therefore, no grounds to pursue the cases further.

HAS ADOPTED THIS DECISION:

The cases arising from seven complaints against Iceland concerning alleged breaches by that State of the Articles 4, 36 and 40 of the EEA Agreement, of the Article 16 of the Act referred to at point 16c of Annex IX to the EEA Agreement (*Directive 2001/24/EC on the*

[64] Case E-1/04, *Fokus Bank*, cited above, paragraph 37; Joined Cases E-5/04, E-6/04, E-7/04 *Fesil ASA and others v the Authority* [2005] EFTA Ct. Rep. 121 paragraph 163.

reorganisation and winding up of credit institutions) and of general principles of EEA law are hereby closed.

Done at Brussels, 15 December 2010

For the EFTA Surveillance Authority

Per Sanderud
President

Sabine Monauni-Tömördy
College Member