

## **Icelandic Banks Update**

### **Purpose of report**

For discussion.

### **Summary**

This paper summarises the work done by the LGA in assisting member authorities to recover money from the failed Icelandic banks. It explains the consequences of the recent victory in the Icelandic Supreme Court, and sets out the further work that will be needed in order to enable authorities to realise their full entitlements from the Icelandic insolvencies.

### **Recommendation**

Members are asked to note the success of the work done so far and approve the continuing work programme.

### **Action**

Director of Finance and Resources

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## **Icelandic banks update**

### **Background**

1. In October 2008, some 145 local authorities, including councils, police and fire authorities, had just over £1 billion in total deposited with four Icelandic banks. These banks along with some other Icelandic banks collapsed on 6 and 7 October 2008, leaving authorities exposed to losses of uncertain amount. Local authorities' deposits were roughly broken down as follows:
  - 1.1 Heritable - £319 million;
  - 1.2 Kaupthing, Singer, Friedlander (KSF) - £86 million;
  - 1.3 Glitnir - £219 million;
  - 1.4 Landsbanki - £413 million.
2. Heritable and KSF are UK incorporated subsidiaries of Icelandic banks, so in these two cases the banks were put into administration under UK law, with insolvency partners from Ernst & Young appointed as Administrators of the banks. Glitnir and Landsbanki are incorporated in Iceland and consequently their operations in London are subject to Icelandic rather than UK insolvency procedures. In these cases the Icelandic government appointed Resolution Committees to manage the affairs of the failed banks. For various reasons the banks were not immediately placed into formal insolvency proceedings, but when they were, on 22 April 2009, Winding Up Boards (WUB) were appointed and these Winding Up Boards are responsible for the conduct of dealings with creditors and for the orderly payment of money recovered from the insolvencies in satisfaction of creditors' claims.
3. From the outset, the LGA has sought to provide maximum support to member authorities affected by the collapse of the Icelandic banks. Our support work has included:
  - 3.1 making representations to Government for assistance to assist authorities in managing the immediate consequences of the collapse of the banks;
  - 3.2 dealing on all authorities' behalf with the massive media interest in the Icelandic banks story;
  - 3.3 giving evidence to the Parliamentary and Audit Commission investigations that followed the collapse;
  - 3.4 leading work to ensure that potential losses could be calculated and reported consistently in local authorities' accounts; and
  - 3.5 maximising local authorities' recoveries through the bank insolvency processes here and in Iceland.
4. All of this support was rapidly set up following the October 2008 collapse. Within the first six weeks a huge amount of work had been done and, in particular, a legal team had been recruited consisting of Bevan Brittan solicitors

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in the UK and Logos Legal Services in Iceland. The LGA convened a meeting of all local authority creditors which took place in November 2008. This meeting endorsed the principle of collective action on behalf of all LGA member authorities. It agreed to establish a Steering Committee of officers from a number of authorities to manage the work. The Steering Committee has continued to meet periodically throughout the last three years, and has approved a number of decisions that have been critical in the overall process of maximisation of recoveries.

5. It is often the case in an insolvency that most creditors will look for a swift return of what cash is available, and will take the view that it better suits their interests to recover some money quickly than to seek to maximise recoveries over a longer time period. The view was taken at a very early stage that this was not the best strategy for local authority creditors to pursue. In general terms, capital is much less costly for a local authority than for a private business, and cash flow is much more secure, so a longer term view could be taken. Furthermore, given the very large amounts of money at stake and the decision to take action collectively, local authorities have been in a position to exercise significant influence over the conduct of the insolvencies. The strategy followed has therefore been to:
  - 5.1 maximise our collective power as creditors;
  - 5.2 look to maximise long term rather than short term value for local authorities; and
  - 5.3 obtain the highest quality professional advice in support of our work.
  
6. This strategy has delivered many benefits for local authorities. For example, we have been able to maximise our creditor power through being able to vote local authority representatives (Nick Vickers of Kent County Council, Kevin Bartle of Haringey Council and John Harrison of Peterborough City Council) onto the statutory creditor committees of the Heritable and KSF administrations. Our representatives continue to provide input to the Administrators and have encouraged the adoption of approaches to the management of the ongoing business that will maximise long term value. As a result, we have seen the estimated outturns from the administrations rise from 70p – 80p in the pound to 86p – 90p in the pound in the case of Heritable; and from a minimum 50p in the pound to a range of 78p – 86p in the pound in the case of KSF. Each administration has already paid out interim distributions of more than 60p in the pound, and further dividends are being declared at regular intervals.
  
7. In the Landsbanki and Glitnir administrations, Icelandic law does not provide for formal representation of creditors on the Winding Up Boards or Resolution Committees, but we have been deeply involved in proceedings of the informal creditor committees that have been established, and have joined with various other public sector creditor groups (in particular, the UK Financial Services Compensation Scheme, the Dutch Central Bank and Dutch local authorities) on matters where our interests have been aligned. This resulted in the negotiation

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of arrangements in the Landsbanki administration for a deal between the bank and its successor bank in Iceland that was far superior to what had originally been on offer. The deal, finalised at the end of 2009, means that Landsbanki creditors will have the benefit of a 10-year debt instrument from the new Landsbanki worth a minimum of ISK 260 billion (around £1.4 billion) and with the possibility of uplift by a further ISK 92 billion (around £0.5 billion). In very broad terms, the deal with the successor bank is worth around £100 million to local authority creditors in Landsbanki.

**Local authorities' priority creditor status**

8. After the collapse of the banks in Iceland, the Icelandic government had to pass emergency legislation to ensure that confidence in the country's banking system could be restored. The legislation included new provisions that gave priority creditor status to depositors in the case of bank insolvencies.
9. It is this legislation that allowed local authorities to claim priority creditor status in the Glitnir and Landsbanki administrations and that has been tested in the recent Supreme Court hearings in Iceland. Not surprisingly, our and other depositors' claims to priority creditor status were challenged by other creditors, because our success comes at their expense and reduces their returns from the two administrations. Other creditors' returns in Glitnir reduce by around one-eighth from what they would have been if we had not enjoyed priority, but in the case of Landsbanki the impact is much more severe, potentially destroying almost all of the value of other creditors' claims. Overall, we estimate that the difference in value for local authorities between winning and losing the depositor priority litigation could be as much as £470 million.
10. The cases were therefore fought with great intensity, and the final trials in the Supreme Court followed initial mediation proceedings in early 2010 and trials in the Reykjavik District Court earlier this year. Stephen Jones and Nick Vickers from Kent County Council attended all these proceedings and Stephen gave evidence at the Glitnir mediation proceedings which were conducted in English. The trials were of course conducted in Icelandic. There had been some uncertainty in Icelandic legal opinion about whether local authorities were entitled to depositor priority and so, whilst in Landsbanki we were seeking to ensure that an initial favourable decision on the status of our claims was upheld, in Glitnir it was necessary for us to appeal against an initial adverse decision by their Winding Up Board. Opposing both us and the Landsbanki Winding Up Board were no fewer than five distinct groups of other creditors representing international bondholders, international banks, local Icelandic bondholders, Landsbanki's subsidiary in Guernsey and Deutsche Bank Trust company of America. Cases involving the Financial Services Compensation Scheme, the Dutch Central Bank and Dutch local authorities were heard alongside our appeals. At the final hearings in the Supreme Court, the Court ordered that each trial would concentrate on different aspects of the argument. We therefore co-operated with other members of the wider depositor group to share legal

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expertise. For example, we had done a great deal of work to address challenges made by our opponents that the depositor priority law was either unconstitutional within the terms of the Icelandic Constitution, or was in breach of the European Convention on Human Rights. These issues were tried by the Supreme Court through one of the other hearings but we shared the benefits of our legal work in order to assist the FSCS and Dutch Central Bank. The UK local authority trials covered the basic issue of whether wholesale deposits are 'guaranteed deposits' enjoying priority under the new Icelandic legislation. There was also a subsidiary issue about whether, if a local authority's deposit had matured between the collapse of the banks in October 2008 and the commencement of winding up on 22 April 2009, the claim could include interest after the date of maturity and, if so, at what rate.

11. The trials in the Supreme Court took place in September, and the Court's decisions were announced on 28 October. The Court, which had sat with a panel of seven judges, decided by a 6-1 majority that:
  - 11.1 local authorities' claims are deposits that qualify in full for priority in the bank administrations;
  - 11.2 in the case of Landsbanki, no interest is added to claims that mature in the 'gap' period between maturity and 22 April 2009;
  - 11.3 in the case of Glitnir, where the WUB had allowed contractual interest on deposits maturing in the 'gap' period, the WUB's decision on interest will be allowed to stand;
  - 11.4 each party will bear their own legal costs associated with the appeals to the District Court and the Supreme Court.
12. These decisions are now final and there is no further right of appeal.
13. This result is a massive victory for local authorities and reflects great credit on our legal team, in particular Virginia Cooper of Bevan Brittan LLP, our UK counsel Matthew Collings QC and Jason Coppel and our Icelandic advocate Olafur Eiriksson hrl.

**Next steps**

14. Now that the Courts have determined that local authorities' deposits qualify for priority, we expect that the Winding Up Boards will apply the same decisions to cases other than the test cases selected for the litigation.
15. In the case of Glitnir, sufficient cash has already been realised in the Winding Up to allow for priority creditors' claims to be met immediately and in full. However, the Winding Up Board will need to take decision on the rates of exchange to be adopted in paying out distributions and the currency of payment. At present, Glitnir holds cash and government bonds denominated in a range of currencies including sterling, the US dollar and the Euro; but funds are also held in Icelandic kronur. The kronur cannot be converted into sterling

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or other international currencies without the permission of the Central Bank of Iceland, and it is likely that around 10 per cent of local authorities' entitlement will fall to be paid out in kronur. The Winding Up Board will therefore need to take decisions about the way in which priority creditors are paid out, and these decisions will either need to be accepted by other creditors or, if not accepted, referred to the Icelandic Courts for further rulings. Local authorities' approach to these issues has yet to be settled by the Steering Committee, but it is likely that we will wish to negotiate a way forward that is acceptable to the non-priority creditors as well as to authorities, so as to avoid the need for a further Court hearing.

16. The issues around conversion into sterling of the part of the recovery proceeds that is paid out in Icelandic kronur will need to be resolved by discussion with the Central Bank of Iceland. Whether and on what terms conversion might be allowed is not yet known.
17. It is proposed that these matters are taken forward by the LGA on behalf of local authority creditors that are currently in membership of the LGA, the WLGA or COSLA. This service will not be offered to authorities that are not currently in membership or to any authorities that leave membership before the matter is finally resolved.
18. The position in Landsbanki is similar in principle, but there are two important differences:
  - 18.1 cash held and available for distribution to priority creditors currently comprises only around one-third of the total assets: other assets held by the Winding Up Board are not readily convertible into cash and it will take a number of years for them to be realised; and
  - 18.2 around 5 per cent of the available cash is held in kronur.
19. Continuing involvement with the Landsbanki insolvency process will therefore be essential in order to maximise the total value of recoveries and ensure that sterling proceeds are made available to local authorities as quickly as possible. It is proposed that the LGA service in monitoring the insolvency and negotiating with the Winding Up Board and other creditors is restricted to authorities that are in membership of the LGA, the WLGA or COSLA.
20. The total costs of the litigation are expected to amount to around £3.7 million (£2 million for Landsbanki and £1.7 million for Glitnir). These costs, and other external costs related to input into the insolvency processes, are shared between the affected authorities. LGA officer time and input is not charged out.

**Recommendation**

21. Members are recommended to note the successful conclusion of the Icelandic litigation and to approve the provision of continuing support for authorities on the basis set out in this report.