

From: "Flanagan, Mark Joseph" <MFLLANAGAN@imf.org>
Date: Tue, 14 Apr 2009 19:01 EDT
To: <indridi.h.thorlaksson@fjr.stjr.is>,
"Rozwadowski, Franek J." <FROZWADOWSKI@imf.org>
Cc: <svavar.gestsson@utn.stjr.is>, Huginn Þorsteinsson@huginn.thorsteinsson,
<Huginn_þorsteinsson@huginn.thorsteinsson>,
<steingrimur.j.sigfusson@fjr.stjr.is>
Subject: Re: Icesave negotiations

Dear Indriði:

Thank you for the update on the status of the Icesave negotiations.

First, let me say that I know that these negotiations are a very sensitive issue in Iceland, and that bringing them to a conclusion will take some time. This does remain a crucial issue for the review, however, and it will be very difficult to have it forward until there is some agreement between the Icelandic authorities and the U.K. and Dutch.

We of course would like to expedite matters, but the Fund cannot be directly involved in these bilateral negotiations. We can provide information to both sides, and I want you to know that we have already explained to your negotiation counterparts that the new information on Iceland's external debt burden leaves less room for maneuver than we had previously thought as regards the terms and conditions of loans. We can also encourage both sides to talk, and we did so when we were approached last week by your counterparts about your new proposal (their initial reaction was more negative).

We would have no objection to the new proposal if the U.K. and Dutch are willing to sign on. I can certainly see that it addresses your political constraints. There are some issues that we would raise with you, for instance does this put you into a position of budgetary control of Landsbanki, (1) and how do you reach the determinations of numbers and the pace of asset recovery, but these are matters separate from your negotiations. And of course we are willing to answer any questions that the Dutch and U.K may have for us, but I have to reiterate that we cannot become involved in the negotiations or try to influence them.

However, I hasten to add that I see stumbling blocks to a positive conclusion. I am not at all surprised by the Dutch and U.K.'s reserved reaction. A number of legal issues are already apparent to us. Can Landsbanki enter into new debt or collateralization agreements given that it is under moratorium? How will other creditors react, and if there are lawsuits, how will this affect your proposed amortization schedule?(2) The U.K. and Dutch may not want this additional risk without a government guarantee (but if you provide a guarantee the difference between the new and the old proposal fades away). Working these issues out would take time, and this may delay the review.

In sum, while we have no problem with your pursuing the new approach, we also think that you should stay open to the original route of a loan. In this context, we do think that something approximating Paris club terms could work from a debt sustainability perspective (that is, 12+ years

maturity, 5 years grace, and an interest rate at cost of funds plus 150 basis points). This could also lead to a solution more quickly. And in the end, there must be a way to explain a loan to the Icelandic population and calm sensitivities; after all the loans would still largely be paid by asset recovery.

I look forward to discussing this further with you at the IMF's Spring Meetings, and am at your disposal if you wish to talk about it today or tomorrow.

Best regards
Mark Flanagan

Endnotes:

(1) This would activate the Funds "lending into arrears" policy, implying that we should have to assess, at each review, whether a good faith effort was being made in negotiations with creditors of the old banks.

(2) The fact that the new proposal would require a valuation of assets sets up another avenue of valuation disputes with the bondholders who might claim that undervaluation is stripping them of any recovery.

-----Original Message-----

From: indridi.h.thorlaksson@fjr.stjr.is

[mailto:indridi.h.thorlaksson@fjr.stjr.is]

Sent: Mon 4/13/2009 9:29 AM

To: Rozwadowski, Franek J., Flanagan, Mark Joseph

Cc: svavar.gestsson@utn.stjr.is; Huginn Porsteinsson@huginn.thorsteinsson, steingrimur.j.sigfussor@fjr.stjr.is

Subject: Icesave negotiations

Dear Mark, dear Franek

I wish to inform you on the status on the Icesave negotiations and seek your advice and possible assistance as regards the relations to the UK and Netherlands authorities and the Fund.

We have prepared a proposal for a new solution to the Icesave problem, different from the earlier discussed loan agreement. I indicated the new approach to Franek some time ago and it is set out in the attached copy of letter to the UK and Netherlands ministries of finance.

Our aim with the new approach is to avoid increasing the governmental debt and interest payments over the next years. We further believe that the new approach facilitates to take into account the shared responsibility of the European states for inadequate rules on deposit insurance and the financial market as well as the damages done by improper and detrimental action of the UK government (application of terrorist law and the freezing order) that has recently been clearly documented in the report of House of Commons, Treasury Committee on the Banking Crisis: The Impact of the Failure of the Icelandic Banks.

I am leaving for Copenhagen for a meeting with representatives of the UK and Netherlands and possibly Germany. So far we have no firm sign from these countries as regards our proposal other that they are willing to give it a consideration. However we notice a hint of a intimidation in their comments to our proposal (If your idea is not feasible i.e. does not give same or better legal certainty outcome for lenders, then we need to work fast on delivering Iceland's IMF commitment before the upcoming IMF

Review that they will use the IMF review as a pressure to produce a advantageous results on their behalf.

I am communicating this information to you in the expectation that you possibly can influence the UK and Netherlands authorities favourably and to inform you that a loan agreement along the previous lines (increased governmental debt) would be politically impossible to accomplish before the election on April 25 and possibly very difficult for a considerable period of time after the elections, in particular because of the aforementioned British report that has revived the discussion (and emotions) on the damaging action of the British government.

I hope you will be able to considerate the issue. I can be reached Tuesday and Wednesday at e-mail inhauth@mac.com and tel: +3548634332

With best regards

Indriði H. Þorláksson