Icelandic Icesave negotiation team

February 25, 2010 Icelandic Icesave offer to UK-NL

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Abstract. Confidential Feb 25 offer (conveyed around 10AM, GMT) from the Icelandic Icesave negotiation team to their British and Dutch counterparts. Iceland agreed to cover all monies associated with the UK-NL Icesave payouts, but forcefully objects to a 2.75% "profiteering" fee demanded by UK-NL over and above base interest rates.

Key Points

In summary, and leaving aside the question of Iceland´s legal obligation in this matter, this is what Iceland proposes:

-Iceland will ensure that the full amount expended by the United Kingdom and the Netherlands to pay Icesave depositors in each of those countries (up to the EUR 20,887 minimum provided for in accordance with the EU Deposit Guarantee Scheme) is recovered by the Governments of those two countries.

-Iceland will, in addition, reimburse the United Kingdom and the Netherlands for the reasonable time value of the funds expended for this purpose until recovered by those Governments.

We think it unwise, however, to encourage the perception that this arrangement would, in effect, return a profit to the Governments of the United Kingdom and the Netherlands for the monies expended to repay depositors in those countries at the expense of the Icelandic taxpayer. The last communication from the British and Dutch negotiators proposed that Iceland pay a margin (in effect, a profit element) of 2.75 percentage points above the cost of the funds expended for this purpose for the last four years of the six-year loan.

To set this in context, the current cost of funds for pounds sterling (for a six month LIBOR deposit) is approximately 0.9% per annum. The proposal put forward by the British and Dutch negotiators on February 19, 2010 -- purportedly as their "final and best" offer -- sought a margin of 2.75% on top of the cost of funds rate. In other words, that proposal sought to recover a profit component of more than three times the current base rate.

Taking into account the concession of a two-year interest holiday in years 2009 and 2010 (which we estimate will represent approximately ISK 20 billion cost to the United Kingdom and the Netherlands (based on prevailing LIBOR/Eurobor rates)), just the 2.75% margin element until the loan is fully repaid in accordance with your proposal would, we estimate, add ISK 110 billion to the total bill. The net profit to the United Kingdom and the Netherlands under that proposal is therefore approximately ISK 90 billion.

And to set these figures in context, the additional return to the taxpayers of the United Kingdom and the Netherlands equates to a further contribution of approximately ISK 280,000 from each citizen of Iceland (equivalent to approximately EUR 1,600).

In the resolution of this regrettable affair, we believe that all three Governments should be seen as acting with restraint and balance.

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* Structure: TIF Loan Agreement

Bullet maturity -- June 5, 2016

* Outstanding balance of loan to accrue interest, commencing January 1, 2012, at the following per annum rates:

2012 2.50%
2013 2.75%
2014 3.00%
2015 3.25%

2016 (until June 5) 3.50%

*   On June 5, 2016, the entire outstanding balance of the loan (remaining principal plus accrued interest) will become the "Shortfall" covered by the Shortfall Indemnity Agreement (in the form previously supplied).

Iceland would be prepared to prepay in cash the full anticipated amount of interest, discounted at an appropriate rate.