9. desember 2010

Samantekt samninganefndar á niðurstöðum viðræðna við bresk og hollensk stjórnvöld vegna Icesave

1. Með samkomulagi þeirra stjórnmálaflokka sem fulltrúa eiga á Alþingi var ákveðið í janúar sl. að lagt yrði í viðræður við bresk og hollensk stjórnvöld um uppgjör vegna Icesave-reikninga Landsbankans. Haft var samráð um skipun samninganefndar Íslands, og um umboð hennar í megindráttum.
2. Samninganefndina skipuðu Lee C. Buchheit lögmaður og sérfræðingur í alþjóðlegum lánasamningum frá bandarísku lögmannsstofunni Cleary, Gottlieb, Steen & Hamilton í New York, Guðmundur Árnason ráðuneytisstjóri í fjármálaráðuneytinu, Einar Gunnarsson ráðuneytisstjóri í utanríkisráðuneytinu og hæstaréttarlögmennirnir Jóhannes Karl Sveinsson og Lárus Blöndal, hinn síðarnefndi tilnefndur sameiginlega af flokkum utan ríkisstjórnar.
3. Með samninganefndinni störfuðu náið um lengri eða skemmri tíma þeir Andrew Speirs fjármálaráðgjafi frá Hawkpoint lögfræðistofunni, Nigel Ward lögmaður frá Ashurst lögfræðistofunni, Kristján Andri Stefánsson sendiherra og Hrafn Steinarsson hagfræðingur frá efnahags- og viðskiptaráðuneytinu. Nefndin naut auk þess liðsinnis annarra innlendra og erlendra sérfræðinga og ráðgjafa.
4. Samskipti hafa verið milli samninganefndar Íslands og fulltrúa breskra og hollenskra stjórnvalda síðan í febrúar. Samningaviðræður fóru fram í Lundúnum í febrúar sl. og fram að þjóðaratkvæðagreiðslu um frambúðargildi laga nr. 1/2010, sem fram fór 6. mars sl., en nokkurn tíma tók eftir það að koma á virkum samskiptum á ný. Samningsaðilarnir funduðu í Reykjavík í byrjun júnímánaðar og aftur í Haag í byrjun september. Að auki hafa farið fram nokkrir óformlegir fundir, en samskipti hafa að öðru leyti verið í síma og í gegnum tölvuskeyti.
5. Samninganefndirnar náðu í gær saman um samningsniðurstöðu sín í milli og voru samningsdrög árituð í Lundúnum í gær, 8.desember. Af Íslands hálfu voru samningadrögin árituð af öllum fimm samningarnefndarmönnum Íslands, ásamt stjórnarformanni Tryggingasjóðs innstæðueigenda og fjárfesta, sem á aðild að samningunum. Rétt er að árétta að áritunin jafngildir ekki undirritun samninga, heldur er með árituninni eingöngu staðfest að fengin sé niðurstaða í samningaviðræðurnar. Endanleg undirritun og skuldbinding af Íslands hálfu bíður þess að Alþingi hafi veitt til þess nauðsynlegar heimildir.
6. Samninganefndin hefur í dag lagt áritaða samninga fyrir formenn og fulltrúa allra þeirra flokka sem stóðu að því að veita henni umboð sitt til samningaviðræðna, ásamt því að afhenda þeim drög að frumvarpi til laga ". . . um heimild til handa fjármálaráðherra til að staðfesta samninga, sem áritaðir voru í Lundúnum, 8. desember 2010, um ábyrgð á (a) endurgreiðslu Tryggingarsjóðs innstæðueigenda og fjárfesta til breska og hollenska ríkisins á kostnaði af greiðslu lágmarkstryggingar til innstæðueigenda í útibúum Landsbanka Íslands hf. í Bretlandi og Hollandi og (b) á greiðslu eftirstöðva og vaxta af þeim skuldbindingum."

Þar með hefur samninganefndin lokið hlutverki sínu, a.m.k. hvað hina eiginlegu samningagerð varðar.

Um niðurstöðuna:

7. **Uppbygging samninganna.** Niðurstöður viðræðnanna gera í stórum dráttum ráð fyrir að í stað hefðbundinna lánssamninga verði gerðir endurgreiðslu- og skaðleysissamningar (e. Reimbursement and Indemnity Agreements) með aðild hlutaðeigandi ríkja og Tryggingarsjóðs innstæðueigenda og fjárfesta (TIF). Endurgreiðslusamningarnir eru um margt með öðru sniði en fyrri lánssamningar vegna uppgjörs lágmarkstryggingar við innstæðueigendur Landsbankans í Bretlandi og Hollandi. Þeir gera ráð fyrir að Tryggingarsjóður innstæðureigenda og fjárfesta endurgreiði breskum og hollenskum stjórnvöldum þær fjárhæðir sem þau hafa lagt út af því tilefni en fái í staðinn framseldan samsvarandi hluta krafna þeirra í bú bankans og annist um að innheimta þær. Gert er ráð fyrir að tryggingasjóðurinn nýti áður en til þess kemur þá fjármuni sem nú þegar eru til í sjóðnum til endurgreiðslu. Að því búnu verði greiðslur inntar af hendi jöfnum höndum eftir því sem úthlutað er úr búi Landsbankans allt til loka júnímánaðar 2016.

8. **Ábyrgð ríkisins** er takmörkuð eins og kostur er og í raun eingöngu bundin við (a) samtímagreiðslur vaxta fram til júní 2016 og (b) þann hluta sem ekki hefur verið innheimtur úr búi bankans að þeim tíma liðnum.

9. **Vextir.** Vaxtaákvæði hinna nýju samninga eru verulega frábrugðin samningsákvæðum í hinum fyrri samningi.

- Í fyrsta lagi er samið um fasta vexti fram á mitt ár 2016. Vextirnir eru 3,0% á hinum hollenska hluta lánanna, en 3,3% vextir á hinum breska hluta (2/3). Meðalvextir eru eru því 3,2%.
    - samið er um að engir vextir skuli reiknast á skuldbindinganar fyrr en eftir 1. október 2009 (jafngildir 9 mánaða vaxtahléi m.v. fyrri samning);
    - áfallnir vextir fyrir árin 2009 og 2010 eru greiddir í ársbyrjun 2011;
    - vextir eru greiddir ársfjórðungslega frá ársbyrjun 2011 til miðs árs 2016.

  Að teknu tilliti til vaxtahlés og áætlana um lækkun höfuðstóls samsvara áætlaðir vextir 2009 -2016 því að þeir væru að meðaltali 2,64% .

- Í öðru lagi er samið um að þær eftirstöðvar sem kunna að vera á lánunum eftir mitt ár 2016 gildi viðeigandi CIRR-vextir, eða útflutningslánavextir sem reiknaðir eru og birtir af OECD, án nokkurs vaxtaálags. Þeir vextir eru almennt hinir allra lægstu sem tíðkast í lánasamningum opinberra aðila.

10. **Efnahagslegir fyrirvarar.** Samið er um efnahagslega fyrirvara sem eru tvíþættir, en í þeim felst annars vegar að sett er þak á árlegar greiðslur úr ríkissjóði og hins vegar að

ef höfuðstóll eftirstöðva af skuldbindingu TIF verður hærri en tiltekin fjárhæð, lengist lánstíminn sjálfkrafa eftir júnímánuð 2016 í ákveðnu hlutfalli við þá fjárhæð sem þá stendur eftir.

- **þak á árlegar greiðslur** ríkisins eftir 2016 miðast við 5% af tekjum ríkisins á næstliðnu ári. Komi til þess að sú fjárhæð, sem það hlutfall ríkistekna jafngildir, verði lægri en 1,3% af landsframleiðslu skal hámark endurgreiðslna miðast við það hlutfall landsframleiðslunnar (1,3% af VLF jafngildir nú um 20 milljörðum króna).
- **lenging lánstíma** er ákvörðuð með þeim hætti að verði eftrstöðvar höfuðstóla af skuldbindingum TIF lægri en sem nemur 45 milljörðum króna greiðast þær að fullu innan 12 mánaða, þ.e. síðari hluta árs 2016 og fyrrihluta árs 2017. Fari svo að skuldbindingin verði hærri, lengist endurgreiðslutíminn um eitt ár fyrir hverja 10 milljarða króna, þó þannig að sú fjárhæð sem eftir stæði yrði greidd í lok 30 ára endurgreiðslutíma frá 2016 að telja.

Með framangreindum fyrirvörum má telja algjörlega tryggt að greiðslur vegna Icesave skuldbindingarinnar verði ávallt innan vel viðráðanlegra marka. Ólíklegt er að nokkru sinni muni reyna á framangreint þak á greiðslur, enda verði árleg greiðslubyrði langt innan þeirra.

11. **Lagaleg atriði.** Ýmis lagaleg atriði breytast Íslandi í hag frá fyrri samningum, svo sem gjaldfellingarákvæði, vanefndaúrræði, fjárhæðaviðmið og greiðslufrestir. Mestu varðar þó að úrlausn ágreiningsmála er flutt úr lögsögu breskra dómstóla og undir regluverk Alþjóðagerðardómstólsins í Haag. Færi svo að máli vegna samninganna yrði vísað til hans myndu aðilar tilnefna hvor sinn fulltrúann og fulltrúarnir síðan koma sér saman um oddamann. Þannig er tryggt að í málum er varða Ísland sitji ávallt aðili í gerðardóminum sem tilnefndur er af Íslandi.

Í samningsdrögunum er haldið inni sambærilegum ákvæðum og áður um samráð aðila gefi efnahagsleg staða á Íslandi tilefni til, skýrt er tekið fram að ákvæði um takmörkun friðhelgisréttinda hafi engin áhrif á eignir ríkisins sem njóta friðhelgi skv. Vínarsamningnum um stjórnmálasamband, þær eignir á Íslandi sem nauðsynlegar séu fyrir Ísland sem fullvalda ríki eða eigur Seðlabanka Íslands. Síðast en ekki síst er áfram sambærilegt ákvæði og fyrr um náttúruauðlindir.

12. **Kostnaður.** Samninganefndin hefur áætlað kostnað sem ætla má að falli á Ísland við framkvæmd samninganna. Við áætlunina er byggt á mati Skilanefndar Landsbankans á heimtum á eignum þrotabúsins, horfum á greiðslum til kröfuhafa eins og þær eru metnar af slitastjórn bankans, og reikniforsendum Seðlabanka Íslands varðandi þróun á gengi gjaldmiðla.

Niðurstaða matsins er að sá kostnaður sem falli á ríkissjóð verði innan við 50 milljarðar króna, eða rúm 3% af landsframleiðslu. Er þá tekið tillit til þess að búið væri að ráðstafa um 20 milljörðum króna af núverandi eigum TIF upp í skuldbindingarnar.

Framangreind niðurstaða felur í sér að það verði eingöngu vaxtakostnaður sem falli á ríkissjóð. Til greiðslu í byrjun næsta árs kæmu uppsafnaðir vextir, alls 26 milljarðar, þar af 6 milljarðar úr ríkissjóði, en greiðslur yrðu um 17 milljarðar á næsta ári og færu hratt lækkandi árin þar á eftir. Greiðslum yrði að fullu lokið 2016.

Miðað við núverandi forsendur um heimtur eigna þrotabúsins hefði kostnaður við fyrri samning numið yfir 180 milljörðum króna (um 162 milljarðar að teknu tilliti til eigna TIF). Margt gerir að verkum að kostnaður fer lækkandi, þar skipta mestu lægri vextir (vextir hafa haldist lágir á alþjóðamörkuðum) og styrking á gengi íslensku krónunnar frá því að kröfulýsingarfrestur í þrotabú Landsbankans rann út í apríl 2009, en kröfufjárhæðir eru miðaðar við gengi krónunnar á þeim tíma. Kostnaður svarar því til vel innan við þriðjung af fyrra kostnaðarmati.

13. **Áhættuþættir** vegna samninganna eru einkanlega þrír og þeir varða eignaheimtur þrotabús Landsbankans, tímasetningu á greiðslum krafna og gengisþróun.

Meiri vissa er nú en þegar málið kom síðast til kasta Alþingis um endurheimtur úr búi Landsbankans og skilanefnd bankans hefur nú náð fullu valdi á eignum hans í Bretlandi og Hollandi. Skilanefndin telur í skýrslu sinni til kröfuhafafundar 9. nóvember 2010 að úthlutun upp í forgangskröfur muni nema 86%. Mat á eignum hefur reynst raunhæft og varfærið. Hins vegar er ekki hægt að útiloka að þar gætu orðið ófyrirséðar breytingar á sem hafa myndu áhrif á það hversu mikið heimtist upp í kröfur. Eignaheimtur gætu orðið verri en nú er talið, en þær gætu jafnframt batnað.
Tafir á því að úthlutað sé úr þrotabúi Landsbankans myndu valda því að uppsafnaðir vextir á ógreiddan höfuðstól yrðu hærri. Það eru einkanlega mögulegar tafir á úrlausn dómsmála sem kynnu að valda slíkri frestun, en í því mati sem sett er fram að framan er byggt á núverandi mati slitastjórnar um útgreiðslur.

Loks hefur gengi íslensku krónunnar, og innbyrðis gengi annarra gjaldmiðla, áhrif á það, hver heildarkostnaður ríkissjóðs yrði. Sem áður segir hefur styrking krónunnar frá því í apríl 2009 haft þar áhrif til lækkunnar. Sú niðurstaða að heildarkostnaður ríkisins af Icesave-samningum verði um 47 milljarðar, byggir á reikniforsendum Seðlabankans sem fela í sér að gengi íslensku krónunnar muni fara hækkandi á komandi árum.

14. **Málsmeðferð**. Sem kunnugt er hefur Eftirlitsstofnun EFTA (ESA) stofnað til samningsbrotamáls á hendur íslenskum stjórnvöldum vegna Icesave-málsins. Ef samningar takast ekki um lausn málsins má búast við að það mál haldi áfram með hefðbundnum hætti, þ.e. með útgáfu rökstudds álits frá ESA og eftir atvikum málshöfðun fyrir EFTA dómstólnum. Sú málsmeðferð gæti tekið allt að tveimur árum. Ef niðurstaða yrði Íslandi í óhag gætu vaknað spurningar um skaðabótaskyldu ríkisins og sérstök vandkvæði vegna framkvæmdar EES samningsins í framhaldinu. Fyrir liggur að ESA muni fella niður áðurnefnt samningsbrotamál ef Íslendingar, Bretar og Hollendingar komast að samkomulagi um lausn Icesave-málsins.

Á grundvelli hins nýja samkomulags hafa verið gerð drög að frumvarpi til laga, sem kynnt hefur verið forsvarsmönnnum stjórnmálaflokka sem sæti eiga á Alþingi. Meginefni þess frumvarps er

fólgið í heimild til að staðfesta hina nýju samninga við bresk og hollensk stjórnvöld og áréttað að heimilt verði samkvæmt þeim að skuldbinda ríkissjóð til að mæta eftirstöðvum og vöxtum vegna krafna Hollendinga og Breta vegna greiðslu lágmarkstryggingar á reikningum í útibúum Landsbankans í Hollandi og Bretlandi.

Samningarnir voru áritaðir með upphafsstöfum samninganefndarmanna landanna í Lundúnum í gær, 8. desember 2010. Sem áður segir er áritunin er eingöngu til vitnis um þá niðurstöðu sem fengin er í viðræðum ríkjanna, en fyrir liggur að samningarnir verða ekki undirritaðir nema Alþingi hafi veitt samþykki sitt fyrir því að stjórnvöld takist þær skuldbindingar á herðar.

9 December 2010

Summary of the Negotiating Committee on the Outcome of Discussions with the UK and Dutch Governments concerning Icesave

1. Following an agreement between the political parties represented in the Icelandic parliament *Althingi* in January this year, a decision was taken to hold discussions with the UK and Dutch governments on a settlement concerning Landsbanki's Icesave accounts. Consultations were held on the composition of Iceland's negotiating committee and its general mandate.
2. The negotiating committee was comprised of Lee C. Buchheit, attorney and expert in international financial agreements, of the US law office Cleary Gottlieb Steen & Hamilton LLP in New York; Guðmundur Árnason, Permanent Secretary of the Ministry of Finance; Einar Gunnarsson, Permanent Secretary of the Ministry for Foreign Affairs; and Supreme Court Attorneys Jóhannes Karl Sveinsson and Lárus L. Blöndal; the latter was appointed jointly by the parties in opposition.
3. The negotiating committee was assisted by a number of internal and external experts and advisors, throughout by Andrew Speirs, financial consultant from the advisory firm Hawkpoint; attorney Nigel Ward from the legal office Ashurst; ambassador Kristján Andri Stefánsson; and economist Hrafn Steinarsson of the Ministry of Economic Affairs.
4. In addition to those states involved in the agreements, the Icelandic Depositors' and Investors' Guarantee Fund (TIF) is a party to them along with the Icelandic government. The Chairman of the Board of the TIF is attorney Guðrún Þorleifsdóttir of the Ministry of Industry and its general counsel is Eiríkur Elís Þorláksson, Supreme Court attorney.
5. Communications have been exchanged by the negotiating committee and representatives of UK and Dutch governments since February this year. Negotiating meetings were held in London in February this year and up until the referendum in Iceland on the validity of Act No. 1/2010, which was held on 6 March. Some time elapsed thereafter before active exchanges could recommence. The negotiating parties met in Reykjavík at the beginning of June and again in The Hague at the beginning of September. In addition, several informal meetings have been held. Apart from this communications have been conducted by telephone and e-mail.
6. Yesterday the negotiating committees reached agreement between themselves on an outcome to the negotiations, with draft agreements initialled in London yesterday 8 December. On Iceland's behalf the draft agreements were endorsed by all five of its negotiators, together with the Chairman of the Board of the Depositors' and Investors' Guarantee Fund (TIF), initialling them. It should be emphasised that this initialling is not equivalent to the signing of the agreements; rather, it merely confirms that an outcome has been attained in the negotiations. Final signing and acceptance of obligation on Iceland's part awaits the granting of the necessary authorisation by the *Althingi*.

7. The negotiating committee has today presented the initialled agreements to the leaders and representatives of all the parties who mandated the negotiations, together with a draft bill of legislation. "authorising the Minister of Finance to ratify agreements initialled in London on 8 December 2010, to guarantee (a) repayment by the Depositors' and Investors' Guarantee Fund to the UK and the Netherlands of cost incurred in payment of minimum guarantees to depositors in branches of Landsbanki Íslands hf. in the UK and the Netherlands, and (b) payment of outstanding amounts (the shortfall) and interest on these obligations."

The negotiating committee has thereby completed its task, at least as far as the actual drafting of agreements is concerned.

The Results

8. **Structure of the agreements.** Generally speaking, the results of the negotiations provide for the conclusion of Reimbursement and Indemnity Agreements, involving the states concerned and the respective TIFs, rather than traditional loan facilities. The Reimbursement Agreements differ in many respects from the previous loan agreements for settlement of minimum guarantees for Landsbanki's depositors in the UK and the Netherlands. They provide for the Icelandic TIF to repay to the UK and Dutch authorities the amounts which they advanced for this purpose, and to receive in return the corresponding portion of their claims against the bank's estate and handle their collection. Before this is effected, the Icelandic TIF is expected to utilise the funds it already possesses for reimbursement. Thereafter, payments will be made following distributions from Landsbanki's estate until the end of June 2016.

9. **Liability of the state** is limited as far as possible and in fact solely limited to (a) payment of interest as it accrues until June 2016, and (b) the portion which has not been recovered from the bank's estate after that time (the shortfall).

10. **Interest.** The interest provisions of the new agreements differ substantially from the contractual provisions of previous agreements.

- Firstly, the interest rate is fixed until mid-2016. Interest on the Dutch portion of the loan is 3.0% and 3.3% on the UK portion. The average interest rate is approximately 3.2%.
    - Under the agreements no interest is calculated on the obligations until after 1 October 2009 (equivalent to a 9-month interest holiday as compared to the previous agreement).
    - Accrued interest for 2009 and 2010 is paid at the beginning of 2011.
    - Interest is paid quarterly from the beginning of 2011 until mid-2016.

- In the second phase, under the agreement the interest on any outstanding principal on the loans after mid-2016 will be the appropriate Commercial Interest Reference Rates (CIRR), or documentary credit interest, as calculated and published by the

OECD, without any interest premium. These interest rates are generally the very lowest used in credit agreements between public parties.

11. **Macroeconomic provisos.** The agreement includes two macroeconomic provisos, which on the one hand place a ceiling on annual payments from the treasury and on the other hand extend the term of the loan automatically if the outstanding principal remaining of the TIF's obligations is higher than a specified amount, in proportion to the amount remaining.

- **Ceiling on annual payments** by the state after 2016 of 5% of Treasury revenue of the preceding year. Should the amount equivalent to this proportion of the state's revenue prove to be lower than 1.3% of GDP, the maximum repayment shall be based on this percentage of GDP (1.3% of GDP is currently equivalent to around ISK 20 billion).
- **Extension of the loan term.** If the outstanding principal of the TIF's obligations amounts to less than the equivalent of ISK 45 billion, this is to be paid in full within 12 months, i.e. in the latter half of 2016 and the first half of 2017. In the event that the outstanding obligation is higher, the repayment period is lengthened by one year for each ISK 10 billion, although with the limit that the amount outstanding must be paid by the end of a 30-year repayment period beginning in 2016.

The above-mentioned provisions are to ensure categorically that repayments of Icesave obligations will always be within quite manageable limits. It is unlikely that the above-mentioned ceiling on payments will in fact be tested, as the annual debt service will be well below this amount.

12. **Legal questions.** Various legal issues have been amended to Iceland's advantage from previous agreements, including acceleration clauses, default provisions, reference amounts and payment deadlines. Most significant, however, is that dispute resolution is transferred from jurisdiction of UK courts to that of the Permanent Court of Arbitration in The Hague. Should any issue concerning the agreements be referred to this Court, the parties would each appoint their representative and the representatives then agree on a third arbitrator. This means that, in cases concerning Iceland, one party on the arbitration committee will always be appointed by Iceland.

The draft agreements retain similar provisions as before concerning consultations by the parties, should the economic situation in Iceland give cause for such; it is clearly stated that limits on inviolable rights shall not affect those rights of the state which enjoy protection under the Vienna Convention on Diplomatic Relations, those assets in Iceland which are vital to Iceland as a sovereign state, or the assets of the Central Bank of Iceland. Last but not least, a similar clause as before is included on natural resources.

13. **Cost.** The negotiating committee has estimated the cost which Iceland can be expected to incur in implementing the agreement. This estimate is based on an assessment by Landsbanki's Resolution Committee of recovery of the estate's assets,

the outlook for distributions to creditors, as estimated by the bank's Winding-up Board, and assumptions of the Central Bank of Iceland concerning exchange rate developments.

The conclusion of this estimate is that the cost which will be borne by the Treasury will be less than ISK 50 billion, or just over 3% of GDP. This is assuming that some ISK 20 billion of the current assets of the TIF have been utilised for the obligations.

The above outcome implies that only interest cost will be borne by the Treasury. At the beginning of next year, payment will be made of accumulated interest, totalling ISK 26 billion, of which ISK 6 billion will come from the Treasury. The following year payments should be around ISK 17 billion, decreasing rapidly in subsequent years. Payments should be complete in 2016.

Based on the current assumptions for recovery of the assets from the insolvent estate, the cost of the previous agreement would have amounted to over ISK 180 billion (approx. ISK 162 billion if the assets of the TIF are taken into consideration). Due to a number of factors, the cost has been decreasing. Here lower interest rates are of most significance (interest rates have remained low on international markets) together with ISK appreciation since April 2009, as the amount of claims is based on the exchange rate at that time. The cost therefore is equivalent to less than one-third of the previous cost assessment.

14. **Risk factors** in the agreements are primarily three and concern the recovery of the assets of Landsbanki's estate, the timing of payment of claims and exchange rate developments.

The outlook for recovery from Landsbanki's estate is more certain now, however, than when this matter was previously dealt with by the *Althingi* and the bank's Resolution Committee has now acquired full control of its assets in the UK and the Netherlands. In its report to a creditors' meeting on 9 November 2010, the Resolution Committee estimated that distributions would cover 86% of priority claims. Valuation of assets has proven to be realistic and cautious. The possibility cannot be excluded, however, that unforeseen changes could occur which would affect recovery of the bank's claims. Asset recovery could be lower than currently anticipated, but it could also improve. Delays in making distributions from Landsbanki's estate could increase the amount of accumulated interest on the principal. It is, in particular, delays in resolving court disputes which could result in such postponement. The estimates provided above are based on the current assessment of the Winding-up Board regarding distributions.

Finally, the ISK exchange rate, and relative exchange rates of the various currencies concerned, also affect what the total cost to the Treasury may be. As previously mentioned, ISK strengthening since April 2009 has resulted in a reduction. The conclusion, that the state's total cost of the Icesave agreements will amount to around ISK 47 billion, is based on assumptions by the Central Bank which provide for further ISK appreciation in coming years.

15. **Infringement proceedings**. As is known, the EFTA Surveillance Authority (ESA) has issued a letter of formal notice to the Icelandic authorities for infringement of provisions of the EEA Agreement. Should no agreement be reached to resolve the dispute, this action can be expected to continue in the traditional manner, i.e. with the delivery of a reasoned opinion from ESA and, as the case may be, referral of the case to the EFTA Court. Such a procedure could last for up to two years. If the outcome were to be unfavourable to Iceland, questions could arise concerning the state's liability together with specific problems in the implementation of the EEA Agreement thereafter. It is established that ESA will withdraw the afore-mentioned action if Iceland, the UK and the Netherlands arrive at an agreement to resolve the Icesave dispute.

Based on this new agreement, a draft bill of legislation has been prepared, which has been presented to the leaders of the parties represented in parliament. The main substance of this Bill involves authorisation to endorse the new agreements with the UK and Dutch governments, confirming that in accordance with them the Treasury may be obliged to bear the cost of outstanding amounts and interest on claims by the British and Dutch for having advanced funds in payment of minimum deposit guarantees for accounts in Landsbanki's branches in the UK and the Netherlands.

The agreements were initialled by the countries' negotiators in London yesterday, 8 December 2010. As previously stated, this initialling merely attests to the outcome which has been obtained in negotiations between the countries. It is established that the agreements will not be signed unless the *Althingi* has given its consent for the government to undertake these obligations.

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Datum 9 december 2010
Betreft Stand van zaken onderhandelingen Icesave

Geachte Voorzitter,

Bij deze brief wil ik u de stand van zaken geven inzake het Icesave akkoord. De afgelopen maanden is regelmatig gesproken en onderhandeld met de IJslandse regering en vertegenwoordigers van de IJslandse oppositie. Dit werk heeft zijn vruchten afgeworpen en heeft geleid tot de parafering van een nieuw Icesave akkoord op het niveau van onderhandelaars. Over de inhoud van het geparafeerde akkoord kan ik u de volgende zaken mededelen:

1. Er zal volledige terugbetaling plaatsvinden van alle bedragen die door Nederland en het Verenigd Koninkrijk in het kader van het depositogarantiestelsel aan IJsland voorgefinancierd zijn om nationale spaarders bij Icesave tot het minimumbedrag te compenseren. Voor Nederland gaat het om 1,3 miljard euro.

2. IJsland betaalt Nederland een vaste rente van 3,0 procent, opgebouwd vanaf de uitstaande balans van 1 oktober 2009 tot 30 juni 2016. Deze rente dekt onze 'cost of funding'. Het Verenigd Koninkrijk ontvangt 3,30 procent rente. Dit verschil in rente is gerelateerd aan het verschil van de 'cost of funding' tussen Nederland en het Verenigd Koninkrijk.

3. De terugbetaling van de uitstaande balans van alle voornoemde bedragen (na verdeling van de boedeluitkeringen) zal beginnen in juli 2016. De terugbetalingsperiode wordt vastgesteld volgens een formule gebaseerd op de grootte van de (eventuele) uitstaande balans in 2016. Hoe groter het uitstaande bedrag op de balans is, hoe langer de terugbetalingsperiode zal zijn. De maximale periode voor terugbetaling mag niet verder gaan dan 1 januari 2046.

4. De hoogte van de rente op de uitstaande balans van de leningen in juli 2016 wordt bepaald aan de hand van de toepasselijke Commercial Interest Reference Rate (CIRR) voor de Pond sterling en de Euro op dat moment. CIRRs zijn de minimum rentes gepubliceerd door de OESO en toepasselijk voor exportkredieten uitgegeven door OESO-landen.

5. Het jaarlijkse bedrag (nominaal bedrag plus rente) dat IJsland terugbetaalt is gemaximeerd op 5 procent van de centrale IJslandse overheidsinkomsten van het voorgaande jaar. Bij een overschrijding van deze bovengrens wordt het resterende deel vooruitgeschoven naar het volgende jaar totdat het betaald kan worden binnen de bovengrens. Het jaarlijkse bedrag kan daarbij nooit lager zijn dan 1,3 procent van het IJslandse BNP.

Wij staan in het proces op een belangrijk moment. Alle IJslandse onderhandelaars, inclusief de onderhandelaars die aangewezen zijn door de IJslandse oppositie, hebben de overeenkomst geparafeerd. Naar verwachting zal nu op zeer korte termijn de benodigde machtigingswet naar het IJslands parlement gezonden worden. Indien het parlement de overeenkomst en de wet aanneemt en de President van IJsland zijn handtekening zet, verkrijgt de IJslandse regering daardoor mandaat voor het finaal tekenen van het akkoord. Het akkoord zal dan ook door de Britse en Nederlandse delegatie worden ondertekend.

Deze Icesave saga is nog niet tot een einde, maar het is van belang dat u op de hoogte bent van deze laatste stand van zaken. Ik hoop dat ik u spoedig kan mededelen dat het daadwerkelijk tot een akkoord gaat komen met IJsland inzake Icesave.

Hoogachtend,

De Minister van Financiën,

mr. drs. J.C. de Jager

REIMBURSEMENT AND INDEMNITY AGREEMENT

dated [*], 2010

among

The Depositors'and Investors' Guarantee Fund of Iceland

and

Iceland

and

The State of The Netherlands

This ***REIMBURSEMENT AND INDEMNITY AGREEMENT***, dated [**], 2010 (this "*Agreement*"), among **THE DEPOSITORS' AND INVESTORS' GUARANTEE FUND OF ICELAND** (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*), a private foundation incorporated under the laws of Iceland (the "*Guarantee Fund*"), **ICELAND** ("*Iceland*") and **THE STATE OF THE NETHERLANDS** ("*The Netherlands*" and, together with the Guarantee Fund and Iceland collectively, the "*Parties*").

RECITALS

WHEREAS, the Parties have entered into the Loan Agreement and the Acceptance and Amendment Agreement, which together set out the arrangements initially foreseen by the Parties in relation to the matters described in these Recitals. The Parties now wish to enter into this Agreement to settle those matters, and also to terminate the Loan Agreement and the Acceptance and Amendment Agreement, but conditional upon this Agreement coming into effect.

WHEREAS, the claims of Landsbanki Amsterdam Depositors against Landsbanki are guaranteed by the Guarantee Fund according and subject to Act No. 98/1999 which implements Directive 94/19/EC up to EUR 20,887 per Landsbanki Amsterdam Depositor.

WHEREAS, DNB has paid compensation to Landsbanki Amsterdam Depositors in respect of their claims against Landsbanki and the Guarantee Fund under Act No. 98/1999 in return for an assignment by such Landsbanki Amsterdam Depositors of such claims to DNB. DNB has accepted the majority of the applications for compensation and has completed making such compensation payments on 2 June 2009. DNB has refused the applications of a minority of Landsbanki Amsterdam Depositors for payment of compensation. Certain of these Landsbanki Amsterdam Depositors have opposed such refusal by DNB. DNB's refusal is subject to judicial review and it is uncertain on the date of this Agreement to what extent DNB may be ordered by a court to pay compensation in respect of these claims.

WHEREAS, The Netherlands has prefinanced the payment of compensation by DNB in respect of the claims of Landsbanki Amsterdam Depositors against Landsbanki and the Guarantee Fund under Act No. 98/1999 and related costs. The Parties have agreed that the Guarantee Fund shall reimburse The Netherlands for its prefinancing in accordance with the terms of this Agreement. In addition, in this Agreement, the Parties determine the amount for which the Guarantee Fund shall reimburse The Netherlands.

WHEREAS, the Parties confirm that this Agreement has been negotiated in accordance with the "Agreed Guidelines" of 14 November 2008 as agreed between Iceland and the member states of the European Union.

ARTICLE I
DEFINITIONS

Section 1.1 *Certain Defined Terms*. (a) As used herein, the terms defined in Schedule I shall have the meaning set out in that Schedule.

(b) For the purpose of the definitions of "Interest Proceeds", if any part of the Guarantee Fund Estate Proceeds shall be denominated in a currency other than euro and shall not

have been converted by the Guarantee Fund pursuant to paragraph (a) of Section 3.7, such amount shall be converted into euro at such rate as may be reasonably selected by The Netherlands.

Section 1.2 *Other Interpretative Provisions*. (a) The meanings of defined terms are equally applicable to the singular and plural forms of the defined terms.

(b) The words "hereof," "herein," "hereunder" and similar words refer to this Agreement as a whole and not to any particular provision of this Agreement, and any subsection, Section, Article and Schedule references are to this Agreement unless otherwise specified.

(c) The term "documents" includes any and all documents, instruments, written agreements, certificates, indentures, notices and other writings, however evidenced (including electronically).

(d) The term "including" is not limiting and (except to the extent specifically provided otherwise) shall mean "including without limitation."

(e) Unless otherwise specified, in the computation of periods of time from a specified date to a later specified date, the word "from" shall mean "from and including," the words "to" and "until" each shall mean "to but excluding," and the word "through" shall mean "to and including."

(f) The terms "may" and "might" and similar terms used with respect to the taking of an action by any Person shall reflect that such action is optional and not required to be taken by such Person.

(g) The term "continuation" of a Mandatory Prepayment Event shall reflect that such Mandatory Prepayment Event has occurred and has not been remedied and not been waived in accordance with Section 9.5.

(h) Unless otherwise expressly provided herein: (i) references to agreements (including this Agreement) and other documents shall be deemed to include all subsequent amendments and other modifications thereto, but only to the extent that such amendments and other modifications are not prohibited by any Relevant Document, and (ii) references to any Applicable Law are to be construed as including all statutory and regulatory provisions or rules consolidating, amending, replacing, supplementing, interpreting or implementing such Applicable Law.

ARTICLE II
REIMBURSEMENT, ETC.

Section 2.1 *Undertaking to reimburse*. In consideration of (a) the execution by DNB of the DNB Assignment Agreement, (b) the payment of compensation by DNB to Landsbanki Amsterdam Depositors in respect of their claims against Landsbanki and the Guarantee Fund under Act No. 98/1999 as referred to in the Recitals, and (c) the prefinancing by The Netherlands of the payment of such compensation by DNB, the Guarantee Fund undertakes to reimburse The

Netherlands for that prefinancing and to therefore pay to The Netherlands the Reimbursement Amount in accordance with the terms of this Agreement.

Section 2.2 *Reimbursement Amount*. The Parties agree, for all purposes under this Agreement and the other Relevant Documents, that the Reimbursement Amount as at the date of this Agreement shall be an amount of EUR 1,322,242,850 (one billion three hundred twenty two million two hundred forty two thousand eight hundred and fifty euro) and that the Reimbursement Amount may reduce from time to time in accordance with the terms of this Agreement.

ARTICLE III
PAYMENTS OF REIMBURSEMENT, COMPENSATION AND PAY-OUT COSTS

Section 3.1 *Payment of the Reimbursement*. (a) This Section 3.1 shall apply from the Second Phase Start Date and onwards.

(b) Subject to paragraph (d) below, the Guarantee Fund agrees to pay to The Netherlands the Second Phase Reimbursement Amount in consecutive Quarterly Installments, payable on each Reimbursement Payment Date.

(c) The number of and amount of Quarterly Installments shall be calculated as follows:

(i) if, as at the day immediately preceding the Second Phase Start Date, the aggregate of the ISK Equivalent of the Second Phase Reimbursement Amount and the ISK Equivalent of the UK Second Phase Reimbursement Amount is equal to or less than ISK 45,000,000,000, (A) the number of Quarterly Installments shall be four, and (B) the amount of each Quarterly Installment shall be the Second Phase Reimbursement Amount divided by four;

(ii) if, as at the day immediately preceding the Second Phase Start Date, the aggregate of the ISK Equivalent of the Second Phase Reimbursement Amount and the ISK Equivalent of the UK Second Phase Reimbursement Amount is more than ISK 45,000,000,000, (A) the number of Quarterly Installments shall be the lesser of (I) four plus an additional four for each ISK 10,000,000,000 (or portion thereof) by which that aggregate exceeds ISK 45,000,000,000, and (II) 118, and (B) the amount of each Quarterly Installment shall be the Second Phase Reimbursement Amount divided by the number of Quarterly Installments so determined;

(d) (i) notwithstanding paragraphs (b) and (c) above and subject to paragraph (iii) below, if on any Reimbursement Payment Date the aggregate of (A) the ISK Equivalents on that Reimbursement Payment Date of the Quarterly Installment payable on that Reimbursement Payment Date and the amount of compensation payable on that Reimbursement Payment Date pursuant to paragraph (a) of Section 3.2, and (B) the ISK Equivalents of the UK Quarterly Installment payable on or about that Reimbursement Payment Date and the amount of compensation payable on or about that Reimbursement

Payment Date pursuant to paragraph (a) of Section 4.2 of the UK Disbursement, Reimbursement and Indemnity Agreement, exceeds 1.25 per cent. of Relevant Icelandic Total Government Revenue in relation to that Reimbursement Payment Date, then (X) such aggregate shall be reduced by the minimum amount necessary to ensure that such aggregate no longer exceeds 1.25 per cent. of Relevant Icelandic Total Government Revenue in relation to that Reimbursement Payment Date, (Y) the amount of such reduction (expressed in Krónur) shall be attributed to The Netherlands and the HMT Commissioners in accordance with their respective *Pro Rata* Entitlements, and (Z) the amount of the Quarterly Installment referred to in item (A) above (and, if the *Pro Rata* Entitlement of The Netherlands exceeds the amount of such Quarterly Installment, the amount of compensation referred to in that item) will be reduced by the *Pro Rata* Entitlement of The Netherlands of such reduction (converted into euro at the rate used to calculate the ISK Equivalents referred to above).

(ii) Any amount by which a Quarterly Installment or any amount of compensation is reduced pursuant to paragraph (i) above will remain payable and will be added to the Quarterly Installment due on the next Reimbursement Payment Date (but that Quarterly Installment, thus increased, will be subject to the application of paragraph (i) above and accordingly will (subject always to paragraph (iii) below) only be payable if and to the extent payable pursuant to paragraph (i) above). Any amount by which an amount of compensation is reduced pursuant to paragraph (i) above will be deemed part of the Reimbursement Amount from the Reimbursement Payment Date on which, absent paragraph (i) above, that amount would have been payable in accordance with paragraphs (b) and (c) above, and compensation will accrue on it accordingly.

(iii) Paragraphs (i) and (ii) above shall not apply in relation to the Reimbursement Payment Date on which the last Quarterly Installment is due to be paid (as determined in accordance with paragraph (c) above) and the Quarterly Installment due on that Reimbursement Payment Date, any compensation due to be paid on that Reimbursement Payment Date and any amount payable on that Reimbursement Payment Date pursuant to paragraph (ii) above shall be payable on that Reimbursement Payment Date in full.

Section 3.2 *Compensation*. (a) The Guarantee Fund shall pay to The Netherlands compensation in respect of the Reimbursement Amount, (i) for the period from October 1, 2009 to the Second Phase Start Date, at the First Phase Rate, and (ii) for the period from the Second Phase Start Date onwards, at the Second Phase CIRR. Any such compensation shall continue to accrue, to the fullest extent permitted by Applicable Law, after as well as before any bankruptcy, insolvency, reorganization, liquidation, judicial or out-of-court reorganization proceedings, dissolution, arrangement or winding up or composition or readjustment of debts of the Guarantee Fund. For the avoidance of doubt, no compensation is payable in respect of any period prior to October 1, 2009.

(b) Notwithstanding the foregoing, the Guarantee Fund shall pay to The Netherlands compensation on any Defaulted Amount at the Arrears Rate. Any such compensation shall be compounded on each Payment Date with the amount in respect of which it has accrued.

(c) Accrued compensation on the Reimbursement Amount or any other amount shall be payable (i) in the case of compensation accrued to the first Payment Date (compounded with the amount in respect of which it has accrued on each date which would have been a Payment Date if the first Payment Date had been January 1, 2010 rather than January 1, 2011), on the first Payment Date, (ii) on each subsequent Payment Date, and (ii) in the case of any prepayment of any part of the Reimbursement Amount (whether voluntary or mandatory), on the date such part of the Reimbursement Amount is so prepaid (but such compensation shall be payable only to the extent accrued to the date of prepayment on the part of the Reimbursement Amount so prepaid), *provided* that compensation payable at the Arrears Rate on Defaulted Amounts shall also be payable from time to time on request by The Netherlands.

(d) Compensation accruing on the Reimbursement Amount or any other amount shall be computed on the basis of a year of three hundred and sixty five (365) days and actual days elapsed occurring in the period for which payable.

Section 3.3 *Optional Prepayments*. (a) The Guarantee Fund may prepay the Reimbursement Amount in whole or in part, *provided* that the Guarantee Fund (or Iceland on its behalf) shall give The Netherlands notice of such prepayment as provided in Section 3.4 and, upon the date specified in such notice, the amount to be prepaid and any compensation payable thereon in accordance with Section 3.2 shall become due and payable under this Agreement. Amounts prepaid under this Agreement may not be re-claimed.

(b) At the same time as making any optional prepayment in accordance with paragraph (a) above, the Guarantee Fund shall make a *pro rata* optional prepayment of the UK Reimbursement Amount then outstanding under the UK Disbursement, Reimbursement and Indemnity Agreement, such that the same proportion of the Reimbursement Amount and the UK Reimbursement Amount then outstanding is prepaid under this Agreement and under the UK Disbursement, Reimbursement and Indemnity Agreement respectively (subject to any rounding).

(c) Any prepayment of any amount of the Reimbursement Amount pursuant to paragraph (a) above shall, subject to paragraph (b) of Section 3.7, reduce the Reimbursement Amount by the amount of the prepayment and shall, if made on or after the Second Phase Start Date, be applied *pro rata* towards each of the remaining Quarterly Installments.

Section 3.4 *Certain Notices*. A notice of prepayment pursuant to paragraph (a) of Section 3.3 above shall be effective only if received by The Netherlands before close of business (Amsterdam time) on the date which is three (3) Business Days before the date of such prepayment. Each notice of prepayment shall specify the amount to be prepaid and the requested prepayment date (which shall be a Business Day).

Section 3.5 *Mandatory Prepayments and other payments out of Guarantee Fund Estate Proceeds*. (a)

(i) If the Guarantee Fund receives any Guarantee Fund Estate Proceeds, it shall within five (5) Business Days pay to each of The Netherlands and the HMT Commissioners its *Pro Rata* Entitlement to that amount (such payment, to the extent to

be made to The Netherlands, to be made in the currency required under Section 3.7 and, to the extent to be made to the HMT Commissioners, to be made in the currency required under the UK Disbursement, Reimbursement and Indemnity Agreement), *provided* that the Guarantee Fund shall not be obliged to make such payment (i) if, to the extent and for as long as the terms under which the payment made to the Guarantee Fund and resulting in receipt by the Guarantee Fund of the relevant amount prohibits the Guarantee Fund from applying that amount towards any payment to any other Person, or (ii) if and to the extent that the Guarantee Fund is required to pay the relevant amount to DNB under the DNB Assignment Agreement, or to the FSCS under the FSCS Deed of Assignment or the UK Settlement Agreement.

(ii) Any amount received by The Netherlands out of Guarantee Fund Estate Proceeds (whether pursuant to (x) paragraph (i) above, (y) paragraph 2.4 of the DNB Assignment Agreement, or (z) paragraph (a)(i)(A) of Section 4.7 of the UK Disbursement, Reimbursement and Indemnity Agreement) shall be applied:

(A) at any time before the Recovery Percentage is less than 86, in prepayment of the Reimbursement Amount; or

(B) at any time after the Recovery Percentage is less than 86:

(1) first, in payment to The Netherlands of such amount as is necessary to ensure that, after such application, the NL Interest Share Receipts equal the NL Interest Share at that time; and

(2) second, in prepayment of the Reimbursement Amount.

(iii) Any prepayment of any amount of the Reimbursement Amount pursuant to this paragraph shall, subject to paragraph (b) of Section 3.7, reduce the Reimbursement Amount by the amount of the prepayment and shall, if made on or after the Second Phase Start Date, be applied *pro rata* towards each of the remaining Quarterly Installments.

(b) If any of the following events (each such event a "*Mandatory Prepayment Event*") occurs, then on and at any time during the continuation of that Mandatory Prepayment Event The Netherlands may by notice to the Guarantee Fund, with a copy to Iceland, declare the Reimbursement Amount, any compensation accrued thereon and all other amounts payable by any Reimbursement Party under this Agreement or any other Relevant Document to be immediately due and payable, whereupon such amounts shall be immediately due and payable without presentment, demand, protest or other formalities of any kind, all of which are hereby expressly waived by the Reimbursement Parties:

(i) (A) any part of the Reimbursement Amount or compensation or any other amount to be paid by any Reimbursement Party to The Netherlands under this Agreement or any other Relevant Document shall not be paid in full when due, at the place and in the currency in which it is expressed to be payable, unless (1) in the case of a failure to so pay any part of the Reimbursement Amount or any compensation payable on a Payment Date pursuant to Section 3.1 (in the case of any part of the Reimbursement Amount) or

paragraph (c)(i) of Section 3.2 (in the case of any compensation), such failure is due solely to administrative or technical error and such amount is paid within five (5) Business Days of the due date for payment, or (2) in any other case, such amount is paid within twenty (20) Business Days of the due date for payment, (B) any payment of Reimbursement Amount or compensation or of any other amount under this Agreement or any other Relevant Document previously made by any Reimbursement Party is avoided, set aside, invalidated or reduced;

(ii) any Reimbursement Party shall default or, in the case of a default which is capable of remedy, shall default for not less than a period ending twenty (20) Business Days after the earlier of (A) the day on which The Netherlands gives the relevant Reimbursement Party notice of the default, or (B) the day on which any senior officer of any Reimbursement Party becomes aware or should reasonably have become aware of the default, in the observance or performance of any of its obligations under this Agreement or any other Relevant Document (other than as provided in paragraph (i) above) (and for this purpose a "senior officer" shall be, in the case of the Guarantee Fund, a director of the Guarantee Fund and, in the case of Iceland, a Minister or Permanent Secretary in the Ministry of Finance or the Ministry of Foreign Affairs of Iceland, and the heads or deputy heads of the department or departments within the government of Iceland in charge of administering Iceland's Sovereign Debt (including its debt under this Agreement);

(iii) any representation made or deemed made by any Reimbursement Party in this Agreement or any other Relevant Document or any document delivered by any Reimbursement Party in connection with any Relevant Document has been or shall prove to have been false or misleading in any material respect as of the time made or deemed made;

(iv) the payment obligations of the Guarantee Fund under this Agreement and the other Relevant Documents shall cease to rank at least *pari passu* with the present and future claims of all of its other creditors or the payment obligations of Iceland under this Agreement or the other Relevant Documents shall cease to rank at least *pari passu* with the present and future Sovereign Debt of Iceland, in each case other than claims which are mandatorily preferred by Applicable Law in force on the date of this Agreement;

(v) (A) this Agreement or any other Relevant Document shall at any time be suspended, revoked or terminated or for any reason cease to be valid and binding or in full force and effect (other than upon expiration in accordance with the terms thereof or as a result of any act or omission of The Netherlands or DNB), (B) performance by the relevant Reimbursement Party of any obligation thereunder shall become unlawful, (C) any Reimbursement Party shall so assert in writing, or (D) the validity or enforceability thereof shall be contested by any Reimbursement Party;

(vi) the Guarantee Fund (A) shall be dissolved or liquidated, (B) shall admit in writing its inability to, or be generally unable to, pay its debts as such debts become due, taking into account any support available to it, or (C) suspends (whether voluntarily or involuntarily) making payments on any of its debts, in each case except if prior to the

occurrence of such event (1) its obligations under this Agreement and the other Relevant Documents have been assumed by a successor entity on terms approved by The Netherlands (such approval not to be unreasonably withheld or delayed), and (2) Iceland has provided such confirmations and entered into such documents as The Netherlands may reasonably require to ensure that Iceland's obligations under this Agreement and the other Relevant Documents continue in full force and effect as if such successor had been a party to this Agreement and the other Relevant Documents from their inception;

(vii) Iceland (or any governmental or ministerial authority thereof) fails to make any payment in respect of any of its Sovereign Debt on its due date (or within any originally applicable grace period set out in the agreement constituting such Sovereign Debt) or any such Sovereign Debt becomes due earlier than its stated date of payment by reason of an event of default (however described), provided that no Mandatory Prepayment Event will occur under this paragraph (vii) unless the aggregate amount of Sovereign Debt in respect of which any amount has not been paid when due or which has become due early exceeds GBP 50,000,000 or its equivalent in other currencies;

(viii) (A) any Reimbursement Party shall fail to comply with any Applicable Law to which it is subject, in circumstances where such failure might have a Mandatory Prepayment-Related Material Adverse Effect, or (B) any Applicable Law at any time necessary to enable the Guarantee Fund or Iceland to comply with any of its obligations under any of the Relevant Documents shall be revoked, withdrawn, withheld or otherwise not in full force and effect or shall be modified or amended in a manner that (in the aggregate) has had or would have a Mandatory Prepayment-Related Material Adverse Effect.

(c) *Notification of Mandatory Prepayment Event*. If any Reimbursement Party becomes aware that a Mandatory Prepayment Event has occurred, it shall notify The Netherlands of such occurrence as soon as possible, together with details of the events or circumstances comprising such Mandatory Prepayment Event and of the steps being taken to remedy the same.

Section 3.6 *Pay-out Costs*. (a) The Guarantee Fund agrees to pay to The Netherlands the amount of its Pay-out Costs, which the Parties agree, for all purposes under this Agreement and the other Relevant Documents, to be an amount of EUR 7,000,000 (seven million euro).

(b) The Guarantee Fund agrees to pay to The Netherlands on each Payment Date falling in 2011 an amount equal to the aggregate of (i) one quarter of the Pay-out Costs, and (ii) compensation on the amount so paid, accrued at the First Phase Rate from October 1, 2009 until the relevant Payment Date.

Section 3.7 *Payments*. (a) All payments of any part of the Reimbursement Amount, any compensation and all other amounts to be made by the Guarantee Fund to The Netherlands under this Agreement and the other Relevant Documents shall be received in euro, in immediately available funds, without deduction, set-off or counterclaim, in the NL Settlement Account not later than 5:00 p.m. (Amsterdam time) on the date on which such payment is due (and each such payment received after such time on such due date to be deemed to have been received on the next Business Day), provided that:

(i) if The Netherlands receives an amount from DNB pursuant to paragraph 2.4 of the DNB Assignment Agreement, The Netherlands shall, as soon as reasonably possible:

(A) pay to the HMT Commissioners their *Pro Rata* Entitlement to that amount to be applied in accordance with paragraph (a)(ii) of Section 4.5 of the UK Disbursement, Reimbursement and Indemnity Agreement, such payment to be made in the currency received and without making any conversion, with any conversion into Sterling to be made by the HMT Commissioners pursuant to the UK Disbursement, Reimbursement and Indemnity Agreement; and

(B) if any such payment from DNB is received in a currency other than euro, convert the remaining amount of such payment into euro at such rate as The Netherlands may reasonably select and such payment shall from the time of such conversion be applied in accordance with paragraph (a)(ii) of Section 3.5 and to the extent that it is so applied in accordance with paragraph (a)(ii)(A) or paragraph (a)(ii)(B)(2) of Section 3.5 shall satisfy the obligation to repay the Reimbursement Amount up to the euro amount obtained by The Netherlands as a result of such conversion; and

(ii) if The Netherlands receives an amount from the HMT Commissioners pursuant to paragraph (a)(i)(A) of Section 4.7 of the UK Disbursement, Reimbursement and Indemnity Agreement, paragraph (i)(B) above shall apply *mutatis mutandis*.

(b) If the Guarantee Fund makes a payment to The Netherlands that is insufficient to discharge all matured payments then due under this Agreement and the other Relevant Documents from the Guarantee Fund to The Netherlands, that payment shall be applied (i) first, towards discharging any costs and expenses of The Netherlands which the Guarantee Fund is required to reimburse pursuant to this Agreement or any other Relevant Document, (ii) second, towards payment of any accrued compensation which is due but unpaid under this Agreement or any other Relevant Document, and (iii) third, towards payment of such part of the Reimbursement Amount as is then due.

(c) If any payment under this Agreement is stated to be due on a day that is not a Business Day, or if any period by reference to which any such sum is calculated under this Agreement or any other Relevant Document would end on a day which is not a Business Day, then such date or period shall be extended to the next Business Day and such extension of time shall in such case be included in the computation of payment of compensation (if applicable), *provided* that, if such extension would cause such payment to be made, or such period to end, in the next following calendar month, such date shall be brought forward to, or such period shall end, on the next preceding Business Day.

ARTICLE IV
LOSSES, ETC.

Section 4.1 *Losses*. The Guarantee Fund shall pay to The Netherlands, upon the request of The Netherlands, such amount as shall be sufficient to compensate it for any loss, cost

or liability that is attributable to (a) the conversion of one currency into another currency pursuant to this Agreement or any other Relevant Document, (b) the occurrence of any Mandatory Prepayment Event or any breach by any Reimbursement Party of any of its obligations under this Agreement or any other Relevant Document, or (c) the preservation, perfection or enforcement of any right, power or privilege of The Netherlands under this Agreement or any other Relevant Document, other than, in each case, any "costs of arbitration" within the meaning of the PCA Rules which an arbitral tribunal in arbitration proceedings as referred to in Section 9.10 has determined are to be borne by The Netherlands.

Section 4.2 *Taxes*. All payments of any part of the Reimbursement Amount or compensation and all other amounts payable under this Agreement or any other Relevant Document by any Reimbursement Party to The Netherlands shall be made free and clear of and without reduction or liability for or on account of any Taxes, *provided* that if any Reimbursement Party shall be required by Applicable Law to deduct any Taxes from such payments, then the sum payable shall be increased as necessary so that after making all required deductions (including deductions applicable to additional sums payable under this Section 4.2) The Netherlands receives an amount equal to the sum it would have received had no such deductions been made.

Section 4.3 *Full and final settlement* (a) The Netherlands shall not have (and to the extent that absent this Section 4.3 it would have, it irrevocably renounces) any claim against any Reimbursement Party in relation to the payment of compensation by DNB in respect of the claims of Landsbanki Amsterdam Depositors as referred to in the Recitals, other than the claims of The Netherlands under this Agreement and the other Relevant Documents.

(b) No Reimbursement Party shall make (and to the extent that absent this paragraph (b) it would have, it irrevocably renounces) any claim, or initiate any proceedings, including indemnification proceedings against The Netherlands or DNB in relation to (i) the payment of compensation by DNB in respect of claims of Landsbanki Amsterdam Depositors as referred to in the Recitals (including any rejections of such claims), or (ii) any claim of a Landsbanki Amsterdam Depositor in respect of which compensation was not paid by DNB (for whatever reason). DNB has the benefit of and may enforce the provisions of the preceding sentence.

ARTICLE V
INDEMNITY

Section 5.1 *Representation, warranty and indemnity*. For good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Iceland hereby:

(a) irrevocably and unconditionally represents, warrants and undertakes to The Netherlands that the Guarantee Fund will ensure the full and punctual payment and performance (whether at stated maturity, upon acceleration or otherwise) of all its obligations under this Agreement and the other Relevant Documents and thus ensure that there will at no time be any Shortfall Amount;

(b) undertakes to The Netherlands that, whenever there is any Shortfall Amount, it will, on demand, pay that Shortfall Amount to The Netherlands as if it were the principal obligor; and

(c) undertakes to indemnify The Netherlands, on demand, against any cost, loss or liability suffered by The Netherlands if (a) any Shortfall Amount arises, or (b) any obligation of the Guarantee Fund under this Agreement or any other Relevant Document is or becomes illegal, not binding, invalid or unenforceable. The amount of the cost, loss or liability will be equal to the amount which The Netherlands would otherwise have been entitled to recover.

Section 5.2 *Obligations Unconditional*. The obligations of Iceland under this Article V shall be unconditional and absolute and, without limiting the generality of the foregoing, shall not be released, discharged or otherwise affected by:

(a) any extension, renewal, settlement, compromise, waiver or release in respect of any obligation(s) of any Reimbursement Party under this Agreement or the other Relevant Documents, by operation of law or otherwise (other than with respect to any such extension, renewal, settlement, compromise, waiver or release agreed in accordance with the terms hereunder as expressly applying to the obligations of Iceland hereunder);

(b) any modification, novation, extension, restatement of or supplement to this Agreement or any other Relevant Document (other than with respect to any modification, novation, extension, restatement, amendment of or supplement agreed in accordance with the terms hereof as expressly applying to the obligations of Iceland under this Article V);

(c) any release, impairment, non-perfection or invalidity of any Lien securing any Shortfall;

(d) any change in the corporate existence, structure or ownership of the Guarantee Fund or any other Person, or any insolvency, reorganisation or similar proceedings in respect of Landsbanki , the Guarantee Fund or any other Person;

(e) the existence of any claim, set-off or other rights that The Netherlands may have at any time against the Guarantee Fund or any other Person, whether in connection herewith or with any unrelated transactions;

(f) any invalidity or unenforceability relating to or against any Reimbursement Party for any reason of this Agreement or any other Relevant Document, or any provision of Applicable Law purporting to prohibit the performance by any Reimbursement Party of any of its obligations under this Agreement or any other Relevant Document (other than any such invalidity or unenforceability with respect solely to the obligations of Iceland under this Article V);

(g) any other act or omission to act or delay of any kind by any Reimbursement Party or any other Person or any other circumstance whatsoever that might, but for the provisions of this Section 5.2, constitute a legal or equitable discharge of the obligations of any Reimbursement Party under this Agreement or any other Relevant Document.

Section 5.3 *Discharge Only upon Payment in Full; Reinstatement In Certain Circumstances*. The obligations of Iceland under this Article V constitute continuing obligations which will extend to the ultimate balance of any Shortfall Amount, regardless of any intermediate payment or discharge, whether in whole or in part, and shall remain in full force and effect until all Shortfall Amounts shall have been paid or otherwise performed in full and no other Shortfall Amount can arise. If at any time any payment made under this Agreement or any other Relevant Document is rescinded or must otherwise be restored or returned upon the insolvency, bankruptcy, reorganization or similar event of the Guarantee Fund or any other Person or otherwise, then the obligations of Iceland hereunder with respect to such payment shall be reinstated at such time as though such payment had been due but not made at such time.

Section 5.4 *Waiver*. Iceland hereby irrevocably and unconditionally waives, to the fullest extent permitted by Applicable Law, (a) notice of acceptance of this Agreement and notice of any liability to which this Agreement may apply, (b) all notices that may be required by Applicable Law or otherwise to preserve intact any rights of The Netherlands against the Guarantee Fund, including any demand, presentment, protest, proof of notice of non-payment, notice of any failure on the part of the Guarantee Fund to perform and comply with any covenant, agreement, term, condition or provision of any agreement and any other notice to any other Person that may be liable in respect of the obligations of the Guarantee Fund except any of the foregoing as may be expressly required hereunder, (c) any right to the enforcement, assertion or exercise by The Netherlands of any right, power, privilege or remedy conferred upon it under this Agreement, any other Relevant Document or otherwise, and (d) any requirement that the Netherlands exhaust any right, power, privilege or remedy, or mitigate any damages resulting from a default, under this Agreement or any other Relevant Document. This waiver applies irrespective of any Applicable Law or any provision of this Agreement or any other Relevant Document to the contrary.

Section 5.5 *Subrogation*. Iceland shall not enforce any payment by way of subrogation, indemnity, contribution or otherwise, or exercise any other right, (or otherwise benefit from any payment or other transfer arising from any such right) which it may have against the Guarantee Fund by reason of the performance by it of its obligations under this Agreement or any other Relevant Document so long as any obligations under this Agreement or any other Relevant Document remain unpaid or unsatisfied (and, if Iceland receives any payment or distribution in relation to such rights, it will promptly turn such payment or distribution over to The Netherlands).

Section 5.6 *Additional security*. The representation, warranty, undertaking and indemnity set out in this Article V is in addition to and is not in any way prejudiced by any other representation, warranty, indemnity, security or other document or instrument now or subsequently held by The Netherlands or any other Person.

ARTICLE VI
CONDITIONS PRECEDENT

Section 6.1 *Conditions Precedent*. The effectiveness of this Agreement is subject to the conditions precedent that:

(a) The Netherlands shall have received the following documents, each of which shall be in form and substance satisfactory to The Netherlands:

(i) Confirmation re. UK Disbursement, Reimbursement and Indemnity Agreement. Confirmation from the HMT Commissioners that all conditions precedent to be satisfied in order for the UK Disbursement, Reimbursement and Indemnity Agreement to become effective (other than receipt of confirmation from The Netherlands that all conditions precedent to be satisfied in order for this Agreement to become effective) have been satisfied;

(ii) Authorising Act. A copy of an Act from Iceland, which has come into force and is not, or no longer, capable of being revoked or avoided by any referendum and which provides for the unconditional and unreserved authorization of the indemnity set out in Article V and for any other authorization necessary to ensure that the obligations of the Reimbursement Parties under this Agreement and the other Relevant Documents are legal, valid, binding and enforceable, together with a certified translation thereof into English;

(iii) Other authorizations. A copy of an exemption granted by the Central Bank of Iceland (*Seðlabanki Íslands*) to the Guarantee Fund under Rules 370/2010 on Foreign Exchange in respect of the Guarantee Fund's execution and performance of this Agreement and the other Relevant Documents, together with a certified translation thereof into English; and

(iv) Opinions of Counsel. An opinion of Lex, legal advisers to the Guarantee Fund as to the laws of Iceland and an opinion of the State Attorney of Iceland (*Ríkislögmaður*) in respect of, *inter alia*, the capacity and due authorization of, and valid execution of this Agreement and each other Relevant Document by, each of the Reimbursement Parties; and

(b) the Guarantee Fund and DNB shall have entered into the DNB Assignment Agreement and the DNB *Pari Passu* Agreement.

Section 6.2 *DNB Assignment Agreement and DNB Pari Passu Agreement*. (a) The DNB Assignment Agreement shall provide that:

(i) DNB shall assign to the Guarantee Fund, in consideration of the Guarantee Fund's undertaking to reimburse The Netherlands as set out in Section 2.1, the claims (or parts thereof) of the Landsbanki Amsterdam Depositors against Landsbanki assigned to DNB in connection with its payment of compensation in respect of those claims, all as detailed in the DNB Assignment Agreement;

(ii) DNB agrees that it shall not have (and to the extent that absent such agreement it would have, it irrevocably renounces) any claim against the Guarantee Fund or Iceland in relation to the payment of compensation by DNB in respect of the claims of Landsbanki Amsterdam Depositors as referred to in the Recitals and that both

Reimbursement Parties shall have the benefit of and may enforce this agreement by DNB;

(iii) it shall be governed by, and construed in accordance with, the laws of The Netherlands and the laws of Iceland as set out in it; and

(iv) it will take effect simultaneously with this Agreement.

(h) The DNB *Pari Passu* Agreement shall provide that:

(i) to the extent that, following the assignment referred to in paragraph (a) above, DNB retains any part of any claim (due to the fact that such claim exceeds the amount assigned to the Guarantee Fund), then the part of the claim which has been assigned to the Guarantee Fund shall, to the fullest extent permitted by Applicable Law, rank *pari passu* in all respects with the part of that claim retained by DNB;

(ii) in the event that, for any reason whatsoever (including any preferential status accorded to the Guarantee Fund under any Applicable Law of Iceland), following the assignment of a part of any given claim to the Guarantee Fund, either the Guarantee Fund or DNB experiences a greater *pro rata* level of recovery in respect of such claim, than that experienced by the other, the Guarantee Fund or DNB (as appropriate) shall, as soon as practicable, unless paragraph (iii) below applies, make such balancing payment to DNB or the Guarantee Fund, as the case may be, as is necessary to ensure that each of the Guarantee Fund's and DNB's *pro rata* level of recovery in respect of such claim is the same as the other's;

(iii) if (A) a court of Iceland gives a final and non-appealable order or judgment which (I) determines that all or part of any claim assigned to the Guarantee Fund, or the rights retained by DNB, as the case may be, shall be entitled to receive distributions in the Landsbanki estate on a preferential basis relative to other claims originating from the same deposits, and (II) is not in conflict with an advisory opinion obtained from the Court of the European Free Trade Area on that preferential status, or (B) the Winding-up Board of Landsbanki determines that all or part of any claim assigned to the Guarantee Fund, or the rights retained by DNB, as the case may be, shall be entitled to receive distributions in the Landsbanki estate on a preferential basis relative to the other claims originating from the same deposits but such ruling is not challenged in a court of Iceland by any depositor or creditor and such failure to challenge is not the result of a change of Applicable Law made after the Commencement Date which renders such a challenge more difficult or impossible, then, unless that preferential status results from any revocation, withdrawal, withholding or other ceasing to be in full force and effect, or any modification or amendment of any Applicable Law effected or made after the Commencement Date, the obligation described in paragraph (ii) above for the Guarantee Fund or DNB, as the case may be, to make balancing payments shall not apply;

(iv) it shall be governed by, and construed in accordance with, the laws of England; and

(v) it will take effect simultaneously with this Agreement.

Section 6.3 *Satisfaction of Conditions Precedent*. If the actions referred to in Section 6.1 have not been completed by December 31, 2010:

(a) if the non-completion consists of DNB not having executed and delivered to the Guarantee Fund the DNB Assignment Agreement and the DNB *Pari Passu* Agreement, the Reimbursement Parties may, by notice to The Netherlands, terminate this Agreement; and

(b) if the non-completion consists of any other action referred to in Section 6.1, The Netherlands may by notice to the Guarantee Fund, with a copy to Iceland, terminate this Agreement,

whereupon, in each case, this Agreement shall cease to have any effect.

Section 6.4 *Termination of Loan Agreement and Acceptance and Amendment Agreement*. On the date on which this Agreement becomes effective, the Loan Agreement and the Acceptance and Amendment Agreement shall terminate, if not previously terminated.

ARTICLE VII
REPRESENTATIONS AND WARRANTIES

Section 7.1 *Guarantee Fund representations*. The Guarantee Fund represents and warrants to The Netherlands as of the date of this Agreement as follows:

(a) The Guarantee Fund is (a) a private foundation, duly organized, validly existing and, to the extent applicable under the laws of Iceland, in good standing under the laws of Iceland, and (b) has all requisite corporate power necessary to own its assets and carry on its business as now being conducted.

(b) This Agreement and each other Relevant Document to which it is a party have been duly executed and delivered by it, and constitute legal, valid and binding obligations of it, enforceable against it in accordance with their terms, in each case except as may be limited by equitable principles of general applicability which are specifically referred to in the relevant legal opinion referred to in paragraph (a)(iv) of Section 6.1.

Section 7.2 *Reimbursement Party representations*. Each Reimbursement Party represents and warrants to The Netherlands as of the date of this Agreement that the exemption granted by the Central Bank of Iceland (*Seðlabanki Íslands*) to the Guarantee Fund under Rules 370/2010 on Foreign Exchange in respect of the Guarantee Fund's execution and performance of this Agreement and the other Relevant Documents referred to in paragraph (a)(iii) of Section 6.1 is unconditional, irrevocable and in full force and effect and there are no other authorizations, licenses, consents or other approvals or actions required from any Icelandic Governmental Authority in connection with the execution or performance of this Agreement or the other Relevant Documents or to ensure that the obligations of the Reimbursement Parties under this Agreement and the other Relevant Documents are legal, valid, binding and enforceable.

ARTICLE VIII
COVENANTS

Section 8.1 *Comparability of treatment*. If any Reimbursement Party enters into any Relevant Financing Arrangement and, under that Relevant Financing Arrangement (taken as a whole), the financier party to that Relevant Financing Arrangement enjoys an overall more favorable treatment than The Netherlands under this Agreement and the other Relevant Documents, or has the benefit of any Lien, then the Reimbursement Parties shall grant The Netherlands the same favorable treatment or the benefit of a similar Lien (and the Reimbursement Parties shall enter into any documentation necessary or desirable in order to do so).

Section 8.2 *Equal treatment*. If the Guarantee Fund, any Other Guarantee Fund or Iceland makes any Excess Payment, the Guarantee Fund shall pay (or ensure that each relevant Other Guarantee Fund pays) an amount equal to the Excess Payment to each Landsbanki Amsterdam Depositor, *provided* that, to the extent that The Netherlands or DNB has made any payment to a Landsbanki Amsterdam Depositor in respect of a claim of that Landsbanki Amsterdam Depositors under Act No. 98/1999 in excess of EUR 20,887 per claim, the payment under this Section shall be made to The Netherlands or DNB, as the case may be.

ARTICLE IX
MISCELLANEOUS

Section 9.1 *Change of circumstance*. The Netherlands agrees that, if at any time the then most recently published Article IV review by the IMF in relation to Iceland states that a significant deterioration has occurred in the sustainability of the debt of Iceland, relative to the assessment of such sustainability by the IMF Fund as of November 19, 2008, then, if Iceland so requests, The Netherlands will meet with Iceland to discuss the situation and consider whether, and if so how, this Agreement and the other Relevant Documents should be amended to reflect the relevant change in circumstances.

Section 9.2 *Other changes*. If the Accepted Claims Amount or the Accepted Interest Amount shall at any time change as a result of any decision of the Winding up Board of Landsbanki or of any competent court:

(i) any calculation pursuant to this Agreement or the other Relevant Documents which is directly or indirectly based on the Accepted Claims Amount or the Accepted Interest Amount shall be recalculated as if the Accepted Claims Amount or the Accepted Interest Amount had been the as so changed Accepted Claims Amount or the Accepted Interest Amount with effect from the date of this Agreement;

(ii) if any amount shall have been paid or allocated on the basis of the previous calculation then such payment or allocation shall be reversed or as the case may be reallocated to the extent required in order to reflect such recalculation.

Section 9.3 *Waiver*. No failure on the part of The Netherlands to exercise and no delay in exercising, and no course of dealing with respect to, any right, power or privilege under

the Agreement or any other Relevant Document shall impair that right, power or privilege or operate as a waiver or variation thereof, nor shall any single or partial exercise of any right, power or privilege under any Relevant Document preclude any other or further exercise thereof or the exercise of any other right, power or privilege. Any liberty or power which may be exercised or any determination which may be made under this Agreement by The Netherlands (including any act, matter or thing as agreed, specified, determined, decided or notified by The Netherlands to the Guarantee Fund or Iceland) may be exercised or made in the absolute and unfettered discretion of The Netherlands from time to time, which will not be under any obligation to give reasons therefor.

Section 9.4 *Notices*. All notices, requests, instructions, directions and other communications provided for herein shall be given or made in writing in English by personally delivered letter or by fax (and may be copied, but not validly served, by e-mail) delivered to the intended recipient as follows:

(a) if to the Guarantee Fund, to it at Borgartun 26, 3rd floor, 105 Reykjavik, Iceland, Fax: +354 590 2606, Attn.: Managing Director, with a copy to Iceland, at Ministry of Finance, Arnarhvoli Lindargötu, 150 Reykjavík, Iceland, Fax: +354 5628280, Attn.:Permanent Secretary;

(b) if to Iceland, to it at Ministry of Finance, Arnarhvoli Lindargötu, 150 Reykjavík, Iceland, Fax: +354 5628280, Attn.:Permanent Secretary; and

(c) if to The Netherlands, to it at Ministerie van Financiën, Korte Voorhout 7, 2511 CW The Hague, The Netherlands, P.O. Box 20201, 2500 EE The Hague, The Netherlands, Fax: +31 70 342 79 03, Attn.:Treasurer-General (*Thesaurier-generaal*).

Except as otherwise provided in this Agreement, all such communications shall be deemed to have been duly given, (i) when personally delivered at the address of the Person to be served, at the time when it is so left (or, if left on a day that is not a Business Day, at 8:15am (local time) on the next following Business Day), and (ii) when sent by facsimile transmission, when confirmation of receipt is received from the receiving facsimile machine (or, if sent on a day that is not a Business Day, at 8:15am (local time) on the next following Business Day), *provided* that, in proving the giving of notice under or in connection with this Agreement, it shall be sufficient to prove that the notice was delivered to the address for service.

Section 9.5 *Amendments, Etc*. Except as otherwise expressly provided in this Agreement, any provision of this Agreement and (except as specifically provided therein) any other Relevant Document may be modified, supplemented or waived only in writing executed by the Parties affected by the modification, supplement or waiver.

Section 9.6 *Successors and Assigns*. (a) This Agreement shall be binding upon and inure to the benefit of the Parties. No Party may assign, transfer or encumber any of its rights or obligations under this Agreement or any other Relevant Document (any attempt to do so being null and void *ab initio*).

(b) This Agreement is made and entered into for the sole protection and legal benefit of the Parties and no other Person shall be a direct or indirect legal beneficiary of, or have any

direct or indirect cause of action or claim in connection with, this Agreement under the Contracts (Rights of Third Parties) Act 1999, *provided* that DNB has the benefit of and may enforce any right accorded to it, or any term or condition expressed to be for its benefit, in this Agreement.

Section 9.7 *Captions*. The table of contents and captions and section headings appearing herein are included solely for convenience of reference and are not intended to affect the interpretation of any provision of this Agreement.

Section 9.8 *Counterparts*. This Agreement may be executed in any number of counterparts, all of which taken together shall constitute one and the same instrument, and any of the Parties may execute this Agreement by executing any such counterpart. Each counterpart shall be an original copy of this Agreement, but they shall together constitute one and the same instrument.

Section 9.9 *Governing Law*. THIS AGREEMENT AND ANY MATTER, CLAIM OR DISPUTE ARISING OUT OF OR IN CONNECTION WITH IT, WHETHER CONTRACTUAL OR NON-CONTRACTUAL, SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF ENGLAND.

Section 9.10 *Arbitration*. (a) ANY DISPUTE, LEGAL ACTION OR PROCEEDING BY OR AGAINST ANY PARTY HERETO WITH RESPECT TO OR ARISING OUT OF THIS AGREEMENT, WHETHER CONTRACTUAL OR NON-CONTRACTUAL AND INCLUDING ANY DISPUTE, LEGAL ACTION OR PROCEEDING REGARDING THE EXISTENCE, VALIDITY, FORMATION OR TERMINATION OF THIS AGREEMENT (A "*DISPUTE*") SHALL BE SETTLED BY FINAL AND BINDING ARBITRATION IN ACCORDANCE WITH THE PCA RULES WHICH RULES ARE DEEMED INCORPORATED BY REFERENCE INTO THIS CLAUSE EXCEPT TO THE EXTENT THAT THEY RELATE TO THE NATIONALITY OF THE ARBITRATOR.

(b) In any arbitral proceedings as referred to in paragraph (a) above:

(i) the number of arbitrators shall be three;

(ii) if all Parties are party to the arbitral proceedings, each of (A) the Reimbursement Parties jointly (and failing such joint appointment Article 7(2) of the PCA Rules shall apply), and (B) The Netherlands shall appoint one arbitrator and the two arbitrators thus appointed shall choose the third arbitrator who will act as the presiding arbitrator of the arbitral tribunal;

(iii) the appointing authority shall be the Secretary-General of the Permanent Court of Arbitration;

(iv) the place of arbitration shall be London, England;

(v) the language to be used in the arbitral proceedings shall be English;

(vi) the IBA Rules on the Taking of Evidence in International Arbitration of 29 May 2010 shall apply;

(vii) the arbitral tribunal shall use its best efforts to make a final award within twelve months of the appointment of the third arbitrator who acts as the presiding arbitrator of the arbitral tribunal, and shall conduct the arbitral proceedings accordingly;

(viii) the arbitral tribunal shall rule in accordance with the laws of England (and not, for the avoidance of doubt, as *amiable compositeur* or *ex aequo et bono*); and

(ix) all Parties, the arbitrators and the Secretary-General and the International Bureau of the Permanent Court of Arbitration shall protect the confidentiality of the existence of the arbitral proceedings and of any information received by them in connection with such proceedings.

Section 9.11 *Waiver of Sovereign Immunity*. Each of the Reimbursement Parties consents generally to the issue of any process in connection with any Dispute and to the giving of any type of relief or remedy against it, including the making, enforcement or execution against any of its Property or assets (regardless of its or their use or intended use) of any order, judgment or award (including, for the avoidance of doubt, any arbitral award made in arbitral proceedings pursuant to Section 9.10). If any Reimbursement Party or any of its Property or assets is entitled in any jurisdiction to any immunity from service of process or of other documents relating to any Dispute, or to any immunity from jurisdiction, suit, judgment, award, execution, attachment (whether before judgment, in aid of execution or otherwise) or other legal process, this is irrevocably waived to the fullest extent permitted by the law of that jurisdiction. Each of the Reimbursement Parties also irrevocably agrees not to claim any such immunity for themselves or their respective Property or assets. The Parties confirm that this paragraph does not extend to any assets of Iceland which enjoy immunity under the Vienna Convention on Diplomatic Relations, any assets of Iceland located in Iceland which are necessary for the proper functioning of Iceland as a sovereign power, or to any assets of the Central Bank of Iceland (*Seðlabanki Íslands*); and

Section 9.12 *Severability*. The illegality or unenforceability in any jurisdiction of any provision hereof or of any document required hereunder shall not in any way affect or impair the legality or enforceability of the remaining provisions of this Agreement or such other document in such jurisdiction or such provision in any other jurisdiction.

[*Signatures Follow.*]

nothing in this Agreement or any other Relevant Document is intended to remove or shall have the effect of removing from Iceland its control of its natural resources and its right to decide on the administration and form of ownership thereof.

IN WITNESS WHEREOF, the Parties have caused this Agreement to be duly executed and delivered as of the day and year first above written.

The Depositors' and Investors' Guarantee Fund of Iceland (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*)

By: _____
Name: [*]
Title: [*]

Iceland

By: _____
Name: [*]
Title: [*]

The State of the Netherlands

By: _____
Name: [*]
Title: [*]

SCHEDULE 1
to Reimbursement Agreement

"*Acceptance and Amendment Agreement*" means the Acceptance and Amendment Agreement dated 19 October 2009 between the Parties.

"*Accepted Claims Amount*" means, at any time, the amount of the Assigned Claim which has at that time been accepted by the Winding up Board of Landsbanki (or by a competent court, such court determination to prevail if different from such Winding up Board acceptance and binding upon such Winding up Board) as constituting a valid claim in the winding up of Landsbanki under Article 112 of the Icelandic Act no. 21/1991 on Bankruptcies etc. (*Lög nr. 21/1991 um gjaldþrotaskipti o.fl.*).

"*Accepted Interest Amount*" means, at any time, the amount of any interest included in the Accepted Claims Amount.

"*Assigned Claim*" means, collectively, the claims against Landsbanki assigned or expressed to be assigned to the Guarantee Fund by DNB pursuant to the DNB Assignment Agreement.

"*Act No. 98/1999*" means the Icelandic Act No. 98/1999 on Deposit and Investor-Compensation Scheme (*Lög nr. 98/1999 um innstæðutryggingar og tryggingakerfi fyrir fjárfesta*) as in force on 11 October 2008.

"*Agreement*" has the meaning set forth in the introduction hereto.

"*Applicable Law*" means any applicable statute, law, regulation, ordinance, rule, judgment, rule of common law, order, decree, approval, concession, grant, franchise, license, agreement, directive, guideline, policy, requirement or other governmental restriction or any similar form of decision of, or determination by (or any interpretation or administration of any of the foregoing by), any Governmental Authority, whether in effect as of the date hereof or (unless a contrary indication appears in this Agreement or any other Relevant Document) thereafter.

"*Arrears Rate*" means, at any time of determination, a rate *per annum* equal to the sum of (a) for the period from the date of this Agreement to the Second Phase Start Date, the First Phase Rate plus 0.3 per cent. *per annum*, and (b) for the period from the Second Phase Start Date onwards, the Second Phase CIRR plus 0.5 per cent. *per annum*.

"*Business Day*" means a day (other than Saturday or Sunday) on which commercial banks are not authorized or required to close in Reykjavik (Iceland) or Amsterdam (The Netherlands).

"*Commencement Date*" means 5 June 2009.

"*Defaulted Amount*" means each amount which has fallen due for payment by a Reimbursement Party but remains unpaid in breach of the terms of this Agreement.

"*Directive 94/19/EC*" means Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes as in force on 11 October 2008 (subject to any contrary indication).

"*DNB*" means the Central Bank of The Netherlands (*De Nederlandsche Bank N.V.*).

"*DNB Assignment Agreement*" means the Assignment Agreement to be entered into between the Guarantee Fund and DNB in the form agreed between the Parties before the date of this Agreement and which complies with Section 6.2.

"*DNB Pari Passu Agreement*" means the *Pari Passu* Agreement to be entered into between the Guarantee Fund and DNB in the form agreed between the Parties before the date of this Agreement and which complies with Section 6.2.

"*euro*" or "*EUR*" means the lawful currency for the time being of the Member States of the European Union that adopt or have adopted the euro as their lawful currency in accordance with legislation of the European Community relating to Economic and Monetary Union.

"*Excess Payment*" means any payment in excess of an amount of EUR 20,887 in respect of any claim or claims of a Landsbanki Depositor (not including, for the avoidance of doubt, any former Landsbanki Depositor who became a depositor of NBI hf.) other than a Landsbanki Amsterdam Depositor.

"*First Phase Rate*" means 3.0 per cent. *per annum*.

"*FSCS*" means the "FSCS" as defined in the UK Disbursement, Reimbursement and Indemnity Agreement.

"*FSCS Deed of Assignment*" means the "FSCS Deed of Assignment" as defined in the UK Disbursement, Reimbursement and Indemnity Agreement.

"*Governmental Authority*" means any nation or government, any state or municipality, any multi-lateral or similar organization or any other agency, instrumentality or political subdivision thereof and any entity exercising executive, legislative, judicial, monetary, regulatory or administrative functions of or pertaining to government.

"*Guarantee Fund*" has the meaning set forth in the introduction hereto.

"*Guarantee Fund Estate Proceeds*" means (i) any amount received by the Guarantee Fund in respect of the claims of or formerly of Landsbanki Depositors or otherwise in respect of the insolvency of Landsbanki, and (ii) any amount received by DNB which is payable by DNB to The Netherlands pursuant to paragraph 2.4 of the DNB Assignment Agreement, and (iii) any amount received by the FSCS which is payable by the FSCS to the HMT Commissioners pursuant to paragraph 2.5 of the FSCS Deed of Assignment.

"*HMT Commissioners*" means the Commissioners of Her Majesty's Treasury of the United Kingdom of Great Britain and Northern Ireland.

"*Iceland*" has the meaning set forth in the introduction hereto.

"*Interest Proceeds*" means, at any time, an amount (expressed in euro) equal to a fraction of the Guarantee Fund Estate Proceeds at that time, calculated by multiplying the amount of those Guarantee Fund Estate Proceeds by a fraction the numerator of which is equal to the Accepted Interest Amount and the denominator of which is equal to the Accepted Claims Amount, in each case at that time.

"*ISK Equivalent*" means, in relation to any amount in euro or Sterling and as at any day, the equivalent of such amount in Krónur calculated at the average of the published daily rates of exchange as published by the Central Bank of Iceland (*Seðlabanki Íslands*) (or, to the extent that no such rates of exchange are published by the Central Bank of Iceland, the published daily rates of exchange derived from a source reasonably agreed between Iceland and The Netherlands or, if Iceland and The Netherlands fail to agree such rate prior to the date for which the relevant ISK Equivalent is to be determined, as determined by arbitration in accordance with Section 9.10) for the period of one month ending on the day immediately preceding that day.

"*Krónur*" or "*ISK*" means the lawful currency for the time being of Iceland.

"*Landsbanki*" means Landsbanki Íslands hf., a financial undertaking incorporated under the laws of Iceland.

"*Landsbanki Amsterdam*" means the Amsterdam branch of Landsbanki.

"*Landsbanki Amsterdam Depositor*" means each Person who has deposited any funds, or otherwise has any credit balance, with Landsbanki Amsterdam and whose corresponding claim against Landsbanki is guaranteed by the Guarantee Fund according and subject to Act No. 98/1999.

"*Landsbanki Depositor*" means each Person who has deposited any funds, or otherwise has any credit balance, with Landsbanki and whose corresponding claim against Landsbanki is guaranteed by the Guarantee Fund according and subject to Act No. 98/1999 (including, for the avoidance of doubt, each Landsbanki Amsterdam Depositor).

"*Lien*" means any mortgage, lien, pledge, fiduciary transfer, charge, encumbrance or other security interest.

"*Loan Agreement*" means the Loan Agreement dated 5 June 2009 between the Parties.

"*Mandatory Prepayment Event*" means any event or circumstance specified as such in paragraph (b) of Section 3.5.

"*Mandatory Prepayment-Related Material Adverse Effect*" means any effect which impairs the ability of any Reimbursement Party to perform its payment or other material obligations under this Agreement or any other Relevant Document.

"*NL Interest Share Receipts*" means, at any time, the aggregate of all amounts applied in accordance with paragraph (a)(ii)(B)(1) of Section 3.5 at or prior to that time.

"*NL Interest Share*" means, at any time, a fraction of the Interest Proceeds at that time, calculated by multiplying those Interest Proceeds by a fraction dependent on the Recovery Percentage at that time and determined in accordance with the following table:

Recovery Percentage	NL Interest Share
86 or less	Zero
≥86 < 87	0.05
≥87 ≤ 88	0.10
>88 ≤ 89	0.15
≥90 ≤ 91	0.20
≥91 ≤ 92	0.25
>92 ≤ 93	0.35
≥93 < 94	0.45
≥94 ≤ 95	0.55
>95 ≤ 96	0.65
≥96 < 97	0.75
≥97 ≤ 98	0.85
>98 ≤ 99	0.95
≥99 < 100	1

"*NL Settlement Account*" means account nr. 600113019 (BIC: MIFTNL2G; IBAN: NL10FLOR0600113019) with DNB in the name of The Netherlands.

"*Other Guarantee Fund*" means any deposit-guarantee scheme introduced and officially recognized in Iceland for the purpose of Directive 94/19/EC (including any modification or re-enactment thereof or any substitution therefor), other than the Guarantee Fund.

"*Parties*" has the meaning set forth in the introduction hereto.

"*Payment Date*" means January 1, 2011 and each April 1, July 1, September 1 and January 1 falling after January 1, 2011.

"*Pay-out Costs*" means the costs incurred by The Netherlands in paying compensation to Landsbanki Amsterdam Depositors in respect of their claims against Landsbanki and the Guarantee Fund under Act No. 98/1999 as referred to in the Recitals, which is an amount of EUR 7,000,000 (seven million euro).

"*PCA Rules*" means Permanent Court of Arbitration Optional Rules for Arbitrating Disputes between Two Parties of Which Only One Is a State, as in effect on the date hereof.

"*Person*" means any individual, corporation, company, voluntary association, partnership, limited liability company, joint venture, trust, unincorporated organization, Governmental Authority or other entity of whatever nature.

"*Pro Rata Entitlement*" means, as at any time, a fraction calculated by dividing (a) (i) in the case of The Netherlands, an amount of GBP 1,134,680,211.10 (being the Sterling equivalent

of the amount of the Reimbursement Amount as at the date of this Agreement converted into Sterling at a rate of EUR 1,1653 to GBP 1,00), or (ii) in the case of the HMT Commissioners, the aggregate of all "Disbursements" as defined in the UK Disbursement, Reimbursement and Indemnity Agreement made up to that time under the UK Disbursement, Reimbursement and Indemnity Agreement (which the Parties believe to have been GBP 2,254,417,851.51 as at November 24, 2010), by (b) the aggregate of the amounts referred to in item (a) above.

"*Property*" of any Person means any property, rights or revenues, or interest therein, of such Person.

"*Quarterly Installments*" means the quarterly installments in which the Second Phase Reimbursement Amount must be paid, the amount and number of which are determined in accordance with Section 3.1 (subject to the other provisions of this Agreement).

"*Recovery Percentage*" means, at any time, such fraction, expressed as a percentage, of the Accepted Claims Amount as under Icelandic Act no. 21/1991 on Bankruptcies etc. (*Lög nr. 21/1991 um gjaldþrotaskipti o.fl.*) (or otherwise under the laws of Iceland) has been or is deemed to have been paid by the Winding up Board of Landsbanki in payment of the Accepted Claims Amount at that time.

"*Reimbursement Amount*" means the amount to be reimbursed by the Guarantee Fund to The Netherlands pursuant to this Agreement (or the outstanding amount thereof from time to time) which at the date of this Agreement is an amount of EUR 1,322,242,850 (one billion three hundred twenty two million two hundred forty two thousand eight hundred and fifty euro) and which may reduce pursuant to the terms of this Agreement.

"*Reimbursement Parties*" means, collectively, the Guarantee Fund and Iceland.

"*Reimbursement Payment Date*" means each Payment Date falling after the Second Phase Start Date.

"*Relevant Documents*" means, collectively, this Agreement, the DNB Assignment Agreement, the DNB *Pari Passu* Agreement and any other agreement or document designated as a Relevant Document by the Parties.

"*Relevant Financing Arrangement*" means any agreement, arrangement or treaty entered into by any Reimbursement party with any financier (including any Sovereign, international organization, private entity or other Person) for the purpose of financing claims of any depositors of an Icelandic bank where such claims arose prior to the date of this Agreement, but excluding (a) the UK Disbursement, Reimbursement and Indemnity Agreement, and (b) any agreement, arrangement or treaty entered into for the purpose of financing or refinancing (i) any part of the Reimbursement Amount or compensation or any other amount payable by any Reimbursement Party to The Netherlands under this Agreement or any other Relevant Document (or any successor agreement or document), or (ii) any amount payable by any Reimbursement Party under the UK Disbursement, Reimbursement and Indemnity Agreement or any other "Relevant Documents" as defined in the UK Disbursement, Reimbursement and Indemnity Agreement (or any successor agreement or document).

"*Relevant Icelandic Total Government Revenue*" means, in relation to any Reimbursement Payment Day falling in a given period starting on July 1 of any year and ending on June 30 of the immediately following year (a "*Relevant Period*"), (a) Iceland's "Total Central Government Revenue" for the calendar year immediately preceding that Relevant Period as published by the Statistical Bureau of Iceland (*Hagstofa Íslands*), or (b) if such Total Central Government Revenue (i) has not yet been published, or (ii) is less than 26 per cent. of the then

amount equal to the aggregate of the amounts which The Netherlands would otherwise have been entitled to recover from the Guarantee Fund if that obligation had been or had continued to be enforceable, valid and legal.

"*Sovereign*" means any nation or government having sovereign authority.

"*Sovereign Debt*" means any present or future borrowing, debt or other obligation, whether actual or contingent, which is (a) payable to non-residents of Iceland or, if in the form of bonds, notes, debentures, loan stock or other securities, at least 25 per cent. in aggregate principal amount of which is or was initially offered to non-residents of Iceland, or (b) denominated in a currency other than Krónur or, if denominated in Krónur, under the terms of which payment of principal, premium (if any) or interest can be or is required to be made in or by reference to any other currency, including, for the avoidance of doubt, (i) any borrowing, debt or other obligation owing to the International Monetary Fund, and (ii) any borrowing, debt or other obligation owing under the UK Disbursement, Reimbursement and Indemnity Agreement.

"*Sterling*" or "*GBP*" means the lawful means the lawful currency for the time being of the United Kingdom of Great Britain and Northern Ireland.

"*UK Disbursement, Reimbursement and Indemnity Agreement*" means the Reimbursement Agreement entered or to be entered into on or about the date of this Agreement between the Guarantee Fund, Iceland and the IMF Commissioners.

"*UK Quarterly Installment*" means a "Quarterly Installment" as defined in the UK Disbursement, Reimbursement and Indemnity Agreement.

"*UK Reimbursement Amount*" means, from time to time, the "Reimbursement Amount" as defined in the UK Disbursement, Reimbursement and Indemnity Agreement.

"*UK Second Phase Reimbursement Amount*" means the "Second Phase Reimbursement Amount" as defined in the UK Disbursement, Reimbursement and Indemnity Agreement.

"*UK Settlement Agreement*" means the "Settlement Agreement" as defined in the UK Disbursement, Reimbursement and Indemnity Agreement.

"*Taxes*" means all present and future income, stamp, registration and other taxes and levies, imposts, deductions, charges and withholdings whatsoever, and all interest, penalties or similar amounts with respect thereto or with respect to the non-payment thereof, now or hereafter imposed, assessed, levied or collected by any authority, on or in respect of this Agreement or any other Relevant Document, any payment under this Agreement or any other Relevant Document or the recording, registration, notarization or other formalization of any thereof.

"*The Netherlands*" has the meaning set forth in the introduction hereto.

ICESAVE
DOCUMENTS LIST
8 December 2010

Nr	Document	Status
	Dutch documents	
1.	Reimbursement and Indemnity Agreement	• Accrued interest language to be agreed • Otherwise final
2.	Currency side letter	• Final
3.	DNB Assignment Agreement	• Nauta to conform to FSCS Deed of Assignment • Potential outstanding issue: EUR 333K cost contribution
4.	DNB *Pari Passu* Agreement	• Timing of withdrawal of TIF objections to be confirmed • Otherwise final
5.	LEX opinion	• LEX to produce new draft
6.	State Attorney Opinion	• State to produce new draft
	UK documents	
7.	Disbursement, Reimbursement and Indemnity Agreement	• Accrued interest language to be agreed • SandM to make conforming changes to Dutch RIA • Otherwise final
8.	Currency side letter	• Final
9.	Side Letter to Settlement Agreement	• Final
	• Settlement Agreement	• Final
10.	UK Deed of Assignment	• Potential outstanding issue: EUR 333K cost contribution • Otherwise final
11.	LEX opinion	• See item 5. No separate UK opinion prepared yet.

Final draft dated 8 December 2010
Subject to board approval DNB

Assignment Agreement

This Assignment Agreement (the "**Agreement**") is entered into between:

1. Tryggingarsjóður Innstæðueigenda og fjárfesta, whose registered office is at Borgartún 26, 105 Reykjavík, Iceland; and

2. De Nederlandsche Bank N.V., whose registered office is at Westeinde 1, 1017 ZN, Amsterdam, the Netherlands.

The parties referred to under 1 and 2 above are each referred to in this Agreement as a "**Party**" and collectively as the "**Parties**".

WHEREAS

(A) TIF is a private foundation organised under the laws of Iceland, entrusted under such laws with the execution of the IDGS in accordance with the provisions of Act No. 98/1999 on Deposit Guarantees and Investor Compensation Scheme.

(B) DNB is a public limited liability company incorporated under the laws of the Netherlands, the objects and tasks and activities of which are laid down in the Bank Act 1998, and is entrusted under the Act on Financial Supervision and the Royal Decree on Special Prudential Measures, Investor Compensation and Deposit Guarantee Schemes with the execution of the DDGS.

(C) In June 2006, Landsbanki Islands hf. opened a branch in the Netherlands.

(D) On 13 October 2008 DNB decided to apply the DDGS with respect to Landsbanki Amsterdam Depositors.

(E) On 27 October 2008 FME issued its opinion that on 6 October 2008 Landsbanki was unable to pay its debts and that therefore pursuant to Article 9 of the Icelandic Act No. 98/1999 TIF was obligated to pay compensation to clients of Landsbanki, including with respect to Landsbanki Amsterdam Depositors.

(F) The DDGS only covered claims of Landsbanki Amsterdam Depositors to the extent that the level and scope of the DDGS coverage with respect to these Landsbanki Amsterdam Depositors exceeds the maximum amount payable by TIF to each Landsbanki Amsterdam Depositor if the IDGS

applied exclusively. TIF has confirmed to DNB that this maximum amount per single Landsbanki Amsterdam Depositor (or where applicable per joint account-holder) is EUR 20,887.

(G) As TIF did not have the necessary funds immediately available to make compensation payments to the Landsbanki Amsterdam Depositors, by Royal Decree of 4 December 2008 DNB was granted permission to perform the activities required to make payment to Landsbanki Amsterdam Depositors on the basis of claims submitted to it by those Landsbanki Amsterdam Depositors for reimbursement which should have been paid to them under the IDGS. This special measure was taken by the State of the Netherlands in the interest of (legal protection of) Landsbanki Amsterdam Depositors. Accordingly, DNB has handled the claims of Landsbanki Amsterdam Depositors for compensation under the DDGS and for the account of the IDGS. Compensation paid by DNB to Landsbanki Amsterdam Depositors for the account of the IDGS has been prefinanced by the State of the Netherlands.

(H) DNB has acquired from Landsbanki Amsterdam Depositors, by way of subrogation or assignment, in consideration of the distributions made by DNB for the account of the IDGS (on behalf of TIF) and under the IDGS to these Landsbanki Amsterdam Depositors, their claims against Landsbanki for the amount of the distributions made.

(I) On 19 October 2009 DNB filed a priority claim in the winding up of Landsbanki. DNB's claim has been accepted by the WuB as a priority claim and there is no disagreement between DNB and the WuB as regards the principal amount.

(J) Certain creditors of Landsbanki have objected to the WuB's decision to grant the DNB's claim priority as well as the approved amount of DNB's claim, both with regards to principal amount, interest and costs. The WuB has referred the dispute to the District Court of Reykjavik for resolution and judicial proceedings (case no. X-37/2010) are currently ongoing.

(K) On or about the date of this Agreement, TIF, Iceland and the State of the Netherlands, entered into a Reimbursement and Indemnity Agreement pursuant to which, in consideration of (a) the execution by DNB of this Agreement, (b) the payment of compensation by DNB to Landsbanki Amsterdam Depositors in respect of their claims against Landsbanki and TIF under the IDGS, and (c) the Netherlands' prefinancing of the payment of compensation by DNB, TIF undertakes to reimburse the Netherlands for that prefinancing.

Draft dated 8 December 2010
Subject to board approval DNB

(L) DNB hereby agrees to assign the IDGS-claims (including Icelandic Proof IDGS-Claims) and the Costs Claim (including Icelandic Proof Costs-Claim) to TIF to enable TIF to have recourse against Landsbanki for the distributions made by DNB for the account of the IDGS on behalf of TIF.

IT IS AGREED AS FOLLOWS

1. Interpretation

1.1 Capitalised words used in this Agreement and the recitals above, have the meaning ascribed to them in Schedule 1 to this Agreement. Words importing the singular shall include the plural and vice versa. In addition, unless the context otherwise requires, terms defined in the Reimbursement and Indemnity Agreement, to the extent not defined in Schedule 1 to this Agreement, have the same meaning when used in this Agreement.

2. Assignment

2.1 DNB hereby, with effect from the Effective Date, assigns to TIF:

(i) all its rights, title, interest and benefit in and to:
(a) each IDGS-claim which, as at the Effective Date, has been assigned to DNB by Landsbanki Amsterdam Depositors or conferred on it by operation of law or otherwise, as registered on the list referred to in paragraph 2.8 and/or as such claims are set forth in, are identifiable from and may be evidenced by the records of DNB or any other records that may legitimately be used for the purpose of determining which claims are assigned pursuant to this Agreement; and
(b) the Costs Claim; and

(ii) all its rights, title, interest and benefit in and to:
(a) its Icelandic Proof IDGS-Claims associated with each such IDGS-claim; and
(b) its Icelandic Proof Costs-Claim associated with the Costs Claim; and

(iii) all its rights and entitlements incidental to or related to (i) and (ii) above including all interest accrued with respect to the IDGS-claims (and/or the Icelandic Proof IDGS-Claims) and the Costs Claims, provided however that:

(a) no claim against Landsbanki for the costs incurred by DNB in respect of the handling of the claims of Landsbanki Amsterdam Depositors for compensation under the applicable deposit guarantee scheme is assigned to TIF other than the Costs Claim; and

(b) TIF shall not acquire nor invoke any right of pledge or right of setoff DNB may have obtained against Landsbanki and TIF will have no entitlements to the proceeds or financial benefit of such right of pledge or right of setoff.

2.2 TIF hereby accepts such assignment and notification thereof will be made by DNB to Landsbanki Íslands hf in accordance with paragraph 2.6. DNB will provide to TIF a confirmation of such notification having been sent to Landsbanki Íslands hf.

2.3 The Parties agree that if for any reason as a result of DNB assigning and transferring Icelandic Proof IDGS-claims and/or the Icelandic Proof Costs-Claim to TIF under this Agreement TIF receives any payment or distribution attributable to the part of the Claims that are not IDGS-claims or Costs Claims, it will promptly upon knowledge of receipt of any such recovery transfer such amount to DNB.

2.4 If as a result of the assignment of the IDGS-claims contemplated in this Agreement being wholly or partly invalid or for any other reason DNB receives any recovery from Landsbanki Íslands hf. and/or the WoB with respect to any IDGS-claim which DNB by entering into this Agreement agrees to assign to TIF, DNB will promptly upon knowledge of receipt of any such recovery transfer these amounts to the State of the Netherlands for the account of the State of the Netherlands and HMT for distribution (after the required currency conversion by or on behalf of the State of the Netherlands) in accordance with section 3.5(a) of the Reimbursement and Indemnity Agreement. The payments made by DNB in accordance with this paragraph 2.4 shall be construed as a payment on behalf of TIF and shall be made in the currency in which the relevant amount has been received by DNB, in immediately available funds, without deduction, set-off or counterclaim. Such payments shall be made free and clear of and without deduction or liability for or on account of any Taxes, provided that if DNB shall be required by Applicable Law to deduct any Taxes from such payments, then the sum payable shall be increased as necessary so that after making all required deductions the State of the Netherlands receives an amount equal to the sum it would have received had no such deductions been made. If any amount has fallen due for

payment by DNB under this paragraph 2.5 but remains unpaid in breach of the terms of this Agreement, DNB shall pay to TIF interest on such amount at the Arrears Rate. Any such interest shall be compounded on each Payment Date with the amount in respect of which it has accrued.

2.5 The aggregate notional principal amount of all the IDGS-claims assigned by DNB to TIF hereunder amounts to EUR 1,322,242,850. The Costs Claim amounts to EUR 7 million.

2.6 DNB shall, within five Business Days of the Effective Date, deliver a notice of assignment to Landsbanki Íslands hf (att. the Resolution Committee and the WuB) substantially in the form set out in Schedule 2 (*Form of Notice of Assignment*) hereto.

2.7 The Parties shall, no later than on the Effective Date or as soon as reasonably possible upon the occurrence of the Effective Date, execute a Claim Transfer Request Form in accordance with the template made available by the WuB in relation to the Icelandic Proof IDGS-Claims and the Icelandic Proof Costs-Claim hereby assigned and transferred. On or before the Effective Date, TIF will provide a draft Claim Transfer Request Form to DNB which TIF considers to comply with the requirements applied by the WuB. The Parties agree to sign and submit such Claim Transfer Request Form to the WuB on the Effective Date or as soon as reasonably possible upon the occurrence of the Effective Date. Such filing will be conducted in accordance with the procedures set out in the FAQs posted at http://lbi.is/winding-upboard-claimsprocess/faqwinding-upboard/. The Parties agree that if for any reason as a result of executing and submitting a Claim Transfer Request Form to the WuB, TIF receives any payment or distribution attributable to the part of the Claims that are not IDGS-claims or Costs Claims, it will hold such amount in escrow for DNB and promptly pay such amount to DNB.

2.8 Subject to the final sentence of paragraph 2.10 below, DNB shall:

(i) within five Business Days of the Effective Date, provide a list of the names, account numbers and account balances of the Landsbanki Amsterdam Depositors whose Claims relate to any of the IDGS-claims which have been assigned to TIF pursuant to paragraph 2.1 above; and

(ii) from time to time, provide TIF with such other information which DNB has available to it as TIF may reasonably request in

connection with the IDGS-claims and the Costs Claim which have been assigned to TIF pursuant to paragraph 2.2 above.

2.9 The list referred to above shall be for identification purposes only with respect to the IDGS-claims subject of the assignment and a textual or numerical error in this list shall not cause the assignment to be invalid or liable to be nullified. DNB shall promptly rectify any apparent errors in the list at TIF's request.

2.10 TIF hereby confirms that it already possesses, in its capacity as the administrator of the IDGS, a complete list of the names, account numbers and account balances of the Landsbanki Amsterdam Depositors. TIF further confirms that any processing by it of information provided to it pursuant to paragraph 2.8(i) and 2.8(ii) above shall be carried out in accordance with applicable Icelandic data protection and other laws. The provision of information pursuant to paragraph 2.8(i) and 2.8(ii) above is made in reliance upon these confirmations. DNB shall not be obliged to provide any information other than the information referred to in paragraph 2.8(i) above to TIF if providing such information would, in DNB's reasonable opinion, breach or risk breaching any law or regulation (including any law or regulation dealing with data protection) applicable to it.

2.11 Payments by TIF under this Agreement, including paragraph 2.3 and/or 2.7, shall be made in the currency in which the relevant amount has been received by TIF, in immediately available funds, without deduction, set-off or counterclaim, to such account in the Netherlands as DNB may have notified to TIF at not less than five Business Days prior notice. Such payments shall be made free and clear of and without reduction or liability for or on account of any Taxes, provided that if TIF shall be required by Applicable Law to deduct any Taxes from such payments, then the sum payable shall be increased as necessary so that after making all required deductions DNB receives an amount equal to the sum it would have received had no such deductions been made. If any amount has fallen due for payment by TIF under paragraph 2.3 and/or paragraph 2.7, respectively, but remains unpaid in breach of the terms of this Agreement, TIF shall pay to DNB compensation on such amount at the Arrears Rate. Any such compensation shall be compounded on each Payment Date with the amount in respect of which it has accrued.

3. Incremental Rights

3.1 The Parties agree that each IDGS-claim includes:

a. the principal amount of such claim, which cannot exceed EUR 20,887 per Landsbanki Amsterdam Depositor (or where applicable, per joint account-holder); and

b. any claim to interest and/or other sums which have accrued or may accrued on that principal amount or otherwise conferred on it by operation of law to the extent assigned to DNB by the relevant Landsbanki Amsterdam Depositor.

3.2 TIF hereby confirms that the IDGS-claims shall not include the right of DNB to claim in the winding-up of Landsbanki for costs and expenses (which are not part of the Costs Claim) incurred by DNB in pursuing its claim under the Claims (including the IDGS-claims) in the winding-up of Landsbanki.

4. Further assurance

4.1 Each Party shall, at its own expense, do, or procure the doing of, all such acts and things, and execute, or procure the execution of, all such documents, as may reasonably be required to give full effect to this Agreement.

4.2 Without limiting paragraph 4.1 and without prejudice to paragraphs 2.3 and 2.8, DNB will at the reasonable request of TIF execute (as soon as practicable) such documents as TIF may from time to time require to validate or establish DNB's original interest in the IDGS-claims and Costs Claim, to vest the IDGS-claims, Costs Claim, Icelandic Proof IDGS-Claims and Icelandic Proof Costs-Claims in TIF, to elevate any equitable interest to a legal interest (if legally possible), to establish or perfect TIF's interest in the IDGS-claims, Costs Claim, Icelandic Proof IDGS-Claims and Icelandic Proof Costs-Claims and exercise its rights to claim in the winding-up of Landsbanki in respect of the IDGS-claims, Costs Claim, Icelandic Proof IDGS-Claims and Icelandic Proof Costs-Claims.

4.3 Without limiting paragraph 4.1, TIF will at the reasonable request of DNB execute (as soon as practicable) such documents as DNB may from time to time require to validate or establish DNB's interest in the DDGS-claims, to ensure that the DDGS-claims remain vested (or vest) in DNB, to elevate any equitable interest to a legal interest (if legally possible), to establish or perfect DNB's interest in the DDGS-claims and any other claim of DNB, including but not limited to a claim for costs and exercise its rights to claim in the winding-up of Landsbanki in respect of the DDGS-claims or other claim.

4.4 For the avoidance of doubt, the above does not mean that the Parties make a warranty that the assignments contemplated under this Agreement are effective nor that they are acceptable to or will be accepted by the WuB.

4.5 Without prejudice to the Pari Passu Agreement, the Parties shall refrain from any action, including but not limited to judicial proceedings, arbitration and third-party rulings, that could reasonably be expected to interfere with TIF's entitlements with respect to the IDGS-claims or Costs Claim transferred pursuant to this Agreement and/or DNB's rights and entitlements with respect to the part of the Claims retained by DNB (due to the fact that such claim exceeds EUR 20,887 in aggregate) and any other claim of DNB, including but not limited to a claim for costs. The Parties shall not apply for or invoke any judgement or ruling concerning such claims if such judgement or ruling would interfere with TIF's entitlements and/or DNB's rights and entitlements referred to in the preceding sentence. TIF shall, no later than on the Effective Date, withdraw all objections to the decision of the WuB regarding the claim filed by DNB referred to in recital (J) to this Agreement.

5. **Waiver and indemnity**

5.1 The Parties hereby agree that upon the occurrence of the Effective Date (A) DNB will not have (and to the extent necessary it irrevocably renounces) any claim against TIF or Iceland in relation to the payment of compensation by DNB in respect of the claims of Landsbanki Amsterdam Depositors for the account of the IDGS other than those set out in this Agreement, the Reimbursement and Indemnity Agreement and the Pari Passu Agreement or permitted by the terms of any of either agreements; and (B) TIF will not have (and to the extent necessary it irrevocably renounces) any claim against DNB in respect of the claims set-out under (A), including but not limited to claims in respect of DNB filing such claims with the WuB and/or the dispute referred to in recital (J) above, other than those set out in this Agreement or the Pari Passu Agreement or permitted by the terms of either agreement.

5.2 TIF shall on or within five Business Days of the Effective Date make a payment to DNB of EUR 333,000 by way of contribution towards the costs incurred by DNB in relation to (i) the verification of the claims referred to under (A) in paragraph 5.1 above with the WuB and (ii) the dispute with the Reykjavik District Court referred to under (B) in paragraph 5.1 above.

6. Costs and Expenses

6.1 TIF shall bear all costs payable to the WuB or any governmental authority in Iceland in connection with the assignment of the Icelandic Proof IDGS-Claims associated with each IDGS-claim and the Icelandic Proof Costs-Claim associated with the Costs Claim.

6.2 Without prejudice to the other provisions of this Agreement or the terms of the Reimbursement and Indemnity Agreement, each Party shall bear its own costs and expenses in connection with the preparation, negotiation and execution of this Agreement and all related documents.

7. Incorporation of Terms by Reference

The provisions of sections 9.2 (Waivers), 9.4 (Amendments, Etc.) 9.7 (Counterparts) and 9.10 (Waiver of Sovereign Immunity) of the Reimbursement and Indemnity Agreement are incorporated into this Agreement as if set out in full herein and as if references in those paragraphs to "this Agreement" were, except where the context otherwise requires, references to this Agreement and as if references in those paragraphs to a "Party" were, except where the context otherwise requires, references to a Party to this Agreement.

8. Governing Law and Jurisdiction

8.1 Subject to paragraph 8.2 and 8.3 below, this Agreement, including the provisions of the Reimbursement and Indemnity Agreement that are incorporated into this Agreement pursuant to paragraph 7 of this Agreement, and any matter, claim or dispute arising out of or in connection with this Agreement, whether contractual or non-contractual, shall be governed by, and construed in accordance with, the laws of the Netherlands.

8.2 To the extent paragraph 2.1 of this Agreement operates to assign and transfer the Icelandic Proof IGDS-Claims and/or Icelandic Proof Costs-Claim such assignment and transfer is governed by Icelandic law.

8.3 The assignments and transfers implemented by this Agreement are made for the purpose of and in accordance with Article 115 of Icelandic Bankruptcy Act No. 21/1991.

8.4 Any dispute between TIF and DNB concerning or in connection with

this Agreement, whether contractual or non-contractual, including a dispute regarding the existence, validity or termination of this Agreement will be subject to the exclusive jurisdiction of the courts of the Netherlands.

9. Notices

9.1 Any communication, other than the communication referred to in paragraph 2.6 above, to be made under or in connection with this Agreement will be made in writing in English and, unless otherwise stated, may be made by letter or fax (and may be copied, but not validly served, by e-mail). The communications referred to in paragraph 2.8 may be provided by e-mail.

9.2 The address and fax number (and the department or official, if any, for whose attention the communication is to be made) of each Party for any communication to be made under or in connection with this Agreement is:

(i) if to DNB:
De Nederlandsche Bank N.V., Westeinde 1, P.O. Box 98, 1000 AB Amsterdam, The Netherlands;
Fax +31 20 524 2517;
Attn: Jan Reinder de Carpentier and Sander Timmerman. Division legal affairs;
Email: j.r.de.carpentier@dnb.nl; and
s.timmerman@dnb.nl;

with a copy to:
Dutch Ministry of Finance, at Ministerie van Financiën, Korte Voorhout 7, 2511 CW The Hague, The Netherlands, P.O. Box 20201, 2500 EE The Hague, The Netherlands;
Fax: +31 70 342 79 03;
Attn.: Treasurer-General (Thesaurier-generaal);
Email: j.c.barnard@minfin.nl

or

(ii) If to TIF:
[Tryggingarsjóður Innstæðueigenda og fjárfesta, Borgartun 26, 3rd floor, 105 Reykjavik, Iceland;
Fax: 1354 590 2606;
Attn.: Managing Director,

Draft dated 8 December 2010
Subject to board approval DNB

Email: [•]

with a copy to:
Iceland, at Ministry of Finance, Arnarhvoli Lindargötu. 150 Reykjavik, Iceland;
Fax: −354 5628280;
Attn.:Permanent Secretary;
Email [•]]

or, in each case, any substitute address or fax number (or department or official) which any of the above may notify to the others by not less than five (5) Business Days' notice.

IN WITNESS WHEREOF the Parties have executed this Agreement on the respective dates specified below.

Draft dated 8 December 2010
Subject to board approval DNB

Tryggingarsjóður Innstæðueigenda og fjárfesta

By:

Date:
Name:
Title:

Date:
Name:
Title:

De Nederlandsche Bank N.V.

By:

Date:
Name:
Title:

Date:
Name:
Title:

Draft dated 8 December 2010
Subject to board approval DNB

SCHEDULE 1

Definitions

Applicable Law	any applicable statute, law, regulation, ordinance, rule, judgment, rule of common law, order, decree, approval, concession, grant, franchise, license, agreement, directive, guideline, policy, requirement or other governmental restriction or any similar form of decision of, or determination by (or any interpretation or administration of any of the foregoing by), any Governmental Authority, whether in effect as of the date of this Agreement or thereafter
Arrears Rate	in relation to any amount and as at any day, the Dutch statutory commercial interest rate (*wettelijke handelsrente*) as referred to in Section 6:119a of the Dutch Civil Code.
Business Day	a day (other than Saturday or Sunday) on which commercial banks are not authorized or required to close in Reykjavik (Iceland) or Amsterdam (The Netherlands)
Claim	a claim on Landsbanki of a Landsbanki Amsterdam Depositor acquired by DNB from that Landsbanki Amsterdam Depositor as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor under and/or for the account of the DDGS and/or the IDGS. Any Claim may include any or both of an IDGS-claim and a DDGS-claim
Costs Claim	the claim against Landsbanki for the costs incurred by DNB in respect of the handling of the claims of Landsbanki Amsterdam Depositors for compensation under the applicable deposit guarantee scheme up to an amount of (EUR 7 million)
DDGS	the Dutch deposit guarantee scheme established under the Dutch Decree on special prudential measures, investor compensation scheme and deposit guarantee scheme (*Besluit bijzondere prudentiële maatregelen, beleggerscompensatie en depositogarantie Wft*)
DDGS-claims	each Claim to the extent acquired by DNB from

	the relevant Landsbanki Amsterdam Depositor other than as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor for the account of the IDGS
DNB	De Nederlandsche Bank N.V., a public limited liability company incorporated under the laws of the Netherlands
Effective Date	the date the Reimbursement and Indemnity Agreement becomes effective in accordance with clause 6.1 (*Conditions Precedent*) thereof
FME	the Financial Supervisory Authority in Iceland (Fjármálaeftirlitið)
Governmental Authority	any nation or government, any state or municipality, any multi-lateral or similar organization or any other agency, instrumentality or political subdivision thereof and any entity exercising executive, legislative, judicial, monetary, regulatory or administrative functions of or pertaining to government
Icelandic Proof IDGS-Claims	claim 2 with reference no. 200910-0981 filed on 19 October 2009 by DNB with the WuB in respect of (and to the extent it relates to) the IDGS-claims
Icelandic Proof Costs-Claim	claim 2 with reference no. 200910-0981 filed on 19 October 2009 by DNB with the WuB in respect of (and to the extent it relates to) the Costs Claim
IDGS	the Icelandic deposit guarantee scheme established by Icelandic Act No. 98/1999, the maximum amount of coverage with respect to each Landsbanki Amsterdam Depositor is determined at EUR 20.887
IDGS-claims	each Claim to the extent acquired by DNB from the relevant Landsbanki Amsterdam Depositor as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor for the account of the IDGS
Landsbanki	depending on the context in which it is used, Landsbanki Íslands hf. and/or Landsbanki Íslands hf., Amsterdam branch
Landsbanki Amsterdam Depositors	persons or entities that deposited any funds or otherwise had any credit balance with Landsbanki Íslands hf., Amsterdam branch

Draft dated 8 December 2010
Subject to board approval DNB

Landsbanki Íslands hf.	Landsbanki Íslands hf., a company with limited liability incorporated under the laws of Iceland
Landsbanki Íslands hf., Amsterdam branch	The Dutch branch office of Landsbanki Íslands hf.
Pari Passu Agreement	the Pari Passu Agreement to be entered into between TIF and DNB which complies with Section 6.2 of the Reimbursement and Indemnity Agreement
Payment Date	means 1 January, 1 April, 1 July and 1 September of any year
Reimbursement and Indemnity Agreement	the Reimbursement and Indemnity Agreement between the Netherlands, Iceland and TIF entered into on or about the date of this Agreement
Taxes	all present and future income, stamp, registration and other taxes and levies, imposts, deductions, charges and withholdings whatsoever, and all interest, penalties or similar amounts with respect thereto or with respect to the non-payment thereof, now or hereafter imposed, assessed, levied or collected by any authority, on or in respect of this Agreement, any payment under this Agreement or the recording, registration, notarization or other formalization of any thereof
TIF	Tryggingarsjóður Innstæðueigenda og fjárfesta, a private foundation incorporated under the laws of Iceland, entrusted under such laws with the execution of the IDGS in accordance with the provisions of Icelandic Act No. 98/1999 on Deposit Guarantees and Investor Compensation Scheme
WuB	the Winding-up Board of Landsbanki Íslands hf.

Draft dated 8 December 2010
Subject to board approval DNB

SCHEDULE 2

Form of Notice of Assignment

NOTICE OF ASSIGNMENT

To: **Landsbanki Íslands hf**
Austurstræti 11
155 Reykjavik
Iceland

Attention: The Resolution Committee

CC: **Tryggingarsjóður Innstæðueigenda og fjárfesta**
Borgartún 26
105 Reykjavik
Iceland

Attention: Managing Director

CC: **Landsbanki Íslands hf**
Austurstræti 16
101 Reykjavik
Iceland

Attention: The Winding up Board

The Winding-Up Board of Landsbanki Islands Hf.
c/o Epiq Systems Limited
11 Old Jewry, 4th Floor
London, EC2R 8DU

Attention: Landsbanki Claim Transfer Agent

From: **De Nederlandsche Bank N.V.**
Westeinde 1
1017 ZN Amsterdam
the Netherlands

Dear Sirs

As you will be aware, DNB has made payments to Landsbanki Amsterdam Depositors on behalf of TIF to enable TIF to discharge its obligations to those Depositors under the IDGS.

Draft dated 8 December 2010
Subject to board approval DNB

We hereby notify you that, pursuant to an assignment agreement (the "**Assignment Agreement**") dated [•] 2010 between DNB and TIF, a copy of which is enclosed:

(A) With effect from [ ] 2010, all our rights, title, interest and benefit in and to the IDGS-claims (and Icelandic Proof IDGS Claims) which, as at the Effective Date, had previously been assigned to us by Landsbanki Amsterdam Depositors or conferred on us by operation of law or otherwise, have been assigned and transferred by us to TIF. For the avoidance of doubt, we note that each IDGS-claim cannot exceed EUR 20,887 per Landsbanki Amsterdam Depositor (or where applicable per joint account-holder). The total notional principal amount of the IDGS-claims assigned to TIF amounts to EUR 1,322,242,850. The remainder of the Claims will be retained by DNB. In connection to these IDGS-claims, with effect from [ ] 2010 the Costs Claim (and Icelandic Proof Costs-Claims) amounting to EUR 7 million has been assigned to TIF.

(B) Details of the names, account numbers and account balances of the related Landsbanki Amsterdam Depositors are stated on the list referred to in paragraph 2.8 of the Assignment Agreement provided by us to TIF and attached hereto and/or are identifiable from and may be evidenced by the records of DNB or any other records that may legitimately be used for the purpose of determining which claims are assigned pursuant to the Assignment Agreement; and

The assignment effected by the Assignment Agreement is an assignment pursuant to article 115 of Icelandic Bankruptcy Act No. 21/1991.

As a result of the above assignment, you should, in the future, deal solely with TIF in respect of the IDGS-claims (and Icelandic Proof IDGS-Claims) and the Costs Claim (and Icelandic Proof Costs-Claims) and you will only be able to discharge yourselves in respect of these claims by making payment to TIF.

We hereby confirm that we remain the holder of the Claims to the extent that these are not IDGS-claims (and Icelandic Proof IDGS-Claims) and you should continue to deal solely with us with respect to such (part of the) Claims, including, among other things, any interest which may have accrued on such (part of the) Claims, and that you will only be able to discharge yourselves in respect thereof by making payment to us.

Capitalised words used in this notice shall have the meaning ascribed to them in

Draft dated 8 December 2010
Subject to board approval DNB

Annex A hereto.

Yours faithfully,

for and on behalf of
De Nederlandsche Bank N.V.

Draft dated 8 December 2010
Subject to board approval DNB

ANNEX A

to Notice of Assignment

Definitions

Claim	a claim on Landsbanki of a Landsbanki Amsterdam Depositor acquired by DNB from that Landsbanki Amsterdam Depositor as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor under and/or for the account of the DDGS and/or the IDGS. Any Claim may include any or both of an IDGS-claim and a DDGS-claim
Costs Claim	the claim against Landsbanki for the costs incurred by DNB in respect of the handling of the claims of Landsbanki Amsterdam Depositors for compensation under the applicable deposit guarantee scheme up to an amount of [EUR 7 million]
DDGS	the Dutch deposit guarantee scheme established under the Dutch Decree on special prudential measures, investor compensation scheme and deposit guarantee scheme (*Besluit bijzondere prudentiele maatregelen, beleggerscompensatie en depositogarantie Wft*)
DDGS-claims	each Claim to the extent acquired by DNB from the relevant Landsbanki Amsterdam Depositor other than as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor for the account of the IDGS
DNB	De Nederlandsche Bank N.V., a public limited liability company incorporated under the laws of the Netherlands
Icelandic Proof IDGS-Claims	claim 2 with reference no. 200910-0981 filed on 19 October 2009 by DNB with the Landsbanki Winding-up Board in respect of (and to the extent it relates to) the IDGS-claims
Icelandic Proof Costs-Claim	claim 2 with reference no. 200910-0981 filed on 19 October 2009 by DNB with the Landsbanki Winding-up Board in respect of (and to the extent it relates to) the Costs Claim
IDGS	the Icelandic deposit guarantee scheme;

	established by Icelandic Act No. 98/1999, the maximum amount of coverage with respect to each Landsbanki Amsterdam Depositor is determined at EUR 20,887
IDGS-claims	each Claim to the extent acquired by DNB from the relevant Landsbanki Amsterdam Depositor as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor for the account of the IDGS
Landsbanki	depending on the context in which it is used, Landsbanki Íslands hf. and/or Landsbanki Íslands hf., Amsterdam branch
Landsbanki Amsterdam Depositors	persons or entities that deposited any funds or otherwise had any credit balance with Landsbanki Íslands hf., Amsterdam branch
Landsbanki Íslands hf.	Landsbanki Íslands hf., a company with limited liability incorporated under the laws of Iceland
Landsbanki Íslands hf., Amsterdam branch	The Dutch branch office of Landsbanki Íslands hf.
TIF	Tryggingarsjóður Innstæðueigenda og fjárfesta, a private foundation incorporated under the laws of Iceland, entrusted under such laws with the execution of the IDGS in accordance with the provisions of Icelandic Act No. 98/1999 on Deposit Guarantees and Investor Compensation Scheme

PARI PASSU AGREEMENT

dated [*], 2010

between

The Depositors'and Investors' Guarantee Fund of Iceland

and

The Dutch Central Bank

This ***PARI PASSU AGREEMENT***, dated [**], 2010 (this "*Pari Passu Agreement*"), between **THE DEPOSITORS' AND INVESTORS' GUARANTEE FUND OF ICELAND** (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*), a private foundation incorporated under the laws of Iceland (the "*Guarantee Fund*"), and **THE DUTCH CENTRAL BANK** (*De Nederlandsche Bank N.V.*), a limited liability company (*naamloze vennootschap*) incorporated under the laws of the Netherlands with its corporate seat in Amsterdam, the Netherlands, ("*DNB*" and, together with the Guarantee Fund collectively, the "*Parties*").

RECITAL

WHEREAS, the Guarantee Fund, Iceland and the State of the Netherlands have entered into the Reimbursement and Indemnity Agreement.

WHEREAS, it is a condition precedent to the effectiveness of the Reimbursement and Indemnity Agreement that Guarantee Fund and DNB shall have entered into the this *Pari Passu* Agreement.

ARTICLE I
DEFINITIONS

Section 1.1 *Certain Defined Terms*. (a) As used in this *Pari Passu* Agreement, the terms defined in Schedule I shall have the meaning set out in that Schedule.

Section 1.2 *Other Interpretative Provisions*. (a) The meanings of defined terms are equally applicable to the singular and plural forms of the defined terms.

(b) In this *Pari Passu* Agrement (i) references to agreements (including this *Pari Passu* Agreement) and other documents shall be deemed to include all subsequent amendments and other modifications thereto and (ii) references to any Applicable Law are to be construed as including all statutory and regulatory provisions or rules consolidating, amending, replacing, supplementing, interpreting or implementing such Applicable Law.

ARTICLE II
PARI PASSU TREATMENT

Section 2.1 *Pari passu treatment*. For good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree as follows:

(a) to the extent that, following the assignment by DNB to the Guarantee Fund of all claims of the Landsbanki Amsterdam Depositors against Landsbanki (both as defined in the Reimbursement and Indemnity Agreement) assigned to DNB in connection with its payment of compensation in respect of those claims, as recorded in the DNB Assignment Agreement, DNB retains any part of any claim (due to the fact that such claim exceeds the amount assigned to the Guarantee Fund), then the part of the claim which has been assigned to the Guarantee Fund shall, to the fullest extent permitted by Applicable Law, rank *pari passu* in all respects with the part of that claim retained by DNB;

(b) in the event that, for any reason whatsoever (including, without limitation, any preferential status accorded to the Guarantee Fund under any Applicable Law of Iceland), following the assignment of a part of any given claim to the Guarantee Fund, either the Guarantee Fund or DNB experiences a greater *pro rata* level of recovery in respect of such claim, than that experienced by the other, the Guarantee Fund or DNB (as appropriate) shall, as soon as practicable, unless paragraph (c) below applies, make such balancing payment to DNB or the Guarantee Fund, as the case may be, as is necessary to ensure that each of the Guarantee Fund's and DNB's *pro rata* level of recovery in respect of such claim is the same as the other's; and

(c) if (i) a court of Iceland gives a final and non-appealable order or judgment which (A) determines that all or part of any claim assigned to the Guarantee Fund, or the rights retained by DNB, as the case may be, shall be entitled to receive distributions in the Landsbanki estate on a preferential basis relative to other claims originating from the same deposits, and (B) is not in conflict with an advisory opinion obtained from the Court of the European Free Trade Area on that preferential status, or (ii) the Winding-up Board of Landsbanki determines that all or part of any claim assigned to the Guarantee Fund, or the rights retained by DNB, as the case may be, shall be entitled to receive distributions in the Landsbanki estate on a preferential basis relative to the other claims originating from the same deposits but such ruling is not challenged in a court of Iceland by any depositor or creditor and such failure to challenge is not the result of a change of Applicable Law made after the Commencement Date which renders such a challenge more difficult or impossible, then, unless that preferential status results from any revocation, withdrawal, withholding or other ceasing to be in full force and effect, or any modification or amendment of any Applicable Law effected or made after the Commencement Date, the obligation described in paragraph (b) above for the Guarantee Fund or DNB, as the case may be, to make balancing payments shall not apply.

Section 2.2. *Payments*. (a) All payments of any amounts to be made by any Party under this *Pari Passu* Agreement shall be made in the currency in which the relevant amount has been received by such Party, in immediately available funds, without deduction, set-off or counterclaim, to such account in the Netherlands (in the case of DNB) or Iceland (in the case of the Guarantee Fund) as the other Party may have notified to such Party at not less than five Business Days prior notice.

(b) All payments of any amounts payable by any Party under this *Pari Passu* Agreement shall be made free and clear of and without reduction or liability for or on account of any Taxes, *provided* that if any Party shall be required by Applicable Law to deduct any Taxes from such payments, then the sum payable shall be increased as necessary so that after making all required deductions (including deductions applicable to additional sums payable under this Section 2.2) the other Party receives an amount equal to the sum it would have received had no such deductions been made.

(c) If any amount has fallen due for payment by a Party under this *Pari Passu* Agreement but remains unpaid in breach of the terms of this *Pari Passu* Agreement, such Party shall pay to other Party compensation on such amount at the Arrears Rate. Any such compensation shall be compounded on each Payment Date with the amount in respect of which it has accrued.

ARTICLE III
OTHER MATTERS

Section 3.1 *Super priority*. The Guarantee Fund may, at any time, seek to argue that its claim or claims in the winding-up of Landsbanki should enjoy a higher priority in the payment of distributions from the Landsbanki estate than the remaining claims of DNB (any such argument a "*Higher Priority Argument*") and DNB may bring objections to any such Higher Priority Argument raised by the Guarantee Fund, both with the Winding-up Board of Landsbanki, in any court proceedings, in any mediation process which may precede any such court proceeding or otherwise. Neither the Guarantee Fund nor DNB may, however, bring any argument as to the validity, quantum or (save for any Higher Priority Argument) priority of any claim of the other in the Landsbanki winding-up.

Section 3.2 *Existing arguments*. The Guarantee Fund shall, no later than on the date on which this *Pari Passu* Agreement becomes effective, withdraw any argument it has raised, whether with the Winding-up Board of Landsbanki, in any court proceedings or otherwise, against the validity or quantum or (save for any Higher Priority Argument) priority of any claim of DNB in the Landsbanki winding-up and shall use its best efforts to ensure that process or proceedings instigated by it, whether with Winding-up Board of Landsbanki or in any court or other body with judicial authority, shall be terminated to the extent that they relate to such validity or quantum.

ARTICLE IV
CONDITIONS PRECEDENT

Section 4.1 *Conditions Precedent*. The effectiveness of this *Pari Passu* Agreement is subject to the conditions precedent that:

(a) the DNB Assignment Agreement shall have been executed by all the parties thereto; and

(b) the Reimbursement and Indemnity Agreement shall have become effective in accordance with Section 5.1 thereof.

ARTICLE V
MISCELLANEOUS

Section 5.1 *Notices*. All notices, requests, instructions, directions and other communications provided for in this *Pari Passu* Agreement shall be given or made in writing in English by personally delivered letter or by fax (and may be copied, but not validly served, by e-mail) delivered to the intended recipient as follows:

(a) if to the Guarantee Fund, to it at Borgartun 26, 3rd floor, 105 Reykjavik, Iceland, Fax: +354 590 2606, Attn.: Managing Director, with a copy to Iceland, at Ministry of Finance, Arnarhvoli Lindargötu, 150 Reykjavik, Iceland, Fax: +354 5628280, Attn.:Permanent Secretary;

(b) if to DNB, to it at Westeinde 1, P.O. Box 98, 1000 AB Amsterdam, The Netherlands, Fax +31 20 524 2517, Attn: Jan Reinder de Carpentier and Sander Timmerman,

Division legal affairs, with a copy to The Netherlands at Ministerie van Financiën, Korte Voorhout 7, 2511 CW The Hague, The Netherlands, P.O. Box 20201, 2500 EE The Hague, The Netherlands, Fax: +31 70 342 79 03, Attn.: Treasurer-General (*Thesaurier-generaal*).

Except as otherwise provided in this Agreement, all such communications shall be deemed to have been duly given, (i) when personally delivered at the address of the person to be served, at the time when it is so left (or, if left on a day that is not a Business Day, at 8:15am (local time) on the next following Business Day), and (ii) when sent by facsimile transmission, when confirmation of receipt is received from the receiving facsimile machine (or, if sent on a day that is not a Business Day, at 8:15am (local time) on the next following Business Day), *provided* that, in proving the giving of notice under or in connection with this Agreement, it shall be sufficient to prove that the notice was delivered to the address for service.

Section 5.2 *Amendments, Etc.* Any provision of this *Pari Passu* Agreement may be modified, supplemented or waived only in writing.

Section 5.3 *Successors and Assigns.* (a) This *Pari Passu* Agreement shall be binding upon and inure to the benefit of the Parties. No Party may assign, transfer or encumber any of its rights or obligations under this *Pari Passu* Agreement (any attempt to do so being null and void *ab initio*).

(b) This *Pari Passu* Agreement is made and entered into for the sole protection and legal benefit of the Parties and no other person shall be a direct or indirect legal beneficiary of, or have any direct or indirect cause of action or claim in connection with, this *Pari Passu* Agreement under the Contracts (Rights of Third Parties) Act 1999.

Section 5.4 *Captions.* The captions and section headings appearing in this *Pari Passu* Agreement are included solely for convenience of reference and are not intended to affect the interpretation of any provision of this *Pari Passu* Agreement.

Section 5.5 *Counterparts.* This *Pari Passu* Agreement may be executed in any number of counterparts, all of which taken together shall constitute one and the same instrument, and any of the Parties may execute this *Pari Passu* Agreement by executing any such counterpart. Each counterpart shall be an original copy of this *Pari Passu* Agreement, but they shall together constitute one and the same instrument.

Section 5.6 *Governing Law and Jurisdiction.* THIS *PARI PASSU* AGREEMENT AND ANY MATTER, CLAIM OR DISPUTE ARISING OUT OF OR IN CONNECTION WITH IT, WHETHER CONTRACTUAL OR NON-CONTRACTUAL, SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF ENGLAND.

Section 5.7 *Arbitration.* (a) ANY DISPUTE, LEGAL ACTION OR PROCEEDING BY OR AGAINST ANY PARTY TO THIS *PARI PASSU* AGREEMENT WITH RESPECT TO OR ARISING OUT OF THIS *PARI PASSU* AGREEMENT, WHETHER CONTRACTUAL OR NON-CONTRACTUAL AND INCLUDING, WITHOUT LIMITATION, ANY DISPUTE, LEGAL ACTION OR PROCEEDING REGARDING THE EXISTENCE, VALIDITY, FORMATION OR TERMINATION OF THIS *PARI PASSU* AGREEMENT (A "*DISPUTE*")

SHALL BE SETTLED BY FINAL AND BINDING ARBITRATION IN ACCORDANCE WITH THE PCA RULES WHICH RULES ARE DEEMED INCORPORATED BY REFERENCE INTO THIS CLAUSE EXCEPT TO THE EXTENT THAT THEY RELATE TO THE NATIONALITY OF THE ARBITRATOR.

(b) In any arbitral proceedings as referred to in paragraph (a) above:

(i) the number of arbitrators shall be three;

(ii) the appointing authority shall be the Secretary-General of the Permanent Court of Arbitration;

(iii) the place of arbitration shall be The Hague, Peace Palace (*Vredespaleis*), the Netherlands;

(iv) the language to be used in the arbitral proceedings shall be English;

(v) the IBA Rules on the Taking of Evidence in International Arbitration of 29 May 2010 shall apply;

(vi) the arbitral tribunal shall use its best efforts to make a final award within twelve months of the appointment of the third arbitrator who acts as the presiding arbitrator of the arbitral tribunal, and shall conduct the arbitral proceedings accordingly;

(vii) the arbitral tribunal shall rule in accordance with the laws of England (and not, for the avoidance of doubt, as *amiable compositeur* or *ex aequo et bono*); and

(viii) both Parties, the arbitrators and the Secretary-General and the International Bureau of the Permanent Court of Arbitration shall protect the confidentiality of the existence of the arbitral proceedings and of any information received by them in connection with such proceedings.

Section 5.8 *Waiver of Sovereign Immunity*. Each of the Parties consents generally to the issue of any process in connection with any Dispute and to the giving of any type of relief or remedy against it, including, without limitation, the making, enforcement or execution against any of its Property or assets (regardless of its or their use or intended use) of any order, judgment or award (including, for the avoidance of doubt, any arbitral award made in arbitral proceedings pursuant to Section 4.7). If any Party or any of its Property or assets is entitled in any jurisdiction to any immunity from service of process or of other documents relating to any Dispute, or to any immunity from jurisdiction, suit, judgment, award, execution, attachment (whether before judgment, in aid of execution or otherwise) or other legal process, this is irrevocably waived to the fullest extent permitted by the law of that jurisdiction. Each of the Parties also irrevocably agrees not to claim any such immunity for themselves or their respective property or assets.

[*Signatures Follow.*]

IN WITNESS WHEREOF, the Parties have caused this *Pari Passu* Agreement to be duly executed and delivered as of the day and year first above written.

The Depositors' and Investors' Guarantee Fund of Iceland (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*)

By:_____
Name: [*]
Title: [*]

The Dutch Central Bank (*De Nederlandsche Bank N.V.*)

By:_____
Name: [*]
Title: [*]

SCHEDULE I
to *Pari Passu* Agreement

"*Applicable Law*" means any applicable statute, law, regulation, ordinance, rule, judgment, rule of common law, order, decree, approval, concession, grant, franchise, license, agreement, directive, guideline, policy, requirement or other governmental restriction or any similar form of decision of, or determination by (or any interpretation or administration of any of the foregoing by), any Governmental Authority, whether in effect as of the date of this *Pari Passu* Agreement or thereafter.

"*Arrears Rate*" means, in relation to any amount and as at any day, a rate *per annum* equal to the sum of (a) the Commercial Interest Reference Rate for the currency in which that amount is expressed as applicable as at that day and as published by the Organisation for Economic Co-operation and Development for a loan with shortest duration for which such rate is available (or, if no such rate is published by that organization, a comparable rate reasonably agreed between the Parties or, if the Parties fail to agree such comparable rate within four weeks after the time when it should be determined, as determined by arbitration in accordance with Section 4.7), and (b) 0.5 per cent. *per annum*.

"*Business Day*" means a day (other than Saturday or Sunday) on which commercial banks are not authorized or required to close in Reykjavik (Iceland) or Amsterdam (The Netherlands).

"*Commencement Date*" means 5 June 2009.

"*DNB*" has the meaning set forth in the introduction to this *Pari Passu* Agreement.

"*DNB Assignment Agreement*" means the Assignment Agreement to be entered into between the Parties in the form agreed between the parties to the Reimbursement and Indemnity Agreement before the date of the Reimbursement and Indemnity Agreement and which complies with Section 6.2 of the Reimbursement and Indemnity Agreement.

"*Guarantee Fund*" has the meaning set forth in the introduction to this *Pari Passu* Agreement.

"*Higher Priority Argument*" has the meaning set forth in Section 3.1.

"*Parties*" has the meaning set forth in the introduction to this *Pari Passu* Agreement.

"*Governmental Authority*" means any nation or government, any state or municipality, any multi-lateral or similar organization or any other agency, instrumentality or political subdivision thereof and any entity exercising executive, legislative, judicial, monetary, regulatory or administrative functions of or pertaining to government.

"*Guarantee Fund*" has the meaning set forth in the introduction to this *Pari Passu* Agreement.

"*Payment Date*" means January 1, April 1, July 1 and September 1 of any year.

"*Reimbursement and Indemnity Agreement*" means the Reimbursement and Indemnity Agreement between the Guarantee Fund, Iceland and the State of the Netherlands dated on or about the date of this *Pari Passu Agreement*.

"*Taxes*" means all present and future income, stamp, registration and other taxes and levies, imposts, deductions, charges and withholdings whatsoever, and all interest, penalties or similar amounts with respect thereto or with respect to the non-payment thereof, now or hereafter imposed, assessed, levied or collected by any authority, on or in respect of this *Pari Passu* Agreement, any payment under this *Pari Passu* Agreement or the recording, registration, notarization or other formalization of any thereof.

FINAL DRAFT 8 DECEMBER 2010

To: (i) The Depositors' and Investors' Guarantee Fund of Iceland (the "*Guarantee Fund*"); and

(ii) Iceland ("*Iceland*")

From: The State of the Netherlands ("*The Netherlands*")

Date: [**] 2010

Dear Madam/Sir,

Reimbursement and Indemnity Agreement dated [**] 2010

Reference is made to the Reimbursement and Indemnity Agreement dated [**] 2010 referred to above ("*Reimbursement and Indemnity Agreement*"). As used herein, the terms defined in Schedule I to the Reimbursement and Indemnity Agreement shall have the meaning set out in that Schedule.

The purpose of this letter is to confirm the agreement reached between the Parties relating to the definition of "*ISK Equivalent*" set out below.

The Parties designate this letter as a Relevant Document.

The Parties agree that this letter will take effect simultaneously with the Reimbursement and Indemnity Agreement.

With reference to the definition of "*ISK Equivalent*" in Schedule I to the Reimbursement and Indemnity Agreement, the Parties agree that, if any of (a) Iceland, or (b) any of the United Kingdom and The Netherlands (a "*Reimbursed Country*") changes its lawful currency into another currency, then, following such change:

(a) if as a result Iceland and the relevant Reimbursed Country have a common lawful currency, the ISK Equivalent of any amount which, prior to such change, would have been expressed in the lawful currency of such Reimbursed Country but, as a result of such change is expressed in such common lawful currency instead, shall be equal to that amount so expressed in the common lawful currency; and

(b) otherwise, the ISK Equivalent of any amount expressed in the lawful currency of the relevant Reimbursed Country shall be that amount translated into the lawful currency of Iceland in the manner set out in the definition of "*ISK Equivalent*" but using rates of exchange derived from a source reasonably agreed between Iceland and The Netherlands or, if Iceland and

The Netherlands fail to agree such rate prior to the date for which the relevant ISK Equivalent is to be determined, as determined by arbitration in accordance with Section 9.9 of the Reimbursement and Indemnity Agreement.

The Parties agree that Sections 1.2, 9.4, 9.5 and 9.7 through 9.11 of the Reimbursement and Indemnity Agreement shall apply to this letter as if set out in this letter in full, *provided* that, for all purposes hereof, all references in those Sections to "this Agreement" will be deemed to refer to this letter.

Please sign and return this letter in evidence of your agreement to this letter.

Yours sincerely,

The State of the Netherlands

The Minister of Finance

on his behalf

Name:

Signed for agreement on

The Depositors' and Investors' Guarantee Fund of Iceland (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*)

Name:

Title:

Iceland

Name:

Title:

Final draft dated 8 December 2010
Subject to board approval DNB

Assignment Agreement

This Assignment Agreement (the "**Agreement**") is entered into between:

1. Tryggingarsjóður Innstæðueigenda og fjárfesta, whose registered office is at Borgartún 26, 105 Reykjavík, Iceland; and

2. De Nederlandsche Bank N.V., whose registered office is at Westeinde 1, 1017 ZN, Amsterdam, the Netherlands.

The parties referred to under 1 and 2 above are each referred to in this Agreement as a "**Party**" and collectively as the "**Parties**".

WHEREAS

(A) TIF is a private foundation organised under the laws of Iceland, entrusted under such laws with the execution of the IDGS in accordance with the provisions of Act No. 98/1999 on Deposit Guarantees and Investor Compensation Scheme.

(B) DNB is a public limited liability company incorporated under the laws of the Netherlands, the objects and tasks and activities of which are laid down in the Bank Act 1998, and is entrusted under the Act on Financial Supervision and the Royal Decree on Special Prudential Measures, Investor Compensation and Deposit Guarantee Schemes with the execution of the DDGS.

(C) In June 2006, Landsbanki Íslands hf. opened a branch in the Netherlands.

(D) On 13 October 2008 DNB decided to apply the DDGS with respect to Landsbanki Amsterdam Depositors.

(E) On 27 October 2008 FME issued its opinion that on 6 October 2008 Landsbanki was unable to pay its debts and that therefore pursuant to Article 9 of the Icelandic Act No. 98/1999 TIF was obligated to pay compensation to clients of Landsbanki, including with respect to Landsbanki Amsterdam Depositors.

(F) The DDGS only covered claims of Landsbanki Amsterdam Depositors to the extent that the level and scope of the DDGS coverage with respect to these Landsbanki Amsterdam Depositors exceeds the maximum amount payable by TIF to each Landsbanki Amsterdam Depositor if the IDGS

applied exclusively. TIF has confirmed to DNB that this maximum amount per single Landsbanki Amsterdam Depositor (or where applicable per joint account-holder) is EUR 20,887.

(G) As TIF did not have the necessary funds immediately available to make compensation payments to the Landsbanki Amsterdam Depositors, by Royal Decree of 4 December 2008 DNB was granted permission to perform the activities required to make payment to Landsbanki Amsterdam Depositors on the basis of claims submitted to it by those Landsbanki Amsterdam Depositors for reimbursement which should have been paid to them under the IDGS. This special measure was taken by the State of the Netherlands in the interest of (legal protection of) Landsbanki Amsterdam Depositors. Accordingly, DNB has handled the claims of Landsbanki Amsterdam Depositors for compensation under the DDGS and for the account of the IDGS. Compensation paid by DNB to Landsbanki Amsterdam Depositors for the account of the IDGS has been prefinanced by the State of the Netherlands.

(H) DNB has acquired from Landsbanki Amsterdam Depositors, by way of subrogation or assignment, in consideration of the distributions made by DNB for the account of the IDGS (on behalf of TIF) and under the DDGS to these Landsbanki Amsterdam Depositors, their claims against Landsbanki for the amount of the distributions made.

(I) On 19 October 2009 DNB filed a priority claim in the winding up of Landsbanki. DNB's claim has been accepted by the WuB as a priority claim and there is no disagreement between DNB and the WuB as regards the principal amount.

(J) Certain creditors of Landsbanki have objected to the WuB's decision to grant the DNB's claim priority as well as the approved amount of DNB's claim, both with regards to principal amount, interest and costs. The WuB has referred the dispute to the District Court of Reykjavik for resolution and judicial proceedings (case no. X-37/2010) are currently ongoing.

(K) On or about the date of this Agreement, TIF, Iceland and the State of the Netherlands, entered into a Reimbursement and Indemnity Agreement pursuant to which, in consideration of (a) the execution by DNB of this Agreement, (b) the payment of compensation by DNB to Landsbanki Amsterdam Depositors in respect of their claims against Landsbanki and TIF under the IDGS, and (c) the Netherlands' prefinancing of the payment of compensation by DNB, TIF undertakes to reimburse the Netherlands for that prefinancing.

(L) DNB hereby agrees to assign the IDGS-claims (including Icelandic Proof IDGS-Claims) and the Costs Claim (including Icelandic Proof Costs-Claim) to TIF to enable TIF to have recourse against Landsbanki for the distributions made by DNB for the account of the IDGS on behalf of TIF.

IT IS AGREED AS FOLLOWS

1. Interpretation

1.1 Capitalised words used in this Agreement and the recitals above, have the meaning ascribed to them in Schedule 1 to this Agreement. Words importing the singular shall include the plural and vice versa. In addition, unless the context otherwise requires, terms defined in the Reimbursement and Indemnity Agreement, to the extent not defined in Schedule 1 to this Agreement, have the same meaning when used in this Agreement.

2. Assignment

2.1 DNB hereby, with effect from the Effective Date, assigns to TIF:

(i) all its rights, title, interest and benefit in and to:
(a) each IDGS-claim which, as at the Effective Date, has been assigned to DNB by Landsbanki Amsterdam Depositors or conferred on it by operation of law or otherwise, as registered on the list referred to in paragraph 2.8 and/or as such claims are set forth in, are identifiable from and may be evidenced by the records of DNB or any other records that may legitimately be used for the purpose of determining which claims are assigned pursuant to this Agreement; and
(b) the Costs Claim; and

(ii) all its rights, title, interest and benefit in and to:
(a) its Icelandic Proof IDGS-Claims associated with each such IDGS-claim; and
(b) its Icelandic Proof Costs-Claim associated with the Costs Claim; and

(iii) all its rights and entitlements incidental to or related to (i) and (ii) above including all interest accrued with respect to the IDGS-claims (and/or the Icelandic Proof IDGS-Claims) and the Costs Claims, provided however that:

(a) no claim against Landsbanki for the costs incurred by DNB in respect of the handling of the claims of Landsbanki Amsterdam Depositors for compensation under the applicable deposit guarantee scheme is assigned to TIF other than the Costs Claim; and

(b) TIF shall not acquire nor invoke any right of pledge or right of setoff DNB may have obtained against Landsbanki and TIF will have no entitlements to the proceeds or financial benefit of such right of pledge or right of setoff.

2.2 TIF hereby accepts such assignment and notification thereof will be made by DNB to Landsbanki Íslands hf in accordance with paragraph 2.6. DNB will provide to TIF a confirmation of such notification having been sent to Landsbanki Íslands hf.

2.3 The Parties agree that if for any reason as a result of DNB assigning and transferring Icelandic Proof IDGS-claims and/or the Icelandic Proof Costs-Claim to TIF under this Agreement TIF receives any payment or distribution attributable to the part of the Claims that are not IDGS-claims or Costs Claims, it will promptly upon knowledge of receipt of any such recovery transfer such amount to DNB.

2.4 If as a result of the assignment of the IDGS-claims contemplated in this Agreement being wholly or partly invalid or for any other reason DNB receives any recovery from Landsbanki Íslands hf. and/or the WuB with respect to any IDGS-claim which DNB by entering into this Agreement agrees to assign to TIF, DNB will promptly upon knowledge of receipt of any such recovery transfer these amounts to the State of the Netherlands for the account of the State of the Netherlands and HMT for distribution (after the required currency conversion by or on behalf of the State of the Netherlands) in accordance with section 3.5(a) of the Reimbursement and Indemnity Agreement. The payments made by DNB in accordance with this paragraph 2.4 shall be construed as a payment on behalf of TIF and shall be made in the currency in which the relevant amount has been received by DNB, in immediately available funds, without deduction, set-off or counterclaim. Such payments shall be made free and clear of and without deduction or liability for or on account of any Taxes, provided that if DNB shall be required by Applicable Law to deduct any Taxes from such payments, then the sum payable shall be increased as necessary so that after making all required deductions the State of the Netherlands receives an amount equal to the sum it would have received had no such deductions been made. If any amount has fallen due for

payment by DNB under this paragraph 2.5 but remains unpaid in breach of the terms of this Agreement, DNB shall pay to TIF interest on such amount at the Arrears Rate. Any such interest shall be compounded on each Payment Date with the amount in respect of which it has accrued.

2.5 The aggregate notional principal amount of all the IDGS-claims assigned by DNB to TIF hereunder amounts to EUR 1,322,242,850. The Costs Claim amounts to EUR 7 million.

2.6 DNB shall, within five Business Days of the Effective Date, deliver a notice of assignment to Landsbanki Íslands hf (att. the Resolution Committee and the WuB) substantially in the form set out in Schedule 2 (*Form of Notice of Assignment*) hereto.

2.7 The Parties shall, no later than on the Effective Date or as soon as reasonably possible upon the occurrence of the Effective Date, execute a Claim Transfer Request Form in accordance with the template made available by the WuB in relation to the Icelandic Proof IDGS-Claims and the Icelandic Proof Costs-Claim hereby assigned and transferred. On or before the Effective Date, TIF will provide a draft Claim Transfer Request Form to DNB which TIF considers to comply with the requirements applied by the WuB. The Parties agree to sign and submit such Claim Transfer Request Form to the WuB on the Effective Date or as soon as reasonably possible upon the occurrence of the Effective Date. Such filing will be conducted in accordance with the procedures set out in the FAQs posted at http://lbi.is/winding-upboard-claimsprocess/faqwinding-upboard/. The Parties agree that if for any reason as a result of executing and submitting a Claim Transfer Request Form to the WuB, TIF receives any payment or distribution attributable to the part of the Claims that are not IDGS-claims or Costs Claims, it will hold such amount in escrow for DNB and promptly pay such amount to DNB.

2.8 Subject to the final sentence of paragraph 2.10 below, DNB shall:

(i) within five Business Days of the Effective Date, provide a list of the names, account numbers and account balances of the Landsbanki Amsterdam Depositors whose Claims relate to any of the IDGS-claims which have been assigned to TIF pursuant to paragraph 2.1 above; and

(ii) from time to time, provide TIF with such other information which DNB has available to it as TIF may reasonably request in

connection with the IDGS-claims and the Costs Claim which have been assigned to TIF pursuant to paragraph 2.2 above.

2.9 The list referred to above shall be for identification purposes only with respect to the IDGS-claims subject of the assignment and a textual or numerical error in this list shall not cause the assignment to be invalid or liable to be nullified. DNB shall promptly rectify any apparent errors in the list at TIF's request.

2.10 TIF hereby confirms that it already possesses, in its capacity as the administrator of the IDGS, a complete list of the names, account numbers and account balances of the Landsbanki Amsterdam Depositors. TIF further confirms that any processing by it of information provided to it pursuant to paragraph 2.8(i) and 2.8(ii) above shall be carried out in accordance with applicable Icelandic data protection and other laws. The provision of information pursuant to paragraph 2.8(i) and 2.8(ii) above is made in reliance upon these confirmations. DNB shall not be obliged to provide any information other than the information referred to in paragraph 2.8(i) above to TIF if providing such information would, in DNB's reasonable opinion, breach or risk breaching any law or regulation (including any law or regulation dealing with data protection) applicable to it.

2.11 Payments by TIF under this Agreement, including paragraph 2.3 and/or 2.7, shall be made in the currency in which the relevant amount has been received by TIF, in immediately available funds, without deduction, set-off or counterclaim, to such account in the Netherlands as DNB may have notified to TIF at not less than five Business Days prior notice. Such payments shall be made free and clear of and without reduction or liability for or on account of any Taxes, provided that if TIF shall be required by Applicable Law to deduct any Taxes from such payments, then the sum payable shall be increased as necessary so that after making all required deductions DNB receives an amount equal to the sum it would have received had no such deductions been made. If any amount has fallen due for payment by TIF under paragraph 2.3 and/or paragraph 2.7, respectively, but remains unpaid in breach of the terms of this Agreement, TIF shall pay to DNB compensation on such amount at the Arrears Rate. Any such compensation shall be compounded on each Payment Date with the amount in respect of which it has accrued.

3. Incremental Rights

3.1 The Parties agree that each IDGS-claim includes:

a. the principal amount of such claim, which cannot exceed EUR 20,887 per Landsbanki Amsterdam Depositor (or where applicable, per joint account-holder); and

b. any claim to interest and/or other sums which have accrued or may accrued on that principal amount or otherwise conferred on it by operation of law to the extent assigned to DNB by the relevant Landsbanki Amsterdam Depositor.

3.2 TIF hereby confirms that the IDGS-claims shall not include the right of DNB to claim in the winding-up of Landsbanki for costs and expenses (which are not part of the Costs Claim) incurred by DNB in pursuing its claim under the Claims (including the IDGS-claims) in the winding-up of Landsbanki.

4. Further assurance

4.1 Each Party shall, at its own expense, do, or procure the doing of, all such acts and things, and execute, or procure the execution of, all such documents, as may reasonably be required to give full effect to this Agreement.

4.2 Without limiting paragraph 4.1 and without prejudice to paragraphs 2.3 and 2.8, DNB will at the reasonable request of TIF execute (as soon as practicable) such documents as TIF may from time to time require to validate or establish DNB's original interest in the IDGS-claims and Costs Claim, to vest the IDGS-claims, Costs Claim, Icelandic Proof IDGS-Claims and Icelandic Proof Costs-Claims in TIF, to elevate any equitable interest to a legal interest (if legally possible), to establish or perfect TIF's interest in the IDGS-claims, Costs Claim, Icelandic Proof IDGS-Claims and Icelandic Proof Costs-Claims and exercise its rights to claim in the winding-up of Landsbanki in respect of the IDGS-claims, Costs Claim, Icelandic Proof IDGS-Claims and Icelandic Proof Costs-Claims.

4.3 Without limiting paragraph 4.1, TIF will at the reasonable request of DNB execute (as soon as practicable) such documents as DNB may from time to time require to validate or establish DNB's interest in the DDGS-claims, to ensure that the DDGS-claims remain vested (or vest) in DNB, to elevate any equitable interest to a legal interest (if legally possible), to establish or perfect DNB's interest in the DDGS-claims and any other claim of DNB, including but not limited to a claim for costs and exercise its rights to claim in the winding-up of Landsbanki in respect of the DDGS-claims or other claim.

4.4 For the avoidance of doubt, the above does not mean that the Parties make a warranty that the assignments contemplated under this Agreement are effective nor that they are acceptable to or will be accepted by the WuB.

4.5 Without prejudice to the Pari Passu Agreement, the Parties shall refrain from any action, including but not limited to judicial proceedings, arbitration and third-party rulings, that could reasonably be expected to interfere with TIF's entitlements with respect to the IDGS-claims or Costs Claim transferred pursuant to this Agreement and/or DNB's rights and entitlements with respect to the part of the Claims retained by DNB (due to the fact that such claim exceeds EUR 20,887 in aggregate) and any other claim of DNB, including but not limited to a claim for costs. The Parties shall not apply for or invoke any judgement or ruling concerning such claims if such judgement or ruling would interfere with TIF's entitlements and/or DNB's rights and entitlements referred to in the preceding sentence. TIF shall, no later than on the Effective Date, withdraw all objections to the decision of the WuB regarding the claim filed by DNB referred to in recital (J) to this Agreement.

5. Waiver and indemnity

5.1 The Parties hereby agree that upon the occurrence of the Effective Date (A) DNB will not have (and to the extent necessary it irrevocably renounces) any claim against TIF or Iceland in relation to the payment of compensation by DNB in respect of the claims of Landsbanki Amsterdam Depositors for the account of the IDGS other than those set out in this Agreement, the Reimbursement and Indemnity Agreement and the Pari Passu Agreement or permitted by the terms of any of either agreements; and (B) TIF will not have (and to the extent necessary it irrevocably renounces) any claim against DNB in respect of the claims set-out under (A), including but not limited to claims in respect of DNB filing such claims with the WuB and/or the dispute referred to in recital (J) above, other than those set out in this Agreement or the Pari Passu Agreement or permitted by the terms of either agreement.

5.2 TIF shall on or within five Business Days of the Effective Date make a payment to DNB of EUR 333,000 by way of contribution towards the costs incurred by DNB in relation to (i) the verification of the claims referred to under (A) in paragraph 5.1 above with the WuB and (ii) the dispute with the Reykjavik District Court referred to under (B) in paragraph 5.1 above.

6. Costs and Expenses

6.1 TIF shall bear all costs payable to the WuB or any governmental authority in Iceland in connection with the assignment of the Icelandic Proof IDGS-Claims associated with each IDGS-claim and the Icelandic Proof Costs-Claim associated with the Costs Claim.

6.2 Without prejudice to the other provisions of this Agreement or the terms of the Reimbursement and Indemnity Agreement, each Party shall bear its own costs and expenses in connection with the preparation, negotiation and execution of this Agreement and all related documents.

7. Incorporation of Terms by Reference

The provisions of sections 9.2 (Waivers), 9.4 (Amendments, Etc.) 9.7 (Counterparts) and 9.10 (Waiver of Sovereign Immunity) of the Reimbursement and Indemnity Agreement are incorporated into this Agreement as if set out in full herein and as if references in those paragraphs to "this Agreement" were, except where the context otherwise requires, references to this Agreement and as if references in those paragraphs to a "Party" were, except where the context otherwise requires, references to a Party to this Agreement.

8. Governing Law and Jurisdiction

8.1 Subject to paragraph 8.2 and 8.3 below, this Agreement, including the provisions of the Reimbursement and Indemnity Agreement that are incorporated into this Agreement pursuant to paragraph 7 of this Agreement, and any matter, claim or dispute arising out of or in connection with this Agreement, whether contractual or non-contractual, shall be governed by, and construed in accordance with, the laws of the Netherlands.

8.2 To the extent paragraph 2.1 of this Agreement operates to assign and transfer the Icelandic Proof IGDS-Claims and/or Icelandic Proof Costs-Claim such assignment and transfer is governed by Icelandic law.

8.3 The assignments and transfers implemented by this Agreement are made for the purpose of and in accordance with Article 115 of Icelandic Bankruptcy Act No. 21/1991.

8.4 Any dispute between TIF and DNB concerning or in connection with

this Agreement, whether contractual or non-contractual, including a dispute regarding the existence, validity or termination of this Agreement will be subject to the exclusive jurisdiction of the courts of the Netherlands.

9. Notices

9.1 Any communication, other than the communication referred to in paragraph 2.6 above, to be made under or in connection with this Agreement will be made in writing in English and, unless otherwise stated, may be made by letter or fax (and may be copied, but not validly served, by e-mail). The communications referred to in paragraph 2.8 may be provided by e-mail.

9.2 The address and fax number (and the department or official, if any, for whose attention the communication is to be made) of each Party for any communication to be made under or in connection with this Agreement is:

(i) if to DNB:
De Nederlandsche Bank N.V., Westeinde 1, P.O. Box 98, 1000 AB Amsterdam, The Netherlands;
Fax +31 20 524 2517;
Attn: Jan Reinder de Carpentier and Sander Timmerman, Division legal affairs;
Email: j.r.de.carpentier@dnb.nl; and
s.timmerman@dnb.nl;

with a copy to:
Dutch Ministry of Finance, at Ministerie van Financiën, Korte Voorhout 7, 2511 CW The Hague, The Netherlands, P.O. Box 20201, 2500 EE The Hague, The Netherlands;
Fax: +31 70 342 79 03;
Attn.:Treasurer-General (Thesaurier-generaal);
Email: j.c.barnard@minfin.nl

or

(ii) If to TIF:
[Tryggingarsjóður Innstæðueigenda og fjárfesta, Borgartun 26, 3rd floor, 105 Reykjavik, Iceland;
Fax: +354 590 2606;
Attn.: Managing Director,

Email: [•]

with a copy to:
Iceland, at Ministry of Finance, Arnarhvoli Lindargötu, 150 Reykjavík, Iceland;
Fax: +354 5628280;
Attn.:Permanent Secretary;
Email [•]]

or, in each case, any substitute address or fax number (or department or official) which any of the above may notify to the others by not less than five (5) Business Days' notice.

IN WITNESS WHEREOF the Parties have executed this Agreement on the respective dates specified below.

Draft dated 8 December 2010
Subject to board approval DNB

Tryggingarsjóður Innstæðueigenda og fjárfesta

By:

Date:	Date:
Name:	Name:
Title:	Title:

De Nederlandsche Bank N.V.

By:

Date:	Date:
Name:	Name:
Title:	Title:

SCHEDULE 1

Definitions

Applicable Law	any applicable statute, law, regulation, ordinance, rule, judgment, rule of common law, order, decree, approval, concession, grant, franchise, license, agreement, directive, guideline, policy, requirement or other governmental restriction or any similar form of decision of, or determination by (or any interpretation or administration of any of the foregoing by), any Governmental Authority, whether in effect as of the date of this Agreement or thereafter
Arrears Rate	in relation to any amount and as at any day, the Dutch statutory commercial interest rate (*wettelijke handelsrente*) as referred to in Section 6:119a of the Dutch Civil Code.
Business Day	a day (other than Saturday or Sunday) on which commercial banks are not authorized or required to close in Reykjavik (Iceland) or Amsterdam (The Netherlands)
Claim	a claim on Landsbanki of a Landsbanki Amsterdam Depositor acquired by DNB from that Landsbanki Amsterdam Depositor as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor under and/or for the account of the DDGS and/or the IDGS. Any Claim may include any or both of an IDGS-claim and a DDGS-claim
Costs Claim	the claim against Landsbanki for the costs incurred by DNB in respect of the handling of the claims of Landsbanki Amsterdam Depositors for compensation under the applicable deposit guarantee scheme up to an amount of [EUR 7 million]
DDGS	the Dutch deposit guarantee scheme established under the Dutch Decree on special prudential measures, investor compensation scheme and deposit guarantee scheme (*Besluit bijzondere prudentiële maatregelen, beleggerscompensatie en depositogarantie Wft*)
DDGS-claims	each Claim to the extent acquired by DNB from

	the relevant Landsbanki Amsterdam Depositor other than as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor for the account of the IDGS
DNB	De Nederlandsche Bank N.V., a public limited liability company incorporated under the laws of the Netherlands
Effective Date	the date the Reimbursement and Indemnity Agreement becomes effective in accordance with clause 6.1 (*Conditions Precedent*) thereof
FME	the Financial Supervisory Authority in Iceland (Fjármálaeftirlitið)
Governmental Authority	any nation or government, any state or municipality, any multi-lateral or similar organization or any other agency, instrumentality or political subdivision thereof and any entity exercising executive, legislative, judicial, monetary, regulatory or administrative functions of or pertaining to government
Icelandic Proof IDGS-Claims	claim 2 with reference no. 200910-0981 filed on 19 October 2009 by DNB with the WuB in respect of (and to the extent it relates to) the IDGS-claims
Icelandic Proof Costs-Claim	claim 2 with reference no. 200910-0981 filed on 19 October 2009 by DNB with the WuB in respect of (and to the extent it relates to) the Costs Claim
IDGS	the Icelandic deposit guarantee scheme established by Icelandic Act No. 98/1999, the maximum amount of coverage with respect to each Landsbanki Amsterdam Depositor is determined at EUR 20,887
IDGS-claims	each Claim to the extent acquired by DNB from the relevant Landsbanki Amsterdam Depositor as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor for the account of the IDGS
Landsbanki	depending on the context in which it is used, Landsbanki Íslands hf. and/or Landsbanki Íslands hf., Amsterdam branch
Landsbanki Amsterdam Depositors	persons or entities that deposited any funds or otherwise had any credit balance with Landsbanki Íslands hf., Amsterdam branch

Landsbanki Íslands hf.	Landsbanki Íslands hf., a company with limited liability incorporated under the laws of Iceland
Landsbanki Íslands hf., Amsterdam branch	The Dutch branch office of Landsbanki Íslands hf.
Pari Passu Agreement	the Pari Passu Agreement to be entered into between TIF and DNB which complies with Section 6.2 of the Reimbursement and Indemnity Agreement
Payment Date	means 1 January, 1 April, 1 July and 1 September of any year
Reimbursement and Indemnity Agreement	the Reimbursement and Indemnity Agreement between the Netherlands, Iceland and TIF entered into on or about the date of this Agreement
Taxes	all present and future income, stamp, registration and other taxes and levies, imposts, deductions, charges and withholdings whatsoever, and all interest, penalties or similar amounts with respect thereto or with respect to the non-payment thereof, now or hereafter imposed, assessed, levied or collected by any authority, on or in respect of this Agreement, any payment under this Agreement or the recording, registration, notarization or other formalization of any thereof
TIF	Tryggingarsjóður Innstæðueigenda og fjárfesta, a private foundation incorporated under the laws of Iceland, entrusted under such laws with the execution of the IDGS in accordance with the provisions of Icelandic Act No. 198/1999 on Deposit Guarantees and Investor Compensation Scheme
WuB	the Winding-up Board of Landsbanki Íslands hf.

Draft dated 8 December 2010
Subject to board approval DNB

SCHEDULE 2

Form of Notice of Assignment

NOTICE OF ASSIGNMENT

To: **Landsbanki Íslands hf**
Austurstræti 11
155 Reykjavík
Iceland

Attention: The Resolution Committee

CC: **Tryggingarsjóður Innstæðueigenda og fjárfesta**
Borgartún 26
105 Reykjavík
Iceland

Attention: Managing Director

CC: **Landsbanki Íslands hf**
Austurstræti 16
101 Reykjavík
Iceland

Attention: The Winding-up Board

The Winding-Up Board of Landsbanki Islands Hf.
c/o Epiq Systems Limited
11 Old Jewry, 4th Floor
London, EC2R ADU

Attention: Landsbanki Claim Transfer Agent

From: **De Nederlandsche Bank N.V.**
Westeinde 1
1017 ZN Amsterdam
the Netherlands

Dear Sirs

As you will be aware, DNB has made payments to Landsbanki Amsterdam Depositors on behalf of TIF to enable TIF to discharge its obligations to those Depositors under the IDGS.

Draft dated 8 December 2010
Subject to board approval DNB

We hereby notify you that, pursuant to an assignment agreement (the "**Assignment Agreement**") dated [•] 2010 between DNB and TIF, a copy of which is enclosed:

(A) With effect from [ ] 2010, all our rights, title, interest and benefit in and to the IDGS-claims (and Icelandic Proof IDGS-Claims) which, as at the Effective Date, had previously been assigned to us by Landsbanki Amsterdam Depositors or conferred on us by operation of law or otherwise, have been assigned and transferred by us to TIF. For the avoidance of doubt, we note that each IDGS-claim cannot exceed EUR 20,887 per Landsbanki Amsterdam Depositor (or where applicable per joint account-holder). The total notional principal amount of the IDGS-claims assigned to TIF amounts to EUR 1,322,242,850. The remainder of the Claims will be retained by DNB. In connection to these IDGS-clams, with effect from [ ] 2010 the Costs Claim (and Icelandic Proof Costs-Claims) amounting to EUR 7 million has been assigned to TIF.

(B) Details of the names, account numbers and account balances of the related Landsbanki Amsterdam Depositors are stated on the list referred to in paragraph 2.8 of the Assignment Agreement provided by us to TIF and attached hereto and/or are identifiable from and may be evidenced by the records of DNB or any other records that may legitimately be used for the purpose of determining which claims are assigned pursuant to the Assignment Agreement; and

The assignment effected by the Assignment Agreement is an assignment pursuant to article 115 of Icelandic Bankruptcy Act No. 21/1991.

As a result of the above assignment, you should, in the future, deal solely with TIF in respect of the IDGS-claims (and Icelandic Proof IDGS-Claims) and the Costs Claim (and Icelandic Proof Costs-Claims) and you will only be able to discharge yourselves in respect of these claims by making payment to TIF.

We hereby confirm that we remain the holder of the Claims to the extent that these are not IDGS-claims (and Icelandic Proof IDGS-Claims) and you should continue to deal solely with us with respect to such (part of the) Claims, including, among other things, any interest which may have accrued on such (part of the) Claims, and that you will only be able to discharge yourselves in respect thereof by making payment to us.

Capitalised words used in this notice shall have the meaning ascribed to them in

Draft dated 8 December 2010
Subject to board approval DNB

Annex A hereto.

Yours faithfully,

_____

for and on behalf of
De Nederlandsche Bank N.V.

Draft dated 8 December 2010
Subject to board approval DNB

ANNEX A

to Notice of Assignment

Definitions

Claim	a claim on Landsbanki of a Landsbanki Amsterdam Depositor acquired by DNB from that Landsbanki Amsterdam Depositor as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor under and/or for the account of the DDGS and/or the IDGS. Any Claim may include any or both of an IDGS-claim and a DDGS-claim
Costs Claim	the claim against Landsbanki for the costs incurred by DNB in respect of the handling of the claims of Landsbanki Amsterdam Depositors for compensation under the applicable deposit guarantee scheme up to an amount of [EUR 7 million]
DDGS	the Dutch deposit guarantee scheme established under the Dutch Decree on special prudential measures, investor compensation scheme and deposit guarantee scheme (*Besluit bijzondere prudentiële maatregelen, beleggerscompensatie en depositogarantie Wft*)
DDGS-claims	each Claim to the extent acquired by DNB from the relevant Landsbanki Amsterdam Depositor other than as a result of or related to DNB making payment to such Landsbanki Amsterdam Depositor for the account of the IDGS
DNB	De Nederlandsche Bank N.V., a public limited liability company incorporated under the laws of the Netherlands
Icelandic Proof IDGS-Claims	claim 2 with reference no. 200910-0981 filed on 19 October 2009 by DNB with the Landsbanki Winding-up Board in respect of (and to the extent it relates to) the IDGS-claims
Icelandic Proof Costs-Claim	claim 2 with reference no. 200910-0981 filed on 19 October 2009 by DNB with the Landsbanki Winding-up Board in respect of (and to the extent it relates to) the Costs Claim
IDGS	the Icelandic deposit guarantee scheme

FINAL DRAFT 8 DECEMBER 2010

PARI PASSU AGREEMENT

dated [*], 2010

between

The Depositors'and Investors' Guarantee Fund of Iceland

and

The Dutch Central Bank

This ***PARI PASSU AGREEMENT***, dated [**], 2010 (this "*Pari Passu Agreement*"), between **THE DEPOSITORS' AND INVESTORS' GUARANTEE FUND OF ICELAND** (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*), a private foundation incorporated under the laws of Iceland (the "*Guarantee Fund*"), and **THE DUTCH CENTRAL BANK** (*De Nederlandsche Bank N.V.*), a limited liability company (*naamloze vennootschap*) incorporated under the laws of the Netherlands with its corporate seat in Amsterdam, the Netherlands, ("*DNB*" and, together with the Guarantee Fund collectively, the "*Parties*").

RECITAL

WHEREAS, the Guarantee Fund, Iceland and the State of the Netherlands have entered into the Reimbursement and Indemnity Agreement.

WHEREAS, it is a condition precedent to the effectiveness of the Reimbursement and Indemnity Agreement that Guarantee Fund and DNB shall have entered into the this *Pari Passu* Agreement.

ARTICLE I
DEFINITIONS

Section 1.1 *Certain Defined Terms*. (a) As used in this *Pari Passu* Agreement, the terms defined in Schedule I shall have the meaning set out in that Schedule.

Section 1.2 *Other Interpretative Provisions*. (a) The meanings of defined terms are equally applicable to the singular and plural forms of the defined terms.

(b) In this *Pari Passu* Agrement (i) references to agreements (including this *Pari Passu* Agreement) and other documents shall be deemed to include all subsequent amendments and other modifications thereto and (ii) references to any Applicable Law are to be construed as including all statutory and regulatory provisions or rules consolidating, amending, replacing, supplementing, interpreting or implementing such Applicable Law.

ARTICLE II
PARI PASSU TREATMENT

Section 2.1 *Pari passu treatment*. For good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Parties agree as follows:

(a) to the extent that, following the assignment by DNB to the Guarantee Fund of all claims of the Landsbanki Amsterdam Depositors against Landsbanki (both as defined in the Reimbursement and Indemnity Agreement) assigned to DNB in connection with its payment of compensation in respect of those claims, as recorded in the DNB Assignment Agreement, DNB retains any part of any claim (due to the fact that such claim exceeds the amount assigned to the Guarantee Fund), then the part of the claim which has been assigned to the Guarantee Fund shall, to the fullest extent permitted by Applicable Law, rank *pari passu* in all respects with the part of that claim retained by DNB;

(b) in the event that, for any reason whatsoever (including, without limitation, any preferential status accorded to the Guarantee Fund under any Applicable Law of Iceland), following the assignment of a part of any given claim to the Guarantee Fund, either the Guarantee Fund or DNB experiences a greater *pro rata* level of recovery in respect of such claim, than that experienced by the other, the Guarantee Fund or DNB (as appropriate) shall, as soon as practicable, unless paragraph (c) below applies, make such balancing payment to DNB or the Guarantee Fund, as the case may be, as is necessary to ensure that each of the Guarantee Fund's and DNB's *pro rata* level of recovery in respect of such claim is the same as the other's; and

(c) if (i) a court of Iceland gives a final and non-appealable order or judgment which (A) determines that all or part of any claim assigned to the Guarantee Fund, or the rights retained by DNB, as the case may be, shall be entitled to receive distributions in the Landsbanki estate on a preferential basis relative to other claims originating from the same deposits, and (B) is not in conflict with an advisory opinion obtained from the Court of the European Free Trade Area on that preferential status, or (ii) the Winding-up Board of Landsbanki determines that all or part of any claim assigned to the Guarantee Fund, or the rights retained by DNB, as the case may be, shall be entitled to receive distributions in the Landsbanki estate on a preferential basis relative to the other claims originating from the same deposits but such ruling is not challenged in a court of Iceland by any depositor or creditor and such failure to challenge is not the result of a change of Applicable Law made after the Commencement Date which renders such a challenge more difficult or impossible, then, unless that preferential status results from any revocation, withdrawal, withholding or other ceasing to be in full force and effect, or any modification or amendment of any Applicable Law effected or made after the Commencement Date, the obligation described in paragraph (b) above for the Guarantee Fund or DNB, as the case may be, to make balancing payments shall not apply.

Section 2.2 *Payments*. (a) All payments of any amounts to be made by any Party under this *Pari Passu* Agreement shall be made in the currency in which the relevant amount has been received by such Party, in immediately available funds, without deduction, set-off or counterclaim, to such account in the Netherlands (in the case of DNB) or Iceland (in the case of the Guarantee Fund) as the other Party may have notified to such Party at not less than five Business Days prior notice.

(b) All payments of any amounts payable by any Party under this *Pari Passu* Agreement shall be made free and clear of and without reduction or liability for or on account of any Taxes, *provided* that if any Party shall be required by Applicable Law to deduct any Taxes from such payments, then the sum payable shall be increased as necessary so that after making all required deductions (including deductions applicable to additional sums payable under this Section 2.2) the other Party receives an amount equal to the sum it would have received had no such deductions been made.

(c) If any amount has fallen due for payment by a Party under this *Pari Passu* Agreement but remains unpaid in breach of the terms of this *Pari Passu* Agreement, such Party shall pay to other Party compensation on such amount at the Arrears Rate. Any such compensation shall be compounded on each Payment Date with the amount in respect of which it has accrued.

ARTICLE III
OTHER MATTERS

Section 3.1 *Super-priority*. The Guarantee Fund may, at any time, seek to argue that its claim or claims in the winding-up of Landsbanki should enjoy a higher priority in the payment of distributions from the Landsbanki estate than the remaining claims of DNB (any such argument a "*Higher Priority Argument*") and DNB may bring objections to any such Higher Priority Argument raised by the Guarantee Fund, both with the Winding-up Board of Landsbanki, in any court proceedings, in any mediation process which may precede any such court proceeding or otherwise. Neither the Guarantee Fund nor DNB may, however, bring any argument as to the validity, quantum or (save for any Higher Priority Argument) priority of any claim of the other in the Landsbanki winding-up.

Section 3.2 *Existing arguments*. The Guarantee Fund shall, no later than on the date on which this *Pari Passu* Agreement becomes effective, withdraw any argument it has raised, whether with the Winding-up Board of Landsbanki, in any court proceedings or otherwise, against the validity or quantum or (save for any Higher Priority Argument) priority of any claim of DNB in the Landsbanki winding-up and shall use its best efforts to ensure that process or proceedings instigated by it, whether with Winding-up Board of Landsbanki or in any court or other body with judicial authority, shall be terminated to the extent that they relate to such validity or quantum.

ARTICLE IV
CONDITIONS PRECEDENT

Section 4.1 *Conditions Precedent*. The effectiveness of this *Pari Passu* Agreement is subject to the conditions precedent that:

(a) the DNB Assignment Agreement shall have been executed by all the parties thereto; and

(b) the Reimbursement and Indemnity Agreement shall have become effective in accordance with Section 5.1 thereof.

ARTICLE V
MISCELLANEOUS

Section 5.1 *Notices*. All notices, requests, instructions, directions and other communications provided for in this *Pari Passu* Agreement shall be given or made in writing in English by personally delivered letter or by fax (and may be copied, but not validly served, by e-mail) delivered to the intended recipient as follows:

(a) if to the Guarantee Fund, to it at Borgartun 26, 3rd floor, 105 Reykjavik, Iceland, Fax: +354 590 2606, Attn.: Managing Director, with a copy to Iceland, at Ministry of Finance, Arnarhvoli Lindargötu, 150 Reykjavík, Iceland, Fax: +354 5628280, Attn.:Permanent Secretary;

(b) if to DNB, to it at Westeinde 1, P.O. Box 98, 1000 AB Amsterdam, The Netherlands, Fax +31 20 524 2517, Attn: Jan Reinder de Carpentier and Sander Timmerman,

Division legal affairs, with a copy to The Netherlands at Ministerie van Financiën, Korte Voorhout 7, 2511 CW The Hague, The Netherlands, P.O. Box 20201, 2500 EE The Hague, The Netherlands, Fax: +31 70 342 79 03, Attn.:Treasurer-General (*Thesaurier-generaal*).

Except as otherwise provided in this Agreement, all such communications shall be deemed to have been duly given, (i) when personally delivered at the address of the person to be served, at the time when it is so left (or, if left on a day that is not a Business Day, at 8:15am (local time) on the next following Business Day), and (ii) when sent by facsimile transmission, when confirmation of receipt is received from the receiving facsimile machine (or, if sent on a day that is not a Business Day, at 8:15am (local time) on the next following Business Day), *provided* that, in proving the giving of notice under or in connection with this Agreement, it shall be sufficient to prove that the notice was delivered to the address for service.

Section 5.2 *Amendments, Etc*. Any provision of this *Pari Passu* Agreement may be modified, supplemented or waived only in writing.

Section 5.3 *Successors and Assigns*. (a) This *Pari Passu* Agreement shall be binding upon and inure to the benefit of the Parties. No Party may assign, transfer or encumber any of its rights or obligations under this *Pari Passu* Agreement (any attempt to do so being null and void *ab initio*).

(b) This *Pari Passu* Agreement is made and entered into for the sole protection and legal benefit of the Parties and no other person shall be a direct or indirect legal beneficiary of, or have any direct or indirect cause of action or claim in connection with, this *Pari Passu* Agreement under the Contracts (Rights of Third Parties) Act 1999.

Section 5.4 *Captions*. The captions and section headings appearing in this *Pari Passu* Agreement are included solely for convenience of reference and are not intended to affect the interpretation of any provision of this *Pari Passu* Agreement.

Section 5.5 *Counterparts*. This *Pari Passu* Agreement may be executed in any number of counterparts, all of which taken together shall constitute one and the same instrument, and any of the Parties may execute this *Pari Passu* Agreement by executing any such counterpart. Each counterpart shall be an original copy of this *Pari Passu* Agreement, but they shall together constitute one and the same instrument.

Section 5.6 *Governing Law and Jurisdiction*. THIS *PARI PASSU* AGREEMENT AND ANY MATTER, CLAIM OR DISPUTE ARISING OUT OF OR IN CONNECTION WITH IT, WHETHER CONTRACTUAL OR NON-CONTRACTUAL, SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF ENGLAND.

Section 5.7 *Arbitration*. (a) ANY DISPUTE, LEGAL ACTION OR PROCEEDING BY OR AGAINST ANY PARTY TO THIS *PARI PASSU* AGREEMENT WITH RESPECT TO OR ARISING OUT OF THIS *PARI PASSU* AGREEMENT, WHETHER CONTRACTUAL OR NON-CONTRACTUAL AND INCLUDING, WITHOUT LIMITATION, ANY DISPUTE, LEGAL ACTION OR PROCEEDING REGARDING THE EXISTENCE, VALIDITY, FORMATION OR TERMINATION OF THIS *PARI PASSU* AGREEMENT (A "*DISPUTE*")

SHALL BE SETTLED BY FINAL AND BINDING ARBITRATION IN ACCORDANCE WITH THE PCA RULES WHICH RULES ARE DEEMED INCORPORATED BY REFERENCE INTO THIS CLAUSE EXCEPT TO THE EXTENT THAT THEY RELATE TO THE NATIONALITY OF THE ARBITRATOR.

(b) In any arbitral proceedings as referred to in paragraph (a) above:

(i) the number of arbitrators shall be three;

(ii) the appointing authority shall be the Secretary-General of the Permanent Court of Arbitration;

(iii) the place of arbitration shall be The Hague, Peace Palace (*Vredespaleis*), the Netherlands;

(iv) the language to be used in the arbitral proceedings shall be English;

(v) the IBA Rules on the Taking of Evidence in International Arbitration of 29 May 2010 shall apply;

(vi) the arbitral tribunal shall use its best efforts to make a final award within twelve months of the appointment of the third arbitrator who acts as the presiding arbitrator of the arbitral tribunal, and shall conduct the arbitral proceedings accordingly;

(vii) the arbitral tribunal shall rule in accordance with the laws of England (and not, for the avoidance of doubt, as *amiable compositeur* or *ex aequo et bono*); and

(viii) both Parties, the arbitrators and the Secretary-General and the International Bureau of the Permanent Court of Arbitration shall protect the confidentiality of the existence of the arbitral proceedings and of any information received by them in connection with such proceedings.

Section 5.8 *Waiver of Sovereign Immunity*. Each of the Parties consents generally to the issue of any process in connection with any Dispute and to the giving of any type of relief or remedy against it, including, without limitation, the making, enforcement or execution against any of its Property or assets (regardless of its or their use or intended use) of any order, judgment or award (including, for the avoidance of doubt, any arbitral award made in arbitral proceedings pursuant to Section 4.7). If any Party or any of its Property or assets is entitled in any jurisdiction to any immunity from service of process or of other documents relating to any Dispute, or to any immunity from jurisdiction, suit, judgment, award, execution, attachment (whether before judgment, in aid of execution or otherwise) or other legal process, this is irrevocably waived to the fullest extent permitted by the law of that jurisdiction. Each of the Parties also irrevocably agrees not to claim any such immunity for themselves or their respective property or assets.

[*Signatures Follow.*]

IN WITNESS WHEREOF, the Parties have caused this *Pari Passu* Agreement to be duly executed and delivered as of the day and year first above written.

The Depositors' and Investors' Guarantee Fund of Iceland (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*)

By:_____
Name: [*]
Title: [*]

The Dutch Central Bank (*De Nederlandsche Bank N.V.*)

By:_____
Name: [*]
Title: [*]

SCHEDULE I
to *Pari Passu* Agreement

"*Applicable Law*" means any applicable statute, law, regulation, ordinance, rule, judgment, rule of common law, order, decree, approval, concession, grant, franchise, license, agreement, directive, guideline, policy, requirement or other governmental restriction or any similar form of decision of, or determination by (or any interpretation or administration of any of the foregoing by), any Governmental Authority, whether in effect as of the date of this *Pari Passu* Agreement or thereafter.

"*Arrears Rate*" means, in relation to any amount and as at any day, a rate *per annum* equal to the sum of (a) the Commercial Interest Reference Rate for the currency in which that amount is expressed as applicable as at that day and as published by the Organisation for Economic Co-operation and Development for a loan with shortest duration for which such rate is available (or, if no such rate is published by that organization, a comparable rate reasonably agreed between the Parties or, if the Parties fail to agree such comparable rate within four weeks after the time when it should be determined, as determined by arbitration in accordance with Section 4.7), and (b) 0.5 per cent. *per annum*.

"*Business Day*" means a day (other than Saturday or Sunday) on which commercial banks are not authorized or required to close in Reykjavik (Iceland) or Amsterdam (The Netherlands).

"*Commencement Date*" means 5 June 2009.

"*DNB*" has the meaning set forth in the introduction to this *Pari Passu* Agreement.

"*DNB Assignment Agreement*" means the Assignment Agreement to be entered into between the Parties in the form agreed between the parties to the Reimbursement and Indemnity Agreement before the date of the Reimbursement and Indemnity Agreement and which complies with Section 6.2 of the Reimbursement and Indemnity Agreement.

"*Guarantee Fund*" has the meaning set forth in the introduction to this *Pari Passu* Agreement.

"*Higher Priority Argument*" has the meaning set forth in Section 3.1.

"*Parties*" has the meaning set forth in the introduction to this *Pari Passu* Agreement.

"*Governmental Authority*" means any nation or government, any state or municipality, any multi-lateral or similar organization or any other agency, instrumentality or political subdivision thereof and any entity exercising executive, legislative, judicial, monetary, regulatory or administrative functions of or pertaining to government.

"*Guarantee Fund*" has the meaning set forth in the introduction to this *Pari Passu* Agreement.

"*Payment Date*" means January 1, April 1, July 1 and September 1 of any year.

"*Reimbursement and Indemnity Agreement*" means the Reimbursement and Indemnity Agreement between the Guarantee Fund, Iceland and the State of the Netherlands dated on or about the date of this *Pari Passu Agreement*.

"*Taxes*" means all present and future income, stamp, registration and other taxes and levies, imposts, deductions, charges and withholdings whatsoever, and all interest, penalties or similar amounts with respect thereto or with respect to the non-payment thereof, now or hereafter imposed, assessed, levied or collected by any authority, on or in respect of this *Pari Passu* Agreement, any payment under this *Pari Passu* Agreement or the recording, registration, notarization or other formalization of any thereof.

DISBURSEMENT, REIMBURSEMENT AND INDEMNITYAGREEMENT

dated 2010

among

The Depositors'and Investors' Guarantee Fund of Iceland

and

Iceland

and

The Commissioners of Her Majesty's Treasury

This ***DISBURSEMENT, REIMBURSEMENT AND INDEMNITY AGREEMENT***, dated , 2010 (this "*Agreement*"), among **THE DEPOSITORS' AND INVESTORS' GUARANTEE FUND OF ICELAND** (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*), a private foundation incorporated under the laws of Iceland (the "*Guarantee Fund*"), **ICELAND** ("*Iceland*") and **THE COMMISSIONERS OF HER MAJESTY'S TREASURY** (the "*HMT Commissioners*" and, together with the Guarantee Fund and Iceland collectively, the "*Parties*").

RECITALS

WHEREAS, the Parties have entered into the Loan Agreement and the Acceptance and Amendment Agreement, which together set out the arrangements initially foreseen by the Parties in relation to the matters described in these Recitals. The Parties now wish to enter into this Agreement to settle those matters, and also to terminate the Loan Agreement and the Acceptance and Amendment Agreement, but conditional upon this Agreement coming into effect.

WHEREAS, the claims of Landsbanki London Depositors against Landsbanki are guaranteed by the Guarantee Fund according and subject to Act No. 98/1999 which implements Directive 94/19/EC up to €20,887 per Landsbanki London Depositor.

WHEREAS, the FSCS has paid compensation to the majority of Landsbanki London Depositors in respect of their claims against Landsbanki and the Guarantee Fund under Act No. 98/1999 in return for a transfer by such Landsbanki London Depositors of such claims to the FSCS. The process by which the FSCS will settle (on behalf of the Guarantee Fund) the remaining claims of the Landsbanki London Depositors against the Guarantee Fund under Act No. 98/1999, and the Guarantee Fund will settle its obligations to the FSCS, is detailed in the Settlement Agreement.

WHEREAS, the HMT Commissioners have prefinanced the payment of compensation by the FSCS in respect of the claims of Landsbanki London Depositors against Landsbanki and the Guarantee Fund under Act No. 98/1999 and related costs. The Parties have agreed that the Guarantee Fund shall reimburse the FSCS for the amounts expended by it in paying compensation to Landsbanki London Depositors (the aggregate of such payments on behalf of the Guarantee Fund as at 24th November 2010 being estimated to be £2,254,417,851.51) and that HMT Commissioners shall put the FSCS in funds to settle (on behalf of the Guarantee Fund) the remaining claims of the Landsbanki London Depositors against the Guarantee Fund (estimated to total £20,969,252.03) under Act No. 98/1999 in accordance with the terms of this Agreement.

WHEREAS, the Parties confirm that this Agreement has been negotiated in accordance with the "Agreed Guidelines" of 14 November 2008 as agreed between Iceland and the member states of the European Union.

ARTICLE I
DEFINITIONS

Section 1.1 *Certain Defined Terms*. (a) As used herein, the terms defined in Schedule I shall have the meaning set out in that Schedule.

(b) For the purpose of the definitions of "Interest Proceeds" ~~and "HMT Reimbursement Proceeds"~~, if any part of the Guarantee Fund Estate Proceeds shall be denominated in a currency

other than Sterling and shall not have been converted by the Guarantee Fund pursuant to paragraph (a) of Section 4.7, such amount shall be converted into Sterling at such rate as may be reasonably selected by the HMT Commissioners.

Section 1.2 *Other Interpretative Provisions*. (a) The meanings of defined terms are equally applicable to the singular and plural forms of the defined terms.

(b) The words "hereof," "herein," "hereunder" and similar words refer to this Agreement as a whole and not to any particular provision of this Agreement, and any subsection, Section, Article and Schedule references are to this Agreement unless otherwise specified.

(c) The term "documents" includes any and all documents, instruments, written agreements, certificates, indentures, notices and other writings, however evidenced (including electronically).

(d) The term "including" is not limiting and (except to the extent specifically provided otherwise) shall mean "including without limitation."

(e) Unless otherwise specified, in the computation of periods of time from a specified date to a later specified date, the word "from" shall mean "from and including," the words "to" and "until" each shall mean "to but excluding," and the word "through" shall mean "to and including."

(f) The terms "may" and "might" and similar terms used with respect to the taking of an action by any Person shall reflect that such action is optional and not required to be taken by such Person.

(g) The term "continuation" of a Mandatory Prepayment Event shall reflect that such Mandatory Prepayment Event has occurred and has not been remedied and not been waived in accordance with Section 10.5.

(h) Unless otherwise expressly provided herein: (i) references to agreements (including this Agreement) and other documents shall be deemed to include all subsequent amendments and other modifications thereto, but only to the extent that such amendments and other modifications are not prohibited by any Relevant Document, and (ii) references to any Applicable Law are to be construed as including all statutory and regulatory provisions or rules consolidating, amending, replacing, supplementing, interpreting or implementing such Applicable Law.

ARTICLE II
THE FACILITY

Section 2.1 *The Facility*. (a) Subject to the terms of this Agreement, the HMT Commissioners make available to the Guarantee Fund a Sterling facility in a maximum principal amount of £2,350,000,000 or such other amount as the HMT Commissioners and the Guarantee Fund may agree in writing from time to time (the "**Facility Amount**").

(b) Disbursements made under the Facility shall be applied (or, pending such application, placed on interest-bearing deposit in order to be subsequently applied) by the Guarantee Fund or on its behalf towards one or more of the following purposes:

(i) the repayment (whether by way of set-off or otherwise) of any amounts borrowed by the FSCS from the HMT Commissioners which have been applied by the FSCS (on behalf of the Guarantee Fund) in order to pay compensation in respect of claims of Landsbanki London Depositors under Act No. 98/1999 for up to £16,872.99 per claim, together with compensation accrued on such amounts borrowed from October 1, 2009 at the First Phase Rate as described in paragraph (a)(ii) of Section 4.2;

(ii) the settlement by the FSCS (on behalf of the Guarantee Fund) of the claims of Landsbanki London Depositors under Act No. 98/1999 for up to £16,872.99 per depositor (or, where applicable, per joint-account holder); and

(iii) payment to the FSCS by way of compensation and funding for certain costs.

(c) Notwithstanding paragraph (b) above, the HMT Commissioners shall not be bound to monitor nor be concerned with the use or application of any Disbursement.

Section 2.2 *Operation of the Facility*. (a) Without prejudice to the liability of Iceland under this Agreement, the Guarantee Fund shall be the sole borrower under the Facility, shall be the debtor in respect of all Disbursements made under the Facility and shall be primarily liable for all sums (including, without limitation, the Reimbursement Amount and any compensation, costs and expenses arising in connection therewith) which are or may become due to the HMT Commissioners under this Agreement and the other Relevant Documents.

(b) The FSCS may, and the Guarantee Fund (with the consent of Iceland) hereby irrevocably authorises the FSCS to, on behalf of the Guarantee Fund, make drawings under the Facility in the form of one or more Disbursements, which the FSCS may request by delivery to the HMT Commissioners of a duly completed Disbursement Request in accordance with the Settlement Agreement.

(c) A Disbursement Request must be submitted to the HMT Commissioners by no later than 11:00 am (London time) on the proposed Disbursement Date.

(d) The FSCS may, on behalf of the Guarantee Fund, make drawings under the Facility in accordance with this Section 2.2:

(i) in order to make any payment necessary or desirable for any of the purposes set out in Section 2.1; and

(ii) until (and so that no Disbursement Date falls after) March 30, 2012 and in an aggregate principal amount not exceeding the Facility Amount.

Section 2.3 *Making of a Disbursement*. (a) Provided that:

(i) this Agreement has come into force in accordance with Article VII; and

(ii) no Mandatory Prepayment Event has occurred and been notified to the HMT Commissioners and is unremedied or unwaived, or would (to the knowledge of the HMT Commissioners, who have not waived the same) occur as a result of the proposed Disbursement being made,

the HMT Commissioners will make each Disbursement available to the FSCS on its Disbursement Date. Each Disbursement shall be made available by credit to an the FSCS Bank Account (or, in the case of a Disbursement to be used for the purpose of repaying any amount borrowed by the FSCS from the HMT Commissioners, by setting off such Disbursement against the amount already borrowed).

(b) Only the FSCS may request and receive the proceeds of a Disbursement and the Guarantee Fund will, notwithstanding (and without prejudice to) its obligations as borrower under the Facility, not have any right or claim to request or receive the proceeds of any Disbursement.

Section 2.4 *Confirmation of Disbursements*

(a) The HMT Commissioners will, as soon as reasonably possible after making any Disbursement, notify the Guarantee Fund and Iceland of:

(i) the amount of the Disbursement and its Disbursement Date; and

(ii) the amount of the Reimbursement immediately after the making of the Disbursement.

(b) Any failure to comply with paragraph (a) above shall not in any way limit the duties or liabilities of the Guarantee Fund and Iceland under this Agreement.

ARTICLE III
REIMBURSEMENT, ETC.

Section 3.1 *Undertaking to reimburse.* In consideration of (a) the execution by the FSCS of the the FSCS Deed of Assignment, (b) the payment of compensation by the FSCS to Landsbanki London Depositors in respect of their claims against Landsbanki and the Guarantee Fund under Act No. 98/1999 as referred to in the Recitals, (c) the prefinancing by the HMT Commissioners of the payment of such compensation by the FSCS, and the provision of the Facility, the Guarantee Fund undertakes to reimburse the HMT Commissioners for all Disbursements made by it hereunder by paying the Reimbursement Amount in accordance with the terms of this Agreement.

ARTICLE IV
PAYMENTS OF REIMBURSEMENT, COMPENSATION AND PAY-OUT COSTS

Section 4.1 *Payment of the Reimbursement.* (a) This Section 4.1 shall apply from the Second Phase Start Date and onwards.

(b) Subject to paragraph (d) below, the Guarantee Fund agrees to pay to the HMT Commissioners the Second Phase Reimbursement Amount in consecutive Quarterly Installments, payable on each Reimbursement Payment Date.

(c) The number of and amount of Quarterly Installments shall be calculated as follows:

(i) if, as at the day immediately preceding the Second Phase Start Date, the aggregate of the ISK Equivalent of the Second Phase Reimbursement Amount and the ISK Equivalent of the NL Second Phase Reimbursement Amount is equal to or less than ISK 45,000,000,000, (A) the number of Quarterly Installments shall be four, and (B) the amount of each Quarterly Installment shall be the Second Phase Reimbursement Amount divided by four;

(ii) if, as at the day immediately preceding the Second Phase Start Date, the aggregate of the ISK Equivalent of the Second Phase Reimbursement Amount and the ISK Equivalent of the NL Second Phase Reimbursement Amount is more than ISK 45,000,000,000, (A) the number of Quarterly Installments shall be the lesser of (I) four plus an additional four for each ISK 10,000,000,000 (or portion thereof) by which that aggregate exceeds ISK 45,000,000,000, and (II) 118, and (B) the amount of each Quarterly Installment shall be the Second Phase Reimbursement Amount divided by the number of Quarterly Installments so determined;

(d) (i) notwithstanding paragraphs (b) and (c) above and subject to paragraph (iii) below, if on any Reimbursement Payment Date the aggregate of (A) the ISK Equivalents on that Reimbursement Payment Date of the Quarterly Installment payable on that Reimbursement Payment Date and the amount of compensation payable on that Reimbursement Payment Date pursuant to paragraph (a) of Section 4.2, and (B) the ISK Equivalents of the NL Quarterly Installment payable on or about that Reimbursement Payment Date and the amount of compensation payable on or about that Reimbursement Payment Date pursuant to paragraph (a) of Section 3.2 of the NL Reimbursement and Indemnity Agreement, exceeds 1.25 per cent. of Relevant Icelandic Total Government Revenue in relation to that Reimbursement Payment Date, then (X) such aggregate shall be reduced by the minimum amount necessary to ensure that such aggregate no longer exceeds 1.25 per cent. of Relevant Icelandic Total Government Revenue in relation to that Reimbursement Payment Date, (Y) the amount of such reduction (expressed in Krónur) shall be attributed to The Netherlands and the HMT Commissioners in accordance with their respective *Pro Rata* Entitlements, and (Z) the amount of the Quarterly Installment referred to in item (A) above (and, if the Pro Rata Entitlement of the HMT Commissioners exceeds the amount of such Quarterly Installment, the amount of compensation referred to in that item) will be reduced by the *Pro Rata* Entitlement of the HMT Commissioners of such reduction (converted into Sterling at the rate used to calculate the ISK Equivalents referred to above).

(ii) Any amount by which a Quarterly Installment or any amount of compensation is reduced pursuant to paragraph (i) above will remain payable and will be added to the Quarterly Installment due on the next Reimbursement Payment Date (but that

Quarterly Installment, thus increased, will be subject to the application of paragraph (i) above and accordingly will (subject always to paragraph (iii) below) only be payable if and to the extent payable pursuant to paragraph (i) above). Any amount by which an amount of compensation is reduced pursuant to paragraph (i) above will be deemed part of the Reimbursement Amount from the Reimbursement Payment Date on which, absent paragraph (i) above, that amount would have been payable in accordance with paragraphs (b) and (c) above, and compensation will accrue on it accordingly.

(iii) Paragraphs (i) and (ii) above shall not apply in relation to the Reimbursement Payment Date on which the last Quarterly Installment is due to be paid (as determined in accordance with paragraph (c) above) and the Quarterly Installment due on that Reimbursement Payment Date, any compensation due to be paid on that Reimbursement Payment Date and any amount payable on that Reimbursement Payment Date pursuant to paragraph (ii) above shall be payable on that Reimbursement Payment Date in full.

Section 4.2 *Compensation*. (a) (i) The Guarantee Fund shall pay to the HMT Commissioners compensation in respect of the Reimbursement Amount, (A) for the period from October 1, 2009 to the Second Phase Start Date, at the First Phase Rate, and (B) for the period from the Second Phase Start Date onwards, at the Second Phase CIRR.

(ii) In respect of the period from October 1, 2009 to the date of the first Disbursement hereunder, the Reimbursement Amount shall for the purposes of calculating such compensation payable be deemed on any date to be an amount equal to the aggregate of all amounts which on that date had been paid out by the FSCS on behalf of the Guarantee Fund in the settlement by the FSCS (on behalf of the Guarantee Fund) of the claims of Landsbanki London Depositors under Act No. 98/1999 for up to £16,872.99 per depositor (or, where applicable, per joint-account holder) aggregated with the amount of any compensation compounded pursuant to paragraph (c)(i) below.

(iii) Any such compensation shall continue to accrue, to the fullest extent permitted by Applicable Law, after as well as before any bankruptcy, insolvency, reorganization, liquidation, judicial or out-of-court reorganization proceedings, dissolution, arrangement or winding up or composition or readjustment of debts of the Guarantee Fund.

For the avoidance of doubt, no compensation is payable in respect of any period prior to October 1, 2009.

(b) Notwithstanding the foregoing, the Guarantee Fund shall pay to the HMT Commissioners compensation on any Defaulted Amount at the Arrears Rate. Any such compensation shall be compounded on each Payment Date with the amount in respect of which it has accrued.

(c) Accrued compensation on the Reimbursement Amount or any other amount shall be payable (i) in the case of compensation accrued to the first Payment Date (compounded with the amount in respect of which it has accrued on each date which would have been a Payment Date if the first Payment Date had been January 1, 2010 rather than January 1, 2011), on the first Payment

Date, (ii) on each subsequent Payment Date, and (ii) in the case of any prepayment of any part of the Reimbursement Amount (whether voluntary or mandatory), on the date such part of the Reimbursement Amount is so prepaid (but such compensation shall be payable only to the extent accrued to the date of prepayment on the part of the Reimbursement Amount so prepaid), *provided* that compensation payable at the Arrears Rate on Defaulted Amounts shall also be payable from time to time on request by the HMT Commissioners.

(d) Compensation accruing on the Reimbursement Amount or any other amount shall be computed on the basis of a year of three hundred and sixty five (365) days and actual days elapsed occurring in the period for which payable.

Section 4.3 *Optional Prepayments*. (a) The Guarantee Fund may prepay the Reimbursement Amount in whole or in part, *provided* that the Guarantee Fund (or Iceland on its behalf) shall give the HMT Commissioners notice of such prepayment as provided in Section 4.4 and, upon the date specified in such notice, the amount to be prepaid and any compensation payable thereon in accordance with Section 4.2 shall become due and payable under this Agreement. Amounts prepaid under this Agreement may not be re-claimed.

(b) At the same time as making any optional prepayment in accordance with paragraph (a) above, the Guarantee Fund shall make a *pro rata* optional prepayment of the NL Reimbursement Amount then outstanding under the NL Reimbursement and Indemnity Agreement, such that the same proportion of the Reimbursement Amount and the NL Reimbursement Amount then outstanding is prepaid under this Agreement and under the NL Reimbursement and Indemnity Agreement respectively (subject to any rounding).

(c) Any prepayment of any amount of the Reimbursement Amount pursuant to paragraph (a) above shall, subject to paragraph (b) of Section 4.7, reduce the Reimbursement Amount by the amount of the prepayment and shall, if made on or after the Second Phase Start Date, be applied *pro rata* towards each of the remaining Quarterly Installments.

Section 4.4 *Certain Notices*. A notice of prepayment pursuant to paragraph (a) of Section 4.3 above shall be effective only if received by the HMT Commissioners before close of business (London time) on the date which is three (3) Business Days before the date of such prepayment. Each notice of prepayment shall specify the amount to be prepaid and the requested prepayment date (which shall be a Business Day).

Section 4.5 *Mandatory Prepayments and other payments out of Guarantee Fund Estate Proceeds*. (a)

(i) If the Guarantee Fund receives any Guarantee Fund Estate Proceeds, it shall within five (5) Business Days pay to each of the HMT Commissioners and The Netherlands, its *Pro Rata* Entitlement to that amount (such payment, to the extent to be made to the HMT Commissioners, to be made in the currency required under Section 4.7 and, to the extent to be made to The Netherlands, to be made in the currency required under the NL Reimbursement and Indemnity Agreement), *provided* that the Guarantee Fund shall not be obliged to make such payment (i) if, to the extent and for as long as the terms under which the payment made to the Guarantee Fund and resulting in receipt by the Guarantee Fund of the relevant amount prohibits the Guarantee Fund

from applying that amount towards any payment to any other Person, or (ii) if and to the extent that the Guarantee Fund is required to pay the relevant amount to DNB under the DNB Assignment Agreement, or to the FSCS under the FSCS Deed of Assignment or the Settlement Agreement.

(ii) Any amount received by the HMT Commissioners out of Guarantee Fund Estate Proceeds (whether pursuant to (x) paragraph (i) above, (y) paragraph 2.5 of the FSCS Deed of Assignment, or (z) paragraph (a)(i)(A) of Section 3.7 of the NL Reimbursement and Indemnity Agreement) shall be applied:

(A) at any time before the Recovery Percentage is less than 86, in prepayment of the Reimbursement Amount; or

(B) at any time after the Recovery Percentage is less than 86:

(1) first, in payment to the HMT Commissioners of such amount as is necessary to ensure that, after such application, the HMT Interest Share Receipts equal the HMT Interest Share at that time; and

(2) second, in prepayment of the Reimbursement Amount.

(iii) Any prepayment of any amount of the Reimbursement Amount pursuant to this paragraph shall, subject to paragraph (b) of Section 4.7, reduce the Reimbursement Amount by the amount of the prepayment and shall, if made on or after the Second Phase Start Date, be applied *pro rata* towards each of the remaining Quarterly Installments.

(b) If any of the following events (each such event a "*Mandatory Prepayment Event*") occurs, then on and at any time during the continuation of that Mandatory Prepayment Event the HMT Commissioners may by notice to the Guarantee Fund, with a copy to Iceland, declare the Reimbursement Amount, any compensation accrued thereon and all other amounts payable by any Reimbursement Party under this Agreement or any other Relevant Document to be immediately due and payable, whereupon such amounts shall be immediately due and payable without presentment, demand, protest or other formalities of any kind, all of which are hereby expressly waived by the Reimbursement Parties:

(i) (A) any part of the Reimbursement Amount or compensation or any other amount to be paid by any Reimbursement Party to the HMT Commissioners under this Agreement or any other Relevant Document shall not be paid in full when due, at the place and in the currency in which it is expressed to be payable, unless (1) in the case of a failure to so pay any part of the Reimbursement Amount or any compensation payable on a Payment Date pursuant to Section 4.1 (in the case of any part of the Reimbursement Amount) or paragraph (c)(i) of Section 4.2 (in the case of any compensation), such failure is due solely to administrative or technical error and such amount is paid within five (5) Business Days of the due date for payment, or (2) in any other case, such amount is paid within twenty (20) Business Days of the due date for payment, (B) any payment of Reimbursement Amount or compensation or of any other amount under this Agreement or any other Relevant Document previously made by any Reimbursement Party is avoided, set aside, invalidated or reduced;

(ii) any Reimbursement Party shall default or, in the case of a default which is capable of remedy, shall default for not less than a period ending twenty (20) Business Days after the earlier of (A) the day on which the HMT Commissioners gives the relevant Reimbursement Party notice of the default, or (B) the day on which any senior officer of any Reimbursement Party becomes aware or should reasonably have become aware of the default, in the observance or performance of any of its obligations under this Agreement or any other Relevant Document (other than as provided in paragraph (i) above) (and for this purpose a "senior officer" shall be, in the case of the Guarantee Fund, a director of the Guarantee Fund and, in the case of Iceland, a Minister or Permanent Secretary in the Ministry of Finance or the Ministry of Foreign Affairs of Iceland, and the heads or deputy heads of the department or departments within the government of Iceland in charge of administering Iceland's Sovereign Debt (including its debt under this Agreement);

(iii) any representation made or deemed made by any Reimbursement Party in this Agreement or any other Relevant Document or any document delivered by any Reimbursement Party in connection with any Relevant Document has been or shall prove to have been false or misleading in any material respect as of the time made or deemed made;

(iv) the payment obligations of the Guarantee Fund under this Agreement and the other Relevant Documents shall cease to rank at least *pari passu* with the present and future claims of all of its other creditors or the payment obligations of Iceland under this Agreement or the other Relevant Documents shall cease to rank at least *pari passu* with the present and future Sovereign Debt of Iceland, in each case other than claims which are mandatorily preferred by Applicable Law in force on the date of this Agreement;

(v) (A) this Agreement or any other Relevant Document shall at any time be suspended, revoked or terminated or for any reason cease to be valid and binding or in full force and effect (other than upon expiration in accordance with the terms thereof or as a result of any act or omission of the HMT Commissioners or the FSCS), (B) performance by the relevant Reimbursement Party of any obligation thereunder shall become unlawful, (C) any Reimbursement Party shall so assert in writing, or (D) the validity or enforceability thereof shall be contested by any Reimbursement Party;

(vi) the Guarantee Fund (A) shall be dissolved or liquidated, (B) shall admit in writing its inability to, or be generally unable to, pay its debts as such debts become due, taking into account any support available to it, or (C) suspends (whether voluntarily or involuntarily) making payments on any of its debts, in each case except if prior to the occurrence of such event (1) its obligations under this Agreement and the other Relevant Documents have been assumed by a successor entity on terms approved by the HMT Commissioners (such approval not to be unreasonably withheld or delayed), and (2) Iceland has provided such confirmations and entered into such documents as the HMT Commissioners may reasonably require to ensure that Iceland's obligations under this Agreement and the other Relevant Documents continue in full force and effect as if such successor had been a party to this Agreement and the other Relevant Documents from their inception;

(vii) Iceland (or any governmental or ministerial authority thereof) fails to make any payment in respect of any of its Sovereign Debt on its due date (or within any originally applicable grace period set out in the agreement constituting such Sovereign Debt) or any such Sovereign Debt becomes due earlier than its stated date of payment by reason of an event of default (however described), provided that no Mandatory Prepayment Event will occur under this paragraph (vii) unless the aggregate amount of Sovereign Debt in respect of which any amount has not been paid when due or which has become due early exceeds £50,000,000 or its equivalent in other currencies;

(viii) (A) any Reimbursement Party shall fail to comply with any Applicable Law to which it is subject, in circumstances where such failure might have a Mandatory Prepayment-Related Material Adverse Effect, or (B) any Applicable Law at any time necessary to enable the Guarantee Fund or Iceland to comply with any of its obligations under any of the Relevant Documents shall be revoked, withdrawn, withheld or otherwise not in full force and effect or shall be modified or amended in a manner that (in the aggregate) has had or would have a Mandatory Prepayment-Related Material Adverse Effect.

(b) *Notification of Mandatory Prepayment Event.* If any Reimbursement Party becomes aware that a Mandatory Prepayment Event has occurred, it shall notify the HMT Commissioners of such occurrence as soon as possible, together with details of the events or circumstances comprising such Mandatory Prepayment Event and of the steps being taken to remedy the same.

Section 4.6 *Pay-out Costs.* (a) The Guarantee Fund agrees to reimburse to the HMT Commissioners the amount of any one or more Disbursements (together the "Pay-out Costs Disbursement") made prior to 31st March, 2010 in respect of Pay-out Costs.

(b) The Guarantee Fund agrees to pay to the HMT Commissioners on each Payment Date falling in 2011 an amount equal to the aggregate of (i) one quarter of the Pay-out Costs Disbursement, and (ii) compensation thereon, accrued at the First Phase Rate from October 1, 2009 until the relevant Payment Date.

Section 4.7 *Payments.* (a) All payments of any part of the Reimbursement Amount, any compensation and all other amounts to be made by the Guarantee Fund to the HMT Commissioners under this Agreement and the other Relevant Documents shall be received in Sterling, in immediately available funds, without deduction, set-off or counterclaim, in the HMT's Settlement Account not later than 5:00 p.m. (Amsterdam time) on the date on which such payment is due (and each such payment received after such time on such due date to be deemed to have been received on the next Business Day) provided that:

(i) if the HMT Commissioners receive an amount from the FSCS pursuant to paragraph 2.5 of the FSCS Deed of Assignment, the HMT Commissioners shall, as soon as reasonably possible:

(A) pay to The Netherlands its *Pro Rata* Entitlement to that amount to be applied in accordance with paragraph (a)(ii) of Section 3.5 of the NL Reimbursement and Indemnity Agreement, such payment to be made in the currency received and without making any

conversion, with any conversion into euro to be made by The Netherlands pursuant to the NL Reimbursement and Indemnity Agreement;

(B) if such payment has been received from the FSCS in a currency other than Sterling, convert the remaining amount of such payment into Sterling at such rate as it may reasonably select and such payment shall from the time of such conversion be applied in accordance with paragraph (a)(ii) of Section 4.5 and to the extent that it is so applied in accordance with paragraph (a)(ii)(A) or paragraph (a)(ii)(B)(2) of Section 4.5 shall satisfy the obligation to repay the Reimbursement Amount up to the Sterling amount obtained by the HMT Commissioners as a result of such conversion; and

(ii) if the HMT Commissioners receive an amount from The Netherlands pursuant to paragraph (a)(i)(A) of Section 3.7 of the NL Disbursement and Indemnity Agreement, paragraph (i)(B) above shall apply mutatis mutandis.

(b) If the Guarantee Fund makes a payment to the HMT Commissioners that is insufficient to discharge all matured payments then due under this Agreement and the other Relevant Documents from the Guarantee Fund to the HMT Commissioners, that payment shall be applied (i) first, towards discharging any costs and expenses of the HMT Commissioners which the Guarantee Fund is required to reimburse pursuant to this Agreement or any other Relevant Document, (ii) second, towards payment of any accrued compensation which is due but unpaid under this Agreement or any other Relevant Document, and (iii) third, towards payment of such part of the Reimbursement Amount as is then due.

(c) If any payment under this Agreement is stated to be due on a day that is not a Business Day, or if any period by reference to which any such sum is calculated under this Agreement or any other Relevant Document would end on a day which is not a Business Day, then such date or period shall be extended to the next Business Day and such extension of time shall in such case be included in the computation of payment of compensation (if applicable), *provided* that, if such extension would cause such payment to be made, or such period to end, in the next following calendar month, such date shall be brought forward to, or such period shall end, on the next preceding Business Day.

ARTICLE V
LOSSES, ETC.

Section 5.1 *Losses*. The Guarantee Fund shall pay to the HMT Commissioners, upon the request of the HMT Commissioners, such amount as shall be sufficient to compensate it for any loss, cost or liability that is attributable to (a) the conversion of one currency into another currency pursuant to this Agreement or any other Relevant Document, (b) the occurrence of any Mandatory Prepayment Event or any breach by any Reimbursement Party of any of its obligations under this Agreement or any other Relevant Document, or (c) the preservation, perfection or enforcement of any right, power or privilege of the HMT Commissioners under this Agreement or any other Relevant Document, other than, in each case, any "costs of arbitration" within the meaning of the PCA Rules which an arbitral tribunal in arbitration proceedings as referred to in Section 10.10 has determined are to be borne by the HMT Commissioners.

Section 5.2 *Taxes*. All payments of any part of the Reimbursement Amount or compensation and all other amounts payable under this Agreement or any other Relevant Document by any Reimbursement Party to the HMT Commissioners shall be made free and clear of and without reduction or liability for or on account of any Taxes, *p rovided* that if any Reimbursement Party shall be required by Applicable Law to deduct any Taxes from such payments, then the sum payable shall be increased as necessary so that after making all required deductions (including deductions applicable to additional sums payable under this Section 5.2) the HMT Commissioners receive an amount equal to the sum they would have received had no such deductions been made.

Section 5.3 *Full and final settlement* (a) The HMT Commissioners shall not have (and to the extent that absent this Section 5.3 it would have, it irrevocably renounces) any claim against any Reimbursement Party in relation to the payment of compensation by the FSCS in respect of the claims of Landsbanki London Depositors as referred to in the Recitals, other than the claims of the HMT Commissioners under this Agreement and the other Relevant Documents.

(b) No Reimbursement Party shall make (and to the extent that absent this paragraph (b) it would have, it irrevocably renounces) any claim, or initiate any proceedings, including indemnification proceedings against the HMT Commissioners or the FSCS in relation to (i) the payment of compensation by the FSCS in respect of claims of Landsbanki London Depositors as referred to in the Recitals (including any rejections of such claims), or (ii) any claim of a Landsbanki London Depositor in respect of which compensation was not paid by the FSCS (for whatever reason). The FSCS has the benefit of and may enforce the provisions of the preceding sentence.

ARTICLE VI
INDEMNITY

Section 6.1 *Representation, warranty and indemnity*. For good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Iceland hereby:

(a) irrevocably and unconditionally represents, warrants and undertakes to the HMT Commissioners that the Guarantee Fund will ensure the full and punctual payment and performance (whether at stated maturity, upon acceleration or otherwise) of all its obligations under this Agreement and the other Relevant Documents and thus ensure that there will at no time be any Shortfall Amount;

(b) undertakes to the HMT Commissioners that, whenever there is any Shortfall Amount, it will, on demand, pay that Shortfall Amount to the HMT Commissioners as if it were the principal obligor; and

(c) undertakes to indemnify the HMT Commissioners, on demand, against any cost, loss or liability suffered by the HMT Commissioners if (a) any Shortfall Amount arises, or (b) any obligation of the Guarantee Fund under this Agreement or any other Relevant Document is or becomes illegal, not binding, invalid or unenforceable. The amount of the cost, loss or liability will be equal to the amount which the HMT Commissioners would otherwise have been entitled to recover.

Section 6.2 *Obligations Unconditional*. The obligations of Iceland under this Article VI shall be unconditional and absolute and, without limiting the generality of the foregoing, shall not be released, discharged or otherwise affected by:

(a) any extension, renewal, settlement, compromise, waiver or release in respect of any obligation(s) of any Reimbursement Party under this Agreement or the other Relevant Documents, by operation of law or otherwise (other than with respect to any such extension, renewal, settlement, compromise, waiver or release agreed in accordance with the terms hereunder as expressly applying to the obligations of Iceland hereunder);

(b) any modification, novation, extension, restatement of or supplement to this Agreement or any other Relevant Document (other than with respect to any modification, novation, extension, restatement, amendment of or supplement agreed in accordance with the terms hereof as expressly applying to the obligations of Iceland under this Article VI);

(c) any release, impairment, non-perfection or invalidity of any Lien securing any Shortfall;

(d) any change in the corporate existence, structure or ownership of the Guarantee Fund or any other Person, or any insolvency, reorganisation or similar proceedings in respect of Landsbanki , the Guarantee Fund or any other Person;

(e) the existence of any claim, set-off or other rights that the HMT Commissioners may have at any time against the Guarantee Fund or any other Person, whether in connection herewith or with any unrelated transactions;

(f) any invalidity or unenforceability relating to or against any Reimbursement Party for any reason of this Agreement or any other Relevant Document, or any provision of Applicable Law purporting to prohibit the performance by any Reimbursement Party of any of its obligations under this Agreement or any other Relevant Document (other than any such invalidity or unenforceability with respect solely to the obligations of Iceland under this Article VI);

(g) any other act or omission to act or delay of any kind by any Reimbursement Party or any other Person or any other circumstance whatsoever that might, but for the provisions of this Section 6.2, constitute a legal or equitable discharge of the obligations of any Reimbursement Party under this Agreement or any other Relevant Document.

Section 6.3 *Discharge Only upon Payment in Full; Reinstatement In Certain Circumstances*. The obligations of Iceland under this Article VI constitute continuing obligations which will extend to the ultimate balance of any Shortfall Amount, regardless of any intermediate payment or discharge, whether in whole or in part, and shall remain in full force and effect until all Shortfall Amounts shall have been paid or otherwise performed in full and no other Shortfall Amount can arise. If at any time any payment made under this Agreement or any other Relevant Document is rescinded or must otherwise be restored or returned upon the insolvency, bankruptcy, reorganization or similar event of the Guarantee Fund or any other Person or otherwise, then the obligations of Iceland hereunder with respect to such payment shall be reinstated at such time as though such payment had been due but not made at such time.

Section 6.4 *Waiver*. Iceland hereby irrevocably and unconditionally waives, to the fullest extent permitted by Applicable Law, (a) notice of acceptance of this Agreement and notice of any liability to which this Agreement may apply, (b) all notices that may be required by Applicable Law or otherwise to preserve intact any rights of the HMT Commissioners against the Guarantee Fund, including any demand, presentment, protest, proof of notice of non-payment, notice of any failure on the part of the Guarantee Fund to perform and comply with any covenant, agreement, term, condition or provision of any agreement and any other notice to any other Person that may be liable in respect of the obligations of the Guarantee Fund except any of the foregoing as may be expressly required hereunder, (c) any right to the enforcement, assertion or exercise by the HMT Commissioners of any right, power, privilege or remedy conferred upon it under this Agreement, any other Relevant Document or otherwise, and (d) any requirement that the Netherlands exhaust any right, power, privilege or remedy, or mitigate any damages resulting from a default, under this Agreement or any other Relevant Document. This waiver applies irrespective of any Applicable Law or any provision of this Agreement or any other Relevant Document to the contrary.

Section 6.5 *Subrogation*. Iceland shall not enforce any payment by way of subrogation, indemnity, contribution or otherwise, or exercise any other right, (or otherwise benefit from any payment or other transfer arising from any such right) which it may have against the Guarantee Fund by reason of the performance by it of its obligations under this Agreement or any other Relevant Document so long as any obligations under this Agreement or any other Relevant Document remain unpaid or unsatisfied (and, if Iceland receives any payment or distribution in relation to such rights, it will promptly turn such payment or distribution over to the HMT Commissioners).

Section 6.6 *Additional security*. The representation, warranty, undertaking and indemnity set out in this Article VI is in addition to and is not in any way prejudiced by any other representation, warranty, indemnity, security or other document or instrument now or subsequently held by the HMT Commissioners or any other Person.

ARTICLE VII
CONDITIONS PRECEDENT

Section 7.1 *Conditions Precedent*. The effectiveness of this Agreement is subject to the conditions precedent that:

(a) the HMT Commissioners shall have received the following documents, each of which shall be in form and substance satisfactory to the HMT Commissioners:

(i) Confirmation re. NL Reimbursement and Indemnity Agreement. Confirmation from The Netherlands that all conditions precedent to be satisfied in order for the NL Reimbursement and Indemnity Agreement to become effective (other than receipt of confirmation from the HMT Commissioners that all conditions precedent to be satisfied in order for this Agreement to become effective) have been satisfied;

(ii) Authorising Act. A copy of an Act from Iceland, which has come into force and is not, or no longer, capable of being revoked or avoided by any referendum and which

provides for the unconditional and unreserved authorization of the indemnity set out in Article VI and for any other authorization necessary to ensure that the obligations of the Reimbursement Parties under this Agreement and the other Relevant Documents are legal, valid, binding and enforceable, together with a certified translation thereof into English;

(iii) Other authorizations. A copy of an exemption granted by the Central Bank of Iceland (*Seðlabanki Íslands*) to the Guarantee Fund under Rules 370/2010 on Foreign Exchange in respect of the Guarantee Fund's execution and performance of this Agreement and the other Relevant Documents, together with a certified translation thereof into English; and

(b) Opinions of Counsel. An opinion of Lex, legal advisers to the Guarantee Fund as to the laws of Iceland and an opinion of the State Attorney of Iceland (*Ríkislögmaður*) in respect of, *inter alia*, the capacity and due authorization of, and valid execution of this Agreement and each other Relevant Document by, each of the Reimbursement Parties;

(c) the Guarantee Fund and the FSCS shall have entered into the FSCS Deed of Assignment; and

(d) the Guarantee Fund and the FSCS shall have entered into the Settlement Agreement Side Letter.

Section 7.2 *Satisfaction of Conditions Precedent*. If the actions referred to in Section 7.1 have not been completed by December 31, 2010:

(a) if the non-completion consists of the FSCS not having executed and delivered to the Guarantee Fund the FSCS Deed of Assignment and the Settlement Agreement Side Letter, the Reimbursement Parties may, by notice to the HMT Commissioners, terminate this Agreement; and

(b) if the non-completion consists of any other action referred to in Section 7.1, the HMT Commissioners may by notice to the Guarantee Fund, with a copy to Iceland, terminate this Agreement,

whereupon, in each case, this Agreement shall cease to have any effect.

Section 7.3 *Termination of Loan Agreement and Acceptance and Amendment Agreement*. On the date on which this Agreement becomes effective, the Loan Agreement and the Acceptance and Amendment Agreement shall terminate, if not previously terminated.

ARTICLE VIII
REPRESENTATIONS AND WARRANTIES

Section 8.1 *Guarantee Fund representations.* The Guarantee Fund represents and warrants to the HMT Commissioners as of the date of this Agreement as follows:

(A) The Guarantee Fund is (a) a private foundation, duly organized, validly existing and, to the extent applicable under the laws of Iceland, in good standing under the laws of Iceland, and (b) has

all requisite corporate power necessary to own its assets and carry on its business as now being conducted.

(B) This Agreement and each other Relevant Document to which it is a party have been duly executed and delivered by it, and constitute legal, valid and binding obligations of it, enforceable against it in accordance with their terms, in each case except as may be limited by equitable principles of general applicability which are specifically referred to in the relevant legal opinion referred to in paragraph (c) of Section 7.1.

Section 8.2 *Reimbursement Party representations.* Each Reimbursement Party represents and warrants to the HMT Commissioners as of the date of this Agreement that the exemption granted by the Central Bank of Iceland (*Seðlabanki Íslands*) to the Guarantee Fund under Rules 370/2010 on Foreign Exchange in respect of the Guarantee Fund's execution and performance of this Agreement and the other Relevant Documents referred to in paragraph (a)(iii) of Section 6.1 is unconditional, irrevocable and in full force and effect and there are no other authorizations, licenses, consents or other approvals or actions required from any Icelandic Governmental Authority in connection with the execution or performance of this Agreement or the other Relevant Documents or to ensure that the obligations of the Reimbursement Parties under this Agreement and the other Relevant Documents are legal, valid, binding and enforceable.

ARTICLE IX
COVENANTS

Section 9.1 *Comparability of treatment.* If any Reimbursement Party enters into any Relevant Financing Arrangement and, under that Relevant Financing Arrangement (taken as a whole), the financier party to that Relevant Financing Arrangement enjoys an overall more favorable treatment than the HMT Commissioners under this Agreement and the other Relevant Documents, or has the benefit of any Lien, then the Reimbursement Parties shall grant the HMT Commissioners the same favorable treatment or the benefit of a similar Lien (and the Reimbursement Parties shall enter into any documentation necessary or desirable in order to do so).

Section 9.2 *Equal treatment.* If the Guarantee Fund, any Other Guarantee Fund or Iceland makes any Excess Payment, the Guarantee Fund shall pay (or ensure that each relevant Other Guarantee Fund pays) an amount equal to the Excess Payment to each Landsbanki London Depositor, *provided* that, to the extent that the HMT Commissioners or the FSCS has made any payment to a Landsbanki London Depositor in respect of a claim of that Landsbanki London Depositors under Act No. 98/1999 in excess of €20,887 per claim, the payment under this Section shall be made to the HMT Commissioners or the FSCS, as the case may be.

ARTICLE X
MISCELLANEOUS

Section 10.1 *Change of circumstance.* The HMT Commissioners agree that, if at any time the then most recently published Article IV review by the IMF in relation to Iceland states that a significant deterioration has occurred in the sustainability of the debt of Iceland, relative to

the assessment of such sustainability by the IMF Fund as of November 19, 2008, then, if Iceland so requests, the HMT Commissioners will meet with Iceland to discuss the situation and consider whether, and if so how, this Agreement and the other Relevant Documents should be amended to reflect the relevant change in circumstances.

Section 10.2 *Other changes*. If the Accepted Claims Amount or the Accepted Interest Amount shall at any time change as a result of any decision of the Winding up Board of Landsbanki or of any competent court:

(i) any calculation pursuant to this Agreement or the other Relevant Documents which is directly or indirectly based on the Accepted Claims Amount or the Accepted Interest Amount shall be recalculated as if the Accepted Claims Amount or the Accepted Interest Amount had been the as so changed Accepted Claims Amount or the Accepted Interest Amount with effect from the date of this Agreement;

(ii) if any amount shall have been paid or allocated on the basis of the previous calculation then such payment or allocation shall be reversed or as the case may be reallocated to the extent required in order to reflect such recalculation.

Section 10.3 *Waiver*. No failure on the part of the HMT Commissioners to exercise and no delay in exercising, and no course of dealing with respect to, any right, power or privilege under the Agreement or any other Relevant Document shall impair that right, power or privilege or operate as a waiver or variation thereof, nor shall any single or partial exercise of any right, power or privilege under any Relevant Document preclude any other or further exercise thereof or the exercise of any other right, power or privilege. Any liberty or power which may be exercised or any determination which may be made under this Agreement by the HMT Commissioners (including any act, matter or thing as agreed, specified, determined, decided or notified by the HMT Commissioners to the Guarantee Fund or Iceland) may be exercised or made in the absolute and unfettered discretion of the HMT Commissioners from time to time, which will not be under any obligation to give reasons therefor.

Section 10.4 *Notices*. All notices, requests, instructions, directions and other communications provided for herein shall be given or made in writing in English by personally delivered letter or by fax (and may be copied, but not validly served, by e-mail) delivered to the intended recipient as follows:

(a) if to the Guarantee Fund, to it at Borgartun 26, 3rd floor, 105 Reykjavik, Iceland, Fax: +354 590 2606, Attn.: Managing Director, with a copy to Iceland, at Ministry of Finance, Arnarhvoli Lindargötu, 150 Reykjavík, Iceland, Fax: +354 5628280, Attn.:Permanent Secretary;

(b) if to Iceland, to it at Ministry of Finance, Arnarhvoli Lindargötu, 150 Reykjavík, Iceland, Fax: +354 5628280, Attn.:Permanent Secretary; and

(c) in the case of the HMT Commissioners, to them at HM Treasury, 1 Horse Guards Road, London SW1A 2HQ, United Kingdom and +44 (0)20 7270 5764 (attention: Tom Scholar); and

(d) in the case of the FSCS, to it at Financial Services Compensation Scheme, 7th Floor, Lloyds Chamber, 1 Portsoken Street, London E1 8BN, United Kingdom and +44 (0)20 7892 7637 (attention: Mark Neale).

Except as otherwise provided in this Agreement, all such communications shall be deemed to have been duly given, (i) when personally delivered at the address of the Person to be served, at the time when it is so left (or, if left on a day that is not a Business Day, at 8:15am (local time) on the next following Business Day), and (ii) when sent by facsimile transmission, when confirmation of receipt is received from the receiving facsimile machine (or, if sent on a day that is not a Business Day, at 8:15am (local time) on the next following Business Day), *provided* that, in proving the giving of notice under or in connection with this Agreement, it shall be sufficient to prove that the notice was delivered to the address for service.

Section 10.5 *Amendments, Etc.* Except as otherwise expressly provided in this Agreement, any provision of this Agreement and (except as specifically provided therein) any other Relevant Document may be modified, supplemented or waived only in writing executed by the Parties affected by the modification, supplement or waiver.

Section 10.6 *Successors and Assigns.* (a) This Agreement shall be binding upon and inure to the benefit of the Parties. No Party may assign, transfer or encumber any of its rights or obligations under this Agreement or any other Relevant Document (any attempt to do so being null and void *ab initio*).

(b) This Agreement is made and entered into for the sole protection and legal benefit of the Parties and no other Person shall be a direct or indirect legal beneficiary of, or have any direct or indirect cause of action or claim in connection with, this Agreement under the Contracts (Rights of Third Parties) Act 1999, *provided* that the FSCS has the benefit of and may enforce any right accorded to it, or any term or condition expressed to be for its benefit, in this Agreement.

Section 10.7 *Captions.* The table of contents and captions and section headings appearing herein are included solely for convenience of reference and are not intended to affect the interpretation of any provision of this Agreement.

Section 10.8 *Counterparts.* This Agreement may be executed in any number of counterparts, all of which taken together shall constitute one and the same instrument, and any of the Parties may execute this Agreement by executing any such counterpart. Each counterpart shall be an original copy of this Agreement, but they shall together constitute one and the same instrument.

Section 10.9 *Governing Law.* THIS AGREEMENT AND ANY MATTER, CLAIM OR DISPUTE ARISING OUT OF OR IN CONNECTION WITH IT, WHETHER CONTRACTUAL OR NON-CONTRACTUAL, SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF ENGLAND.

Section 10.10 *Arbitration.* (a) ANY DISPUTE, LEGAL ACTION OR PROCEEDING BY OR AGAINST ANY PARTY HERETO WITH RESPECT TO OR ARISING OUT OF THIS AGREEMENT, WHETHER CONTRACTUAL OR NON-CONTRACTUAL AND INCLUDING ANY DISPUTE, LEGAL ACTION OR PROCEEDING REGARDING THE

EXISTENCE, VALIDITY, FORMATION OR TERMINATION OF THIS AGREEMENT (A "*DISPUTE*") SHALL BE SETTLED BY FINAL AND BINDING ARBITRATION IN ACCORDANCE WITH THE PCA RULES, WHICH RULES ARE DEEMED INCORPORATED BY REFERENCE INTO THIS CLAUSE EXCEPT TO THE EXTENT THAT THEY RELATE TO THE NATIONALITY OF THE ARBITRATOR.

(b) In any arbitral proceedings as referred to in paragraph (a) above:

(i) the number of arbitrators shall be three;

(ii) if all Parties are party to the arbitral proceedings, each of (A) the Reimbursement Parties jointly (and failing such joint appointment Article 7(2) of the PCA Rules shall apply), and (B) the HMT Commissioners shall appoint one arbitrator and the two arbitrators thus appointed shall choose the third arbitrator who will act as the presiding arbitrator of the arbitral tribunal;

(iii) the appointing authority shall be the Secretary-General of the Permanent Court of Arbitration;

(iv) the place of arbitration shall be London, England;

(v) the language to be used in the arbitral proceedings shall be English;

(vi) the IBA Rules on the Taking of Evidence in International Arbitration of 29 May 2010 shall apply;

(vii) the arbitral tribunal shall use its best efforts to make a final award within twelve months of the appointment of the third arbitrator who acts as the presiding arbitrator of the arbitral tribunal, and shall conduct the arbitral proceedings accordingly;

(viii) the arbitral tribunal shall rule in accordance with the laws of England (and not, for the avoidance of doubt, as *amiable compositeur* or *ex aequo et bono*); and

(ix) all Parties, the arbitrators and the Secretary-General and the International Bureau of the Permanent Court of Arbitration shall protect the confidentiality of the existence of the arbitral proceedings and of any information received by them in connection with such proceedings.

Section 10.11 *Waiver of Sovereign Immunity*. Each of the Reimbursement Parties consents generally to the issue of any process in connection with any Dispute and to the giving of any type of relief or remedy against it, including the making, enforcement or execution against any of its Property or assets (regardless of its or their use or intended use) of any order, judgment or award (including, for the avoidance of doubt, any arbitral award made in arbitral proceedings pursuant to Section 10.10). If any Reimbursement Party or any of its Property or assets is entitled in any jurisdiction to any immunity from service of process or of other documents relating to any Dispute, or to any immunity from jurisdiction, suit, judgment, award, execution, attachment (whether before judgment, in aid of execution or otherwise) or other legal process, this is irrevocably waived to the fullest extent permitted by the law of that jurisdiction. Each of the

Reimbursement Parties also irrevocably agrees not to claim any such immunity for themselves or their respective Property or assets. The Parties confirm that this paragraph does not extend to any assets of Iceland which enjoy immunity under the Vienna Convention on Diplomatic Relations, any assets of Iceland located in Iceland which are necessary for the proper functioning of Iceland as a sovereign power, or to any assets of the Central Bank of Iceland (*Seðlabanki Íslands*).

Section 10.12 *Severability*. The illegality or unenforceability in any jurisdiction of any provision hereof or of any document required hereunder shall not in any way affect or impair the legality or enforceability of the remaining provisions of this Agreement or such other document in such jurisdiction or such provision in any other jurisdiction.

[*Signatures Follow.*]

and (ii) nothing in this Agreement or any other Relevant Document is intended to remove or shall have the effect of removing from Iceland its control of its natural resources and its right to decide on the utilisation and form of ownership thereof

IN WITNESS WHEREOF, the Parties have caused this Agreement to be duly executed and delivered as of the day and year first above written.

The Depositors' and Investors' Guarantee Fund of Iceland (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*)

By:_____
Name: [*]
Title: [*]

Iceland

By:_____
Name: [*]
Title: [*]

The Commissioners of Her Majesty's Treasury

By:_____
Name: [*]
Title: [*]

SCHEDULE I
to Reimbursement Agreement

"*Acceptance and Amendment Agreement*" means the Acceptance and Amendment Agreement dated 19 October 2009 between the Parties.

"*Accepted Claims Amount*" means, at any time, the amount of the Assigned Claim which has at that time been accepted by the Winding up Board of Landsbanki (or by a competent court, such court determination to prevail if different from such Winding up Board acceptance and binding upon such Winding up Board) as constituting a valid claim in the winding up of Landsbanki under Article 112 of the Icelandic Act no. 21/1991 on Bankruptcies etc. (*Lög nr.21/1991 um gjaldþrotaskipti o.fl.*).

"*Accepted Interest Amount*" means, at any time, the amount of any interest included in the Accepted Claims Amount.

"*Assigned Claim*" means, collectively, the claims against Landsbanki assigned or expressed to be assigned to the Guarantee Fund by FSCS pursuant to the FSCS Deed of Assignment.

"*Act No. 98/1999*" means the Icelandic Act No. 98/1999 on Deposit and Investor-Compensation Scheme (*Lög nr. 98/1999 um innstæðutryggingar og tryggingakerfi fyrir fjárfesta*) as in force on 11 October 2008.

"*Agreement*" has the meaning set forth in the introduction hereto.

"*Applicable Law*" means any applicable statute, law, regulation, ordinance, rule, judgment, rule of common law, order, decree, approval, concession, grant, franchise, license, agreement, directive, guideline, policy, requirement or other governmental restriction or any similar form of decision of, or determination by (or any interpretation or administration of any of the foregoing by), any Governmental Authority, whether in effect as of the date hereof or (unless a contrary indication appears in this Agreement or any other Relevant Document) thereafter.

"*Arrears Rate*" means, at any time of determination, a rate *per annum* equal to the sum of (a) for the period from the date of this Agreement to the Second Phase Start Date, the First Phase Rate plus 0.3 per cent. *per annum*, and (b) for the period from the Second Phase Start Date onwards, the Second Phase CIRR plus 0.5 per cent. *per annum*.

"*Business Day*" means a day (other than Saturday or Sunday) on which commercial banks are not authorized or required to close in Reykjavik (Iceland) or London (England).

"*Commencement Date*" means 5 June 2009.

"*Defaulted Amount*" means each amount which has fallen due for payment by a Reimbursement Party but remains unpaid in breach of the terms of this Agreement.

"*Directive 94/19/EC*" means Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes as in force on 11 October 2008 (subject to any contrary indication).

"*Disbursement*" means a disbursement made or to be made under this Agreement.

"*Disbursement Date*" means the date on which a Disbursement is or is to be made.

"*Disbursement Request*" means a notice substantially in the form of Schedule II.

"*DNB*" means "DNB" as defined in the NL Reimbursement and Indemnity Agreement.

"*DNB Assignment Agreement*" means the "DNB Assignment Agreement" as defined in the NL Reimbursement and Indemnity Agreement.

"*euro*" or "€" means the lawful currency for the time being of the Member States of the European Union that adopt or have adopted the euro as their lawful currency in accordance with legislation of the European Community relating to Economic and Monetary Union.

"*Excess Payment*" means any payment in excess of an amount of €20,887 in respect of any claim or claims of a Landsbanki Depositor (not including, for the avoidance of doubt, any former Landsbanki Depositor who became a depositor of NBI hf.) other than a Landsbanki London Depositor.

"*Facility*" means the term facility described in paragraph (a) of Section 2.1.

"*Facility Amount*" has the meaning ascribed thereto in paragraph (a) of Section 2.1.

"*First Phase Rate*" means 3.3 per cent. *per annum*.

"*FSCS*" means the Financial Services Compensation Scheme Limited.

"*FSCS Bank Account*" means one or more bank accounts maintained by the HMT Commissioners in their books for the FSCS.

"*FSCS Deed of Assignment*" means the deed of assignment of claims to be entered into between the Guarantee Fund and the FSCS in the form agreed between the Parties before the date of this Agreement.

"*Governmental Authority*" means any nation or government, any state or municipality, any multi-lateral or similar organization or any other agency, instrumentality or political subdivision thereof and any entity exercising executive, legislative, judicial, monetary, regulatory or administrative functions of or pertaining to government.

"*Guarantee Fund*" has the meaning set forth in the introduction hereto.

"*Guarantee Fund Estate Proceeds*" means (i) any amount received by the Guarantee Fund in respect of the claims of or formerly of Landsbanki Depositors or otherwise in respect of the insolvency of Landsbanki, and (ii) any amount received by DNB which is payable by DNB to The

Netherlands pursuant to paragraph 2.4 of the DNB Assignment Agreement, and (iii) any amount received by the FSCS which is payable by the FSCS to the HMT Commissioners pursuant to paragraph 2.5 of the FSCS Deed of Assignment.

"*HMT Commissioners*" has the meaning set forth in the introduction hereto.

"*HMT Interest Share Receipts*" means, at any time, the aggregate of all amounts applied in accordance with paragraph (a)(ii)(B)(1) of Section 4.5 at or prior to that time.

"*HMT Interest Share*" means, at any time, a fraction of the Interest Proceeds at that time, calculated by multiplying those Interest Proceeds by a fraction dependent on the Recovery Percentage at that time and determined in accordance with the following table:

Recovery Percentage	**HMT Interest Share**
86 or less	Zero
≥86 ≤ 87	0.05
≥87 ≤ 88	0.10
≥88 ≤ 89	0.15
≥90 ≤ 91	0.20
≥91 ≤ 92	0.25
≥92 ≤ 93	0.35
≥93 ≤ 94	0.45
≥94 ≤ 95	0.55
≥95 ≤ 96	0.65
≥96 ≤ 97	0.75
≥97 ≤ 98	0.85
≥98 ≤ 99	0.95
≥99 ≤ 100	1

"*HMT's Settlement Account*" means one or more bank accounts maintained by the HMT Commissioners from time to time as notified by the HMT Commissioners to the Guarantee Fund.

"*Iceland*" has the meaning set forth in the introduction hereto.

"*Interest Proceeds*" means, at any time, an amount (expressed in Sterling) equal to a fraction of the Guarantee Fund Estate Proceeds at that time, calculated by multiplying the amount of those Guarantee Fund Estate Proceeds by a fraction the numerator of which is equal to the Accepted Interest Amount and the denominator of which is equal to the Accepted Claims Amount, in each case at that time.

"*ISK Equivalent*" means, in relation to any amount in euro or Sterling and as at any day, the equivalent of such amount in Krónur calculated at the average of the published daily rates of exchange as published by the Central Bank of Iceland (*Seðlabanki Íslands*) (or, to the extent that no such rates of exchange are published by the Central Bank of Iceland, the published daily rates of exchange derived from a source reasonably agreed between Iceland and the HMT Commissioners or, if Iceland and the HMT Commissioners fail to agree such rate prior to the date for which the

relevant ISK Equivalent is to be determined, as determined by arbitration in accordance with Section 10.10) for the period of one month ending on the day immediately preceding that day.

"*Krónur*" or "*ISK*" means the lawful currency for the time being of Iceland.

"*Landsbanki*" means Landsbanki Íslands hf., a financial undertaking incorporated under the laws of Iceland.

"*Landsbanki Depositor*" means each Person who has deposited any funds, or otherwise has any credit balance, with Landsbanki and whose corresponding claim against Landsbanki is guaranteed by the Guarantee Fund according and subject to Act No. 98/1999 (including, for the avoidance of doubt, each Landsbanki London Depositor).

"*Landsbanki London*" means the London branch of Landsbanki.

"*Landsbanki London Depositor*" means (i) each depositor with Landsbanki London's "Icesave" product; (ii) any person who has submitted an application to open an account with Landsbanki London's "Icesave" product and has transferred money to Barclays as UK clearing bank for Landsbanki London but for whom no "Icesave" account has been opened, so that the money transferred continues to be held by Barclays; and (iii) any other person who has deposited any funds, or otherwise has any credit balance, with Landsbanki London, provided that, in this final case, the corresponding claim against Landsbanki is eligible for compensation under the rules of the FSCS.

"*Lien*" means any mortgage, lien, pledge, fiduciary transfer, charge, encumbrance or other security interest.

"*Loan Agreement*" means the Loan Agreement dated 5 June 2009 between the Parties.

"*Mandatory Prepayment Event*" means any event or circumstance specified as such in paragraph (b) of Section 4.5.

"*Mandatory Prepayment-Related Material Adverse Effect*" means any effect which impairs the ability of any Reimbursement Party to perform its payment or other material obligations under this Agreement or any other Relevant Document.

"*NL Quarterly Installment*" means a "Quarterly Installment" as defined in the NL Reimbursement and Indemnity Agreement.

"*NL Reimbursement and Indemnity Agreement*" means the Reimbursement and Indemnity Agreement entered or to be entered into on or about the date of this Agreement between the Guarantee Fund, Iceland and The Netherlands.

"*NL Reimbursement Amount*" means, from time to time, the "Reimbursement Amount" as defined in the NL Reimbursement and Indemnity Agreement.

"*NL Second Phase Reimbursement Amount*" means the "Second Phase Reimbursement Amount" as defined in the NL Reimbursement and Indemnity Agreement.

"*Other Guarantee Fund*" means any deposit-guarantee scheme introduced and officially recognized in Iceland for the purpose of Directive 94/19/EC (including any modification or re-enactment thereof or any substitution therefor), other than the Guarantee Fund.

"*Parties*" has the meaning set forth in the introduction hereto.

"*Payment Date*" means January 1, 2011 and each April 1, July 1, September 1 and January 1 falling after January 1, 2011.

"*Pay-out Costs*" means the costs incurred by the FSCS in paying compensation to Landsbanki London Depositors in respect of their claims against Landsbanki and the Guarantee Fund under Act No. 98/1999 as referred to in the Recitals, which is an amount of £10,000,000 (ten million pounds Sterling).

"*PCA Rules*" means Permanent Court of Arbitration Optional Rules for Arbitrating Disputes between Two Parties of Which Only One Is a State, as in effect on the date hereof.

"*Person*" means any individual, corporation, company, voluntary association, partnership, limited liability company, joint venture, trust, unincorporated organization, Governmental Authority or other entity of whatever nature.

"*Pro Rata Entitlement*" means, as at any time, a fraction calculated by dividing (a) (i) in the case of The Netherlands, an amount of £1,134,680,211.10 (being the Sterling equivalent of the amount of the NL Reimbursement Amount as at the date of the NL Reimbursement and Indemnity Agreement converted into Sterling at a rate of €1.1653 to £1.00), or (ii) in the case of the HMT Commissioners, the aggregate amount of all Disbursements made up to that time (which the Parties believe to have been GBP 2,254,417,851.51 as at November 24, 2010), by (b) the aggregate of the amounts referred to in item (a) above.

"*Property*" of any Person means any property, rights or revenues, or interest therein, of such Person.

"*Quarterly Installments*" means the quarterly installments in which the Second Phase Reimbursement Amount must be paid, the amount and number of which are determined in accordance with Section 4.1 (subject to the other provisions of this Agreement).

"*Recovery Percentage*" means, at any time, such fraction, expressed as a percentage, of the Accepted Claims Amount as under Icelandic Act no. 21/1991 on Bankruptcies etc. (*Lög nr. 21/1991 um gjaldþrotaskipti o.fl.*) (or otherwise under the laws of Iceland) has been or is deemed to have been paid by the Winding up Board of Landsbanki in payment of the Accepted Claims Amount

obtained by dividing the HMT Reimbursement Proceeds at that time by the aggregate amount of the Reimbursement Amount as at the date of this Agreement.

"*Reimbursement Amount*" means, at any time (whether before or after the Reimbursement Amount is required to be paid by the Guarantee Fund to the HMT Commissioners), the aggregate amount of the Disbursements, or the amount outstanding for the time being of that amount.

"*Reimbursement Parties*" means, collectively, the Guarantee Fund and Iceland.

"*Reimbursement Payment Date*" means each Payment Date falling after the Second Phase Start Date.

"*Relevant Documents*" means, collectively, this Agreement, the Settlement Agreement, the Settlement Agreement Side Letter, the FSCS Deed of Assignment and any other agreement or document designated as a Relevant Document by the Parties.

"*Relevant Financing Arrangement*" means any agreement, arrangement or treaty entered into by any Reimbursement party with any financier (including any Sovereign, international organization, private entity or other Person) for the purpose of financing claims of any depositors of an Icelandic bank where such claims arose prior to the date of this Agreement, but excluding (a) the NL Reimbursement and Indemnity Agreement, and (b) any agreement, arrangement or treaty entered into for the purpose of financing or refinancing (i) any part of the Reimbursement Amount or compensation or any other amount payable by any Reimbursement Party to the HMT Commissioners under this Agreement or any other Relevant Document (or any successor agreement or document), or (ii) any amount payable by any Reimbursement Party under the NL Reimbursement and Indemnity Agreement or any other "Relevant Documents" as defined in the NL Reimbursement and Indemnity Agreement (or any successor agreement or document).

"*Relevant Icelandic Total Government Revenue*" means, in relation to any Reimbursement Payment Day falling in a given period starting on July 1 of any year and ending on June 30 of the immediately following year (a "Relevant Period") , (a) Iceland's "Total Central Government Revenue" for the calendar year immediately preceding that Relevant Period as published by the Statistical Bureau of Iceland (*Hagstofa Íslands*), or (b) if such Total Central Government Revenue (i) has not yet been published, or (ii) is less than 26 per cent. of the then most recent estimate of the gross domestic product of Iceland for the calendar year immediately preceding that Relevant Period as published by the International Monetary Fund in its most recent World Economic Outlook (the "*Relevant Icelandic GDP*"), an amount equal to 26 per cent. of the Relevant Icelandic GDP (or, if there is a material change in the component elements or any of such Total Central Government Revenue or gross domestic product or any such figure for such Total Central Government Revenue or Relevant Icelandic GDP is not published by the relevant organization, a comparable figure (or comparable figures) for such revenue Total Central Government Revenue or Relevant Icelandic GDP reasonably agreed between Iceland and the HMT Commissioners or, if Iceland and the HMT Commissioners fail to agree such figure (or figures) prior to that Reimbursement Payment Day, as determined by arbitration in accordance with Section 10.10).

"*Second Phase CIRR*" means the Commercial Interest Reference Rate for Sterling as applicable on 15 June 2016 and as published by the Organisation for Economic Co-operation and Development (or, if no such rate is published by that organization, a comparable rate reasonably agreed between Iceland and the HMT Commissioners or, if Iceland and the HMT Commissioners fail to agree such comparable rate before the Second Phase Start Date, as determined by arbitration in accordance with Section 10.10) for a loan with a duration longer than the scheduled payment period for the Second Phase Reimbursement Amount (or (a) if there is more than one such rate for loans with a duration longer than the scheduled payment period for the Second Phase Reimbursement Amount, such rate for a loan with the shortest duration which is longer than such

scheduled payment period, and (b) if there is no such rate for a loan with a duration longer than the scheduled payment period for the Second Phase Reimbursement Amount, such rate for a loan with a duration closest to such scheduled payment period) and, for this purpose, the "*scheduled payment period for the Second Phase Reimbursement Amount*" shall be the period from the Second Phase Start Date through the Reimbursement Payment Date on which the last Quarterly Installment is due to be paid (as determined in accordance with paragraphs (b) and (c) of Section 4.1).

"*Second Phase Reimbursement Amount*" means the Reimbursement Amount as at the end of the day immediately preceding the Second Phase Start Date (excluding, however, any part of the Reimbursement Amount which has fallen due for payment before, but remains unpaid in breach of the terms of this Agreement on, the Second Phase Start Date).

"*Second Phase Start Date*" means July 1, 2016.

"*Settlement Agreement*" means the settlement agreement dated June 5, 2009 entered into between the FSCS and the Guarantee Fund as amended by an Amendment Agreement dated October 19, 2009.

"*Settlement Agreement Side Letter*" means the side letter to the Settlement Agreement to be entered into between the FSCS and the Guarantee Fund, confirming certain matters in relation to the Settlement Agreement and in the form agreed between the Parties before the date of this Agreement.

"*Shortfall Amount*" means, from time to time, (a) any amount expressed to be payable by the Guarantee Fund to the HMT Commissioners under this Agreement or any other Relevant Document which has not been paid, and remains unpaid, in full when due, at the place and in the currency in which it is expressed to be payable, and (b) if any obligation of the Guarantee Fund under this Agreement or the other Relevant Documents is or becomes unenforceable, invalid or illegal, an amount equal to the aggregate of the amounts which the HMT Commissioners would otherwise have been entitled to recover from the Guarantee Fund if that obligation had been or had continued to be enforceable, valid and legal.

"*Sovereign*" means any nation or government having sovereign authority.

"*Sovereign Debt*" means any present or future borrowing, debt or other obligation, whether actual or contingent, which is (a) payable to non-residents of Iceland or, if in the form of bonds, notes, debentures, loan stock or other securities, at least 25 per cent. in aggregate principal amount of which is or was initially offered to non-residents of Iceland, or (b) denominated in a currency other than Krónur or, if denominated in Krónur, under the terms of which payment of principal, premium (if any) or interest can be or is required to be made in or by reference to any other currency, including, for the avoidance of doubt, (i) any borrowing, debt or other obligation owing to the International Monetary Fund, and (ii) any borrowing, debt or other obligation owing under the NL Reimbursement and Indemnity Agreement.

"*Sterling*" or "£" means the lawful means the lawful currency for the time being of the United Kingdom of Great Britain and Northern Ireland.

"*Taxes*" means all present and future income, stamp, registration and other taxes and levies, imposts, deductions, charges and withholdings whatsoever, and all interest, penalties or similar amounts with respect thereto or with respect to the non-payment thereof, now or hereafter imposed, assessed, levied or collected by any authority, on or in respect of this Agreement or any other Relevant Document, any payment under this Agreement or any other Relevant Document or the recording, registration, notarization or other formalization of any thereof.

"*The Netherlands*" means the State of the Netherlands.

[TO BE PRINTED ON FSCS HEADED PAPER]

The Depositors' and Investors' Guarantee Fund of Iceland
(*Tryggingarsjóður Innstæðueigenda og Fjárfesta*)
Borgartun 26, 3rd Floor
105 Reykjavik
Iceland

For the attention of: the Managing Director

2010

Dear Sir / Madam,

Settlement Agreement dated 5 June 2009, as amended by an Amendment Agreement dated 19 October 2009, each between the FSCS and TIF

1. Reference is made to:

   (a) the Settlement Agreement between the FSCS and TIF dated 5 June 2009 (the "**Original Settlement Agreement**");

   (b) the Amendment Agreement to the Original Settlement Agreement, also between the FSCS and TIF and dated 19 October 2009, providing for certain amendments to the Original Settlement Agreement (the Original Settlement Agreement as so amended, the "**Amended Settlement Agreement**"); and

   (c) the Disbursement, Reimbursement and Indemnity Agreement dated [•] 2010 between TIF, Iceland and HMT (the "**Disbursement, Reimbursement and Indemnity Agreement**").

   Terms defined in the Amended Settlement Agreement have the same meaning in this letter. Unless a contrary intention appears, references in this letter to paragraphs and subparagraphs are to paragraphs and subparagraphs of the Amended Settlement Agreement.

2. The Parties confirm (for the avoidance of doubt) that all references in the Amended Settlement Agreement to the "Loan Agreement" shall with effect from the coming into force of the Disbursement, Reimbursement and Indemnity Agreement be construed as references to the "Disbursement, Reimbursement and Indemnity Agreement". Accordingly:

   a. The reference in recital (g) of the Amended Settlement Agreement to the Loan Agreement should be to the Disbursement, Reimbursement and Indemnity Agreement;

b. The reference in clause 1.3 of the Amended Settlement Agreement, to interest accruing from the date of payment by FSCS of amounts, should in accordance with the Disbursement, Reimbursement and Indemnity Agreement be to interest accruing from 1st October 2009, and the words from and including "plus interest thereon" in the first sentence of clause 1.3 shall be disregarded; and

c. FSCS confirms that the payment to it by TIF of the Euro 333,000 pursuant to the Assignment Agreement between them dated on or about the date of this letter shall satisfy all actual and contingent obligations of TIF under Clause 7.4 of the Amended Settlement Agreement and further that following the taking effect of that assignment FSCS shall no longer be pursuing the Assigned Rights and so that indemnity shall not thereafter apply.

3. FSCS and TIF takes this opportunity to note that

a. since the date of the Original Settlement Agreement there is a new Chief Executive of the FSCS and accordingly and with reference to subparagraph 12.2(a) (*Notices)* any notice to be provided to the FSCS shall be provided to Mark Neale, the current Chief Executive of the FSCS, and that, accordingly, the words "loretta.minghella@fscs.org.uk" shall be replaced by the words "mark.neale@fscs.org.uk" and the words "Loretta Minghella" shall be replaced by the words "Mark Neale";

b. since the date of the Original Settlement Agreement the address of TIF for the purposes of subparagraph 12.2(b) (*Notices)* shall be Borgartun 26, 35 Reykjavik, Iceland; and

c. TIF and FSCS agree that notices shall not be provided by registered international post and accordingly paragraph (c) of Clause 12.3 shall be disregarded.

4. The Parties agree that paragraphs 9 (*Entire Agreement*), 11 (*Counterparts*), 12 (*Notices*), 13 (*Governing law and jurisdiction*) and 18 (*Waiver of Sovereign Immunity*) apply to this letter as if set out in it and for this purpose all references in those paragraphs to "this agreement" will be deemed to be references to this letter.

5. Please sign and return this letter in evidence of your agreement to this letter.

Yours faithfully,

The Financial Services Compensation Scheme Limited

Signed for agreement on 2010

The Depositors' and Investors' Guarantee Fund of Iceland

(*Tryggingarsjóður Innstæðueigenda og Fjárfesta*)

506170532

SETTLEMENT AGREEMENT

This Settlement Agreement is dated 5 June 2009 and has been entered into between:

1. **FINANCIAL SERVICES COMPENSATION SCHEME LIMITED** (CRN: 3943048), whose registered office is at 7th Floor, Lloyds Chambers, 1 Portsoken Street, London E1 8BN, United Kingdom ("**FSCS**"); and

2. **THE DEPOSITORS' AND INVESTORS' GUARANTEE FUND OF ICELAND** (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*), a private foundation incorporated under Icelandic law, whose registered office is at Kalkofnsvegur 1, 150 Reykjavik, Iceland ("**TIF**").

FSCS and TIF are each referred to in this agreement as a "**party**" and, collectively, as the "**parties**".

WHEREAS:

a) FSCS is the Scheme Manager of the Financial Services Compensation Scheme established under Part XV of the UK Financial Services and Markets Act 2000 (the "**Scheme**"). The Scheme is the deposit guarantee scheme established in the United Kingdom for the purposes of the EC Deposit Guarantee Directive (94/19/EC).

b) TIF is a private foundation incorporated under the laws of Iceland, entrusted under such laws with the execution of the Icelandic Deposit Guarantee Scheme in accordance with the provisions of Icelandic Act No. 98/1999 on deposit guarantees and investor compensation schemes.

c) Under the rules of the Scheme, the London branch (the "**UK Branch**") of Landsbanki Íslands hf ("**Landsbanki**"), a company with limited liability incorporated in Iceland, authorised in Iceland to act as a bank and regulated by the Financial Supervisory Authority in Iceland (the "**FME**"), elected to join the Scheme to provide "top up" cover to eligible depositors with the UK Branch.

d) On or about 31 October 2006, FSCS and TIF agreed a Memorandum of Understanding (the "**MOU**") setting out, inter alia, certain principles for the handling of claims for compensation from depositors with UK branches of certain Icelandic banks. Under the terms of the MOU, TIF had lead responsibility to deal with and assess and pay such depositors' claims.

e) On 6 October 2008, Landsbanki encountered severe liquidity and other financial difficulties which led it to default on its obligations to depositors and other creditors and which resulted in the "Icesave" website operated by the UK Branch ceasing to function. On 8 October 2008, the Financial Services Authority (the "**FSA**") in the United Kingdom

declared the UK Branch to be "in default" under the Scheme. On 27 October 2008, FME issued its opinion that Landsbanki was, on 6 October 2008, unable to make payment of the amount demanded by certain depositors and that, therefore, TIF was obligated to pay compensation in accordance with Article 9 of Icelandic Act No. 98/1999. In respect of the claims of depositors with the UK Branch, TIF became obligated to pay an amount of up to €20,887 to each individual depositor.

f) Following the declaration of default by the FSA and the issuance of the opinion by the FME, the parties have not handled claims as anticipated by the MOU. On 4 November 2008, FSCS made a determination under the rules of the Scheme, following which FSCS has, with the knowledge of TIF, proceeded to handle and pay claims of depositors in the "Icesave" product of the UK Branch. All "Icesave" depositors of the UK Branch have received or will receive from FSCS compensation for their deposits with the UK Branch including in respect of claims which TIF was obligated to pay to each such depositor. As part of the compensation process and as a precondition to payment of compensation by FSCS, depositors transfer and assign to FSCS their related rights (the "**Assigned Rights**") to claim against Landsbanki, TIF and third parties.

g) On or about the date of this agreement, TIF, the Republic of Iceland ("**Iceland**") and the Commissioners of Her Majesty's Treasury ("**HMT**") have entered into or will enter into a loan agreement (the "**Loan Agreement**"). Under the Loan Agreement, TIF may (by virtue of Disbursement Requests issued by FSCS (on behalf of TIF), as provided in the Loan Agreement) borrow from HMT funds to (i) settle the claim by FSCS on TIF in respect of the compensation already paid by FSCS to depositors with the UK Branch up to an amount of £16,872.99 per depositor; (ii) allow the settlement by FSCS (on behalf of TIF) of the claims of depositors with the UK Branch under Icelandic Act No. 98/1999 for up to £16,872.99 per claim; and (iii) pay an amount to FSCS in compensation for certain related costs incurred and to be incurred by it.

h) By this agreement, the parties agree the process by which FSCS will (i) recover from TIF amounts of up to £16,827.99 per depositor already paid by way of compensation to depositors of the UK Branch; (ii) to the extent depositors of the UK Branch have not already received such compensation, make payments on behalf of TIF to such depositors of up to £16,872.99 per depositor using funds drawn by FSCS (on behalf of TIF) under the Loan Agreement; (iii) receive payment in relation to certain related past and future costs using funds drawn by FSCS (on behalf of TIF) under the Loan Agreement; and (iv) assign to TIF such proportion of the Assigned Rights as relate to depositors' claims (being not more than £16,872.99 per depositor) which it is obligated to guarantee under Icelandic Act No. 98/1999.

IT IS AGREED AS FOLLOWS:

1. **FSCS recovery from TIF of compensation already paid**

1.1 The parties acknowledge that FSCS has already, with TIF's knowledge, made payments in accordance with the Scheme rules to individual depositors of the UK Branch for claims

in respect of which TIF has compensation obligations under Icelandic Act No. 98/1999. Furthermore, the parties acknowledge that FSCS may continue to make such payments until the date (the "**Refinancing Date**") notified by FSCS to TIF as being the date on which FSCS will cease making such payments and commence making compensation payments (on behalf of TIF) using the proceeds of Disbursements under the Loan Agreement. The aggregate of all such amounts, whether paid before or on or after the date of this agreement but provided they are made before the Refinancing Date, is referred to as the "**Refinancing Amount**". The Refinancing Date shall fall not more than thirty days after the date on which the conditions precedent to Disbursements under the Loan Agreement have been satisfied and FSCS shall notify TIF in writing of the Refinancing Date not less than two Business Days in advance of the Refinancing Date.

1.2 The parties agree that the maximum amount payable in full by TIF for or in respect of deposits with the UK Branch is £16,872.99 for each depositor (where deposits were held in pounds Sterling). The parties agree that this sum represents the pounds Sterling equivalent as of 27 October 2008 of the minimum level of depositor protection provided by TIF of €20,887.

1.3 The parties agree that FSCS may, on the Refinancing Date, request (on behalf of TIF) a Disbursement under the Loan Agreement of an amount equal to the Refinancing Amount plus interest thereon (at a rate equal to that payable by TIF under the Loan Agreement, such rate to apply to each individual compensation amount paid on or prior to the Refinancing Date in respect of the period from (and including) the payment of such amount as described in paragraph 1.1 to (but excluding) the Refinancing Date). Such Disbursement shall be applied by FSCS (on behalf of TIF) to reimburse FSCS and allow it to repay amounts borrowed by it from HMT to fund the making of the compensation payments described in paragraph 1.1.

1.4 As soon as reasonably practicable after the Refinancing Date, FSCS will provide to TIF a list of the UK Branch depositors, together with their account numbers and account balances, in respect of which the compensation payments constituting the Refinancing Amount have been made.

1.5 TIF agrees that it will not raise any objection in respect of the Refinancing Amount (or FSCS's right to be reimbursed by TIF for payments of compensation comprising such amounts, together with interest thereon) on the grounds:

(a) that any depositor is or was not entitled to be paid the amount of compensation calculated by FSCS for any reason under Article 9 of Icelandic Act No. 98/1999 or the regulations of TIF or otherwise; or

(b) that FSCS has calculated compensation in accordance with the rules of the Scheme and not according to any methodology which would have been used by TIF.

2. **FSCS payment of compensation on behalf of TIF**

2.1 The parties agree that FSCS may, on or after the Refinancing Date, make payments on behalf of TIF in accordance with the Scheme rules to individual depositors of the UK Branch, for claims in respect of which TIF has compensation obligations under Icelandic Act No. 98/1999.

2.2 The parties agree that the payments described in paragraph 2.1 shall be funded by FSCS requesting (on behalf of TIF) Disbursements under and in accordance with the Loan Agreement. FSCS agrees that it will not submit a Disbursement Request (on behalf of TIF) to the Lender in respect of the funding of compensation payments to UK Branch depositors, nor apply (on behalf of TIF) the proceeds of the corresponding Disbursement, unless it has already provided, or at the same time provides, to TIF a list (a "**Depositor List**") of the UK Branch depositors, together with their account numbers and account balances, whom the proceeds of the Disbursement are to be used to compensate, together with a draft of the Disbursement Request.

2.3 TIF agrees that payments made by FSCS (on behalf of TIF) as described in paragraph 1.1 and paragraph 2.1 will be made in accordance with the Scheme rules and that, accordingly, it will not raise any objection in respect of the amounts covered by any corresponding Disbursement Request on the grounds:

(a) that any depositor is or was not entitled to be paid the amount of compensation calculated by FSCS for any reason under Article 9 of Icelandic Act No. 98/1999 or the regulations of TIF or otherwise; or

(b) that FSCS has calculated compensation in accordance with the rules of the Scheme and not according to any methodology which would have been used by TIF.

2.4 Whether in respect of claims for which compensation has not been paid to depositors whose deposits were held in fixed term or notice accounts or otherwise, nothing in this agreement shall prevent the parties from making alternative arrangements for payment by TIF to FSCS in respect of claims of FSCS or depositors at any time, including before FSCS has paid compensation to the relevant depositors.

3. **Payment to FSCS in respect of historic and future costs**

3.1 FSCS may submit (on behalf of TIF) one Disbursement Request for £10,000,000 (ten million pounds) in respect of the costs incurred or to be incurred by FSCS in the handling and payment of compensation to depositors with the UK Branch and in dealing with related matters including, without limitation, recoveries and any disputes which may result.

3.2 The proceeds of any Disbursement made in respect of FSCS's costs may be retained by FSCS for its own account.

4. **Claims against Landsbanki**

4.1 For the purpose of pursuing the Assigned Rights, FSCS may appoint TIF, on terms to be agreed, as its agent and/or representative for the submission and conduct of the claims against Landsbanki, in Iceland, or elsewhere. TIF may represent FSCS in discussions with Landsbanki, and/or the representatives of the bankruptcy estate of Landsbanki, but shall have no authority to bind or commit FSCS without FSCS's prior written instruction and consent.

4.2 FSCS and TIF agree that FSCS will, in consideration for TIF's undertaking to reimburse FSCS for compensation paid to depositors with the UK Branch in respect of claims which are guaranteed by TIF under Icelandic Act No. 98/1999, assign such proportion of the Assigned Rights as relate to claims of depositors (being not more than £16,872.99 per depositor) against Landsbanki or any third party, other than TIF or Iceland, which TIF was obligated to guarantee under Icelandic Act No. 98/1999. The assignment shall be conditional upon the Loan Agreement coming into effect. The parties hereby agree that, and the terms of the assignment shall provide that:

(a) to the extent that, following such assignment, FSCS retains any proportion of the Assigned Rights in respect of any given claim (due to the fact that such claim exceeds £16,872.99 in aggregate), then the proportion of such Assigned Rights which assigned to TIF shall, to the fullest extent permitted by applicable law, rank pari passu in all respects with the proportion of such Assigned Rights retained by FSCS;

(b) in the event that, for any reason whatsoever (including, without limitation, any preferential status accorded to TIF under Icelandic law), following the assignment of a proportion of the Assigned Rights in respect of any given claim to TIF, either TIF or FSCS experiences a greater pro rata level of recovery, in respect of such claim, than that experienced by the other, TIF or FSCS (as appropriate) shall, as soon as practicable, make such balancing payment to the other party as is necessary to ensure that each of the Guarantee Fund's and FSCS's pro rata level of recovery in respect of such claim is the same as the other's; and

(c) to the extent that, following the completion of such assignment, any further compensation payments are made by FSCS (on behalf of TIF) to depositors with the UK Branch in respect of the claims of such depositors which are guaranteed by TIF under Icelandic Act No. 98/1999, then the proportion of the Assigned Rights which relate to those claims shall, to the fullest extent permitted by applicable law, be automatically on-assigned by FSCS to TIF on terms which are identical to those which apply to the initial assignment referred to above in this paragraph 4.2.

4.3 Pending completion of the assignment described in paragraph 4.2, any recoveries in respect of the Assigned Rights shall be paid to FSCS, for distribution between FSCS and TIF. Such recoveries shall be deemed to be:

(a) due entirely to TIF to the extent that such recoveries are received in respect of Assigned Rights from depositors whose total claim for compensation is £16,872.99 or less; and

(b) due to FSCS and TIF to the extent that such recoveries are received in respect of Assigned Rights from depositors whose total claim exceeds £16,872.99, in which case the recoveries shall be allocated on a *pro rata* basis between FSCS and TIF, being due to TIF in the proportion which £16,872.99 bears to the total claim for compensation and due to FSCS for the remainder.

4.4 Any recoveries in respect of the Assigned Rights shall, to the extent that they are (i) following completion of the assignment described in paragraph 4.2, received by TIF or, (ii) pending completion of the assignment described in paragraph 4.2, received by FSCS but due to TIF, be applied by or on behalf of TIF in satisfaction of TIF's obligations in accordance with the terms of the Loan Agreement.

4.5 TIF shall report in writing to FSCS at such intervals as FSCS shall require on the position of Landsbanki and the bankruptcy estate of Landsbanki, and shall notify FSCS promptly in writing of any material developments in the estate and/or for the position of creditors of Landsbanki. TIF shall forward to FSCS promptly on receipt any information received regarding Landsbanki or the bankruptcy estate of Landsbanki, including any letters or other communications received from Landsbanki or the representatives of the bankruptcy estate of Landsbanki (including, without limitation, the Landsbanki resolution committee and the Landsbanki winding-up committee).

5. Confidentiality

The parties agree that this agreement shall be confidential to the parties and may not be disclosed to any person, at any time, without the consent of the other, save that either party may make disclosure to their respective home state governmental and regulatory authorities, professional advisers or as may be required by law. It is agreed that a copy of this agreement shall be made available to the parties to the Loan Agreement and their respective professional advisers.

6. Entry into force and miscellaneous provisions

6.1 The provisions of paragraph 4.2 of this agreement (and, only to the extent required to give efficacy to such provisions, the provisions of paragraphs 9 to 15) shall come into force on the date on which this agreement is executed. The remaining provisions of this agreement shall come into force on the date on which the Loan Agreement comes into force.

6.2 Nothing in this agreement shall be deemed at law to constitute a partnership or similar relationship and neither party shall have any authority to bind the other, save as provided for in this agreement.

6.3 Nothing in this agreement or in the arrangements described hereunder will give rise to any trust or fiduciary obligations on the part of FSCS, whether owed to TIF or any third party.

6.4 This agreement and the benefit of its terms may not be assigned or transferred by either party to any other party without the prior written consent of both parties to this agreement.

6.5 Nothing in this agreement shall affect the obligations of TIF under Icelandic Act No. 98/1999 on deposit guarantees and investor compensation schemes. In particular, the fact that there may be Landsbanki London Depositors to whom compensation payments by TIF are not to be funded under the Loan Agreement shall not affect the existence or scope of the related compensation obligation of TIF.

7. Liability and indemnity

7.1 The following actions shall not be open to dispute by TIF on any ground other than (without prejudice to paragraph 1.5 and paragraph 2.3) an allegation that FSCS has not acted in good faith:

(a) the submission of a Disbursement Request by FSCS (on behalf of TIF) to the Lender in accordance with the Loan Agreement and the process specified in paragraph 1.3, 2.2 or (as the case may be) 3.1;

(b) the receipt by FSCS (on behalf of TIF) of the proceeds of the corresponding Disbursement; and

(c) the application of such proceeds by FSCS in accordance with the Loan Agreement and paragraph 1, 2 or (as the case may be) 3, being, in the case of paragraph 2, the payment by FSCS (on behalf of TIF) of compensation (funded by the proceeds of such Disbursement) to UK Branch depositors in respect of all or part of the claim of such depositors against TIF.

7.2 This paragraph 7.2 applies if, by reference to any Depositor List provided to TIF pursuant to paragraph 2.2, or by reference to the list and information provided to TIF pursuant to paragraph 1.4, a greater amount (the "**Excess**") has been drawn by FSCS (on behalf of TIF) under the Loan Agreement in order to compensate depositors than has actually been paid by way of compensation by FSCS to the relevant depositors with the UK Branch. If this paragraph 7.2 applies, and provided that TIF has notified FSCS of the alleged Excess not later than 15 March 2012, FSCS shall make a reduction equal to the Excess in the amount of the next Disbursement. If no further Disbursements are to be made, then FSCS shall (on behalf of TIF) prepay the Reimbursement in an amount equal to the Excess at the end of the then current interest period under the Loan Agreement.

7.3 FSCS shall not be liable to TIF for any claim or loss (whether direct or indirect and/or consequential) and TIF agrees that it shall not take any action against FSCS for any act or omission or failure to comply with the terms of this agreement or otherwise when acting under or in relation to this agreement or in pursuing (whether before or after the date of this agreement) the Assigned Rights, except in the event of bad faith on the part of FSCS.

7.4 TIF will indemnify FSCS on demand for any loss or liability it incurs or suffers in pursuing the Assigned Rights prior to the completion of the assignment described in paragraph 4.2, to the extent that such Assigned Rights are pursued by FSCS for the benefit of TIF or in order to realise funds which will be applied (on behalf of TIF) in reducing the amount outstanding under the Loan Agreement or in discharging any other liability of TIF.

8. Representations and warranties

8.1 TIF represents and warrants that:

(a) it shall not undertake any action without the prior approval of FSCS if such action would impede or harm the right of FSCS to make a claim against Landsbanki or any other party on the basis of the rights which have passed or it is intended shall pass to FSCS from the depositors of the UK Branch by way of transfer, assignment or subrogation;

(b) it is a private foundation, duly incorporated and validly existing under the law of Iceland and it has the power to own its assets and carry on its business as it is being conducted;

(c) the obligations expressed to be assumed by it in this agreement will be, subject to any general principles of law limiting its obligations which are specifically disclosed to FSCS in writing prior to the date of this agreement, legal, valid, binding and enforceable obligations; and

(d) its signatories to this agreement are duly authorised to sign this agreement on its behalf.

8.2 TIF undertakes to (i) use its best efforts to promote the enactment of legislative and other measures; and (ii) obtain the requisite internal and external approvals, in both cases to permit or facilitate the actions envisaged by this agreement and the Loan Agreement.

9. Entire agreement

This agreement may be amended, supplemented or waived only by mutual consent in the form of a written agreement between FSCS and TIF.

10. MOU

In the event of a conflict between the MOU and the terms of this agreement, the latter shall prevail.

11. **Counterparts**

This agreement may be executed in any number of counterparts, and by the parties on separate counterparts, and this shall have the same effect as if the signatures on the counterparts were on a single copy of this agreement. Each counterpart shall be an original copy of this agreement, but they shall together constitute one and the same agreement.

12. **Notices**

12.1 Any communication to be made under or in connection with this agreement will be made in writing in English and, unless otherwise stated, may be made by letter, fax or email.

12.2 The address, fax number and email address (and the department or officer, if any, for whose attention the communication is to be made) for any communication to be made under or in connection with this agreement is:

(a) in the case of FSCS, Financial Services Compensation Scheme, 7th Floor, Lloyds Chambers, 1 Portsoken Street, London E1 8BN, United Kingdom; loretta.minghella@fscs.org.uk and +44 (0)20 7892 7637 (attention: Loretta Minghella, Chief Executive), with a copy to HMT, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ, United Kingdom; tom.scholar@hm-treasury.x.gsi.gov.uk and +44 (0)20 7270 5764 (attention: Tom Scholar); and

(b) in the case of TIF, Borgartun 26, 3rd floor, 105 Reykjavik, Iceland and +354 590 2606 (attention: Managing Director),

or, in each case, any substitute address, fax number or email address (or department or officer) which any of the above may notify to the others by not less than five Business Days' notice.

12.3 Any notice served by personal delivery, post, fax or email shall be deemed to have been duly given:

(a) if left at the address of the person to be served, at the time when it is so left (or, if left on a day that is not a Business Day, at 8:15am (local time) on the next following Business Day);

(b) if sent by email, when received in legible form (or, if sent on a day that is not a Business Day, at 8:15 am (local time) on the next following Business Day);

(c) if sent by registered international post, on the second Business Day following the day of posting; and

(d) if sent by fax, when confirmation of receipt is received from the receiving fax machine (or, if sent on a day that is not a Business Day, at 8:15am (local time) on the next following Business Day),

and provided that, in proving the giving of notice under or in connection with this agreement, it shall be sufficient to prove that the notice was delivered to the address for service or that the envelope containing such notice was properly addressed and posted by registered international post (as the case may be).

13. Governing law and jurisdiction

13.1 This agreement and any matter, claim or dispute arising out of or in connection with this agreement, whether contractual or non-contractual, shall be governed by, and construed in accordance with, the laws of England.

13.2 Any matter, claim or dispute arising out of or in connection with this agreement, whether contractual or non-contractual, and including any matter, claim or dispute regarding the existence, validity or termination of this agreement (a "**Dispute**"), shall be subject to the exclusive jurisdiction of the English courts.

13.3 The parties agree that the courts of England are the most appropriate and convenient courts to settle Disputes and accordingly no party will argue to the contrary.

13.4 Paragraphs 13.2 and 13.3 are for the benefit of FSCS only. As a result, FSCS shall not be prevented from taking proceedings relating to a Dispute in any other courts with jurisdiction. To the extent allowed by law, FSCS may take concurrent proceedings in any number of jurisdictions.

13.5 Without prejudice to any other mode of service allowed under any relevant law, TIF hereby irrevocably appoints the Embassy of Iceland, of 2A Hans Street, SW1X 0JE London, England as its agent for service of process in relation to any proceedings before the English courts in connection with this agreement and agrees that failure by the process agent to notify it of any process will not invalidate the proceedings concerned.

14. Waiver of sovereign immunity

TIF consents generally to the issue of any process in connection with any Dispute and to the giving of any type of relief or remedy against it, including the making, enforcement or execution against any of its property or assets (regardless of its or their use or intended use) of any order or judgment. If TIF is entitled in any jurisdiction to any immunity from service of process or of other documents relating to any Dispute, or to any immunity from jurisdiction, suit, judgment, execution, attachment (whether before judgment, in aid of execution or otherwise) or other legal process, this is irrevocably waived to the fullest extent permitted by the law of that jurisdiction.

15. **Defined terms**

Terms defined in the recitals to this agreement shall have the same meaning when used in the operative provisions of this agreement. In addition, terms defined in the Loan Agreement shall, unless they are given an alternative meaning in this agreement or the context otherwise requires, have the same meaning when used in this agreement.

THIS AGREEMENT HAS BEEN MADE ON THE DATE STATED AT THE BEGINNING OF THIS AGREEMENT BY:

.....

Financial Services Compensation Scheme Limited
Name: Aleksander J Kuczynski
Title: General Counsel

.....

The Depositors' and Investors' Guarantee Fund of Iceland (*Tryggingarsjóður Innstæðueigenda og Fjárfesta*)
Name: Aslaug Arnadottir
Title: Chairperson of the Board

CF091550236

WORKING DRAFT
12/11/03 (Corrected)

THE *PARI PASSU* CLAUSE IN SOVEREIGN DEBT INSTRUMENTS

Lee C. Buchheit
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Jeremiah S. Pam
jpam@cgsh.com

WORKING PAPER

ABSTRACT

The pari passu *clause found in most cross-border lending instruments contains the borrower's promise to ensure that the obligation will always rank equally in right of payment with all of the borrower's other unsubordinated debts. The international financial markets have long understood the clause to protect a lender against the risk of legal subordination in favor of another creditor (something that can't happen under U.S. law without the lender's consent, but that can occur involuntarily under the laws of some other countries). In 2000, however, a new interpretation of the* pari passu *clause was advanced by a judgment creditor of a sovereign borrower as a purported legal basis for preventing the sovereign from paying its other creditors without making a ratable payment to the judgment creditor. If this "ratable payment" interpretation of the clause is correct (and it has now been advanced in a number of other lawsuits against both sovereign and corporate borrowers), it would significantly change the patterns of international finance. The authors argue that the ratable payment theory of the* pari passu *clause is a fallacy. They trace the origin of the clause back to its usage in nineteenth century credit instruments and then follow its evolution into the standard cross-border credit agreements used today.*

THE *PARI PASSU* CLAUSE IN SOVEREIGN DEBT INSTRUMENTS

Lee C. Buchheit
Jeremiah S. Pam*

* Lee C. Buchheit and Jeremiah S. Pam are lawyers practicing in the New York office of the law firm Cleary, Gottlieb, Steen & Hamilton. Cleary, Gottlieb, Steen & Hamilton acted as counsel to the Republic of Peru in the appeal of the Brussels action referred to in footnote 16 of this article, and is acting as counsel to the Republic of Nicaragua in the action referred to in footnote 29. A great many individuals have helped the authors in their hunt for *pari passu* over the last few years. Among these are: Luis de Carlos Bertrán, Frank G. Dawson, T.H. Donaldson, Marc Ellenbogen, G. Mitu Gulati, Andrew Haldane, Catherine Hovaguimian, G. Hartwell Hylton, William Ledward, Robert P. McDonald, G. Alfred Mudge, John Orbell, Charles E. Olson, Ekaterina Y. Pischalnikova, Hugh S. Pigott, Armando L. Suratos, Michael R. Tomz and Andrew Yianni. We are also grateful to the library of the Bank of England, the ING Barings Archives and the microfiche section of the Harvard Law Library for their generous assistance in our research.

THE *PARI PASSU* CLAUSE IN SOVEREIGN DEBT INSTRUMENTS

This is the story of the *pari passu* clause, a provision that appears in most cross-border credit instruments. The clause itself is short; usually a single sentence occupying no more than three or four lines of text. With that brevity, however, comes a measure of opacity.

For several decades, lenders and borrowers in the international capital markets have, by their behavior, demonstrated a collective understanding of the import of the clause. But it is difficult to corroborate that understanding based solely on the text of the provision. Inevitably, there was a risk that the oracular nature of the clause would tempt someone to speculate about alternative meanings. That risk has recently materialized, with potentially serious consequences for both lenders and borrowers.

I. THE CLAUSE

A. The Text

Here is a typical formulation of the *pari passu* clause in a modern cross-border credit instrument:

> The Notes rank, and will rank, *pari passu* in right of payment with all other present and future unsecured and unsubordinated External Indebtedness of the Issuer.

The Latin phrase "*pari passu*" means "in equal step" or just "equally." The phrase *pari passu* was often used in equity jurisprudence to express the ratable interest of parties in the disposition of equitable assets.[1] As explained by an English commentator in 1900:

> There is no special virtue in the words "*pari passu*," "equally" would have the same effect, or any other words showing that the [debt instruments] were intended to stand on the same level footing without preference or priority among themselves, but the words *pari passu* are adopted as a general term well recognized in the administration of assets in courts of equity."[2]

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[1] *See* Joseph Story, COMMENTARIES ON EQUITY JURISPRUDENCE, Vol I, 590 (1873), ("[I]n equity, it is a general rule that equitable assets shall be distributed equally, and *pari passu*, among all creditors, without any reference to the priority or dignity of the debts . . . .").

[2] Francis B. Palmer, COMPANY PRECEDENTS, 109-10 (8th ed. 1900) [hereinafter Palmer, *Company Precedents*].

B. The Context

The conventional explanation of the *pari passu* covenant is that this provision prevents the borrower from incurring obligations to other creditors that rank legally senior to the debt instrument containing the clause.[3]

The practical significance of equal ranking is most clearly visible in the event of a bankruptcy or insolvency of a corporate debtor: any legally senior obligations would enjoy a priority claim against the debtor's assets in a liquidation,

[3] For examples of commentators that describe the function of the clause as preserving the legal ranking of the debt, see Keith Clark & Andrew Taylor, *Conditions precedent and covenants in Eurocurrency loan agreements*, INT'L FIN. L. REV., Aug. 1982, at 18, ("The negative pledge ensures that the banks' right to be repaid is not subordinated to the rights of secured creditors: a *pari passu* covenant will ensure that they are not subordinated to any unsecured creditors."); Richard Slater, *The Transnational Law of Syndicated Loans – A Hopeless Cause?, in* THE TRANSNATIONAL LAW OF INTERNATIONAL COMMERCIAL TRANSACTIONS 329, 335 (Norbert Horn and Clive M. Schmitthoff, eds., 1983) [hereinafter *Slater*], ("Typical examples [of undertakings in international syndicated loan agreements] are undertakings by the borrower . . . to ensure that the loan ranks equally with all its other unsecured indebtedness (the '*pari passu* clause',) . . . ."); Qamar S. Siddiqi, *Some Critical Issues in Negotiations and Legal Drafting*, in SOVEREIGN BORROWERS: GUIDELINES ON LEGAL NEGOTIATIONS WITH COMMERCIAL LENDERS 44, 57 (Lars Kalderén and Qamar S. Siddiqi eds., 1984) [hereinafter *Sovereign Borrowers*], ("For a sovereign borrower, the covenants in a general term loan should normally be restricted to . . . the following: 1. The ranking of the borrower's obligations, which aims to ensure that the loan will rank '*pari passu*' with all other present or future unsecured and unsubordinated indebtedness of the borrower; this is likely to have little practical significance in the case of a sovereign borrower, where there may not be an occasion for a forced distribution of the assets to unsecured claimants following the bankruptcy, insolvency or liquidation of the borrower . . . ."); K. Venkatachari, *The Eurocurrency Loan: Role and Content of the Contract*, in *Sovereign Borrowers*, *id.* 73, 92 [hereinafter *Venkatachari*] ("[A *pari passu* clause] in the case of a corporate borrower is directed towards ensuring that other unsecured creditors are not given rights of priority of payment over the lender, leaving, perhaps, insufficient assets available to satisfy the claims of the lender either in full or, in the event of bankruptcy, insolvency, liquidation or forced distribution of assets of the borrower, to the same extent as all other unsecured creditors."); Mark A. Walker and Lee C. Buchheit, *Legal issues in the restructuring of commercial bank loans to sovereign borrowers*, in SOVEREIGN LENDING: MANAGING LEGAL RISK 139, 146 (M. Gruson, R. Reisner, eds., 1984) [hereinafter *Restructuring Commercial Bank Loans*], ("A *pari passu* covenant will, however, restrict the borrower from subordinating in a formal way the debt being incurred (or restructured) pursuant to the agreement containing this clause in favor of some other external obligation."); United Nations Center for Transnational Securities, UNCTC Advisory Studies, No. 4, Series B, INTERNATIONAL DEBT RESTRUCTURING: SUBSTANTIVE ISSUES AND TECHNIQUES 29 (1989) ("A *pari passu* covenant will, however, restrict the borrower from legally subordinating in a formal way the debt being incurred or rescheduled in favour of some other external obligation."); Frank Graaf, EUROMARKET FINANCE: ISSUES OF EUROMARKET SECURITIES AND SYNDICATED EUROCURRENCY LOANS 350 (1991), ("[T]his [pari passu] clause . . . requires the borrower to ensure that the lending banks' rights under the loan agreement will, *at all times*, rank at least equally (*'pari passu*') with all of the borrower's other unsecured and unsubordinated obligations so that the banks' share of the borrower's assets in the event of its liquidation will be equal to that of all other unsecured and unsubordinated creditors . . . ."); Ravi C. Tennekoon, THE LAW AND REGULATION OF INTERNATIONAL FINANCE 89 (1991) ("The primary objective of the clause is to ensure that the borrower has not conferred priority to any other unsecured creditor at the time the syndicated loan agreement is agreed."); Lee C. Buchheit, *The pari passu clause sub specie aeternitatis*, INT'L FIN. L. REV., Dec. 1991 at 11, 12 [hereinafter *Sub Specie Aeternitatis*], ("[I]f a sovereign borrower intends as a practical matter to discriminate among its creditors in terms of payments, the *pari passu* undertaking will at least prevent the sovereign from attempting to legitimize the discrimination by enacting laws or decrees which purport to bestow a senior status on certain indebtedness or give a legal preference to certain creditors over others . . . ."); Joseph J. Norton, INTERNATIONAL SYNDICATED LENDING AND ECONOMIC DEVELOPMENT IN LATIN AMERICA: THE LEGAL CONTEXT 43 (1997) [hereinafter *Norton*] ("The *pari passu* clause prevents the borrower from assuming new debts which subordinate the interests of the syndicate members."); Tony Rhodes, Keith Clark and Mark Campbell, SYNDICATED LENDING: PRACTICE AND DOCUMENTATION 285 (3d ed., 2000) [hereinafter *Syndicated Lending*] ("The [pari passu] clause in effect states that there are no legal provisions which would cause the loans to be subordinated to other indebtedness of the Company."); Lee C. Buchheit, HOW TO NEGOTIATE EUROCURRENCY LOAN AGREEMENTS 83 (2d ed., 2000) [hereinafter *Eurocurrency Loan Agreements*] ("The purpose of the *pari passu* clause is to ensure that the borrower does not have, nor will it subsequently create, a class of creditors whose claims against the borrower will rank legally senior to the indebtedness represented by the loan agreement.").

and would receive preferential treatment over subordinated creditors in a Chapter 11-type debt reorganization.[4]

Pari passu covenants[5] of this kind do not often appear in the documentation for purely domestic credit transactions.[6] The reason is that U.S. law does not permit the involuntary legal subordination of an existing creditor, so it is not necessary to ask the borrower to promise to refrain from doing something that it cannot in any event do without the lender's express consent.[7] As discussed

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[4] *See*, *e.g.*, Philip R. Wood, INTERNATIONAL LOANS, BONDS AND SECURITIES REGULATION 41 (Law and Practice of International Finance 1995) [hereinafter Wood, *International Loans*] ("The clause requires the equal ranking of unsecured claims on a forced distribution of available assets to unsecured creditors, primarily on insolvency."); Edward Lee-Smith, NEGOTIATING INTERNATIONAL LOAN AGREEMENTS at 4-10 (2d ed., 2000) 4-11 ("The purpose of the *pari passu* clause is to satisfy the Banks' concern that in an insolvent liquidation of the Borrower the Banks' claims should rank equally with all other unsecured and unsubordinated claims."); Jon Yard Arnason and Ian M. Fletcher, PRACTITIONER'S GUIDE TO CROSS-BORDER INSOLVENCIES, England chapter (prepared by Hamish Anderson), at ENG – 3 (July 2001) ("The principle of *pari passu* distribution applies only in liquidation.").

[5] A reference to *pari passu* ranking can also appear as a representation and warranty confirming the equal ranking of the new debt . This serves the purpose of uncovering, before a new loan is made, the existence of senior debt, and one occasionally sees such a representation in a U.S. domestic lending instrument. *See*, *e.g.*, Sandra Schnitzer Stern, STRUCTURING AND DRAFTING COMMERCIAL LOAN AGREEMENTS Vol. I, 4.16 (2001) ("[T]he bank may also require [the *pari passu*] representation stating that its loan is not subordinated to any of the borrower's other loans."). Significantly, however, Stern's subsequent discussion of a related covenant (by which the borrower agrees "to grant it a security interest, if the borrower should grant a security interest in its property to any third party, and to agree in advance to amend the loan agreement if any debt that is not subordinated to the bank's loan is created") refers to negative pledge and debt limitation covenants rather than a conventional *pari passu* covenant of the kind used in cross-border debt instruments. On the distinction between the *pari passu* representation and warranty and the *pari passu* covenant generally, see *Eurocurrency Loan Agreements*, *supra* note 3, at 82-83.

[6] The reference materials we have consulted dealing with standard credit documentation for domestic (U.S.) lending do not refer to *pari passu* clauses. *See*, *e.g.*, John J. McCann, TERM LOAN HANDBOOK (Committee on Developments in Business Financing of the Section of Corporation, Banking and Business Law of the American Bar Association ed., 1983) (*cf.* discussion of negative pledge covenant at 166-167, 229) and Robert H. Behrens and James W. Evans, FUNDAMENTALS OF COMMERCIAL LOAN DOCUMENTATION (Bank Administration Institute, ed., 1989) (*cf.* discussion of negative pledge covenant at 53). The MODEL CREDIT AGREEMENT AND COMMENTARY prepared by the New York law firm of Simpson Thacher & Bartlett (3d printing, July 1996) (copy on file with authors), at E-3, discusses the *pari passu* covenant only in an Appendix captioned "Sovereign (And Other Foreign) Borrower Provisions," noting that "In sovereign loans it is customary to provide not only for a negative pledge clause but also that the obligations being created rank at least *pari passu* with all other obligations of the Borrower, so the lenders can be sure there is no other debt which has a prior claim on any assets of the Borrower. The CREDIT AGREEMENT COMMENTARY prepared by the New York law firm of Shearman & Sterling (4th ed., 1994) (copy on file with the authors) does not refer to a *pari passu* covenant in a standard domestic credit agreement.

As for domestic bonds, *pari passu* clauses are not included in the COMMENTARIES ON MODEL DEBENTURE INDENTURE PROVISIONS published by the American Bar Foundation (1971), or the REVISED MODEL SIMPLIFIED INDENTURE published by the American Bar Association, 55 *Bus. Law.* 1115 (2000).

See also, Barry W. Taylor, *Swaps: Managing Interest Rate and Exchange Rate Risk from a Credit Perspective*, CORPORATE LAW AND PRACTICE COURSE HANDBOOK SERIES, 532 PLI/Corp 341 at 358, *Practising Law Institute,* 1986) ("In cross-border documents, whether they be loan agreements or swap agreements, parties often use a '*pari passu*' clause, an example of which is set forth below . . . . This kind of provision would probably be construed strictly to apply to the subordination of unsecured obligations over other unsecured obligations, which may be of little or no value except in particular jurisdictions.") (emphasis added).

[7] *See* Debra J. Schnebel, *Intercreditor and Subordination Agreements – A Practical Guide*, 118 BANKING L.J. 48, 53 (Jan. 2001) ("Generally, the claims of all unsecured creditors against a borrower are on a parity. . . . The creditors, however, may contractually alter this relationship through a subordination agreement. Debt subordination involves the agreement of one creditor (the junior creditor) to allow payment of indebtedness due to another creditor (the senior creditor) prior to the payment of indebtedness owed to it"). A subordination agreement is a type of intercreditor agreement between or among the affected creditors that describes the nature and the mechanics of an agreed

below, however, procedures exist in some other countries that can have just that effect, hence the tendency among cautious drafters of cross-border debt instruments to include an express promise on the part of the borrower to maintain the unsubordinated status of the debt.[8]

C. The Sovereign Debt Enigma

If the practical significance of maintaining a debt's *pari passu* ranking is most apparent in the event of a bankruptcy of the borrower, why is the clause also routinely included in debt instruments for sovereign borrowers -- entities that are not subject to domestic bankruptcy laws, their own or anyone else's? What were the drafters of *pari passu* clauses in sovereign debt instruments attempting to achieve?

As we discuss below, there are good historical answers to this question[9], but they cannot easily be divined from the black letter of the clause. Over the years, a few commentators (including one of the authors) have offered possible explanations for the appearance of *pari passu* covenants in sovereign credit instruments. These explanations have ranged from a suggestion that drafters may have wanted to prevent an informal "earmarking" of a sovereign's assets or revenues to service a particular debt,[10] to the more cynical explanation that this type of clause had a tendency to migrate -- through the ignorance or inattention of contract drafters -- from cross-border corporate debt instruments to sovereign debt instruments.[11] The common theme among these commentators was a degree of agnosticism about the precise denotation of the *pari passu* clause in a sovereign context.[12]

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legal subordination. *See* Schnebel, *id.*, ("[I]ntercreditor relationships and the concept of subordination do not have a common meaning established by status or case law. Rather, the intercreditor relationship is defined by the parties to a particular transaction or relationship in an agreement which details the respective rights and obligations of the parties."). Such subordination agreements are enforceable under the U.S. Bankruptcy Code. 11 U.S.C. § 510(a) (2003).

[8] See Part III.C.(iii), *infra.*

[9] See Part III.C, *infra*.

[10] *See*, *e.g.,* Philip R. Wood, LAW AND PRACTICE OF INTERNATIONAL FINANCE 156 (1980) [hereinafter Wood, *International Finance*] ("In the case of a sovereign state, . . . [t]he clause is primarily intended to prevent the earmarking of revenues of the government or the allocation of its foreign currency reserves to a single creditor and generally is directed against legal measures which have the effect of preferring one set of creditors over the other or discriminating between creditors."); William Tudor John, *Sovereign Risk And Immunity Under English Law And Practice*, *in* INTERNATIONAL FINANCIAL LAW, Vol. I, 79, 96 (2d ed. R. Rendell ed., 1983) [hereinafter *Tudor John*] ("[T]he *pari passu* clause . . . is primarily intended to prevent the earmarking of revenues of the government toward a single creditor . . . ."); *Venkatachari*, *supra* note 3, at 92 ("In the case of a sovereign borrower the [pari passu] clause is intended to prevent the borrower giving preference to certain creditors by, say, giving them first bite at its foreign currency reserves or its revenues . . . . This kind of clause catches arrangements which merely give a right of priority of payment; it is not concerned with arrangements as to creation of security over the assets of the borrower (or others) – that will be provided for in the negative pledge clause."); ENCYLOPAEDIA OF BANKING LAW, F1204 (Sir Peter Cresswell *et al.* eds., 2002) ("[A] *pari passu* clause in state credit is primarily intended to prevent the legislative earmarking of revenues of the government or the legislative allocation of inadequate foreign currency reserves to a single creditor and is generally directed against legal measures which have the effect of preferring one set of creditors over the others or discriminating between creditors.").

[11] Lee C. Buchheit, *Negative Pledge Clauses: The Games People Play*, INT'L FIN. L. REV., July 1990, at 10.

[12] *See*, *e.g.,* Philip R. Wood, PROJECT FINANCE, SUBORDINATED DEBT AND STATE LOANS (Law and Practice of International Finance 1995) 165 ("In the state context, the meaning of the clause is

The commentators did agree, however, that the clause was intended to address only borrower actions having the effect of changing the legal *ranking* of the debt or perhaps the earmarking of assets or revenue streams to benefit specific creditors. None was prepared to say that a borrower not yet in bankruptcy or within the statutory period for recovering preferential payments prior to a bankruptcy filing (or, in the case of a sovereign borrower, not eligible for bankruptcy), was obligated by virtue of this clause to pay all equally-ranking debt on a strictly lockstep basis.[13] Nor did these commentators suggest that differential payments by a borrower subject to this clause would expose the borrower, as well as the recipients of the differential payments or a third party through which such a payment is processed, to legal remedies extending beyond those customarily available to unpaid creditors.[14]

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uncertain because there is no hierarchy of payment which is legally enforced under a bankruptcy regime. Probably the clause means that on a *de facto* inability to pay external debt as it falls due, one creditor will not be preferred by a method going beyond contract; and (perhaps) that there will be no discrimination against the same class in the event of insolvency."; Wood*, International Loans*, *supra* note 4, at 41 ("In government loans, the clause is probably to be construed as a general non-discrimination clause prohibiting, *e.g.*, the allocation of insufficient assets to one creditor if the state is effectively bankrupt."); *Sub Specie Aeternitatis*, *supra* note 3, at 11 ("The fact that no one seems quite sure what the clause really means, at least in the context of a loan to a sovereign borrower, has not stunted its popularity.").

[13] *See*, *e.g.,* Wood, *International Finance*, *supra* note 10, at 156 ("It should also be observed that the *pari passu* clause has nothing to do with the time of payment of unsecured indebtedness since this depends upon contractual maturity. The *pari passu* undertaking is not broken merely because one creditor is paid before another."); *Restructuring Commercial Bank Loans*, *supra* note 3, at 146 ("Such [*pari passu*] clauses do not obligate the borrower to repay all of its debt at the same time."); World Bank, *Review of IBRD's Negative Pledge Policy With Respect to Debt and Debt Service Reduction Operations* 2 (July 19, 1990) [hereinafter *World Bank Negative Pledge Policy*] (copy on file with authors) ("The *pari passu* clause, for example, does not prevent a debtor from, as a matter of practice, discriminating in favor of international financial institutions such as the [World] Bank and the IMF in making debt service payments."); *Sub Specie Aeternitatis*, *supra* note 3, at 12 ("The existence of a conventional *pari passu* undertaking in a loan agreement will have no effect on the sovereign's legal ability to pay one creditor even if it is then in default on its payment obligations to other creditors, to prepay one lender ahead of some others or to pledge assets to secure the borrower's obligations under one loan without giving equal security in respect of its other indebtedness."); *Norton, supra* note 3, 43-44 ("This [*pari passu*] clause is designed to ensure the equal ranking of unsecured claims on liquidation of assets to unsecured creditors on the borrower's insolvency. . . . The *pari passu* clause does not require concurrent or equal payment prior to that time, and does not restrict guaranteed loans or setoffs."); *Eurocurrency Loan Agreements*, *supra* note 3, at 83 ("Finally, a lender who remains unpaid at a time when other creditors are current on their loans may articulate his grievance in terms of liberty, equality or fraternity, but he should not invoke the *pari passu* covenant as the legal basis for his disappointment. This provision assures the creditor that its loan will not be subordinated to the claims of other creditors in the event of the borrower's bankruptcy, but it does not force the solvent borrower to make *pro rata* payments to all its creditors.").

[14] *See*, *e.g.*, Tudor John, *supra* note 10, at 96 ("[I]t seems certain that where a borrowing state in financial difficulties agrees to give the most pressing set of creditors preferential treatment, the mere making of priority payment will not constitute a breach of the *pari passu* clause unless accompanied by specific legal measures which disturb the right to be treated equally in the distribution of insufficient assets."); Peter Gabriel, LEGAL ASPECTS OF SYNDICATED LOANS 64 (1986) ("[P]ayment of a debt which has not matured under another contract prior to payment under the present loan contract which has matured, will not be a breach of [the *pari passu*] warranty.); Thomas A. Duvall, III, *Legal Aspects of Sovereign Lending*, in Thomas M. Klein (ed.), EXTERNAL DEBT MANAGEMENT: AN INTRODUCTION (World Bank Technical Paper Number 245, 1994), at 43-44 ("In practice, it is unlikely that a standard pari passu clause prevents a sovereign from discriminating between creditors unless it establishes a legal basis for so doing. For example, many developing countries have continued to make payments to multilateral financial institutions, such as the World Bank, even when they were unable to service commercial bank loans. The so-called 'preferred creditor status' of the World Bank rests on practical considerations rather than legal grounds and, thus, is not thought to violate such countries' pari passu undertakings. Because such discriminatory actions between creditors (whether under the same or different loans) are unlikely to be addressed by the pari passu clause, lenders may seek to include other provisions in the lending arrangement, such as mandatory prepayment clauses and, for syndicated loans, sharing clauses.").

II. THE RATABLE PAYMENT INTERPRETATION

A. Tom, Dick and Harry in Brussels

In June 2000, Elliott Associates, L.P., a New York-based hedge fund, obtained a federal court judgment against the Republic of Peru and a Peruvian public sector bank.[15] The underlying claim arose pursuant to a 1983 New York law-governed letter agreement and guarantee of Peru containing a *pari passu* clause. Elliott knew that Peru was obliged to make a payment in September 2000 to holders of the external bonds Peru had issued to restructure its old bank debt ("*Brady Bonds*"). That payment was to flow through the Chase Manhattan Bank, in its capacity as the fiscal agent for the Brady Bonds, and would eventually be credited to bondholder accounts maintained with the Euroclear System in Belgium and the Depository Trust Company ("*DTC*") in the United States.

In an effort to intercept the Brady Bond payment, Elliott served Restraining Notices on Chase Manhattan, Morgan Guaranty Trust Company (in its capacity as the operator of the Euroclear System), DTC and the Bank of New York (in its capacity as the cash correspondent for the Euroclear System).

On September 22, 2000, Elliott also filed an *ex parte* motion with the President of the Commercial Court in Brussels seeking to enjoin Morgan Guaranty Trust Company, as the operator of the Euroclear System, from processing any payments received from Peru in respect of its Brady Bonds. The Commercial Court denied the motion.[16] Elliott appealed to the Court of Appeals of Brussels, also on an *ex parte* basis.

Among Elliott's challenges to the lower court's dismissal was an argument that "the Peruvian Republic attempts to make payments in violation of a principle of equal treatment (*pari passu* clause) among foreign creditors, whereby Elliott Associates is excluded, and tries to use the Euroclear System to achieve that objective."[17]

Elliott's support for this *pari passu* argument came in the form of an affidavit it had commissioned from Professor Andreas F. Lowenfeld (a law professor with the New York University School of Law). Professor Lowenfeld admitted no shard of doubt about either the meaning of the *pari passu* clause in a sovereign debt instrument or its effect on creditor remedies. He opined in these terms:

> I have no difficulty in understanding what the *pari passu* clause means: it means what it says -- a given debt will rank equally with other debt of the borrower, whether that borrower is an individual, a company, or a sovereign state. A borrower from Tom, Dick, and Harry can't say 'I will pay Tom and Dick in full, and if there is anything left over I'll pay Harry.' If there is not enough money to go around, the borrower faced with a *pari passu* provision must pay all three of them on the same basis.

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[15] *See Elliott Assocs., L.P. v. Banco de la Nacion*, No. 96 Civ. 7916 (RSW), 2000 WL 1449862 (S.D.N.Y. Sept. 29, 2000)

[16] *See Elliott Assocs., L.P.*, General Docket No. 2000/QR/92 (Court of Appeals of Brussels, 8th Chamber, Sept. 26, 2000) (unofficial translation on file with authors) ¶ 3 [hereinafter *Brussels Opinion*].

[17] *Id.*, at 2.

> Suppose, for example, the total debt is $50,000 and the borrower has only $30,000 available. Tom lent $20,000 and Dick and Harry lent $15,000 each. The borrower must pay three fifths of the amount owed to each one – *i.e.*, $12,000 to Tom, and $9,000 each to Dick and Harry. Of course the remaining sums would remain as obligations of the borrower. But if the borrower proposed to pay Tom $20,000 in full satisfaction, Dick $10,000 and Harry nothing, a court could and should issue an injunction at the behest of Harry. The injunction would run in the first instance against the borrower, but I believe (putting jurisdictional considerations aside) to Tom and Dick as well.[18]

No authority was cited in the affidavit for these opinions.

Professor Lowenfeld thus advanced an interpretation of the *pari passu* clause containing these elements:

(i) that the clause requires equal legal ranking of the debt with, in this case, Peru's other external debts;

(ii) that equally ranking debt must be paid equally, at least when the debtor promises in a *pari passu* clause to maintain the equal ranking;

(iii) that if there is not enough money to pay all equally-ranking creditors in full, each holder of equally-ranking debt must receive a ratable share;

(iv) that propositions (ii) and (iii) above are enforceable against the debtor by means of an injunction; and

(v) that propositions (ii) and (iii) above are also enforceable against the recipients of non-ratable payments by injunction.

We shall call this the "ratable payment" interpretation of the *pari passu* clause.

Proposition (i) above is the orthodox reading of the clause. Proposition (ii) contains the innovation -- that a debtor not yet in bankruptcy who has accepted a *pari passu* covenant must *pay* all its equally ranking debts equally. This is also the lynchpin. If proposition (ii) is false (as a matter of contract interpretation of the *pari passu* covenant), then propositions (iii), (iv) and (v) fall away as well.

Four days after Elliott's filing of the *ex parte* appeal, on September 26, 2000, the Belgian Court of Appeals reversed the lower court and granted Elliott's motion to block Peru's Brady Bond payment. In its decision, the Court said:

> It also appears from the basic agreement that governs the repayment of the foreign debt of Peru that the various creditors benefit from a *pari passu* clause that in effect provides that the debt must be repaid *pro rata* among all creditors. This seems to

[18] *See* Declaration of Professor Andreas F. Lowenfeld at 11-12, *Elliott Assocs., L.P. v. Banco de la Nacion, supra* note 15*; Elliott Assocs., L.P. v. Republic of Peru*, 96 Civ. 7916 (RWS), 2000 U.S. Dist. LEXIS 368 (S.D.N.Y. Jan. 18, 2000) (executed Aug. 31, 2000) (on file with authors).

> lead to the conclusion that, upon an interest payment, no creditor can be deprived of its proportionate share.[19]

Shortly thereafter the case was settled, with Peru paying Elliott virtually everything Elliott had been seeking. Of course, the Belgian Court of Appeals was being asked to interpret New York law, as it applied to a boilerplate provision in an unsecured New York loan agreement, in the absence of any controlling (or, for that matter, any) New York judicial precedents on the point. Nevertheless, the Belgian Court's decision was significant: the ratable payment interpretation of the *pari passu* clause had been unleashed.

B. Implications

The ratable payment interpretation of this clause arguably has four practical implications:

(i) It may provide a legal basis for a creditor to seek specific performance of the covenant; that is, a court order directing the debtor not to pay other debts of equal rank without making a ratable payment under the debt benefiting from the clause.

(ii) It may provide a legal basis for a judicial order directed to a third-party creditor instructing that creditor not to accept a payment from the debtor unless the *pari passu*-protected lender receives a ratable payment.

(iii) It may provide a legal basis for a court order directing a third party financial intermediary such as a fiscal agent or a bond clearing system to freeze any non-ratable payment received from the debtor and to turn over to the *pari passu*-protected creditor its ratable share of the money.

(iv) It may make a third-party creditor that has knowingly received and accepted a non-ratable payment answerable to the *pari passu*-protected creditor for a ratable share of the money.[20]

C. Proliferation

Following the Belgian decision in *Elliott v. Peru*, it did not take long for other creditors to see the extraordinary implications of the ratable payment interpretation of the *pari passu* clause on creditor remedies. For example:

- On May 29, 2001, Red Mountain Finance, a judgment creditor of the Democratic Republic of the Congo, sought an order from a

[19] *See* Brussels Opinion, *supra* note 16, at 3.

[20] In other contexts, U.S. courts have sometimes been prepared to fashion remedies against a third party that knowingly colludes with a debtor in breaching a financial covenant benefiting another lender. *See generally*, Carl S. Bjerre, *Secured Transactions Inside Out: Negative Pledge Covenants, Property and Perfection*, 84 CORNELL L. REV. 305, 329-30 (1999). In *First Wyoming Bank, Casper v. Mudge*, 748 F.2d 713 (Wyo. 1988), for example, a bank was held liable for tortious interference with contractual relations because it knowingly took security from a borrower in violation of an existing negative pledge undertaking. *But cf.* Schnebel, *supra* note 7, at 49 ("Subject to the provisions of Section 547 of the Federal Bankruptcy Code in respect of preference payments, a borrower may favor one lender by the payment of additional fees or loan prepayments. If this is a concern, the loan or credit agreement may restrict or prohibit such action by the borrower. If the borrower violates the agreement and makes such payment, however, the lender will have no recourse against the favored lender.")

federal District Court judge in California seeking the Congo's specific performance -- on the ratable payment theory -- of a *pari passu* clause in a 1980 credit agreement with the Congo. According to the transcript of the court hearing, the judge expressly denied the request for specific performance of that clause but nevertheless enjoined the Congo from making any payments in respect of its External Indebtedness (as defined in the 1980 credit agreement) without making a "proportionate payment" to Red Mountain.[21] The case subsequently settled.

- In April 2003, Kensington International Limited, a creditor of the Republic of the Congo ("*Congo-Brazzaville*"), sought summary judgment in London on a money claim against Congo-Brazzaville, as well as an order from the High Court in London restraining the defendant from paying its other creditors without making a *pro rata* payment to Kensington. The legal basis for the requested order was a *pari passu* clause in a loan agreement. The English trial judge apparently viewed this motion for injunctive relief as "novel and unprecedented," and he denied it.[22] On appeal, the Court of Appeals affirmed that denial.[23]

- In *Nacional Financiera, S.N.C. v. Chase Manhattan Bank, N.A.*, Judge Martin of the U.S. District Court for the Southern District of New York was called upon to interpret a *pari passu* provision in a fiscal agency agreement. It was alleged that the borrower, Tribasa, had defaulted on its payment obligations to certain noteholders (called the "*Smith Parties*"). Tribasa was alleged to have then issued new notes to another creditor, Nafin, and paid those new notes. When the Smith Parties argued that this practice violated Tribasa's *pari passu* covenant, Judge Martin ruled that the *pari passu* provision's only effect in terms of legal remedies was to ensure that, in the event of Tribasa's bankruptcy, all of Tribasa's noteholders would share equally in the distribution of the company's unencumbered accounts.[24] Nafin, before it accepted a payment by Tribasa, was under no obligation to assure itself that other noteholders were also being paid on their claims.[25]

  Citing the *Elliott v. Peru* decision in Brussels, however, Judge Martin speculated that the *pari passu* covenant "may . . . have given the Smith Parties the right to obtain an injunction to bar Tribasa from making preferential payments to some of its note holders and

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[21] *See Red Mountain Fin., Inc. v. Democratic Republic of Congo and Nat'l Bank of Congo*, Case No. CV 00-0164 R (C.D. Cal. May 29, 2001).

[22] *See Kensington Int'l Ltd. v. Republic of the* Congo, 2002 No. 1088, at 6:13-16 (Commercial Ct. April 16, 2003) (judgment of Mr. Justice Tomlinson) (characterizing J. Cresswell as finding motion for injunctive relief "novel and unprecedented" and denying injunctive relief).

[23] See *Kensington Int'l Ltd. v. Republic of the Congo*, No. [2003] EWCA Civ. 709 (C.A. May 13, 2003).

[24] See *Nacional Financiera, S.N.O. v. Chase Manhattan Bank, N.A.*, No. 00 Civ. 1571 (JSM), 2003 WL 1878415, at *2 (S.D.N.Y. Apr. 14, 2003).

[25] *Id.*

that another note holder with notice of that injunction could be liable . . . if it thereafter accepted preferential payments."[26]

- On August 13, 2003, Kensington International Limited sued BNP Paribas S.A. in a state court in New York alleging, among other things, that BNP had tortiously interfered with Kensington's rights as a creditor of Congo-Brazzaville under a 1984 loan agreement (containing a *pari passu* clause) in which Kensington had purchased an assignment interest. Congo-Brazzaville defaulted on its payment obligations under the loan agreement in 1985. BNP subsequently entered into new financings with Congo-Brazzaville, and those new financings had been paid. Based on the ratable payment theory of the *pari passu* clause, Kensington alleged that BNP's acceptance of those payments at a time when the 1984 loan agreement remained in default tortiously interfered with Kensington's rights under Congo-Brazzaville's *pari passu* covenant.[27]

- In September 2003, the same trial court in Brussels that heard the *Elliott v. Peru* case in 2000 found itself confronting a very similar fact pattern. In the *Elliott* case, this court had denied Elliott's motion to freeze payments passing through the Euroclear System, only to be reversed by the Belgian Court of Appeals. Now a judgment creditor of Nicaragua, LNC, was seeking an injunction preventing Euroclear from processing payments on certain Nicaragua bonds. The legal basis for this request was a *pari passu* covenant in a 1980 loan agreement of Nicaragua. This time the Belgian trial court granted the injunction.[28] That decision has been appealed.

D. Criticisms

The most telling arguments against the ratable payment interpretation tend to highlight the implausibility of that interpretation in light of the historical behavior of market participants.[29] For example:

- Domestic credit agreements. If the simple device of a three-line *pari passu* clause really gives a creditor the ability to enforce ratable payments by a debtor in distress, why is it not an invariable feature of domestic credit agreements?[30] After all, most corporate borrowers faced with a cash squeeze will engage in a form of financial triage -- paying some creditors (like suppliers) while trying

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[26] *Id.*

[27] *See* Kensington Int'l Limited v. BNP Paribas SA, No. 03602569 (N.Y. Sup. Ct.) (complaint filed August 13, 2003).

[28] *See* Public Hearing of Summary Proceedings of Thursday, September 11, 2003, Republic of Nicaragua v. LNC Investments and Euroclear Bank S.A. (free translation) (copy on file with authors) [hereinafter *LNC Opinion*].

[29] There has been a limited amount of academic commentary about the ratable payment interpretation of the *pari passu* clause since the Belgian court decision in the *Elliott* case in 2000. These commentaries have criticized the ratable payment interpretation. *See* G. Mitu Gulati and Kenneth N. Klee, *Sovereign Piracy*, 56 BUS. LAW. 635 (2001) and Philip R. Wood, *Pari Passu Clauses – What Do They Mean?,* BUTTERWORTH'S JOURNAL OF INTERNATIONAL BANKING (Nov. 2003), at 374.

[30] *See supra* note 6.

to sweet-talk others into showing flexibility. An unpaid lender to a U.S. corporate borrower that objects to this triage may force the debtor into bankruptcy. Once there, the lender can be assured of equal treatment of all similarly-situated creditors, and can force the clawback of preferential payments made to other creditors within 90 days of the bankruptcy filing. Under the ratable payment interpretation of the *pari passu* clause, however, such a lender could presumably arrest the financial triage without the need for an involuntary bankruptcy filing and perhaps even claw back preferential payments made much earlier than the 90-day statutory window. Indeed, only the statute of limitations might constrain the outer limits of a *pari passu*-protected lender's ability to pursue remedies against another creditor that knowingly accepted a non-ratable payment. Why then should domestic lenders have overlooked a short contractual provision that, if the ratable payment interpretation is correct, would have so significantly enhanced their available remedies outside of bankruptcy?

- Sovereign restructuring practices. Financial triage is not wholly unknown to the sovereign debtor community either. For various reasons, financially-distressed sovereigns typically pay certain types of creditors (*e.g.*, trade creditors, suppliers and international financial institutions like the World Bank) even while they restructure debts owed to banks, bondholders and bilateral creditors. Every sovereign debt restructuring in the 1980s began with a painstaking negotiation of these so-called "excluded debt" categories (excluded, that is, from the restructuring).[31] Why? If the *pari passu* clauses in all of the underlying loan agreements required ratable payments of all equally-ranking debts, why didn't some creditor somewhere obtain a court order halting this practice of allowing the debtor to continue paying *de facto* preferred creditors while restructuring the others? At the very least, why didn't the drafters of the restructuring agreements that resulted from these negotiations feel the need to include waivers or amendments of the many *pari passu* covenants in the underlying credit instruments?

- Redundant contractual provisions. Syndicated commercial bank loan agreements invariably contain a so-called "sharing clause" (sometimes running to four or five pages in length) designed to ensure that any disproportionate payment received by one member of the syndicate will be shared ratably with all the rest.[32] Why? Under the ratable payment interpretation of the *pari passu* clause, these lenders already had an effective mechanism to enforce ratable payments both within a specific syndicate of banks and more broadly with all other equally-ranking creditors. Why devote so much energy to drafting a redundant provision? Equally mysterious, why did the lawyers drafting these agreements feel the need to spill four or five pages of ink in describing the intra-syndicate sharing mechanism if the prospect of global sharing with

[31] *See Restructuring Commercial Bank Loans*, *supra* note 3, at 142.

[32] *See Eurocurrency Loan Agreements*, *supra* note 3, at 76-81.

all other equally ranking lenders could comfortably be lodged in the three lines of the *pari passu* clause, without ever using the word "share" or one of its synonyms?

- Sharing among bondholders. In 1998, official sector participants (mainly the G-10 governments and the International Monetary Fund) suggested, as part of the "new international financial architecture" debate, that emerging market sovereign bonds begin to incorporate sharing clauses modeled on those typically found in syndicated commercial bank loans.[33] Of all the proposals to change sovereign bond documentation, the investor community reserved its special wrath for the sharing clause idea. Trade associations representing bond market investors were uniform in their rejection of the proposal to add sharing clauses to sovereign bonds.[34] But why? If the ratable payment interpretation of the *pari passu* clause is correct, bonds containing *pari passu* clauses (which is most of them) already included a legally-enforceable obligation on the bondholders to share any non-ratable payments. Why then did the investor community react so fiercely to the idea of spelling out the mechanics of such sharing in a new clause?

- Wider use. We have been talking about this clause in the context of credit instruments. But if indeed the provision carries the ratable payment baggage, why does it not appear in all manner of commercial instruments and invoices? Such a clause might read: "The customer's obligations under this bar tab will rank *pari passu* in priority of payment with all of the customer's other payment obligations." By adding these few words, would the bartender acquire a legal basis (outside of bankruptcy) to keep the customer from paying her taxes before the bar tab had been settled? If served with an injunction to that effect, would the Internal Revenue Service be obliged to decline a tax payment or to turn over a ratable share of the money to the bartender?

- The butcher and the baker. The ratable payment interpretation turns upon the proposition that equally ranking debts must be paid equally. The *pari passu* clause does not itself say this of course -- indeed, it refers only to the ranking of the debt -- but this is the quiet inference that the proponents of the ratable payment theory draw from a borrower's promise to maintain equal ranking. Putting aside statutory preferences recognized in bankruptcy, contractually senior or subordinated debts and secured debts, however, most claims against an individual or a corporation will fall into the broad classification of "general unsecured" obligations. But if those

[33] *See* G-22, REPORT OF THE WORKING GROUP ON INTERNATIONAL FINANCIAL CRISES, at 20. *See generally*, Lee C. Buchheit, *Changing Bond Documentation: The Sharing Clause*, INT'L FIN. L. REV., July 1998, at 17.

[34] *See*, *e.g.,* Edward Luce, *Pakistan a warning to bond holders*, FIN. TIMES (Feb. 18, 1999) ("Clifford Dammers, head of the International Primary Market Association -- the body representing the international bond markets -- says . . . the market opposes the sharing clause . . . ."); Emerging Market Traders Association, *Paris Club Asks Pakistan to Reschedule Eurobonds*, (undated paper, copy on file with authors) ("[I]t is EMTA's position that radical changes in bond documentation (such as including sharing clauses . . .) are undesirable . . . .").

general unsecured debts by law rank equally, must not they too be paid ratably? To continue the trend of homey examples, must not Aunt Agatha refrain -- under threat of a legal injunction -- from paying the baker while ignoring the butcher? Or does the obligation to make ratable payments derive not from the *fact* of the equal ranking of the claims, but somehow from the borrower's contractual *promise* to maintain such equal ranking? So that Aunt Agatha is free to make differential payments unless and until the baker gets her to acknowledge that he ranks *pari passu* with the butcher?

- Third-party beneficiaries. The ratable payment interpretation suggests that the phrase "this bond shall rank *pari passu* in priority of payment with all of the borrower's other debts" constitutes an enforceable promise not to pay other debts while this bond is in default. But doesn't that same sentence also confirm that the borrower's other debts rank equally with this bond? And if they do, a consistent application of the ratable payment theory leads to the conclusion that the borrower should never be paying this bond if it is then in default on any of its other debts. Remember, equally ranking debts must be paid equally -- that's the theory. By the debtor's openly announcing its agreement (in a registration statement filed with the U.S. Securities and Exchange Commission, for example) to maintain the equal ranking of this bond with those other debts, have those other creditors been given the power to enjoin a payment under this bond, regardless of whether the instruments evidencing those other debts contain their own *pari passu* covenants?

  And if there is even the remotest possibility of this outcome, why would the purchasers of such a bond agree up front to decline to accept payments under their instrument unless every other equally-ranking lender to that borrower was also being paid in full? Analyzed in this way, a *pari passu* covenant is a positively dangerous clause to include in any debt instrument.

- Plain speaking. "Following the occurrence of a [payment default] hereunder, the Borrower agrees that it will not, directly or indirectly, make any payment of any other present or future External Indebtedness of the Borrower unless, simultaneously with such payment, a ratable payment is made of amounts then due under this Agreement." If this is what the contract drafter had wanted to say, why not just say it? Is it even remotely plausible that a sophisticated drafter would have left the parties to extrapolate this conclusion from the text of a clause that speaks only about the legal ranking of debt?[35]

[35] Even this plain-speaking text conceals a number of crucial issues that the drafter would inevitably need to spell out in the contract. For example, what does "ratable" mean in this context? Lender A has five loans outstanding to the Borrower, each in the amount of $100. Lender B has one loan to that Borrower, in the amount of $1,000, but the Borrower has stopped paying Lender B on that credit. Now the Borrower pays $50 to Lender A to be applied toward one of the five outstanding loans from Lender A. Lender B calls for a ratable payment of its $1,000 defaulted credit. But what is ratable? The obvious options are:

(i) $50 (the same dollar amount paid to Lender A), or

- Tom, Dick, Harry and Sue. Let's go back to Tom, Dick and Harry. Tom and Dick, at the sharp end of the injunctions obtained by Harry based upon a ratable payment theory of his *pari passu* clause, have been obliged to turn over a ratable share of their payments to Harry. But now along comes Sue, also a lender to the same borrower and also benefiting from a *pari passu* covenant. Sue seeks an injunction requiring Harry (who, unlike Tom and Dick, lives in her neighborhood) to turn over a "ratable portion" of the payment Harry had so recently extracted from Tom and Dick. What is poor Harry to do now, take another run at Tom and Dick? And if he gets a supplemental payment from them to top-up for the cash he gave to Sue, will not Sue renew her own pursuit of Harry for a ratable share of the top-up? Then Fred, also an unpaid creditor of the same borrower, hears about Sue's success and decides to come after her. And so forth and endlessly so on.

  To avoid this tangled skein of claims, counterclaims and cross-claims among creditors, the ratable payment interpretation of the *pari passu* covenant should logically require that all payments by the borrower to any equally-ranking creditor be placed into some form of global trust account, with a procedure for filing claims with the trustee and an eventual ratable distribution to all beneficiaries of *pari passu* protection. Once again, is it plausible that professional drafters of financial contracts would intend such a massive set of legal arrangements to be interpolated into the slender three lines of a conventional *pari passu* covenant?

  Or try this hypothetical: borrower defaults on a bond. One (but only one) bondholder sues and levies against an asset of the borrower to satisfy its judgment. Is the litigious creditor now holding those funds as constructive trustee for the ratable benefit of its erstwhile fellow bondholders? After all, the judgment creditor knew perfectly well that the underlying bond contained a *pari passu* covenant and that the other bondholders had not been paid.[36]

(ii) $100 (corresponding to the proportion that the $50 payment to Lender A represents of the $500 total amount due to Lender A), or

(iii) $500 (corresponding to the proportion that the $50 payment represents of the specific $100 loan that was repaid).

Of course, if one believes that a conventional *pari passu* clause has the same meaning as the plain-speaking version of the clause set out in the main text above, it raises identical interpretative issues.

[36] The judgment creditor will probably argue that it is *not* obliged to share with the other bondholders because, pursuant to the doctrine of "merger", all its claims under its original bond have been merged into the judgment. "When the plaintiff recovers a valid and final personal judgment, his original claim is extinguished and rights upon the judgment are substituted for it." RESTATEMENT (SECOND) OF JUDGMENTS § 18, cmt. a (1982). But if the doctrine of merger severs the judgment creditor from its obligation to share recoveries with its *pari passu*-ranking fellow bondholders (if such an obligation exists), why does not the doctrine of merger also sever the judgment creditor from that same *pari passu* clause when the creditor seeks -- based on the ratable payment interpretation of the clause -- to intercept payments going to other equally-ranking creditors? If the doctrine of merger detaches a judgment creditor from its obligations under that clause, surely it also separates the judgment creditor from its rights under that clause (assuming again, that such rights and obligations actually arise under the clause).

There is a single answer to all of these "whys": neither lenders nor borrowers nor their respective legal counsel nor academic commentators ever believed that a conventional *pari passu* covenant in a debt instrument carried the ratable payment interpretation. The behavior of participants in the financial markets since this clause first made its appearance in unsecured, cross-border debt instruments in the 1970s (as discussed below) demonstrates that they did not believe, or even suspect, that the clause required ratable payments (outside of bankruptcy) of all equally-ranking debts.

One is tempted to end the inquiry there: after all, contracts mean what the parties intend them to mean. In the case of boilerplate contractual provisions, the clauses carry the meaning accepted by general consensus among market participants. When in doubt, look at how the market acts, or sometimes doesn't act, in the face of a particular clause. If a question is raised about the meaning of a boilerplate clause, the established behavior (what one court has called the "deliberate and enduring course of conduct")[37] of the thousands of commercial parties to contracts containing that clause gives the best insight into their understanding of its meaning.

New York has adopted just this approach to interpreting boilerplate provisions in commercial contracts.[38] New York courts have been reluctant to risk disturbing the market's demonstrated understanding of the meaning of boilerplate clauses by, for example, allowing interpretations of those clauses to be made by juries rather than judges.[39]

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[37] *See* Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039, 1049 (2d Cir. 1982).

[38] In *Sharon Steel*, *id*., the Second Circuit Court of Appeals affirmed the District Court's refusal to allow a boilerplate clause in a standard debenture to be submitted to a jury for interpretation. After noting that boilerplate provisions are not the consequence of the relationship of particular borrowers and lenders and do not depend upon particularized intentions of the parties, the Second Circuit said:

> Whereas participants in the capital market can adjust their affairs according to a uniform interpretation, whether it be correct or not as an initial proposition, the creation of enduring uncertainties as to the meaning of boilerplate provisions would decrease the value of all debenture issues and greatly impair the efficient working of capital markets. Such uncertainties would vastly increase the risks and, therefore, the costs of borrowing with no offsetting benefits either in the capital market or in the administration of justice.

Id. at 1048.

[39] "When standard [contract] terms exist, the role of judicial interpretation should be to promote the functions of standard terms . . ., while allowing firms to opt out of those standards and customize their own terms." Marcel Kahan and Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate"),* 83 VA. L. Rev. 713, 764-5 (1997). Professors Kahan and Klausner list among the benefits of standard clauses (i) drafting efficiency, (ii) reduced uncertainty over the meaning and validity of a term and (iii) familiarity with a term among lawyers, other professionals and the investment community. *Id.* at 719-25.

III. THE HUNT FOR PARI PASSU

There is something intellectually unsatisfying, however, about confining the inquiry to what the *pari passu* clause does *not* mean. It leaves open intriguing questions about the origin of the clause, what factors influenced its migration over the centuries into unsecured, cross-border credit instruments (including credit instruments with sovereign borrowers) and, most importantly, what protections the drafters of the provision were trying to achieve by inserting the clause into these contracts. In an effort to answer these questions, the authors embarked several years ago on a small exercise in legal paleontology: the hunt for *pari passu*.

A. Preferences and Priorities

The *pari passu* covenant is a contractual provision. Contract drafters do not usually write into their contracts what the law already provides. Drafters do not, for example, often add this sentence to their agreements: "If either party breaches this Agreement, the other party shall have the rights and remedies provided by law." The reason? The law already supplies this premise; saying it adds nothing. So when drafters feel compelled to burden their documents with express provisions, it is a pretty good sign that they are trying to address a matter that they feel needs a customized treatment. They either want to record an understanding of the parties on a matter that the law does not already cover or they seek to clarify a point on which the law is seen as murky or equivocal.

When the contract in question evidences an extension of unsecured credit to a corporate borrower, the lender will worry about four things that may affect the lender's ability to recover the debt. These are:

(i) The nature of the claims against the borrower that will, as a matter of law, enjoy a priority in a bankruptcy of the debtor. Such claims may include tax assessments, unpaid employee wages, contributions to corporate-sponsored pension programs and so forth. We shall call this category of preferred claims "*Statutory Preferences*."[40]

(ii) Claims (outside of Statutory Preferences) that rank legally senior in, and sometimes out of, bankruptcy to the debtor's general unsecured obligations. We shall call these "*Legally Senior Debts*."

(iii) Claims that benefit from a security interest over the debtor's property or revenues that can be realized in, or out of, bankruptcy. Examples include mortgages, pledges, charges, hypothecations, conditional sale arrangements and so forth. We shall call these "*Secured Debts*."

(iv) The aggregate size of other general unsecured claims against the borrower. Even if these claims will not enjoy a priority in the distribution of the debtor's unencumbered assets in bankruptcy, increasing the aggregate size of these claims will tend to dilute the recovery that any individual unsecured creditor can expect to receive from the finite pool of such unencumbered assets.

There is nothing much a creditor can do about Statutory Preferences other perhaps than to seek a clear idea of what they are in the borrower's

[40] *See, e.g.*, Section 507 of the U.S. Bankruptcy Code which contains the list of the priorities recognized in U.S. bankruptcy practice. 11 U.S.C. § 507 (2003).

jurisdiction before lending the money. A debtor cannot, by contract, opt out of Statutory Preferences such as claims for unpaid taxes. The most that can be achieved is to include contractual commitments by the debtor to pay its taxes, pension fund contributions and so forth as they fall due, so that unsatisfied claims constituting Statutory Preferences never arise in the first place.

As noted above, drafters of U.S. domestic credit agreements do not usually include express provisions precluding the debtor's ability to incur Legally Senior Debts. The reason is that U.S. law does not permit an existing creditor to be legally subordinated without its consent. This is an example of the "don't say what you don't need to say" rule of contract drafting described in the first paragraph of this Part 3.

Secured Debts and the overall size of the pool of equally-ranking unsecured debts, however, are another matter. The law does not constrain a debtor's ability to pledge its assets or revenues, or to incur additional unsecured debts. If a creditor wants to limit this behavior by its borrower, the creditor must look to its contract as the source for that protection.

In the case of Secured Debts, this contractual protection takes the form of something called a negative pledge clause. Although there are many drafting variations, the negative pledge clause typically precludes the borrower from creating liens over its assets or revenues in favor of other lenders (often subject to specific exceptions) without equally and ratably securing the creditor benefiting from the clause.[41] The purpose is to ensure that the borrower's assets will remain unencumbered and available to satisfy the claims of all general, unsecured creditors in a bankruptcy. As one writer was later to put it, the negative pledge clause is intended to say: "If I'm unsecured, so must everybody else be."[42]

In some agreements, a protection against bloating the class of unsecured creditors takes the form of a "debt limitation" clause. It caps the ability of the borrower to incur additional, equally-ranking debt above a specified level.[43] The negative pledge clause, the debt limitation clause and, for that matter, the *pari passu* covenant, are all species under the genus "financial covenants." Their presence in a financial contract reveals the drafter's belief that these protections must be sought by contract because the ambient law governing the relationship will not otherwise provide them.

B. The Pari Passu Odyssey

Our research suggests that the *pari passu* clause evolved in three broad phases in Anglo-American credit agreements. In its original form (nineteenth and early twentieth centuries), the clause appeared in secured debt instruments and confirmed the ratable interests of the debtholders in the collateral securing that instrument (an assurance that the law -- absent express contractual language -- did not supply). By the middle of the twentieth century, a painful history had taught

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[41] *See generally*, *Eurocurrency Loan Agreements*, *supra* note 3, at 86-91.

[42] T.H. Donaldson, *American Banks: Experienced Lenders or....?* EUROMONEY (Oct. 1971) [hereinafter Donaldson, *Experienced Lenders or ....?*], at 46, 47.

[43] *See* David E. Webb, DOCUMENTATION FOR HIGH YIELD DEBT (2001) at 17; John McCann, TERM LOAN HANDBOOK, *supra* note 6, at 171 ("Clearly, to the extent that the creditors of a borrower . . . are limited, the more likely it is that those creditors' claims will be satisfied by the borrower's assets in a distress/liquidation situation.").

the cross-border lenders to rely less on collateral security for emerging market bonds. Cross-border lending in this period was therefore mainly *un*secured and, in that context, the traditional *pari passu* covenant was not necessary. Instead of security and the accompanying *pari passu clause*, the drafters of mid-twentieth century unsecured debt instruments looked to the negative pledge clause to protect themselves against an erosion in credit position as a result of a borrower's pledging its assets in favor of other lenders. By the late twentieth century, however, most of the private capital flows to emerging market borrowers were coming from a new breed of lender, the international commercial banks. These institutions, apart from insisting on a negative pledge clause to safeguard their credit position as unsecured lenders, also worried that legal procedures in some countries could -- even without their knowledge or consent -- result in an involuntary subordination of the banks' claims. The banks responded to this threat with a contractual protection against such involuntary subordination: a version of the *pari passu* clause that speaks in terms of "*pari passu* in priority of payment".

(i) Nineteenth and Early Twentieth Centuries:
Pari Passu in Secured Credits

A version of the *pari passu* clause was routinely used in debentures and other debt instruments issued by both corporate and sovereign borrowers in the nineteenth and early twentieth centuries, but *only* when the instrument benefited from collateral security. A representative clause might read as follows:

> The debentures of [this] series are all to rank *pari passu* in point of charge without any preference or priority one over another . . . .[44]

Here is how Francis Beaufort Palmer, a leading nineteenth century English commentator, explained the purpose of this clause in a secured debenture (a debenture is a type of debt instrument):

> The object of the above *pari passu* provision is to place all the debentures on the same level as to security; so that, if the security is to be enforced, whatever is realized from it shall be divided amongst them ratably. But for some such provision the debentures would rank in point of security according to their dates of issue; and, accordingly, the first issued would rank as a first charge, and the next issued as a second charge, and so on . . . and this would be entirely destructive of the marketable character of the security.[45]

Indeed, Palmer was later to express his doubts about what purpose a *pari passu* clause could possibly serve in what he called a "naked or unsecured" debenture; the very presence of the clause, in Palmer's view, showed that the debenture was *not* intended to be a "naked" (unsecured) one.[46]

There was a very good reason for including a *pari passu* clause in a secured debt instrument during this period. A common practice in the nineteenth century, particularly in the case of debt securities issued by railroads, was to issue

[44] Francis B. Palmer, COMPANY LAW 197 (2d ed. 1898) [hereinafter Palmer, *Company Law*].

[45] *Id.* at 198.

[46] Palmer, *Company Precedents*, *supra* note 2, at 110.

multiple series of bonds that all benefited from a security interest in a common pool of collateral such as the railroad's real estate and rolling stock. Under prevailing English law, absent a contractual agreement to the contrary, multiple claims by the holders of the various series of bonds against a common asset pledged as collateral would have been ranked in the temporal order in which the bonds were issued.[47] Thus, a series of bonds issued in 1876 would have had a priority claim over the disposition of the common collateral in preference to a second series issued, say, in 1877.

The situation in the United States was particularly chaotic and worrisome for debtholders whose instruments did not contain an express confirmation of their *pari passu* ranking. In some situations, U.S. courts followed the English "first to be issued" priority rule in applying the proceeds of collateral among several debtholders.[48] Other courts looked to the dates on which the debt instruments were scheduled to mature as a basis for establishing the priority of claims against collateral.[49] Other states provided that all debtholders should share equally and ratably in the pledged assets.[50]

But these English and U.S. rules establishing the priority of interests in collateral among various creditors *could* be changed by contract.[51] Enter the *pari passu* clause, which confirmed the intention of the parties that all debtholders secured by the same collateral would share equally and ratably in the security, whatever the generally applicable priority rule in a particular jurisdiction. The phrase *pari passu* was thus being employed in a manner consistent with its use in the equity courts (as a way of expressing the ratable interests of multiple parties in a single asset or pool of equitable assets).

The inclusion of this provision in a debt instrument had practical consequences for the creditors. The clause served, in effect, to establish contractually the rule governing the application of the proceeds from the liquidation of collateral. If one debtholder attempted to enforce the security interest by levying against the pledged property, for example, it was forced to do so for the benefit of all its *pari passu*-ranking fellow debtholders. Any proceeds from the levy were to be held in trust for all debtholders whose claims against the borrower were secured by that collateral.

It is significant that at this stage in its life (the nineteenth and early twentieth centuries), the *pari passu* clause was used exclusively in *secured* debt instruments. The intercreditor responsibilities connoted by the presence of a *pari passu* clause in a debt instrument were strictly limited to enforcement against the collateral securing that instrument. The clause implied no broader intercreditor

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[47] *See id.* at 109.

[48] *See* cases collected at 63 N.Y. JUR. 2D GUARANTY AND SURETYSHIP, 272 (2003) ("Application of Collateral Where Judgment Is Received on Several Debts").

[49] *See* cases collected at AM. JUR. 2D MORTGAGES § 315 (2003) ("Earlier-Maturity Rule"); *see also* Silvester E. Quindry, BONDS AND BONDHOLDERS: RIGHTS AND REMEDIES, Vol. 1, 388 (1934) [hereinafter Quindry] ("The earlier maturity rule, i.e. that the holders of bonds have priority in the proceeds of sale according to the priority of the maturity dates, the earlier having preference over the latter, is recognized in many jurisdictions, where the bonds mature at different dates and the trust deed is silent on the question of priorities.").

[50] *See* cases collected at AM. JUR. 2D MORTGAGES § 314 (2003) ("Pro-Rata Rule").

[51] *Quindry*, *supra* note 49, at 388. ("But, of course, the parties may contract as to priorities and preferences and the courts will enforce the agreement.").

duties. Specifically, if a creditor could -- with or without the aid of a judgment -- obtain payment of his instrument from the issuer without recourse to the pledged property, he was under no obligation to share that payment with other *pari passu*-ranking debtholders. Here is Francis Beaufort Palmer on the point:

> The presence of a *pari passu* clause does not, however, prevent a debenture holder, whose debt is due, from getting judgment and obtaining payment from the company if he can, and so, too, if, without judgment, he can obtain payment from the company, he cannot be called on to hand back what he has received for the benefit of the other debenture holders.[52]

In its original form, therefore, the *pari passu* covenant did not connote the kind of intercreditor duties that the ratable payment interpretation has recently sought to ascribe to it. Specifically, a borrower was *not* prevented by the clause from *paying* one debtholder ratably while ignoring other, equally-ranking creditors, as long as the payment was not sourced from the specifically pledged collateral to secure the issue. Nor was the creditor receiving such a payment under any obligation to account to his fellow debtholders for their ratable share of the payment.

(ii) Middle Twentieth Century:
Negative Pledge in Unsecured Credits

Cross-border lending practices changed dramatically in the middle of the twentieth century. Many of the nineteenth and early twentieth century debt instruments issued by sovereign borrowers in the international markets were secured, or at least they appeared to be.[53] The bonds would frequently be described as benefiting from some form of security or guarantee: a vaguely-worded interest in the proceeds from the sale of guano, for example, or in certain tax revenues to be collected by a sovereign borrower. These bonds often included a *pari passu* clause to confirm the bondholders' ratable interests in that collateral.

In practice, the ostensible security for these bonds was frequently of very little help in getting the bonds paid in the face of a default by the issuer, particularly a sovereign issuer. A security feature might influence the relative priority of the bond in a general diplomatic settlement of a sovereign's debts,[54] but bondholders

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[52] Palmer, *Company Law*, *supra* note 44, at 198.

[53] *See* 7 SEC. AND EXCH. COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES 11 (May 14, 1937) [hereinafter *SEC Report*] ("[O]f the 172 [defaulted foreign bond issues listed in the annual report of the Foreign Bondholders Protective Council, Inc., for the year 1935], 109 were secured, and of these 70 were secured by pledges of revenue while but 11 were secured by mortgages of physical property only. Twenty-eight loans were secured by both the mortgaging of physical property and the pledging of revenues."). *See also* John T. Madden & Marcus Nadler, FOREIGN SECURITIES (1929) 165-66 ("Weaker countries, and especially those whose credit standing is not well established, cannot obtain foreign loans on financially satisfactory terms without pledging certain revenues as security for the payment of principal and interest on debt. . . . For a considerable period before the [first] World War, the practice of requiring specific security for government loans was becoming less common but the disorganized state of governmental finances after the war, brought about a revival of the custom.").

[54] *See* Edwin Borchard, STATE INSOLVENCY AND FOREIGN BONDHOLDERS, Vol. I, 98, 99 (1951) [hereinafter Borchard] ("[E]xperience shows that lending houses and investors, when they appeal to their governments for diplomatic interposition, have usually a better chance of obtaining governmental cooperation if there exists a specific 'pledge.' . . . During the different stages of the liquidation and readjustment of the Turkish and Egyptian public debt, as well as in other settlements, holders of secured bonds have received preferential treatment either in the form of priorities in payment and amortization, by being subjected to a smaller reduction of interest than the holders of

typically lacked the ability to enforce the security interest in the borrower's own territory absent some diplomatic or military assistance from their own governments.[55] The market's appetite for secured sovereign bonds diminished rapidly after the market crash of 1929 when these security features were shown to have little effect in promoting monetary recoveries from defaulting sovereign issuers.[56] As secured lending to sovereign borrowers declined, the *pari passu* clause (in its conventional, nineteenth century form) was no longer needed.

Negative pledge clauses, however, had become common in unsecured U.S. domestic bonds by at least the 1890s.[57] In general, they did not appear in secured debt instruments, presumably on the theory that as long as a lender is itself fully secured (and the legal validity of such security can be relied upon), it should not have any interest in how the borrower disposes of its other assets.

For the first two decades following World War II, development lending to what we would now call emerging market sovereigns came principally from bilateral (government-to-government) sources and from multilateral sources such the World Bank and other multilateral development banks. Early on, the World Bank decided as a matter of policy that it would not seek collateral security for its loans from sovereign borrowers.[58] In the absence of collateral security, there was

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unsecured bonds, by being spared any reduction in interest, or by being left entirely unaffected by the readjustment procedure."); Ernst H. Feilchenfeld, *Rights and Remedies of Foreign Bondholders*, in *Quindry*, *supra* note 49, II, at 216 [hereinafter Feilchenfeld*, Rights and Remedies*], ("[Q]uasi-secured creditors frequently try to obtain preferential treatment in the award of a higher percentage out of all available assets. . . . the expectation of such preferential treatment seems to be the major intended function of the revenue pledges and charges inserted in loan agreements . . . .").

[55] *See* Borchard, *id*., at 91 ("[A] revenue pledge can become a real security in the hands of the creditors only if the assignment of the revenues to the service of the debt is coupled with some device removing them from the debtor's unhampered control and committing them directly to the administration of the creditors. Such implementation of a pledge, however, is feasible only in exceptional cases.").

[56] *See, e.g.*, the testimony of Allen W. Dulles, then a partner in the Wall Street law firm of Sullivan & Cromwell, before a U.S. Securities and Exchange Commission committee that during the late 1930s investigated the causes of the widespread bond defaults earlier in the decade. Mr. Dulles testified:

> I have reached the conclusion the pledges of revenues are not worth the paper they are written on, on foreign loans, unless the revenues are collected and disbursed by persons other than the debtor. . . . Generally, you are forced back to the situation where the borrowing government is the collector and the disburser, and when that is the situation I don't think the security is worth anything. . . . I don't think it is worth appreciably more than the general obligation of the foreign government to pay. . . . In a debt negotiation in which I had a part I don't think where we had a first or second lien on some revenue that was not being collected would prove of any value in any situation.

The SEC report goes on to note: "This is a frank admission by a partner of a firm which drafted many of the foreign loan agreements that to him the protective covenants are empty phrases." SEC Report, *supra* note 53, at 22-23.

[57] Francis Jacob, *The Effect of Provision for Ratable Protection of Debenture Holders in Case of Subsequent Mortgage*, 52 HARV. L. REV. 77, 78 (1938).

[58] *World Bank Negative Pledge Policy, supra* note 13, at 3, fn. 3 ("In 1948, the then Treasurer of the Bank stated that in his view the Bank's real security lay in the sound economic and financial position of the borrowing country. He stated that the taking of collateral weakened the Bank's ability to induce the country to 'keep his house in order', because in taking collateral, the Bank would have less reason to 'inquire deeply' into conditions in the borrower's country."). Note that this approach to sovereign lending on the part of an international financial institution contrasts with the view of some private sector commentators who during this period continued to see benefits to secured lending, notwithstanding the admitted limitations of such pledges. See, *e.g.*, Borchard, *supra* note 54, at 81-82 ("To guard against abuses in the appropriation of funds to the various functions of government, creditors of states of weak credit standing will be well advised to insist that certain assets and

no point in adding a conventional *pari passu* clause, and in fact *pari passu* clauses did not (and still do not) appear in the standard terms and conditions for World Bank loans.[59]

For its unsecured loans to sovereign market borrowers, the World Bank opted to rely on a very strict negative pledge undertaking from the borrower.[60] This clause prevented both the sovereign and its governmental agencies from pledging collateral to secure any other external borrowings (subject to only two exceptions). Once the World Bank and the other multilateral development banks adopted this policy of using a strict negative pledge clause, of course, member countries that had signed loan agreements with the multilateral development banks were strictly limited in their ability to borrow from private sector lenders on a secured basis. The trend toward *un*secured lending to public sector borrowers in emerging market countries in the decades after 1950 was significantly boosted by these policies.

(iii) Late Twentieth Century:
Pari Passu and Negative Pledge in Unsecured Credits

In the late 1960s, another great shift occurred in private cross-border financing to emerging market borrowers. A new class of lender appeared on the scene (international commercial banks), prepared to lend money sourced from a new pool of capital (the Eurodollar market) pursuant to a new type of debt instrument (a syndicated loan agreement).[61] The general evolution of standard Eurocurrency loan agreements over the roughly 40-year history of this market is beyond the scope of this article. We shall concentrate on only two provisions in these agreements, the *pari passu* clause and the negative pledge clause.

(a) Early Euromarket Documentation

The very earliest forms of syndicated Eurodollar loan agreements (circa mid-1960s) were quite short, often only five or six pages in length.[62] A few years

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revenues – even if the assignment is unenforceable – be placed outside the reach of the government's unlimited spending power during the life of the loan and be devoted exclusively to the service of the debt.")

[59] *See, e.g.*, International Bank for Reconstruction and Development, GENERAL CONDITIONS APPLICABLE TO LOAN AND GUARANTEE AGREEMENTS FOR FIXED-SPREAD LOANS (September 1, 1999) available at http://wbln0018.worldbank.org/legal/legbdl.nsf/0/1c3f3a4937be3671852568ba0062c21a.

[60] For the current text of the clause, see *World Bank Negative Pledge Policy*, *supra* note 13, § 9.03. On the connection between the Bank's policy against taking security and its reliance on the negative pledge clause, *see*, id. at 2-3 ("The reason for requiring negative pledge clauses stems from the long standing policy of the Bank not to seek, in making loans, special security from the member concerned. . . . Where existing assets or future income streams are 'pledged' to certain external creditors in ways which effectively allocate foreign exchange to such creditors, the amount of foreign exchange available to service unsecured creditors, including the Bank, diminishes. It is this risk that the Bank's negative pledge clause seeks to reduce.").

[61] *See generally*, E. Wayne Clendenning, THE EURODOLLAR MARKET (1970).

[62] *See* David Levine, *It's time for Eurobankers to work out what they mean by market practice*, EUROMONEY (Aug. 1976), at 38 ("Not long ago borrowers (particularly sovereign borrowers) insisted, and lenders agreed, that agreements be only five or six pages long . . . . [T]oday agreements of 20-30 pages are common.") *See also* Robert P. McDonald, INTERNATIONAL SYNDICATED LOANS 36 (1982) ("The agency provision in a Eurocurrency loan contract is only one of the many evolutionary changes which contributed to the growth of the document from an average of 15 pages in 1971-72 to 60 pages or more a decade later.").

later, an editorial writer described the Eurodollar loan documentation practices in this era as "immature, inadequate and incomplete."[63]

The reason was historical. European bankers had not developed the same affinity for financial covenants in their loan documentation as had their American colleagues, in part because unsecured "term" loans (in which principal repayment is deferred for a period of, say, five or seven years) were not very common in Europe at the time. Contractual provisions that allow a lender to monitor a credit and that inhibit the borrower from taking actions during the term of the loan that could jeopardize its ability to repay at maturity were simply not necessary in short-term credits or credits repayable upon demand by the lender. When the time came in the mid-1960s to prepare the prototypes of Eurodollar syndicated loan agreements, therefore, the drafters followed documentary customs that were familiar to European borrowers and this meant few, if any, financial covenants.[64]

It did not take long for American bankers to agitate for more rigorous restrictive clauses in the Eurodollar term loan agreements in which their institutions participated. They recognized, however, that these shifts in documentation practices would take both time and persuasion. Here is a Euromarket banker writing in 1971:

> [American banks] must accept . . . that they cannot expect Euroborrowers to go straight from no restrictive clauses to all the ones used in the States. It is important therefore to keep exposing all potential borrowers and lenders in this market to various clauses, and developing a feel for those that are acceptable, and viable alternatives to those that are not.[65]

Among the aims of a "well drawn" loan agreement, this banker urged, was "[t]o ensure that the particular loan is in at least as favorable position as other loans of a comparable nature, and ideally as all other loans."[66]

(b) The Great Leap: *Pari Passu* in Unsecured Euroloans

Standard forms of Eurodollar loan agreements therefore changed very rapidly in the late 1960s and early 1970s. They got longer, much longer. Contemporary observers noted that loan agreements of only five or six pages were common at the beginning of this period; by the early 1970s, the agreements had grown to 20 or 30 pages in length.[67] They would eventually get even longer.

Among the provisions bulking up standard Eurodollar loan agreements were a version of both the *pari passu* clause and a negative pledge clause. The two would very often be combined into a single clause. Here is an example from a 1972 credit agreement with Zaire (later, the Democratic Republic of the Congo):

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[63] Editorial, *Legal Dynamite*, EUROMONEY (Sept. 1976), at 11. Today's bond investors seem to feel much the same way. *See* R. Mannix, *Investors push for rewrite of Eurobond covenants*, INT'L FIN. L. REV., Nov. 2003, at 33 ("Clauses that have remained largely unchanged since the [Eurobond] market's beginning in the early sixties [*e.g.*, the negative pledge clause] are suddenly at the center of a heated debate.").

[64] *See* Donaldson, *Experienced Lenders or …?*, *supra* note 42, at 46.

[65] *Id.*

[66] *Id.*

[67] *See* note 62 *supra*.

> The Borrower will maintain in all its force the power to contract other credits, *provided*, *however*, that the Borrower agrees that any additional external debt or any extension or refunding of presently existing external debt *will rank on a basis not more favorable than* the Advances made hereunder and that if any lien or encumbrance shall be created on any assets or revenues of the Borrower in connection with such additional external debt or extension or refunding of any presently existing external debt, then such lien or encumbrance will equally and ratably secure the payment of the principal of, and interest on, the Advances made hereunder and other amounts payable in respect of this Agreement.[68]

Here is another example from a 1980 loan agreement with an Iraqi borrower:

> The [Borrower] undertakes with the Banks that . . . the liabilities of the [Borrower] under this Agreement will rank at least equally and rateably (*pari passu*) in point of priority and security with all its other liabilities . . . .[69]

The *pari passu* clause thus apparently made a great leap in the early 1970s. For the first time, it was being used in *un*secured cross-border debt instruments. The clause had gone from confirming the equal ranking of debt instruments "in point of charge" or "in point of security" (or words to that effect) in nineteenth and early twentieth century secured bonds, to confirming the equal ranking of debt instruments "in priority of payment" or "in right of payment" (or words to that effect) in *un*secured Eurodollar loan agreements of the early-1970s. Why?

Well, for one thing, most Eurodollar loans did not call for collateral security, and certainly it was very rare in this market for a common collateral pool to secure two or more separate loans, so there was no need to include a contractual provision overriding a generally-applicable legal rule regarding the priority of claims against collateral.

The more intriguing question is why drafters of cross-border Eurodollar loan agreements began in the early 1970s to feel it necessary to revamp the *pari passu* clause, and to use it in an unsecured lending context, to address the legal ranking of their loans with all of the borrower's other unsecured indebtedness. As noted above, no similar clause then appeared (or even now appears) in standard loan agreements used in a purely domestic (U.S.) lending context.

The answer is that commercial banks had become aware that in some countries an existing creditor *could* be involuntarily subordinated to another lender, quite apart from the known risks posed by Statutory Preferences. The

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[68] Quoted in Complaint ¶ 9(a), *Citibank, N.A. v. Export-Import Bank of the United States*, No. 76 Civ. 3514 (CBM) (S.D.N.Y. filed Aug. 9, 1976) [hereinafter *Citibank Complaint*] (emphasis added).

[69] U.S. $100,000,000 Letter of Credit Refinancing Agreement for the Benefit of International Contractors Group, S.A.K., Kuwait, Clause 13.1(a) (copy on file with authors).

countries most often cited in the contemporary literature were Spain and the Philippines.[70] As explained by William Tudor John:

> In Spain and certain other Spanish related jurisdictions, such as the Philippines, an unsecured creditor can, by registering the financial agreement in the prescribed manner and by paying a document tax, achieve priority over other unsecured creditors who do not formalize their agreements and, possibly, also over other unsecured creditors whose agreements are subsequently formalized. Further debt securities, such as bonds, may under local corporate laws rank for payment in a liquidation according to their date of issue.[71]

Mr. Tudor John was referring to Article 913 of the Spanish Commercial Code and paragraph 3 of Article 1924 of the Spanish Civil Code. These provisions say that "*acreedores escriturarios*" (that is, creditors holding credits contained in a public deed authorized by a Notary Public) and those that hold their credits by virtue of commercial titles or agreements intervened by a Notary Public, will rank ahead of ordinary creditors.[72] These rules were incorporated into Spanish commercial and civil laws in the nineteenth century. The rationale is that the authenticity of notarized credits has already been established and such credits should therefore be preferred over instruments that are not notarized and as to which some shadow of doubt may exist.

The Spanish procedure requires both the creditor and the debtor to appear before the notary public. The priority will take effect from the date of such notarization and will have no effect if the debtor has already entered into a bankruptcy proceeding.

Significantly, the priorities established by this procedure operate both within *and* outside of bankruptcy. For example, even before a formal bankruptcy of the debtor, if an asset has been seized by an ordinary creditor to satisfy a debt, a senior creditor whose instrument has been notarized in accordance with these rules will be entitled to bring a third-party action ("*terceria de mejor derecho*") claiming that his preferential claim must be satisfied first with the proceeds of the sale of that asset before any amounts may be paid to the ordinary creditor. This feature will become significant when we discuss the meaning of the *pari passu* clause in sovereign debt instruments (where bankruptcy is not a concern).

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[70] *See*, *e.g.*, Wood, *International Finance*, *supra* note 10, at 156 ("In Spain and certain other Spanish-related jurisdictions, such as the Philippines, an unsecured creditor can, by publicising the bonds in the prescribed manner before a public official and by paying a documentary tax, achieve priority over other unsecured creditors who do not publicise their agreement and possibly, also over other unsecured creditors whose agreements are subsequently formalised."); Wood, *International Loans*, *supra* note 4, at 41 ("In some states, especially Spain and related jurisdictions, unsecured creditors may rank ahead of other unsecured creditors if their credit document is notarized in the prescribed way (*escritura publica*)."); Slater, *supra* note 3, at 344-45 ("The first problem which banks run into [in Spain] is the question of whether they should secure their priority in the liquidation of the borrower by 'elevating' the debt by means of one of the various procedures which can be used for this purpose in Spain. Fn 23: Broadly speaking, the order of priority in the winding-up of a Spanish company can be determined by the chronological order in which the debts of its various creditors are elevated into '*escritura publica.*').

[71] Tudor John, *supra* note 10, at 95.

[72] We are obliged to Luis de Carlos Bertrán of the firm Uria & Menendez for the information on which this description of the Spanish procedure is based.

A similar procedure existed, and still exists in the Philippines. Title XIX of the Civil Code of the Philippines ("Concurrence and Preference of Credits") sets out the priorities of creditor claims over property of a debtor. Articles 2241 and 2242 deal with priorities in specific movable and immovable property. Article 2244 then lists, in descending order of priority, preferred claims against other real or personal property of a debtor.

Subsection (14) of Article 2244 gives a priority to credits (not otherwise benefiting from a special privilege) that "appear in a public instrument … or … in a final judgment …". These credits, the law says, "shall have preference among themselves in the order of priority of the dates of the [public] instruments and of the judgments respectively."[73] The significance of Article 2244(14) is discussed at length under Part III. C ("*Pari Passu* in Unsecured Sovereign Credits") below.

Other unexpected hazards awaited the international lender that assumed its credits would rank equally with a borrower's other obligations (apart from Statutory Preferences and Secured Debts) in the event of the bankruptcy of the borrower. In 1972, for example, Argentina enacted laws that perpetuated a practice (dating back to 1862) of subordinating the claims of foreign creditors in the bankruptcy of an Argentine borrower.[74] The subordinated foreign creditor could not even file its claim until all local creditors had been paid in full.[75]

A *pari passu* covenant in a loan agreement requiring the borrower to ensure that the subject loan will always rank at least *pari passu* with all of the borrower's other unsubordinated indebtedness should either prevent the borrower from participating in the Spanish or Philippine notarization procedure described above in respect of its other debts or at least make it an event of default if the borrower did so. A representation and warranty in a loan agreement with an Argentine borrower that the loan ranks *pari passu* "in priority of payment" with all of the borrower's other indebtedness should have brought to the creditor's attention the subordination risks lurking in Argentine law.

Once cross-border lenders became aware that some legal systems permitted actions that had the effect of legally subordinating existing debt to other obligations of the borrower, in or out of bankruptcy, they needed contractual provisions that would (i) bring to light, at the time a new loan was being considered, whether such senior claims already existed in the borrower's debt stock, and (ii) prevent the borrower from subsequently subordinating the new loan. Adapting the traditional *pari passu* clause was the answer.

The phrase "ranks and will rank" in this new version of the *pari passu* clause was designed to encompass both a representation and a covenant. Replacing the old clause's "in point of security" with the qualifier "in priority of payment" or "in right of payment" showed that the drafter was concerned with the legal ranking of the debt (senior/subordinated), not with the creditor's ratable interest in collateral securing the debt. Requiring that the debt rank equally with all of the borrower's other "unsecured Indebtedness" revealed that this clause was intended to preclude the incurrence of Senior Debt, not Secured Debt (the negative pledge clause dealt with Secured Debt), and that the drafter was not focusing here

[73] Article 2244(14), Civil Code of the Philippines.

[74] *See generally* Emilio J. Cardenas, *International Lending: Subordination of Foreign Claims Under Argentine Bankruptcy Law*, in David Suratgar (ed.), DEFAULT AND RESCHEDULING 63 (1984).

[75] *Id*. at 74.

on Statutory Preferences (which generally do not constitute "Indebtedness" as that term is defined in cross-border credit agreements).

Following its introduction into cross-border syndicated loans in the 1970s to deal with the risk of involuntary subordination, this new version of the *pari passu* clause prospered. For the last thirty years, it has been a standard feature of cross-border credit agreements for both corporate and sovereign borrowers.

(c) Negative Pledge in Unsecured Euroloans

As evidenced by the 1972 Zaire clause quoted above, some early Eurodollar loan documentation tended to combine the negative pledge provision and the new "*pari passu* in priority of payment" language into a single clause even though the underlying concepts are quite distinct. The negative pledge clause is intended to safeguard the lender's resort to the borrower's general assets by restricting the borrower's ability to incur Secured Debt. The "*pari passu* in priority of payment" clause, however, curbs the borrower's ability to create Senior Debt. Additional Secured Debt would prejudice an existing creditor by diminishing the pool of unencumbered assets to which that creditor would have recourse in the event of a bankruptcy of the borrower. New Senior Debt, on the other hand, would tend to submerge the existing creditor beneath lenders whose claims will be satisfied as a matter of legal priority in any bankruptcy and may even, as discussed below, have consequences outside of bankruptcy. In other words, although the size of the borrower's pool of unencumbered assets would be unaffected, a recently-subordinated creditor would share in those assets only after the senior debtholders had been paid in full. These are two separate risks and the international debt market eventually evolved two distinct clauses to address the risks.

For the first decade of the Euromarket's history, however, creditors hoped that one or the other of the clauses would impede a certain kind of behavior that did not fit neatly into the Secured Debt/Senior Debt taxonomy. A regular feature of sovereign external borrowings, all the way back to the loans raised by the newly-independent Latin American Republics in the London market in the 1820s, had been the practice of allocating assets or revenue streams as ostensible security for the debts.[76] Commentators have referred to this practice as the "earmarking" of those assets.[77] In many cases, this earmarking did not rise to the level of a formal security interest (a pledge, charge, mortgage and so forth); it was rather an informal undertaking on the part of the debtor notionally to hive off the specified asset or revenue stream from the debtor's general property and to treat the foreign debtholders as having a preferential interest in those funds. When words such as "pledge", "mortgage" or "hypothecation" were used in the offering circulars for such bonds, the most charitable inference is that the terms were often being employed merely as figures of speech.[78]

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[76] *See* text accompanying notes 53 – 56, *supra*.

[77] Ernst H. Feilchenfeld, Earle de Maury Elrick & Orrin G. Judd, *Priority Problems in Public Debt Settlements*, 1930 COLUM. L. REV. 1115, 1122 (1930) (hereinafter Feilchenfeld, *Priority Problems*) ("The chief value of such a pledge is that it constitutes an earmarking of funds, so that the creditor knows that normally there will be wherewithal to pay him."). Feilchenfeld calls these "quasi-secured debts."

[78] *See* Feilchenfeld, *Rights and Remedies*, *supra* note 54, *at* 180 ("The public bought many loans because it was thought that they were secured by the equivalent of a valuable mortgage; in reality many pledges and charges provided for in government loans amounted only to additional promises, which did not even afford a clear priority in case of bankruptcy. An unsound psychology

If all of this sounds muddled and murky, it was. These "security" features were widely advertised when the debt instruments were being marketed. Consider, for example, this assurance in the prospectus for the Honduras Railway Loan of 1867:

> The interest and sinking fund of the loan are specifically guaranteed by a first charge upon the intended railway itself and its revenue, and also by a first mortgage upon the whole of the domains and forests of the State of Honduras, which, according to official report, are of immense value.[79]

Significantly, however, the negative pledge clauses of this period typically referred to the types of security interests known to the common law: pledges, charges, mortgages, hypothecations and so forth. These were sometimes lumped together in a defined term "Liens" in the credit documentation. Informal earmarking arrangements did not worry the lender to a corporate borrower under U.S. or English law because such arrangements would not be respected in bankruptcy. They did not create Secured Debt.

But in a cross-border lending context, this legal effect -- or more precisely, lack of legal effect -- was far less certain. Certainly there had been numerous examples throughout the nineteenth and early twentieth centuries of foreign creditors attempting to "foreclose" (again, often in the metaphorical sense of the word) on earmarked assets or revenues of a sovereign borrower in order to satisfy a particular debt. Moreover, there was always the chance that a sovereign borrower would feel itself morally obliged to honor such an informal undertaking with the result that scarce foreign exchange would not be available to pay the sovereign's other obligations.[80] The practice of earmarking assets and revenues to benefit a specific sovereign credit was therefore a matter of potential concern to all other lenders to that sovereign.

The question was what sort of contractual covenant would restrict such earmarking. The traditional negative pledge clause covered only the creation of formal security interests, and these earmarking arrangements were usually not

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was cultivated because the public was taught to rely on security provisions instead of investigating the paying capacity and reliability of the debtor country. Without the name 'secured loan' the public would probably have refused to buy bonds of countries with which it was entirely unfamiliar."); *see also id.* at 1120-22.

[79] Quoted in D.C.M. Platt, *British Bondholders in Nineteenth Century Latin America – Inquiry and Remedy*, 14 INTER-AMERICAN ECONOMIC AFFAIRS 3, 18 (Winter 1960).

[80] *Cf.* Borchard, *supra* note 54, at 94 ("[T]o conclude from this inability of creditors of governments to assert their rights by the same means as private law creditors that security clauses in government loans are nothing but "boilerplate" and "not worth the paper they are written on" would mean to ignore entirely the clear manifestation in these clauses of a will on the part of the debtor government to obligate itself over and above its promises to pay interest and principal to the lender. The revenues are 'earmarked' for a specified purpose, which is the subject of a legally binding obligation. They thereby cease to be at the free disposal of its debtor-owner. That means that the debtor state is not at liberty to alter their contents or to abrogate them altogether; it has in this respect submitted to a partial control of its domestic fiscal policy by its foreign creditors."); Feilchenfeld, *Priority Problems, supra* note 77, at 1125 ("[I]t must be admitted that the quasi-secured creditor [*i.e.*, the beneficiary of earmarked assets or revenues of the sovereign debtor] has bargained for and obtained something more than the mere promise to pay given to ordinary creditors. Even though he cannot secure full satisfaction in case of general default, the fact that specific funds have been earmarked for him assures him of rapid payment, without the delay necessitated by the balancing of the budget, and of a more certain payment in case of a temporary deficit not serious enough to cause insolvency.").

formal security interests. For its part, the new "*pari passu* in priority of payment" clause spoke in terms of the "ranking" of the debt. Did the earmarking of assets really affect legal ranking of the debt?

It was probably only a matter of time before someone tried to exploit this gap in the coverage of the standard negative pledge and *pari passu* clauses used in early Euromarket credit documentation. The trick here was to devise a form of preferential arrangement over assets of the borrower that would be adequate to induce a new lender to lend. Such an arrangement, however, must stop short of creating a formal security interest in the debtor's property that might run afoul of the borrower's existing negative pledge clauses. And it must also stop short of giving the new debt a higher legal ranking "in priority of payment", because this would violate the borrower's *pari passu* covenants.

That time came in 1976. The Republic of Zaire had borrowed money from a group of commercial banks in 1972. The *pari passu*/negative pledge clause contained in Zaire's 1972 credit agreement is quoted above.[81] In 1976, Manufacturers Hanover Trust Company ("*MHT*") and the U.S. Eximbank proposed to enter into a new credit facility with Zaire. As part of this new facility, Zaire agreed to direct the proceeds from the sale of its copper exports into a "Special Deposit" account at Manufacturers Hanover where those funds would presumably have been available for debit or set off in the event the new MHT loan was not paid.[82]

Some of the lenders in the 1972 credit agreement were outraged when they learned of the proposed MHT/Eximbank transaction in July 1976.[83] "While arguably not against the letter this was flagrantly against the spirit of the negative pledge clauses in the commercial banks' loan agreements", wrote two observers of the dispute.[84] They were presumably referring to the fact that the "security" feature of the new facility did not rise to the level of a formal "lien or encumbrance" (the words used in the 1972 credit agreement's negative pledge clause) over Zaire's revenues. It thus arguably fell beyond the reach of that clause.

A month later, on August 9, 1976, Citibank, N.A. (on behalf of itself and as Agent for the other lenders in the 1972 credit agreement with Zaire) filed a complaint in the U.S. federal district court in Manhattan naming Manufacturers Hanover and Eximbank as defendants.[85] The complaint alleged that the proposed new MHT facility violated Zaire's 1972 contractual covenants. Citibank offered several theories on which the court was invited to fashion some relief, ranging from the imposition of a constructive trust over the proceeds of copper sales in favor of the 1972 lenders, to damages for tortious interference with the 1972 lenders' contract rights.[86]

The case was quickly settled and the proposed MHT/Eximbank facility scrapped. What resulted from this public bank-to-bank squabble, however, was a

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[81] *See* text accompanying note 68, *supra*.

[82] *See* T.H. Donaldson, LENDING IN INTERNATIONAL COMMERCIAL BANKING 81 (2d ed. 1988).

[83] Anthony B. Greayer & W. John N. Moore, *Zaire Promises to Do Better*, EUROMONEY (Dec. 1976), at 114.

[84] *Id.*

[85] *Citibank Complaint*, *supra* note 68.

[86] *Id.* ¶¶ 13 and 14.

change to the standard form of Euromarket negative pledge clause. No longer would the list of impermissible liens cover only formal security interests. Following the Zaire incident, drafters of Eurocurrency loan agreements increasingly added this phrase (or something like it) to the definition of "Lien" in their in their loan agreements: "or any other preferential arrangement having the practical effect of constituting a security interest."[87]

Zaire's own credit agreements are a good example of this shift in drafting practices. The 1972 version of Zaire's *pari passu*/negative pledge loans (quoted above) required that future debts not "rank on a basis…more favorable" than the 1972 advances, and not benefit from a "lien or encumbrance".[88] When Zaire next needed to refinance its external debt (in 1981), the new form of restrictive clauses read as follows:

> So long as any Credit shall remain outstanding [Zaire] will
>
> * * * *
>
> Ensure that at all times its payment obligations hereunder constitute unconditional general obligations of [Zaire] ranking at least *pari passu* in priority of payment with all other External Indebtedness of [Zaire] now or hereafter outstanding.[89]
>
> * * * *
>
> So long as any Credit shall remain outstanding [Zaire] will not:
>
> (a) Create or permit to be created and continue, nor permit the Bank of Zaire or any other Governmental Agency or Governmental Enterprise to create or permit to be created and continue,
>
> (i) any Lien for any purpose upon or with respect to (A) any International Monetary Assets or (B) any Foreign Exchange or gold owned or held by [Zaire], the Bank of Zaire or any Governmental Agency of Governmental Enterprise;
>
> (ii) any Lien upon or with respect to any Asset of [Zaire], the Bank of Zaire or any Governmental Agency or Governmental Enterprise to secure or provide for the payment of External Indebtedness of any Person; or
>
> (iii) any Lien upon or with respect to any Exportable Assets of any Person to secure or provide for the payment of External Indebtedness incurred or Guaranteed by [Zaire], the Bank of Zaire or any Governmental Agency or Governmental Enterprise . . . .[90]

For this purpose, the term "Lien" was defined as:

> "Lien" means any lien, mortgage, deed of trust, charge, pledge, security interest or other encumbrance on or with respect to, *or*

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[87] *See Eurocurrency Loan Agreements*, *supra* note 3, at 88.

[88] *See* text accompanying note 68, *supra*.

[89] Refinancing Credit Agreement dated as of March 31, 1980 among Republic of Zaire as Obligor and the Agents and Banks referred to therein, § 8.01(c) (copy on file with the authors).

[90] *Id*., § 8.02(a).

> *any preferential arrangement which has the practical effect of constituting a security interest with respect to the payment of any obligation with or from the proceeds of*, any Asset.[91]

Note how dramatically these provisions had changed in the nine years between 1972 and 1981. The negative pledge was split off from *pari passu* into a separate provision. Apart from the expansion of the definition of "Liens" to cover informal preferential arrangements, the drafter of the 1981 negative pledge left no doubt about what types of government property could not be encumbered.

C. Pari Passu in Unsecured Sovereign Credits

We now come to the most intriguing question of all: what motivated modern drafters to include a *pari passu* provision (of the "*pari passu* in priority of payment" variety) in their unsecured credit instruments with sovereign borrowers. The motivation must have been something other than a desire to protect the lender against involuntary subordination in bankruptcy, for the simple reason that sovereigns are not subject to bankruptcy regimes.

Our research suggests that had they been asked at the time (the 1970s onward) to justify the presence of a *pari passu* clause in an unsecured cross-border credit instrument with a sovereign borrower, contract drafters would have given three reasons: a lingering concern about the earmarking of assets, the danger that a foreign sovereign decree altering the legal ranking of existing debts might be given effect by a court outside of the debtor country and the risk of involuntary subordination through action by another lender. The opacity of the clause is explained by the fact that in the minds of the early Euromarket drafters, it was intended to protect lenders against all three, very different, risks. They thus saw a positive virtue in the vagueness of the phrase "*pari passu* in priority of payment." As the decades moved on, one of these concerns (earmarking) was addressed through an expanded negative pledge clause in most cross-border credit instruments. A second risk (the effect of sovereign decrees) was addressed by judicial decisions. But the third (involuntary subordination through action by another lender) remains a serious concern for the cross-border lender, and the *pari passu* clause persists as the contractual mitigant for that risk.

(i) Earmarking

The traditional nineteenth century practice of a sovereign earmarking a revenue stream or asset for the benefit of one set of creditors continued to be a matter of concern for the unsecured cross-border lenders in the last quarter of the twentieth century. The commentators of the time confirm that this was so.[92] The question faced by the bankers and lawyers drafting sovereign credit agreements was how to curb this practice; a traditional negative pledge clause only restricted the creation of formal security interests. One of the original motivations for shifting the focus of a *pari passu* covenant to ranking of the debt "in right of payment" was that the drafters hoped to sweep in the kind of informal preferential arrangements that might otherwise have slipped through the negative pledge restriction.[93]

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[91] *Id.* § 1.01 (emphasis added).

[92] *See* authorities referred to in note 10, *supra*.

[93] *See* J.A. Donaldson and T.H. Donaldson, THE MEDIUM-TERM LOAN MARKET 130 (1982) ("The pari passu clause requires the debt it covers to rank pari passu with, in most cases, all other

As just described, when this gap in coverage of the two clauses became highly visible in 1976 at the time of the *Citibank v. Manufacturers Hanover* lawsuit, the market's reaction was to expand the standard form of negative pledge clause so that it would thereafter pick up "preferential arrangements that have the practical effect of constituting a security interest." The drafters did *not* attempt to resolve the problem by changing the language of the *pari passu* clause. The persistence of the clause even *after* this drafting change shows that the risk of sovereign earmarking was not the only motivation for inclusion of a *pari passu* clause in sovereign credit instruments, at least in the period after 1976.

(ii) Effect of Sovereign Decrees

A second concern justifying the inclusion of a *pari passu* clause in a sovereign credit agreement was unique to sovereign borrowers. As the lawgiving authority in its own country, what would stop a sovereign from passing a law that, for example, purported legally to subordinate all of its existing foreign lenders in favor of some new set of creditors (with the consequence that the old lenders would only be entitled to collect on their claims once the new lenders had been paid in full)?[94] More importantly, would such legislation or governmental decree be given effect by the courts in the lenders' own jurisdictions in an action to enforce payment of the old debt?

To the creditors participating in the early years of the Euromarkets, there were no certain answers to these questions, at least under the law of New York. It was not until the mid-1980s (in two highly-publicized cases, *Libra Bank Ltd. v. Banco Nacional de Costa Rica, S.A.*[95] and *Allied Bank International v. Banco Credito Agricola de Cartago*[96]), that the U.S. federal courts clarified that an American judge need *not* defer to the actions or decrees of a foreign sovereign affecting that sovereign's own debt obligations, as long as the debts in question have features (such as payments to foreign bank accounts, foreign governing law, submission to foreign court jurisdiction and so forth) that connect the debts to

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debt. It originated in countries whose law specifies an order of priority for unsecured debt unless action is taken to avoid it. . . . Otherwise, the pari passu clause has much the same effect as a negative pledge, and may even catch ways of preferring some creditors which do not qualify as a full pledge."). There is even some suggestion in the contemporary literature that Euromarket lawyers may have relied on the *pari passu* covenant as a kind of backdoor negative pledge undertaking when confronted by borrowers that balked at the traditional negative pledge. S*ee* J. Horsfall Turner, writing in 1974:

> [T]here are borrowers, particularly sovereign ones, who object to any sort of negative pledge merely because it would be seen to fetter their sovereignty. They may either not wish to do so or may be prohibited from doing so by the terms of their constitution. They may have no particular wish to create any secured borrowings. Luckily there are clauses which have the same effect and do not cause the same problems so that the borrower and the banker can both be satisfied with no loss of face.

J. Horsfall Turner, *New Trends in Eurodollar Loan Agreements*, EUROMONEY (Mar. 1974), at 29.

[94] *See* Michael Gruson, *Legal Aspects of International Lending*, in Ingo Walter (ed.), HANDBOOK OF INTERNATIONAL BUSINESS 27-13 (1983) ("[H]istory has shown that a sovereign, when in trouble, tends to change its law to alleviate its troubles.").

[95] 570 F. Supp. 870 (S.D.N.Y. 1983).

[96] 566 F. Supp. 1440 (S.D.N.Y. 1983), *rev'd*, 757 F.2d 516 (2d Cir.), *cert. dismissed*, 473 U.S. 934 (1985).

places outside the sovereign's own country.[97] But for a drafter of a Eurodollar loan agreement in 1970, these judicial decisions were fourteen years in the future. The inclusion of a contractual promise by the sovereign not to disturb the legal ranking of the debt by governmental fiat would therefore have seemed a very sensible precaution.

(iii) Involuntary Subordination

Lastly, at least some commercial bank lenders of the 1970s were acutely aware of the risk of an involuntary subordination of their credits as a result of procedures such as those existing in Spain and the Philippines. This risk was also present, in a somewhat different form, in loans to sovereign borrowers. The Spanish procedure for acquiring seniority through the notarization of a debt instrument, for example, can have practical consequences for an "ordinary" creditor even outside of bankruptcy.[98] A promise by the debtor to maintain the legal ranking of a loan at a level equal to or above all of its other unsubordinated indebtedness was the first and only contractual line of defense against this sort of mischief.

The Philippines is a particularly fascinating example of these concerns because the documentary record suggests that the subordination risks resulting from the priorities scheme contained in the Philippine Civil Code were first realized by commercial bank lenders in the late 1970s, then forgotten for about twenty years, only to reappear in 1998 as the Philippines was actively issuing bonds in the international capital markets.

In the late 1970s, the commercial bank lenders to Philippine public sector borrowers stumbled upon the possibility that, under Philippine law, subsequently-incurred debts could leapfrog their own loans in terms of legal seniority by being notarized in a public instrument. The commercial banks' response was to insist that the Central Bank of the Philippines issue a Circular (Circular 618 of July 14, 1979) to all Philippine public sector borrowers warning them -- under penalty of being denied the necessary foreign exchange approval from the Central Bank -- not to permit their credit instruments to be notarized in a public instrument.

Here is the full text of Circular 618:

> Effective immediately, no foreign loan agreements, deferred payment agreements or any other agreements which give rise to a foreign currency obligation or liability submitted to the Central Bank of the Philippines for approval and/or registration under the provisions of existing CB circulars, rules and regulations, and no promissory notes or guaranties issued in connection therewith, shall be approved and/or registered if these are notarized or are otherwise evidenced by a public instrument.[99]

When the Republic of the Philippines returned to the bond market in 1993 (after exactly ten years of debt rescheduling), the priority risks posed by

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[97] *See generally* W.H. Knight, Jr. *International Debt and the Act of State Doctrine: Judicial Abstention Reconsidered,* 13 N.C. J. INT'L COM. REG. 35, 54-56 (1988).

[98] *See supra* text accompanying notes 70-72.

[99] Central Bank of the Philippines, Circular No. 618, Series of 1978 (July 14, 1978) (copy on file with authors).

Article 2244(14) of the Civil Code[100] appear to have faded from everyone's collective consciousness. The terms and conditions of the Philippines' first Eurobond in 1993 confirmed that: "The payment obligations of the Republic under the Notes and the Coupons shall, subject to [the negative pledge clause], at all times rank at least equally with its other present and future unsecured and unsubordinated External Indebtedness."[101] Identical language appeared in a subsequent issue of Republic of Philippine bonds in 1996. No mention was made of Article 2244(14).[102]

By 1998, however, the due diligence process leading up to the Republic of the Philippines 8.875% Bonds due 2008 (the first Philippine issue to be registered with the U.S. Securities and Exchange Commission) must have once again unearthed the old worry about the possible effect of Article 2244(14) of the Civil Code. This time, the description of the *pari passu* clause in the prospectus specifically called attention to the risk of involuntary subordination: "Subject to the discussion below of Article 2244(14) of the Civil Code of the Philippines, the Bonds will rank *pari passu* in priority of payment with all other unsecured and unsubordinated External Indebtedness of the Philippines."[103]

The disclosure about Article 2244(14) Prospectus deserves to be quoted in full because it reveals precisely the type of situation that cross-border lenders expected a *pari passu* clause to uncover and to address. It reads:

> Under Philippine law, in the event of insolvency or liquidation of a borrower, unsecured debt of the borrower (including guarantees of debt) which is evidenced by a public instrument as provided in Article 2244(14) of the Civil Code of the Philippines will rank ahead of unsecured debt of the borrower which is not so evidenced. Under Philippine law, debt becomes evidenced by a public instrument when it has been acknowledged before a notary or any person authorized to administer oaths in the Philippines. The Government is of the view that debt of the Republic is not subject to the preferences granted under Article 2244(14) or cannot be evidenced by a public instrument without the cooperation of the Republic. This matter has never been addressed by Philippine courts, however, and it is therefore uncertain whether a document evidencing Peso or non-Peso denominated debt (including External Indebtedness) of the Republic, notarized without the knowledge or consent of the Republic, would be considered a public instrument. If such debt were considered evidenced by a public instrument, it would then rank ahead of the Bonds in the event the Republic were unable to service its debt obligations.

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[100] *See supra* text accompanying note 73.

[101] Rule 144A Placement Memorandum, Republic of the Philippines U.S.$150,000,000 7 7/8% Notes due 1996 (Feb. 18, 1993), at 4, § 3 (copy on file with authors).

[102] Invitation by the Republic of the Philippines to Offer to Exchange (Sept. 2, 1996), at 20, § 3 (copy on file with authors).

[103] Prospectus, U.S.$500,000,000 Republic of the Philippines 8.875% Bonds due 2008 (April 2, 1998), at 71 (copy on file with authors).

> The Republic has represented that it has not in respect of any External Indebtedness prepared, executed or filed any public instrument as provided in Article 2244(14) of the Civil Code of the Philippines, or consented to or assisted in the preparation or filing of any such public instrument. The Republic has also agreed in the Bonds that it will not create any preference or priority in respect of any External Public Indebtedness pursuant to Article 2244(14) of the Civil Code of the Philippines unless amounts payable under the Bonds are granted preference or priority equally and ratably therewith.[104]

Identical disclosure language about Article 2244(14) appears in the most recent issue of Republic of the Philippines 8.25% Global Bonds due 2014 (Prospectus dated October 16, 2003).[105]

What is important for our purposes is the part of this disclosure (the last sentence of the first paragraph) warning bondholders of a remote risk that their bonds could be involuntarily subordinated through the actions of the Republic's other lenders. Although the disclosure does not spell out what the practical consequences of such a subordination might be "in the event the Republic were unable to service its debt obligations", the implication is that the consequences could be disagreeable for these bondholders. Significantly, however, these consequences, whatever they may be, will have nothing to do with a formal bankruptcy proceeding (to which the Philippine state is obviously not subject).

As the Philippine documents show, the risk that sovereign debt might be involuntarily subordinated as the result of local law procedures -- with implications outside of bankruptcy -- is still a concern for cross-border lenders. The contractual impediment to such involuntary subordination has been, and remains, a financial covenant of the "*pari passu* in priority [or right] of payment" variety. Having discovered the problem in some jurisdictions, lenders were not prepared to run the risk that similar pitfalls might await them, undiscovered, elsewhere. Bondholders and even commercial banks often perform only a perfunctory due diligence on features of the borrower's local law that might affect their investments. The clause therefore became a standard feature of most cross-border lending instruments.

IV. CONCLUSION

In summary, the *pari passu* clause has migrated from its original home in nineteenth century secured domestic debt instruments into the unsecured cross-border debt instruments of the last thirty years. Along the way, it has made several jumps, and for each jump there was a good reason: from secured to unsecured credits; from domestic to cross-border credit instruments; and from an expression of the debtholders' ratable interests in the collateral securing the instrument to a promise to maintain the unsubordinated character of the debtholders' unsecured claims.

At no time in its long journey, however, did the *pari passu* clause ever require a borrower to make ratable payments to all of its equally-ranking creditors.

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[104] *Id.*

[105] Prospectus Supplement to Prospectus Dated September 24, 2003, U.S.$300,000,000 Republic of the Philippines 10.625% Global Bonds due 2025 (October 16, 2003) at 95-96 (copy on file with the authors).

Nor did it ever provide a legal basis for one unsecured creditor to enjoin or intercept non-ratable payments to another creditor, notwithstanding the equal legal ranking of their respective claims against the borrower. The ratable payment theory of the *pari passu* clause is, under the light of history, just a fallacy. If anything, the ratable payment theory episode highlights the dangers of allowing boilerplate contractual provisions to detach themselves from the market's collective memory of where they originated and what they were designed to achieve.

This leads us to the final question: how could a fallacious interpretation of a boilerplate clause -- without a basis in law, or practice or commentary -- have taken even a shallow root in the minds of some market participants? It is true that the text of the *pari passu* clause itself is remarkably unconfiding about what the drafters were seeking to achieve with the provision, but that only explains why it presented such an attractive target for creative explanations by litigants in search of an effective remedy against a sovereign debtor.

We believe that the ratable payment interpretation of the *pari passu* clause had an intuitive, almost an emotional, appeal to some people because it only seems fair that debtors not discriminate among similarly-situated creditors when faced with financial difficulties. And if a practice of differential payments just *feels* wrong, these people reasoned, then surely there must be something in the underlying instruments that forbids it? When a thorough search of the underlying instruments turned up no express prohibition against the making of differential payments, the last resort was to read such a prohibition into the Area 51, the Roswell, of cross-border credit instruments – the *pari passu* clause.

The truth is that creditors *do* sometimes worry about cash-strapped borrowers discriminating among similarly-situated creditors in terms of payments and, when they do, there are a variety of documentary techniques for dealing with the problem. For example:

- Sharing clauses are a nearly invariable feature of syndicated commercial bank loan agreements. The clauses were motivated by a concern that participating banks without an on-going business relationship with the borrower might be the first to feel a payment default, while the borrower's "house" banks continued to be paid. The sharing clause constitutes an intercreditor agreement among the banks in the syndicate to share any disproportionate payments or recoveries among themselves on a ratable basis. [106]

- In many bond issues (including all publicly-issued corporate bond issues in the United States), the securities are issued pursuant to a trust indenture (in English practice, a trust deed). The trustee is obliged to distribute all payments or recoveries among bondholders

[106] Interestingly, Schnebel, *supra* note 7, at 50, describes sharing provisions as necessary to give practical effect to the *pari passu* status of lenders in a syndicated loan:

> A multi-bank credit facility is one situation in which an agreement is used to establish and maintain parity among unsecured creditors. The credit agreement for a multi-bank credit facility will provide for the lenders to be on a *pari passu* basis. In order to implement this intercreditor relationship, the credit agreement will contain a provision requiring each lender to share any payments made to it (whether by setoff or otherwise) under the credit agreement in a greater proportion than its pro rata share of amounts payable under the credit agreement.

on a strictly ratable basis. Indeed, in U.S. trust indenture practice most, and in English practice all enforcement actions against the borrower are centralized in the trustee so that the goal of ratable sharing of recoveries is preserved.[107]

- Many project finance transactions, where several different types of lenders participate, call for an intercreditor agreement among the lenders to ensure ratable sharing of payments and losses.[108]
- Intercreditor agreements are also frequently used in corporate debt workouts where the parties wish to keep the borrower out of a formal bankruptcy proceeding. Equal treatment of similar-situated creditors is, of course, a fundamental premise of most bankruptcy systems. Creditors desiring to replicate this feature in an out-of-court debt workout can do so by means of an intercreditor agreement that provides for ratable sharing of payments or recoveries. [109]
- Subordination agreements are the instruments of choice when lenders to the same borrower want to establish legally-enforceable priorities that will take effect in, and sometimes out of, bankruptcy. These agreements come in many different varieties, but they all have one thing in common: they establish contractual payment priorities among creditors that would otherwise have equally-ranking claims against the borrower.[110]

In short, lenders are indeed sometimes concerned about borrowers making differential payments to similarly-situated creditors. To this extent, the proponents of the ratable payment theory of the *pari passu* clause have accurately analyzed a sentiment in the creditor community. But when lenders wish to address this issue, they do so explicitly (and very often elaborately) in contracts or clauses that establish their right to receive ratable payments, as well as their remedies -- against the Borrower and against each other -- if they do not. Such intercreditor duties are not inferred merely by virtue of being a lender to the same borrower (under the "it's only fair" theory of intercreditor relationships), nor are they implied by a lender's equal legal ranking with other creditors or by a contractual promise by the borrower to preserve that equal ranking.

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[107] *See* Andrew Yianni, *Resolution of Sovereign Financial Crises – Evolution of the Private Sector Restructuring Process*, FIN. STABILITY REV., June 1999, at 78, 81; *see* also Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1331-32 (Fall 2002).

[108] *See generally* Jacob J. Worenklein, *Loan Documentation for Project Finance*, Practising Law Institute, Real Estate Law and Practice Course Handbook Series, PLI Order No. N4-4460, 284 PLI/Real 271, 303-4 (October 23, 1986).

[109] *See generally* Schnebel, *supra* note 7.

[110] See *generally* Kevin C. Dooley & Thomas G. Rock, *Subordination Agreements: Suggested Approaches to Key Issues*, 113 BANKING L. J. 708, 714 (July/August 1996).

V. POSTSCRIPT: A NOTE ON CONTRACT PALEONTOLOGY

Lytton Strachey, in his book *Eminent Victorians*, offered some advice to historians confronted by a subject around which a vast amount of information had accumulated. "[R]ow out over that great ocean of material," Strachey counseled, "and lower down into it, here and there, a little bucket, which will bring up to the light of day some characteristic specimen, from those far depths, to be examined with a careful curiosity."[111]

We believe that standardized commercial and financial contracts are organic things: they evolve over time in response to a complex and shifting set of influences. These include changes in the underlying legal rules, unexpected and aberrant judicial decisions whose teaching must be disowned by contract, subtle but nonetheless palpable shifts in the treatment that parties expect to receive in contract negotiations, and cross-pollination among the "model" documents produced by different participants such as banks and law firms.

A contract can only be understood in the context of the legal rules at the time it was prepared, and these rules sometimes change. When they do, a perceptive contract drafter adjusts her provisions accordingly; some get dropped, some added and others modified. The very notion of what constitutes a standard document is itself highly subjective. It can be very hard sometimes to disentangle the descriptive from the aspirational in the word "standard". The proponents of the first drafts of commercial contracts have always cherished the word "standard." Once uttered on the battlefield of a contract negotiation, it is thought to be irresistible, unanswerable (except by the proffering of equally standard clauses) and intentionally demoralizing to the opposition.

Proponents of contracts also like to pretend that their documentation practices are eternal -- not just long-lived like Rome or the solar system or Dick Clark -- but eternal. Even better, they like to leave the impression that at some point in the document's history, its drafting was influenced by divine revelation. But of course this is silly. Documentary practices, even in the context of stultifyingly standard commercial and financial documents, do change. And in this lies this challenge for the historian attempting to dip Strachey's little bucket into a vast reservoir composed of thousands of allegedly standard commercial or financial agreements prepared over many decades.

When dipped, the little bucket will bring up from this reservoir individual examples of contracts or specific clauses in contracts. The historian will then note the drafting changes, dramatic or incremental, that have taken place over time. What the black letter of the documents will not confide, however, is the motivation for any single change. Did some feature of the underlying legal regime shift, rendering prior text obsolete or requiring the addition of new language? Was there a scandal in the market or an unexpected judicial decision? Did the text come from the hand of a drafter who knew more, or who knew less, than his contemporaries about the subject matter? Was the change just a matter of a different "house style" by the law firm or financial institution preparing that particular example, with no difference in substantive content intended? Or was it, after all, just a mistake attributable to an untutored or sleep-deprived drafter?

[111] Lytton Strachey, EMINENT VICTORIANS (1920), Preface at v.

The historian will need to look beyond the text of the clause to answer these questions. The sources for this information may include descriptions of the relevant law at the time the contract was drafted, or the history of contemporary disturbances to the market, or that most rare source -- a practicing lawyer of the day taking the time to record for posterity why documentation patterns were changing.

The exercise is therefore a kind of paleontology. A scientist examines the fossil record and seeks to explain why a prehistoric species may have evolved in the way the fragmentary fossil evidence suggests it did. Contract paleontology starts with a similar effort to locate examples of contracts or clauses from an often equally fragmentary record. Commercial contracts are not thought to be documents of literary or historical significance. When the business relationship is over, or the debt repaid, the legal agreements often fall victim to the remorseless dictates of someone's "document retention" policy, a euphemism in most organizations for not retaining documents.

Even when examples can be found of a particular type of agreement or clause, it is hazardous to assume that all signs of evolution in the historical drafting of the document were deliberate or even conscious. Practicing lawyers whose experience qualifies them to draft contracts in a competent way often enjoy the seniority that permits them to delegate those tasks to junior lawyers lacking both experience and competence in the job at hand. The contractual fossil record, even more than the natural fossil record, is therefore apt to be populated with specimens that have no rational explanation.

What makes a paleontological study of standard form contracts and boilerplate clauses possible is the standard nature of the documents. Forms, models and precedents tend to reproduce themselves in deal after deal, sometimes with only limited customizing of the operative provisions to fit a specific transaction, and usually with no changes to the boilerplate clauses. The text of such a document therefore contains its drafting DNA; even slight alterations to the genetic code will be visible in subsequent iterations of the document. The historian's job is to track these changes over time and, when confronted by what appears to be intentional drafting change, to discover the motivation for the shift.

To read a standard form of commercial agreement or a boilerplate contractual provision with a knowledge of its historical evolution is to appreciate the inherent drama of the instrument. To read it without that knowledge is to mistake it for an inanimate thing, without progenitors and without posterity.

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FINANCIAL MARKETS LAW COMMITTEE

ISSUE 79 – PARI PASSU CLAUSES

Analysis of the role, use and meaning of *pari passu* clauses in sovereign debt obligations as a matter of English law

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1. INTRODUCTION

1.1 Background

The purpose of this report is to analyse the role, use and, most importantly, the meaning, as a matter of English law, of *pari passu*[1] clauses in sovereign debt obligations. The preparation of this report has been prompted by recent litigation in the courts of Belgium, California, New York and England concerning the interpretation of these clauses. In this litigation, creditors who had purchased sovereign debt that was in default argued, or attempted to argue, that the *pari passu* clause contained in that debt should prevent the sovereign debtor from making payments to other creditors without at the same time paying the litigating creditors on a *pro rata* basis.

The Financial Markets Law Committee (the "**FMLC**"), at a meeting on 27th November, 2003, decided that it should establish a Pari Passu Clause Working Group (the "**Working Group**") to consider these issues and publish a report which would set out its opinion on the proper meaning of *pari passu* clauses in sovereign debt obligations as a matter of English law.

1.2 Executive summary

A *pari passu* clause is a standard clause found in international syndicated bank loan agreements and bond issues. The clause is a covenant or a warranty that the bank loans and the bonds "rank *pari passu*" with all the other unsecured debt of the borrower or issuer. The clause appears in both corporate and sovereign debt obligations.

Until recently it was thought that the clause prescribed only that on the insolvency of the debtor unsecured claims, including the debtor obligations concerned, would rank *pari passu* or equally as a matter of insolvency or statutory law. The purpose was a statement, sanctioned by an event of default, as to equal ranking as a matter of law so that the creditors were assured that on competition between creditors there was no mandatory provision for unequal payment.

Recently another interpretation has found favour in court decisions in California and Belgium. This interpretation is that the clause in effect requires that, once the debtor is actually

[1] The Latin phrase "*pari passu*" means "in equal step" or "side by side".

insolvent, the debtor will in fact pay all its claims *pro rata* and could thus be prevented from paying one creditor in full if the obligations concerned went unpaid.

This report asserts that, so far as English law is concerned, the wide "payment" interpretation is incorrect and that the "ranking" interpretation is the proper construction. There are three reasons which support this assertion:

- The principal reason is that the "payment" interpretation would not be acceptable to debtors and indeed to creditors, and would be unworkable. In short, it would offend the "business commonsense" principle used by English courts when construing a contract. In particular, it would lead to the result that once the debtor actually became insolvent the debtor would not be able to make any ordinary course of business payments necessary to enable the debtor to maintain its business. Hold-out creditors in pursuit of a bargaining position against other creditors could prevent payments and bring the business to a premature halt. An action of this type could be used to seriously disrupt payment systems through which the debtor made its payments and securities settlement systems through which the debtor paid for investments. Hence if the payment interpretation were correct, the *pari passu* clause would be prejudicial not only to debtors but also to creditors by making it impracticable for all creditors to sustain the debtor's business if only one of them objected.

- Another reason is based on the principles of English rules of contract construction that the words used be given their ordinary and natural meaning and that they should be considered in the context of the entire transaction. The language itself on the most literal interpretation requires a "rank" of the claims, *i.e.* a legal rank. It does not require *pari passu* "payment". In addition, other provisions are typically found in debt obligations which do require equal payment and this suggests that the *pari passu* clause was not intended to require equal payment.

- The final reason is based on an analysis of English case law which provides persuasive authority against the payment interpretation.

The remainder of this paper provides a detailed analysis of the issues.

1.3 Structure of the report

Sections 2.1 to 2.3 of this report describe a typical *pari passu* clause and the two principal interpretations of such a clause that exist today. Because the *pari passu* clause is a contractual provision, section 2.4 then identifies the principles for construing contracts

governed by English law. The most important of these in the context of this report is the "business commonsense" principle for construing commercial contracts described by Lord Diplock in the *Antaios*[2] case although it is also helpful to analyse the actual language used. Section 2.4 also contains an analysis of the most helpful English case law on the point although this provides only persuasive authority against the payment interpretation.

Adopting the business commonsense principle of contractual construction, section 3 looks in detail at the consequences that would follow from the implementation of the payment interpretation and concludes that these would offend that principle.

Picking up on another important principle of contractual construction, section 4 provides an analysis of the actual wording used and determines that this too supports the ranking interpretation over the payment interpretation.

Finally, section 5 sets out the conclusions reached in this report.

[2] *Antaios Compania Naviera S.A. v. Salen Rederierna A.B.* 1 A.C. 191.

2. ANALYSIS

2.1 Description of a typical *pari passu* clause

Pari passu clauses are a standard feature in cross-border[3] unsecured[4] debt obligations. They are found in both loan agreements and securities issues.

In a loan agreement, the *pari passu* clause is often drafted as follows:

> "The payment obligations of the borrower under this Agreement rank at least *pari passu* with all its other present and future unsecured obligations."

In an international securities issue, the *pari passu* clause is usually found in the "status" or "ranking" condition and is often drafted as follows:

> "The bonds and the coupons are direct, unconditional and unsecured obligations of the issuer and rank and will rank at least *pari passu*, without any preference among themselves, with all other outstanding, unsecured and unsubordinated obligations of the issuer, present and future."

The standard formulation for a bond *pari passu* clause therefore has two limbs:

(i) the *internal* limb: that the bonds rank *pari passu* with each other[5]; and

(ii) the *external* limb: that the bonds rank *pari passu* with other unsecured indebtedness of the issuer.

The internal limb is not found in loan agreements.

As a matter of contractual analysis, the standard loan agreement *pari passu* clause is a representation that, as a matter of fact, the payment obligations of the borrower rank in the manner described. This clause may be complemented by a corresponding covenant under which the borrower promises that the payment obligations will rank *pari passu* as described in the representation. In the context of the standard securities issue provision, the *pari passu*

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[3] A *pari passu* clause is often omitted in domestic debt obligations.
[4] The clause is inapplicable in the case of secured lending. If a *pari passu* clause was expressed to apply to secured, rather than unsecured, indebtedness it would be a concealed negative pledge clause.
[5] One reason for the internal ranking limb was probably to deal with the argument that the ranking of bonds depended on their date of issue – a point which was pertinent in relation to secured bonds where debentures of the same series might be issued in tranches at different times but were intended to enjoy equal ranking as regards the security but which has no relevance to modern unsecured bond issues.

clause is both a representation as to the present ranking, and an undertaking as to the future ranking, of the securities. A court would therefore view the representation as a promise that the particular ranking exists as at the date of the contract and, where there is an undertaking, a promise that the future conduct of the borrower will ensure that the particular ranking will exist during the life of the contract.

There are, of course, many different ways to draft this clause and this report will consider the principal variations in more detail below. The *pari passu* clauses found in sovereign debt obligations mirror these standard formulations. Sovereign debt obligations, however, frequently limit the scope of the *pari passu* clause to "external indebtedness", which is usually defined as unsecured indebtedness denominated in a currency other than that of the sovereign debtor or by reference to the residence of the holder of the debt so that it does not capture indebtedness targeted at domestic creditors or investors.

2.2 Sample *pari passu* clauses

In preparing this report, the Working Group has conducted a survey of the *pari passu* clauses contained in a number of public sovereign bonds issued during the period beginning on 1st January, 1999 and ending on 31st January, 2004. Where a particular sovereign issued a number of bonds during this period, only one example was included in the survey. Based on this survey, this report asserts that, save in one highlighted case[6], the differences in the actual drafting used in these bonds are not material to its conclusion as to the proper meaning of the *pari passu* clause under English law. Examples of the two principal variations are set out, and analysed, in section 4.

2.3 The two principal interpretations of the *pari passu* clause

(i) Corporate debt obligations

Most jurisdictions have in place an insolvency system that provides for the orderly distribution of a company's assets once it has been liquidated. A lender is clearly interested to know where its indebtedness would rank in such a distribution if the borrower became insolvent. This explains why, as was seen in section 2.1 above, it is common for there to be a representation as to where the particular indebtedness ranks at the date of the agreement. If, for example, the borrower is an English company, a debtor who obtains a representation that its debt is "senior" knows that it will rank

after any secured indebtedness, but before any subordinated indebtedness incurred by that borrower. The current bankruptcy rule for such an English company is that, except for debts which are made preferential (as to which see the next paragraph) or subordinated by specific statutory direction, all ordinary (or "senior") debts rank equally between themselves and shall be paid in full or, in the event of a deficiency of assets to meet them, abate in equal proportions between themselves[7].

However, there may be a number of situations in which indebtedness incurred by a borrower may acquire seniority to that of the lender. For example:

(a) In many jurisdictions, taxes and wages rank in priority to the claims of other unsecured creditors in the liquidation of a corporation.

(b) In some countries retail depositors with banks or other financial institutions or the holders of insurance policies of an insurance company in liquidation must be paid out before other creditors.

(c) In the Philippines, an unsecured creditor can and, until recently, in Spain[8] could, by publicising the relevant agreement in the prescribed manner before a public official and by paying a documentary tax, achieve priority over unsecured creditors who do not publicise their agreement and, possibly, also over other unsecured creditors whose agreements are subsequently formalised.

(d) Debt securities may under local corporate laws rank for payment in liquidation according to their date of issue.

There is little that a lender can do in relation to (a) and (b) above[9], but a covenant by the borrower that the indebtedness *will* rank at least *pari passu* with all other senior indebtedness should give the lender some comfort that the borrower will not assist any other lenders in a way that would give their indebtedness priority. The Spanish notarisation procedure described in (c) above, for example, used to require the participation of the lender. Similarly, the disclosure language relating to a bond

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[6] See section 4.
[7] Gough, *Company Charges* (2nd edition) at p. 948.
[8] Under the "Ley Concursal" (Ley 22/2003) which came into force on 1st September, 2004, all unsecured creditors, whether or not their obligations are contained in a public deed, are required to be paid on a *pro rata* basis upon the insolvency of the debtor.
[9] Indeed, it is common to see an exception in corporate *pari passu* clauses for "obligations mandatorily preferred by law".

issued by the Philippines' notes that the Philippines believes that its cooperation is required in order to obtain this notarisation.

The purpose of the *pari passu* clause in corporate debt obligations, therefore, is to provide a commitment or warranty that on a liquidation or a forced distribution of assets by reason of insolvency, unsecured creditors will be entitled to a *pro rata* payment *i.e.* that unsecured creditors have in law *pro rata* claims against the assets of the insolvent borrower.

(ii) Sovereign debt obligations

The fundamental point that most commentators make when discussing the meaning of the *pari passu* clause in sovereign debt obligations is that sovereigns, unlike corporates, cannot become insolvent. In the first place a government cannot be liquidated because it has insufficient assets to meet its liabilities and, although governments may be unable to, or refuse to, pay their debts, there are no procedures equivalent to the bankruptcy procedures for a domestic corporation whereby a government's assets can be compulsorily realised and the proceeds distributed to its creditors. As a result, the purpose of a *pari passu* clause in a sovereign debt obligation must be different.

There are two principal interpretations of what the *pari passu* clause means in sovereign debt obligations. The first is a "ranking" interpretation that argues that the *pari passu* clause merely affirms that the obligations rank and will rank *pari passu* with all other unsecured debt as a matter of mandatory law and the second is a "payment" interpretation that argues that the borrower has undertaken that it will in fact pay its obligations *pro rata* when it is unable to pay all of them in full.

Until recently, the ranking interpretation was the only interpretation and, accordingly, the only purpose of the clause was believed to be to prevent sovereigns from "earmarking" revenues of the government or allocating foreign currency reserves to a single creditor or, more generally, to prevent the sovereign from adopting legal measures which have the effect of preferring one set of creditors against the others. In other words, although a sovereign cannot be subjected to a formal bankruptcy

regime, it can promise not to pass a law that would legitimise a preference given to one unsecured creditor over another[10].

However, the payment interpretation of the *pari passu* clause seems to have recently been accepted by the Cour d'Appel de Bruxelles (Brussels Court of Appeal) in a case brought by an investment fund called Elliott Associates[11], which had purchased defaulted Peruvian indebtedness. This payment interpretation is neatly summed-up in the following opinion from Professor Andreas Lowenfeld of New York University, which was obtained by Elliott Associates for the purpose of the Peru litigation. Professor Lowenfeld opined that the meaning of the *pari passu* clause was clear:

> "I have no difficulty in understanding what the *pari passu* clause means: it means what it says – a given debt will rank equally with other debt of the borrower, whether that borrower is an individual, a company, or a sovereign state. A borrower from Tom, Dick, and Harry can't say "I will pay Tom and Dick in full, and if there is anything left over I'll pay Harry." If there is not enough money to go around, the borrower faced with a *pari passu* provision must pay all three of them on the same basis.
>
> Suppose, for example, the total debt is $50,000 and the borrower has only $30,000 available. Tom lent $20,000 and Dick and Harry lent $15,000 each. The borrower must pay three fifths of the amount owed to each one – *i.e.*, $12,000 to Tom, and $9,000 each to Dick and Harry. Of course the remaining sums would remain as obligations of the borrower. But if the borrower proposed to pay Tom £20,000 in full satisfaction, Dick £10,000 and Harry nothing, a court could and should issue an injunction at the behest of Harry. The injunction would run in the first instance against the borrower, but I believe

[10] For this reason, it would not make sense to insert the exception typically found in corporate *pari passu* clauses relating to "obligations mandatorily preferred by law", since this would give the sovereign an escape route for passing laws in the future that have the effect of preferring a particular creditor.

[11] *Elliott Assocs., L.P.,* General Docket No. 2000/QR/92 (Court of Appeals of Brussels, 8th Chamber, 26th September, 2000). Other recent litigation which has concerned the proper interpretation of the *pari passu* clause has included: *Republic of Nicaragua* vs. *LNC Investments LLC and Euroclear Bank S.A./N.V.* (litigation in Belgium); *Red Mountain Fin, Inc*. v. *Democratic Republic of Congo and Nat'l Bank of Congo* (litigation in California, U.S.A.); *Kensington Int'l Ltd*. v. *Republic of Congo* (litigation in England); and *Macrotechnic Int'l Corp* v. *The Republic of Argentina* and *EM Ltd* v. *The Republic of Argentina* (current litigation in New York, U.S.A.).

(putting jurisdictional considerations aside) to Tom and Dick as well."[12]

2.4 The English law position

Given that two different interpretations exist, this part of the report considers the principles which an English court would use to construe a *pari passu* clause in order to determine its proper meaning.

(i) Construction of contractual terms

The object of all construction of the terms in a written agreement is to discover therefrom the intention of the parties to the agreement[13]. Every contract is to be construed with reference to its object and the whole of its terms, and accordingly, the whole context must be considered in endeavouring to collect the intention of the parties, even though the immediate object of inquiry is the meaning of an isolated word or clause.

An important principle of modern English contract law to be considered when construing a commercial contract is that the words used must be given a sensible and commonsense business meaning. This principle was laid down by the House of Lords in the *Antaios*[14] case. In one part of his judgment, Lord Diplock stated "if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense." Lord Diplock's words were later approved by Lord Hoffmann in *Investors Compensation Scheme Ltd. v. West Bromwich Building Society*[15], the leading modern authority concerning the construction of commercial contracts.

Against the background of the general principles to be applied when construing a contract, there are number of "rules" of construction, which the modern law would regard as merely guidelines or assumptions as to what the court may regard as the normal use of language and which assist judges to arrive at a reasonable interpretation of the parties' intentions, though subject to examination of the relevant circumstances

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[12] Extract reproduced from version set out in Buchheit and Pam, *The Pari Passu Clause in Sovereign Debt Instruments* (working paper, draft dated 11th December, 2003).
[13] *Marquis of Cholmondeley v. Clinton* (1820) 2 Jac. & W. 1, 91.
[14] *Antaios Compania Naviera S.A.* v. *Salen Rederierna A.B.* 1 A.C. 191.

surrounding the transaction. One such "rule" of construction is "established judicial construction": where the same words or contractual provisions have for many years received a judicial construction, the court will suppose that the parties have contracted upon the belief that their words will be understood in the accepted legal sense. This rule favours the ranking interpretation.

(ii) Analysis of case law

The most important English law case in this context is *Kensington Int'l Ltd. v. Republic of the Congo*[16]. In the *Kensington* case, a fund purchased defaulted indebtedness under a loan agreement (governed by English law) made in April 1984. On 20th December, 2002, the claimant sought a money judgment against the Congo, together with a claim for specific performance (among other grounds, on the basis of the *pari passu* clause[17] contained in the loan agreement) to prevent the Congo making payments to other creditors.

The claim for specific performance was considered by Tomlinson J. The Congo was not represented at those proceedings. Counsel for Kensington noted the lack of direct English law authority on this point and then rehearsed the two basic interpretations of what the *pari passu* clause meant. He went on to assert that the *pari passu* clause contained in the loan agreement was plainly a sharing clause[18] , compelling Congo to pay the claimant on a pro rata basis when it pays other creditors. Counsel's submission was based on the following considerations:

(a) the literal meaning of the words "*pari passu*[19]" ;

(b) the decision in *Bowen v. Brecon Railway Company*[20] ,which counsel argued strongly suggests that the *pari passu* clause means that money to be distributed should be distributed or paid on a *pari passu* basis;

(c) the actual wording used, with an emphasis on the words "and priority of payment". Counsel suggested that it is difficult to "accord any sensible

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[15] [1998] 1 W.L.R. 896.
[16] 16th April, 2003, unreported. Approved by the Court of Appeal [2003] EWCA Civ 709.
[17] The relevant clause of the loan agreement contains an undertaking by the Congo "to procure that the claims of all other parties under [the loan] agreement will rank as general obligations of the People's Republic of the Congo, at least pari passu in right and priority of payment with the claims of all other creditors of the People's Republic of the Congo . . .".
[18] True "sharing" clauses are considered in further detail at section 3.6 below.
[19] See section 4 of below for a further discussion of this point.
[20] (1866-67) LR 3 Eq 541.

meaning to the emphasised words if payments are not to be made *pari passu*";

(d) the argument that as a sovereign cannot be liquidated, the meaning of a *pari passu* clause in the context of a sovereign borrower must be different to the meaning of a *pari passu* clause in the context of a corporate borrower. Counsel argued that the clause, when appearing in a sovereign loan, must be there to provide some further protection to creditors to compensate for their inability to invoke insolvency procedures against the state and that protection, according to Kensington's counsel, must be an enforceable obligation on the state to pay creditors on a *pro rata* basis;

(e) overseas authority having some indirect bearing on the point:

- *Merchant Bills Corporation Limited v. Permanent Nominees Australia Limited*[21];

- the *Red Mountain Finance*[22] case; and

- the *Elliott* case (see above).

Tomlinson J. decided that he could attach "little weight" to the decisions in the *Red Mountain Finance* and *Elliott* cases because:

- "no reasons for [the decision]" in the *Red Mountain Finance* action had been shown to him and because the Congo had not been represented in that case; and

- the *Elliott* action was an *ex parte* decision and the order was directed towards a bank (Euroclear) and not towards the Peruvian state.

Tomlinson J. also expressed reservations about the legal correctness of the broader interpretation of the *pari passu* clause on the basis of the discussion on *pari passu* clauses found in the Encyclopaedia of Banking Law.

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[21] 1972-73 Australian Law Reports 565.
[22] Case No. CV 00-0164 R (C.D. Cal. 29th May, 2001).

In the end, Tomlinson J. denied Kensington's claim for an injunction on other grounds and this was upheld on appeal. Accordingly, his views expressed on the *pari passu* clause are of persuasive authority only.

In addition, in the absence of direct English case law on a particular point, an English court might find the decisions of a Commonwealth or United States court persuasive[23]. However, having reviewed a number of other English and Commonwealth authorities[24], the Working Group concluded that the standard formulation *pari passu* clause has not received a particular judicial construction which would assist in ascertaining the intentions of the parties.

(iii) Analysis of the actual language

In the absence of clear judicial authority on the point, a careful review of the words used in the *pari passu* clause is also necessary in order to help determine its meaning. This is because the starting point in construing a contract is that words are to be given their ordinary and natural meaning. This is not necessarily the dictionary meaning of the word, but that in which it is generally understood.

An analysis of the ordinary and natural meaning of the principal variations in the actual language used in *pari passu* clauses is set out in section 4 below. This also favours the ranking interpretation.

[23] An interesting example of an instance in which an English court relied on a U.S. precedent in a sovereign context is *Crescent Oil* v. *Banco Nacional de Angola* (unreported), 28th May, 1999 Com Ct., where Cresswell J. applied *de Sanchez* v. *Banco Central de Nicaragua*, 770 F. 2d 1385 (5th cir. 1985), a decision of the United States Court of Appeals for the Fifth Circuit.

[24] See: *Bowen* v. *Brecon Railway Co* (1866-67) LR 3 Eq 541, *Murray* v. *Scott* (1884) 9 AC 519, HL, *Small* v. *Smith* (1885) 10 AC 119, *Re Midland Express*, *Limited*, [1914] 1 Ch. 41, *Merchant Bills Corporation Ltd* v. *Permanent Nominees* (*Aust*) *Ltd* 1972-73 Australian Law Reports 565.

3. CONSEQUENCES OF THE PAYMENT INTERPRETATION

3.1 Introduction

The consequences of the payment interpretation are "background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract"[25] and are therefore relevant in construing the intention of the parties at the time that they made the contract. In particular, based on the views expressed by Lord Diplock in the *Antaios* case, if these consequences would produce results which offend "business commonsense", it is unlikely that a court would be prepared to find in favour of the payment interpretation of the *pari passu* clause.

The payment interpretation of the *pari passu* clause would provide, in effect, that the borrower agrees that, once it is unable to pay all of its debts as they fall due or is otherwise insolvent, it will not pay any other unsecured indebtedness unless at the same time its pays the indebtedness in question in the same proportion by amount as that in which it pays the other indebtedness. This report asserts that the practical consequences that follow from the payment interpretation are such that the parties would not have agreed that the *pari passu* clause should have that meaning had they been presented with these consequences at the time that they entered into their contract. The principal consequences are set out below.

3.2 Effect on the borrower's freedom to run its business or economy

In times of economic distress, a company or a state will wish to prioritise payments to different lenders. Such prioritisation usually takes place for the practical reason that using its resources in this way prevents the business (in the case of a company) or the economy (in the case of a state) from grinding to a halt.

The practical need for sovereigns to prioritise payments has been noted for a number of years. In *State Insolvency and Foreign Bondholders*[26], the authors note that when a sovereign is in financial distress "[f]airness and justice in the adjustment of public debts require that all bondholders be treated alike. The principle of equality, however, does not signify uniformity of treatment. As will appear presently, the grading and grouping, according to their intrinsic merits, of claims with respect to the utilization of the available assets of the debtor have, in

[25] Per Lord Hoffmann in Investors Compensation Scheme Ltd v. West Bromwich Building Society [1998] 1 W.L.R. 896.
[26] Borchard, *State Insolvency and Foreign Bondholders* Vol. 1, General Principles (1951) (Yale University Press).

fact, been expressly recognized in some of the major adjustment plans. All that the principle implies is that preferential treatment shall not be accorded to particular classes of bondholders without valid cause"[27]. The authors go on to argue that a principle of differentiation exists when a sovereign becomes insolvent:

> "While the private law of bankruptcy is governed by the principle of equality of claims in the distribution of the debtor's assets . . . differential treatment of the holders of foreign government bonds in case of default is the ordinary rule. The reason therefor lies in the semipolitical nature of government loans and in the great variety of forms and purposes for which such loans are issued"[28].

The authors then cite examples of how sovereign debtor rescheduling plans have differentiated between various creditors. One example is where the obligations are secured. Another is that "the significance of a loan for the economic or political life of the country may provide the reason for granting [that indebtedness] a priority or preference. Thus, the League Loans Committee claimed priority for the post-war loans issued under the auspices of the League, on the ground that these loans had been devoted to the economic and financial rehabilitation of the countries concerned".

An analogy can clearly be drawn here with the indebtedness granted by the World Bank and International Monetary Fund in modern times.

The consequence of the payment interpretation, however, is that if the borrower is a sovereign state unable to service its foreign currency debt as it falls due, it will not be allowed to pay any of its senior creditors in full. These include the IMF, the World Bank and any of the other multilateral organisations that may have lent it money. The restriction potentially bites even wider than this and would prevent the borrower from paying in full creditors who have sold it commodities or licensed it intellectual property rights or from paying in full its government ministers, civil servants, police force, armed forces, judges and state teachers.

It is argued that if the parties were presented with these consequences of the payment interpretation of the *pari passu* clause at the date that they entered into their contract, they would have concluded that this meaning does not make commercial sense and would have

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[27] *Ibid* at pp. 337-338.
[28] *Ibid* at p. 340.

provided for extensive exemptions from its application. Accordingly, it is submitted that the parties could not have intended the *pari passu* clause to have the payment interpretation.

3.3 Lender liability

Creditors do not readily agree to lend money to debtors on terms that could potentially expose them to liability to third parties. This is not a risk that they agree to assume as part of the commercial deal to lend money to a debtor. However, lender liability is a potential consequence of the payment interpretation of the *pari passu* clause.

As will be seen at section 3.6 of this report "sharing clauses", which are intended to require a *pro rata* distribution of recovery proceeds and "most favoured debt clauses", are usually substantially longer than the typical *pari passu* clause and are often heavily negotiated. One reason for extensive negotiation and detailed drafting of such clauses is that lenders do not wish to be exposed to potential liability to third parties as a result of the obligations that they have agreed to in a loan agreement. When negotiating sharing clauses and most favoured debt clauses, lenders are mindful that they may be exposing themselves to liability in tort or otherwise for interfering in third party contracts. The payment interpretation of the *pari passu* clause could expose lenders to the same potential liabilities. If the payment interpretation is correct, lenders may also be exposing themselves to liability as constructive trustees if they are on notice that there are other unpaid lenders of the same debt or other debt incurred by the sovereign borrower.

It is submitted that the lenders in a standard international syndicated loan or bond issue would not have intended the *pari passu* clause to expose them to such liabilities. Indeed, potential liability as a consequence of a particular construction was relied upon by Lord Diplock in the *Miramar*[29] case as a reason to favour a different construction. In that case he said: "Mr Lords, I venture to assert that no business man who had not taken leave of his senses would intentionally enter into a contract which exposed him to a potential liability of this kind; and this, in itself, I find to be an overwhelming reason for not indulging in verbal manipulation of the actual contractual words used.".

This consequence provides further support to the argument that the payment interpretation is not correct because it would not make business sense for a lender to agree to such potential liabilities to third parties.

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[29] *Miramar Maritime Corporation v. Holborn Oil Trading Ltd* [1984] A.C. 676 at 685.

3.4 Implications for payment and settlement systems

Actions by creditors based on the payment interpretation of the *pari passu* clause could be used to interfere with international payment and securities settlement systems by stopping payments by the borrower to the system or payments by the system to the borrower. Indeed, such action was taken against Euroclear in the *Elliott* litigation. Commercial banks are integrated into the world's payment and settlement systems so that attacks on them as innocent bystanders could have systemic consequences in upsetting the requirement for finality in systems which deal with very high volumes at high speeds in circumstances where liquidity is essential. As an operational matter it would be extremely difficult to try to administer payment instructions which may be the subject of a court injunction along the lines of that obtained by Elliott Associates in the Peru litigation.

In addition to these practical reasons for not favouring the payment interpretation, the public policy objective of preventing this sort of disruption is mirrored in the Directive of the European Parliament and of the Council of 19th May, 1998 on settlement finality in payment and securities settlement systems, 98/26/EC, OJ L 166, 11/06/1998, p.45 (the "**Settlement Finality Directive**"). The preamble to the Settlement Finality Directive outlines the policy of the European Union in this area. The recitals note, among other things, that the Settlement Finality Directive aims at contributing to the efficient and cost effective operation of cross-border payment and securities settlement arrangements in the European Community, and that the reduction of systemic risk requires in particular the finality of settlement. It is noted that the provisions of the Settlement Finality Directive do not prohibit the kinds of attachment proceedings pursued in the *Elliott* case[30].

3.5 Implications for restructuring sovereign debt

One particular mischief caused by the payment interpretation is the implications that follow from it in the context of restructuring sovereign debt. As is noted from the facts of the *Elliot* case, a sovereign debt restructuring is usually effected through an exchange offer whereby existing debt obligations are exchanged for new debt obligations on terms more favourable to

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[30] Under Article 9 of the Belgian Act of April 28, 1999, (EU settlement finality directive), as modified by Article 15 of the Belgian Act of November 19, 2004, no cash settlement account with a settlement system operator or agent *nor any transfer of money to be credited to such cash settlement account, via a Belgian or foreign credit institution,* may in any manner whatsoever be attached, put under trusteeship or blocked by a participant (other than the settlement system operator or agent), a counterparty or a third party. The amendment, which is reflected in italics, was published in the Belgian State gazette of December 28, 2004 and entered into force in January 2005. As noted by the European Central Bank (ECB) when consulted on the draft Belgian legislation, "the draft law enhances legal certainty in relation to payments through payment and settlement systems and thus fosters the safety and efficiency of payment and settlement systems". See Opinion of the European Central Bank of 16 March, 2004 at the request of the Belgian Ministry of Finance (CON/2004/9), para 9, published on the ECB's website at www.ecb.int.

the debtor. Those creditors who decline to accept the exchange offer are referred to as "holdout" creditors.

A theme that pervades throughout this area is that the orderly and expeditious resolution of sovereign debt crises in a manner beneficial to both debtors and creditors is a policy objective to be pursued (see, for example, the Statement of Interest filed by the United States in the *Argentina* litigation). In this regard, recent statements have been published by the G-10 and G-7 regarding the important contribution which appropriately drafted terms and conditions included in sovereign debt instruments can play in the resolution of sovereign debt crises[31].

From the sovereign debtor's perspective and from the perspective of the majority of the creditors who wish to restructure the defaulted indebtedness in order to maximise the dividend they will receive as a class, the use of the *pari passu* clause as a tool to disrupt the process does not make business sense. Time and valuable resources would need to be expended defending actions based on the payment interpretation of the *pari passu* clause. Accordingly, it is again asserted that the parties to the agreement, if presented with this consequence of the payment interpretation of the *pari passu* clause, could not have intended it to have that meaning.

3.6 The *pari passu* clause in the context of the contract as a whole

When considering what the parties to an agreement intended a particular clause in a contract to mean, it will be highly relevant to consider other clauses in that agreement and what the parties meant by them as this may assist in determining the meaning of the clause in question. In this context, there are examples of clauses which are designed to achieve *pro rata* payment and, significantly, are often found along side the standard *pari passu* clause. The most important for these purposes are the "sharing clause" and the "most favoured debt" clause.

A sharing clause is typically found in a syndicated loan agreement and is designed to ensure that any disproportionate payment received by one member of the syndicate will be shared rateably with all the rest[32]. It is important to note that:

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[31] "See, for example, Statement of G-7 Finance Ministers and Central Bank Governors, Washington DC, 27th September, 2002; Communiqué of the Ministers and Governors of the Group of Ten, Washington DC, 27th September, 2002; and Report of the G-10 Working Group on Contractual Clauses, September 2002, published on the website of the Bank for International Settlements at http://www.bis.org/publ/.

[32] It should be noted that sharing clauses (or even the concept) would never have been put in an early eurobond as those bonds were invariably issued in definitive bearer form and the clearing systems did not exist at the time. As a consequence, neither the issuer nor the bondholders would have been able to identify the other holders and so, as a practical matter, sharing would not have been possible. The bearer nature of the bonds would also create difficulties if the effect of knowingly receiving more than one's correct share were to create a constructive trust of the moneys: neither the trustees nor the beneficiaries would be readily identifiable. It is understood that a sharing clause could not be included even today since the clearing systems will not accept securities which impose or purport to impose obligations

(a) syndicated loan agreements with sharing clauses often include *pari passu* clauses too; and

(b) sharing clauses are designed to protect a narrowly defined set of creditors whereas a *pari passu* clause potentially applies to a broad range of unsecured debtors.

These two considerations suggest that the two clauses aim to achieve different ends and, consequently, that the *pari passu* clause should not be given the payment interpretation.

A "most favoured debt" clause is typically found in a work-out agreement for rescheduling a borrower's debt. A "most favoured debt" clause usually provides that if any other foreign currency debt having the same maturity as the rescheduled debt is paid out more quickly, then the borrower must repay the rescheduled debt. The clause will then go on to exclude certain categories of debt which can be paid in priority, for example IMF debt, trade debt, public bonds and other agreed categories. The reason for these exceptions is to allow the sovereign to run its economy and it is submitted that the absence of such exceptions from the standard *pari passu* clause tends to suggest that, properly construed, it is not intended to require equal payments.

The clauses examined in the previous paragraph are rarely expressed to apply to all senior indebtedness in the way that would follow if the payment interpretation of the *pari passu* clause was correct. Where a wider equality is desired, creditors can and do draft an appropriate clause – a most favoured debt clause, a negative pledge, a *pro rata* sharing clause, a provision for payment to a trustee of a bond issue on default who then pays bondholders on a *pro rata* basis, or a cross-default clause. Neither the sharing clause nor the most favoured debt clause prohibits all unequal payments. It must therefore be questioned why, if the *pari passu* clause already achieves *pro rata* payment, parties would wish to include "sharing", "*pro rata* distribution of recovery proceeds" or "most favoured debt" clauses. Their inclusion strongly suggests that the *pari passu* clause was never intended to require *pro rata* payment.

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on the holders. However, where bonds are issued under a trust structure, the obligation imposed on the trustee to pay bondholders pro rata has some consequences which are similar in effect to a sharing clause.

4. ANALYSIS OF SAMPLE CLAUSES

Further support for the ranking interpretation can be gained through an analysis of the actual wording used in two sample clauses identified from the survey referred to in section 2.2 above. It is concluded that the language itself requires a "rank" of the claims, rather than requiring *pari passu* payment in fact. The two clauses relate to bond issues by the Republic of Estonia (in June 2002) and the Republic of Croatia (in February 2001) and are set out below:

Republic of Estonia:

> "The Notes and Coupons rank and . . . will rank *pari passu*, without any preference among themselves, with all other outstanding unsecured and unsubordinated obligations of the Issuer, present and future."

Republic of Croatia:

> "The Notes and Coupons rank *pari passu*, without any preference among themselves, and at least *pari passu* in right of payment with all other present and future unsecured obligations of the Republic, save only for such obligations as may be preferred by mandatory provisions of applicable law."

The Republic of Estonia clause does not contain any reference to the word "payment" in the final sentence. This report therefore asserts that the operative words are "rank *pari passu*". The word "rank" means:

> "Arrange . . . in a rank or in ranks; arrange in a row or rows, set in line . . . Assign to a certain rank in a scale or hierarchy; classify, rate; include within a specified rank or class (foll. by *among, with,* etc.) . . . Occupy a certain rank in a hierarchy; belong to a specified rank or class (foll. by *among, with,* etc.); be on a par *with* . . ."[33]

There is nothing within this definition that suggests *pro rata* payment in fact. Accordingly, this report concludes that the clause merely asserts legal ranking and does not require *pro rata* payment.

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[33] Definition found in Shorter Oxford English Dictionary.

Turning to the Republic of Croatia's clause, it will be noted immediately that this clause contains the additional words "in right of payment" after the words "*pari passu*". It is important, therefore, to examine whether or not these additional words justify this clause being given the payment interpretation. It is submitted that they do not for the following reasons.

(i) The words are similar to the formulation Professor Lowenfeld opined upon in the Nicaragua litigation, which contained the phrase ". . . ranking at least pari passu in priority of payment and in rank of security". They are also similar to the words used in the *Kensington* case, which read ". . . *pari passu* in right and priority of payment". It is worth considering Professor Lowenfeld's arguments here as he characterises his view as the "plain meaning" of the clause. Professor Lowenfeld's principal argument is that the words "rank" and "pay" are used interchangeably in the relevant *pari passu* clause: "By agreeing to rank all the holders of its debt pari passu in priority of payment, the issuer of the debt obligates itself not to rank one creditor higher and another lower, i.e., not to pay one creditor while declining to pay another"[34]. The dictionaries do not support the contention that to say that one will not rank one creditor higher or lower than another is the same thing as saying that one will not pay one creditor while declining to pay another. The key words, again, are "rank *pari passu*" and not "payment".

(ii) It can be argued that the addition of the words "in right of payment" is only meant to clarify that other rights attached to the indebtedness (such as maturity date, interest rate, etc.) are irrelevant to the *pari passu* ranking of the obligations. It follows, therefore, that the addition of the words does not require *pro rata* payment in fact.

(iii) The *Kensington* case involved a clause that referred to "payment". As has already been seen, Tomlinson J. did not seem to be persuaded by counsel's argument that looking at the actual wording used, with an emphasis on the words "and priority of payment", suggested that it was difficult to "accord any sensible meaning to the emphasised words if payments are not to be made *pari passu*".

(iv) The Working Group discovered only one issue of bonds as part of its survey where the drafting appears to favour the payment interpretation. This bond was issued by

[34] Professor Lowenfeld's declaration in the Nicaragua litigation, at p. 7.

the Philippines and contains the additional words "and shall be discharged in such manner" at the end of the status condition. It is submitted that the use of these specific words suggests that the draftsman consciously intended something other than the ranking interpretation, otherwise the additional words would be redundant. This tends to suggest that clauses without these additional words in them are understood to have the ranking interpretation.

(v) There is one further argument that can be made in the context of an issue of debt securities (including the two sample clauses). As noted in Section 2.1, the standard formulation for a *pari passu* clause in an issue of debt securities clause has two limbs:

(a) the *internal* limb: that the bonds rank *pari passu* with each other and without any preference among themselves; and

(b) the *external* limb: that the bonds rank *pari passu* with other unsecured indebtedness of the issuer.

The internal limb imposes broader obligations on the issuer than the external limb. In relation to the treatment of the bondholders themselves, the issuer's obligations must both rank *pari passu* and so rank without preference among themselves. In the context of the ranking interpretation, the language in the internal limb can be explained as no more than another example of surplusage. Proponents of the payment interpretation, however, would argue that the latter part of the language implies an obligation to treat the bondholders equally and, if insufficient funds are available, to pay them on a *pro rata* basis. This is logical given that in a normal securities issue the various lenders are all making the same credit decision at the same time and on identical terms, even though they may actually lend different amounts. In these circumstances, lenders might reasonably expect their securities to be treated equally.

The external limb, however, only requires that the bonds rank *pari passu* to other indebtedness. Since it is only the bonds themselves which must be paid equally (or "without preference") it follows that that the mere *pari passu* language itself cannot confer a similar right to absolute equality of treatment – it must confer something less. If no equality in right of *payment* applies, then there can only be equality in right of *ranking*.

5. CONCLUSION

The purpose of this report has been to analyse the role, use and meaning, as a matter of English law, of *pari passu* clauses in sovereign debt obligations. This report has noted that there appear to be two basic interpretations as to their proper meaning. The first interpretation, which is referred to in this report as the "**ranking**" interpretation, is that the clause is merely an assertion of how particular debt will rank in the insolvency of the debtor, and the second, which is referred to in this report as the "**payment**" interpretation, is that the clause operates to prevent a debtor from paying one of its creditors ahead of any other when it is not in a position to pay all of its creditors in full.

This report has found that the **use** of the *pari passu* clause in sovereign debt obligations is widespread. The survey conducted of the *pari passu* clauses found in contemporary sovereign bond issues has also revealed a diversity in the actual language used in these clauses.

In attempting to determine the **role** and **meaning** of *pari passu* clauses in sovereign debt obligations, this report started with the English law principles laid down for construing contracts. As has been seen, this requires both a careful review of the actual words used in the clause and an examination of the consequences that would follow if the payment interpretation was correct.

This report has concluded that the consequences of the payment interpretation are such that both debtors and creditors would be prejudiced by such a construction. Sovereign borrowers would be prevented from prioritising which creditors they pay first thereby restraining their freedom to prioritise payments to creditors during times of economic distress. Creditors may find themselves exposed to potential liability to third parties and, when attempting to negotiate a restructuring of the sovereign's indebtedness, could suffer at the hands of hold-out creditors seeking to deploy an argument based on the payment interpretation of the *pari passu* clause.

This report concludes, therefore, that as a matter of English law the ranking interpretation is the proper interpretation of the *pari passu* clause in sovereign debt obligations. The key word within the clause is "rank" and not the words "*pari passu*". Given the lack of formal insolvency procedures in the context of a sovereign debtor the meaning of the clause is limited to an obligation on the sovereign not to involuntarily subordinate one class of creditors by the enactment of new legislation or otherwise. Where a broader equality of payment is desired in a particular instance, creditors can and often do include appropriate clauses to this effect in sovereign debt instruments governed by English law. It is therefore strongly asserted that the payment interpretation of the *pari passu* clause is unsupportable as a matter of English law except where the clause is very clearly drafted to achieve this effect.

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