

4-14-2015

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Recommended Citation

Benjamin C. Kelsey, *Crisis in Iceland: Deposit-Guarantee Scheme Failure and State Liability*, 38 B.C. Int'l & Comp. L. Rev. E. Supp. 30 (2015), <http://lawdigitalcommons.bc.edu/iclr/vol38/iss3/4>

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CRISIS IN ICELAND: DEPOSIT-GUARANTEE SCHEME FAILURE AND STATE LIABILITY

BENJAMIN C. KELSEY*

Abstract: On January 28, 2013, the Court of Justice of the European Free Trade Association States held that Iceland was not required to compensate foreign depositors of Landsbanki, an Icelandic bank, when the deposit-guarantee scheme failed to reimburse depositors following the 2008 financial crisis. The court supported its conclusion with the text of the Directive that established deposit-guarantee schemes as well as policy arguments regarding consumer protection and moral hazard. The court also found that Iceland's failure to repay foreign depositors did not constitute an act of discrimination. Although the court correctly interpreted both the text and policy goals of the Directive, the precedential value of the court's decision may be limited due to the severity of the 2008 crisis.

INTRODUCTION

The 2008 financial crisis had a profound impact on economies worldwide, but the small island-nation of Iceland was hit particularly hard.¹ In fact, ninety-three percent of the commercial banking sector in Iceland had failed by March 2009.² One of the many banks that collapsed was Landsbanki Íslands hf (Landsbanki).³ Landsbanki provided online savings accounts under the brand name Icesave to depositors in the Netherlands and the United Kingdom (UK).⁴ When Landsbanki failed and the deposit-guarantee scheme was unable to provide reimbursement for lost deposits, the European Free Trade Association Surveillance Authority (Surveillance Authority) claimed that the State of Iceland was obligated to pay Icesave's liabilities.⁵

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¹ *Cracks in the Crust*, ECONOMIST (Dec. 11, 2008), <http://www.economist.com/node/12762027>, archived at <https://perma.cc/27KU-87ZV>.

² Case E-16/11, EFTA Surveillance Auth. v. Iceland, 2013 Rep. EFTA Ct. 3, 20 (2013), available at http://www.eftacourt.int/fileadmin/user_upload/Files/AnnualReports/EFTA_Court_Report_Book_1_2013.pdf, archived at <https://perma.cc/9CM5-JD57>.

³ *Id.* at 18.

⁴ *Id.* at 16–17.

⁵ *Id.* at 24–25. The EFTA Surveillance Authority (Surveillance Authority) oversees the EFTA states of Iceland, Norway, and Liechtenstein and monitors their compliance with their obligations under the Agreement on the European Economic Area. See Agreement on the European Economic

In January 2013, the Court of Justice of the European Free Trade Association States (EFTA Court) ruled on the State of Iceland's liability to Icesave's foreign depositors.⁶ In *EFTA Surveillance Authority v. Iceland*, the EFTA Court held that Directive 94/19/EC (the 1994 Directive), which provides minimum rules regarding the establishment and operation of deposit-guarantee schemes, did not impose liability on the State of Iceland in a "systemic crisis of the magnitude experienced in Iceland" in 2008 through 2009.⁷ In addition, the court found that Iceland, in not reimbursing depositors from the Netherlands and the UK, did not commit an act of discrimination contrary to the 1994 Directive or Article 4 of the Agreement on the European Economic Area (EEA Agreement).⁸

Part I of this Comment provides a brief factual and procedural history of *EFTA Surveillance Authority v. Iceland*. Part II offers a discussion of the EFTA Court's reasoning in finding for the defendant. This section reviews the court's interpretation of the 1994 Directive and also examines the court's opinion on the role of moral hazard and consumer protection in the context of a deposit-guarantee scheme. Part III argues that the court correctly incorporated the goal of consumer protection and the risks of moral hazard into its analysis, but that the long-term effect of the court's decision is difficult to determine given the European legislature's subsequent amendments to the 1994 Directive.

Area arts. 55, 56, concluded May 2, 1992, 1801 U.N.T.S. 3, 21–22 (entered into force Jan. 1, 1994) [hereinafter EEA Agreement]; *About the Authority*, EFTA SURVEILLANCE AUTHORITY, <http://www.eftasurv.int/about-the-authority/the-authority-at-a-glance/> (last visited Feb. 26, 2015), archived at <http://perma.cc/88HR-L9CP>. The Surveillance Authority monitors compliance with EEA rules on competition, state aid, and discrimination, among other things. *About the Authority*, *supra*.

⁶ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 54. The EFTA Court has jurisdiction over EFTA states that are parties to the EEA Agreement and deals mainly with infringement actions brought by the Surveillance Authority against EFTA States. See *Introduction to the EFTA Court*, EFTA COURT, <http://www.eftacourt.int/the-court/jurisdiction-organisation/introduction/> (last visited Feb. 26, 2015), archived at <http://perma.cc/PHK7-KQDQ>.

⁷ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 44.

⁸ *Id.* at 51, 53. The EEA Agreement entered into force on January 1, 1994. EEA Agreement, *supra* note 5, at 4 n.1. The EEA Agreement binds together the EU Member States and the EFTA States, creating a single market. See *Introduction to the EFTA Court*, *supra* note 6. EU legislation on the free movement of goods, services, persons, and capital applies to EFTA States through the EEA Agreement. See *id.*

I. BACKGROUND

A. Landsbanki's Collapse

On January 1, 2000, Iceland enacted Act No 98/1999, which created the Depositors' and Investors' Guarantee Fund (TIF).⁹ In accordance with the 1994 Directive, deposits at the British and Dutch branches of Landsbanki were under the responsibility of the TIF.¹⁰ In addition, Landsbanki branches in the UK and the Netherlands joined the respective deposit-guarantee schemes in their host countries.¹¹

The worldwide financial crisis in 2008 manifested itself in Iceland through a drop in the value of the Icelandic *kronur*, inflation, and the nationalization of the country's three largest banks, including Landsbanki.¹² As a result of the crisis, Landsbanki's Icesave website in the Netherlands and the UK stopped functioning on October 6, 2008, and depositors were unable to access their deposits.¹³ The following day, Landsbanki collapsed and the Icelandic Financial Supervisory Authority (FME) took control of the bank.¹⁴ The next day, the UK government froze the assets of Landsbanki in the UK.¹⁵ Then, the following week, the District Court of Amsterdam appointed administrators to handle all of Landsbanki's assets and dealings with its customers.¹⁶

Between October 9 and October 22 of that year, domestic Icelandic deposits in Landsbanki were transferred to a new bank, New Landsbanki, which was established by the Icelandic Government.¹⁷ The transfer of domestic deposits to New Landsbanki was based on a decision by FME as part of its effort to restructure Icelandic banks.¹⁸ On October 27 and thereafter, the FME "made statements triggering an obligation" for the TIF to make payments to

⁹ Case E-16/11, EFTA Surveillance Auth. v. Iceland, 2013 Rep. EFTA Ct. 3, 16 (2013). TIF is the abbreviation for the Icelandic translation of Depositors' and Investors' Guarantee Fund, Tryggingarsjóður innstæðueigenda og fjárfesta. TRYGGINGARSJÓÐUR INNSTÆÐUEIGENDA OG FJÁRFESTA [DEPOSITORS' AND INVESTORS' GUARANTEE FUND], <http://www.tryggingarsjodur.is/> (last visited Feb. 26, 2015) (Ice.), archived at <http://perma.cc/2Q2S-HJUV>.

¹⁰ EFTA Surveillance Auth., 2013 Rep. EFTA Ct., at 17.

¹¹ *Id.* When the Dutch branch of Landsbanki joined the Netherlands deposit-guarantee scheme, deposits were insured up to a minimum of EUR 40,000 per depositor. *Id.* This was later raised to EUR 100,000 per depositor. *Id.* For British depositors, deposits in excess of the amount insured by the Icelandic TIF were insured by the British scheme up to a maximum of GBP 50,000. *Id.*

¹² *Cracks in the Crust*, *supra* note 1.

¹³ EFTA Surveillance Auth., 2013 Rep. EFTA Ct., at 17.

¹⁴ *Id.* at 18.

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

Landsbanki depositors in the UK and the Netherlands.¹⁹ In late 2008, deposit-guarantee schemes in the UK and the Netherlands paid compensation to Landsbanki depositors in their respective countries.²⁰ The TIF, however, never made any payments.²¹

B. Procedural History Before the EFTA Court

On May 26, 2010, the Surveillance Authority issued a letter of formal notice to Iceland for failure to ensure that Icesave depositors in the UK and the Netherlands received their guaranteed compensation.²² In reply, the Icelandic government argued that it was not in violation of its obligations under the 1994 Directive or Article 4 of the EEA Agreement.²³ Following further exchanges, the Surveillance Authority brought an action in the EFTA Court against Iceland on December 15, 2011, seeking a declaration that Iceland had failed to comply with Articles 3, 4, 7, and 10 of the 1994 Directive.²⁴ The Surveillance Authority alleged further that Iceland's actions constituted discrimination contrary to the 1994 Directive and Article 4 of the EEA Agreement.²⁵

The EFTA Court also granted the European Commission's request to intervene in support of the Surveillance Authority.²⁶ In addition, the Governments of the UK, Liechtenstein, Norway, and the Netherlands submitted written observations.²⁷

II. DISCUSSION

To reach its finding, the EFTA Court considered both the text of the 1994 Directive as well as its underlying policy goals as articulated in the 1994 Directive's preamble.²⁸ The court relied on Articles 4 and 7 of the

¹⁹ *Id.* at 19.

²⁰ *Id.*

²¹ See Jill Treanor & Simon Bowers, *British and Dutch Authorities Claim £5.3bn Over Iceland Banking Crash*, *GUARDIAN* (Feb. 10, 2014), <http://www.theguardian.com/business/2014/feb/11/iceland-banking-crash-claim-fund>, archived at <http://perma.cc/3YKQ-PZM6>.

²² *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 21.

²³ *Id.*

²⁴ *Id.* at 22.

²⁵ *Id.* at 46.

²⁶ *Id.* at 22, 23, 26. The European Commission supported the Surveillance Authority's position because it believed that any other interpretation would render the provisions incapable of achieving the 1994 Directive's goal. *Id.* at 26.

²⁷ *Id.* at 23. As might be expected, the governments of the UK and the Netherlands submitted observations in support of the Surveillance Authority. See *id.* Norway and Liechtenstein supported Iceland's position that the 1994 Directive does not impose upon Iceland the obligation to compensate foreign depositors following a crisis of the magnitude experienced in Iceland. *Id.* at 30–32.

²⁸ Case E-16/11, *EFTA Surveillance Auth. v. Iceland*, 2013 Rep. EFTA Ct. 3, 44 (2013).

1994 Directive as well as Article 4 of the EEA Agreement in considering the Surveillance Authority's discrimination claims.²⁹

A. The Court's Interpretation of the Text of the 1994 Directive

The EFTA Court began its analysis of the 1994 Directive by noting that one of the "principal characteristics of directives is precisely that they are intended to achieve a specific result" while leaving the means of achieving that result up to the discretion of the EEA State itself.³⁰ The substantive provisions of the 1994 Directive determine the nature of the result to be achieved.³¹ The Surveillance Authority alleged that the 1994 Directive was intended to achieve the specific result of ensuring that foreign depositors were compensated.³² In analyzing this alleged obligation, the court addressed Articles 3, 7 and 10 of the 1994 Directive, but made no mention of Article 4 until its discussion of the discrimination allegation.³³

Article 3 of the 1994 Directive reads, "Each Member State shall ensure that within its territory one or more deposit-guarantee schemes are introduced and officially recognized."³⁴ The court found that Article 3 relates only to the introduction and proper functioning of the deposit-guarantee scheme.³⁵ It is meant to guarantee to depositors that the credit institution in which they make a deposit is part of a deposit-guarantee scheme.³⁶ Although states must fulfill certain advisory tasks—such as ensuring that credit institutions comply with their obligations as members of a deposit-guarantee scheme—the Article does not envisage that EEA States have to ensure the payment of aggregate deposits in all circumstances.³⁷

Article 7 of the 1994 Directive stipulates the minimum level of coverage that deposit-guarantee schemes must provide to depositors.³⁸ The text of the version of Article 7 that was in force during the relevant time period ("old Article 7") provided that, "Deposit-guarantee schemes shall stipulate that the aggregate deposits of each depositor must be covered up to"³⁹ The court noted that the European legislature had since amended the text of

²⁹ *Id.* at 51, 53.

³⁰ *Id.* at 32.

³¹ *Id.*

³² *Id.* at 24.

³³ *Id.* at 35, 37–38, 50. The Surveillance Authority claimed that Iceland had an obligation to compensate foreign depositors based on Articles 3, 4, 7 and 10 of the 1994 Directive. *Id.* at 22.

³⁴ Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on Deposit-Guarantee Schemes art. 3, 1994 O.J. (L 135) 8 [hereinafter 1994 Directive].

³⁵ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 35–36.

³⁶ *Id.*

³⁷ *Id.*

³⁸ 1994 Directive, *supra* note 34, at art. 7.

³⁹ *Id.*

Article 7 to require that, “Member States shall ensure that the coverage for the aggregate deposits of each depositor shall be”⁴⁰ This “Member State” language replaced the “deposit-guarantee scheme” language from the old Article 7.⁴¹ The court interpreted this new version of Article 7 as obliging EEA States themselves to ensure a certain level of coverage.⁴² From this change in language, the court reasoned that the European legislature found it necessary to expand the responsibility of EEA States beyond the mere establishment of an effective deposit-guarantee scheme framework.⁴³ Accordingly, the obligation created by the old Article 7 was limited to providing national rules that imposed a minimum coverage level for deposit-guarantee schemes. It did not require states to ensure compensation if a deposit-guarantee scheme were unable to meet its obligations.⁴⁴

In addition to establishing the minimum level of coverage required of deposit-guarantee schemes, Article 7 states, “Member States shall ensure that the depositor’s rights to compensation may be the subject of an action by the depositor against the deposit-guarantee scheme.”⁴⁵ The court found that this provision required only the maintenance and adoption of rules allowing a depositor to file an action against the deposit-guarantee scheme itself in the case of non-payment.⁴⁶ This obligation cannot be extended to require that the EEA State itself compensate depositors when the deposit-guarantee scheme cannot do so.⁴⁷ The court did not explicitly elaborate upon its reasoning for not extending this obligation, but it appears that the court relied heavily on the text of the 1994 Directive, which only requires states to protect the depositor’s right to legal action.⁴⁸

Finally, Article 10 establishes time limits within which deposit-guarantee schemes must compensate depositors.⁴⁹ The court found that the obligations imposed by this Article are merely procedural in nature and require only that states provide a mandatory and effective procedural framework with respect to time limits.⁵⁰ More specifically, the Article ensures that EEA States may not release deposit-guarantee schemes from the relatively short deadlines imposed by the Article except in “exceptional circum-

⁴⁰ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 36–37.

⁴¹ *Id.*

⁴² *Id.* at 37.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ 1994 Directive, *supra* note 34, at art. 7.

⁴⁶ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 37.

⁴⁷ *Id.* at 37–38.

⁴⁸ *See id.*

⁴⁹ 1994 Directive, *supra* note 34, at art. 10.

⁵⁰ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 38.

stances” or “special cases.”⁵¹ The court held that an obligation for states to compensate depositors in the event that the deposit-guarantee scheme is unable to do so could not be derived from this purely procedural Article.⁵²

Thus, the court found that the text of the 1994 Directive provides only for the establishment of a deposit-guarantee scheme and a procedural framework through which it must be governed.⁵³ The text of the 1994 Directive does not envisage that a state itself must compensate depositors when the deposit-guarantee scheme fails to do so.⁵⁴

B. The Court’s Interpretation of the Objective of the 1994 Directive

In addition to the text of the 1994 Directive, the court looked to the overall purpose of the 1994 Directive to support its conclusion.⁵⁵ The court interpreted the 1994 Directive’s objectives to be twofold: (1) to ensure freedom for banks to provide banking services across EEA states and (2) to protect both consumers and the stability of the banking system.⁵⁶ The court derived these objectives from the 1994 Directive’s preamble.⁵⁷

In order to further the 1994 Directive’s first goal, Article 3 provides that a credit institution may be exempted from participation in a deposit-guarantee scheme by the EEA State when it belongs to an alternate system that meets a number of specific requirements.⁵⁸ The court noted that one of these requirements is that states themselves cannot offer a guarantee to the credit institution.⁵⁹ Consistent with the 1994 Directive’s goal of providing freedom to offer banking services throughout Member States, this restriction was designed to limit the anti-competitive impact that a state-funded deposit-guarantee

⁵¹ 1994 Directive, *supra* note 34, at art. 10.

⁵² *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 38.

⁵³ *See id.* at 35–38.

⁵⁴ *Id.* at 44.

⁵⁵ *See id.* at 34.

⁵⁶ *Id.*

⁵⁷ *Id.* at 11, 40. The court cites to Recital 23 to support the proposition that the 1994 Directive’s objective is for the banking system to function in the interests of consumers and the economy as a whole. *Id.* The Recital reads:

Whereas it is not indispensable, in this Directive, to harmonize the methods of financing schemes guaranteeing deposits or credit institutions themselves, given, on the one hand, that the cost of financing such schemes must be borne, in principal, by credit institutions themselves and, on the other hand, that the financing capacity of such schemes must be in proportion to their liabilities; whereas this must not, however, jeopardize the stability of the banking system of the Member State concerned

...

1994 Directive, *supra* note 34, at pmb1.

⁵⁸ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 41.

⁵⁹ *Id.*

scheme would have.⁶⁰ Indeed, if the state itself could ensure deposits at a particular bank, that bank would have a competitive advantage over a bank backed only by a private deposit-guarantee scheme.⁶¹ The court therefore reasoned that were a Member State legally obligated to ensure the compensation of depositors, the anti-competitive impact of such an assurance would run counter to one of the 1994 Directive's objectives.⁶² Accordingly, the court held that, had the European legislature intended to adopt the state-funded approach to deposit-guarantee schemes, it would have done so explicitly.⁶³

The court also found an additional problem with the idea of a state-backed deposit-guarantee scheme: moral hazard.⁶⁴ Specifically, if deposit-guarantee schemes were to be backed by the state itself, banks would have less of an incentive to act in a responsible manner, knowing that the state would always be there to save it from the adverse consequences of its risk-taking.⁶⁵ The court noted that such state support specifically counters the intent of the European legislature, which wrote in Recital 16 of the 1994 Directive's preamble that such support "might in certain cases have the effect of encouraging the unsound management of credit institutions."⁶⁶ Such unsound management could imperil the stability of the banking system, thus undermining the 1994 Directive's second goal.⁶⁷

The court further reasoned that the 1994 Directive's goal of consumer protection necessarily involves a balance of the costs and benefits thereof.⁶⁸ When consumer protection goes past a certain point, the costs of such protections can become counter-productive and actually expose the consumer to a greater risk of harm.⁶⁹ Although the court did not specifically identify where the tipping point is, it found that, in this case, the costs to the consumer of a state-backed deposit-guarantee scheme would outweigh the benefits that it provides.⁷⁰ Thus, requiring Iceland to reimburse foreign Icesave depositors would contradict the objectives of the 1994 Directive under which deposit-guarantee schemes are mandated.⁷¹

⁶⁰ See *id.* at 41–42.

⁶¹ See *id.* at 41.

⁶² *Id.* at 41–42.

⁶³ *Id.*

⁶⁴ See *id.* at 42–43.

⁶⁵ See *id.* at 43.

⁶⁶ *Id.* at 42–43.

⁶⁷ See *id.* at 40.

⁶⁸ See *id.* at 43.

⁶⁹ See *id.*

⁷⁰ See *id.* at 44.

⁷¹ See *id.* at 43–44.

C. The Court Finds No Discrimination

In its second and third pleas, the Surveillance Authority contended that Iceland, in failing to compensate Icesave depositors in the Netherlands and the UK, violated anti-discrimination provisions in both the 1994 Directive and Article 4 of the EEA Agreement.⁷² The court, however, disagreed and dismissed both pleas.⁷³

The 1994 Directive requires that depositors at any branches established by credit institutions in other EEA States belong to the deposit-guarantee scheme established in the home EEA State.⁷⁴ Because both foreign and domestic depositors must be treated equally when it comes to payment of minimum compensation in the event of institutional insolvency, the 1994 Directive prohibits discrimination on the basis of nationality by the deposit-guarantee scheme itself.⁷⁵ More generally, the court found that “the principal of non-discrimination inherent in the Directive requires that there should be no difference in the way a deposit-guarantee scheme treats depositors, and the way it pays out its funds.”⁷⁶

The court held that there was no violation of the 1994 Directive’s anti-discrimination policy in the present case because no difference in the treatment between domestic and foreign Icesave depositors was possible.⁷⁷ After Landsbanki failed, domestic deposits were transferred to New Landsbanki based on a decision by the FME.⁷⁸ The transfer of domestic deposits took place between October 9 and October 22, 2008.⁷⁹ This occurred before the TIF was obligated to make payments to depositors on October 27, 2008.⁸⁰ Thus, at the time that the deposit-guarantee scheme was obligated to make payments, the funds of domestic depositors were not covered by TIF.⁸¹ Since neither the funds of domestic depositors nor foreign depositors were covered by the deposit-guarantee scheme on October 27, there was no difference in the way the scheme treated depositors and thus no discrimination.⁸²

The court also found no acts of discrimination contrary to Article 4 of the EEA Agreement.⁸³ The court pointed out that the Surveillance Authority

⁷² *Id.* at 46.

⁷³ *Id.* at 51, 54.

⁷⁴ *Id.* at 50.

⁷⁵ *Id.*

⁷⁶ *Id.* at 51.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.* at 18.

⁸⁰ *Id.* at 19, 51.

⁸¹ *Id.*

⁸² *Id.* at 51.

⁸³ *Id.* at 53–54.

limited the scope of its application by alleging discrimination not in Iceland's transferring only domestic deposits to New Landsbanki, but only in the failure of the Icelandic government to ensure that depositors in the Netherlands and UK receive compensation.⁸⁴ Framed in this manner, the Surveillance Authority must first show that Iceland was under an obligation to ensure payments to foreign depositors in order to prove the allegation.⁸⁵ The court already found that this obligation does not exist under the 1994 Directive and went on to explain that it cannot be derived from Article 4 of the EEA Agreement alone.⁸⁶ Thus the plea could not succeed and must be dismissed.⁸⁷

As a result of the court's decision, Iceland did not compensate Ice-save's foreign depositors and the EFTA Surveillance Authority was ordered to pay its own legal costs and those incurred by Iceland.⁸⁸

III. ANALYSIS

In *EFTA Surveillance Authority v. Iceland*, the court not only properly interpreted the text of the 1994 Directive but also, critically, emphasized the 1994 Directive's policy goals.⁸⁹ The court correctly reasoned that the 1994 Directive's goal of consumer protection precluded finding Iceland liable to foreign depositors.⁹⁰ Appropriately, the risk of moral hazard also played a significant role in the court's analysis.⁹¹ Significantly, the court settled the question of Iceland's liability under the 1994 Directive as it stood in 2008.⁹² The ultimate relevance of this determination, however, is not clear given the European Parliament's subsequent amendments to the 1994 Directive.⁹³

Recital 16 in the 1994 Directive's preamble prescribes that one of its goals is consumer protection.⁹⁴ Although the court acknowledged that the preamble is not a legally binding portion of the agreement, it used the preamble to guide its interpretation and application of the 1994 Directive.⁹⁵ The court recognized that if Iceland were forced to compensate foreign de-

⁸⁴ *Id.* at 52.

⁸⁵ *Id.* at 53.

⁸⁶ *Id.*

⁸⁷ *Id.* at 53–54.

⁸⁸ *Id.*

⁸⁹ See Case E-16/11, *EFTA Surveillance Auth. v. Iceland*, 2013 Rep. EFTA Ct. 3, 43–44 (2013).

⁹⁰ See *id.* at 43.

⁹¹ See *id.* at 42–43.

⁹² *Id.* at 54.

⁹³ See *id.* at 36–37; Eyvindur G. Gunnarsson, *The Icelandic Regulatory Responses to the Financial Crisis*, 12 EUR. BUS. ORG. L. REV. 1, 33, 34 (2011).

⁹⁴ See 1994 Directive, *supra* note 34, at pmb1.

⁹⁵ See *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 33.

positors, it could ultimately hurt consumers *more* than if the deposit-guarantee scheme were allowed to fail.⁹⁶ Essentially, a banking crisis, particularly one as large as Iceland's, could lead to an even more serious sovereign debt crisis.⁹⁷ The court weighed the costs and benefits of consumer protection and determined that a potential sovereign default is a cost that is not justified by the protection provided by a state-funded deposit-guarantee scheme.⁹⁸ In a way, the court's decision in *EFTA Surveillance Authority* is a recognition that the banks in Iceland were in fact "too big to bail."⁹⁹

This, of course, raises the question of the extent to which the court's decision in this case was influenced by the sheer magnitude of Iceland's financial crisis.¹⁰⁰ The language of the opinion suggests that the size of the Icelandic crisis was important in the court's analysis of state liability.¹⁰¹ Consideration of the magnitude of the crisis is also taken into account in the court's balancing the costs and benefits of consumer protection.¹⁰² Furthermore, implicit in the court's analysis is the idea that deposit-guarantee schemes are not designed to alleviate system-wide failures, but rather to protect consumers in the event of the collapse of a single small or medium-sized bank.¹⁰³ Given the extent of the crisis in Iceland, and the potential repercussions for consumers if the state were to be liable, the court correctly held that the 1994 Directive did not contemplate state liability under these circumstances.¹⁰⁴

Another cost of state-funded deposit-guarantee schemes that the court shrewdly incorporated into its analysis is that of moral hazard.¹⁰⁵ Again, the court's interpretation of the 1994 Directive was guided by the 1994 Directive's preamble, which cautions against the risk of moral hazard.¹⁰⁶ The court recognized that if it found Iceland liable to foreign depositors, it could

⁹⁶ See *id.* at 43.

⁹⁷ See *Cracks in the Crust*, *supra* note 1.

⁹⁸ See *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 40.

⁹⁹ See *id.* at 43; Gunnarsson, *supra* note 93, at 38.

¹⁰⁰ See *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 39; Gunnarsson, *supra* note 93, at 38.

¹⁰¹ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 39, 43–44. The court's holding reads, "[T]he Court holds that the Directive does not envisage that the defendant itself must ensure payments to depositors . . . in a systemic crisis of the magnitude experienced in Iceland." *Id.* at 44 (emphasis added).

¹⁰² See *id.* at 40.

¹⁰³ See *id.* at 39; Gunnarsson, *supra* note 93, at 31.

¹⁰⁴ See *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 41–42; Gunnarsson, *supra* note 93, at 33, 34.

¹⁰⁵ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 42–43.

¹⁰⁶ See *id.* Recital 16 of the 1994 Directive reads, in relevant part, "[I]t would not be appropriate to impose throughout the Community a level of protection which might in certain cases have the effect of encouraging the unsound management of credit institutions . . ." 1994 Directive, *supra* note 34, at pmb1.

create the type of moral hazard the 1994 Directive itself warns against.¹⁰⁷ If the sovereign state bails out a financial institution, then that institution and those like it are insulated from the costs of their risky activity.¹⁰⁸ Financial institutions, then, are incentivized to act in an imprudent manner because the state will be there to bail them out.¹⁰⁹ Thus moral hazard, in addition to being a threat against which the 1994 Directive warns in its own right, incentivizes financial institutions to act in a way that undermines consumer protection.¹¹⁰ The court, therefore, was right to factor the risk of moral hazard into its analysis.¹¹¹

Although the court arrived at the correct decision given the particular circumstances in this case, the relevance of the court's decision to future disputes is difficult to determine.¹¹² Following the crisis in Iceland, the European Parliament replaced key text in Article 7 of the 1994 Directive.¹¹³ The court suggested that this new language would require the state to ensure a certain level of coverage if a deposit-guarantee scheme were to fail.¹¹⁴ If this were the case, it would seem that the impact of the court's decision in this case would be limited to settling this individual dispute, as the amended Directive (2009 Directive) more clearly stipulates state liability.¹¹⁵

The 2009 Directive, however, falls short of explicitly stating that in the event of the failure of a deposit-guarantee scheme the state itself would be liable to depositors.¹¹⁶ The European Parliament, at the time it amended the 1994 Directive, was certainly aware of the question of state liability following a deposit-guarantee scheme failure.¹¹⁷ As commentators have pointed out, the

¹⁰⁷ See *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 42–43.

¹⁰⁸ Tom Bangay, *Financial Crisis: The Moral of the Story*, INT'L BAR ASS'N, <http://www.ibanet.org/Article/Detail.aspx?ArticleUid=7ef920ca-9a29-402a-ae0b-451bc4db5105> (last visited Feb. 26, 2015), archived at <http://perma.cc/J2FN-7TDQ>.

¹⁰⁹ See *id.*

¹¹⁰ See *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 43.

¹¹¹ See *id.* at 42–43.

¹¹² See *id.* at 37 (positing that the new Article 7 would require states to provide deposit-guarantee coverage); *but cf.* Gunnarsson, *supra* note 93, at 33 (positing that the new article 7 would not impose state obligation to provide deposit-guarantee coverage).

¹¹³ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 37. On March 11, 2009, the European Parliament adopted Directive 2009/14/EC which replaced the text of Article 7(1) of Directive 94/19/EC with: "Member States shall ensure that the coverage for the aggregate deposits of each depositor shall be at least EUR 50 000 in the event of deposits being unavailable." Directive 2009/14/EC, of the European Parliament and of the Council of 11 March 2009 Amending Directive 94/19/EC on Deposit-Guarantee Schemes as Regards the Coverage Level and the Payout Delay art. 1, 2009 O.J. (L 68) 3 [hereinafter 2009 Directive].

¹¹⁴ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 37.

¹¹⁵ See *id.* at 36–37.

¹¹⁶ Gunnarsson, *supra* note 93, at 33.

¹¹⁷ *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 18–19. The amendments to the 1994 Directive were adopted on March 11, 2009, more than four months after the failure of the TIF. See 2009 Directive, *supra* note 113, at 7.

legislature's failure to explicitly address this question in the text of the 2009 Directive suggests that it still did not intend to impose full state liability under such circumstances.¹¹⁸

Thus, the overarching question of state liability for deposit-guarantee schemes established under the 2009 Directive appears to remain unanswered.¹¹⁹ The court's decision in *EFTA Surveillance Authority* offers cogent analysis, but forfeits its usefulness to the extent that the ruling was driven by the sheer magnitude of the crisis in Iceland.¹²⁰ With the European Parliament's failure to explicitly address the question in its 2009 Directive, similar issues will likely be brought to the court in the future.¹²¹

CONCLUSION

In *EFTA Surveillance Authority v. Iceland*, the EFTA Court found that, under the 1994 Directive, Iceland had no obligation to compensate foreign Icesave depositors following its banking crisis. The court focused on the text of the 1994 Directive but also prudently incorporated the policy goals of the 1994 Directive into its analysis. The court's decision was, at its core, driven by concerns of consumer protection and moral hazard. Although the impact of its decision on international banking going forward is unclear, the EFTA Court made the right decision regarding Icesave.

¹¹⁸ Gunnarsson, *supra* note 93, at 33, 34.

¹¹⁹ See *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 39; Gunnarsson, *supra* note 93, at 33.

¹²⁰ See *EFTA Surveillance Auth.*, 2013 Rep. EFTA Ct., at 42–44 (finding that the 1994 Directive did not require full-deposit guarantees specifically in the context of a systemic banking crisis like the one experienced by Iceland in 2008 to 2009).

¹²¹ See *id.*; Gunnarsson, *supra* note 93, at 33.