

## BASE PROSPECTUS



KAUPTHING BANK

# KAUPTHING BANK HF.

*(incorporated in Iceland as a public limited company)*

**€12,000,000,000**

*(increased from €8,000,000,000)*

## Euro Medium Term Note Programme

Under this €12,000,000,000 Euro Medium Term Note Programme (the “**Programme**”), Kaupthing Bank hf. (the “**Issuer**”) may from time to time issue notes (the “**Notes**”) denominated in any currency agreed between the Issuer and the relevant Dealer (as defined below). Prior to the date of this Base Prospectus the maximum nominal amount of the Programme was €8,000,000,000.

The maximum aggregate nominal amount of all Notes from time to time outstanding under the Programme will not exceed €12,000,000,000 (or its equivalent in other currencies calculated as described in the Programme Agreement described herein), subject to increase as described herein.

The Notes may be issued on a continuing basis to one or more of the Dealers specified under “**Summary of the Programme**” and any additional Dealer appointed under the Programme from time to time by the Issuer (each a “**Dealer**” and together the “**Dealers**”), which appointment may be for a specific issue or on an ongoing basis. References in this Base Prospectus to the “**relevant Dealer**” shall, in the case of an issue of Notes being (or intended to be) subscribed by more than one Dealer, be to all Dealers agreeing to purchase such Notes.

**An investment in Notes issued under the Programme involves certain risks.** For a discussion of these see “**Risk Factors**”.

Application for approval will be made to the *Commission de Surveillance du Secteur Financier* (the “**CSSF**”) in its capacity as competent authority under the *loi relative aux prospectus pour valeurs mobilières* (the **Luxembourg Act relating to prospectuses for securities**) to approve this document as a Base Prospectus and application will be made to the Luxembourg Stock Exchange for Notes issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market.

Notice of the aggregate nominal amount of Notes, interest (if any) payable in respect of Notes, the issue price of Notes and any other terms and conditions not contained herein which are applicable to each Tranche (as defined under “**Terms and Conditions of the Notes**”) of Notes will be set out in the final terms (the “**Final Terms**”).

The Programme provides that Notes may be listed or admitted to trading, as the case may be on such other or further stock exchanges or markets as may be agreed between the Issuer and the relevant Dealer. The Issuer may also issue unlisted Notes and/or Notes not admitted to trading on any market.

The Issuer may agree with any Dealer that Notes may be issued in a form not contemplated by the Terms and Conditions of the Notes herein, in which event a Supplementary Base Prospectus under the Programme, if appropriate, will be made available which will describe the effect of the agreement reached.

### Arranger

**Credit Suisse First Boston**

### Dealers

**Barclays Capital  
Daiwa Securities SMBC Europe  
Dresdner Kleinwort Wasserstein  
Kaupthing Bank**

**Credit Suisse First Boston  
Deutsche Bank  
IXIS Corporate & Investment Bank  
SEB Merchant Banking**

This Base Prospectus comprises a base prospectus for the purposes of the Luxembourg Act relating to prospectuses for securities.

The Issuer having taken all reasonable care to ensure that such is the case made all reasonable enquiries, confirms that the information contained in this Base Prospectus is to the best of the knowledge of the Issuer in accordance with the facts and contains no omission likely to affect its import. The Issuer accepts responsibility accordingly.

The Dealers have not independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Dealers as to the accuracy or completeness of the information contained or incorporated in this Base Prospectus or any other information provided by the Issuer in connection with the Programme. No Dealer accepts any liability in relation to the information contained or incorporated by reference in this Base Prospectus or any other information provided by the Issuer in connection with the Programme.

No person is or has been authorised by the Issuer to give any information or to make any representation not contained in or not consistent with this Base Prospectus or any other information supplied in connection with the Programme or the Notes and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer or any of the Dealers. This Base Prospectus may only be used for the purposes for which it has been published.

Neither this Base Prospectus nor any other information supplied in connection with the Programme or any Notes (i) is intended to provide the basis of any credit or other evaluation or (ii) should be considered as a recommendation by the Issuer or any of the Dealers that any recipient of this Base Prospectus or any other information supplied in connection with the Programme or any Notes should purchase any Notes. Each investor contemplating purchasing any Notes should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. Neither this Base Prospectus nor any other information supplied in connection with the Programme or the issue of any Notes constitutes an offer or invitation by or on behalf of the Issuer or any of the Dealers to any person to subscribe for or to purchase any Notes.

Neither the delivery of this Base Prospectus nor the offering, sale or delivery of any Notes shall in any circumstances imply that the information contained herein concerning the Issuer is correct at any time subsequent to the date hereof or that any other information supplied in connection with the Programme is correct as of any time subsequent to the date indicated in the document containing the same. The Dealers expressly do not undertake to review the financial condition or affairs of the Issuer during the life of the Programme or to advise any investor in the Notes of any information coming to their attention. Investors should review, *inter alia*, the most recently published documents incorporated by reference into this Base Prospectus when deciding whether or not to purchase any Notes.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended, (the “*Securities Act*”) and are subject to U.S. tax law requirements. Subject to certain exceptions, the Notes may not be offered, sold or delivered within the United States or to U.S. persons (see “*Subscription and Sale*” below).

This Base Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any Notes in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Base Prospectus and the offer or sale of Notes may be restricted by law in certain jurisdictions. The Issuer and the Dealers do not represent that this Base Prospectus may be lawfully distributed, or that any Notes may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no

action has been taken by the Issuer or the Dealers which would permit a public offering of any Notes outside Luxembourg or distribution of this document in any jurisdiction where action for that purpose is required. Accordingly, no Notes may be offered or sold, directly or indirectly, and neither this Base Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Base Prospectus or any Notes may come must inform themselves about, and observe, any such restrictions on the distribution of this Base Prospectus and the offering and sale of Notes. In particular, there are restrictions on the distribution of this Base Prospectus and the offer or sale of Notes in the United States, the European Economic Area (including the United Kingdom, Italy and Iceland and Japan, see “*Subscription and Sale*”).

All references in this document to “*U.S. dollars*”, “*U.S.\$*” and “*\$*” refer to United States dollars, to “*ISK*”, “*krona*” or “*krónur*” refer to the currency of Iceland, to “*Japanese Yen*” and “*Yen*” refer to the currency of Japan, to “*Swiss francs*” refer to the currency of Switzerland, to “*Sterling*” and “*£*” refer to pounds sterling and to “*euro*” and “*€*” refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended.

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**In connection with the issue of any Tranche of Notes, the Dealer or Dealers (if any) named as the Stabilising Manager(s) (or persons acting on behalf of any Stabilising Manager(s)) in the applicable Final Terms may over-allot Notes (provided that, in the case of any Tranche of Notes to be admitted to the official list and to trading on a regulated market in the EEA, the aggregate principal amount of Notes allotted does not exceed 105 per cent. of the aggregate principal amount of the relevant Tranche) or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager(s) (or persons acting on behalf of a Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the final terms of the offer of the relevant Tranche of Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the relevant Tranche of Notes and 60 days after the date of the allotment of the relevant Tranche of Notes.**

## SUMMARY OF THE PROGRAMME

*This summary must be read as an introduction to this Base Prospectus and any decision to invest in any Notes should be based on a consideration of this Base Prospectus as a whole, including the documents incorporated by reference. Following the implementation of the relevant provisions of the Prospectus Directive in each Member State of the European Economic Area no civil liability will attach to the Issuer in any such Member State in respect of this Summary, including any translation hereof, unless it is misleading, inaccurate or inconsistent when read together with the other parts of this Base Prospectus. Where a claim relating to information contained in this Base Prospectus is brought before a court in a Member State of the European Economic Area, the plaintiff may, under the national legislation of the EEA State where the claim is brought, be required to bear the costs of translating the Base Prospectus before the legal proceedings are initiated. Words and expressions defined in "Form of the Notes" and "Terms and Conditions of the Notes" below shall have the same meanings in this summary.*

**Issuer:** Kaupthing Bank hf. The Issuer, is a Nordic bank offering comprehensive retail and investment banking services to individuals, companies and institutional investors. It is the largest bank in Iceland and a leading player in all key areas of the Icelandic financial market. It has the highest market capitalisation on the Iceland Stock Exchange. The activities of the Issuer and its subsidiaries (together, the "**Group**") in Iceland are divided into retail banking and investment banking but internationally its focus is on investment banking. The Issuer is one of the ten largest banks in the Nordic countries.

The Issuer has six core business areas: Retail Banking; Corporate Banking; Asset Management and Private Banking; Corporate Finance; Capital Markets and Treasury. It also has ancillary divisions such as Risk Management, IT, Finance, and Sales and Marketing.

At the end of 2004, the Issuer had operations in ten countries, including all of the Nordic countries and two of the world's main business centres, London and New York. At 31st December, 2004, the Group's total assets were ISK 1,534 billion and its net earnings for the year then ended were ISK 15.8 billion. At 31st December, 2004, the number of the Group's full time equivalent staff was 1,606.

**Risk Factors:** There are certain factors that may affect the Issuer's ability to fulfil its obligations under the Notes issued under the Programme. These are set out under "*Risk Factors*" below and include the Issuer's exposure to adverse changes in the nordic economy and the risk of increased competition. In addition, there are certain factors which are material for the purpose of assessing the market risks associated with Notes issued under the Programme. These are set out under "*Risk Factors*" below and include the fact that the Notes may not be a suitable investment for all investors and the risks related to the structure of a particular issue of Notes.

**Description:** Euro Medium Term Note Programme

**Arranger:** Credit Suisse First Boston (Europe) Limited

**Dealers:** Barclays Bank PLC  
Credit Suisse First Boston (Europe) Limited  
Daiwa Securities SMBC Europe Limited  
Deutsche Bank AG, London Branch

Dresdner Bank Aktiengesellschaft  
IXIS Corporate & Investment Bank  
Kaupthing Bank hf.  
Skandinaviska Enskilda Banken AB (publ)

and any other Dealers appointed in accordance with the Programme Agreement.

Certain Restrictions:

Each issue of Notes denominated in a currency in respect of which particular laws, guidelines, regulations, restrictions or reporting requirements apply will only be issued in circumstances which comply with such laws, guidelines, regulations, restrictions or reporting requirements from time to time (see “*Subscription and Sale*”) including the following restrictions applicable at the date of this Base Prospectus.

**Notes having a maturity of less than one year**

Notes having a maturity of less than one year will, if the proceeds of the issue are accepted in the United Kingdom, constitute deposits for the purposes of the prohibition on accepting deposits contained in section 19 of the Financial Services and Markets Act 2000 unless they are issued to a limited class of professional investors and have a denomination of at least £100,000 or its equivalent, see “Subscription and Sale”.

According to the Luxembourg Act relating to prospectuses for securities, the CSSF is not competent to approve prospectuses for the listing of money market instruments having a maturity at issue of less than 12 months and complying also with the definition of securities in that Act.

Issuing and Principal  
Paying Agent:

Deutsche Bank AG, London Branch

Programme Size:

Up to €12,000,000,000 (or its equivalent in other currencies calculated as described under “*General Description of the Programme*”) outstanding at any time. The Issuer may increase the amount of the Programme in accordance with the terms of the Programme Agreement.

Distribution:

Notes may be distributed by way of private or public placement and in each case on a syndicated or non-syndicated basis.

Currencies:

Subject to any applicable legal or regulatory restrictions, any currency agreed between the Issuer and the relevant Dealer.

Redenomination:

The applicable Final Terms may provide that certain Notes may be redenominated in euro. The relevant provisions applicable to any such redenomination are contained in Condition 4.

Maturities:

The Notes will have such maturities (or no maturity) as may be agreed between the Issuer and the relevant Dealer, subject to such minimum or maximum maturities as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the Issuer or the relevant Specified Currency.

Issue Price:	Notes may be issued on a fully-paid or a partly-paid basis and at an issue price which is at par or at a discount to, or premium over, par.
Form of Notes:	The Notes will be issued in bearer form as described in “ <i>Form of the Notes</i> ”.
Fixed Rate Notes:	Fixed interest will be payable on such date or dates as may be agreed between the Issuer and the relevant Dealer and on redemption and will be calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer.
Floating Rate Notes:	<p>Floating Rate Notes will bear interest at a rate determined:</p> <ul style="list-style-type: none"> <li>(i) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the 2000 ISDA Definitions (as published by the International Swaps and Derivatives Association, Inc., and as amended and updated as at the Issue Date of the first Tranche of the Notes of the relevant Series); or</li> <li>(ii) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or</li> <li>(iii) on such other basis as may be agreed between the Issuer and the relevant Dealer.</li> </ul> <p>The margin (if any) relating to such floating rate will be agreed between the Issuer and the relevant Dealer for each Series of Floating Rate Notes.</p>
Index Linked Notes:	Payments of principal in respect of Index Linked Redemption Notes or of interest in respect of Index Linked Interest Notes will be calculated by reference to such index and/or formula or to changes in the prices of securities or commodities or to such other factors as the Issuer and the relevant Dealer may agree.
Other provisions in relation to Floating Rate Notes and Index Linked Interest Notes:	<p>Floating Rate Notes and Index Linked Interest Notes may also have a maximum interest rate, a minimum interest rate or both.</p> <p>Interest on Floating Rate Notes and Index Linked Interest Notes in respect of each Interest Period, as agreed prior to issue by the Issuer and the relevant Dealer, will be payable on such Interest Payment Dates, and will be calculated on the basis of such Day Count Fraction, as may be agreed between the Issuer and the relevant Dealer.</p>
Dual Currency Notes:	Payments (whether in respect of principal or interest and whether at maturity or otherwise) in respect of Dual Currency Notes will be made in such currencies, and based on such rates of exchange, as the Issuer and the relevant Dealer may agree.
Zero Coupon Notes:	Zero Coupon Notes will be offered and sold at a discount to their nominal amount and will not bear interest.
Target Redemption Notes:	Target Redemption Notes may bear interest at a variable rate or at a rate that converts from a fixed rate to a variable rate. The cumulative interest earned on a Target Redemption Note cannot



exceed a pre-determined amount. If and when that pre-determined amount is reached, the Target Redemption Note is redeemed.

Range Accrual Notes: Range Accrual Notes generally bear interest at a variable rate reflecting the amount of time during a specified period in which a specified reference rate falls within a defined range.

Redemption: The applicable Final Terms will indicate either that the relevant Notes cannot be redeemed prior to their stated maturity (if any) (other than in specified instalments, if applicable, or for taxation reasons or following an Event of Default) or that such Notes will be redeemable at the option of the Issuer and/or the Noteholders upon giving notice to the Noteholders or the Issuer, as the case may be, on a date or dates specified prior to such stated maturity (if any) and at a price or prices and on such other terms as may be agreed between the Issuer and the relevant Dealer.

The applicable Final Terms may provide that Notes may be redeemable in two or more instalments of such amounts and on such dates as are indicated in the applicable Final Terms.

Notes having a maturity of less than one year may be subject to restrictions on their denomination and distribution, see "*Certain Restrictions – Notes having a maturity of less than one year*" above.

In addition, in the case of Capital Notes only, upon the occurrence of a Special Event (as described in Condition 7), the Issuer may, at its option, having given not less than 30 days' nor more than 60 days' notice to the holders of the Capital Notes in accordance with Condition 14 (which notice shall be irrevocable), redeem all (but not some only) of the Capital Notes on the date(s) specified in the applicable Final Terms at an amount equal to the Special Event Redemption Amount (as specified in the applicable Final Terms).

Any redemption of Capital Notes is subject to the prior approval of the Financial Supervisory Authority of Iceland (*Fjármálaeftirlitið*) (the "FSA") (provided that such approval is at such time required to be given in accordance with applicable rules, regulations and policies of the FSA).

Denomination of Notes: Notes will be issued in such denominations as may be agreed between the Issuer and the relevant Dealer save that the minimum denomination of each Note will be such amount as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the relevant Specified Currency, see "*Certain Restrictions – Notes having a maturity of less than one year*" above, and save that the minimum denomination of each Note admitted to trading on a regulated market within the European Economic Area or offered to the public in a Member State of the European Economic Area in circumstances which require the publication of a prospectus under the Prospectus Directive will be €1,000 (or if the Notes are denominated in a currency other than euro, the equivalent amount in such currency).

Taxation: All payments in respect of the Notes will be made without deduction for or on account of withholding taxes imposed by any Tax



	Jurisdiction, subject as provided in Condition 8. In the event that any such deduction is made, the Issuer will, save in certain limited circumstances provided in Condition 8, be required to pay additional amounts to cover the amounts so deducted.
Negative Pledge:	The terms of the Notes will contain a negative pledge provision as further described in Condition 3.
Cross Default:	The terms of the Notes will contain a cross default provision as further described in Condition 10.
Status of the Senior Notes:	The Senior Notes will constitute direct, unconditional, unsubordinated and, subject to the provisions of Condition 3, unsecured obligations of the Issuer and will rank <i>pari passu</i> among themselves and (save for certain obligations required to be preferred by law) equally with all other unsecured obligations (other than subordinated obligations, if any) of the Issuer, from time to time outstanding.
Subordination:	Payments in respect of the Capital Notes and the Subordinated Notes will be subordinated as described in Conditions 2(b) and 2(c).
Rating:	The rating of Notes to be issued under the Programme will be specified in the applicable Final Terms.
Listing:	<p>Application for approval will be made to the CSSF to approve this document as a Base Prospectus and application will be made to the Luxembourg Stock Exchange for Notes issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market.</p> <p>Notes may be listed or admitted to trading, as the case may be, on other or further stock exchanges or markets agreed between the Issuer and the relevant Dealer in relation to the Series. Notes which are neither listed nor admitted to trading on any market may also be issued.</p> <p>The applicable Final Terms will state whether or not the relevant Notes are to be listed and/or admitted to trading and, if so, on which stock exchanges and/or markets.</p>
Governing Law:	The Notes will be governed by, and construed in accordance with, English law, except the provisions of Conditions 2(b), 2(c), 2(d), 2(e), 5(h) and 7(l) which will be governed by Icelandic law.
Selling Restrictions:	There are restrictions on the offer, sale and transfer of the Notes in the United States, the European Economic Area (including the United Kingdom, Italy and Iceland) and Japan and such other restrictions as may be required in connection with the offering and sale of a particular Tranche of Notes, see " <i>Subscription and Sale</i> ".

## RISK FACTORS

*The Issuer believes that the following factors may affect its ability to fulfil its obligations under Notes issued under the Programme. Most of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.*

*In addition, factors which are material for the purpose of assessing the market risks associated with Notes issued under the Programme are also described below.*

*The Issuer believes that the factors described below represent the principal risks inherent in investing in Notes issued under the Programme, but the inability of the Issuer to pay interest, principal or other amounts on or in connection with any Notes may occur for other reasons which may not be considered significant risks by the Issuer based on information currently available to it or which it may not currently be able to anticipate. Prospective investors should also read the detailed information set out elsewhere in this Base Prospectus and reach their own views prior to making any investment decision.*

### **Factors that may affect the Issuer's ability to fulfil its obligations under Notes issued under the Programme**

The risks and uncertainties described below are some of those that may materially affect Kaupthing Bank and should be considered carefully. These risks and uncertainties could have a material adverse effect on the business, income, profits, assets, credit and liquidity of Kaupthing Bank. The events described may lead to declined credit worthiness and limit the capabilities of Kaupthing Bank to meet its legal obligation and could lead to Kaupthing Bank's bankruptcy.

The Risks discussed are not limited to the parent company of the group but could also have an impact on the group through a subsidiary. The term *Kaupthing Bank* in the following statements may therefore also include current or future subsidiaries and possibly other business partnerships.

This document contains forward looking statements that involve inherent risks and uncertainties. Actual results may differ significantly from the results discussed in such forward-looking statements. Factors that might cause such differences include those discussed below.

### **Kaupthing Bank may be unable to achieve its strategy of becoming a leading Nordic investment bank**

Kaupthing Bank's primary strategic goal is to become a leading Nordic investment bank. Kaupthing Bank has completed several acquisitions since 2000 in its efforts to increase its presence throughout the Nordic region, most significantly through the acquisition of JP Nordiska AB in Sweden in 2002, the merger with Búnadarbanki in Iceland in 2003 and the acquisition of FI-Holding in Denmark during 2004. In late April 2005 Kaupthing Bank announced an offer to acquire British bank Singer & Friedlander Group plc through a wholly owned subsidiary. The board of directors of Singer & Friedlander has recommended that its shareholders accept the offer, which became unconditional as to acceptances on 14th June 2005. These past acquisitions and the one awaiting confirmation have, and potentially will, increase the breadth and size of Kaupthing Bank's operations both in and outside Iceland but they may also increase risk as discussed below.

Kaupthing Bank continues to evaluate potential acquisition and investment opportunities with a view to expanding its international banking operations and plans to use its existing client base and banking operations to expand its business through cross-selling of its products, especially in the areas of investment banking and acquisition and leveraged finance. These efforts will require significant financial resources and attention of the board of directors and senior management, which could place a strain on management resources and adversely impact the management of Kaupthing Bank's current operations. Further, no assurance can be given that Kaupthing Bank will be successful in identifying and acquiring appropriate businesses in the key markets in which

Kaupthing Bank operates, or that other businesses in the future will achieve the return on investments made by Kaupthing Bank in prior periods.

Kaupthing Bank has historically financed the majority of its acquisitions through the issuance of shares as well as additional subordinated bonds. There can be no assurance that Kaupthing Bank will be able to obtain such financing on favourable terms in the future, or at all. Kaupthing Bank's failure to successfully realise its strategy could have a material adverse effect on its financial condition or results of operations in future periods.

#### **Kaupthing Bank may fail to manage its growth properly**

Since 2000, Kaupthing Bank has acquired nine banking enterprises, primarily in the Nordic region, and currently has an acquisition offer pending approval of shareholders. Kaupthing Bank intends to continue to grow its business through further expansion in the Nordic region as well as through further penetration of the banking markets in which it currently operates. Expansion of Kaupthing Bank's operations will require significant investment, increased operating costs, greater allocation of management resources away from daily operations, continued development and integration of Kaupthing Bank's financial and information management control systems across multiple banking platforms, continued training of management and other personnel, adequate employee supervision and delivery of consistent client product and service messages. The failure of Kaupthing Bank to effectively manage these issues as well as Kaupthing Bank's growth, whilst at the same time maintaining adequate focus on its current operations could have a material adverse effect on its business, financial condition and results of operations, eventually leading to decreased creditworthiness and even bankruptcy.

#### **Kaupthing Bank's loan portfolio may not continue to grow at the historical rate**

In 2002, Kaupthing Bank's loan portfolio (excluding interbank loans and off-balance sheet credit related commitments) grew by 32 per cent. to ISK 269,333 million and, in 2003, by 30 per cent. to ISK 350,995 million (pro forma Kaupthing Bank and Búnadarbanki figures for years ended 31st December, 2001 and 2002). Part of the growth in 2003 was attributable to the consolidation of the loan portfolio of Bankaktiebolag JP Nordiska, following its acquisition. In 2004 the loan portfolio grew by 210 per cent. to ISK 1,088,346 million which was mainly due to the acquisition of all issued shares in FI-Holding ("FIH"), the holding company of the Danish bank FIH Erhvervsbank A/S. It is unlikely that, absent other acquisitions in the future, Kaupthing Bank will be able to achieve similar rates of loan portfolio growth. Furthermore, there are a limited number of high credit quality corporate customers to whom banking services may be provided in Kaupthing Bank's target markets. There can be no assurance that Kaupthing Bank's strategy to continue to expand its banking network throughout the Nordic region and the UK and to target these corporate customers will succeed. If Kaupthing Bank is unable to expand further its loan portfolio in general and its corporate customer base in particular, it may not generate sufficient interest income to offset any decline in net interest margins, which could adversely affect Kaupthing Bank's growth objectives and business.

#### **Kaupthing Bank's loan portfolio is concentrated to certain industries**

Kaupthing Bank's loan portfolio is exposed to relatively high industry concentration. As of 31st December, 2004, loans to customers in the industry, service and real estate sectors comprised 29 per cent., 27 per cent. and 15 per cent., respectively, of Kaupthing Bank's loan portfolio (excluding loans to banks and off-balance sheet credit related commitments). Furthermore, as of that date, Kaupthing Bank's 10 largest borrowers represented 21 per cent. of Kaupthing Bank's loan portfolio (excluding loans to banks and off-balance sheet credit related commitments), and loans to its single largest borrower represented 3 per cent. of Kaupthing Bank's loan portfolio (excluding loans to banks and off-balance sheet credit related commitments). Following the acquisition of FI-Holding, Kaupthing Bank's exposure to the service sector declined significantly, while its concentration in the manufacturing, real estate, food and beverages and bank and finance sectors

increased. Kaupthing Bank's total exposure to non-ISK denominated loans comprised approximately 82 per cent. of its loan portfolio (excluding loans to banks and off-balance sheet credit related commitments). Although more diversified, Kaupthing Bank's financial condition will continue to be sensitive to downturns in certain industries and the consequent inability of clients to meet their obligations to Kaupthing Bank. Declines in the financial condition of Kaupthing Bank's largest borrowers and adverse currency movements relative to the Icelandic krona would also adversely impact Kaupthing Bank financially.

After the merger with Búnadarbanki, Kaupthing Bank had to write off approximately ISK 1.4 billion in non-performing loans in 2003 and approximately ISK 5.6 billion in 2004, and also increased its provisions for loans to customers in certain sectors, particularly in the fishing, building and food industries. Kaupthing Bank believes that it has made adequate provision for any remaining non-performing loans in its portfolio but there can be no assurance that this belief is correct. In addition, there can be no assurance that further unanticipated provisions for non-performing loans through loan losses or write offs will not be required in the future, particularly with respect to banking operations that Kaupthing Bank may acquire in the future.

**Kaupthing Bank may be unable to adequately assess the credit risk of potential borrowers and may provide advances to certain customers that increase credit risk exposure**

Kaupthing Bank is exposed to the risk that third parties who owe Kaupthing Bank money, securities or other assets will not meet, or be unable to meet, such obligations. The availability of accurate and comprehensive financial information and general credit information on which to base credit decisions is more limited for small and medium sized enterprises ("SMEs") than is the case for large corporate clients, and is even more limited for individuals. Furthermore, SMEs usually have less capital and business experience than large businesses and are hence more likely to default on their loans. Therefore, in spite of any credit risk determination procedures which Kaupthing Bank has in place, it may be unable to evaluate correctly the current financial condition of each prospective borrower and, in the case of SMEs, to determine their long-term financial viability. The failure of any member of Kaupthing Bank to accurately assess the credit risk of prospective borrowers could have a material adverse effect on the financial condition, results of operations and prospects of Kaupthing Bank.

**A decline in the value or illiquidity of the collateral securing Kaupthing Bank's loans may adversely affect its loan portfolios**

A substantial portion of Kaupthing Bank's loans to corporates and individuals is secured by collateral such as real estate, ships, fishing quotas, securities, receivables, raw materials and inventories. Downturns in the relevant markets or a general deterioration of economic conditions in the industries in which these borrowers operate, or in Iceland, Sweden or Denmark generally, or other markets in which the collateral is located, may result in a decline in the value of collateral securing loans to levels below the outstanding principal balance on those loans. A decline in the value of collateral securing these loans or the inability to obtain additional collateral may, in some cases, require Kaupthing Bank to reclassify the relevant loans, establish additional provisions for loan losses and increase reserve requirements. In addition, a failure to recover the expected value of collateral in the case of foreclosure may expose Kaupthing Bank to losses which may adversely affect its financial condition and results of operations.

**Reporting in accordance with international financial reporting standards (IFRS) and new regulatory requirements may adversely affect Kaupthing Bank's results of operations and financial condition**

Kaupthing Bank, as all Icelandic companies listed on the ICEX, has had to comply with IFRS from 1st January, 2005 onward instead of the Icelandic GAAP, according to which prior financial statements were made. Although first financial statements adopting the new financial standards do

not indicate a material change in financial results the change from Icelandic GAAP to IFRS may have a negative impact in the future on Kaupthing Bank's financial results.

In addition, the risk-adjusted capital guidelines promulgated by the Basel Committee on Banking Supervision, which include guidelines for capital adequacy and implementation, are expected to become effective in 2006 or 2007. At this time, Kaupthing Bank is unable to quantify how the revised guidelines will affect its requirements for capital and the impact these revisions will have on its capital position. However, it is possible that the deployment and use of capital in Kaupthing Bank may have to be altered to ensure that the revised capital adequacy requirements are satisfied. Such actions may adversely affect Kaupthing Bank's profitability in the future.

### **Kaupthing Bank's financial position and results of operations are affected by declines in interest rates**

In recent years, Kaupthing Bank's results of operations have depended to a great extent on earnings attributable to net interest income. Net interest income represented approximately 39 per cent. of Kaupthing Bank's net operating income in 2004, approximately 32 per cent. in 2003, approximately 33 per cent. in 2002 and approximately 42 per cent. in 2001 (the figures for 2002 and 2001 are the sum of the figures for Kaupthing Bank and Búnadabanki).

In Iceland, loans for housing, which are generally the most securely collateralised loans, are financed by the government to a large degree, yet the banks are taking an increasing portion of the financing through new loan possibilities introduced in 2004. Kaupthing Bank's net interest margin has been higher than that for banks operating in many other western European countries. Nonetheless, the net interest margin is beginning to decline as the result of, among other factors, increased competition, rapid growth of loans granted to entities outside Iceland and, as a consequence, reduced weight of loans in Iceland and loans to individuals in particular. While Kaupthing Bank expects that any growth in lending that it is able to achieve, will continue to generate interest income and thus help to offset any decline in its interest margins, the pace of loan portfolio growth may be constrained by, among other factors, Kaupthing Bank's ability to increase lending volumes to customers that meet its credit quality standards. A significant fall in Kaupthing Bank's average interest rates charged on loans to customers that is not fully matched by a decrease in interest rates on its funding sources would have an adverse effect on Kaupthing Bank's results of operations.

### **Kaupthing Bank faces increasing competition in the markets in which it operates**

Kaupthing Bank faces challenges from domestic and international competitors in the various markets in which it operates. Some competitors, including well-established domestic banks in each of the markets in which Kaupthing Bank operates, as well as international banks with operations in most of these markets, may have better banking relationships with the corporate clients that comprise Kaupthing Bank's target customer bases and may have greater resources and better local market knowledge than the members of Kaupthing Bank. These and other factors related to competition could have a material adverse effect on the ability of Kaupthing Bank to compete effectively in these markets, and may adversely affect the business, financial condition, results of operations and strategic prospects of Kaupthing Bank.

In addition, Kaupthing Bank faces increased pressure to meet rising customer demands to provide new banking products that are developing rapidly in the Nordic region. There is no guarantee that Kaupthing Bank's management and employees will succeed in adopting new work methods and approaches to customer service that will keep up with the pace of change in the current banking environment, which may adversely affect Kaupthing Bank's ability to successfully compete in its primary markets.

Further, the number of banking transactions conducted over the internet in the markets in which Kaupthing Bank operates has grown in recent years and is expected to grow further. Kaupthing Bank may be unable to compete with other banks that offer more extensive online services to their



customers than Kaupthing Bank currently offers to its customers. There can be no assurance that some of Kaupthing Bank's clients will not choose to transfer some or all of their business to competitors, which may adversely affect the business, financial condition and results of operations of Kaupthing Bank.

**Adverse price fluctuations of the securities in Kaupthing Bank's proprietary trading portfolio could have a materially adverse impact on Kaupthing Bank's results of operations and financial condition**

Kaupthing Bank has a substantial investment portfolio that includes equity and debt securities of some of the largest issuers of securities in Iceland and the Nordic region. As of 31st December, 2004 Kaupthing Bank's equity and debt investment portfolios totaled ISK 78,686 million and ISK 169,666 million, respectively, and accounted for 5.1 per cent. and 11.1 per cent., respectively, of Kaupthing Bank's total assets. A fall in the price of Kaupthing Bank's Icelandic or other securities could substantially reduce the value of its securities portfolio, and the amount of its other operating income attributable to trading gains.

In addition, Kaupthing Bank maintains large positions in individual issues of securities or total claims on one individual counterparty or group of financially connected counterparties, which have sometimes led to considerable losses, and there can be no assurance that future losses from these holdings will not occur. Further, Kaupthing Bank can be restricted from selling large blocks of these securities on the same day at market price. Thus, the insolvency of an issuer of these securities or any rapid decline in the value of these securities would have an adverse material effect on Kaupthing Bank's financial condition and results of operations.

**Kaupthing Bank's income from investment banking activities is subject to fluctuation**

For the year ended 31st December, 2004, Kaupthing Bank derived approximately 29 per cent. of its net operating income from its investment banking activities. Kaupthing Bank's income from its investment banking activities is in part related to the number and size of the capital market and corporate advisory transactions in which it participates and on underlying market conditions. Fees generated by these transactions are typically not annuity based, and are subject to volatility. Accordingly, income from Kaupthing Bank's investment banking business tends to be variable, and any reduction in the number and/or size of such transactions will affect Kaupthing Bank's results of operations. In addition, Kaupthing Bank's investment banking unit invests in unlisted companies with a view towards exiting these investments in a limited time from acquisition. Kaupthing Bank could also be adversely affected by a decline in the value of this private equity portfolio, which is subject to factors affecting the industries in which the companies in the portfolio operate, such as the retail clothing industry, and general market fluctuations.

**Kaupthing Bank's trading and investment activities within its Treasury are inherently exposed to significant risk**

Kaupthing Bank's Treasury unit maintains trading and investment positions in various financial and other assets, including currency and related derivative instruments as both agent and principal. These positions are exposed to a number of risks related to the movement of market prices in the underlying instruments. This includes the risk of unfavourable market price movement relative to Kaupthing Bank's long or short positions, a decline in the market liquidity of related instruments, volatility in market prices or foreign currency exchange rates relating to these positions, and the risk that instruments chosen to hedge certain positions do not track the market value of those positions.

**Liquidity risk may impair Kaupthing Bank's ability to fund its operations and adversely affect its financial condition**

Ready access to funds is essential to any banking business, including those operated by Kaupthing Bank. Kaupthing Bank relies almost entirely on continuous access to financial markets for long and short-term financing. An inability on the part of Kaupthing Bank to access funds or to access the markets from which funds are raised may put positions in liquid assets at risk and lead to Kaupthing Bank being unable to finance its operations adequately. This could also lead to creditors forming a negative view of Kaupthing Bank's liquidity which could result in less favourable credit ratings and less accessible funds. As Kaupthing Bank also receives a portion of its funding from retail deposits, it is also subject to the risk that depositors could withdraw their funds at a rate faster than the rate at which borrowers repay their loans, thus causing liquidity strains.

In addition, the ability of Kaupthing Bank to raise or access funds may be impaired by factors that are not specific to its operations, such as general market conditions, a severe disruption of the financial markets or negative views about the prospects of the industries to which Kaupthing Bank provides a large proportion of its loans. Strains on the liquidity of Kaupthing Bank caused by any of these factors or otherwise may adversely affect its financial performance and competitive position.

**A mismatch of Kaupthing Bank's positions in foreign currency could adversely affect its financial condition**

Kaupthing Bank's reporting currency is Icelandic krona. As of 31st December, 2004, approximately 82 per cent. of Kaupthing Bank's loan portfolio was comprised of non-ISK-denominated loans. In addition, Kaupthing Bank trades currency on behalf of its clients and for its own account and maintains open currency positions in currencies other than Icelandic krona. Although Kaupthing Bank has taken steps to hedge its foreign currency exposure, adheres to regulatory limits and has further established stricter limits aimed at reducing currency risk, there can be no assurance that future mismatches will not occur or that trading limits will not be breached. As a result, fluctuations in exchange rates could adversely affect Kaupthing Bank's results of operations and financial condition.

**Kaupthing Bank's banking businesses entail operational risks**

Kaupthing Bank is exposed to many types of operational risk, including the risk of fraud by employees or outsiders, operational errors, including clerical or record keeping errors or errors resulting from faulty computer or telecommunications systems, or from external events that may affect the operations and reputation of Kaupthing Bank. Kaupthing Bank's business activities require it to record and process a large number of transactions accurately on a daily basis. The recording and processing of these transactions are potentially exposed to the risk of human and technological errors or a breakdown in internal controls relating to the due authorisation of transactions. A failure or delay in recording or processing transactions, or any other material breakdown in internal controls, could subject Kaupthing Bank to claims for losses and regulatory fines and penalties. Consequently, Kaupthing Bank could suffer reputational or financial harm, which could have a material adverse effect on its financial condition and results of operations. Given Kaupthing Bank's high volume of transactions, errors may be repeated or compounded before they are discovered and rectified, and there can be no assurance that risk assessments made in advance will adequately estimate the costs of these errors.

**Kaupthing Bank's risk management strategies and techniques may leave it exposed to unidentified and unanticipated risks**

Although Kaupthing Bank invests substantial time and effort in its risk management strategies, these strategies may nevertheless fail to protect Kaupthing Bank under certain circumstances, particularly when confronted with risks that have not been identified or anticipated. Kaupthing Bank



seeks to establish policies in the areas exposed to the highest risk, including credit risk, market risk and operational risk, which can all affect its reputation in the markets in which Kaupthing Bank operates. Risk methodologies and techniques that Kaupthing Bank adopts in assessing its risks may be flawed or may not take all risks into account, and it is possible that the methods for assessing risk are not sound or are based on faulty information, or that they will be misunderstood, not implemented correctly or misapplied by Kaupthing Bank's personnel. A failure of Kaupthing Bank's risk management techniques may have a material adverse effect on Kaupthing Bank's reputation in the markets in which it operates and on its results of operations and financial condition.

In addition, Kaupthing Bank's risk management policies are constantly being re-evaluated and it may take time to implement certain procedures and practices or changes thereto throughout Kaupthing Bank. This could result in some members of Kaupthing Bank not being able to adequately assess the risks.

### **Kaupthing Bank may be vulnerable to the failure of its IT systems and breaches of its security systems**

Kaupthing Bank relies on the proper functioning and continuity of its IT systems. Any significant interruption, degradation, failure or lack of capacity of its IT systems or any other systems in its clearing operations or elsewhere could cause it to fail to complete transactions on a timely basis or at all. A sustained failure of Kaupthing Bank's systems centrally or across its subsidiaries or branches would have a significant impact on Kaupthing Bank's operations and the confidence of its customers in the reliability and safety of Kaupthing Bank's banking systems.

The secure transmission of confidential information is a critical element of Kaupthing Bank's operations. It cannot be guaranteed that existing security measures will prevent security breaches, including break-ins, viruses or disruptions. Persons that circumvent the security measures could use Kaupthing Bank's or its clients' confidential information wrongfully, which could expose Kaupthing Bank to a risk of loss, adverse regulatory consequences or litigation.

### **There are regulatory and legal risks inherent to Kaupthing Bank's business**

All of Kaupthing Bank's operations entail considerable regulatory and legal risk. Each member of Kaupthing Bank is subject to government regulation and inquiry as financial companies in the markets in which they operate, and regulations may be extensive and may change rapidly. In addition, many of Kaupthing Bank's operations are contingent upon licenses from financial authorities of the countries in which Kaupthing Bank operates. Violations of rules and regulations, whether intentional or unintentional, may lead to the withdrawal of some of these licenses. Any breach of these or other regulations may adversely affect the reputation or financial condition of Kaupthing Bank. In addition, existing laws and regulations could be amended, the manner in which laws and regulations are enforced or interpreted could change and new laws or regulations could be adopted, which could adversely affect the way Kaupthing Bank operates its business and its market reputation.

Kaupthing Bank is also exposed to legal risks in its role as a financial intermediary and a consultant in third party businesses. These risks include potential liability for Kaupthing Bank's role in determining the price of a company, for advice it provides to participants in corporate transactions and in disputes over the terms and conditions of complex trading arrangements. Kaupthing Bank also faces the possibility that counterparties in complex or highly risk-exposed trading transactions will claim that Kaupthing Bank failed to properly inform them of the risks or that they were not authorised or permitted to enter into these transactions with Kaupthing Bank and that their obligations are therefore not enforceable. Kaupthing Bank is also exposed to claims from dissatisfied customers as part of the increased trend of performance-related litigation.

Kaupthing Bank may also be subject to claims arising from disputes with employees for, among other things, alleged wrongful dismissal, discrimination or harassment. These risks may often be

difficult to assess or quantify and their existence and magnitude often remain unknown for substantial periods of time. Liability resulting from any of the foregoing or other claims could have a material adverse effect on the reputation, results of operations and financial condition of Kaupthing Bank, as the case may be.

All the Nordic countries and the United Kingdom are member states of the European Economic. This provides Kaupthing Bank with conditions similar to those of other European banks in its targeted markets. However, it should be noted that interpretation and implementation of rules on securities trading may still differ between the countries. Moreover, the length of history and volume of trading in the different markets vary and, consequently, so does the legal certainty of the framework within which Kaupthing Bank operates. Thus, Kaupthing Bank faces a risk of incurring liability from violations of these regulations, which may adversely affect its financial condition and results of operations.

#### **Kaupthing Bank's businesses are subject to the general economic conditions prevailing in Western Europe and elsewhere**

The profitability of Kaupthing Bank's businesses could be adversely affected by a worsening of general economic conditions in the Nordic region, Western Europe or the USA. These factors could also adversely affect the credit quality of the balance sheet assets of Kaupthing Bank. An economic downturn in the Nordic region or in the United Kingdom could have a negative impact on the results and financial position of Kaupthing Bank by affecting demand for its products and services. Such a downturn could also affect the credit quality of Kaupthing Bank's counterparties by increasing the risk that a greater number of their respective customers would default on their loans or other obligations, or would refrain from seeking additional credit.

#### **Kaupthing Bank is subject to changes in interest rate policies**

Kaupthing Bank's financial operations are to some degree dependent on interest rates and other monetary policies and changes to such policies, for example loans with fixed rates will become less profitable if interest rates rise. The policies of the Economic and Monetary Union of the European Union, Denmark, Sweden, the United Kingdom and Iceland in this regard are particularly relevant for Kaupthing Bank and are subject to change.

#### **Kaupthing Bank may be unable to recruit or retain experienced and qualified personnel**

Kaupthing Bank's continuing success depends, in part, on its ability to continue to attract, retain and motivate qualified and experienced banking and management personnel, particularly those individuals who are experienced in investment banking and acquisition finance. Competition for personnel with relevant expertise is intense, due to the relatively small number of available qualified individuals. Geographical location of employment may also make it less attractive to a large portion of potential applicants. Further, a loss of key employees with institutional and client knowledge can adversely affect Kaupthing Bank's reputation and operations.

#### **Kaupthing Bank's insurance coverage may not adequately cover losses resulting from the risks for which it is insured**

Kaupthing Bank maintains customary insurance policies for its operations, including insurance for its liquid assets, money transport and directors' and officers' liability, as well as insurance against computer crimes and for employee dishonesty and mistakes. Due to the nature of the operations of Kaupthing Bank and the nature of the risks that it faces, there can be no assurance that the coverage that Kaupthing Bank maintains will be adequate to cover the losses for which it believes it is insured.

## **Factors which are material for the purpose of assessing the market risks associated with Notes issued under the Programme**

### ***The Notes may not be a suitable investment for all investors***

Each potential investor in the Notes must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

- (i) have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained or incorporated by reference in this Base Prospectus or any applicable supplement;
- (ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact the Notes will have on its overall investment portfolio;
- (iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including Notes with principal or interest payable in one or more currencies, or where the currency for principal or interest payments is different from the potential investor's currency;
- (iv) understand thoroughly the terms of the Notes and be familiar with the behaviour of any relevant indices and financial markets; and
- (v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Some Notes are complex financial instruments. Sophisticated institutional investors generally do not purchase complex financial instruments as stand-alone investments. They purchase complex financial instruments as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A potential investor should not invest in Notes which are complex financial instruments unless it has the expertise (either alone or with a financial adviser) to evaluate how the Notes will perform under changing conditions, the resulting effects on the value of the Notes and the impact this investment will have on the potential investor's overall investment portfolio.

### ***Risks related to the structure of a particular issue of Notes***

A wide range of Notes may be issued under the Programme. A number of these Notes may have features which contain particular risks for potential investors. Set out below is a description of the most common such features:

#### ***Notes subject to optional redemption by the Issuer***

An optional redemption feature of Notes is likely to limit their market value. During any period when the Issuer may elect to redeem Notes, the market value of those Notes generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period.

The Issuer may be expected to redeem Notes when its cost of borrowing is lower than the interest rate on the Notes. At those times, an investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Notes being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in light of other investments available at that time.

### *Index Linked Notes and Dual Currency Notes*

The Issuer may issue Notes with principal or interest determined by reference to an index or formula, to changes in the prices of securities or commodities, to movements in currency exchange rates or other factors (each, a **Relevant Factor**). In addition, the Issuer may issue Notes with principal or interest payable in one or more currencies which may be different from the currency in which the Notes are denominated. Potential investors should be aware that:

- (i) the market price of such Notes may be volatile;
- (ii) they may receive no interest;
- (iii) payment of principal or interest may occur at a different time or in a different currency than expected;
- (iv) they may lose all or a substantial portion of their principal;
- (v) a Relevant Factor may be subject to significant fluctuations that may not correlate with changes in interest rates, currencies or other indices;
- (vi) if a Relevant Factor is applied to Notes in conjunction with a multiplier greater than one or contains some other leverage factor, the effect of changes in the Relevant Factor on principal or interest payable likely will be magnified; and
- (vii) the timing of changes in a Relevant Factor may affect the actual yield to investors, even if the average level is consistent with their expectations. In general, the earlier the change in the Relevant Factor, the greater the effect on yield.

### *Partly-paid Notes*

The Issuer may issue Notes where the issue price is payable in more than one instalment. Failure to pay any subsequent instalment could result in an investor losing all of his investment.

### *Variable rate Notes with a multiplier or other leverage factor*

Notes with variable interest rates can be volatile investments. If they are structured to include multipliers or other leverage factors, or caps or floors, or any combination of those features or other similar related features, their market values may be even more volatile than those for securities that do not include those features.

### *Inverse Floating Rate Notes*

Inverse Floating Rate Notes have an interest rate equal to a fixed rate minus a rate based upon a reference rate such as LIBOR. The market values of those Notes typically are more volatile than market values of other conventional floating rate debt securities based on the same reference rate (and with otherwise comparable terms). Inverse Floating Rate Notes are more volatile because an increase in the reference rate not only decreases the interest rate of the Notes, but may also reflect an increase in prevailing interest rates, which further adversely affects the market value of these Notes.

### *Target Redemption Notes*

Potential investors should be aware that Target Redemption Notes will have a variable maturity which depends on when and if the pre-determined interest amount is reached. In addition and as a result, the market value of such a Note may be more volatile than the market value of other conventional fixed or variable rate debt securities.

### *Range Accrual Notes*

Potential investors should be aware that, depending on the performance of the reference rate, they may receive no interest or less interest than on other conventional fixed or variable rate debt securities. In addition and as a result, the market value of such Notes may be more volatile than the market value of other conventional fixed or variable rate debt securities.

### *Fixed/Floating Rate Notes*

Fixed/Floating Rate Notes may bear interest at a rate that converts from a fixed rate to a floating rate, or from a floating rate to a fixed rate. Where the Issuer has the right to effect such a conversion, this will affect the secondary market and the market value of the Notes since the Issuer may be expected to convert the rate when it is likely to produce a lower overall cost of borrowing. If the Issuer converts from a fixed rate to a floating rate in such circumstances, the spread on the Fixed/Floating Rate Notes may be less favourable than then prevailing spreads on comparable Floating Rate Notes tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Notes. If the Issuer converts from a floating rate to a fixed rate in such circumstances, the fixed rate may be lower than then prevailing rates on its Notes.

### *Notes issued at a substantial discount or premium*

The market values of securities issued at a substantial discount or premium from their principal amount tend to fluctuate more in relation to general changes in interest rates than do prices for conventional interest-bearing securities. Generally, the longer the remaining term of the securities, the greater the price volatility as compared to conventional interest-bearing securities with comparable maturities.

### *The Issuer's obligations under Subordinated Notes are subordinated*

The Issuer's obligations under Subordinated Notes will be unsecured and subordinated and will rank junior in priority of payment to Senior Liabilities. **Senior Liabilities** means any unconditional, unsubordinated and unsecured obligations of the Issuer. Although Subordinated Notes may pay a higher rate of interest than comparable Notes which are not subordinated, there is a real risk that an investor in Subordinated Notes will lose all or some of his investment should the Issuer become insolvent.

### ***Risks related to Notes generally***

Set out below is a brief description of certain risks relating to the Notes generally:

#### *Modification*

The conditions of the Notes contain provisions for calling meetings of Noteholders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Noteholders including Noteholders who did not attend and vote at the relevant meeting and Noteholders who voted in a manner contrary to the majority.

#### *EU Savings Directive*

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required, from 1st July, 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have

agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date.

If a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of, tax were to be withheld from that payment, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Note as a result of the imposition of such withholding tax. If a withholding tax is imposed on payment made by a Paying Agent, the Issuer will be required to maintain a Paying Agent in a Member State that will not be obliged to withhold or deduct tax pursuant to the Directive.

#### *Change of law*

The conditions of the Notes are based on English law and, in the case of Conditions 2(b), 2(c), 2(d), 2(e), 5(h) and 7(l) Icelandic law, in effect as at the date of this Base Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to English law, Icelandic law or administrative practice after the date of this Base Prospectus.

#### ***Risks related to the market generally***

Set out below is a brief description of the principal market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk:

##### *The secondary market generally*

Notes may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. Therefore, investors may not be able to sell their Notes easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. This is particularly the case for Notes that are especially sensitive to interest rate, currency or market risks, are designed for specific investment objectives or strategies or have been structured to meet the investment requirements of limited categories of investors. These types of Notes generally would have a more limited secondary market and more price volatility than conventional debt securities. Illiquidity may have a severely adverse effect on the market value of Notes.

##### *Exchange rate risks and exchange controls*

The Issuer will pay principal and interest on the Notes in the Specified Currency. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **Investor's Currency**) other than the Specified Currency. These include the risk that exchange rates may significantly change (including changes due to devaluation of the Specified Currency or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the Specified Currency would decrease (1) the Investor's Currency-equivalent yield on the Notes, (2) the Investor's Currency equivalent value of the principal payable on the Notes and (3) the Investor's Currency equivalent market value of the Notes.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

##### *Interest rate risks*

Investment in Fixed Rate Notes involves the risk that subsequent changes in market interest rates may adversely affect the value of the Fixed Rate Notes.



*Credit ratings may not reflect all risks*

One or more independent credit rating agencies may assign credit ratings to the Notes. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

***Legal investment considerations may restrict certain investments***

The investment activities of certain investors may be subject to law or review or regulation by certain authorities. Each potential investor should determine for itself, on the basis of professional advice where appropriate, whether and to what extent (1) Notes are lawful investments for it, (2) Notes can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of any Notes. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of Notes under any applicable risk-based capital or similar rules.



## DOCUMENTS INCORPORATED BY REFERENCE

The following documents which have been previously published or are published simultaneously with this Base Prospectus shall be deemed to be incorporated in, and to form part of, this Base Prospectus:

- (a) the audited non-consolidated annual financial statements and the audited annual consolidated financial statements each for the financial years ended 31st December, 2003 and 31st December, 2004 (including the audit reports issued in respect thereof); and
- (b) the interim non-consolidated financial statements and the interim consolidated financial statements of the Issuer for the three months ended 31st March, 2005 and for the six months ended 30th June, 2005<sup>(1)</sup>.

Copies of documents incorporated by reference in this Base Prospectus can be obtained from the Issuer's Office as set out at the end of this Base Prospectus. In addition, such documents will be available, free of charge, from the principal office in Luxembourg of Banque Générale du Luxembourg S.A. (the "**Luxembourg Listing Agent**") for Notes admitted to the official list of the Luxembourg Stock Exchange and to trading on the Regulated Market of the Luxembourg Stock Exchange. This Base Prospectus will also be published on the Luxembourg Stock Exchange's website ([www.bourse.lu](http://www.bourse.lu)).

The Issuer will, in the event of any significant new factor, material mistake or inaccuracy relating to information included in this Base Prospectus which is capable of affecting the assessment of any Notes, prepare a supplement to this Base Prospectus or publish a new Base Prospectus for use in connection with any subsequent issue of the Notes to be listed on the Luxembourg Stock Exchange.

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(1) For ease of reference, please note that the relevant auditor's report, balance sheet, income statement, statement of cash flows and notes to the financial statements can be found on (a) pages 88, 90, 89, 92 and 93 to 116 respectively of the annual report 2004 for the year ended 31st December, 2004, (b) pages 80, 82, 81, 84 and 85 to 107 respectively of the annual report for the year ended 31st December, 2003, (c) pages 4, 6, 5, 7 and 8 to 29 respectively of the interim financial statements for the three months ended 31st March, 2005 and (d) pages 4, 6, 5, 7 and 8 to 30 for the six months ended 30th June, 2005 of the Issuer.

## GENERAL DESCRIPTION OF THE PROGRAMME

Under the Programme, the Issuer may from time to time issue Notes denominated in any currency, subject as set out herein. A summary of the terms and conditions of the Programme and the Notes appears below, see “*Summary of the Programme*”. The applicable terms of any Notes will be agreed between the Issuer and the relevant Dealer prior to the issue of the Notes and will be set out in the Terms and Conditions of the Notes endorsed on, attached to, or incorporated by reference into, the Notes, as modified and supplemented by the applicable Final Terms attached to, or endorsed on, such Notes, as more fully described under “*Form of the Notes*”.

Application for approval will be made to the CSSF in its capacity as competent authority under the Luxembourg Act relating to prospectuses for securities to approve this document as a Base Prospectus and application will be made to the Luxembourg Stock Exchange for Notes issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market.

## FORM OF THE NOTES

Each Tranche of Notes will be in bearer form and will be initially issued in the form of a temporary global note (a “**Temporary Global Note**”) or, if so specified in the applicable Final Terms, a permanent Global Note (a “**Permanent Global Note**”) which, in either case, will be delivered on or prior to the original issue date of the Tranche to a common depository (the “**Common Depositary**”) for Euroclear Bank S.A./N.V. as operator of the Euroclear System (“**Euroclear**”) and Clearstream Banking, société anonyme (“**Clearstream, Luxembourg**”). Whilst any Note is represented by a Temporary Global Note, payments of principal, interest (if any) and any other amount payable in respect of the Notes due prior to the Exchange Date (as defined below) will be made against presentation of the Temporary Global Note only to the extent that certification (in a form to be provided) to the effect that the beneficial owners of interests in such Note are not U.S. persons or persons who have purchased for resale to any U.S. person, as required by U.S. Treasury regulations, has been received by Euroclear and/or Clearstream, Luxembourg and Euroclear and/or Clearstream, Luxembourg, as applicable, has given a like certification (based on the certifications it has received) to the Agent.

On and after the date (the “**Exchange Date**”) which is 40 days after a Temporary Global Note is issued, interests in such Temporary Global Note will be exchangeable (free of charge) upon a request as described therein either for (i) interests in a Permanent Global Note of the same Series or (ii) for definitive Notes of the same Series with, where applicable, receipts, interest coupons and talons attached (as indicated in the applicable Final Terms and subject, in the case of definitive Notes, to such notice period as is specified in the applicable Final Terms), in each case against certification of beneficial ownership as described above unless such certification has already been given. The holder of a Temporary Global Note will not be entitled to collect any payment of interest, principal or other amount due on or after the Exchange Date unless, upon due certification, exchange of the Temporary Global Note for an interest in a Permanent Global Note or for definitive Notes is improperly withheld or refused.

Payments of principal, interest (if any) or any other amounts on a Permanent Global Note will be made through Euroclear and/or Clearstream, Luxembourg against presentation or surrender (as the case may be) of the Permanent Global Note without any requirement for certification.

The applicable Final Terms will specify that a Permanent Global Note will be exchangeable (free of charge), in whole but not in part, for definitive Notes with, where applicable, receipts, interest coupons and talons attached upon either (i) not less than 60 days’ written notice from Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Global Note) to the Agent as described therein or (ii) only upon the occurrence of an Exchange Event. For these purposes, “**Exchange Event**” means that (i) an Event of Default (as defined in Condition 10) has occurred and is continuing, (ii) the Issuer has been notified that both Euroclear and Clearstream, Luxembourg have been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or have announced an intention permanently to cease business or have in fact done so and no successor clearing system is available or (iii) the Issuer has or will become subject to adverse tax consequences which would not be suffered were the Notes represented by the Permanent Global Note in definitive form. The Issuer will promptly give notice to Noteholders in accordance with Condition 14 if an Exchange Event occurs. In the event of the occurrence of an Exchange Event, Euroclear and/or Clearstream, Luxembourg (acting on the instructions of any holder of an interest in such Permanent Global Note) may give notice to the Agent requesting exchange and, in the event of the occurrence of an Exchange Event as described in (iii) above, the Issuer may also give notice to the Agent requesting exchange. Any such exchange shall occur not later than 45 days after the date of receipt of the first relevant notice by the Agent.

The following legend will appear on all Notes which have an original maturity of more than 365 days and on all receipts and interest coupons relating to such Notes:

“ANY UNITED STATES PERSON WHO HOLDS THIS OBLIGATION WILL BE SUBJECT TO LIMITATIONS UNDER THE UNITED STATES INCOME TAX LAWS, INCLUDING THE LIMITATIONS PROVIDED IN SECTIONS 165(j) AND 1287(a) OF THE INTERNAL REVENUE CODE.”

The sections referred to provide that United States holders, with certain exceptions, will not be entitled to deduct any loss on Notes, receipts or interest coupons and will not be entitled to capital gains treatment of any gain on any sale, disposition, redemption or payment of principal in respect of such Notes, receipts or interest coupons.

Notes which are represented by a Global Note will only be transferable in accordance with the rules and procedures for the time being of Euroclear or Clearstream, Luxembourg, as the case may be.

Pursuant to the Agency Agreement (as defined under “*Terms and Conditions of the Notes*”), the Agent shall arrange that, where a further Tranche of Notes is issued which is intended to form a single Series with an existing Tranche of Notes, the Notes of such further Tranche shall be assigned a common code and ISIN which are different from the common code and ISIN assigned to Notes of any other Tranche of the same Series until at least the expiry of the distribution compliance period (as defined in Regulation S under the Securities Act) applicable to the Notes of such Tranche.

Any reference herein to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system specified in the applicable Final Terms.

A Note may be accelerated by the holder thereof in certain circumstances described in Condition 10. In such circumstances, where any Note is still represented by a Global Note and the Global Note (or any part thereof) has become due and repayable in accordance with the Terms and Conditions of such Notes and payment in full of the amount due has not been made in accordance with the provisions of the Global Note then the Global Note will become void at 8.00 p.m. (London time) on such day. At the same time, holders of interests in such Global Note credited to their accounts with Euroclear and/or Clearstream, Luxembourg, as the case may be, will become entitled to proceed directly against the Issuer on the basis of statements of account provided by Euroclear and/or Clearstream, Luxembourg on and subject to the terms of a deed of covenant (the “**Deed of Covenant**”) dated 28th April, 2004 and executed by the Issuer.

## Applicable Final Terms

*Set out below is the form of Final Terms which will be completed for each Tranche of Notes issued under the Programme.*

[Date]

### KAUPTHING BANK HF.

#### Issue of [Aggregate Nominal Amount of Tranche] [Title of Notes] under the €12,000,000,000 Euro Medium Term Note Programme

#### PART A – CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Base Prospectus dated 2nd September, 2005 which constitutes a base prospectus for the purposes of the Prospectus Directive (Directive 2003/71/EC) (the **Prospectus Directive**). This document constitutes the Final Terms of the Notes described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with the Base Prospectus. Full information on the Issuer and the offer of the Notes is only available on the basis of the combination of these Final Terms and the Base Prospectus. The Base Prospectus is available for viewing at the office of the Issuer at Borgartun 19, 105 Reykjavic, Iceland and on the Luxembourg Stock Exchange's website ([www.bourse.lu](http://www.bourse.lu)) and copies may be obtained from the Principal Paying Agent at Winchester House, 1 Great Winchester Street, London, EC2N 2DB.

*[Include whichever of the following apply or specify as "Not Applicable" (N/A). Note that the numbering should remain as set out below, even if "Not Applicable" is indicated for individual paragraphs or sub-paragraphs. Italics denote directions for completing the Final Terms.]*

*[When adding any other final terms or information consideration should be given as to whether such terms or information constitute "significant new factors" and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive.]*

*[If the Notes have a maturity of less than one year from the date of their issue, the minimum denomination may need to be £100,000 or its equivalent in any other currency.]*

- |    |                                   |  |
|----|-----------------------------------|--|
| 1. | Issuer:                           | Kaupthing Bank hf.   |
| 2. | (i) Series Number:                | [ ]  |
|    | (ii) Tranche Number:              | [ ]  |
|    |                                   | <i>(If fungible with an existing Series, details of that Series, including the date on which the Notes become fungible)</i>                          |
| 3. | Specified Currency or Currencies: | [ ]  |
| 4. | Aggregate Nominal Amount:         |  |
|    | (i) Series:                       | [ ]  |
|    | (ii) Tranche:                     | [ ]  |
| 5. | Issue Price:                      | [ ] per cent. of the Aggregate Nominal Amount [plus accrued interest from <i>[insert date]</i> (in the case of fungible issues only, if applicable)] |
| 6. | Specified Denominations:          | [ ]  |

*(The minimum denomination of a Note shall not be less than €1,000 or its equivalent: N.B. If an issue of Notes is (i) NOT admitted to trading on an European Economic Area exchange; and (ii) only offered in the European Economic Area in circumstances where a prospectus is not required to be published under the Prospectus Directive, the €1,000 minimum denomination is not required.)*

7. (i) Issue Date: [ ]  
(ii) Interest Commencement Date: [ ]
8. Maturity Date: *[Fixed rate – specify date/  
Floating rate – Interest Payment Date  
falling on or nearest to [specify month]  
Capital Notes – Undated]*
9. Interest Basis: *[[ ] per cent. Fixed Rate]  
[[LIBOR/EURIBOR] +/- [ ] per cent.  
Floating Rate]  
[Zero Coupon]  
[Index Linked Interest]  
[Dual Currency Interest]  
[Target Redemption Interest]  
[Range Accrual Interest]  
[specify other]  
(further particulars specified below)*
10. Redemption/Payment Basis: *[Redemption at par]  
[Index Linked Redemption]  
[Dual Currency Redemption]  
[Partly Paid]  
[Instalment]  
[specify other]  
(N.B. If the Final Redemption Amount is  
less than 100% of the nominal value the  
Notes will be derivative securities for the  
purposes of the Prospectus Directive and  
the requirements of Annex XII to the  
Prospectus Directive Regulation will apply)*
11. Change of Interest Basis or  
Redemption/ Payment Basis: *[Specify details of any provision for change  
of Notes into another Interest Basis or  
Redemption/ Payment Basis]*
12. Put/Call Options: *[Investor Put]  
[Issuer Call]  
[(further particulars specified below)]*
13. (a) Status of the Notes: *[Senior/Subordinated/Capital Notes]  
  
[in the case of Capital Notes, specify any  
details of special provisions of Tier I  
qualifying Capital Notes including relevant*

*interest deferral provisions and details of utilisation/conversion]*

- (b) Date Board approval for issuance of Notes obtained:

[ ]  
*(N.B. Only relevant where Board (or similar) authorisation is required for the particular tranche of Notes, i.e. if the Notes are subordinated or are to be listed on a stock exchange outside the European Economic Area)*

14. Method of distribution:

[Syndicated/Non-syndicated/Capital Notes]

## **PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE**

### **15. Fixed Rate Note Provisions**

[Applicable/Not Applicable]  
*(If not applicable, delete the remaining sub-paragraphs of this paragraph)*

- (i) Rate(s) of Interest:

[ ] per cent. per annum [payable [annually/semi-annually/quarterly] in arrear]  
*(If payable other than annually, consider amending Condition 5(a))*

- (ii) Interest Payment Date(s):

[ ] in each year up to and including the Maturity Date]/[specify other]  
*(NB: This will need to be amended in the case of long or short coupons)*

- (iii) Fixed Coupon Amount(s):

[ ] per [ ] in nominal amount

- (iv) Broken Amount(s):

*[Insert particulars of any initial or final broken interest amounts which do not correspond with the Fixed Coupon Amount]*

- (v) Day Count Fraction:

[30/360 or Actual/Actual (ISMA) or specify other]

- (vi) Determination Date(s):

[ ] in each year  
*[Insert regular interest payment dates, ignoring issue date or maturity date in the case of a long or short first or last coupon  
NB: This will need to be amended in the case of regular interest payment dates which are not of equal duration  
NB: Only relevant where Day Count Fraction is Actual/Actual (ISMA)]*

- (vii) Other terms relating to the method of calculating interest for Fixed Rate Notes:

[None/Give details]

### **16. Floating Rate Note Provisions**

[Applicable/Not Applicable]  
*(If not applicable, delete the remaining sub-paragraphs of this paragraph)*



- (i) Specified Period(s)/Specified Interest Payment Dates: [ ]
- (ii) Business Day Convention: [Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/[specify other]]
- (iii) Additional Business Centre(s): [ ]
- (iv) Manner in which the Rate of Interest and Interest Amount is to be determined: [Screen Rate Determination/ISDA Determination/specify other]
- (v) Party responsible for calculating the Rate of Interest and Interest Amount (if not the Agent): [ ]
- (vi) Screen Rate Determination:
- Reference Rate: [ ]  
(Either LIBOR, EURIBOR or other, although additional information is required if other – including fallback provisions in the Agency Agreement)
  - Interest Determination Date(s): [ ]  
(Second London business day prior to the start of each Interest Period if LIBOR (other than Sterling or euro LIBOR), first day of each Interest Period if Sterling LIBOR and the second day on which the TARGET System is open prior to the start of each Interest Period if EURIBOR or euro LIBOR)
  - Relevant Screen Page: [ ]  
(In the case of EURIBOR, if not Telerate Page 248 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately)
- (vii) ISDA Determination:
- Floating Rate Option: [ ]
  - Designated Maturity: [ ]
  - Reset Date: [ ]
- (viii) Margin(s): [+/-] [ ] per cent. per annum
- (ix) Minimum Rate of Interest: [ ] per cent. per annum
- (x) Maximum Rate of Interest: [ ] per cent. per annum
- (xi) Day Count Fraction: [Actual/365  
Actual/365 (Fixed)  
Actual/365 (Sterling)]

	Actual/360 30/360 30E/360 <i>Other</i> (See Condition 5 for alternatives)
(xii) Fall back provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Notes, if different from those set out in the Conditions:	[ ]
<b>17. Zero Coupon Note Provisions</b>	[Applicable/Not Applicable] (If not applicable, delete the remaining subparagraphs of this paragraph)
(i) Accrual Yield:	[ ] per cent. per annum
(ii) Reference Price:	[ ]
(iii) Any other formula/basis of determining amount payable:	[ ]
(iv) Day Count Fractions in relation to Early Redemption Amount and late payment:	[Conditions 7(f)(iii) and 7(k) apply/specify other] (Consider applicable day count fraction if not U.S. dollar denominated)
<b>18. Index Linked Interest Note Provisions</b>	[Applicable/Not Applicable] (If not applicable, delete the remaining subparagraphs of this paragraph)
(i) Index/Formula:	[give or annex details]
(ii) Calculation Agent responsible for calculating the interest due:	[ ]
(iii) Provisions for determining Coupon where calculation by reference to Index and/or Formula is impossible or impracticable:	[need to include a description of market disruption or settlement disruption events and adjustment provisions]
(iv) Specified Period(s)/Specified Interest Payment Dates:	[ ]
(v) Business Day Convention:	[Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/specify other]
(vi) Additional Business Centre(s):	[ ]
(vii) Minimum Rate of Interest:	[ ] per cent. per annum
(viii) Maximum Rate of Interest:	[ ] per cent. per annum
(ix) Day Count Fraction:	[ ]
<b>19. Dual Currency Interest Note Provisions</b>	[Applicable/Not Applicable]

	<i>(If not applicable, delete the remaining sub-paragraphs of this paragraph)</i>
(i) Rate of Exchange/method of calculating Rate of Exchange:	[give or annex details]
(ii) Calculation Agent, if any, responsible for calculating the interest payable:	[ ]
(iii) Provisions applicable where calculation by reference to Rate of Exchange impossible or impracticable:	<i>[need to include a description of market disruption or settlement disruption events and adjustment provisions]</i>
(iv) Person at whose option Specified Currency(ies) is/are payable:	[ ]
20. Target Redemption Note Provisions:	[Not Applicable/give or annex details]
21. Range Accrual Note Provisions:	[Not Applicable/give or annex details]
<b>PROVISIONS RELATING TO REDEMPTION</b>	
22. Issuer Call:	[Applicable/Not Applicable] <i>(If not applicable, delete the remaining sub-paragraphs of this paragraph)</i>
(i) Optional Redemption Date(s):	[ ]
(ii) Optional Redemption Amount of each Note and method, if any, of calculation of such amount(s):	[ ] per Note of [ ] Specified Denomination
(iii) If redeemable in part:	
(a) Minimum Redemption Amount:	[ ]
(b) Maximum Redemption Amount:	[ ]
(iv) Notice period (if other than as set out in the Conditions):	[ ] <i>(N.B. If setting notice periods which are different to those provided in the Conditions, the Issuer is advised to consider the practicalities of distribution of information through intermediaries, for example, clearing systems and custodians, as well as any other notice requirements which may apply, for example, as between the Issuer and the Agent)</i>
23. Investor Put:	[Applicable/Not Applicable] <i>(If not applicable, delete the remaining sub-paragraphs of this paragraph)</i>
(i) Optional Redemption Date(s):	[ ]
(ii) Optional Redemption Amount of each Note and method, if any, of calculation of such amount(s):	[ ] per Note of [ ] Specified Denomination

- (iii) Notice period (if other than as set out in the Conditions): ☐ *(N.B. If setting notice periods which are different to those provided in the Conditions, the Issuer is advised to consider the practicalities of distribution of information through intermediaries, for example, clearing systems and custodians, as well as any other notice requirements which may apply, for example, as between the Issuer and the Agent)*
24. Target Redemption Provisions: ☐ [Not Applicable/give or annex details]
25. Final Redemption Amount of each Note: ☐ per Note of ☐ Specified Denomination/specify other/see Appendix] *(N.B. In relation to any issue of Notes which are expressed at paragraph 6 above to have a minimum denomination and tradeable amounts above such minimum denomination which are smaller than it the following wording should be added: "For the avoidance of doubt, in the case of a holding of Notes in an integral multiple of ☐ in excess of ☐ as envisaged in paragraph 6 above, such holding will be redeemed at its nominal amount.")*  
*(N.B. If the Final Redemption Amount is other than 100% of the nominal value the Notes will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply.)*
26. Early Redemption Amount of each Note payable on redemption for taxation reasons or on event of default and/or the method of calculating the same (if required or if different from that set out in Condition 7(f)): ☐ per Note of ☐ Specified Denomination
27. Capital Notes Provisions
- (i) Special Event Redemption Amount: ☐
- (ii) Special Event Redemption Date(s): ☐
- (iii) Investment Considerations: [In making an investment decision in respect of Capital Notes, potential investors should carefully consider the merits and risks of an investment in the Capital Notes and carefully review the Conditions and this Final Terms. In particular (i) the Capital Notes are undated and deeply subordinated; (ii) principal in respect of the Capital Notes may be converted into conditional capital contributions as described in Condition

2(d); (iii) conditional capital contributions may only be reconverted and reinstated as provided in Condition 2(e); (iv) the Issuer shall not pay accrued interest in certain circumstances as provided in Condition 5; and (v) the Capital Notes may be redeemed at the option of the Issuer, as specified in the applicable Final Terms subject to prior approval of the FSA and provided that any conditional capital contributions have been reconverted and reinstated as provided in Condition 2(e), all as further described in Condition 7./Other]

## GENERAL PROVISIONS APPLICABLE TO THE NOTES

28. Form of Notes: [Temporary Global Note exchangeable for a Permanent Global Note which is exchangeable for Definitive Notes [on 60 days' notice given at any time/only upon an Exchange Event]]
- [Temporary Global Note exchangeable for Definitive Notes on and after the Exchange Date]
- [Permanent Global Note exchangeable for Definitive Notes [on 60 days' notice given at any time/only upon an Exchange Event]]
29. Additional Financial Centre(s) or other special provisions relating to Payment Dates: [Not Applicable/give details]  
*(Note that this item relates to the place of payment and not Interest Period end dates to which items 16(iii) and 18(vi) relate)*
30. Talons for future Coupons or Receipts to be attached to Definitive Notes (and dates on which such Talons mature): [Yes/No. If yes, give details]
31. Details relating to Partly Paid Notes: amount of each payment comprising the Issue Price and date on which each payment is to be made and consequences of failure to pay, including any right of the Issuer to forfeit the Notes and interest due on late payment: [Not Applicable/give details. NB: a new form of Temporary Global Note and/or Permanent Global Note may be required for Partly Paid issues]
32. Details relating to Instalment Notes:
- (i) Instalment Amount(s): [Not Applicable/give details]
- (ii) Instalment Date(s): [Not Applicable/give details]
33. Redenomination applicable: Redenomination [not] applicable  
*[(If Redenomination is applicable, specify the applicable Day Count Fraction and any provisions necessary to deal with floating*

rate interest calculation (including alternative reference rates)]

34. Other final terms:

[Not Applicable/give details]  
(When adding any other final terms consideration should be given as to whether such terms constitute "significant new factors" and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive.)

## DISTRIBUTION

35. (i) If syndicated, names [and addresses]\*\* of Managers [and underwriting commitments]: [Not Applicable/give names [and addresses and underwriting commitments]\*\*] (Include names and addresses of entities agreeing to underwrite the issue on a firm commitment basis and names and addresses of the entities agreeing to place the issue without a firm commitment or on a "best efforts" basis. If such entities are not the same as the Managers.)\*\*
- (ii) Date of Subscription Agreement\*\*\* [ ]\*\*\*
- (iii) Stabilising Manager (if any): [Not Applicable/give name]
36. If non-syndicated, name [and address]\*\* of relevant Dealer: [Name [and address]\*\*]
37. Total commission and concession\*\*: [ ] per cent. of the Aggregate Nominal Amount\*\*
38. Whether TEFRA D or TEFRA C rules applicable or TEFRA rules not applicable: [TEFRA D/TEFRA C/TEFRA not applicable]
39. Additional selling restrictions: [Not Applicable/give details]

## [LISTING AND ADMISSION TO TRADING APPLICATION

These Final Terms comprise the final terms required to list and have admitted to trading the issue of Notes described herein pursuant to the €12,000,000,000 Euro Medium Term Note Programme of Kaupthing Bank hf.]

## RESPONSIBILITY

The Issuer accepts responsibility for the information contained in these Final Terms. [[ ]has been extracted from [ ]. The Issuer confirms that such information has been accurately reproduced and that, so far as it is aware and is able to ascertain from information published by [ ], no facts have been omitted which would render the reproduced information inaccurate or misleading. ]

Signed on behalf of the Issuer:

By: .....  
Duly authorised

## PART B – OTHER INFORMATION

### 1. LISTING

- (i) Listing: [Luxembourg/other (*specify*)/None]
- (ii) Admission to trading: [Application has been made for the Notes to be admitted to trading on [ ] with effect from [ ].] [Not Applicable.]  
(Where documenting a fungible issue need to indicate that original securities are already admitted to trading.)\*\*
- (iii) Estimate of total expenses related to admission to trading:\* [ ]\*

### 2. RATINGS

- Ratings: The Notes to be issued have been rated:
- Moody's: [ ]
- [[Other]: [ ]]
- [Need to include a brief explanation of the meaning of the ratings if this has previously been published by the rating provider.]\*\*  
(The above disclosure should reflect the rating allocated to Notes of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating.)

### [3. NOTIFICATION

The [name of competent authority in home Member State] [has been requested to provide/has provided - include first alternative for an issue which is contemporaneous with the establishment or update of the Programme and the second alternative for subsequent issues] the [names of competent authorities of host Member States] with a certificate of approval attesting that the Prospectus has been drawn up in accordance with the Prospectus Directive.]

### 4. INTERESTS OF NATURAL AND LEGAL PERSONS INVOLVED IN THE ISSUE

[Save for any fees payable to the Dealers, so far as the Issuer is aware, no person involved in the issue of the Notes has an interest material to the offer. - Amend as appropriate if there are other interests]

### 5. REASONS FOR THE OFFER, ESTIMATED NET PROCEEDS AND TOTAL EXPENSES

- [(i) Reasons for the Offer: [ ]  
(See "Use of Proceeds" wording in Base Prospectus – if reasons for offer different from making profit and/or hedging certain risks will need to include those reasons here.)]\*\*



[(ii)] Estimated net proceeds:

[ ]

*(If proceeds are intended for more than one use will need to split out and present in order of priority. If proceeds insufficient to fund all proposed uses state amount and sources of other funding.)\*\**

[(iii)] Estimated total expenses:

[ ] *[Expenses are required to be broken down into each principal intended "use" and presented in order of priority of "uses".]\*\**

*(N.B. If the Notes are derivative securities to which Annex XII of the Prospectus Directive Regulation applies (i) above is required where the reasons for the offer are different from making profit and/or hedging certain risks regardless of the minimum denomination of the securities and where this is the case disclosure of net proceeds and total expenses at (ii) and (iii) are also required.)*

**6. YIELD (Fixed Rate Notes only)**

Indication of yield:

[ ]

*[Calculated as [include details of method of calculation in summary form] on the Issue Date.]\*\**

The yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.

**7. HISTORIC INTEREST RATES (Floating Rate Notes only)\*\***

Details of historic [LIBOR/EURIBOR/other] rates can be obtained from [Telerate].]

**8. PERFORMANCE OF INDEX/FORMULA, EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS AND OTHER INFORMATION CONCERNING THE UNDERLYING (Index-Linked Notes only)**

*[Need to include details of where past and future performance and volatility of the index/formula can be obtained.]*

*[Need to include a clear and comprehensive explanation of how the value of the investment is affected by the underlying and the circumstances when the risks are most evident.]\*\**

*[Where the underlying is an index need to include the name of the index and a description if composed by the Issuer and if the index is not composed by the Issuer need to include details of where the information about the index can be obtained. Where the underlying is not an index need to include equivalent information.]*

**9. PERFORMANCE OF RATE[S] OF EXCHANGE AND EXPLANATION OF EFFECT ON VALUE OF INVESTMENT (Dual Currency Notes only)**

*[Need to include details of where past and future performance and volatility of the relevant rates can be obtained.]*

*[Need to include a clear and comprehensive explanation of how the value of the investment is affected by the underlying and the circumstances when the risks are most evident.]\*\**

## 10. OPERATIONAL INFORMATION

- |       |  |   |
|-------|--|---|
| (i)   | ISIN Code:   | [ ]   |
| (ii)  | Common Code:   | [ ]   |
| (iii) | Any clearing system(s) other than Euroclear Bank S.A./N.V. and Clearstream Banking, société anonyme and the relevant identification number(s): | [Not Applicable/give name(s) and number(s)] |
| (iv)  | Delivery:  | Delivery [against/free of] payment          |
| (v)   | Names and addresses of additional Paying Agent(s) (if any):  | [ ]   |

---

### Notes:

\* Delete if the minimum denomination is less than €50,000

\*\* Delete if the minimum denomination is €50,000

\*\*\* Delete if the minimum denomination is €50,000 unless the Notes are derivative securities for the purposes of Annex XII of the Prospectus Directive Regulation

## TERMS AND CONDITIONS OF THE NOTES

*The following are the Terms and Conditions of the Notes which will be incorporated by reference into each Global Note (as defined below) and each definitive Note, in the latter case only if permitted by the relevant stock exchange or other relevant authority (if any) and agreed by the Issuer and the relevant Dealer at the time of issue but, if not so permitted and agreed, such definitive Note will have endorsed thereon or attached thereto such Terms and Conditions. The applicable Final Terms in relation to any Tranche of Notes may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the following Terms and Conditions, replace or modify the following Terms and Conditions for the purpose of such Notes. The applicable Final Terms (or the relevant provisions thereof) will be endorsed upon, or attached to, each Global Note and definitive Note. Reference should be made to "Form of the Notes" for a description of the content of Final Terms which will specify which of such terms are to apply in relation to the relevant Notes.*

This Note is one of a Series (as defined below) of Notes issued by Kaupthing Bank hf. (the "**Issuer**") pursuant to the Agency Agreement (as defined below).

References herein to the "**Notes**" shall be references to the Notes of this Series and shall mean:

- (i) in relation to any Notes represented by a global Note (a "**Global Note**"), units of the lowest Specified Denomination in the Specified Currency;
- (ii) any Global Note; and
- (iii) any definitive Notes issued in exchange for a Global Note.

The Notes, the Receipts (as defined below) and the Coupons (as defined below) have the benefit of an Amended and Restated Agency Agreement (such Agency Agreement as amended and/or supplemented and/or restated from time to time, the "**Agency Agreement**") dated 2nd September, 2005 and made between the Issuer, Deutsche Bank AG, London Branch as issuing and principal paying agent and agent bank (the "**Agent**", which expression shall include any successor agent) and the other paying agents named therein (together with the Agent, the "**Paying Agents**", which expression shall include any additional or successor paying agents).

Interest bearing definitive Notes have interest coupons ("**Coupons**") and, if indicated in the applicable Final Terms, talons for further Coupons ("**Talons**") attached on issue. Any reference herein to Coupons or coupons shall, unless the context otherwise requires, be deemed to include a reference to Talons or talons. Definitive Notes repayable in instalments have receipts ("**Receipts**") for the payment of the instalments of principal (other than the final instalment) attached on issue. Global Notes do not have Receipts, Coupons or Talons attached on issue.

The final terms for this Note (or the relevant provisions thereof) are set out in Part A of the Final Terms attached to or endorsed on this Note which supplements these Terms and Conditions (the "**Conditions**") and may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with these Conditions, replace or modify these Conditions for the purposes of this Note. References to the "**applicable Final Terms**" are to Part A of the Final Terms (or the relevant provisions thereof) attached to or endorsed on this Note.

Any reference to "**Noteholders**" or "**holders**" in relation to any Notes shall mean the holders of the Notes and shall, in relation to any Notes represented by a Global Note, be construed as provided below. Any reference herein to "**Receiptholders**" shall mean the holders of the Receipts and any reference herein to "**Couponholders**" shall mean the holders of the Coupons and shall, unless the context otherwise requires, include the holders of the Talons.

As used herein, "**Tranche**" means Notes which are identical in all respects (including as to listing and admission to trading) and "**Series**" means a Tranche of Notes together with any further Tranche or Tranches of Notes which are (i) expressed to be consolidated and form a single series and (ii)

identical in all respects (including as to listing and admission to trading) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices.

The Noteholders, the Receiptholders and the Couponholders are entitled to the benefit of the Deed of Covenant (the “**Deed of Covenant**”) dated 28th April, 2004 and made by the Issuer. The original of the Deed of Covenant is held by the common depositary for Euroclear (as defined below) and Clearstream, Luxembourg (as defined below).

Copies of the Agency Agreement and the Deed of Covenant are available for inspection during normal business hours at the specified office of each of the Paying Agents.

Copies of the applicable Final Terms are available for viewing at the office of the Issuer at Borgartun 19, 105 Reykjavik, Iceland and copies may be obtained from the Principal Paying Agent at Winchester House, 1 Great Winchester Street, London EC2N 2DB. The Noteholders, the Receiptholders and the Couponholders are deemed to have notice of, and are entitled to the benefit of, all the provisions of the Agency Agreement, the Deed of Covenant and the applicable Final Terms which are applicable to them. The statements in these Terms and Conditions include summaries of, and are subject to, the detailed provisions of the Agency Agreement.

Words and expressions defined in the Agency Agreement or used in the applicable Final Terms shall have the same meanings where used in these Terms and Conditions unless the context otherwise requires or unless otherwise stated and provided that, in the event of inconsistency between the Agency Agreement and the applicable Final Terms, the applicable Final Terms will prevail.

## **1. FORM, DENOMINATION AND TITLE**

The Notes are in bearer form and, in the case of definitive Notes, serially numbered, in the Specified Currency and the Specified Denomination(s). Notes of one Specified Denomination may not be exchanged for Notes of another Specified Denomination.

This Note may be a Fixed Rate Note, a Floating Rate Note, a Zero Coupon Note, an Index Linked Interest Note, a Dual Currency Interest Note, a Range Accrual Note, a Target Redemption Note or a combination of any of the foregoing, depending upon the Interest Basis shown in the applicable Final Terms.

This Note may be an Index Linked Redemption Note, an Instalment Note, a Dual Currency Redemption Note, a Partly Paid Note or a combination of any of the foregoing, depending upon the Redemption/Payment Basis shown in the applicable Final Terms.

This Note may also be a Senior Note, a Subordinated Note or a Capital Note, as indicated in the applicable Final Terms.

Whenever there is any adjustment to the principal amount of any Capital Note pursuant to the Conditions, upon presentation of such Capital Note to the Agent at its specified office, a record of such adjustment shall be endorsed by it on such Capital Note provided that any failure to so present or record shall not in any way affect the decrease or increase pursuant to Condition 2(d).

Definitive Notes are issued with Coupons attached, unless they are Zero Coupon Notes in which case references to Coupons and Couponholders in these Terms and Conditions are not applicable.

Subject as set out below, title to the Notes, Receipts and Coupons will pass by delivery. The Issuer and the Paying Agents will (except as otherwise required by law) deem and treat the bearer of any Note, Receipt or Coupon as the absolute owner thereof (whether or not overdue and notwithstanding any notice of ownership or writing thereon or notice of any

previous loss or theft thereof) for all purposes but, in the case of any Global Note, without prejudice to the provisions set out in the next succeeding paragraph.

For so long as any of the Notes is represented by a Global Note held on behalf of Euroclear Bank S.A./N.V. as operator of the Euroclear System ("**Euroclear**") and/or Clearstream Banking, société anonyme ("**Clearstream, Luxembourg**"), each person (other than Euroclear or Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear or of Clearstream, Luxembourg as the holder of a particular nominal amount of such Notes (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the nominal amount of such Notes standing to the account of any person shall be conclusive and binding for all purposes save in the case of manifest error) shall be treated by the Issuer and the Paying Agents as the holder of such nominal amount of such Notes for all purposes other than with respect to the payment of principal or interest on such nominal amount of such Notes, for which purpose the bearer of the relevant Global Note shall be treated by the Issuer and any Paying Agent as the holder of such nominal amount of such Notes in accordance with and subject to the terms of the relevant Global Note and the expressions "**Noteholder**" and "**holder of Notes**" and related expressions shall be construed accordingly. Notes which are represented by a Global Note will be transferable only in accordance with the rules and procedures for the time being of Euroclear and Clearstream, Luxembourg, as the case may be.

References to Euroclear and/or Clearstream, Luxembourg shall, whenever the context so permits, be deemed to include a reference to any additional or alternative clearing system specified in the applicable Final Terms.

## **2. STATUS OF THE SENIOR NOTES AND SUBORDINATION**

### **(a) Status of the Senior Notes**

The Senior Notes and any relative Receipts and Coupons are direct, unconditional, unsubordinated and (subject to the provisions of Condition 3) unsecured obligations of the Issuer and rank *pari passu* among themselves and (save for certain obligations required to be preferred by law) equally with all other unsecured obligations (other than subordinated obligations, if any) of the Issuer, from time to time outstanding.

### **(b) Status of the Subordinated Notes**

The Subordinated Notes and any relative Receipts and Coupons are unsecured and unconditional obligations of the Issuer, subordinated in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act on Financial Undertakings No. 161/2002 (the "**Act**") of the Icelandic Parliament, and rank *pari passu* and ratably and without any preference among themselves and accordingly, on the insolvency or voluntary or involuntary liquidation of the Issuer, the Subordinated Notes rank in right of payment:

- (i) after payment of all obligations of the Issuer which are not expressed to be subordinated in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act (or any provision in any other Act of the Icelandic Parliament which modifies or replaces those provisions) ("**Senior Obligations**");
- (ii) at least *pari passu* with all other obligations of the Issuer (other than obligations of the Issuer in respect of Tier I Capital of the Issuer) (as defined below) which are expressed to be subordinated in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act (or any provision in any other Act of the Icelandic Parliament which modifies or replaces those provisions) ("**Subordinated Obligations**");
- (iii) before all obligations of the Issuer in respect of Capital Securities of the Issuer;

- (iv) in priority to the rights of holders of all classes of ordinary share capital, preferred share capital and other share capital and/or establishment funds (*hlutafe eda stofnfe*) and/or comparable capital and reserves (*sambaerilegt eigid fe*), of the Issuer and in priority to the rights of holders of any obligation of the Issuer expressed to rank junior to the Capital Notes, in each case in relation to their rights as such holders and to payment in respect thereof.

The Issuer undertakes that for so long as any of the Subordinated Notes, Receipts or Coupons remain outstanding (as defined in the Agency Agreement) it will not create any subordinated obligation other than in accordance with and for the purposes of Chapter X; Liquid Assets and Own Funds; Article 84 of the Act or any provision in any other Act of the Icelandic Parliament which modifies or replaces those provisions). The provisions of this Condition 2(b) shall be governed by, and construed in accordance with, Icelandic law.

(c) Status of the Capital Notes

The Capital Notes and any relative Receipts and Coupons are unsecured and unconditional obligations of the Issuer, subordinated in accordance with and for the purposes of Chapter X: Liquid Assets and Own Funds; Article 84 of the Act as described below.

In the event of the insolvency or voluntary or involuntary liquidation of the Issuer, the rights of:

- (a) the holders of the Capital Notes and any relative Receipts and Coupons to payments of the principal amount of the Capital Notes and any other amounts including interest due in respect of the Capital Notes; and
- (b) where the whole or any part of the principal amount of the Capital Notes has been converted into conditional capital contributions as described below and such conditional capital contributions have not been reconverted and reinstated as provided below, the providers of such conditional capital contributions, in respect of such conditional capital contributions,

shall rank:

- (i) *pari passu* without any preference among the holders of the Capital Notes and any relative Receipts and Coupons and such providers;
- (ii) at least *pari passu* with the rights of the holders of any other outstanding Capital Securities whether or not such Capital Securities have been converted in the manner described below and at least *pari passu* with the rights of the holders of any other obligations of the Issuer constituting or eligible (“eligible” to be construed, *mutatis mutandis*, as provided in the definition of Capital Event) as constituting Tier I Capital of the Issuer, in each case in relation to their rights as such holders and to payments in respect thereof;
- (iii) in priority to the rights of holders of all classes of ordinary share capital, preferred share capital and other share capital and/or establishment funds (*hlutafe eda stofnfe*) and/or comparable capital and reserves (*sambaerilegt eigid fev*), of the Issuer and in priority to the rights of holders of any obligation of the Issuer expressed to rank junior to the Capital Notes, in each case in relation to their rights as such holders and to payments in respect thereof; and
- (iv) junior in right of payment to the payment of any present or future claims under Senior Obligation and Subordinated Obligations.

No holder of a Capital Note or any relative Receipt or Coupon or provider of any conditional capital contribution who shall in the event of the insolvency voluntary or involuntary



liquidation of the Issuer be indebted to the Issuer shall be entitled to exercise any right of set-off or counterclaim against moneys owed by the Issuer in respect of the Capital Notes or conditional capital contributions held or provided by such holder or provider, as the case may be.

The Issuer reserves the right to issue Capital Securities in the future or other obligations constituting or eligible as constituting Tier I Capital of the Issuer, provided, however, that any such obligations may not in the event of insolvency or voluntary or involuntary liquidation of the Issuer rank in priority to the Capital Notes.

A “**Capital Event**” means the determination by the Issuer (such determination to be evidenced by a certificate signed by two Directors of the Issuer and to be binding on the Capital Noteholders without further investigation (copies of such certificate to be available for inspection at the specified office of the Agent)), having received confirmation of similar proof thereof from the Financial Supervisory Authority of Iceland (*fjármálaeftirlitid*) or any successor (the “FSA”), that the Capital Notes are no longer eligible for inclusion in Tier I Capital of the Issuer and for these purposes the Capital Notes shall be deemed to be so “eligible” notwithstanding that any limits in respect of obligations which can be included in determining such eligibility would be exceeded by including in such determination all or any part of the Capital Notes and accordingly for these purposes any such limits shall be disregarded.

“**Capital Securities**” means any subordinated and undated debt instruments of the Issuer which are recognised Tier I Capital from time to time by the FSA and including, where the context so requires, the Capital Notes.

“**Tier I Capital**” means capital which is treated as issued tier I capital (*Eiginfjárháttur A*) by the FSA either on a solo or on a consolidated basis.

(d) Utilisation and Conversion of Capital Notes

To the extent that it may be required to avoid the Issuer no longer meeting the requirements with respect to minimum own funds (“**Minimum Own Funds**”) as set out in The Act on Financial Undertaking (161/2002), as amended, of the Icelandic Parliament the Board of Directors of the Issuer, by resolution passed at a board meeting, may decide that the principal amount (or part thereof, as the case may be) of each Capital Note will be utilised by writing down all or part of the principal amount to the extent and by the amount required to avoid falling below the required Minimum Own Funds and converting such aggregate amount (the “**Converted Amount**”) into a conditional capital contribution. The rights of the holders of the Capital Notes on any relative Receipts and Coupons in respect of the Converted Amount will thereupon be converted into rights of providers of conditional capital contributions as set out herein.

Upon utilisation of the Converted Amount as above the Issuer shall give notice to the Capital Noteholders in accordance with Condition 14.

Utilisation of the Converted Amount for the purpose of avoiding the Issuer’s own funds falling below the required Minimum Own Funds shall be made prior to the utilisation for the same purpose of the principal amount of outstanding perpetual/undated subordinated debt issued by the Issuer (other than other Capital Securities) and shall be made following the utilisation for the same purpose of the principal amount of Capital Securities and any other securities ranking junior to the Capital Notes and outstanding at the time of such utilisation and *pro rata* to the principal amount of Capital Securities ranking *pari passu* with the Capital Notes and outstanding at the time of such utilisation.

Where, pursuant to this Condition 2(d), writing down and conversion applies to part only of the principal amount of the Capital Notes, the part of the principal amount of each Capital Note to be subject to such writing down and conversion shall bear the same proportion to the total amount of the principal amount in respect of such Capital Note as the aggregate amount of the principal



amount of all the Capital Notes to be subject to such writing down and conversion bears to the aggregate outstanding principal amount of all the Capital Notes respectively. Any reconversion and reinstatement as provided below will be made on the same basis.

Utilisation of the Converted Amount as aforesaid may only be made provided:

- (a) that the Agent has received prior to such utilisation a certificate signed by two Directors of the Issuer confirming that, following such conversion to a Converted Amount, the rights of the providers thereof in respect of such amounts will rank as provided in Condition 2(c) (copies of such certificate will be available for inspection at the specified office of the Agent);
- (b) that the FSA shall have given its approval thereto provided that such approval can be validly given in accordance with the rules, regulations and policies of the FSA; and
- (c) that the Agent has received prior to such utilisation a certificate signed by two Directors of the Issuer confirming that following such conversion to a Converted Amount, such amount will be a conditional capital contribution and will be accounted for as such in the balance sheet of the Issuer (copies of such certificate will be available for inspection at the specified office of the Agent).

Utilisation as described above of the whole or part of the principal amount of the Capital Notes shall not constitute an Event of Default under Condition 10.

(e) Reconversion and Reinstatement of Capital Notes

Reconversion and reinstatement (in whole or in part) as obligations in respect of the Capital Notes of the Converted Amount may only be made out of Unallocated Distributable Profits of the Issuer and subject to a resolution of the Board of Directors of the Issuer.

Reconversion and reinstatement shall first be made in respect of perpetual/undated subordinated debt (other than Capital Securities) issued by the Issuer that may have been converted into conditional capital contributions.

Reconversion and reinstatement as obligations in respect of the Capital Notes of the Converted Amount shall be made *pro rata* with any amounts converted in respect of other Capital Securities of the Issuer ranking *pari passu* with the Capital Notes. For the avoidance of doubt, amounts converted in respect of Capital Securities and any other securities expressed to rank junior to the Capital Notes shall be reconverted and reinstated as debt only after the Converted Amount (and any other amounts converted in respect of other Capital Securities of the Issuer expressed to rank *pari passu* with the Capital Notes) has been reconverted and reinstated as aforesaid.

If the Issuer's own funds exceed the required Minimum Own Funds allowing for reconversion and reinstatement (in whole or in part) as debt of amounts converted in respect of subordinated indebtedness in the form of Capital Securities and/or perpetual/undated subordinated securities and/or any other securities or reconversion and reinstatement (in whole or in part) as obligations in respect of the Capital Notes of any Converted Amount, the Board of Directors of the Issuer shall subsequently decide that such reconversion and reinstatement shall be made with due observance taken to the prescribed ranking between the relevant instruments to the extent such replenishment does not result in the Issuer's own funds falling below the required Minimum Own Funds.

If and to the extent that any Converted Amount has been reconverted and reinstated as an obligation in respect of such Capital Note in the balance sheet of the Issuer, such amount shall be reconverted and reinstated as principal and shall be added to the principal amount of such Note not converted to a Converted Amount for all purposes thereafter (and references to "principal" and "principal amount" shall be construed accordingly) and interest shall start to accrue on such amount and become payable in accordance with the terms of the Capital Notes as from the date of such reconversion and reinstatement.

Upon reconversion and reinstatement as obligations in respect of the Notes of the Converted Amount as described above the Issuer shall give notice to the Capital Noteholders in accordance with Condition 14.

The principal amount of the Capital Notes may be utilised and converted as described above on one or more occasions.

**“Bank Share Capital”** means the ordinary share capital of the Issuer, together with all other securities of the Issuer, ranking *pari passu* with the ordinary shares of the Issuer as to participation in a liquidation surplus.

**“Unallocated Distributable Profits”** means, in respect of each fiscal year of the Issuer, the aggregate amount, as calculated during the course of such fiscal year in the individual financial statements of the Issuer, of accumulated retained earnings and any other reserves, surpluses, including current operating profits, capable under Icelandic law of being available for distribution as cash dividends to holders of Bank Share Capital in the following year.

### 3. NEGATIVE PLEDGE

So long as any of the Senior Notes, Receipts or Coupons remains outstanding the Issuer undertakes that it will not and that it will procure that none of its Subsidiaries will create or have outstanding any mortgage, charge, pledge, lien or other security interest (each a **“Security Interest”**) (other than a Permitted Security Interest) upon the whole or any part of its undertaking, assets or revenues (including any uncalled capital), present or future, in order to secure any Relevant Indebtedness (as defined below) or to secure any guarantee of or indemnity in respect of any Relevant Indebtedness unless (a) all amounts payable by it under the Senior Notes, Receipts and Coupons are equally and ratably secured therewith by such Security Interest or (b) such other Security Interest or other arrangement (whether or not it includes the giving of a Security Interest) is provided as shall be approved by an Extraordinary Resolution (as defined in the Agency Agreement) of the Noteholders.

For the purposes of these Conditions:

**“Excluded Indebtedness”** means any Relevant Indebtedness in respect of which the person or persons to whom any such Relevant Indebtedness is or may be owed by the relevant borrower has or have no recourse whatsoever to the Issuer or any Subsidiary (whether or not also the relevant borrower) for the repayment thereof other than:

- (i) recourse to such borrower for amounts limited to the cash flow or net cash flow (other than historic cash flow or historic net cash flow) from a Specified Asset; and/or
- (ii) recourse to such borrower for the purpose only of enabling amounts to be claimed in respect of such Relevant Indebtedness in an enforcement of any encumbrance given by such borrower over a Specified Asset or the income, cash flow or other proceeds deriving therefrom (or given by a shareholder or the like in the borrower over its shares or the like in the capital of the borrower) to secure such Relevant Indebtedness, provided that (a) the extent of such recourse to such borrower is limited solely to the amount of any recoveries made on any such enforcement, and (b) such person or persons is/are not entitled, by virtue of any right or claim arising out of or in connection with such Relevant Indebtedness, to commence proceedings for the winding up or dissolution of the borrower or to appoint or procure the appointment of any receiver, trustee or similar person or officer in respect of the borrower or any of its assets (save for the assets the subject of such encumbrance); and/or
- (iii) recourse of such borrower generally, or directly or indirectly to the Issuer or any Subsidiary, under any form of assurance, undertaking or support, which recourse is limited to a claim for damages (other than liquidated damages and damages required to be calculated in a specified way) for breach of an obligation (not being a payment

obligation or an obligation to procure payment by another or an indemnity in respect thereof or any obligation to comply or to procure compliance by another with any financial ratios or other tests of financial condition) by the person against which such recourse is available;

**“Government Entities”** means any body, agency, ministry, department, authority, statutory corporation or other entity of or pertaining to a member state of the European Economic Area or the government thereof or any political subdivision, municipality or local government thereof (whether autonomous or not);

**“Permitted Security Interest”** means any security interest created by the Issuer or its Subsidiaries over the whole or any part of their present or future assets or revenues where such assets or revenues are comprised of the following (or are otherwise qualifying collateral for issues of covered bonds pursuant to any relevant contractual arrangements and/or specific provisions of the laws of Iceland relating to covered bonds): (i) mortgage receivables; or (ii) receivables against Government Entities; or (iii) asset-backed securities backed by any of the assets under paragraph (i) or (ii); or (iv) any other assets permitted by Icelandic law to collateralise the covered bonds, in each case provided that the creation of such security interest is pursuant to the relevant contractual arrangements or, as the case may be, specific provisions of the laws of Iceland relating to covered bonds applicable at the time of creation of such security interest;

**“Relevant Indebtedness”** means any present or future indebtedness (which term shall be construed so as to include any obligation (whether incurred as principal or as surety) for the payment or repayment of money, whether present or future, actual or contingent) in the form of, or represented or evidenced by, bonds, debentures, notes or other securities which are, or are intended to be, with the agreement of the issuer thereof, quoted, listed, dealt in or traded on any stock exchange or over-the-counter or other securities market other than such indebtedness which by its terms will mature within a period of one year from its date of issue and other than Excluded Indebtedness;

**“Specified Asset”** means an asset of the Issuer or any Subsidiary over which security is given in connection with any limited recourse securitisation or other asset-backed financing; and

**“Subsidiary”** means any entity whose affairs are required by law or in accordance with generally accepted accounting principles applicable to Iceland to be consolidated in the consolidated accounts of the Issuer.

#### **4. REDENOMINATION**

##### **(a) Redenomination**

Where redenomination is specified in the applicable Final Terms as being applicable, the Issuer may, without the consent of the Noteholders, the Receiptholders and the Couponholders, on giving prior notice to the Agent, Euroclear and Clearstream, Luxembourg and at least 30 days' prior notice to the Noteholders in accordance with Condition 14, elect that, with effect from the Redenomination Date specified in the notice, the Notes shall be redenominated in euro.

The election will have effect as follows:

- (i) the Notes and the Receipts shall be deemed to be redenominated into euro in the denomination of euro 0.01 with a principal amount for each Note and Receipt equal to the principal amount of that Note or Receipt in the Specified Currency, converted into euro at the Established Rate, provided that, if the Issuer determines, with the agreement of the Agent, that the then market practice in respect of the redenomination into euro of internationally offered securities is different from the provisions specified

above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Noteholders, the stock exchange (if any) on which the Notes may be listed and the Paying Agents of such deemed amendments;

- (ii) save to the extent that an Exchange Notice has been given in accordance with paragraph (iv) below, the amount of interest due in respect of the Notes will be calculated by reference to the aggregate principal amount of Notes presented (or, as the case may be, in respect of which Coupons are presented) for payment by the relevant holder and the amount of such payment shall be rounded down to the nearest euro 0.01;
  - (iii) if definitive Notes are required to be issued after the Redenomination Date, they shall be issued at the expense of the Issuer in the denominations of euro 1,000, euro 10,000, euro 100,000 and (but only to the extent of any remaining amounts less than euro 1,000 or such smaller denominations as the Agent may approve) euro 0.01 and such other denominations as the Agent shall determine and notify to the Noteholders;
  - (iv) if issued prior to the Redenomination Date, all unmatured Coupons denominated in the Specified Currency (whether or not attached to the Notes) will become void with effect from the date on which the Issuer gives notice (the “**Exchange Notice**”) that replacement euro-denominated Notes, Receipts and Coupons are available for exchange (provided that such securities are so available) and no payments will be made in respect of them. The payment obligations contained in any Notes and Receipts so issued will also become void on that date although those Notes and Receipts will continue to constitute valid exchange obligations of the Issuer. New euro-denominated Notes, Receipts and Coupons will be issued in exchange for Notes, Receipts and Coupons denominated in the Specified Currency in such manner as the Agent may specify and as shall be notified to the Noteholders in the Exchange Notice. No Exchange Notice may be given less than 15 days prior to any date for payment of principal or interest on the Notes;
  - (v) after the Redenomination Date, all payments in respect of the Notes, the Receipts and the Coupons, other than payments of interest in respect of periods commencing before the Redenomination Date, will be made solely in euro as though references in the Notes to the Specified Currency were to euro. Payments will be made in euro by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque;
  - (vi) if the Notes are Fixed Rate Notes and interest for any period ending on or after the Redenomination Date is required to be calculated for a period ending other than on an Interest Payment Date, it will be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention; and
  - (vii) if the Notes are Floating Rate Notes, the applicable Final Terms will specify any relevant changes to the provisions relating to interest.
- (b) *Definitions*

In these Conditions, the following expressions have the following meanings:

“**Established Rate**” means the rate for the conversion of the Specified Currency (including compliance with rules relating to roundings in accordance with applicable European

Community regulations) into euro established by the Council of the European Union pursuant to Article 123 of the Treaty;

“**euro**” means the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty;

“**Redenomination Date**” means (in the case of interest bearing Notes) any date for payment of interest under the Notes or (in the case of Zero Coupon Notes) any date, in each case specified by the Issuer in the notice given to the Noteholders pursuant to paragraph (a) above and which falls on or after the date on which the country of the Specified Currency first participates in the third stage of European economic and monetary union; and

“**Treaty**” means the Treaty establishing the European Community, as amended.

## 5. INTEREST

### (a) *Interest on Fixed Rate Notes*

Each Fixed Rate Note bears interest on its outstanding nominal amount (or, if it is a Partly Paid Note, the amount paid up) from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

Except as provided in the applicable Final Terms, the amount of interest payable on each Interest Payment Date in respect of the Fixed Interest Period ending on (but excluding) such date will amount to the Fixed Coupon Amount. Payments of interest on any Interest Payment Date will, if so specified in the applicable Final Terms, amount to the Broken Amount so specified.

As used in these Terms and Conditions, “**Fixed Interest Period**” means the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date.

If interest is required to be calculated for a period other than a Fixed Interest Period, such interest shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

“**Day Count Fraction**” means, in respect of the calculation of an amount of interest in accordance with this Condition 5(a):

- (i) if “Actual/Actual (ISMA)” is specified in the applicable Final Terms:
  - (a) in the case of Notes where the number of days in the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (the “**Accrual Period**”) is equal to or shorter than the Determination Period during which the Accrual Period ends, the number of days in such Accrual Period divided by the product of (1) the number of days in such Determination Period and (2) the number of Determination Dates (as specified in the applicable Final Terms) that would occur in one calendar year; or
  - (b) in the case of Notes where the Accrual Period is longer than the Determination Period during which the Accrual Period ends, the sum of:
    - (1) the number of days in such Accrual Period falling in the Determination Period in which the Accrual Period begins divided by the product of (x) the



- number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and
- (2) the number of days in such Accrual Period falling in the next Determination Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and
- (ii) if “30/360” is specified in the applicable Final Terms, the number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (such number of days being calculated on the basis of a year of 360 days with 12 30-day months) divided by 360.

In these Terms and Conditions:

**“Determination Period”** means each period from (and including) a Determination Date to but excluding the next Determination Date (including, where either the Interest Commencement Date or the final Interest Payment Date is not a Determination Date, the period commencing on the first Determination Date prior to, and ending on the first Determination Date falling after, such date) ; and

**“sub-unit”** means, with respect to any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency and, with respect to euro, one cent.

(b) *Interest on Floating Rate Notes and Index Linked Interest Notes*

(i) *Interest Payment Dates*

Each Floating Rate Note and Index Linked Interest Note bears interest on its outstanding nominal amount (or, if it is a Partly Paid Note, the amount paid up) from (and including) the Interest Commencement Date and such interest will be payable in arrear on either:

- (A) the Specified Interest Payment Date(s) in each year specified in the applicable Final Terms; or
- (B) if no Specified Interest Payment Date(s) is/are specified in the applicable Final Terms, each date (each such date, together with each Specified Interest Payment Date, an **“Interest Payment Date”**) which falls the number of months or other period specified as the Specified Period in the applicable Final Terms after the preceding Interest Payment Date or, in the case of the first Interest Payment Date, after the Interest Commencement Date.

Such interest will be payable in respect of each Interest Period (which expression shall, in these Terms and Conditions, mean the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date).

If a Business Day Convention is specified in the applicable Final Terms and (x) if there is no numerically corresponding day on the calendar month in which an Interest Payment Date should occur or (y) if any Interest Payment Date would otherwise fall on a day which is not a Business Day, then, if the Business Day Convention specified is:

- (1) in any case where Specified Periods are specified in accordance with Condition 5(b)(i)(B) above, the Floating Rate Convention, such Interest Payment Date (i) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (B) below shall apply *mutatis mutandis* or (ii) in the case of (y) above, shall be postponed to the next day which is a Business Day unless it would



thereby fall into the next calendar month, in which event (A) such Interest Payment Date shall be brought forward to the immediately preceding Business Day and (B) each subsequent Interest Payment Date shall be the last Business Day in the month which falls the Specified Period after the preceding applicable Interest Payment Date occurred; or

- (2) the Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day; or
- (3) the Modified Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event such Interest Payment Date shall be brought forward to the immediately preceding Business Day; or
- (4) the Preceding Business Day Convention, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

In these Terms and Conditions, “**Business Day**” means a day which is both:

- (A) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London and any Additional Business Centre specified in the applicable Final Terms; and
- (B) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than London and any Additional Business Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney or Auckland, respectively) or (2) in relation to any sum payable in euro, a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System (the “**TARGET System**”) is open.

(ii) *Rate of Interest*

The Rate of Interest payable from time to time in respect of Floating Rate Notes and Index Linked Interest Notes will be determined in the manner specified in the applicable Final Terms.

(A) *ISDA Determination for Floating Rate Notes*

Where ISDA Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will be the relevant ISDA Rate plus or minus (as indicated in the applicable Final Terms) the Margin (if any). For the purposes of this sub-paragraph (A), “**ISDA Rate**” for an Interest Period means a rate equal to the Floating Rate that would be determined by the Agent under an interest rate swap transaction if the Agent were acting as Calculation Agent for that swap transaction under the terms of an agreement incorporating the 2000 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc. and as amended and updated as at the Issue Date of the first Tranche of the Notes (the “**ISDA Definitions**”) and under which:

- (1) the Floating Rate Option is as specified in the applicable Final Terms;
- (2) the Designated Maturity is a period specified in the applicable Final Terms; and

- (3) the relevant Reset Date is either (i) if the applicable Floating Rate Option is based on the London inter-bank offered rate ("**LIBOR**") or on the Euro-zone inter-bank offered rate ("**EURIBOR**"), the first day of that Interest Period or (ii) in any other case, as specified in the applicable Final Terms.

For the purposes of this sub-paragraph (A), "**Floating Rate**", "**Calculation Agent**", "**Floating Rate Option**", "**Designated Maturity**" and "**Reset Date**" have the meanings given to those terms in the ISDA Definitions.

*(B) Screen Rate Determination for Floating Rate Notes*

Where Screen Rate Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will, subject as provided below, be either:

- (1) the offered quotation; or
- (2) the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards) of the offered quotations,

(expressed as a percentage rate per annum) for the Reference Rate which appears or appear, as the case may be, on the Relevant Screen Page as at 11.00 a.m. (London time, in the case of LIBOR, or Brussels time, in the case of EURIBOR) on the Interest Determination Date in question plus or minus (as indicated in the applicable Final Terms) the Margin (if any), all as determined by the Agent. If five or more of such offered quotations are available on the Relevant Screen Page, the highest (or, if there is more than one such highest quotation, one only of such quotations) and the lowest (or, if there is more than one such lowest quotation, one only of such quotations) shall be disregarded by the Agent for the purpose of determining the arithmetic mean (rounded as provided above) of such offered quotations.

The Agency Agreement contains provisions for determining the Rate of Interest in the event that the Relevant Screen Page is not available or if, in the case of (1) above, no such offered quotation appears or, in the case of (2) above, fewer than three such offered quotations appear, in each case as at the time specified in the preceding paragraph.

If the Reference Rate from time to time in respect of Floating Rate Notes is specified in the applicable Final Terms as being other than LIBOR or EURIBOR, the Rate of Interest in respect of such Notes will be determined as provided in the applicable Final Terms.

*(iii) Minimum Rate of Interest and/or Maximum Rate of Interest*

If the applicable Final Terms specifies a Minimum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is less than such Minimum Rate of Interest, the Rate of Interest for such Interest Period shall be such Minimum Rate of Interest.

If the applicable Final Terms specifies a Maximum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is greater than such Maximum Rate of Interest, the Rate of Interest for such Interest Period shall be such Maximum Rate of Interest.

(iv) *Determination of Rate of Interest and calculation of Interest Amounts*

The Agent, in the case of Floating Rate Notes, and the Calculation Agent, in the case of Index Linked Interest Notes, will at or as soon as practicable after each time at which the Rate of Interest is to be determined, determine the Rate of Interest for the relevant Interest Period. In the case of Index Linked Interest Notes, the Calculation Agent will notify the Agent of the Rate of Interest for the relevant Interest Period as soon as practicable after calculating the same.

The Agent will calculate the amount of interest (the “**Interest Amount**”) payable on the Floating Rate Notes or Index Linked Interest Notes in respect of each Specified Denomination for the relevant Interest Period. Each Interest Amount shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

“**Day Count Fraction**” means, in respect of the calculation of an amount of interest in accordance with this Condition 5(b):

- (i) if “Actual/365” or “Actual/Actual” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365);
- (ii) if “Actual/365 (Fixed)” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365;
- (iii) if “Actual/365 (Sterling)” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 or, in the case of an Interest Payment Date falling in a leap year, 366;
- (iv) if “Actual/360” is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 360;
- (v) if “30/360”, “360/360” or “Bond Basis” is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months (unless (a) the last day of the Interest Period is the 31st day of a month but the first day of the Interest Period is a day other than the 30th or 31st day of a month, in which case the month that includes that last day shall not be considered to be shortened to a 30-day month, or (b) the last day of the Interest Period is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month)); and
- (vi) if “30E/360” or “Eurobond Basis” is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months, without regard to the date of the first day or last day of the Interest Period unless, in the case of the final Interest Period, the Maturity Date is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month).

(v) *Notification of Rate of Interest and Interest Amounts*

The Agent will cause the Rate of Interest and each Interest Amount for each Interest Period and the relevant Interest Payment Date to be notified to the Issuer and any stock exchange on which the relevant Floating Rate Notes or Index Linked Interest Notes are for the time

being listed by no later than the first day of each Interest Period and notice thereof to be published in accordance with Condition 14 as soon as possible after their determination but in no event later than the first day of the relevant Interest Period. Each Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without prior notice in the event of an extension or shortening of the Interest Period. Any such amendment will be promptly notified to each stock exchange on which the relevant Floating Rate Notes or Index Linked Interest Notes are for the time being listed and to the Noteholders in accordance with Condition 14. For the purposes of this paragraph, the expression “**London Business Day**” means a day (other than a Saturday or a Sunday) on which banks and foreign exchange markets are open for general business in London.

(vi) *Certificates to be final*

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition 5(b), whether by the Agent or, if applicable, the Calculation Agent, shall (in the absence of wilful default, bad faith or manifest error) be binding on the Issuer, the Agent, the Calculation Agent (if applicable), the other Paying Agents and all Noteholders, Receiptholders and Couponholders and (in the absence as aforesaid) no liability to the Issuer, the Noteholders, the Receiptholders or the Couponholders shall attach to the Agent or the Calculation Agent (if applicable) in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

(c) *Interest on Dual Currency Interest Notes*

The rate or amount of interest payable in respect of Dual Currency Interest Notes shall be determined in the manner specified in the applicable Final Terms.

(d) *Interest on Partly Paid Notes*

In the case of Partly Paid Notes (other than Partly Paid Notes which are Zero Coupon Notes), interest will accrue as aforesaid on the paid-up nominal amount of such Notes and otherwise as specified in the applicable Final Terms.

(e) *Interest on Target Redemption Notes*

The rate or amount of interest payable in respect of Target Redemption Notes shall be determined in the manner specified in the applicable Final Terms.

(f) *Interest on Range Accrual Notes*

The rate or amount of interest payable in respect of Range Accrual Notes shall be determined in the manner specified in the applicable Final Terms.

(g) *Accrual of interest*

Each Note (or in the case of the redemption of part only of a Note, that part only of such Note) will cease to bear interest (if any) from the date for its redemption unless, upon due presentation thereof, payment of principal is improperly withheld or refused. In such event, interest will continue to accrue until whichever is the earlier of:

- (1) the date on which all amounts due in respect of such Note have been paid; and
- (2) five days after the date on which the full amount of the moneys payable in respect of such Note has been received by the Agent and notice to that effect has been given to the Noteholders in accordance with Condition 14.

(h) *Sufficiency of Available Distributable Funds in respect of Capital Notes*

- (1) Payments of interest on any Interest Payment Date may not exceed, taking into account all payments previously made in the fiscal year in which the Interest Payment Date falls in respect of the Capital Notes, other Capital Securities ranking *pari passu* with the Notes and Other Tier I Securities, the Available Distributable Funds. To the extent that, on any Interest Payment Date, Available Distributable Funds are insufficient to pay or provide for payment in full of all accrued but unpaid interest under the Capital Notes, other Capital Securities ranking *pari passu* with the Capital Notes and Other Tier I Securities (in each case falling due on that Interest Payment Date), the Issuer will make partial payment of all accrued but unpaid interest under the Capital Notes, such other Capital Securities and Other Tier I Securities *pro rata* to the extent of such Available Distributable Funds. If, and to the extent that Available Distributable Funds are insufficient or non-existent and the Issuer makes partial payment of, or does not pay, accrued but unpaid interest, the right of the Capital Noteholders to receive accrued but unpaid interest in respect of the relevant Interest Period will be deferred until the Deferral End Date. At the Deferral End Date the Issuer will make full or partial payment of all deferred but unpaid interest under these Capital Notes and such other Capital Securities and Other Tier 1 Securities *pro rata* to the extent the Issuer has accrued any Unallocated Distributable Profits, as determined by the Board of Directors of the Issuer after consultation with the Issuer's auditors, in such fiscal year. If, and to the extent that, any deferred payments remain unpaid after the applicable Deferral End Date, the right of the Capital Noteholders to receive such deferred payments will be lost. The Issuer will have no obligation to make such payments of unpaid deferred interest or to pay interest thereon, whether or not payments of interest in respect of subsequent Interest Periods are made, and such unpaid deferred interest will not be deemed to have "accrued" or been earned for any purpose.

Notwithstanding anything to the contrary herein, the Issuer will not make any payments of interest if the Issuer, following payment of such interest, would no longer meet the requirements with respect to Minimum Own Funds.

- (2) The Issuer covenants that, so long as any Capital Note is outstanding, if the most recent scheduled payments on the Capital Notes have not been made in full or utilisation of a Converted Amount has been made, as aforesaid:
- (i) subject to sub-clause (1) above, it shall not declare (nor shall its Board of Directors propose the declaration of), pay or distribute interest, a dividend or any other amount on, or in respect of, any Other Tier I Securities or any Junior Securities or make any payment on a Tier I Guarantee (except, in the case of Capital Securities ranking *pari passu* with the Capital Notes, any payments made on a *pro rata* basis as contemplated above);
  - (ii) subject to sub-clause (1) above, it shall not redeem, purchase or otherwise acquire any Other Tier I Securities or Junior Securities or purchase or otherwise acquire any security benefiting from a Tier I Guarantee (save where those shares or securities being redeemed, purchased or acquired are replaced contemporaneously by an issue of shares or securities of the same aggregate principal amount and the same ranking in an insolvency or a voluntary or involuntary liquidation of the Issuer to those shares or securities being redeemed, purchased or acquired); and
  - (iii) it will procure that no payment is made, or any redemption, purchase or acquisition is effected, by any Subsidiary on any security (however named or designated) benefiting from a Tier I Guarantee,

in each case until the Dividend Stopper End Date or, as the case may be, until an amount equal to any Converted Amount has been reconverted and reinstated as an



obligation in respect of the Capital Notes in full in the balance sheet of the Issuer, or such amount has been redeemed (such redemption having been approved by the FSA).

If the Issuer deems that it does not have sufficient Available Distributable Funds to pay accrued interest on the Capital Notes on the next Interest Payment Date, the Issuer shall, if reasonably practicable and if so permitted by the applicable regulations of any stock exchange upon which the Issuer's equity or debt is then listed, give not more than 14 nor less than five days' prior notice to the Capital Noteholders in accordance with Condition 14.

**"Available Distributable Funds"** means, in respect of each fiscal year of the Issuer, the aggregate amount, as calculated as of the end of the immediately preceding fiscal year in the individual financial statements of the Issuer, of accumulated retained earnings and any other reserves and surpluses capable under Icelandic law of being available for distribution as cash dividends to holders of Bank Share Capital, but before deduction of the amount of any dividend or other distribution declared on Bank Share Capital in respect of such prior fiscal year.

**"Deferral End Date"** means the earlier of (i) the date on which the Issuer accrues enough Unallocated Distributable Profits during the fiscal year of the Issuer in which such interest payments were otherwise due, as determined by the Board of Directors of the Issuer after consultation with the Issuer's auditors, to pay the entire deferred payment due under the Capital Notes and under other Capital Securities ranking *pari passu* with the Capital Notes and Other Tier I Securities, and makes such payments or (ii) 31st December of the fiscal year of the Issuer in which such payments were otherwise due.

**"Dividend Stopper End Date"** means the later of (a) if all such scheduled payments are paid on the Deferral End Date applicable to such payment, such Deferral End Date or (b) the date which is twelve calendar months after the earlier of the date (i) on which a full interest payment is not paid on the Capital Notes and (ii) on which a full scheduled dividend, interest payment or distribution on any Capital Security ranking *pari passu* with the Capital Notes has not been paid.

**"Junior Securities"** means (i) ordinary share capital of the Issuer, (ii) each class of preference share capital of the Issuer and any other instrument of the Issuer ranking *pari passu* herewith or junior hereto, and (iii) preference share capital or any other instrument of any Subsidiary of the Issuer subject to any guarantee or support agreement of the Issuer ranking junior to the obligations of the Issuer under the Capital Notes.

**"Other Tier I Securities"** means any securities which are Tier I Capital of the Issuer and which rank on an insolvency or a voluntary or involuntary liquidation of the Issuer *pari passu* with the Capital Notes.

**Subsidiary** means, in relation to the Issuer, any company (i) in which the Issuer holds a majority of the voting rights or (ii) of which the Issuer is a member and has the right to appoint or remove a majority of the board of directors or (iii) of which the Issuer is a member and controls a majority of the voting rights, and includes any company which is a Subsidiary of a Subsidiary of the Issuer.

**"Tier I Guarantee"** means any guarantee, indemnity or other contractual support arrangement entered into by the Issuer in respect of securities (regardless of name or designation) issued by a Subsidiary which constitutes Tier I Capital of the Issuer.



## 6. PAYMENTS

### (a) *Method of payment*

Subject as provided below:

- (i) payments in a Specified Currency other than euro will be made by credit or transfer to an account in the relevant Specified Currency (which, in the case of a payment in Japanese yen to a non-resident of Japan, shall be a non-resident account) maintained by the payee with, or, at the option of the payee, by a cheque in such Specified Currency drawn on, a bank in the principal financial centre of the country of such Specified Currency (which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Sydney and Auckland, respectively); and
- (ii) payments in euro will be made by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque.

Payments will be subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 8.

### (b) *Presentation of definitive Notes, Receipts and Coupons*

Payments of principal in respect of definitive Notes will (subject as provided below) be made in the manner provided in paragraph (a) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of definitive Notes, and payments of interest in respect of definitive Notes will (subject as provided below) be made as aforesaid only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of Coupons, in each case at the specified office of any Paying Agent outside the United States (which expression, as used herein, means the United States of America (including the States and the District of Columbia, its territories, its possessions and other areas subject to its jurisdiction)).

Payments of instalments of principal (if any) in respect of definitive Notes, other than the final instalment, will (subject as provided below) be made in the manner provided in paragraph (a) above against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Receipt in accordance with the preceding paragraph. Payment of the final instalment will be made in the manner provided in paragraph (a) above only against presentation and surrender (or, in the case of part payment of any sum due, endorsement) of the relevant Note in accordance with the preceding paragraph. Each Receipt must be presented for payment of the relevant instalment together with the definitive Note to which it appertains. Receipts presented without the definitive Note to which they appertain do not constitute valid obligations of the Issuer. Upon the date on which any definitive Note becomes due and repayable, unmatured Receipts (if any) relating thereto (whether or not attached) shall become void and no payment shall be made in respect thereof.

Fixed Rate Notes in definitive form (other than Dual Currency Notes, Index Linked Notes, Range Accrual Notes, Target Redemption Notes or Long Maturity Notes (as defined below)) should be presented for payment together with all unmatured Coupons appertaining thereto (which expression shall for this purpose include Coupons falling to be issued on exchange of matured Talons), failing which the amount of any missing unmatured Coupon (or, in the case of payment not being made in full, the same proportion of the amount of such missing unmatured Coupon as the sum so paid bears to the sum due) will be deducted from the sum due for payment. Each amount of principal so deducted will be paid in the manner mentioned above against surrender of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date (as defined in Condition 8) in respect of such principal

(whether or not such Coupon would otherwise have become void under Condition 9) or, if later, five years from the date on which such Coupon would otherwise have become due, but in no event thereafter.

Upon any Fixed Rate Note in definitive form becoming due and repayable prior to its Maturity Date, all unmatured Talons (if any) appertaining thereto will become void and no further Coupons will be issued in respect thereof.

Upon the date on which any Floating Rate Note, Dual Currency Note, Index Linked Note, Range Accrual Note, Target Redemption Note or Long Maturity Note in definitive form becomes due and repayable, unmatured Coupons and Talons (if any) relating thereto (whether or not attached) shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof. A “**Long Maturity Note**” is a Fixed Rate Note (other than a Fixed Rate Note which on issue had a Talon attached) whose nominal amount on issue is less than the aggregate interest payable thereon provided that such Note shall cease to be a Long Maturity Note on the Interest Payment Date on which the aggregate amount of interest remaining to be paid after that date is less than the nominal amount of such Note.

If the due date for redemption of any definitive Note is not an Interest Payment Date, interest (if any) accrued in respect of such Note from (and including) the preceding Interest Payment Date or, as the case may be, the Interest Commencement Date shall be payable only against surrender of the relevant definitive Note.

(c) *Payments in respect of Global Notes*

Payments of principal and interest (if any) in respect of Notes represented by any Global Note will (subject as provided below) be made in the manner specified above in relation to definitive Notes and otherwise in the manner specified in the relevant Global Note against presentation or surrender, as the case may be, of such Global Note at the specified office of any Paying Agent outside the United States. A record of each payment made against presentation or surrender of any Global Note, distinguishing between any payment of principal and any payment of interest, will be made on such Global Note by the Paying Agent to which it was presented and such record shall be prima facie evidence that the payment in question has been made.

(d) *General provisions applicable to payments*

The holder of a Global Note shall be the only person entitled to receive payments in respect of Notes represented by such Global Note and the Issuer will be discharged by payment to, or to the order of, the holder of such Global Note in respect of each amount so paid. Each of the persons shown in the records of Euroclear or Clearstream, Luxembourg as the beneficial holder of a particular nominal amount of Notes represented by such Global Note must look solely to Euroclear or Clearstream, Luxembourg, as the case may be, for his share of each payment so made by the Issuer to, or to the order of, the holder of such Global Note.

Notwithstanding the foregoing provisions of this Condition, if any amount of principal and/or interest in respect of Notes is payable in U.S. dollars, such U.S. dollar payments of principal and/or interest in respect of such Notes will be made at the specified office of a Paying Agent in the United States if:

- (i) the Issuer has appointed Paying Agents with specified offices outside the United States with the reasonable expectation that such Paying Agents would be able to make payment in U.S. dollars at such specified offices outside the United States of the full amount of principal and interest on the Notes in the manner provided above when due;

- (ii) payment of the full amount of such principal and interest at all such specified offices outside the United States is illegal or effectively precluded by exchange controls or other similar restrictions on the full payment or receipt of principal and interest in U.S. dollars; and
- (iii) such payment is then permitted under United States law without involving, in the opinion of the Issuer, adverse tax consequences to the Issuer.

(e) *Payment Day*

If the date for payment of any amount in respect of any Note, Receipt or Coupon is not a Payment Day, the holder thereof shall not be entitled to payment until the next following Payment Day in the relevant place and shall not be entitled to further interest or other payment in respect of such delay. For these purposes, “**Payment Day**” means any day which (subject to Condition 9) is:

- (i) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in:
  - (A) the relevant place of presentation;
  - (B) London;
  - (C) any Additional Financial Centre specified in the applicable Final Terms; and
- (ii) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than the place of presentation, London and any Additional Financial Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Sydney or Auckland, respectively) or (2) in relation to any sum payable in euro, a day on which the TARGET System is open.

(f) *Interpretation of principal and interest*

Any reference in these Terms and Conditions to principal in respect of the Notes shall be deemed to include, as applicable:

- (i) any additional amounts which may be payable with respect to principal under Condition 8;
- (ii) the Final Redemption Amount of the Notes;
- (iii) the Early Redemption Amount of the Notes;
- (iv) the Optional Redemption Amount(s) (if any) of the Notes;
- (v) in relation to Notes redeemable in instalments, the Instalment Amounts;
- (vi) in relation to Zero Coupon Notes, the Amortised Face Amount (as defined in Condition 7(f)); and
- (vii) any premium and any other amounts (other than interest) which may be payable by the Issuer under or in respect of the Notes.

Any reference in these Terms and Conditions to interest in respect of the Notes shall be deemed to include, as applicable, any additional amounts which may be payable with respect to interest under Condition 8.

## 7. REDEMPTION AND PURCHASE

### (a) *Redemption at maturity*

Unless previously redeemed or purchased and cancelled as specified below, each Note (including each Index Linked Redemption Note, Dual Currency Redemption Note and Range Accrual Note but excluding each Target Redemption Note) will be redeemed by the Issuer at its Final Redemption Amount specified in, or determined in the manner specified in, the applicable Final Terms in the relevant Specified Currency on the Maturity Date. Capital Notes shall be undated, with no fixed date for redemption. Each Target Redemption Note will be redeemed by the Issuer at its Final Redemption Amount specified in, or determined in the manner specified in, the applicable Final Terms in the relevant Specified Currency on the date determined in accordance with the applicable Final Terms.

### (b) *Redemption for tax reasons*

The Notes may, subject, in the case of Capital Notes, to the prior approval of the FSA (provided that such approval can validly be given in accordance with the applicable rules, regulations and policies of the FSA) and to Condition 7(l) below, be redeemed at the option of the Issuer in whole, but not in part, at any time (if this Note is neither a Floating Rate Note, an Index Linked Interest Note nor a Dual Currency Interest Note) or on any Interest Payment Date (if this Note is either a Floating Rate Note, an Index Linked Interest Note, a Dual Currency Interest Note, a Target Redemption Note or a Range Accrual Note), on giving not less than 30 nor more than 60 days' notice to the Agent and, in accordance with Condition 14, the Noteholders (which notice shall be irrevocable), if:

- (i) on the occasion of the next payment due under the Notes, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 8 as a result of any change in, or amendment to, the laws or regulations of a Tax Jurisdiction (as defined in Condition 8) or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the date on which agreement is reached to issue the first Tranche of the Notes; and
- (ii) such obligation cannot be avoided by the Issuer taking reasonable measures available to it,

provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such additional amounts were a payment in respect of the Notes then due.

Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Agent a certificate signed by two Directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred, and an opinion of independent legal advisers of recognised standing to the effect that the Issuer has or will become obliged to pay such additional amounts as a result of such change or amendment.

Notes redeemed pursuant to this Condition 7(b) will be redeemed at their Early Redemption Amount referred to in paragraph (f) below together (if appropriate) with interest accrued to (but excluding) the date of redemption.

### (c) *Redemption at the option of the Issuer (Issuer Call)*

If Issuer Call is specified in the applicable Final Terms, the Issuer may, subject, in the case of Capital Notes, to the prior approval of the FSA (provided that such approval can validly be

given in accordance with the applicable rules regulations and policies of the FSA) and to Condition 7(l) below, having given:

- (i) not less than 15 nor more than 30 days' notice to the Noteholders in accordance with Condition 14; and
- (ii) not less than 15 days before the giving of the notice referred to in (i), notice to the Agent;

(which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or (other than in respect of Capital Notes) some only of the Notes then outstanding on any Optional Redemption Date and at the Optional Redemption Amount(s) specified in, or determined in the manner specified in, the applicable Final Terms together, if appropriate, with interest accrued to (but excluding) the relevant Optional Redemption Date. Any such redemption must be of a nominal amount not less than the Minimum Redemption Amount and not more than the Maximum Redemption Amount, in each case as may be specified in the applicable Final Terms. In the case of a partial redemption of Notes, the Notes to be redeemed ("**Redeemed Notes**") will be selected individually by lot, in the case of Redeemed Notes represented by definitive Notes, and in accordance with the rules of Euroclear and/or Clearstream, Luxembourg, in the case of Redeemed Notes represented by a Global Note, not more than 30 days prior to the date fixed for redemption (such date of selection being hereinafter called the "**Selection Date**"). In the case of Redeemed Notes represented by definitive Notes, a list of the serial numbers of such Redeemed Notes will be published in accordance with Condition 14 not less than 15 days prior to the date fixed for redemption. The aggregate nominal amount of Redeemed Notes represented by definitive Notes shall bear the same proportion to the aggregate nominal amount of all Redeemed Notes as the aggregate nominal amount of definitive Notes outstanding bears to the aggregate nominal amount of the Notes outstanding, in each case on the Selection Date, provided that such first mentioned nominal amount shall, if necessary, be rounded downwards to the nearest integral multiple of the Specified Denomination, and the aggregate nominal amount of Redeemed Notes represented by a Global Note shall be equal to the balance of the Redeemed Notes. No exchange of the relevant Global Note will be permitted during the period from (and including) the Selection Date to (and including) the date fixed for redemption pursuant to this paragraph (c) and notice to that effect shall be given by the Issuer to the Noteholders in accordance with Condition 14 at least five days prior to the Selection Date.

(d) *Redemption at the option of the Noteholders (Investor Put)*

If Investor Put is specified in the applicable Final Terms, upon the holder of any Note giving to the Issuer in accordance with Condition 14 not less than 15 nor more than 30 days' notice the Issuer will, upon the expiry of such notice, redeem, subject to, and in accordance with, the terms specified in the applicable Final Terms, such Note on the Optional Redemption Date and at the Optional Redemption Amount together, if appropriate, with interest accrued to (but excluding) the Optional Redemption Date.

To exercise the right to require redemption of this Note the holder of this Note must, if this Note is in definitive form and held outside Euroclear and Clearstream, Luxembourg, deliver, at the specified office of any Paying Agent at any time during normal business hours of such Paying Agent falling within the notice period, a duly completed and signed notice of exercise in the form (for the time being current) obtainable from any specified office of any Paying Agent (a "**Put Notice**") and in which the holder must specify a bank account (or, if payment is required to be made by cheque, an address) to which payment is to be made under this Condition accompanied by, if this Note is in definitive form, this Note or evidence satisfactory to the Paying Agent concerned that this Note will, following delivery of the Put Notice, be held to its order or under its control. If this Note is represented by a Global Note or is in definitive



form and held through Euroclear or Clearstream, Luxembourg, to exercise the right to require redemption of this Note the holder of this Note must, within the notice period, give notice to the Agent of such exercise in accordance with the standard procedures of Euroclear and Clearstream, Luxembourg (which may include notice being given on his instruction by Euroclear or Clearstream, Luxembourg or any common depository for them to the Agent by electronic means) in a form acceptable to Euroclear and Clearstream, Luxembourg from time to time and, if this Note is represented by a Global Note, at the same time present or procure the presentation of the relevant Global Note to the Agent for notation accordingly.

Any Put Notice given by a holder of any Note pursuant to this paragraph shall be irrevocable except where prior to the due date of redemption an Event of Default shall have occurred and be continuing in which event such holder, at its option, may elect by notice to the Issuer to withdraw the notice given pursuant to this paragraph and instead to declare such Note forthwith due and payable pursuant to Condition 10.

(e) *Redemption upon the occurrence of a Special Event*

Subject as provided in Condition 7(l) below, and in the case of Capital Notes only, upon the occurrence of a Special Event (as defined in Condition 7(m) below), the Issuer may, subject to the prior approval of the FSA (provided that such approval can validly be given in accordance with applicable rules, regulations and policies of the FSA), at its option, having given not less than 30 days' nor more than 60 days' notice to the holders of the Capital Notes in accordance with Condition 14 (which notice shall be irrevocable), redeem all (but not some only) of the Capital Notes on any Special Event Redemption Date (as specified in the applicable Final Terms) at an amount equal to the Special Event Redemption Amount (as specified in the applicable Final Terms).

(f) *Early Redemption Amounts*

For the purpose of paragraph (b) above and Condition 10, each Note will be redeemed at its Early Redemption Amount calculated as follows:

- (i) in the case of a Note with a Final Redemption Amount equal to the Issue Price, at the Final Redemption Amount thereof;
- (ii) in the case of a Note (other than a Zero Coupon Note but including an Instalment Note and a Partly Paid Note) with a Final Redemption Amount which is or may be less or greater than the Issue Price or which is payable in a Specified Currency other than that in which the Note is denominated, at the amount specified in, or determined in the manner specified in, the applicable Final Terms or, if no such amount or manner is so specified in the applicable Final Terms, at its nominal amount; or
- (iii) in the case of a Zero Coupon Note, at an amount (the “**Amortised Face Amount**”) calculated in accordance with the following formula:

$$\text{Early Redemption Amount} = \text{RP} \times (1 + \text{AY})^y$$

where:

“**RP**” means the Reference Price;

“**AY**” means the Accrual Yield expressed as a decimal; and

“**y**” is a fraction the numerator of which is equal to the number of days (calculated on the basis of a 360-day year consisting of 12 months of 30 days each) from (and including) the Issue Date of the first Tranche of the Notes to (but excluding) the date fixed for



redemption or (as the case may be) the date upon which such Note becomes due and repayable and the denominator of which is 360,

or on such other calculation basis as may be specified in the applicable Final Terms.

(g) *Instalments*

Instalment Notes will be redeemed in the Instalment Amounts and on the Instalment Dates. In the case of early redemption, the Early Redemption Amount will be determined pursuant to paragraph (f) above.

(h) *Partly Paid Notes*

Partly Paid Notes will be redeemed, whether at maturity, early redemption or otherwise, in accordance with the provisions of this Condition and the applicable Final Terms.

(i) *Purchases*

The Issuer or any Subsidiary of the Issuer may (subject, in the case of Capital Notes, to the prior approval of the FSA and provided that such approval can validly be given in accordance with the rules, regulations and policies of the FSA at any time purchase Notes (provided that, in the case of definitive Notes, all unmatured Receipts, Coupons and Talons appertaining thereto are purchased therewith) at any price in the open market or otherwise. If purchases are made by tender, tenders must be available to all Noteholders alike. Such Notes may be held, reissued, resold or, at the option of the Issuer, surrendered to any Paying Agent for cancellation.

(j) *Cancellation*

All Notes which are redeemed will forthwith be cancelled (together with all unmatured Receipts, Coupons and Talons attached thereto or surrendered therewith at the time of redemption). All Notes so cancelled and any Notes purchased and cancelled pursuant to paragraph (i) above (together with all unmatured Receipts, Coupons and Talons cancelled therewith) shall be forwarded to the Agent and cannot be reissued or resold.

(k) *Late payment on Zero Coupon Notes*

If the amount payable in respect of any Zero Coupon Note upon redemption of such Zero Coupon Note pursuant to paragraph (a), (b), (c) or (d) above or upon its becoming due and repayable as provided in Condition 10 is improperly withheld or refused, the amount due and repayable in respect of such Zero Coupon Note shall be the amount calculated as provided in paragraph (f)(iii) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Note becomes due and payable were replaced by references to the date which is the earlier of:

- (i) the date on which all amounts due in respect of such Zero Coupon Note have been paid; and
- (ii) five days after the date on which the full amount of the moneys payable in respect of such Zero Coupon Notes has been received by the Agent and notice to that effect has been given to the Noteholders in accordance with Condition 14.

(l) *Redemption of Converted Amounts*

Save as provided in Condition 10, where any principal amount has been converted into Converted Amounts as described in Condition 2(d), the Issuer shall not redeem the Capital

Notes until all Converted Amounts have been reconverted and reinstated as debt in full as an obligation in respect of the Capital Notes.

A “**Special Event**” means the occurrence of any of a Tax Event or a Capital Event.

A “**Tax Event**” means the receipt by the Issuer of an opinion of counsel in Iceland (experienced in such matters) to the effect that, as a result of (i) any amendment to, clarification of, or change (including any announced prospective change) in, the laws or treaties (or any regulations thereunder) of Iceland or any political subdivision or taxing authority thereof or therein affecting taxation, (ii) any governmental action or (iii) any amendment to, clarification of, or change in the official position or the interpretation of such governmental action or any interpretation or pronouncement that provides for a position with respect to such government action that differs from the theretofore generally accepted position, in each case, by any legislative body, court, governmental authority or regulatory body, irrespective of the manner in which such amendment, clarification or change is made known, which amendment, clarification or change is effective or such pronouncement or decision is announced on or after the Issue Date of the Capital Notes, there is more than an insubstantial risk that the Issuer is, or will be, subject to more than a *de minimis* amount of other taxes, duties or other governmental charges or civil liabilities with respect to the Capital Notes or any amount payable in respect of the Capital Notes.

## 8. TAXATION

All payments of principal and interest in respect of the Notes, Receipts and Coupons by the Issuer will be made without withholding or deduction for or on account of any present or future duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amounts as shall be necessary in order that the net amounts received by the holders of the Notes, Receipts or Coupons after such withholding or deduction shall equal the respective amounts of principal and interest which would otherwise have been receivable in respect of the Notes, Receipts or Coupons, as the case may be, in the absence of such withholding or deduction; except that no such additional amounts shall be payable with respect to any Note, Receipt or Coupon:

- (i) presented for payment by or on behalf of a holder who is liable for such taxes or duties in respect of such Note, Receipt or Coupon by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Note, Receipt or Coupon; or
- (ii) presented for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Payment Day (as defined in Condition 6(e)); or
- (iii) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (iv) presented for payment by or on behalf of a holder who would have been able to avoid such withholding or deduction by presenting the relevant Note, Receipt or Coupon to another Paying Agent in a Member State of the European Union.

As used herein:

- (A) “**Tax Jurisdiction**” means Iceland or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the

Issuer becomes subject in respect of payments made by it of principal and interest on the Notes, Receipts and Coupons; and

- (B) “**Relevant Date**” means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by the Agent on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Noteholders in accordance with Condition 14.

## 9. PRESCRIPTION

The Notes, Receipts and Coupons will become void unless presented for payment within a period of 10 years (in the case of principal) and five years (in the case of interest) after the Relevant Date (as defined in Condition 8) therefor.

There shall not be included in any Coupon sheet issued on exchange of a Talon any Coupon the claim for payment in respect of which would be void pursuant to this Condition or Condition 6(b) or any Talon which would be void pursuant to Condition 6(b).

## 10. EVENTS OF DEFAULT

### (a) *Events of Default relating to Senior Notes*

If any one or more of the following events (each an “**Event of Default**”) shall occur with respect to any Senior Note:

- (i) if default is made in the payment of any principal, premium (if any) or interest due in respect of the Notes or any of them and the default continues for a period of three days in the case of principal or premium (if any) and seven days in the case of interest; or
- (ii) if the Issuer fails to perform or observe any of its other obligations under these Conditions and (except in any case where the failure is incapable of remedy when no such continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days next following the service by a Noteholder on the Issuer of notice requiring the same to be remedied; or
- (iii) if any borrowed money of the Issuer or any of its Principal Subsidiaries is not paid when due or becomes (whether by declaration or automatically in accordance with the relevant agreement or instrument constituting the same) due and payable by reason of any default (however described) prior to the date when it would otherwise have become due or any creditor of the Issuer or any of its Principal Subsidiaries becomes entitled to declare any such Borrowed Money due and payable by reason of any default (however described) or any facility or commitment available to the Issuer or any of its Principal Subsidiaries relating to Borrowed Money is withdrawn, suspended or cancelled by reason of any default (however described) of the company concerned, provided that, for the purposes of this sub-clause (iii), the Borrowed Money must, when aggregated with all other Borrowed Money to which any part of this Condition 10(a)(iii) applies, exceed U.S.\$5,000,000 (or its equivalent in any other currency); or
- (iv) if any order is made by any competent court or resolution passed for the winding up or dissolution of the Issuer or any of its Principal Subsidiaries, save for the purposes of reorganisation on terms approved by an Extraordinary Resolution of the Noteholders; or
- (v) if the Issuer or any of its Principal Subsidiaries ceases or threatens to cease to carry on the whole or a substantial part of its business, save for the purposes of reorganisation on terms approved by an Extraordinary Resolution of the Noteholders, or the Issuer or any of its Principal Subsidiaries stops or threatens to stop payment of,

or is unable to, or admits inability to, pay, its debts (or any class of its debts) as they fall due, or is deemed unable to pay its debts pursuant to or for the purposes of any applicable law, or is adjudicated or found bankrupt or insolvent; or

- (vi) if (A) proceedings are initiated against the Issuer or any of its Principal Subsidiaries under any applicable liquidation, insolvency, composition, reorganisation or other similar laws, or an application is made for the appointment of an administrative or other receiver, manager, administrator or other similar official, or an administrative or other receiver, manager, administrator or other similar official is appointed, in relation to the Issuer or any of its Principal Subsidiaries or, as the case may be, in relation to the whole or a part of the undertaking or assets of any of them, or an encumbrancer takes possession of the whole or a part of the undertaking or assets of any of them, or a distress, execution, attachment, sequestration or other process is levied, enforced upon, sued out or put in force against the whole or a part of the undertaking or assets of any of them and (B) in any case (other than the appointment of an administrator) the same is not discharged within 14 days; or
- (vii) if the Issuer or any of its Principal Subsidiaries initiates or consents to judicial proceedings relating to itself under any applicable liquidation, insolvency, composition, reorganisation or other similar laws or makes a conveyance or assignment for the benefit of, or enters into any composition or other arrangement with, its creditors generally (or any class of its creditors) or any meeting is convened to consider a proposal for an arrangement or composition with its creditors generally (or any class of its creditors),

then any holder of a Senior Note may, by written notice to the Issuer at the specified office of the Agent, effective upon the date of receipt thereof by the Agent, declare any Senior Notes held by the holder to be forthwith due and payable whereupon the same shall become forthwith due and payable at their Early Redemption Amount (as described in Condition 7(f)), together with accrued interest (if any) to the date of repayment, without presentment, demand, protest or other notice of any kind.

For the purposes of this Condition:

***“Principal Subsidiary”*** at any time shall mean a Subsidiary of the Issuer inter alia:

- (A) whose gross revenues (consolidated in the case of a Subsidiary which itself has Subsidiaries) or whose total assets (consolidated in the case of a Subsidiary which itself has Subsidiaries) represent not less than five per cent. of the consolidated gross revenues, or, as the case may be, consolidated total assets, of the Issuer and its Subsidiaries taken as a whole, all as calculated respectively by reference to the then latest audited accounts (consolidated or, as the case may be, unconsolidated) of the Subsidiary and the then latest audited consolidated accounts of the Issuer and its Subsidiaries; or
- (B) to which is transferred the whole or substantially the whole of the undertaking and assets of a Subsidiary of the Issuer which immediately before the transfer is a Principal Subsidiary,

all as more particularly defined in the Agency Agreement.

A report by the Auditors of the Issuer that in their opinion a Subsidiary of the Issuer is or is not or was or was not at any particular time or throughout any specified period a Principal Subsidiary shall, in the absence of manifest error, be conclusive and binding on all parties.

(b) *Enforcement relating to Subordinated Notes*

- (i) If the Issuer fails to meet its obligations under the Subordinated Notes, any holder of a Subordinated Note may, at its own discretion and without further notice, institute proceedings in Iceland for the compulsory winding-up of the Issuer in accordance with Act No. 161/2002 on Financial Undertakings.
- (ii) Any holder of a Subordinated Note may at its discretion and without further notice institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition or provision binding on the Issuer under the Subordinated Notes provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.
- (iii) If an order is made or an effective resolution is passed for the winding-up or liquidation of the Issuer, then the Subordinated Notes shall become due and payable at their Early Redemption Amount together with interest accrued to the date of repayment, without presentment, demand, protest or other notice of any kind.

(c) *Events of Default relating to Capital Notes*

- (1) The following events or circumstances (each an “Event of Default” shall be an event of default in relation to the Capital Notes:
  - (i) the Issuer shall default in the payment of principal for a period of three days in respect of any Capital Note which has become due and payable in accordance with the Conditions; or
  - (ii) the Issuer shall, to the extent that it is obliged to pay interest under Condition 5(h), default for a period of seven days in the payment of interest due on any Capital Note in accordance with the Conditions; or
  - (iii) a court or agency or supervisory authority in Iceland (having jurisdiction in respect of the same) shall have instituted a proceeding or entered a decree or order for the appointment of a receiver or liquidator in any insolvency, rehabilitation, readjustment of debt, marshalling of assets and liabilities or similar arrangements involving the Issuer or all or substantially all of its property, and such proceedings, decree or order shall not have been vacated or shall have remained in force undischarged or unstayed for a period of 14 days; or
  - (iv) the Issuer shall file a petition to take advantage of any insolvency statute or shall voluntarily suspend payment of its obligations.
- (2) If any Event of Default shall have occurred and shall be continuing, any holder of a Capital Note may give notice to the Issuer that the Capital Note is, and it shall accordingly, subject to this Condition 10(c), forthwith become, immediately due and repayable whether or not the whole or any part of any Converted Amount has been reconverted and reinstated as debt at an amount equal to the principal amount (construed as provided above) of the Capital Notes, together with interest (if any) on the principal amount accrued to, but excluding, the due date for redemption (provided that the Issuer is obliged to make such payment of interest in accordance with Condition 5(h) or would be so obliged were the due date for repayment an Interest Payment Date).
- (3) If a Capital Note has been declared due and payable under this Condition 10(c), the holder of the Capital Note may claim payment in respect of the Capital Notes only in the insolvency or voluntary or involuntary liquidation of the Issuer and may therefore institute such steps, including the obtaining of a judgment against the Issuer for any

amount due in respect of the Capital Notes, as it thinks desirable with a view to having the Issuer declared insolvent or put into liquidation.

- (4) A holder of Capital Notes may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under the Capital Notes (other than, without prejudice to sub paragraphs (2) and (3) above, any obligation for the payment of any principal or interest in respect of the Capital Notes) provided that the Issuer shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

A provider of any Converted Amount may institute such proceedings against the Issuer as it may think fit to enforce any obligation, condition, undertaking or provision binding on the Issuer under Condition 2(c) or 2(d) provided that the Issuer shall not by virtue of the institution of such proceedings be obliged to pay any sum or sums sooner than the same would otherwise have been payable by it.

- (5) No remedy against the Issuer, other than as provided in sub paragraphs (2), (3) and (4) above, or proving or claiming in the insolvency or voluntary or involuntary liquidation of the Issuer in Iceland or elsewhere, shall be available to the holders of Capital Notes, whether for the recovery of amounts owing in respect of the Capital Notes or in respect of any breach by the Issuer of any of its obligations or undertakings with respect to the Capital Notes.

## **11. REPLACEMENT OF NOTES, RECEIPTS, COUPONS AND TALONS**

Should any Note, Receipt, Coupon or Talon be lost, stolen, mutilated, defaced or destroyed, it may be replaced at the specified office of the Agent upon payment by the claimant of such costs and expenses as may be incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Notes, Receipts, Coupons or Talons must be surrendered before replacements will be issued.

## **12. PAYING AGENTS**

The names of the initial Paying Agents and their initial specified offices are set out below.

The Issuer is entitled to vary or terminate the appointment of any Paying Agent and/or appoint additional or other Paying Agents and/or approve any change in the specified office through which any Paying Agent acts, provided that:

- (a) there will at all times be an Agent; and
- (b) so long as the Notes are listed on any stock exchange, there will at all times be a Paying Agent with a specified office in such place as may or admitted to listing by any other relevant authority be required by the rules and regulations of the relevant stock exchange (or other relevant authority); and
- (c) the Issuer undertakes that it will maintain a paying agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive.

In addition, the Issuer shall forthwith appoint a Paying Agent having a specified office in New York City in the circumstances described in Condition 6(d). Any variation, termination, appointment or change shall only take effect (other than in the case of insolvency, when it shall be of immediate effect) after not less than 30 nor more than 45 days' prior notice thereof shall have been given to the Noteholders in accordance with Condition 14.



In acting under the Agency Agreement, the Paying Agents act solely as agents of the Issuer and do not assume any obligation to, or relationship of agency or trust with, any Noteholders, Receiptholders or Couponholders. The Agency Agreement contains provisions permitting any entity into which any Paying Agent is merged or converted or with which it is consolidated or to which it transfers all or substantially all of its assets to become the successor paying agent.

### **13. EXCHANGE OF TALONS**

On and after the Interest Payment Date on which the final Coupon comprised in any Coupon sheet matures, the Talon (if any) forming part of such Coupon sheet may be surrendered at the specified office of the Agent or any other Paying Agent in exchange for a further Coupon sheet including (if such further Coupon sheet does not include Coupons to (and including) the final date for the payment of interest due in respect of the Note to which it appertains) a further Talon, subject to the provisions of Condition 9.

### **14. NOTICES**

All notices regarding the Notes will be deemed to be validly given if published (i) in a leading English language daily newspaper of general circulation in London, and (ii) if and for so long as the Notes are listed on the Luxembourg Stock Exchange, in a daily newspaper of general circulation in Luxembourg or on the Luxembourg Stock Exchange's website ([www.bourse.lu](http://www.bourse.lu)). It is expected that such publication will be made in the *Financial Times* in London and *d'Wort* or the *Tageblatt* in Luxembourg. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules of any stock exchange (or any other relevant authority) on which the Notes are for the time being listed or by which they have been admitted to trading. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers.

Until such time as any definitive Notes are issued, there may, so long as any Global Notes representing the Notes are held in their entirety on behalf of Euroclear and/or Clearstream, Luxembourg, be substituted for such publication in such newspaper(s) the delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg for communication by them to the holders of the Notes and, in addition, for so long as any Notes are listed on a stock exchange or are admitted to trading by another relevant authority and the rules of that stock exchange or relevant authority so require, such notice will be published in a daily newspaper of general circulation in the place or places required by those rules. Any such notice shall be deemed to have been given to the holders of the Notes on the seventh day after the day on which the said notice was given to Euroclear and/or Clearstream, Luxembourg.

Notices to be given by any Noteholder shall be in writing and given by lodging the same, together (in the case of any Note in definitive form) with the relative Note or Notes, with the Agent. Whilst any of the Notes are represented by a Global Note, such notice may be given by any holder of a Note to the Agent through Euroclear and/or Clearstream, Luxembourg, as the case may be, in such manner as the Agent and Euroclear and/or Clearstream, Luxembourg, as the case may be, may approve for this purpose.

### **15. MEETINGS OF NOTEHOLDERS, MODIFICATION AND WAIVER**

The Agency Agreement contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the sanctioning by Extraordinary Resolution of a modification of the Notes, the Receipts, the Coupons or any of the provisions of the Agency Agreement although any modification in relation to Capital Notes cannot be made without the prior approval of the FSA (provided that such approval can be validly given in accordance with the rules, regulations and policies of the FSA). Such a meeting may be

convened by the Issuer or Noteholders holding not less than five per cent. in nominal amount of the Notes for the time being remaining outstanding. The quorum at any such meeting for passing an Extraordinary Resolution is one or more persons holding or representing not less than 50 per cent. in nominal amount of the Notes for the time being outstanding, or at any adjourned meeting one or more persons being or representing Noteholders whatever the nominal amount of the Notes so held or represented, except that at any meeting the business of which includes the modification of certain provisions of the Notes, the Receipts or the Coupons (including modifying the date of maturity of the Notes or any date for payment of interest thereon, reducing or cancelling the amount of principal or the rate of interest payable in respect of the Notes or altering the currency of payment of the Notes, the Receipts or the Coupons), the quorum shall be one or more persons holding or representing not less than two-thirds in nominal amount of the Notes for the time being outstanding, or at any adjourned such meeting one or more persons holding or representing not less than one-third in nominal amount of the Notes for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Noteholders shall be binding on all the Noteholders, whether or not they are present at the meeting, and on all Receiptholders and Couponholders.

The Agent and the Issuer may agree, without the consent of the Noteholders, Receiptholders or Couponholders, to:

- (a) any modification (except as mentioned above) of the Notes, the Receipts, the Coupons or the Agency Agreement which is not prejudicial to the interests of the Noteholders; or
- (b) any modification of the Notes, the Receipts, the Coupons or the Agency Agreement which is of a formal, minor or technical nature or is made to correct a manifest error or to comply with mandatory provisions of the law.

Any such modification shall be binding on the Noteholders, the Receiptholders and the Couponholders and any such modification shall be notified to the Noteholders in accordance with Condition 14 as soon as practicable thereafter.

## **16. FURTHER ISSUES**

The Issuer shall be at liberty from time to time without the consent of the Noteholders, the Receiptholders or the Couponholders to create and issue further notes having terms and conditions the same as the Notes or the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and form a single Series with the outstanding Notes.

## **17. CONTRACTS (RIGHTS OF THIRD PARTIES) ACT 1999**

Except as provided herein in relation to providers of any Converted Amount and as provided in the Global Notes in relation to Accountholders (as defined therein) no person shall have any right to enforce any term or condition of this Note under the Contracts (Rights of Third Parties) Act 1999, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

## **18. GOVERNING LAW AND SUBMISSION TO JURISDICTION**

- (a) *Governing law*

The Agency Agreement, the Deed of Covenant, the Notes (other than Conditions 2(b), 2(c), 2(d), 2(e), 5(h) and 7(l)), the Receipts and the Coupons are governed by, and shall be construed in accordance with, English law. Conditions 2(b), 2(c), 2(d), 2(e), 5(h) and 7(l) of the Notes is governed by, and shall be construed in accordance with, Icelandic law.

(b) *Submission to jurisdiction*

The Issuer agrees, for the exclusive benefit of the Noteholders, the Receiptholders and the Couponholders, that the courts of England are to have jurisdiction to settle any disputes which may arise out of or in connection with the Notes, the Receipts and/or the Coupons and that accordingly any suit, action or proceedings (together referred to as “**Proceedings**”) arising out of or in connection with the Notes, the Receipts and the Coupons may be brought in such courts.

The Issuer hereby irrevocably waives any objection which it may have now or hereafter to the laying of the venue of any such Proceedings in any such court and any claim that any such Proceedings have been brought in an inconvenient forum and hereby further irrevocably agrees that a judgment in any such Proceedings brought in the English courts shall be conclusive and binding upon it and may be enforced in the courts of any other jurisdiction.

Nothing contained in this Condition shall limit any right to take Proceedings against the Issuer in any other court of competent jurisdiction, nor shall the taking of Proceedings in one or more jurisdictions preclude the taking of Proceedings in any other jurisdiction, whether concurrently or not.

(c) *Appointment of Process Agent*

The Issuer appoints Kaupthing Limited of 135-137 New Bond Street, London W15 2TG, England as its agent for service of process, and undertakes that, in the event that Kaupthing Limited ceases so to act or ceases to be registered in England, it will appoint another person as its agent for service of process in England in respect of any Proceedings. Nothing herein shall affect the right to serve proceedings in any other manner permitted by law.

(d) *Waiver of immunity*

The Issuer hereby irrevocably and unconditionally waives with respect to Notes, the Receipts and the Coupons any right to claim sovereign or other immunity from jurisdiction or execution and any similar defence and irrevocably and unconditionally consents to the giving of any relief or the issue of any process, including without limitation, the making, enforcement or execution against any property whatsoever (irrespective of its use or intended use) of any order or judgment made or given in connection with any proceedings.

(e) *Other documents*

The Issuer has in the Agency Agreement and the Deed of Covenant submitted to the jurisdiction of the English courts and appointed an agent for service of process in terms substantially similar to those set out above.

## **USE OF PROCEEDS**

The net proceeds from each issue of Notes will be applied by the Issuer for its general corporate purposes, which include making a profit. If, in respect of any particular issue, there is a particular identified use of proceeds, this will be stated in the applicable Final Terms.

## DESCRIPTION OF THE ISSUER

### Introduction

The Issuer, is a Nordic bank offering comprehensive retail, corporate and investment banking services to individuals, companies and institutional investors. It is the largest bank in Iceland and a leading player in all key areas of the Icelandic financial market. It has the highest market capitalisation on the Iceland Stock Exchange. The activities of the Issuer and its subsidiaries (together, the “**Group**”) in Iceland are divided into retail banking, corporate banking and investment banking but internationally its focus is on corporate and investment banking. The Issuer is one of the ten largest banks in the Nordic countries in terms of its market capitalisation.

The Issuer was created in its present form by the merger of two of Iceland’s foremost banks, Kaupthing Bank and Bunadarbanki Islands hf., both of which enjoyed a strong market position in Iceland. Bunadarbanki Islands dates back to 1929, when the Icelandic parliament, the Althing, passed a law on the founding of Bunadarbanki Islands. At the beginning of 1998 Bunadarbanki Islands hf. became a limited liability company, and the government began to sell its holdings in the bank. The Bank was privatised in stages and this process was completed at the beginning of 2003. Bunadarbanki Islands hf. was listed on the Main List of the Iceland Stock Exchange hf. on 17th December, 1998.

Kaupthing hf. was established by eight Icelanders in 1982, at the same time as the free capital market was launched in Iceland. Kaupthing hf. later became an investment bank and changed its name to Kaupthing Bank in 2002. In September 2000, Kaupthing Bank hf. was listed on the Iceland Stock Exchange main list and on the Stockholm Stock Exchange (Stockholmsbörsen) O-list, in December 2002.

In May 2003, Kaupthing Bank hf. and Bunadarbanki Islands hf. merged under the name Kaupthing Bank hf. Kaupthing Bank hf. took over the assets and liabilities of Bunadarbanki Islands, hf. and shareholders in Bunadarbanki Islands hf. received 48.23 per cent. of the total share capital in Kaupthing Bank hf. in exchange for their shares.

In recent years, the Issuer has strengthened its position abroad by acquiring financial companies and establishing subsidiaries. The most important developments so far have been the acquisition of the Swedish bank, JP Nordiska AB (now Kaupthing Bank Sverige AB), and the recent acquisition of the Danish bank FIH Erhvervsbank A/S (“FIH”). JP Nordiska AB was acquired in 2002 which significantly strengthened the Issuer’s position in the Nordic countries, an area which the Bank defines as its home market. FIH Erhvervsbank A/S is a Danish corporate lending bank which has a nine per cent. market share in lending to corporates in Denmark. FIH was acquired in September 2004 and its acquisition doubled the balance sheet of Kaupthing Bank. In April 2005, the boards of Kaupthing Bank and the UK bank Singer & Friedlander announced that they had reached an agreement on the terms of a recommended cash offer for the entire issued and to be issued share capital of Singer & Friedlander (see further “Recent Developments” below).

The Issuer has six core business areas: Retail Banking; Corporate Banking; Asset Management and Private Banking; Investment Banking; Capital Markets and Treasury. It also has ancillary divisions such as Risk Management, IT, Finance, and Sales and Marketing.

At the end of 2004, the Issuer had operations in ten countries, including all of the Nordic countries and two of the world’s main business centres, London and New York. Its main subsidiaries are Kaupthing Bank Sverige in Sweden, Kaupthing Bank Luxembourg, Kaupthing Bank Sofi Oyj and Norvestia in Finland, FIH in Denmark, Kaupthing Føroyar in the Faroe Islands, Kaupthing New York, Kaupthing Asset Management in Switzerland, Kaupthing Ltd in the United Kingdom, Kaupthing Norge in Norway, Arion Custody Service and KB-LIF in Iceland. At the end of March 2005, the number of the Group’s full-time equivalent staff was 1,606.

The Issuer and its subsidiaries are members of seven stock exchanges in Europe and the United States. Trading in their shares accounted for a combined total of 4.28 per cent. of the equities turnover in the Nordic stock exchanges in 2004. As at 31st December, 2004, the Group's assets under management totalled ISK 508 billion, and its assets in custody amounted to ISK 910 billion.

### **Recent developments**

Following the Issuer's acquisition of FIH in September 2004, the Issuer's subsidiary in Denmark, Kaupthing Bank A/S, was restructured and transferred to the Faroese savings bank, Føroya Sparikassi P/F, which already held 25 per cent. of Kaupthing Bank A/S. Before transfer of the remaining 75 per cent. of the shares, Kaupthing Bank A/S (now Eik Bank) transferred certain of its activities to FIH.

FIH acquired the investment banking division from Kaupthing Bank A/S. The lending operation of Kaupthing Bank A/S remained in the bank, and thus became a part of Føroya Sparikassi P/F's Danish activities. At the same time Kaupthing Bank purchased 49 per cent. of the share capital in Kaupthing Føroyar Virdisbraevameklarafelag P/F from Føroya Sparikassi P/F, which means that all share capital in Kaupthing Føroyar is owned by the Issuer.

On 26th November, 2004, the Issuer announced that its subsidiary, Kaupthing Bank Luxembourg S.A., had acquired all of the shares in PFA Pension Luxembourg. The seller was the leading Danish pension company PFA Pension. PFA Pension Luxembourg S.A. is, amongst other things, a supplier of unit linked policies to both corporate and private individuals.

The purpose of the acquisition was to increase Kaupthing Bank Luxembourg S.A.'s client base in Private Banking as well as to expand the business by offering insurance products to its existing clients. PFA Pension Luxembourg S.A. has an equity capital of DKK 45 million and a portfolio of unit linked products amounting to DKK 375 million.

In December 2004 the Finnish financial supervisory authorities granted Kaupthing Bank's Finnish subsidiary, Kaupthing Sofi Oyj, a banking licence. The company has changed its name to Kaupthing Bank Oyj.

In February 2005 Kaupthing Bank hf. sold its subsidiary Lýsing hf. to Iceland Insurance Company (Vatryggingafelag Islands hf. / VIS) for ISK 6.1 billion. Kaupthing Bank's profit from the transaction is estimated to be ISK 3 billion. Lýsing is one of the two largest leasing companies in Iceland and employs 40 people. The founders of Lýsing in 1986 included Kaupthing Bank (then Búnadarbanki Islands) and VIS. Before the transaction Lýsing was 100% owned by Kaupthing Bank.

In April 2005, Kaupthing Bank hf., through a wholly owned subsidiary, announced an offer to acquire British bank Singer & Friedlander Group plc (Singer & Friedlander) and the board of directors of Singer & Friedlander has recommended that its shareholders accept the offer. If the acquisition takes place, Kaupthing Bank will significantly strengthen its position in the UK, which will become one of the largest markets for the bank alongside Denmark and Iceland. The bid is worth 316 pence per share, which corresponds to approximately £547 million (ISK 64.6 billion) for the entire issued share capital. Kaupthing Bank will pay for the shares in cash. Shareholders on the register on 29th April, 2005 will also retain the right to the 2004 final dividend of 4.25 pence per Singer & Friedlander share. Kaupthing Bank already owns 19.5 per cent. of share capital in Singer & Friedlander.

On 15th June, 2005, Kaupthing Holdings UK announced that as of 14th June, 2005 it had received valid acceptances of the offer in respect of a total of 104,782,244 Singer & Friedlander shares, representing approximately 60.5 per cent. of the total issued share capital of Singer & Friedlander and representing 75.1 per cent. of the Singer & Friedlander shares to which the offer relates. The offer is therefore unconditional as to acceptances taken together with the 33,659,283 Singer & Friedlander shares already owned by Kaupthing Bank, Kaupthing Holdings UK and Kaupthing Bank have acquired or agreed to acquire 138,441,527 Singer & Friedlander shares, representing 79.9 per cent. of the issued share capital of Singer & Friedlander.



This offer has received regulatory approval from the FSA, the Isle of Man Financial Supervision Commission and the Financial Services Authority and is unconditional in all respects.

## Legal Status and Legislative Background

The Issuer is a public limited company incorporated in Iceland in 1982 for an unlimited duration and operating under Icelandic law. It is registered with the registrar of companies in Iceland and its registration number is 560882-0419. The registered office of the Issuer is at Borgartun 19, 105 Reykjavik, Iceland, tel. +354 444 6000. The operations of the Issuer are, among other things, subject to the provisions of Act no. 2/1995 on Public Limited Companies, as amended, and Act no. 161/2002 on Financial Undertakings, as amended. The Issuer is subject to the supervision of the Icelandic Financial Supervisory Authority.

Under the Issuer's constitutional documents, its legal name is Kaupthing Bank hf. (Kaupþing banki hf. in Icelandic, previously Kaupþing Búnadarbanki hf.). Prior to 28th April, 2004, the Issuer issued Notes under the Programme using the legal name Kaupthing Búnadarbanki hf. On and after 28th April, 2004, the Issuer has used the legal name Kaupthing Bank hf. for all purposes under the Programme, since it became the policy of the Issuer to use the legal name Kaupthing Bank hf. abroad instead of the English spelling of the previous Icelandic legal name, Kaupthing Búnadarbanki hf.

## SOURCES OF FUNDS

The Issuer's principal sources of funding are customer deposits and borrowing in the capital markets. Other sources of funding include capital markets and financial institutions.

The table below provides a breakdown of the Group's sources of funds as at 31st December, 2004 and 31st December, 2003 in accordance with local GAAP and as at 1st January, 2005 in accordance with IFRS:

	<i>IFRS</i>	<i>Local</i>	<i>Local</i>
	<i>1/1/2005</i>	<i>31/12/2004</i>	<i>31/12/2003</i>
	<i>(ISK millions)</i>		
Equity	149,370	149,443	45,929
Minority interest in subsidiaries' equity .. .. .	9,539	9,306	10,603
Subordinated loans .. .. .	57,623	57,627	10,704
Deposits .. .. .	234,681	202,038	182,497
<b>Core funding</b> .. .. .	<b>451,213</b>	<b>418,414</b>	<b>249,733</b>
Borrowings .. .. .	968,513	884,219	210,645
Credit institutions .. .. .		147,455	79,267
Financial liabilities .. .. .	68,010		
Other liabilities .. .. .	58,984	74,767	17,278
Provision for Deferred Income-Tax Liability .. .. .	7,733	9,165	1,646
<b>Finance in the market</b> .. .. .	<b>1,103,240</b>	<b>1,115,606</b>	<b>308,836</b>
<b>Total funds</b> .. .. .	<b>1,554,453</b>	<b>1,534,020</b>	<b>558,569</b>

The composition of the Group's funding has changed significantly in recent years as the Issuer's business has moved from primarily serving individuals, small businesses and clients in the agricultural sector to serving larger corporations in the domestic and Nordic markets. As a result, intermediation of borrowing has grown rapidly.

## Equity

The table below sets out the 10 largest shareholders of the Issuer as of 31st December, 2004:

	<i>Shares</i>	<i>%</i>
Meidur ehf. .. .. .	112,180,448	17.0%
Egla ehf. .. .. .	63,733,352	9.7%
Lifeyrissjodir Bankastraeti 7 .. .. .	26,595,340	4.0%
Lifeyrissjodur verslunarmanna .. .. .	25,367,000	3.8%
Vatryggingafelag Islands hf. .. .. .	25,109,701	3.8%
Eignarhaldsfelagid Sveipur ehf. .. .. .	24,777,585	3.8%
Landsbanki Islands hf. .. .. .	13,760,136	2.1%
Islandsbanki hf. .. .. .	13,201,420	2.0%
Lifeyrissjodurinn Framsyn .. .. .	9,478,541	1.4%
Lifeyrissjodur sjomanna .. .. .	9,358,093	1.4%

## Capital Adequacy

According to the provisions of Art. 84 and 85 of the Law no. 161/2002 on Financial Undertakings, a bank's subordinated loans and equity capital, after subtraction of the book value of shares held in other financial institutions, may not at any time fall below 8.0 per cent. of its risk-adjusted asset base, as defined by law. The risk-adjusted asset base of a bank is comprised of total assets as well as guarantees issued and calculated risk factors after the deduction of various figures in the balance sheet, according to the rules of the Financial Supervisory Authority. At 31st December, 2004, the Issuer complies with all statutory ratios in accordance with the provisions of Art. 28 and 83 of the Act on Financial Undertakings. Together with subordinated loans, total capital and reserves amounted to ISK 168,776 million as at 31st December, 2004 of which ISK 81,234 million consisted of Tier 1 capital. It is the Issuer's policy to seek to maintain a 11 per cent. capital ratio for the Group with a minimum Tier 1 ratio of 8 per cent.

Equity at the end of the period amounts to ISK 149,443 million. The capital adequacy ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 14.2%. According to the law the ratio may not go below 8.0%. The ratio is calculated as follows:

	<i>31/12/2004</i>	<i>Weighted</i>
	<i>Book</i>	<i>value</i>
	<i>value</i>	
	<i>(ISK millions)</i>	
<b>Risk base:</b>		
Assets recorded in the Annual Accounts .. .. .	1,534,020	1,166,377
Assets deducted from capital .. .. .		(50,335)
Guarantees and other items not included in the Balance Sheet ..		73,129
		1,189,171
<b>Capital:</b>		
<b>Tier I capital:</b>		
Equity .. .. .		158,749
Goodwill .. .. .		(34,208)
Assets subtracted from capital .. .. .		(1,232)
Subordinated loans .. .. .		13,947
<b>Tier II capital:</b>		
Subordinated loans .. .. .		43,108
Investment in credit institutions .. .. .		(11,598)
<b>Total equity base .. .. .</b>		<b>168,766</b>
Capital ratio .. .. .		14.2%
Thereof Tier I ratio .. .. .		11.5%

## Deposits

As at 31st December, 2004, the Issuer had approximately 260,000 deposit accounts, including current accounts, savings accounts and currency accounts. As at the same date, the Issuer's total deposits amounted to 21 per cent. of the total deposits in all of Iceland's commercial banks and savings banks. The deposits from customers are well diversified, with a majority of the customers having relatively low deposits. Deposit accounts bear interest at a floating rate.

The table below sets out a breakdown of the Issuer's deposits as at 31st December, 2004 and 31st December, 2003 including 2004 in accordance with local GAAP and as at 1st January 2005 in accordance with IFRS:

		<i>IFRS</i> <i>1/1/2005</i>	<i>Local</i> <i>GAAP</i> <i>31/12/2004</i>	<i>Local</i> <i>GAAP</i> <i>31/12/2003</i>
		<i>(ISK millions)</i>		
Deposits on demand	.. .. .	80,084	79,929	103,432
Time deposits	.. .. .	122,109	122,109	79,065
<b>Total</b>	.. .. .	<b>202,193</b>	<b>202,038</b>	<b>182,497</b>
<b>Savings deposits by maturity</b>				
Up to 3 months	.. .. .	82,980	82,980	36,274
Over 3 months and up to 1 year	.. .. .	8,773	8,773	20,999
Over 1 year and up to 5 years	.. .. .	23,922	23,922	16,797
Over 5 years	.. .. .	6,434	6,434	4,995
<b>Total</b>	.. .. .	<b>122,109</b>	<b>122,109</b>	<b>79,065</b>

## Other Funding

The majority of the Issuer's funding derives from international capital markets i.e. bond markets and syndicated loans, commercial paper and money markets.

The following table sets out a breakdown of the Issuer's borrowings from bonds and notes issued, as well as borrowings from other credit institutions, as at 31st December, 2004 and 31st December, 2003 in accordance with local GAAP and as at 1st January 2005 in accordance with IFRS. The Group's borrowings in foreign currency, international syndicated loans and private placements generally have maturities from 2 to 5 years.

		<i>IFRS</i> <i>1/1/2005</i>	<i>Local</i> <i>GAAP</i> <i>31/12/2004</i>	<i>Local</i> <i>GAAP</i> <i>31/12/2003</i>
		<i>(ISK millions)</i>		
Bonds issued	.. .. .	850,159	850,159	150,424
Loans	.. .. .	118,354	34,060	60,221
<b>Total</b>	.. .. .	<b>968,513</b>	<b>884,219</b>	<b>210,645</b>

## Uses of Funds

The table below sets out a breakdown of the Issuer's uses of funds as at 31st December, 2004 and 31st December, 2003 in accordance with local GAAP and as at 1st January 2005 in accordance with IFRS :

		<i>IFRS</i>	<i>Local</i>	<i>Local</i>
		<i>1/1/2005</i>	<i>GAAP</i>	<i>GAAP</i>
			<i>31/12/2004</i>	<i>31/12/2003</i>
			<i>(ISK millions)</i>	
Cash and amounts from credit institutions	.. ..	6,290	113,543	50,545
Loans to customers	.. ..	1,186,170	991,093	327,019
Mortgages foreclosed	.. ..		2,402	1,962
Lease contracts	.. ..		94,851	22,014
Bonds and other fixed-income securities	.. ..		169,666	80,832
Shares and other variable-income securities	.. ..		78,686	50,327
Financial assets	.. ..	274,207		
Shares in associated and affiliated companies	.. ..	3,649	8,266	2,926
Other assets	.. ..	84,137	75,513	22,944
<b>Total assets</b>	.. ..	<b>1,554,453</b>	<b>1,534,020</b>	<b>558,569</b>

The predominant lending activity of the Issuer is making loans to an extensive range of corporate customers and private individuals.

The Issuer provides services to all sectors and has sought to establish a diversified portfolio of marketable securities and loans in order to minimise its lending risks. The Issuer believes that its portfolio of loans and marketable securities is well distributed between economic sectors.

The table below sets out the breakdown of the Issuer's total loans and marketable securities by customer categories as at 31st December, 2004:

		<i>31/12</i>
		<i>2004</i>
Industry	.. ..	28.1%
Services	.. ..	27.5%
Real estate	.. ..	15.0%
Individuals	.. ..	13.5%
Trade	.. ..	9.0%
Holding companies	.. ..	6.3%
Transportation	.. ..	0.6%
		<b>100.0%</b>

The table below sets out a breakdown by remaining maturity of the Group's loans to customers and leasing agreements as at 31st December in each of the years indicated:

	2004	2003
	<i>(ISK millions)</i>	
On demand .. .. .	39,611	21,177
Up to 3 months .. .. .	141,288	122,160
Over 3 months and up to 1 year .. .. .	124,813	58,196
Over 1 year and up to 5 years .. .. .	402,552	117,105
Over 5 years .. .. .	377,680	30,395
	<u>1,085,944</u>	<u>349,033</u>

The Issuer's exposure to market risk in bonds, derivatives included, amounts to ISK 72,456 million. The bond portfolio is predominantly comprised of AAA bonds. Kaupthing Bank hf. has entered into derivatives amounting to ISK 12,925 million against its position in shares.

## Risk Management

The Issuer faces various types of risks related to its business as a financial institution, which arise from its day to day operations. The most significant of these risks are listed below. Management devotes a significant portion of its time to the management of risk. Effective risk management involves the identification of the significant risks, the quantification of the Issuer's exposure to these risks and taking appropriate action to limit these risks including constantly monitoring them. Among other risk management techniques, the Issuer has established a range of limits, has sought to ensure that these limits are complied with and has sought to quantify its exposures to different risks. It is management's responsibility to identify where established limits have been exceeded and to take the appropriate action. The Issuer has documented these responsibilities and limits.

## Approval and Revision of Risk Policy

The Issuer's Risk Policy has been adopted and approved by its Board of Directors. It is reviewed and revised at least annually. Amendments or minor changes can be made more frequently but each change needs the approval of the Issuer's chief executive officers (CEOs) before it is effective and then needs to be approved by the Board of the Issuer as soon as practicable thereafter.

## Types of Risks

### *Credit Risk*

Credit risk is managed on a Group-wide level by the Group Credit Committee and the Group Credit Manager (or Head of Credit Risk). The role of the Credit Manager is to manage the process and make sure all the requirements set out by the Credit Committee such as requirements on documentation and collateral are satisfied. The value of collateral is adjusted for volatility (called a "haircut"); such adjustments are different for each asset class depending on its estimated liquidation quality. The Credit Manager monitors collateral quality on a daily basis and reacts to any deficiencies identified. The collateral system integrates loan, foreign exchange and derivative information with custody data and the values of pledged securities in the clients' portfolios and calculates the collateral value daily. The Group Credit Manager ensures that an exposure to a single customer within the group does not exceed certain limits set by the Group Credit Committee.

Credit and collateral risk is managed on a local level in the Issuer's subsidiaries according to the same rules and in accordance with any further requirements of local regulation. The local credit committees and credit managers receive their credit limits from the Group Credit Committee and all larger credits require approval from the Group Credit Committee.

### *Security market risk*

Trading departments are only permitted to trade certain listed stocks on certain exchanges within prescribed limits and in some cases on an intra-day basis only.

### *Currency risk*

Currency risk is the risk associated with fluctuations in assets and liabilities denominated in different currencies due to movements in exchange rates. Currency risk is controlled by the Issuer's Treasury, is subject to limits and is estimated using the risk models described above.

### *Interest rate risk*

Interest rate risk arises due to the maturity or interest rate reset periods of assets and liabilities not coinciding. Fluctuations in market interest rates cause fluctuations in interest income. Short to medium term interest risk is controlled by the Issuer's Treasury using limits on mismatch in expected in- and-outgoing payments as well as limits on interest rate sensitivity of overall interest bearing assets and liabilities. The Issuer's Trading Department is responsible for positions in long term bonds and interest rate risk is further controlled using position limits and estimated using various risk models as described above.

### *Liquidity risk*

The Issuer is subject to the risk of being unable to repay its depositors on demand, or as and when due, through holding insufficient cash or near-cash assets. This risk is measured by constant monitoring of liquidity ratios. The Issuer's Treasury is responsible for maintaining liquidity by maintaining a sufficiently high ratio of liquid assets and available funding to near term liabilities and possible payment outflows. The liquidity measures are calculated at the end of each trading day and monitored by the Head of Risk and reported to the CEOs.

### *Operational risk*

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, human and system error, or from external events that affect the Issuer's operations. These operational risks are monitored through a system of internal control set up at different levels in the Group (including daily controls, supervisory controls and management controls).

## **Risk Monitoring**

At least twice a year the risk management department submits to the Board of Directors an overview of at least the 10 largest credits of the Issuer. The overview includes long- and short-term obligations, stock holdings, collateral and major financial information. At least twice a year a list of the largest credits in doubt is also presented to the Board of Directors.

### *Market Risk Limits*

Position limits and any changes to them are proposed by the Issuer's Head of Trading and accepted by the Issuer's Head of Risk Management (Head of Risk) and reviewed by the CEOs. Each position limit size is based on, among other things, underlying liquidity, the Issuer's risk appetite as well as legal limitations on individual positions stipulated by relevant authorities. The Head of Risk maintains a document detailing current limits and a journal of changes to them. Final approval of all position limits is required from the CEOs. All trades outside of position limits are prohibited and the penalty will be decided by Head of Risk and paid by the relevant Trading Department from its profit and loss account. The penalty amount is, in general, based on the profit or loss generated by the unauthorised trades and is twice that amount or 1 per cent. per day of the limit overrun, whichever is larger. Disputes on breaches of position limits or amounts can be



referred to the CEOs. All violations of this risk policy need to be documented in the journal maintained by Head of Risk and made available to the CEOs.

### *Monitoring*

The Issuer monitors the different risks incurred carefully. The different types of risks (excluding credit risk) are specified below. The overall responsibility of complying with the established limits lies with the Board of Directors. Management is, however, responsible for the day-to-day routines aimed at controlling the different risk parameters. The positions are continuously monitored against the limits where possible and otherwise daily.

## **Risk Reporting**

### *Intra-Day Reports*

All trades and intra-day profit or loss is reported continuously to the Head of Risk through a position monitoring system. The Head of Risk appoints a person and a backup person whose responsibility it is to monitor the intra-day positions and alert the Head of Risk to any deviations or exceptions observed.

### *Daily Reports*

The Issuer's Risk Management sends a daily report on profit and loss and turnover to the Head of Risk, Head of Trading and the CEOs.

### *Monthly Reports*

The Risk Management department sends a monthly risk assessment report to the Head of Trading, the CEOs and the Board of Directors detailing volatility based and scenario based measures such as Value-at-Risk, Earnings-at-Risk and stress tests based on current position limits.

### *Quarterly Reports*

The Head of Trading sends a quarterly report to the Head of Risk and the CEOs on activities, profit and loss and general observations on the market and his view on future prospects for the trading operations.

## **Risk Models**

Risk models employed are position based (risk limits), volatility based (i.e. based on the volatility of market variables and their related co-variance) and scenario based (i.e. based on a prescribed scenario which is likely to cause severe drawdown in profits).

Risk measures are generated by proprietary systems that utilise counter party and market data and trade databases generated and used by the Issuer's trade systems. Additionally the risk management systems are augmented by a number of third party solutions.

## PROVISIONS AND NON-PERFORMING LOANS

The Issuer evaluates non-performing loans according to the rules of the Financial Supervisory Authority, which are based on EU Directive no. 554/1994 regarding rules on the annual accounts of commercial banks. Non-performing loans amounted to ISK 7,013 million as at 31st December, 2004 and ISK 6,584 million at 31st December, 2003. There are no non-performing loans as of 2005. The table below sets out a breakdown of the Group's non-performing loans as at 31st December in each of the years indicated:

												31st December 2004	31st December 2003
												(ISK millions)	
Loans with specific provision for losses	..	..	..	..	..	..	..	..	..	..	..	16,561	7,149
Specific provision for losses	..	..	..	..	..	..	..	..	..	..	..	(12,5421)	(5,465)
Other non-performing loans	..	..	..	..	..	..	..	..	..	..	..	2,973	4,900
<b>Total non-performing loans</b>	..	..	..	..	..	..	..	..	..	..	..	<u>7,013</u>	<u>6,584</u>

Provisions for losses on the loan portfolio have been made each year by the Issuer to meet the estimated risk attached to these assets. These provisions do not represent a final write-off. Certain risk factors are evaluated in addition to a regular contribution for this purpose. The Issuer uses specific provisions as well as general provisions to meet the general risk of lending operations.

The table below sets out changes in the Issuer's provisions as at 31st December, 2004 and 31st December, 2003:

Changes in the provision for losses are specified as follows:

												GAAP 31st December 2004	GAAP 31st December 2003
												Provisions for losses Specific	Provisions for losses General
												Total	Total
												(ISK millions)	
Balance at the beginning of the year	..	..	..	..	..	..	..	..	..	..	..	5,465	2,836
Provision for losses during the year/Impairment	..	..	..	..	..	..	..	..	..	..	..	2,989	831
Exchange rate difference on the translation of foreign subsidiaries	..	..	..	..	..	..	..	..	..	..	..	(378)	(64)
Actual losses during the period	..	..	..	..	..	..	..	..	..	..	..	(5,566)	(36)
Paid in, previously written off	..	..	..	..	..	..	..	..	..	..	..	21	0
Taken over at acquisitions	..	..	..	..	..	..	..	..	..	..	..	9,990	404
Balance at year-end	..	..	..	..	..	..	..	..	..	..	..	<u>12,521</u>	<u>3,971</u>
Provision for losses on the loan portfolio as a percentage of loans and issued guarantees	..	..	..	..	..	..	..	..	..	..	..	1.10%	0.30%

## **BOARD OF DIRECTORS OF THE ISSUER**

The Issuer's Board of Directors consists of nine members and nine alternates.

### *Board*

Sigurdur Einarsson – Born 1960 • Executive Chairman of Kaupthing Bank • Cand. Polit from the University of Copenhagen • Joined Kaupthing Bank in 1994.

Hjorleifur Thor Jakobsson – Born 1957 • Vice Chairman of the Board • Elected 2003 • CEO of Oliufelagid ehf.

Business address: Oliufelagid ehf., Sudurlandsbraut 18, 108 Reykjavik, Iceland

Asgeir Thoroddsen – Born 1942 • Elected 2003 • Attorney to the Supreme Court of Iceland.

Business address: Intrum a Islandi, Laugavegi 97, 101 Reykjavik, Iceland

Bjarnfredur H. Olafsson – Born 1967 • Elected 2003 • Attorney to the District Court of Iceland.

Business address: Taxis logmenn sf, Laugavegi 182, 105 Reykjavik, Iceland

Brynja Halldorsdottir – Born 1957 • Elected 2004 • CFO of Norvik ehf.

Business address: BYKO hf, Skemmuvegi 2a, 200 Kopavogur, Iceland

Finnur Ingolfsson – Born 1954 • CEO of Vatryggingafelag Islands hf • Elected 2003.

Business address: Vatryggingafelag Islands hf, Armula 3, 108 Reykjavik, Iceland

Gunnar Pall Palsson – Born 1961 • Elected 2001 • CEO of Commercial Workers' Union of Reykjavík (VR).

Business address: Verslunarmannafelag Reykjavíkur, Kringlunni 7, 103 Reykjavik, Iceland

Niels de Coninck-Smith – Born 1956 • Elected 2005 • Chief Executive Officer of Ferrosan

Business address: Ferrosan A/S, Sydmarken 5, 2860 Soeborg, Denmark

Tommy Persson – Born 1948 • Elected 2002 • CEO of Lansforsakringar AB • Other directorships: Chairman of the Swedish Insurance Federation and the Swedish Insurance Employers' Association. • Chairman of EurAPCO AG. • Board member of Eureka BV.

Business address: Lansforsakringar AB, Tegeluddsvagen 11-13, Stockholm, SE-173 82, Sweden

### *Senior Management*

#### **Chief Executive Officer**

The Issuer has one Chief Executive Officer who is appointed by the Board of Directors.

Hreidar Mar Sigurdsson – CEO

Born 1970 • Business Studies graduate from University of Iceland • Joined Kaupthing Bank in 1994.

### **Managing Directors of the Profit Centres**

Armann Thorvaldsson – Managing Director of Corporate Finance.

Born 1968, a History graduate with an MBA from Boston University. He has been with Kaupthing Bank since 1994.

Business address: Kaupthing Ltd., 89 New Bond Street, 5th floor, London W1S 1DA, UK

Bjarki H. Diego – Managing Director of Corporate Banking.

Born 1968, Graduated in Law from the University of Iceland in 1993, LL.M from University of London in 1999 • He has been with Kaupthing Bank since 2000.

Fridrik Halldorsson – Managing Director of Retail Banking.

Born 1959, BA in Business Administration, Senior Manager Treasury Bunadarbanci 1993-1999. Deputy Managing Director of Retail Banking 2002-2003. Managing Director of Retail Banking since 2003.

Ingolfur Helgason – Managing Director of Capital Markets.

Born 1967, a Business Studies graduate from the University of Iceland. He has been with Kaupthing Bank since 1993.

Kristin Petursdottir – Managing Director of Treasury.

Born 1965, a Business Studies graduate with an MS in International Business from the Norwegian School of Management in Bergen. She has been with Kaupthing Bank since 1997.

Kristjan Arason – Managing Director of Private Banking.

Born 1961, a Business Studies graduate from University of Iceland. He has been with Kaupthing Bank since 2001.

Thorarinn Sveinsson – Managing Director of Asset Management.

Born 1967, an MSc in Engineering from Massachusetts Institute of Technology (MIT). He has been with Kaupthing Bank since 1999.

### **Managing Directors of Finance and Risk Management**

Gudny Arna Sveinsdottir – Managing Director of Finance and Accounting.

Born 1966, a Business Studies graduate with an MS from the University of Uppsala in Sweden. She has been with Kaupthing Bank since 2001.

Dr. Steingrimur P. Karason – Managing Director of Risk Management.

Born 1968, an Engineering graduate with an ScD in Mechanical Engineering from MIT Boston. He has been with Kaupthing Bank since 1997.

### **Internal Auditor**

Gudjon Johannesson – Internal Auditor

Born 1969. Graduated in Business Administration from the University of Iceland in 1995. Joined Bunadarbanci Islands hf. in 1999.

No director has any actual or potential conflict of interest between his or her duties to the Issuer and his or her private interests or other duties.

Unless otherwise stated. The business addresses of each of the directors set out above is Borgartun 19, 105 Reykjavik, Iceland.

### **State Authorised Public Accountants**

The state authorised public accountants of Kaupthing Bank are KPMG Endurskodun hf. and on their behalf, Sigurdur Jonsson.

Sigurdur Jonsson

Born 1956. State Authorised Public Accountant. Accountant of Kaupthing Bank from 1991.

Business address: KPMG Endurskodun hf., Borgartuni 27, 105 Reykjavik, Iceland.

## **SUMMARY CONSOLIDATED FINANCIAL INFORMATION**

Set out on the following pages are a five year summary consolidated profit and loss account, balance sheet and key ratios for the Group prepared in accordance with Icelandic GAAP, a five year summary consolidated profit and loss account, balance sheet and key ratios for the Group prepared in accordance with IFRS (although certain IFRS balance sheet information for years prior to 2004 is not available) and a reconciliation of the Group's 2004 profit and loss account and balance sheet between Icelandic GAAP and IFRS.



## FIVE YEAR SUMMARY – THE GROUP (PREVIOUS GAAP)

	2004	2003	2002	2001	2000
	(ISK millions)				
<b>Profit and Loss</b>					
Net interest income .. .. .	18,900	10,124	6,998	5,811	4,089
Other operating income .. .. .	29,669	21,656	14,414	8,039	5,112
Net operating income .. .. .	<u>48,569</u>	<u>31,780</u>	<u>21,412</u>	<u>13,850</u>	<u>9,201</u>
Operating expenses .. .. .	-24,402	-18,493	-12,455	-10,565	-7,030
Provision for losses .. .. .	-3,819	-3,894	-2,794	-1,691	-815
Income tax .. .. .	-4,040	-1,486	-764	321	-343
Minority interest .. .. .	-548	-387	-36	-	-
Net earnings .. .. .	<u>15,760</u>	<u>7,520</u>	<u>5,363</u>	<u>1,915</u>	<u>1,013</u>
<b>Assets</b>					
Amounts due from credit institutions .. .. .	113,543	50,546	38,519	17,696	19,553
Loans .. .. .	1,088,346	350,994	269,333	204,552	126,823
Bonds and other fixed-income securities .. .. .	169,666	80,832	69,298	44,264	28,575
Shares and other variable-yield securities .. .. .	86,952	53,253	36,410	37,340	21,761
Goodwill .. .. .	34,208	5,948	3,002	365	0
Fixed assets .. .. .	6,467	5,441	5,377	4,930	4,300
Other assets .. .. .	34,838	11,555	10,473	8,416	6,609
Total assets .. .. .	<u>1,534,020</u>	<u>558,569</u>	<u>432,412</u>	<u>317,563</u>	<u>207,621</u>
<b>Liabilities and Equity</b>					
Amounts owed to credit institutions .. .. .	147,455	79,267	109,865	88,166	47,731
Deposits .. .. .	202,038	182,497	164,570	83,473	67,369
Borrowings .. .. .	884,219	210,645	102,029	109,750	66,828
Other liabilities .. .. .	74,767	17,278	10,034	5,116	5,495
Deferred income tax liability .. .. .	9,165	1,646	411	317	1,337
Subordinate loans .. .. .	57,627	10,704	11,010	8,364	6,187
Minority interest .. .. .	9,306	10,603	1,114	223	58
Equity .. .. .	149,443	45,929	33,379	22,154	12,616
Total liabilities and equity .. .. .	<u>1,534,020</u>	<u>558,569</u>	<u>432,412</u>	<u>317,563</u>	<u>207,621</u>
<b>Key Ratios</b>					
Return on equity .. .. .	22.6%	23.0%	18.7%	-	-
Capital ratio (CAD) .. .. .	14.2%	14.2%	14.7%	11.6%	-
Provision for losses during the year .. .. .	0.4%	1.1%	1.0%	0.8%	0.6%
Provision for losses at year-end .. .. .	1.4%	2.4%	2.1%	2.0%	1.7%
Expenses to net operating income ratio .. .. .	50.2%	58.2%	58.2%	76.3%	76.4%

## FIVE YEAR SUMMARY – THE GROUP (ACCORDING TO IFRS)

	<i>2004</i>	<i>2003</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
	<i>(ISK millions)</i>				
<b>Profit and Loss</b>					
Net interest income .. .. .	18,259	10,124	6,998	5,811	4,089
Other operating income .. .. .	31,687	21,656	14,414	8,039	5,112
<b>Net operating income</b> .. .. .	<u>49,946</u>	<u>31,780</u>	<u>21,412</u>	<u>13,850</u>	<u>9,201</u>
Other operating expenses .. .. .	-23,624	-18,493	-12,455	-10,565	-7,030
Impairment .. .. .	-3,825	-3,894	-2,794	-1,691	-815
Taxes .. .. .	-4,237	-1,486	-764	321	-343
<b>Net earnings</b> .. .. .	<u>18,258</u>	<u>7,907</u>	<u>5,399</u>	<u>1,915</u>	<u>1,013</u>
Net shareholders' earnings .. .. .	17,707	7,520	5,363	1,915	1,013
Minority interest .. .. .	552	387	36	-	-
<b>Balance Sheet</b>					
<b>Assets</b>					
Cash balance with central banks ..	6,290	-	-	-	-
Loans and advances .. .. .	1,154,416	-	-	-	-
Mortgage loans at fair value .. .. .	31,754	-	-	-	-
Trading assets .. .. .	205,186	-	-	-	-
Finance assets at fair value through P/L .. .. .	63,694	-	-	-	-
Financial assets available-for-sale ..	1,507	-	-	-	-
Derivatives used for hedging .. .. .	3,820	-	-	-	-
Investment in associates .. .. .	3,649	-	-	-	-
Intangible assets .. .. .	35,098	-	-	-	-
Investment property .. .. .	19,155	-	-	-	-
Property and equipment .. .. .	6,092	-	-	-	-
Current and deferred tax assets ..	1,092	-	-	-	-
Non-current assets and disposal groups classified as held for sale ..	3,631	-	-	-	-
Reinsurers' share .. .. .	107	-	-	-	-
Other assets .. .. .	18,962	-	-	-	-
<b>Total assets</b> .. .. .	<u>1,554,453</u>	<u>558,569</u>	<u>432,412</u>	<u>317,563</u>	<u>207,620</u>
<b>Liabilities and equity</b>					
Deposits .. .. .	202,193	182,497	164,570	83,473	67,369
Other liabilities .. .. .	1,135,728	308,837	222,339	203,349	121,390
Minority interest .. .. .	9,539	10,603	1,114	223	58
Subordinated loans .. .. .	57,623	10,704	11,010	8,364	6,187
Shareholders' equity .. .. .	149,370	45,928	33,379	22,154	12,616
<b>Total liabilities and equity</b> .. .. .	<u>1,554,453</u>	<u>558,569</u>	<u>432,412</u>	<u>317,563</u>	<u>207,620</u>
<b>KEY RATIOS</b>					
Cost/income ratio .. .. .	47.3%	58.2%	58.2%	76.3%	76.4%
Return on shareholders' equity .. .. .	25.5%	23.0%	18.7%	-	-
Impairment .. .. .	0.4%	1.1%	1.0%	0.8%	0.6%
Total credit reserves .. .. .	1.4%	2.4%	2.1%	2.0%	1.7%
Earnings per share, (ISK) .. .. .	35.6	18.5	14.8	6.1	4.2
Earnings per share diluted, (ISK) ..	35.1	18.4	14.7	6.1	4.2
Average no. of shares outstanding, (million) .. .. .	497	406	362	314	239
Avg. no. of shares outstanding diluted, (million) .. .. .	505	411	364	315	239
No. of shares at end of period, (million) .. .. .	652	438	409	356	239
No. of shares at end of period diluted, (million) .. .. .	660	443	411	358	239

## Profit and Loss account for 2004, change from previous GAAP to IFRS

		<i>Change in valuation</i>		<i>Change in presentation</i>		
				(ISK millions)		
<b>According to previous GAAP</b>					<b>According to IFRS</b>	
Net interest income	18,900	0	(641)	18,259	Net interest income	
		0	467	467	Insurance premium	
Fees, commissions and other service charges	15,645	0	(2,337)	13,308	Fee and commission net income	
Fees, commissions and other service charges, paid	(2,348)	0	2,348	0	Dividends from shares and other holdings	
	4,216	0	(244)	3,972	Dividend income	
Trading gains	11,290	0	(10,798)	492	Net gain on financial assets / liabilities not at fair value	
		0	11,219	11,219	Net gain on trading portfolio	
		0	1,536	1,536	Net gain on assets designated at fair value through profit and loss	
		670	(1,562)	(892)	Foreign exchange difference	
		0	346	346	Gain on disposals of assets other than held for sale	
Other operating income	866	0	278	1,144	Other operating net income	
Salaries and salary related expenses	(12,652)	0	(199)	(12,851)	Salaries and related expenses	
Other administrative expenses	(9,108)	0	(289)	(9,397)	Administration expenses	
Depreciation and amortisation	(2,642)	1,289	(24)	(1,377)	Depreciation and amortisation	
		0	(150)	(150)	Policyholder benefits and claims	
Provision for losses	(3,819)	0	(6)	(3,825)	Impairment on loans and advances	
		0	240	240	Share of profit of associates	
		0	5	5	Profit from non current assets	
Income tax	(4,040)	(12)	(185)	(4,237)	Income tax	
	16,308	1,947	4	18,259	<b>Net earnings</b>	
Minority interest	(548)	0	(4)	(552)	Minority interest	
<b>Net earnings according to previous GAAP</b>	15,760	1,947	0	17,707	<b>Net earnings attributable to shareholders of Kaupthing Bank</b>	

## Balance Sheet, change from previous GAAP to IFRS

<i>Previous GAAP 31st December, 2004</i>		<i>Change in valuation</i>		<i>Change in presentation</i>	<i>IFRS 1st January, 2005</i>
				(ISK millions)	
Cash and amounts due from credit institutions	113,543	0	(107,253)	6,290	Cash and cash balances with central bank
Loans, lease contracts	1,088,346	11,704	54,366	1,154,416	Loans and advanced
–		630	31,124	31,754	Mortgage loans measured at fair value
Bonds, shares and other securities	248,352	30	(43,196)	205,186	Trading assets
–		1,446	62,248	63,694	Financial assets designated at fair value through profit and loss
–		(28)	1,535	1,507	Financial assets available-for-sale
–		3,246	574	3,820	Derivatives used for hedging
Shares in associated companies	8,266	(461)	(4,156)	3,649	Investment in associates
Goodwill	34,208	(11)	901	35,098	Intangible assets
–		377	18,778	19,155	Investment property
Fixed assets	6,467	12	(387)	6,092	Property and equipment
Deferred tax assets	1,039	0	53	1,092	Current and deferred tax assets
–		(61)	3,692	3,631	Non-current assets and disposal groups classified as held for sale
–		0	107	107	Reinsurers' share in insurance fund
Other assets	33,799	109	(14,945)	18,963	Other assets
<b>Total Assets</b>	<b>1,534,020</b>	<b>16,992</b>	<b>3,441</b>	<b>1,554,453</b>	<b>Total Assets</b>
Amounts owed to credit institutions	147,455	0	(114,967)	32,488	Deposits from credit institutions and Central bank
Savings deposits	202,038	0	155	202,193	Other deposits
Borrowings	884,219	2,862	81,432	968,513	Borrowings
Subordinated loans	57,627	0	(4)	57,623	Subordinated loans
–		696	34,180	34,876	Mortgage funding measured at fair value
–		0	1,345	1,345	Insurance liabilities
–		1,654	12,262	13,916	Trading liabilities
–		11,124	8,094	19,218	Derivatives used for hedging
Provision for deferred income-tax liability	9,165	392	(1,824)	7,733	Current and deferred tax liabilities
–		0	1,402	1,402	Liabilities included in disposal groups classified as held for sale
Other liabilities	74,767	337	(18,867)	56,237	Other liabilities
Equity	149,443	(73)	0	149,370	Shareholders' equity
Minority interests in subsidiaries' equity	9,306	0	233	9,539	Minority interest
<b>Total Liabilities and Equity</b>	<b>1,534,020</b>	<b>16,992</b>	<b>3,441</b>	<b>1,554,453</b>	<b>Total Liabilities and Equity</b>

## **TAXATION**

### **1. Icelandic Taxation**

The comments below are of a general nature based on the Issuer's understanding of current law and practice in Iceland. They relate only to the position of persons who are the absolute beneficial owners of the Notes, Receipts and/or Coupons. They may not apply to certain classes of person such as dealers. Prospective holders of the Notes who are in any doubt as to their personal tax position or who may be subject to tax in any other jurisdiction, should consult their professional advisers.

1. There are no taxes or other governmental charges payable under the laws of Iceland or any authority of, or in, Iceland in respect of the principal or interest on the Notes by a holder who is not a resident of Iceland, or in respect of any amount payable under the Programme Agreement or the Agency Agreement.
2. There are no estate or inheritance taxes, succession duties, gift taxes or capital gains taxes imposed by Iceland or any authority of, or in, Iceland in respect of the Notes if, at the time of the death of the holder or the transfer of the Notes, such holder or transferor is not a resident of Iceland.
3. The Issuer is not required by the current laws of Iceland to make any deductions or withholding from any payment of principal or interest due or to become due under the Notes or from any amount payable under the Programme Agreement or the Agency Agreement, if the recipient is not a resident of Iceland.

### **2. EU Savings Directive**

Under EC Council Directive 2003/48/EC on the taxation of savings income, Member States are required, from 1st July, 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date.

### **3. Luxembourg Taxation**

Under Luxembourg tax law, there is currently no withholding tax on payments of principal, premium or interest, nor on accrued but unpaid interest, in respect of the Notes, nor is any Luxembourg withholding tax payable upon redemption or repurchase of the Notes. Luxembourg levies withholding tax on interest payments made by a Luxembourg paying agent to individual beneficial owners who are tax resident of (i) another EU Member State, pursuant to EC Council Directive 2003/48/EC on taxation of savings income in the form of interest payments, or (ii) certain non-EU countries and territories which have agreed to adopt similar measures to those provided for under EC Council Directive 2003/48/EC see "Risk Factors – EU Savings Directive" above. Responsibility for the withholding of such tax will be assumed by the Luxembourg paying agent and not by the Issuer.

## SUBSCRIPTION AND SALE

The Dealers have, in an amended and restated programme agreement (the “**Programme Agreement**”) dated 2nd September, 2005, agreed with the Issuer a basis upon which they or any of them may from time to time agree to purchase Notes. Any such agreement will extend to those matters stated under “*Form of the Notes*” and “*Terms and Conditions of the Notes*”. In the Programme Agreement, the Issuer has agreed to reimburse the Dealers for certain of their expenses in connection with the establishment of the Programme and the issue of Notes under the Programme and to indemnify the Dealers against certain liabilities incurred by them in connection therewith.

### **United States**

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act.

The Notes are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986 and regulations thereunder.

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that it will not offer, sell or deliver Notes (i) as part of their distribution at any time or (ii) otherwise until 40 days after the completion of the distribution, as determined and certified by the relevant Dealer or, in the case of an issue of Notes on a syndicated basis, the relevant lead manager, of all Notes of the Tranche of which such Notes are a part, within the United States or to, or for the account or benefit of, U.S. persons. Each Dealer has further agreed, and each further Dealer appointed under the Programme will be required to agree, that it will send to each dealer to which it sells any Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

Until 40 days after the commencement of the offering of any Series of Notes, an offer or sale of such Notes within the United States by any dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with an available exemption from registration under the Securities Act.

Each issuance of Index Linked Notes or Dual Currency Notes shall be subject to such additional U.S. selling restrictions as the Issuer and the relevant Dealer may agree as a term of the issuance and purchase of such Notes, which additional selling restrictions shall be set out in the applicable Final Terms.

### **European Economic Area**

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a **Relevant Member State**), each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the **Relevant Implementation Date**) it has not made and will not make an offer of Notes to the public in that Relevant Member State except that it may, with effect from and including the Relevant Implementation Date, make an offer of Notes to the public in that Relevant Member State:

- (a) in (or in Germany, where the offer starts within) the period beginning on the date of publication of a prospectus in relation to those Notes which has been approved by the



competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive and ending on the date which is 12 months after the date of such publication;

- (b) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;
- (c) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000 and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts; or
- (d) at any time in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an “offer of Notes to the public” in relation to any Notes in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression **Prospectus Directive** means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

### ***United Kingdom***

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that:

- (i) in relation to any Notes having a maturity of less than one year, (a) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and (b) it has not offered or sold and will not offer or sell any Notes other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or as agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Notes would otherwise constitute a contravention of Section 19 of the FSMA by the Issuer;
- (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of any Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and
- (iii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Notes in, from or otherwise involving the United Kingdom.

### ***Japan***

The Notes have not been and will not be registered under the Securities and Exchange Law of Japan (the “**Securities and Exchange Law**”) and each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will not offer or sell any Notes, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to

a resident of Japan except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Securities and Exchange Law and any other applicable laws, regulations and ministerial guidelines of Japan.

### ***The Republic of Italy***

The offering of the Notes has not been cleared by CONSOB (the Italian Securities Exchange Commission) pursuant to Italian securities legislation and, accordingly, no Notes may be offered, sold or delivered, nor may copies of the Base Prospectus or any documentation relating to the Notes be distributed, in the Republic of Italy, except:

- (i) to professional investors ("*operatori qualificati*"), as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1st July, 1998, as amended; or
- (ii) in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of Legislative Decree No. 58 of 24th February, 1998 (the "Financial Services Act") and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14th May, 1999, as amended.

Any offer, sale or delivery of the Notes or distribution of copies of the Base Prospectus or any other document relating to the Notes in the Republic of Italy under (i) or (ii) above must be:

- (a) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act and Legislative Decree No. 385 of 1st September, 1993 (the "Banking Act"), as amended;
- (b) in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy pursuant to which the issue or the offer of securities in the Republic of Italy may need to be preceded and followed by an appropriate notice to be filled with the Bank of Italy depending, *inter alia*, on the aggregate value of the securities issued or offered in the Republic of Italy and their characteristics; and
- (c) in compliance with any other applicable laws and regulations.

### ***Iceland***

Each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that, during the period up to but excluding the date of implementation of the Prospectus Directive in Iceland, it will not offer Notes to the public in Iceland, except in compliance with the Icelandic Act on Securities Transactions (No. 33/2003) and any applicable laws or regulations of Iceland.

### ***General***

Each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will (to the best of its knowledge and belief) comply with all applicable securities laws and regulations in force in any jurisdiction in which it purchases, offers, sells or delivers Notes or possesses or distributes this Base Prospectus and will obtain any consent, approval or permission required by it for the purchase, offer, sale or delivery by it of Notes under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, offers, sales or deliveries and neither the Issuer nor any of the other Dealers shall have any responsibility therefor.

None of the Issuer and the Dealers represents that Notes may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, or assumes any responsibility for facilitating such sale.

With regard to each Tranche, the relevant Dealer will be required to comply with such other restrictions as the Issuer and the relevant Dealer shall agree and as shall be set out in the applicable Final Terms.

## **GENERAL INFORMATION**

### **Authorisation**

The establishment of the Programme and the issue of Notes was duly authorised by a resolution of the Board of Directors of the Issuer dated 13th June, 2003. Subsequent increases in the amount of the Programme were duly authorised by resolutions of the Board of Directors of the Issuer dated 27th March, 2004 and 23rd November, 2004. The update and increase of the programme on 2nd September, 2005 was duly authorised by a resolution of the Board of Directors of the Issuer dated 27th May, 2005.

### **Listing of Notes**

Application for approval will be made to the CSSF to approve this document as a Base Prospectus and application will be made to the Luxembourg Stock Exchange for Notes issued under the programme to be admitted to trading on the Regulated Market of the Luxembourg Stock Exchange. The Regulated Market of the Luxembourg Stock Exchange is a regulated market for the purposes of Directive 2004/39/EC.

### **Documents Available**

For the period of 12 months following the date of this Base Prospectus, copies of the following documents will, when published, be available free of charge from the registered office of the Issuer and from the specified offices of the Paying Agent for the time being in Luxembourg:

- (i) the articles of association (with an English translation thereof) of the Issuer;
- (ii) the audited financial statements of the Issuer in respect of the financial years ended 31st December, 2004 and 31st December, 2003 in each case together with the audit reports prepared in connection therewith;
- (iii) the most recently published audited annual financial statements of the Issuer and the most recently published unaudited interim financial statements of the Issuer (with an English translation thereof) in each case together with any audit or review reports prepared in connection therewith;
- (iv) the Programme Agreement, the Agency Agreement, the Deed of Covenant and the forms of the Global Notes, the Notes in definitive form, the Receipts, the Coupons and the Talons;
- (v) a copy of this Base Prospectus;
- (vi) any future Base Prospectuses, prospectuses, information memoranda and supplements (including Final Terms save that a Final Terms relating to an unlisted Note will only be available for inspection by a holder of such Note and such holder must produce evidence satisfactory to the Issuer and the Paying Agent as to its holding of Notes and identity) to this Base Prospectus and any other documents incorporated herein or therein by reference; and
- (vii) in the case of each issue of Notes admitted to the official list and to trading on the Regulated Market of the Luxembourg Stock Exchange subscribed pursuant to a subscription agreement, the subscription agreement (or equivalent document).

In addition, copies of this Base Prospectus each Final Terms relating to Notes which are admitted to trading on the Luxembourg Stock Exchange's regulated market and each document incorporated by reference are available on the Luxembourg Stock Exchange's website ([www.bourse.lu](http://www.bourse.lu)).

## **Clearing Systems**

The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg (which are entities in charge of keeping the records). The appropriate Common Code and ISIN for each Tranche of Notes allocated by Euroclear and Clearstream, Luxembourg will be specified in the applicable Final Terms. The address of Euroclear is 1 Boulevard du Roi Albert II, B-1210 Brussels and the address for Clearstream, Luxembourg is 4-2 Avenue JF Kennedy, L-1855, Luxembourg. If the Notes are to clear through an additional or alternative clearing system the appropriate information will be specified in the applicable Final Terms.

## **Conditions for determining price**

The price and amount of Notes to be issued under the Programme will be determined by the Issuer and the relevant Dealer at the time of issue in accordance with prevailing market conditions.

## **Significant or Material Change**

There has been no significant change in the financial or trading position of the Issuer or the Issuer and its subsidiaries, taken as a whole, since 30th June, 2005 and there has been no material adverse change in the prospects of the Issuer or the Issuer and its subsidiaries, taken as a whole, since 31st December, 2004.

## **Litigation**

Neither the Issuer nor any of its subsidiaries is or has been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) in the 12 months preceding the date of this document which may have or have in such period had a significant effect on the financial position or profitability of the Issuer or the Group.

## **Auditors**

The auditors of the Issuer are KPMG Endurskodun hf., chartered accountants and a member of The Institute of State Authorised Public Accountants in Iceland, who have audited the Issuer's accounts, without qualification, in accordance with generally accepted auditing standards in Iceland for each of the two financial years ended on 31st December, 2004. The auditors of the Issuer have no material interest in the Issuer.

The reports of the auditors of the Issuer are included or incorporated in the form and context in which they are included or incorporated, with the consent of the auditors who have authorised the contents of that part of this Base Prospectus.

## **Post-Issuance Information**

The Issuer does not intend to provide any post-issuance information in relation to any assets underlying issues of Notes constituting derivative securities.

#### **THE ISSUER**

##### **Kaupthing Bank hf.**

Borgartun 19  
105 Reykjavik  
Iceland

#### **ISSUING AND PRINCIPAL PAYING AGENT**

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United Kingdom

#### **PAYING AGENT**

##### **Banque Générale du Luxembourg S.A.**

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#### **LEGAL ADVISERS**

*To the Issuer as to Icelandic law*

##### **Sigurmar K. Albertsson**

Lagastod  
Lagmuli 7  
108 Reykjavik  
Iceland

*To the Dealers as to English law*

##### **Allen & Overy LLP**

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London EC4M 9QQ  
United Kingdom

#### **AUDITORS**

*To the Issuer*

##### **KPMG Endurskodun hf.**

Borgartun 27  
105 Reykjavik  
Iceland

#### **ARRANGER**

##### **Credit Suisse First Boston (Europe) Limited**

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London E14 4QJ  
United Kingdom

#### **LUXEMBOURG LISTING AGENT**

##### **Banque Générale du Luxembourg S.A.**

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Luxembourg



## DEALERS

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